



California Corporate & Securities Law

Common Shares Are Commonplace And, In California, Well Defined

By Keith Paul Bishop on November 21, 2011

Corporate lawyers are very familiar with the terms “common” and “preferred” in describing classes of corporate stock. The use of these terms is so habitual that many lawyers may be unaware that the California legislature has taken the time to define them. “Common shares” are shares that “have no preference over any other shares with respect to distribution of assets on liquidation or with respect to payment of dividends”. Cal. Corp. Code § 159.

In contrast, the legislature has chosen to give the term “preferred shares” a decidedly apophatic definition by telling you what they are not rather than what they are. Thus, preferred shares are shares other than common shares. Cal. Corp. Code § 176.

Of course, both of these definitions assume that you know the meaning of “shares”. These are defined as “the units into which the proprietary interests in a corporation are divided in the articles”. Cal. Corp. Code § 184.

California’s definitional precision stands in sharp contrast to Nevada which has eliminated the use of these terms in its corporation law. Nevada’s approach is consistent with the approach adopted by the Model Business Corporation Act which in the 1984 revision abolished the distinction between “preferred shares” and “common shares.” As explained in the official comment, “it is possible under modern corporation statutes to create classes of ‘common’ shares that have important preferential rights and classes of ‘preferred’ shares that are subordinate in all important economic aspects or that are indistinguishable from common shares in either voting rights or entitlement to participate in the assets of the corporation upon dissolution.”

Is there any significance to the fact that California defines “common shares” while Nevada and the MBCA do not? It turns out that there is. When the California Corporations Code uses the term “common shares” (e.g., in § 1001(d), § 1101 or § 1201(a)), it isn’t referring to just any common shares, it is referring to common shares as defined.

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This may be especially surprising to pseudo-foreign corporations that are subject to these provisions pursuant to § 2115. These corporations may be surprised to learn that the shares denominated as “common” in their articles may not be “common shares” at all.

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