

CORPORATIONS:
CONSTITUTIONAL LAW:

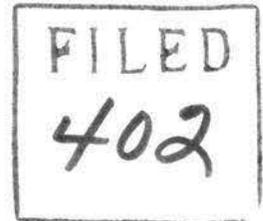
Article XI, Section 7 of the Constitution of Missouri and Section 351.160, RSMo 1969, do not render

void bonds which are sold at less than par or face value where the bonds are issued to promote the legitimate business of the corporation and the discount price is arrived at after bona fide arms length negotiations between the corporation and the purchaser and is the best price that the corporation in good faith could obtain.

OPINION NO. 402

September 25, 1970

Honorable William C. Phelps
State Representative
District No. 4
5016 Grand
Kansas City, Missouri 64112



Dear Representative Phelps:

This is to acknowledge receipt of your request for an opinion from this office which reads in part as follows:

"A Missouri corporation proposes to issue and sell its bonds to a purchaser or purchasers for cash at a price and interest rate to be determined by negotiation. It is believed that the purchasers will offer to buy the bonds at a discount price which is below the par or face value of the bonds. If the bonds are sold at such a discount, the interest rate will be lower than if the bonds are sold at par. It also should be taken as a fact that if the bonds are sold at par or face value a higher interest rate would be demanded by the purchaser or purchasers.

"The sale of the bonds at less than par or face value will mean that the corporation will receive in cash less than 100% of the par or face value of the bonds. The corporation will receive no other consideration for the bonds. It should be assumed that the issuance of the bonds will promote the legitimate business of the corporation, that the discount price was arrived at after bona fide arms length negotiations between the corporation and the purchaser or purchasers and was the best price that the corporation in good faith could obtain.

Honorable William C. Phelps

"Your opinion is requested with respect to the effect of Section 7, Article 11 of the 1945 Constitution of Missouri and Section 351.160. R. S. Mo., as it applies to a sale of the bonds at a discount which will result in the corporation receiving less than the par or face value of the bonds."

Article XI, Section 7 of the Constitution of Missouri provides as follows:

"No corporation shall issue stock, or bonds or other obligations for the payment of money, except for money paid, labor done or property actually received; and all fictitious issues or increases of stock or indebtedness shall be void; provided, that no such issue or increase made for valid bona fide antecedent debts shall be deemed fictitious or void. The stock or bonded indebtedness of corporations shall not be increased nor shall preferred stock be issued, except according to general law."

Section 351.160, RSMo 1969, provides as follows:

"1. No corporation shall issue shares, or bonds or other obligations for the payment of money, except for money paid, labor done or property actually received; and all fictitious issues or increases of shares or indebtedness shall be void; provided, that no such issue or increase made for valid bona fide antecedent debts shall be deemed fictitious or void.

"2. Bonded indebtedness of a corporation shall be incurred or increased only upon prior approval by the board of directors. Unless the articles of incorporation otherwise provide, no vote or consent of shareholders shall be necessary to authorize or approve the incurrence of or an increase in bonded indebtedness."

In construing the meaning of the above provisions, we refer to Memphis & L.R.R. Co. v. Dow, 120 U.S. 287, 7 S.Ct. 482, 30 L.Ed. 595 (1886), where the Supreme Court of the United States construed an identical provision from the Constitution of Arkansas. There the court explained the purpose of the restriction as follows:

Honorable William C. Phelps

". . . The prohibition against the issuing of stock or bonds, except for money or property actually received or labor done, and against the fictitious increase of stock or indebtedness, was intended to protect stockholders against spoliation, and to guard the public against securities that were absolutely worthless. One of the mischiefs sought to be remedied is the flooding of the market with stock and bonds that do not represent anything whatever of substantial value. . . ." (Id. at 298)

The court then borrowed the following language from the Supreme Court of Illinois which had construed a similar provision from the Constitution of Illinois in Peoria & S.R.R. Co. v. Thompson, 103 Ill. 187 (1882):

". . . ' . . . The object was, doubtless, to prevent reckless and unscrupulous speculators, under the guise or pretense of building a railroad or of accomplishing some other legitimate corporate purpose, from fraudulently issuing and putting upon the market bonds or stocks that do not and are not intended to represent money or property of any kind, either in possession or expectancy, the stock or bonds in such case being entirely fictitious. . . .'

"Under this provision of the constitution, railroad companies have no right to lend, give away, or sell on credit, their bonds or stock, nor have they the right to dispose of either, except for a present consideration, and for a corporate purpose.'" (Id. at 298-299)

Finally, the Supreme Court of the United States concluded that the validity of the bonds does not necessarily require the corporation to receive an amount in money equal to the par value of the bonds:

"Recurring to the language employed in the Arkansas constitution, we are of opinion that it does not necessarily indicate a purpose to make the validity of every issue of stock or bonds by a private corporation depend upon the inquiry whether the money, property, or labor actually received therefor was of equal value in the market with the stock or bonds so issued. It is not clear, from the words used,

Honorable William C. Phelps

that the framers of that instrument intended to restrict private corporations--at least when acting with the approval of their stockholders--in the exchange of their stock or bonds for money, property, or labor, upon such terms as they deem proper, provided, always, the transaction is a real one, based upon a present consideration, and having reference to legitimate corporate purposes, and is not a mere device to evade the law and accomplish that which is forbidden. . . ." (Id. at 299)

An identical provision in the Constitution of Texas was construed in Smith v. Ideal Laundry Co., 286 S.W. 285 (Tex.Cir.App. 1926). The court held that the provision did not require that bonds shall be sold at par or that the corporation shall receive face value for them. Relying on Memphis & L.R.R. Co. v. Dow, the court held as follows:

"The provision of the Constitution under consideration would not justify an inquiry as to whether a corporation received full value for its bonds, nor to inquire into whether too much was paid for property; the only matter for inquiry being as to whether the amount received in money or in property bears a reasonable approximation to the amount of the bonds. . . ." (Id. at 286)

Therefore, where the bonds are issued to promote the legitimate business of the corporation and the best price that the corporation in good faith could obtain is a price less than the par value of the bonds, the bonds are not rendered void by Article XI, Section 7 of the Constitution of Missouri or Section 351.160, RSMo 1969, for the reason that such a provision is intended ". . . to guard the public against securities that were absolutely worthless. . . ." not to ". . . make the validity of every issue of stock or bonds by a private corporation depend upon the inquiry whether the money, property or labor actually received therefor was of equal value in the market with the stock or bonds so issued. . . ." The measure, then, is not whether the par value of the bonds was received by the corporation but ". . . whether the amount received in money or in property bears a reasonable approximation to the amount of the bonds. . . ."

CONCLUSION

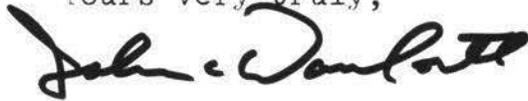
Article XI, Section 7 of the Constitution of Missouri and Section 351.160, RSMo 1969, do not render void bonds which are sold

Honorable William C. Phelps

at less than par or face value where the bonds are issued to promote the legitimate business of the corporation and the discount price is arrived at after bona fide arms length negotiations between the corporation and the purchaser and is the best price that the corporation in good faith could obtain.

The foregoing opinion, which I hereby approve, was prepared by my Assistant, B. J. Jones.

Yours very truly,

A handwritten signature in black ink, appearing to read "John C. Danforth". The signature is written in a cursive style with a large, prominent initial "J".

JOHN C. DANFORTH
Attorney General