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THE ISSUE OF CORPORATE STOCK FOR PROPERTY PURCHASED—A NEW PHASE.

There are few problems in the law of corporations that arise more frequently and none that concern the general public more intimately than those arising in connection with the issue of corporate stock in payment for property purchased by a corporation. The reason for this is not far to seek, for it is well recognized that the exchange of stock for property is the favorite method of stock watering. In this connection it becomes of importance to ascertain the precise meaning and application of enactments upon this subject like that on the statute books of New Jersey, the favorite home of corporations, and of those states which have followed her lead.

Sections forty-eight and forty-nine of the New Jersey "Act concerning Corporations,"[1] Revision of 1896, are as follows:

"48. Nothing but money shall be considered as payment of any part of the capital stock of any corporation under this act, except as hereinafter provided in case of the purchase of property.

"49. Any corporation formed under this act may purchase mines, manufactories or other property necessary for its business . . . and issue stock to the amount of the value thereof in payment therefor . . . ; and in the absence of actual fraud in the transaction, the judgment of the directors as to the value of the property purchased shall be conclusive . . "

Though provisions virtually identical with these are to be found in Connecticut,[2] Delaware,[3] Maine,[4] New York,[5] North

1. Laws of 1896, ch. 185.
2. General Laws, Sec. 3368.
3. Laws of 1901, ch. 167, Sec. 14.
4. Laws of 1901, ch. 229, Sec. 13.
5. General Laws, ch. 36, Sec. 42.

Carolina,[6] and Porto Rico;[7] though the statutes of West Virginia[8] and of Michigan[9] are similar except that they have the word "valuation" instead of "judgment as to the value," the former being precisely equivalent to the latter, and though, in addition, there are other states whose courts, without the aid of legislation, have taken the same position, yet, so far as careful research can disclose, the point of this discussion has never been presented to or passed upon by any court.

To present the question more exactly, let a case be assumed, arising in New Jersey, in which the record shows that the action is by a judgment-creditor of an insolvent corporation, for himself and all those similarly situated, etc., against a stockholder thereof whose stock has been issued to him for property purchased by the corporation; that the record of this latter transaction upon the books of the company is an entry in the directors' minutes to the effect, that it had been resolved by them that the company accept A's (i. e., the defendant's) offer to sell certain property, and that "the Board of Directors do hereby adjudge and declare that said property is of the fair value of——dollars, and that the same is necessary for the business of the company." The case further shows that there is evidence, to the admission of which defendant objects, to prove that the Board of Directors, which adopted this resolution, was composed of "dummies," who, in taking their action, had merely followed instructions so to do upon being told by the attorney or other agent of the real parties in interest that the property purchased was fairly worth the par value of the stock issued in payment for it; that the directors of their independent knowledge or investigation knew nothing about the value of the property purchased; and, finally, that the actual value of the property at the time of its transfer to the corporation was materially smaller than the par value of the stock issued in exchange for it. The ground of defendant's objection to admitting the evidence in question is that it does not tend to prove "actual fraud" and is, therefore, irrelevant. The complainant concedes that it does not tend to prove that there was "actual fraud," but insists that it does show that the directors did not exercise their "judgment," within the terms of the statute, in purchasing the property and issuing

6. Laws of 1901, ch. 2, Sec. 54.
7. Civ. Code, Title II., ch. 1, Sec. 45.
8. Code, ch. 53, Sec. 24.
9. Pub. Acts, 1903, ch. 232, Sec. 1.

stock for it, and that, therefore, it is relevant and entitles him to a recovery. Is the complainant's position correct?

Such a case could be most intelligently decided by considering, first, the evolution of the law upon the general subject of the exchange of stock for property purchased up to the time of the adoption of the enactment in question.

Taken for granted without discussion in Woodfall's Case,[10] the common law rule was definitely settled by Drummond's case[11] to the effect that a corporation may issue its stock in payment for property in order that, in the case of a person having property which the corporation needed and wishing at the same time to become a share-holder thereof, it might not be necessary for him to go through the cumbersome process of first selling the property to the company for cash and of then buying shares in it with the money received. The practical common sense underlying this rule caused it to be generally adopted either by decision[12] or statute or both.

It was not long before the ready means for stock-watering afforded by the otherwise beneficent rule of Drummond's Case was discovered and employed. The problem has, therefore, been the devising and application of rules, such that, while the benefits of the doctrine that stock may be issued for property are preserved, the evil purpose to which it may be perverted may be avoided.

The first step taken toward the solution of that problem was a regulation obviously demanded by justice and honest dealing. If stock may be issued for property as well as for money, then, of course, a given piece of property should command no more stock than its equivalent in money. Hence, the enactment in New Jersey, most of the other states having the same or similar provisions, that stock when issued for property, shall be issued " to the amount of the value thereof" (Section 49).

All along there was the old equity rule, now embodied in Sec-

10. 3 De G. and Sm., 63–1849. Early cases in the United States also are: *Tallmadge v. Fishkill Iron Co.*, 4 Barb., 382, 1848, and *Carr v. Le Fevre*, 27 Pa. St., 413, 1856.

11. L. R., 4 Ch. 772–1869.

12. *Steacy v. Railroad Co.*, 5 Dill., 348, 376; *Farwell v. Telegraph Co.*, 161 Ill., 522, 532; *Foster v. Refining Co.*, 118 Mo., 238, 263; *Brant v. Ehlen* 59 Md., 1, 29; *Foreman v. Bigelow*, 4 Cliff., 508, 526; *Ashuelot Co. v. Hoit*, 56 N. H., 548, 558; *Wetherbee v. Baker*, 35 N. J. E., 501, 512; *Kelley Bros. v. Fletcher*, 94 Tenn., 1; *New Haven Co. v. Linden Spring Co.*, 142 Mass., 349, 355; *Kroenert v. Johnson*, 19 Wash., 96; *Coffin v. Ramsdell*, 110 Ind., 417.

tion 21 of the New Jersey law, that where so much of a corporation's capital as is paid in, the whole thereof not having been paid, is insufficient to satisfy its obligations, the stockholders shall be liable to the corporation's creditors to the extent of the difference between the par value of their stock and the amount paid therefor, if less than that par value. It follows from this and the preceding rule that if more stock at par is issued than the value of the property taken therefor warrants, each share has been issued at a discount, the capital of the company is not at all paid in, and the stockholder should, therefore, in a proper case, be liable to creditors. Though this theory seems clear enough, the decisions are in hopeless confusion on the point of its practical application.

The discord in the decisions may be thus explained: While a given sum of money represents the same amount of value to most men, it is obvious that there may be as many different estimates of the value of a given piece of property as there are people called upon to pass an opinion, even though all act in the best of faith. Moreover, it is just because there is that unity of opinion among men as to the value of money, and that possible, even probable, honest divergence among them as to the value of property, that there is presented the opportunity, soon taken advantage of, for purposely and dishonestly placing a fictitious value on chattels or realty to be changed for the stock of a corporation. The question upon which the courts divided was whether they would treat both cases—i. e., honest and dishonest over-valuation—alike or not.

Most of the courts have agreed, that, if the directors knowingly and intentionally place a fictitious value upon property for which stock is issued, then there has been actual fraud as against the creditors of the corporation, and they may hold the stockholder for the difference between the par value of his shares and the true value of the property given therefor by him.[13]

Suppose, however, that so far from there being any such actual fraud, the directors of the corporation and the stockholder acted with perfect honesty and that despite all their efforts truly and accurately to collate and deliberate upon the various elements that entered into the value of a given piece of property, the parties fell into error or into what becomes such, only because of a subsequent determination by a court differing from that of the directors on a matter purely of opinion. Is the stockholder in such a case to be liable?

On the other hand, it has been held that whether intentional

13. See cases *infra*, beginning with *Young v. Iron Co.*, 65 Mich., 111.

or not, the holding out as full paid stock which is not actually and truly such is a *fraud in law* upon creditors of the corporation, who rely on its assets being as represented and that, therefore, they are to be allowed to come against the stockholder.[14]

Whatever may be the merit of this view, known as the "true value" rule, in the realm of pure legal theory, its impracticability is evident. Under it the transaction of business in corporate form must in most cases be absurdly chaotic, if not hopelessly impossible. Who will take the stock of a corporation in payment for his property so long as the transaction is always subject to be overturned years afterward at the instance of some resourceful creditor who has unearthed an error committed in the strictest honesty by the directors while coming to a judgment as to the value of his property? The answer is given by the leading New York case[15] on this subject, in which Chief Commissioner Lott declares:

"No person could be expected to become a stockholder, and pay his money or appropriate his property, and he nevertheless be held liable to a contribution in favor of creditors, to the extent of the stock issued for such property, if a jury should, subsequently, and at an indefinite and unlimited period thereafter, find that the trustees (directors) had under a mistake, but in an honest exercise of their judgment, concluded, erroneously . . . that their property was in fact, as disclosed by subsequent events, not . . . . actually worth the full sum allowed for it. There are many circumstances that affect values. The time of purchase, the demand for the article sought for, a limited supply, the credit given, a panic in the money market, and various other matters, have their influence and effect, and which cannot be properly appreciated at a remote day after these causes have ceased to operate . . . The construction given to the act by the court below, in its effect imposes a penalty on the stockholder in a company for a mistake and erroneous judgment of its trustees in the faithful and honest discharge of their duties."

This and other defects in the true value were recognized by the courts of most of the states, and they, accordingly, have taken the view that so long as there was no intentional overvaluation, all "legal" or "equitable" (or other adjective showing that there is no "actual") fraud is to be ignored and the judgment arrived

14. *Chisholm v. Forny*, 65 Ia., 333; *Schickle v. Watts*, 94 Mo., 410; *Libby v. Tobey*, 82 Me., 397; *Gillin v. Sawyer*, 93 Me., 151; *Cole v. Adams*, 19 Tex Civ. App. 507; *Berry v. Rood*, 67 S. W. (Mo.) 644.

15. *Schenck v. Andrews*, 57 N. Y., 133, 143.

at in good faith by the directors of the company to be regarded as conclusive upon all parties.[16]

The states following this latter doctrine were then confronted by a further problem. Conceding that actual fraud, consisting of intentional over-valuation, must be found as a fact in order to enable the creditors of a corporation to hold a stockholder thereof, what, in the absence of controlling evidence *aliunde,* is the relevancy and potency as evidence of such fraud, of the naked fact that a given case is one of gross over-valuation ? Though the decisions on this point, also, are by no means harmonious, in general, they take the logical stand that where the value of given property is not obvious and well settled, and especially where it depends upon usefulness and exploitation in the future, it is entirely a matter of opinion upon which there is room for large divergence, and therefore, the mere fact of over-valuation is in such case to be regarded as absolutely no evidence of actual fraud. If, however, property "the value of which is well known and understood, or capable of being easily ascertained, is taken at a most exorbitant estimate far beyond any intrinsic or real value," then some dicta[17] say that there is "strong evidence" of actual fraud, while it is usually held[18] that proof of the above shifts upon the stockholder the burden of going forward with evidence to show that the transaction by which he acquired his stock was not tainted by intentional over-valuation of the property purchased by the directors for the corporation.

In New Jersey, the "good faith" rule—i.e., the majority rule—was established. The first case in point in that state was *Wetherbee v. Baker.*[19] Five persons agreed for the purchase of a tract of land and organized themselves into a corporation, the capital of which was fixed at one hundred thousand dollars, all sub-

16. *Young v. Iron Co.,* 65 Mich., 111, 124; *Powers v. Knapp,* 85 Hun., 38; *Brant v. Ehlen,* 59 Md., 1; *Carr v. Le Fevre,* 27 P. St., 413, 417; *Kelley Bros. v. Fletcher,* 94 Tenn., 1; *Calivada Co. v. Hays,* 119 Fed., 202; *Coit v. Gold Amalgamating Co.,* 119 U.S., 343; *Grant v. Railroad Co.,* 54 Fed., 569; *Troup v. Horbach;* 53 Neb., 795; *Kroenert v. Johnson,* 19 Wash., 96; *Coffin v. Ramsdell,* 110 Ind., 417; *Boynton v. Andrews,* 63 N. Y., 93; *Whitehill v. Jacobs,* 75 Wis., 474; *Welburn v. Chenault,* 43 Kan., 352; *Malting Co. v. Brewing Co.,* 65 Minn., 28; *Schenck v. Andrews,* 57 N. Y., 133; *Richardson v. Mining Co.,* 65 Pac., 74; *Gilkie & Anson Co. v. Gas Co.,* 46 Neb., 333.

17. *Coit v. Gold Amalgamating Co.,* 119 U. S. 343.

18. *Boynton v. Andrews,* 63 N. Y., 93; *Malting Co. v. Brewing Co.,* 65 Minn., 28; *Coleman v. Howe,* 154 Ill., 458; *Taylor v. Walker,* 117 Fed., 737; *Macbeth v. Banfield,* 78 Pac., (Ore.), 692.

19. 35 N. J. E., 501–1882.

scribed for by the five, who also became the directors of the company. The price to be paid for the land was fifty thousand dollars, and the deed being made directly to the corporation, it gave its obligations for the purchase money. The directors then appraised the land at one hundred thousand dollars and by resolution credited fifty thousand dollars of the valuation as payment of fifty per cent of their own subscriptions to the capital stock. The land was not worth more than the original purchase money. In a suit by a creditor of the corporation, then insolvent, against the directors on the ground that nothing had been paid for their stock, the Court of Errors and Appeals, by Judge Depue, declared that "the subscriptions to the capital stock constitute a trust fund for the payment of debts," of which fund the directors are trustees; that as such the latter must administer their trust in good faith, and that in cases of payment for capital stock by property, such as the case before it, it is only when the directors estimate the value of such property in good faith that their valuation can stand against the attacks of creditors of the corporation. In the case before it, the court found that there had not been such good faith, but, on the contrary, that "the appraisement, it is manifest, was illusory and made only in the interest of the directors who were to profit by it."

The bearing of this case, then, is simply in accordance with the general rule, that fraudulent over-valuation renders the stockholder liable, the fraud being found, not a matter of law from the mere fact of a difference between the actual value of the property and that placed upon it by the directors, but as a finding of fact from all the evidence before the court. Though the case is not itself *a decision* following the majority doctrine on the point upon which the courts divide, yet it plainly indicated that in an appropriate case the court would adhere to that view.

The next case is that of *Bickley v. Schlag*.[20] That was a bill by a judgment creditor of an insolvent corporation against the stockholders thereof, to compel them to liquidate, for the benefit of the complainant, the alleged arrears of their subscriptions to the capital stock of the company. The stockholders had paid for their seventy-five thousand dollars, par value, of stock with property found to be the actual value of only sixty-four thousand dollars. The decree below, applying the true value rule, was that the stockholders make good the deficiency. The Court of Errors and Appeals, Chief Justice Beasley writing the opinion, reversed

20. 46 N. J. E., 533–1890.

this, and ranged itself squarely on the side of the good faith rule, declaring that "the substance of the true issue has been overlooked" and that the "valuation of property in making the exchange . . . cannot be supervised or controlled by the court of chancery, for, in the absence of deceit or some other corrupt constituent, the bargain between the parties cannot be disturbed."

Edgerton v. The Electric Improvement and Construction Co. [21] is the next case. The complainant sought the specific performance of a contract by which the defendant corporation agreed to issue to him the whole of its capital stock as fully paid for two inventions. One of the inventions for which the stock was to have been issued was shown to be unperfected, and the goods manufactured under the other to be worthless. Since the directors knew these facts before issuing the stock to complainant, it would, of course, have been actual fraud for them to have issued the stock in compliance with the contract, and so the Vice-Chancellor held, stating that:

"If the officers had issued this amount of stock on the unsubstantial basis indicated, it would have been the duty of this court, if the question had been properly presented for decision, to have declared that such issue was fraudulent and not authorized by the true consideration of the act, and it cannot by its decree direct that to be done which it would thus condemn."

The question arose again in *Hebbard v. The Southwestern Land and Cattle Co.*[22] In that case stock was issued to twenty times the value of the property taken in payment for it. The evidence showed that the property was knowingly and dishonestly over-valued and accordingly the stockholder was held liable.

On the whole, then, these cases lead to the conclusion that even prior to the enactment of Chapter 185, Section 49 of the laws of 1896, the law of New Jersey was that "in the absence of actual fraud, the judgment of the directors as to the value of the property purchased shall be conclusive" upon all parties. In other words, the statute was merely declaratory of the common law of the state.[23]

Beyond the point of declaring their adherence either to the true value rule or to the good faith rule and of determining the significance of the mere fact of over-valuation as evidence of

21. 50 N. J. E., 354–1892.

22. 55 N. J. E.. 18–1896.

23. *Easton National Bank v. American Brick & Tile Co.*, 60 Atl. (N. J.) 54—Feb., 1905; *Donald v. American Smelting Co.*, 62 N. J. E., 729 733.—1900.

actual fraud, none of the courts has gone, up to the present time. The question is now raised as to the precise meaning of the good faith rule, the statute of New Jersey and of the other states which copied it being taken as the correct and accurate expression of that rule.[24]

The vice of the true value rule, which, as we have seen, caused its repudiation by most of the courts, lay in the fact that it was entirely too stringent; it was like the physician who terminates his patient's ills by killing the patient. On the other hand, the question herein discussed is, in ultimate analysis, whether New Jersey, in her real zeal to avoid destructive caution, has rushed to the other extreme, even more impolitic, of establishing a doctrine too loosely liberal. By providing that the directors' "judgment" shall be conclusive, does the statute command that a mere entry by "dummy directors," who are virtually ignorant of everything concerning the business of which they are the titular managers, to the effect that they have "adjudged" a piece of property to be of such and such value—does the statute direct that such a compliance with form and violation of substance shall be final? It is submitted that the answer must be negative, and that, on the elementary principles of statutory interpretation.

The basic principle of all judicial interpretation of a statute is to determine the intent of the legislature, for the intent of a statute is the law.[25]

The next rule which applies to all statutes, is that the intent

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24. Perhaps as good a statement of the good faith rule as any to be found in the books is that in *Powers v. Knapp* (85 Hun. (N. Y.) 38, 41; affd. on opinion below, 158 N. Y., 733), where the court says:

"A mere mistake or error of judgment of the trustees (directors) either as to the necessity of the purchase or as to the value of the property, if made in good faith and not in evasion of the statute, will not subject the holder of the stock issued for property to the liability provided by section 10 (substantially the same as section 21, (referred to in the text at page 114), of the New Jersey Law). Section 2 of the Statute of 1853 (like the New Jersey Law, section 49 before the addition of the provision, in 1896, that "in the absence of actual fraud in the transaction the judgment," etc.) gives the trustees (directors) a discretion, and they are to be the judges both as to the necessity for the property purchased and as to the value of it. Good faith and the exercise of a proper discretion and honest judgment are all that is required."

25. *Orvill v. Woodcliff*. 64 N. J. L., 286; *Ogden v. Strong*, 2 Paine, 584; *McClusky v. Cromwell*, 11 N. Y., 593; *Railroad v. Hemphill*, 35 Miss., 17; *United States v. Hartwell*, 73 U. S. 385, 396; *Atkins v. Disintegrating Co.* 85 U. S. 272, 301; *Riggs v. Palmer*. 115 N. Y., 506; *Manhattan Co. v. Kaldenberg*, 165 N. Y., 1, 7; *Andelo v. People*, 106, Ill. App., 558; *Grimes v. Reynolds*, 68 S. W., 588; *Blair v. Coakley*, 48 S. E., 804; *Fordyce v. Bridges*, 1 H. L. C., 1.

of the legislature is first, of course, to be sought in the words employed in a given enactment.[26]

If the language of the statute is clear, distinct and unambiguous, the quest for the legislative intent is ended, for as the maxim goes, it is not permitted to interpret that which is not in need of interpretation. The plainly and unequivocally expressed mandate of the law-making body must without further ado be obeyed, assuming, of course , that no question of constitutionality enters. [27]

The fourth of these fundamental principles is that the words of a statute are to be regarded as employed in their common, familiar, obvious signification, and are not to be twisted or distorted in order to extend or restrict their meaning.[28]

Applying these principles to the statute in question, the problem reduces itself to the simple one of determining the ordinary, popular meaning of the word "judgment." By "judgment" all who use the term mean the conclusion reached by one who takes the attitude of a judge, that attitude implying, first, knowledge of or acquaintance with the matter to be judged, and, secondly, collation of and deliberation upon the various elements of fact upon which a conclusion must be based. In short, without assuming that definitions given by dictionaries are decisive[29] of the ordinary and popular signification of a word, it is submitted that the familiar meaning of the term "judgment" is the same as that given by the lexicographers. The "Standard Dictionary" declares that "judgment" is "the mental operation by which facts are weighed, com-

26. *Orvill v. Woodcliff, supra*; *McClusky v. Cromwell, supra; Clark v. Mayor*, 29 Md., 277, 283; *United States v. Goldenberg*, 168 U. S., 95, 102; *Mayor v. Railroad*, 143 N. Y., 1, 20; *State v. Insurance Co.*, 66 Ark., 466; *Fordyce v. Bridges, supra.*

27. *Railroad v. Commissioners*, 18 N. J. L., 71; *Townsend v. Brown*, 24 N. J. L., 80; *Rudderow v. Ferry Co.*, 31 N. J. L., 512; *Douglass v. Freeholders*, 38 N. J. L., 214; *Gay v. Hervey*, 41 N. J. L., 39; *Commissioners v. Brewster*, 42 N. J. L., 125; *Woodruff v. State*, 52 Atl., 294; *Swartz v. Siegel*, 117 Fed. 13; *Mayor v. Railroad, supra; People v. Railroad*, 201, Ill. 65; *People v. Sands*, 102 Cal., 12; *McKay v. Railroad*, 75 Conn. 608; *Yerke v. United States*, 143 U. S., 439: *United States v. Fisher*, 2 Cranch, 399.

28. *State v. Deshler*, 25 N. J. L., 177; *McLorinan v. Township*, 49 N. J. L., 614; *McClusky v. Cromwell, supra; Utley v. Hill*, 155 Mo., 232, 264; *People v. Reis*, 76 Cal., 269, 279; *Harrison v. State*, 102 Ala., 170; *Enterprise v. Smith*, 66 Ark., 815; *Bacon v. Commissioners*, 126 Mich., 22; *Power Co. v. Power Co.*, 172 U. S., 474, 491; *Treat v. White*, 181 U. S., 264; *Insurance Association v. Tucker*, L. R., 12 Q. B. D., 176, 186; *Unwin v. Hanson*, L. R. (1891) 2 Q. B., 115.

29. *McLorinan v. Township, supra.*

parison and deductions made, and conclusions reached," or "the decision or conclusion reached, as after consideration or deliberation." In Webster, it is stated that "judgment" is "The determination of the mind, formed from comparing the relations of ideas, or the comparisons of facts and arguments." And to show what is essential to the exercise of "judgment," the author lays it down that, "In the formation of our judgments, we should be careful to weigh and compare all the facts connected with the subject."

Again in *Timmins v. Wade,*[30] the charge of the trial judge to the jury was objected to, because he told them to be guided by their own "judgment" in finding or refusing to find a certain fact. On appeal it was held that the term, as used by the judge (and certainly in instructing a jury, the court employs words in their natural and common-place signification), meant "a decision resulting from the mental process of reasoning, or that faculty of the mind by which a person is enabled, by a comparison of ideas, or an examination of facts, to arrive at a just conclusion in reaching for the truth."

In the hypothetical case, there was no such weighing and comparing of facts or drawing of conclusions; there was no such deliberation upon or consideration of all (nor, indeed, of any) of the facts connected with the subject, and there was, therefore, no exercise of judgment. The only kind of act on the part of the directors which the statute declares shall be conclusive, was, therefore, not present and it follows that the action which the directors did in fact take was not conclusive. The complainant should, accordingly, be allowed to recover the difference between the actual value of the property purchased by the corporation and the par value of the stock issued for it.

At this point this whole discussion might well be concluded, were it not for the fact that it would then be subject to attack on the score of having begged the real question in issue in assuming that the language of the enactment is unambiguous. Because two constructions are sought to be placed upon a given enactment, it does not follow that the enactment is ambiguous; it may well be that one construction contended for is totally incorrect and unwarranted. Such, it is submitted, is the case here. However, in view of the possible criticism just mentioned it is thought best to pursue the subject further.

Assuming, therefore, that the provision is equivocal, or at least not entirely clear, what then?

It is a principle commonly applied in cases where the signifi-

30. 5 Ind. App. 139.

cation of a given portion of an act is not quite free from doubt, the whole act is to be considered with the view to deducing the general intent and purpose of the legislature therefrom and then applying the same to the doubtful clause.[31]

There can be no question that the New Jersey Corporation Law was conceived in a spirit of liberality and intended for that reason to be attractive to corporate enterprise. This was the avowed design of the revision of 1896 and is not to be disputed. It is not true, however, that because liberality was intended, license is to be protected, especially where the line that divides the two is easily ascertainable. The liberality that pervades the act as a whole is fully preserved by the construction of Section 49, which it is herein sought to establish, while to sustain the applicability of the section to a case like the one outlined at the beginning of this discussion would be to extend license to the point of fraud in the field of corporations. And this is easily demonstrated.

In the first place, when it is found, as it must be, that there has been no "judgment" by the directors and it is still insisted that the section applies, it must be on the theory that the section, as it stands, means the same as if it read "and in the absence of actual fraud, the action taken by the directors shall be conclusive." Secondly, the restriction as to "actual fraud" is in practice in nine cases out of ten, as in the hypothetical case, useless and of no effect through being readily rendered inapplicable. For who shall say that there has been actual fraud—i. e., intentional over-valuation at the very least[32] where the directors who placed the value upon the property, so far from having any intention of their own at all, were virtually ignorant of everything connected with its value. The statute would thus have no other meaning or effect than that any action, no matter how arbitrary or capricious, and without restriction as to fraud, taken by the directors in exchanging stock for property shall be conclusive. That looseness run riot would characterize any such enactment cannot be denied, for it would be a source of encouragement and protection to all who wished to trans-

31. *Matter of Thomas Murphy*, 23 N. J. L., 180; *Jersey Co. v. Davison*, 29 N. J. L., 415; *State v. Mayor*, 35 N. J. L., 196; *Scott v. Mayer*, 68 N. J. L., 687; *Matter of John W. Livingston*, 121 N. Y., 94; *Manhattan Co. v. Kaldenberg*, 165 N. Y., 1; *People v. Chicago*, 152 Ill., 546. *State v. Roby*, 142 Ind., 168; *Fitzgerald v. Rees*, 67 Miss., 473; *Trust Co. v. Trust Co.*, 62 Minn., 501; *Pennington v. Coxe*, 2 Cranch, 33; *Newbert v. Fletcher*, 84 Me., 408; *United States v. Buchanan*, 9 Fed., 689.

32. *Easton National Bank v. American Brick & Tile Co.*, 60 Atl. (N. J.) 54—Feb., 1905.

form a hundred dollars into a thousand by the simple process of having "dummy directors" "declare and adjudge" that the hundred dollars in chattels or realty was of the value of a thousand dollars. Can it be that the legislature intended this?

To this question a further salutary and well settled rule of statutory interpretation gives the answer, the rule, namely, that a construction leading to injustice and unreason will not be adopted, because the intention to accomplish either will not be attributed to the legislature, so long as the language of a given statute may be construed so as to avoid those consequences. As an eminent authority on statutory construction expresses it: [33]

"A construction which must necessarily occasion great public and private mischief must never be preferred to a construction which will occasion neither or not in so great a degree, unless the terms of the instrument absolutely require such a preference."

If this principle be applied to Section 49 of the New Jersey law the safe and sane liberality which was intended to characterize the act is fully preserved. The liberality consists in the fact that it does not permit the stockholder to be liable to the honest error of the directors in forming their judgment, as does the true value rule, and the sanity and safety of the position lie in the fact that it does not invite and foster fraud, as would the other construction.

The fact that the New Jersey legislature did not intend any such extraordinary thing as the construction necessary to be applied to the statute in order to have it cover a case like the one assumed is further shown by a statute as to crimes enacted so recently as during the last session and providing that: [34]

"Any person or persons who shall organize or incorporate, or procure to be organized or incorporated, any organization or body corporated under the laws of this state, with intent thereby to further, promote or conduct any fraudulent or unlawful object, shall be guilty of a misdemeanor.

"Any person or persons who, being officers, directors, managers or employees of any corporation or body politic incorporated

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33. Sutherland, Statutory Construction, 2nd Ed. Sec. 489, and cases cited. See also *Jersey Co. v. Davison*, 29 N. J. L., 415; 26 Am. & Eng. Encyc., 646.

34. New Jersey Public Laws, 1905, ch. 257. That it is permissible to consider a subsequent act upon the same subject to ascertain the legislative intent, see: *Penitentiary Co. v. Nelms*, 65 Ga., 67; *United States v. Freeman*, 3 How., 556,585; *Bear v. Bear*, 33 Pa. St., 525, 530; *Matter of Livingston*, 121 N. Y., 94, 104; *Cocheu v. M. P. Church*, 32 N. Y. App. Div., 239; *Rolle v. Whyte*, L. R. 3 Q. B. 286.

under the laws of this state, shall wilfully use, operate or control said corporation or body corporate for the furtherance or promotion of any fradulent object, shall be guilty of a misdemeanor."

On the assumption still that the language of Section 49 is not in itself quite clear, there are yet other canons of interpretation which require the view herein taken.

It is laid down [35] that it is the duty of the court so to construe statutes as to defeat all attempts to evade them. We have seen that the actual fraud, which, alone, under the construction disapproved, can be made the ground for attacking the action taken by the directors in exchanging stock for property is readily evaded by the device of "dummy directors." On the other hand under our interpretation, the statute cannot be so circumvented. The directors, whoever they may be, and irrespective of whether their interest be real or feigned, must exercise their judgment; nothing less will make their action final and conclusive. Again, if while exercising their judgment, they intentionally overestimate one element or ignore another entering into the value of the property to be judged, their action is not final. It is submitted that it is difficult to conceive of any other possible regulation of this subject at the same time so broad and so wholesome.

Again, it is a rule of law as well settled as any can be, that where discretion or judgment to an act in a given matter as he or they deem proper is vested in a given person or body of persons, that discretion is not to be so wielded as to amount to a despotism. [36]

For the same reason that a body vested with the discretion of removing a subordinate officer may not remove him without a hearing, [37] and on the mere accusation, it may be, of an interested party, a body vested with the power to come to a conclusive judgment as to the value of property may not declare *ex cathedra,* or without consideration, that it is of a certain given value, and that on the say-so, as is usually the case, of interested persons. Indeed, the Supreme Court of the United States has said [38] that the exercise of judgment "excludes caprice, whim and every arbitrary award."

35. Endlich, Interpretation of Statutes, Sec. 138.

36. *McManus v. Finan,* 4 Ia., 283, 287; *Lovinier v. Pearce,* 70 N. C., 167, 171: *Rothrock v. Carr,* 55 Ind., 334; *Dooley v. Barker,* 2 Mo., App., 325, 328; *Rose v. Brown,* 11 W. Va., 122, 142; *Norris v. Clinkscales,* 47 S. C., 488, 498; *The Styria v. Morgan,* 186 U. S., 71, 9; *Lee v. Railroad,* L. R. 6 C. P., 576, 580; *In re Taylor,* 4 Ch. D., 157, 159.

37. *Andrews v. King,* 77 Mo. 244.

38. *Colton v. Colton,* 127 U. S., 300, 317.

It is not considered that the interpretation herein placed upon the statute is a strict one. But if it were, it would be proper, for the whole of Section 49, which permits property to be taken as payment for stock, is an exception to the preceding section, and the rule is that the language of exceptions is to be strictly construed in order to give the broadest scope to the general enactment and that he who seeks benefit of an exception must show himself to be clearly within it.[39]

Indeed, the whole corporation act, because it grants an extraordinary power—namely, that of being a corporation—is to be strictly construed so as to protect the general public to the fullest.[40]

Thus, assuming even that the statute in itself is not entirely clear, there seems to be no doubt that when the legislature enacts that the judgment of the directors, and not that any action taken by them shall be conclusive, it means that the conclusion reached by the directors after the consideration of all relevant facts and only that should be conclusive. Accordingly, when the Court in *Donald v. American Smelting Co.*,[41] says in a dictum that "*after the property has been purchased and the stock issued therefor*, nothing short of actual fraud in the transaction can impair the right of the holder to hold his stock as full paid stock, free from further call," the statement can be regarded as correct only provided that the directors had exercised their "judgment" when negotiating the transaction.

Indeed, the truth of this view as to the significance of the term "judgment" seems to have been appreciated in practice by those most intimately concerned; this is fairly indicated by the fact that a compliance, *pro forma*, with the statute, as herein interpreted, is usually observed by first having the nominal directors informed either by the prospective recipient of the stock or by his agent that

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39. *Roberts v. Yarboro*, 41 Tex., 449, 452; *Bragg v. Clark*, 50 Ala., 363. 365; *Ryan v. Carter*, 93 U. S., 78, 83; *Epps v. Epps*, 17 Ill. App. 196, 200; *United States v. Dickson*, 15 Pet. 141, 165; *McRae v. Holcomb*, 46 Ark., 306, 311.

40. *Railroad v. Briggs*, 22 N. J. L. 623, 644; *Jersey City v. Railroad*, 40 N. J. E., 417; *Black v. Canal Co.*, 24 N. J. E., 455, 474; *Morris Canal Co. v. Railroad Co.*, 16 N. J. E., 419, 436; *Bridge Co. v. Ferry Co.*, 29 Conn., 210, 223; *Huntington v. Bank*, 96 U. S., 388, 392; *Railroad v. Railroad*, 130 U. S., 1, 20.

41. 62 N. J. E., 729, 732, 1901. This statement was only a dictum because the case directly before the court involved merely questions arising *before* the issue of stock for property.

the property is worth the par value of the stock to be issued for it, and by then having them "adjudge" that it is of that value.

Accordingly, in the hypothetical case, evidence tending to show that the directors were "dummies" is admissible, and on proof of that fact complainant should recover. But let this be clearly understood. The ground of complainant's recovery is not, that by failing to exercise their judgment the directors were *ipso facto* guilty of actual fraud. That is not the contention. The contention is, that in order to make the action of the directors in taking property for stock conclusive, two requirements must under the statute have been fulfilled—namely, an exercise of judgment must have been present and actual fraud must have been absent; that failure to satisfy *either* of the requirements renders the stockholder liable, and that in the case under consideration the stockholder is liable because the former was not satisfied.

In conclusion, it may be well to point out that, if the contention that the statute requires the directors to act in a judicial capacity in order that their action in exchanging stock for property may be conclusive is sound, it follows, since no man may be the judge in his own cause, and since this maxim applies not only to judges *eo nomine* but also to all persons exercising judicial functions,[42] that, even though the "dummy directors" did come to a judgment, properly speaking, such judgment, if they were "dummies" in the true sense of the term, is not conclusive, because they were the creatures of one of the parties interested in the matter to be judged.

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42. *State, Winans et al. Pros. v. Crane*, 36 N. J. L., 394; *Traction Co. v. Board of Works*, 56 N. J. L., 431.