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## THE CAPITAL MARGIN CONCEPT AND THE WYOMING CORPORATION LAW

E. GEORGE RUDOLPH\*

It has recently been suggested that corporation statutes must affirmatively provide for authorized procedures and devices in considerable detail because of the negative attitude demonstrated by courts in holding various innovations in corporate organization illegal in the absence of express statutory authorization.<sup>1</sup> Whether this judicial attitude results from a basic mistrust of corporations, or whether it is merely the inevitable result of the inadequacy of conventional contract or agency law to take care of the needs of corporations, we need not pause to consider. In any event most modern corporation statutes contain rather complete provisions concerning forms of organization and reorganization and permissible activity in the conduct of the corporation's business and the management of its internal affairs. In this respect the Wyoming Statute, by comparison with others, seems inadequate to meet the needs of the corporation and its legal advisor. This deficiency is most serious in the area of corporate finance and especially with respect to the stockholders' investment.

Before discussing the particular problems arising in this field it seems desirable, even at the risk of being overly elementary, to restate in general terms the capital margin theory.<sup>2</sup> Originally all stock was par value stock, and a corporation could begin business only after its entire authorized stock had been issued and payment for it received. Under this state of the law the capital figure in the charter or articles of incorporation represented a required total of net assets at the outset of corporate existence, and it could logically be suggested that this margin was intended for the protection of the corporation's creditors, serving as a substitute for the personal liability of the proprietors. From this it followed that the corporation's net assets could not be reduced below this amount by distributions to shareholders while the corporation continued in business. Of course, the assets might be so reduced involuntarily through unfavorable business operations, and in that event the stockholders would not be required to restore the margin since that would be inconsistent with the theory of limited liability. Two rather early innovations in the general corporation statutes pretty well destroyed this capital margin concept in its original form. The first of these was the elimination of the requirement that all or any substantial part of the capital stock must be paid in as a condition precedent to doing business, and the second was the authoriza-

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1. Kenneth K. Luce, *Trends in Modern Corporation Legislation*, 50 Mich. L. R. 1291 (1952).
2. See Ballantine and Hills, *Corporate Capital and Restrictions Upon Dividends*, 23 Calif. L. R. 229 (1935).

tion of no par stock. Thus a corporation no longer needs to be provided with any original minimum of net assets, nor does each share of stock represent a definite and uniform contribution to such assets. Most modern corporation statutes none-the-less contain rather elaborate provisions retaining the capital margin theory so far as it can be made consistent with these other propositions. It is in such provisions that the Wyoming Statute is so notably lacking.

It shall be the plan of this paper to compare the Wyoming Statute with others, in particular the Model Business Corporation Act, on the questions and then to determine if the gaps and omissions which appear in the Wyoming Statute can be filled by reference to case law, or whether, on particular questions, the silence of the statute itself affords an answer, and finally in this way to determine the irreducible minimum of unanswerable questions under the present Wyoming law.

#### CREATION OF THE CAPITAL MARGIN

The Model Act provides that shares having a par value shall be issued for such consideration, not less than the par value, as shall be fixed by the directors, and shares without par value shall be issued at such consideration as may be fixed by the directors from time to time unless the right to fix such consideration is reserved to the shareholders by the Articles of Incorporation.<sup>3</sup> The Act then provides that on the issuance of par value shares "stated capital" shall be increased by the par value of such shares, and the consideration over and above the par value, if any, received for such shares shall be credited to "capital surplus." On the issuance of shares without par value the entire consideration received is to be credited to "stated capital" except that the directors may credit not more than twenty-five per cent of such consideration to "capital surplus."<sup>4</sup>

Leaving aside for the moment the significance of "stated capital" and "capital surplus," the only legal requirement in the above provisions would seem to be that par value shares must be issued for a consideration not less than par. While the Wyoming statute contains no similar requirement, the omission is probably not fatal to the proposition. In the first place, such a rule seems to be assumed by the provision of Section 44-126<sup>5</sup> authorizing the directors to issue stock for property "to the amount of the value thereof" and providing that such stock shall be fully paid and non-assessable. Secondly, the requirement for the payment of full par value has most often been invoked to hold shareholders of an insolvent corporation liable to the corporation's creditors for the difference between the price they paid for their shares and the par value of such shares. For the purpose of such liability an express statutory requirement for the payment of full

3. The Model Business Corporation Act, Section 17. The Act has been published as Vol. VI, No. 1 of *The Business Lawyer*.

4. *Ibid.* Section 19.

5. References throughout the paper to statutory sections shall be to Wyoming Compiled Statutes, 1945, unless otherwise noted.

par is probably not necessary, since the liability is generally predicated on either the "trust fund theory" or the "fraud theory," the former purportedly being grounded in equity and the latter in the common law.<sup>6</sup> Furthermore, there would seem to be no purpose served by the statute making any provision for par value shares unless some such liability was intended.<sup>7</sup>

However, doubt may be cast on the validity of this conclusion under the Wyoming law by a reference to legislative history. At one time the Wyoming statute did contain an express provision imposing such a liability on shareholders in favor of the corporation's creditors.<sup>8</sup> This provision was eliminated by the amendment of 1939<sup>9</sup> and, of course, it can be argued with considerable logic that the legislature, in doing this, intended to eliminate the liability. A more definite answer to this problem must await further action by either the Supreme Court or the Legislature.

Before leaving the subject of the issue price of shares, it should be noted that other shareholders as well as creditors have an interest in this. The rights, if any, of persons becoming shareholders after the issuance of the shares in question are generally measured by the difference between the par value of such shares and the amount actually paid for them, on the theory, apparently, that such later shareholders rely on the payment of the full par value of all previously issued shares when they purchase.<sup>10</sup> On the other hand, the rights of existing shareholders, with respect to the price of later issues, are generally based on the actual value of the shares rather than the par value, since a sale below actual value will dilute their interest regardless of the par value, whereas a sale at less than par will not injure them in any manner, providing that it is not also below actual value.<sup>11</sup> There are some instances in which a proposed issue at less than

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6. See *Scoville v. Thayer*, 105 U.S. 143, 26 L.Ed. 968 (1881) in which the court was dealing with a Kansas corporation but none-the-less applied the "trust fund theory" as the equitable doctrine of the United States Supreme Court. The leading case on the "fraud theory" is *Hospes v. Northwestern Mfg. and Car Co.*, 48 Minn. 174, 50 N.W. 1117 (1892) which speaks of putting the liability "upon the ground of fraud, and applying the old and familiar rules of law upon that subject. . . ."
  7. *Stone v. Young*, 210 App. Div. 303, 206 N.Y.S. 95 (1924).
  8. Wyoming Compiled Statutes 1931, Section 28-127. The wording of this section was somewhat ambiguous since it made shareholders liable to creditors "to the amount of unpaid assessments" and this could logically be construed to include only the amount remaining unpaid on the contract between the corporation and the shareholder. However, in *Tuttle v. Rohrer*, 23 Wyo. 305, 149 Pac. 857 (1915) the court apparently interpreted it to include also the difference between the agreed price and the par value.
  9. Session Laws of Wyoming 1939, Ch. 62, Section 10. The original provision may be found in Wyoming Compiled Statutes 1931, Section 28-127.
  10. See *Old Dominion Copper Co. v. Bigelow*, 203 Mass. 159, 89 N.E. 193 (1909) and the many cases which have followed it. The statement to which this note is appended does not correctly summarize the holdings of the Bigelow case since technically the cause of action under the doctrine is in the corporation for breach of the promoters' fiduciary duty. But in spite of that it is generally recognized that the injury is actually to the later purchasers of shares rather than to the corporation. See *Jeff v. Utah Light and Power Co.*, 136 Me. 454, 12 A. 2d 592 (1940). Following this reasoning the Utah court in *Roberson v. Dranery*, 53 Utah 263, 178 Pac. 35 (1918) refused to enforce any liability on the suit of later shareholders when their stock was worth the amount they paid regardless of the original overvaluation of the property exchanged for the promoters' shares.
  11. *Bodell v. General Gas and Elec. Corp.*, 15 Del. Ch. 119, 132 A. 442 (1926).

par has been enjoined on the suit of a shareholder where the statute has expressly prohibited such issues.<sup>12</sup> Generally speaking, however, the rights of both subsequent and existing shareholders in this regard have not been predicated directly on any statutory provisions and the Wyoming Statute is not, therefore, more inadequate than others in this respect.

#### MAINTAINING THE CAPITAL MARGIN

The concepts of "stated capital" and "capital surplus," provided for by the Model Act, have their chief significance in the various roles respecting distributions of corporate assets to shareholders. Although ordinary dividends constitute the most usual type of such distributions, the term should also be understood to include the purchase by a corporation of its own shares, since such shares, when purchased, have no value to the corporation, and the end result of the transaction, so far as the corporation is concerned is merely a reduction of its net assets.

With respect to dividends, the Model Act provides that dividends may not be paid while the corporation is insolvent, or which will render it insolvent, and may be paid only out of unreserved earned surplus, with certain exceptions.<sup>13</sup> Surplus is defined as the excess of net assets over stated capital, and earned surplus is defined as the portion of surplus equal to the balance of the net profits, income and gains and loses from the date of incorporation.<sup>14</sup> Many other statutes contain provisions which are similar in substance although widely varied in form.<sup>15</sup>

By comparison, the Wyoming Statute only prohibits the payment of dividends when the corporation is insolvent or will be made insolvent by the dividend. On a different question the Wyoming Supreme Court has held that the impairment of a corporation's capital is not equivalent to insolvency.<sup>16</sup> Stated differently, the capital or capital stock is not to be treated as a liability for the purpose of determining solvency or insolvency of a corporation. This would seem obvious as a matter of principle, but confusion none-the-less exists as shown by court opinions and even some statutory provisions.<sup>17</sup> However, once this is understood it seems clear

12. *Kraft v. Griffin Co.*, 82 App. Div. 29, 81 N.Y.S. 438 (1903).

13. The Model Business Corporation Act, Section 40.

14. *Ibid.* Section 2. Stated more simply surplus is the excess of net assets over capital. The chief difficulties in applying the formula occur in the valuation of various types of assets. To some extent the accepted accounting procedures for this have been crystallized into law by court decisions. Thus fixed assets must generally be carried at cost less depreciation whereas current assets such as raw materials and inventory must generally be carried at the lower of cost or market value. See Comment, "The Concept of Surplus as Applicable to Dividends," 2 Wyo. L. J. 114.

15. The Delaware statute constitutes a notable exception to this generalization in providing that dividends may be paid from surplus or if none such then from the net profits from the current or preceding year. Revised Code of Del. 1935, Section 1625. See also the Nevada statute cited in note 17.

16. *Harle-Haas Drug Company v. Rogers Drug Company*, 19 Wyo. 35, 113 Pac. 791 (1910).

17. The Nevada provision on dividends speaks of the surplus of assets over "liabilities including capital." Nevada Comp. Laws 1929, Section 1625. Similar language may be found in the court's opinion in *Peters v. United States Mfg. Co.*, 13 Del. Ch. 11, 114 A. 598 (1921).

that there is nothing in the Wyoming statute itself to prohibit a dividend which leaves the corporation with net assets less than the aggregate par value of its issued and outstanding shares. The question thus arises as to whether such a prohibition can be spelled out as a matter of general law.

In Mississippi and Massachusetts, which are among the few jurisdictions with statutes similar to Wyoming's on this point, the courts have been able to work out a rule prohibiting dividends which impair capital by the same line of reasoning which is used to support the requirement for paying full par on the issuance of shares.<sup>18</sup> If net assets equal to the aggregate par value of the issued and outstanding shares are to be considered a trust fund for the protection of the corporation's creditors, then any distribution to stockholders which reduces net assets below this amount is a wrong to such creditors. But many courts, including the Wyoming court, have refused to accept the trust fund theory in this broad form.<sup>19</sup> Furthermore, the 1939 amendment to the statute eliminated an express provision forbidding dividends which impaired capital and, in view of this, it seems difficult to find any such restriction now by implication.<sup>20</sup>

A further obstacle under the Wyoming statute to any rule forbidding dividends which impair capital is found in the provision for no-par shares.<sup>21</sup> In the case of par value shares the capital which must be maintained against dividend distributions is determined by computing the total par value of all issued and outstanding shares, but no such measure is available for no par shares. The Model Act takes care of this by providing that the entire consideration received for no par shares shall be credited to "stated capital" except that the directors may allocate not more than twenty-five per cent of such consideration to "capital surplus."<sup>22</sup> By contrast the Wyoming statute is completely silent on the creation of capital by the issuance of shares. In view of this it seems impossible to spell out any restriction, short of insolvency, on the payment of dividends, in case of no-par shares, as it seems that substantially all of the consideration received for such shares could be credited to surplus rather than capital.<sup>23</sup>

As just indicated, surplus as well as capital may be created on the issuance of no-par shares. Likewise in the case of par value shares surplus will result when the issue price exceeds the par value. Such surplus is generally referred to as paid-in surplus, although the Model Act uses the term "capital surplus" and also includes under this designation surplus which results from a reduction of capital.<sup>24</sup> Obviously such surplus is not

18. *Kimbraugh v. Davies*, 104 Miss. 722, 61 So. 697 (1913); *Spiegel v. Beacon Participations, Inc.*, 297 Mass. 398, 8 N.E. 2d 895 (1937).

19. *Harle-Haas Drug Company v. Rogers Drug Company*, 19 Wyo. 35, 113 Pac. 791 (1910).

20. Session Laws of Wyoming 1939, Ch. 62, Section 12. The previous provision may be found in Wyoming Revised Statutes 1931, Section 28-131.

21. Wyoming Compiled Statutes 1945, Section 44-120.

22. The Model Business Corporation Act, Section 19.

23. See the discussion of this in Hills, *Model Corporation Act*, 48 Harv. L. R. 1334 at pp. 1337-1338.

24. The Model Corporation Act, Section 63.

the same as earned surplus and it should be treated differently for purposes of dividends. The Model Act allows the directors to pay cumulative preferred dividends from capital surplus, but otherwise allows the distribution of such surplus only when authorized by a two-thirds vote of the shareholders and then labels it a distribution in partial liquidation.<sup>25</sup> However, the directors may use capital surplus to eliminate a deficit and thereby make subsequent earnings, which would otherwise have to be applied to the deficit, available for dividends.<sup>26</sup> This provision would seem to be in derogation of the capital margin theory, or at least to compromise the position of a capital surplus as a part of the capital margin. The restrictions on distributing capital surplus are imposed primarily for the protection of shareholders. Dividends from such surplus may be prejudicial to shareholders in several ways. In the first place the shareholders theoretically expect to have their investment retained by the corporation and used in its business rather than returned to them. Secondly, such dividends may give an untruthful appearance of successful operation, and lastly, the shareholder may pay federal income tax on what was not income at all but merely a return of his original investment. More will be said of the shareholders' rights in this respect in the next section on reducing the capital margin. So far as the Wyoming law on paid-in surplus is concerned, it need only be said that since the law makes no provision for establishing a capital figure, it obviously cannot provide any rules with respect to surplus, paid-in or otherwise.

As previously mentioned, the purchase by a corporation of its own shares in substance amounts to a distribution to shareholders. It differs from a dividend in that it is made to one shareholder rather than to all equally and has the effect of retiring the investment of such shareholder. Such a purchase will be unfair to other shareholders if the price at which it is made exceeds the value of the shares because in such event that shareholder will be getting more than his just proportion of the corporate assets. While this proposition has received some judicial recognition<sup>27</sup> it has not been included in any corporation statute so far as the writer has been able to determine.

On the other hand, the Model Act and most other modern statutes contain provisions designed to protect the creditors against impairment of the capital margin by such purchases. This is accomplished by allowing the corporation to make such purchases only from earned surplus with certain limited exceptions.<sup>28</sup> A similar rule can be worked out from the provisions found in some of the older statutes which prohibit in general terms any distributions to shareholders which impair capital.<sup>29</sup> But ob-

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25. *Ibid.*, Section 41.

26. The Model Corporation Act, Section 63.

27. See the dissenting opinion of Epes, J. in *Grace Securities Corporation v. Roberts*, 158 Va. 792, 164 S.E. 700 (1932). Dictum to the same effect may be found in *Laue v. Bethlehem Steel Corp.*, 243 App. Div. 57, 276 N.Y.S. 173 (1934).

28. The Model Business Corporation Act, Section 5.

29. *Ashman v. Miller*, 101 F. 2d 85 (CCA 6 1939); Compare *Schulte v. Boulevard Gardens Land Co.*, 164 Cal. 464, 129 Pac. 582 (1913).

viously no such rule can be spelled out under the Wyoming statute since it gives no recognition to the concept of legal or stated capital.<sup>30</sup>

Some of the older cases took an entirely different approach to this question and held that the purchase by a corporation of its own shares was prohibited by the doctrine of *ultra vires*.<sup>31</sup> This, of course, amounts to a flat prohibition of such purchases under any circumstances and without regard to the financial condition of the corporation. This rule has been justly criticized on the ground that the doctrine of *ultra vires* pertains only to the business being carried on by the corporation and not to the management of its internal financial affairs.<sup>32</sup> But in any event such a rule would not seem possible in Wyoming since the 1939 amendment which repealed the express prohibition of such purchases previously included in the statute.<sup>33</sup>

In the interest of completeness it should be noted that certain exceptions have generally been recognized to the rules prohibiting or restricting the purchase of treasury shares. As codified by the Model Act these include purchases made to eliminate fractional shares, collect indebtedness, pay dissenting shareholders in reorganizations, and to effect the retirement of redeemable shares.<sup>34</sup>

#### REDUCING THE CAPITAL MARGIN

In one sense, anytime the net assets of a corporation fall below the aggregate par value of its issued and outstanding shares through unfavorable business operations, the capital has been reduced. This, however, is generally referred to as an impairment of capital and the term "reduction of capital" is used to describe a reduction of the capital figures or stated capital. Such a reduction does not in itself, involve any reduction in net assets. However, it may be followed by a distribution of the surplus which will result from any such reduction of capital which exceeds in amount the amount of any prior deficit. As a matter of mechanics such a reduction may be accomplished in a number of different ways; some of which necessarily involve distributions in partial liquidation and others of which do not. The Model Act contains a number of sections, designed for the protection of creditors and shareholders, governing these various methods of reducing capital.

The general provisions for a reduction of capital under the Model Act are included in Section 62 which provides that, in cases where the proposed

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30. It is interesting to note that in Massachusetts, which has a statute similar to Wyoming's in prohibiting dividends only in the event of insolvency, a corporation is permitted to purchase its own shares even though it amounts to reduction of capital. *Scriggins v. Thomas Dalby Co.*, 290 Mass. 414, 195 N.E. 749 (1935). This, of course, is not consistent with the judge-made rule on dividends. Note 17 *supra*.
31. *Darnell-Love Lumber Co. v. Wiggs*, 144 Tenn. 113, 230 S.W. 391 (1921).
32. *Ballantine on Corporations*, 1946, Section 356a.
33. *Session Laws of Wyoming*, 1939, Ch. 62, Section 6. The original provision may be found in *Wyoming Compiled Statutes 1931*, Section 28-122.
34. *The Model Corporation Act*, Section 5.



reduction does not require an amendment of the articles or the cancellation of shares, the reduction can be accomplished by the affirmative vote of a majority of the shares entitled to vote. The plan for reduction is to be proposed by a resolution of the directors, and a statement concerning the reduction must be filed with an appropriate state official. Under these provisions a reduction of capital can be accomplished if the corporation has no par shares or, in the case of par value shares, if the total stated capital exceeds the aggregate par value of the issued shares. Also a reduction of capital under this section could be effected by reducing the number of issued and outstanding shares. If the reduction is to be accomplished by reducing the par value of the issued shares or by changing such shares from par value to no par value, then it is necessary to proceed under the provisions for amending the articles.<sup>35</sup> The principal substantive difference between these sections and the one just described is the requirement for a two-thirds vote to amend the articles rather than the simple majority required for a reduction of capital without amendment. Reduction of capital by the cancellation of treasury shares or the redemption of redeemable shares will be considered later.

As mentioned previously the reduction of capital, in itself, does not result in any reduction of net assets. However, unless the reduction of capital is made for the purpose of eliminating a deficit it will normally be followed by a distribution to the shareholders. Such distributions are accurately designated by the Model Act as "Distributions in Partial Liquidation."<sup>36</sup> The Act provides that such distributions may be made either from stated capital or from capital surplus, but it would seem that stated capital should be available for this purpose only to the extent that the distribution is accompanied by a reduction of capital. A further section of the Act provides that all surplus created by a reduction of capital is to be deemed capital surplus.<sup>37</sup> The interests of the corporation's creditors in this are protected by the Act only to the extent that it forbids such distributions when the corporation is insolvent or when the corporation will be made insolvent by the distribution. While this might be considered an abandonment of the capital margin theory it is no more so than the rule which permits the corporation to begin business in the first place without a substantial amount of capital paid in. On the other hand the Act gives considerable recognition to the shareholders' rights in this respect. In the first place such a distribution may be made only with the affirmative vote of two-thirds of the shares of each class entitled to vote. Secondly, no such distribution may be made on any class of shares unless the cumulative dividends on all prior classes are fully paid, nor may any such distribution be made on any class of shares if it will reduce the

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35. *Ibid.*, Section 53 through 58.

36. *Ibid.*, Section 41.

37. *Ibid.*, Section 63.

net assets below the total liquidation preferences of all shares having equal or prior rank.<sup>38</sup>

The provisions of the Model Act concerning the reduction of capital by the cancellation of reacquired shares are somewhat confusing. Even at the risk of departing somewhat from the general theme of this paper it seems desirable to explore these difficulties in some detail, since it is matter that should be given thought in any state considering the adoption of legislation patterned after the Model Act. As noted in the previous section, the Act permits the purchase of treasury shares only from earned surplus. Such a purchase, then, would seem to result in a reduction of earned surplus but no reduction in capital. A further section provides for the cancellation of such shares by resolution of the directors and requires that a statement concerning the cancellation be filed with the appropriate state official.<sup>39</sup> The cancellation would appear to be the stage at which the reduction of capital occurs,<sup>40</sup> but doubt is cast on this by a still further provision. Section 63 provides that the surplus created by a reduction of capital shall be deemed capital surplus, but goes on to state that where such reduction is accomplished by the cancellation of treasury shares, such surplus shall only be created to the extent that the stated capital represented by such shares exceeded the cost of such shares to the corporation. This latter restriction can only be complied with if some reduction in capital occurred on the acquisition of the shares by the corporation. The section was undoubtedly drafted in the light of the common accounting practice with reference to treasury shares, which in fact shows a reduction of capital to the extent of the par value of such shares and then "restricts" earned surplus to the same amount. The effect of the restriction, of course, is to make such surplus unavailable for dividends or further purchases of treasury shares until the restriction is removed. Although the Act recognizes the concept of restricted surplus,<sup>41</sup> it makes no provision for the manner in which the restriction is to be removed in these circumstances. Presumably the restriction disappears when the shares are cancelled. The effect of the cancellation of treasury shares, then, is to create earned surplus rather than capital surplus, and such surplus will be available for distribution as dividends or for the purchase of more treasury shares without complying with the requirements established for distributions in partial liquidation. This, of course, is clearly contrary to the principles controlling the distribution of surplus resulting from other methods of capital reduction.

The Act also provides for a reduction of capital by the purchase or redemption of redeemable preferred shares.<sup>42</sup> Such shares are cancelled automatically upon redemption or purchase, and thereupon revert to the

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38. *Ibid.*, Section 62.

39. *Ibid.*, Section 61.

40. As a matter of fact, this is expressly stated in the Act, Section 61.

41. Section 63 provides that reserves may be created from earned surplus and that such surplus shall be restricted to such extent. This, of course, is a different type of restriction than we are concerned with here but the effect is the same.

42. *Ibid.*, Section 60.

status of authorized but unissued shares unless the articles provide that such shares may not be reissued. In keeping with the theory that redeemable shares do not form a permanent part of the capital structure the Act only forbids their redemption when the corporation would be rendered insolvent or the net assets would be reduced below the aggregate liquidation preferences of shares with prior or equal liquidation rights.<sup>43</sup> There is no restriction that such shares may be redeemed only from surplus.

Turning now to the Wyoming Statute we find only one provision relating to the reduction of capital and it is rather ambiguous to say the least. Section 44-131 provides that a corporation may "increase or diminish its capital stock by complying with the provisions of this article, to any amount which may be deemed sufficient and proper for the purposes of the corporation. . . ." Succeeding sections then specify the procedure for making such change, requiring among other things a two-thirds vote of the shareholders and the filing of a certificate of such action with the Secretary of State. All of these sections taken together raise a considerable question as to whether they refer to increasing or reducing the capital amount, as we have been considering it or, on the other hand, to changing the authorized capital as provided for by the certificate of incorporation.

In favor of the latter construction it may be noted that these same sections authorize other changes, such as changing the name of the corporation, or the nature of its business, which in effect amount to amendments of the certificate of incorporation. There is no other provision of the statute which authorizes such amendments. Furthermore, it would not be possible to increase the capital, in the sense we have been considering the term, merely by such action. Somebody has to purchase the shares and pay for them. On the other hand, the authorized capital may be increased or reduced by an amendment of the certificate.

In favor of the opposite conclusion it might be contended that the proviso limiting the reduction of capital to an amount sufficient for the business of the corporation indicates that the legislature had in mind the actual capital resulting from the issuance of shares. But in view of the fact that the statute does not require any particular amount of capital to be paid in on the organization of a corporation, the proviso seems meaningless even when so construed. Section 44-134 requires that the certificate to be filed in connection with the change must state the "amount of capital actually paid in . . . ." This clearly indicates that the provision was intended to cover a reduction in capital, not merely a reduction in authorized capital. But viewing the statute as a whole this provision seems somewhat meaningless too. At one time the statute required the filing of a certificate showing the amount of capital stock originally paid in, but this provision was repealed by the 1939 amendment, and in view of this, there

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43. *Ibid.*, Section 59.

does not seem to be any purpose to serve by requiring a filing in connection with a reduction of capital.<sup>44</sup>

By way of conclusion, it can only be said that the Wyoming statute is completely inadequate in providing means for the reduction of capital. In the absence of express statutory authorization, such as that found in the Model Act for example, it is at least arguable that no such reduction can be made which will operate to change the interest of any shareholder without his consent.

#### CRITICAL EVALUATION

Probably the most serious charge that can be made against the Wyoming Statute is that it makes for uncertainty. To a large extent this uncertainty is due to the fact that the statute does not contain answers to questions which are customarily governed by express statutory provisions. The result is that such questions for the most part must remain completely up in the air unless and until the Wyoming Supreme Court gives an answer, since there is no general common law of corporations on which to fall back in the absence of statute. On the other hand there is a considerable amount of uniformity among corporation statutes (the Wyoming statute excepted, of course), and the temptation is strong to assume the same answer to a given question in Wyoming, where there is no applicable statute, as is reached in almost every other state by express statutory provisions. But such a process involves considerable danger because it is possible that the legislature had quite revolutionary motives in enacting the 1939 amendments.

Taken altogether the various changes made by this amendment seem to represent a conscious effort to abolish the capital margin concept *in toto*. Thus there is no requirement for an original margin of paid-in capital nor is there any rule against impairing such capital margin by distributions to shareholders. It would seem to follow that there is consequently no need to regulate the reduction of such capital margin, although the absence of statutory provisions on this last matter is apt to be construed as a complete lack of authorization to make such reductions rather than as a grant of complete license with respect to them.

As a matter of legal principle, this abandonment of the capital margin requirement cannot be greatly criticized. Under the provisions of modern statutes the capital margin requirements do not provide any significant protection for the creditors of a corporation for the simple reason that they do not require any substantial minimum of original paid-in capital.<sup>45</sup> It is doubtful that any satisfactory requirement of that sort can be worked

44. Session Laws of Wyoming, 1939, Ch. 62, Section 11. The original provision may be found in Wyoming Compiled Statutes, 1939, Section 28-130.

45. The Model Act, Section 51, provides that before the corporation can begin business there must have been paid for the issuance of shares consideration of the value of at least one thousand dollars.

out. Obviously the amount of capital necessary in any particular case will depend largely on the size and nature of the business to be conducted. It has been suggested, as a substitute for capital requirements, that corporations be required to retain a certain ratio of assets over liabilities.<sup>46</sup> But even such a provision would seem too inflexible to work fairly in all situations. In the last analysis there is probably nothing wrong with putting the burden on the creditor to determine, in each instance, if the resources of the corporation are sufficient to merit the contemplated credit.

But even if this is conceded it may still be argued that, however inadequate the original capital margin might have been, the creditors should be protected in that amount against distributions to the shareholders. This argument, of course, applies only in favor of creditors becoming such prior to the distribution. When so limited the idea appears to be simply a large extension of the rule of fraudulent conveyances which makes void as to creditors any voluntary transfer by an insolvent. Considering the question in this light, it is hard to justify such a discrimination against corporate debtors. Furthermore, the argument loses its validity entirely when we remember that under most of the modern statutes, of which the Model Act is a fair sample, the capital margin can be reduced to a nominal amount by stockholder action and without any regard to the rights of existing creditors.

The above discussion is not intended to demonstrate that the Wyoming statute is the best possible corporation law, or even that it is superior to the Model Act and similar statutes. In the writer's opinion, quite the contrary is true. In general, there is much to be gained by following convention unless some good reason suggests itself for not doing so. Wyoming lawyers could work with more assurance, and with greater benefit from the decisions and practices of other states, if the Wyoming statute conformed more nearly to the prevailing form. On many of these questions, it is of principal importance that there be a clear and definite rule. The substance of the rule is unimportant by comparison.

Furthermore, even though the modern version of the capital margin concept is of little value in protecting creditors of corporations, it does serve to protect certain legitimate interests of shareholders. For example, each is entitled to some assurance that he has received a fair proportionate interest in the corporation on the basis of his investment. Likewise, the shareholder is entitled to have his investment retained in the corporation and used in the conduct of the business until the shareholders as a body

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46. See Ballantine and Hills, "Corporate Capital and Restrictions on Dividends Under Modern Corporation Laws," 23 Calif. L. R. 229 at P. 262. Prior to 1939 the Wyoming statute contained a completely ambiguous provision that was probably intended to express some such restriction. It provided that the indebtedness of the company should not exceed its capital stock. See Wyo. Comp. Stat. 1931, section 28-132. This may have required a ratio of assets over liabilities of two to one although it is difficult to determine what purpose was intended to be served by measuring liabilities against capital. But in any event the section has been repealed. Wyoming Session Laws 1939, Ch. 62, Section 13.

determine, in accordance with the original agreement, that a part or all of it should be returned. Furthermore, the shareholder should be protected against the false appearance of prosperity which results from a return of invested capital in the guise of ordinary dividends.

Enough has been said, it would seem, to show that Wyoming is badly in need of a new corporation law. The easiest solution, and on the whole probably the most satisfactory, would be a law patterned after the Model Act or one of the other comprehensive statutes which have recently been adopted in a number of states. But if the Bar and the business community wish to assume a pioneering role with an even more liberal law which completely disregards the capital margin concept, then the statute should at least provide definite answers to the following questions: 1) What obligations, if any, does a shareholder owe to creditors and to other shareholders with respect to the amount and kind of consideration paid for his shares? 2) What rights, if any, do creditors and shareholders have to insist that the invested capital, or some specified part thereof, be retained in the business rather than returned to the shareholders in the form of dividends or purchases of treasury shares? 3) Assuming an affirmative answer to the last question, then what obligation does the corporation have to restore a prior loss of such invested capital from earnings rather than using such earnings for dividends? 4) Again assuming an affirmative answer to the second question, what means are available to the corporation and the shareholders to reduce the amount of capital that must be retained as against distributions to shareholders and what rights, if any, do the creditors of the corporation have with respect to such reductions? If a negative answer is intended for any or all of the questions, then it is necessary, in order to avoid hopeless uncertainty, that the statute should clearly express such intention.