Revisiting The Par Value Regime

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I. INTRODUCTION

Shares represent fractional ownership of assets in a company. Under the par or nominal value regime shares of a company are ascribed an arbitrary value[1] at the time of incorporation. The memorandum of association of a company states the total share capital with division thereof into shares of a fixed par value, which is usually reflected as:

“The share capital is AED X, divided into Y shares, of AED Z each”

The par value thus becomes a fixed price upon which shares are issued, which is required either in law or in practice[2]. While the par value may represent the value of share capital contributed at the time of incorporation of a company, the same does not remain true over the life of the company as, inter alia, the number and value of assets of a company change. As such a fixed par value does not recognise the ever changing intrinsic or market value of shares, and hence can be misrepresentative of the same.

This apparent misrepresentation, along with various considerations discussed herein below, questions the merits of a par value regime, which regime may well have lost its value.

At the outset may I state that the scope of this article is to discuss the merits of the par value regime and to introduce an alternative regime for consideration of lawyers and regulators – the no par regime. As such this paper is a discussion and not an exhaustive analysis of the par and no par value regimes, which analysis will be required particularly in relation to differences in laws for different forms of entities, both in mainland UAE and in free zones (including offshore).

II. ISSUE OF SHARES

Par value regime complicates further issuance of shares. Where the prevailing market value of shares is lesser than the par value, and shares are issued at a price lower than par value – the difference between the par and issue price is referred to as the ‘discount’. Accordingly, where the prevailing market value of shares is greater than par value, and the shares are issued at a price higher than the par value – the difference between the par and issue price is referred to as the ‘premium’. The foregoing concept of discount and premium may seem odd considering the determining factor, the benchmark par value, is itself an arbitrary value.

Paradoxically, a discount in its true sense is a premium where shares are issued below their par value but above the market value. And accordingly a premium is truly a discount where shares are issued above their par value but below the market value. This incongruity can be dealt with by introducing a no-par regime, which eliminates the cause of the confusion – the par value itself.

The concept of discount and premium is discussed further below:

Discount

Since the par value is the minimum price at which shares are to be issued, it is said to protect interests of existing shareholders by serving as a floor for contributions from new shareholders, thereby preventing potential fraud.

However the said protection is often misconceived as shares are in fact usually issued at a discount where the prevailing price of the shares has slipped below par, and the cash strapped company is in need of injection of capital. It may be strongly argued that such injection of capital, albeit lesser per share, is on the contrary to the advantage of the present shareholders as it provides the company funding in time of financial drought. Further it is worth stating that the present shareholders will in any event have the benefit of pre-emptive rights over further issue of shares and can hence subscribe to the discounted shares.

Premium

Certain laws [3] in relation to free zone companies permit issuance of shares at a premium and require that the share premium received by the company be deposited in a 'share premium account', which is a separate account to the general share capital account where equity is otherwise deposited. The said laws further prescribe a manner in which the funds in the share premium account are to be applied.

On the other hand another law [4]in relation to a public joint stock companies, while provides a procedure for issuance of shares at premium subject to approval of concerned authorities, does not have a concept of a 'share premium account' or otherwise prescribe a manner for application of proceeds of an issue at premium.

In relation to the above stated approval it may be noted that what may be a premium at the time of the approval, could have been a discount if the company had arbitrarily set its par value high enough at inception, and in such event the said approval would not be required even though the company would have priced the issue of shares at that same value.

In a no par value regime since the par value will be eliminated there will be no concept of premium (or discount). As such there will be no share premium account and the entire proceeds of an issue will be credited to the general share capital account. The returns on account of share capital account may only be through dividend distributions or bonus issues from revenue reserves. Any related inconsistencies in law as discussed above or confusion in application thereof will be eliminated. This would be a more logical and simpler approach.

Transfer of Shares

Currently in a transfer of shares two values of shares come into play. The first is the par value of shares, which is reflected in the agreement for transfer of shares notarized by the notary public. The second is the value of the shares actually paid as consideration, representative of the working capital and true book value of the shares or the market value, and which is usually reflected in a 'side agreement'. It is argued that this practice of carrying along two values is superfluous. The value material to the transaction and to the seller and purchaser is the true intrinsic or market value, not the par value. The practice of having side agreements for the purpose stated above is unnecessary.

The current practice can be particularly confusing for an unsophisticated investor buying a share in a limited liability company. A share purchased at discount or premium, would declare on the share certificate a different value – the par.

III. OVERSTATED CREDITORS' PROTECTION

Another common justification for the par value is that it protects creditors. It is said the total capital paid by shareholders at par value is an indication of solvency of the company, the adequacy of which is relied on by creditors while extending finance. However, to put this protection in context, it is argued that in practice creditors place far greater reliance on other factors such as the goodwill, relationship, net worth and cash flow of the company, than they do on the paid up capital.

IV. FINANCIAL REPORTING

While the affects of a no par regime on financial reporting is an area beyond legal analysis and as such is not in the purview of this article, the following comments are noteworthy:

(a) Prevailing standards of financial reporting provide for both a par value and a no par value regime. For instance Paragraph 79 of International Accounting Standard 1 'Presentation of Financial Statements' in relation to disclosure, states that "An entity shall disclose the following, either in the statement of financial position or the statement of changes in equity, or in the notes … (iii) par value per share, or that the shares have no par value" (emphasis added).

(b) A noticeable feature in all the jurisdictions that have implemented the no par regime is the presence of a developed accounting regime. In UAE while public joint stock companies have robust financial reporting requirements, the same is not true for private companies (at least in practice). Regular, if not perpetual, assessment of the intrinsic value of shares as envisaged in the no par regime will require sound accounting regimes for private companies as well.

V. OTHER JURISDICTIONS

Various jurisdictions such as Australia, Germany, Japan, New Zealand, South Africa, Cayman Islands have migrated to the no par regime. 'The no par value regime was introduced in the US in 1912 in the state of New York and subsequently almost every state has adopted this new regime'.[5] The migration is being seriously considered by UK, India, Hong Kong, Pakistan and various other jurisdictions. Research reveals that while these jurisdictions acknowledge the benefits of the no par regime, implementation remains outstanding often due to the inertia induced by familiarity of the par regime.

VI. PROPOSAL

It is suggested that the relevant regulators, legislators and stakeholders consider implementation of the no par regime in light of certain proposals as under:

(i) The concept of discount and premium be abolished which requires elimination of the par value;

(ii) The memorandum should reflect the share capital without fixing the share price, as follows:

"The share capital is AED. X, divided into Y shares"[6]

(iii) The price at which shares are issued should be determined by the board of directors of the company. In making such determination the directors will be bound by their fiduciary duty to act in good faith. The board may also seek assistance from financial advisors, which may however come as an increase in the cost of doing business;

(iv) A further safeguard for existing shareholders, in addition to the directors fiduciary duty, may be introduced 'requiring a special resolution to approve the issue price where it is less than the immediately preceding issue price of shares of the company'[7];

(v) The no-par regime shall be implemented mandatorily across all types of companies, irrespective of whether they are incorporated in the free zone or mainland. Various jurisdictions implemented an optional system whereby companies could opt for either of the two regimes. Certain jurisdictions allowed a dual system whereby one company could have both a par and no-par regime concurrently. The foregoing options however created further confusion, and given that simplicity and clarity are at the heart of a no par regime, 'jurisdictions have opted (or changed) to the mandatory system because it is much simpler for all concerned'[8]. It being acknowledged here that the no par regime will have to be studied in further depth to ensure compatibility with public joint stock companies; and

(vi) The implementation of no-par regime shall be led by legislative reform to reflect, inter alia, the proposals stated above. As the no par value regime does not seek to distinguish between issued capital and the premium/discount on shares, there would likely need to be consequential amendments to laws.

Particularly laws relating to: (i) fixing the par value, (ii) issuance of shares at a premium, (iii) issuance of shares at a discount, (iv) 'share premium account' and application of funds therein, will need to be amended. With the force of law relevant provisions in instruments and agreements will not be left to the parties to amend. Laws requiring more robust financial reporting systems for private companies will need to be introduced.

VII. CONCLUSION

Companies should not have to associate themselves with a value of shares which is not a true representation of fractional ownership of its assets. This tends to unnecessarily complicate matters, particularly for shareholders. Significant discrepancy in par and intrinsic values is often seen in companies which have been incorporated for a long period of time or which have seen a surge in their share value. The confusion deepens when conceptual inconsistencies and superfluity of the par regime are embedded in law and procedure.

A no par regime is a significantly cleaner and simpler system with notable practical benefits. The purpose of this article is to encourage discourse on migration towards a no par regime in line with advanced jurisdictions. Time may be taken in preparing a feasible implementation plan suitable for the local dynamics, as notwithstanding its idiosyncrasies the par is a 'functional', though not optimal, system.

Put another way, in my view, the par is a classic case of 'path dependence', best summed up below:

"I eat my peas with honey. I've done it all my life. It makes 'em taste quite funny, but it keeps them on the knife."[9]

I am advocating the use of a folk.

Footnotes:

1. Depending on the type of the company and where it is incorporated (mainland or a free zone), the relevant laws may prescribe a minimum par value, a fixed par value, a range between which the par value may be chosen, or require the company to itself choose a fixed par value. Where the law does not have such prescription, the memorandum of association will prescribe an arbitrary par value as a matter of practice.
2. Example: Article 227 of the Commercial Companies Law (Federal Law No. 8 of 1984) was amended by Federal Law No. 1 of 2009, which earlier provided that 'the capital of a limited liability company must not be less than one hundred and fifty thousand Dirhams and should be comprised of equal shares of a minimum value of one thousand Dirhams each' (emphasis added). This was amended to read: 'a limited liability company shall have capital that is sufficient… The capital shall consist of equal shares'. Even though the requirement of a minimum par value of one thousand Dirhams each share has been waived, in practice the memorandum of association continues to state a par value out of custom and practice.
3. Regulations 25 and 26 respectively, of the Dubai Metals & Commodities Centre Authority, DMCC Company Regulations, Regulation No. (1/03), issued in Dubai 2003, and Regulations 25 and 26 respectively, of the Dubai Technology and Media Free Zone, Private Companies Regulations, issued on April 9, 2003, Free Zone.
4. Article 203 of the Commercial Companies Law (Federal Law No. 8 of 1984)
5. Ho Yew Kee & Lan Luh Luh, The Par Value of Shares: An Irrelevant Concept in Modern Company Law, Singapore Journal of Legal Studies [1999] 552-572 at page 556.
6. Requirement of 'equal' shares may be added.
7. Consultation Study Concerning the Implications of Adopting a No-Par Value Share Regime in Hong Kong, Final Report, by Freshfields Bruckhaus Deringer, (29 November 2004), page 80
8. Consultation Study Concerning the Implications of Adopting a No-Par Value Share Regime in Hong Kong, Final Report, by Freshfields Bruckhaus Deringer, (29 November 2004), page 77.
9. An old Bostonian jump roping rhyme taken from an essay on Path Dependence, published in Quarterly Journal of Political Science, 2006, 1: 87–115, by Scott E. Page Center for the Study of Complex Systems,

University of Michigan, Ann Arbor.