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DEFECTS AND AMBIGUITIES OF THE CORPORATION LAW

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The Corporation Law was originally enacted on the 1st of March, 1906, by the Philippine Commission. Since then, numerous amendments have been made by the Philippine Legislature, the most important of which being the Amendatory Act of 1928 which had to be forwarded to the Congress of the United States for approval in view of certain provisions which repealed or amended some provisions of the Jones Law.

I remember having read in the papers that one of the prominent speakers who appeared before the Committee of the Insular House of Representatives during the public hearings on the independence of the Philippine Islands had made the statement that if we could only repeal the Corporation Law as it now stands, we would be better off under the present political status than with the Hawes-Cutting-bill as originally drafted. Undoubtedly, he was referring to the 1928 amendments to the Corporation Law when he tried to convey the idea that such an act curtails our liberties. If this news item is true, the only thing I can say is, that he was talking about an act that he had never read or, if he had ever done so, that he was not capable of understanding what he read. Apart from the no-par value stocks which may be issued by corporations organized under the law and the authorized stock dividends, additional power is given to corporations to engage in the business of buying and selling private lands and the power to amend the articles of incorporation by a majority vote of its board of directors and the vote or written assent of two-thirds of the stock, even to the extent of restricting the rights of the minority stockholders, and the power to hold stocks in other corporations. I do not see anything in

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the law that may be construed as curtailing the liberties of the Filipinos. The worst that can be said about these amendments is that the rights of the minority stockholders have been somehow curtailed; but the law itself provides that in case any stockholder believes that his rights have been restricted by the action of the majority, he has the right to compel the corporation to buy his stocks at the market price as ascertained by three disinterested persons, one chosen by the dissenting stockholder, another by the corporation, and a third by the two thus appointed. With regard to public lands, the law provides that no corporation may engage in the business of buying and selling public lands, and every corporation authorized to engage in agriculture is bound to the same limitations as in the original act, that is, 1024 hectares. The law also prohibits corporations engaged in agriculture or mining to hold stocks in other corporations of the same nature, and declares it unlawful for any person or corporation to own more than 15% of the capital stock then outstanding and entitled to vote of each of such corporations and forbidding them further to own and hold such stocks for other purposes than for investment as it is strictly prohibited for them to own such stock for the purpose of bringing about or attempting to bring about a combination to exercise control over such corporations; or to directly or indirectly violate any of the provisions of the Public Land Law. The speaker must have entertained the fear that, in accordance with the 1928 amendments, public and private lands of the Philippine Islands might be grabbed by the big corporations of America or that huge corporations may be organized to monopolize everything in this country; but anybody conversant with the law must necessarily reach the conclusion that that would be impossible and that, in this regard, we have the same limitations and the same safeguards as we had before.

Coming now to the defects and ambiguities of the Corporation Law, I find that the provisions about the registration of a corporation authorized to issue no-par value stock is somehow defective. The Law provides that when the corporation is issuing no-par value stocks exclusively, or par value stocks and no-par value stocks at the same time, it is not necessary to state what is the capital represented by the no-par value stock, it being required only to state the capital stock represented by the par value stocks and the number of the no-par value ones. At the

same time, the law requires that the Treasurer of the corporation, before its registration in the Bureau of Commerce, should file a sworn statement stating that 20% of the shares have been subscribed and 25% of the subscription paid in. On the other hand, the law provides, with regard to the no-par value stocks, that the value of these stocks may be fixed in the articles of incorporation or by the board of directors or stockholders from time to time. If the corporation chooses to give the board of directors or the stockholders the power to fix the value of the no-par value stock from time to time, then at the time of filing the papers in the Bureau of Commerce, nobody would be able to know the value of the no-par value stock and, if this be the case, under what basis can the treasurer of the corporation file his sworn statement that 25% of the subscription have been paid in?

In a very shrewd way the Bureau of Commerce, for the purpose of complying with the law, and taking as basis ₱5.00 as the minimum price of no-par value stock, investigates if the money in the hands of the treasurer is exactly 25% of the subscription which, in turn, should be 20% of the computed capital. Once this is found, the Bureau of Commerce stops to investigate the true value of the subscription.

Another ambiguity of the Corporation Law is that which refers to the revocation of the power to delegate the adoption of by-laws to the Board of Directors. The law provides that the delegation may be made when two-thirds of the subscribed capital stock authorize affirmatively such delegation; provided, however, that any power thus delegated to amend or repeal any by-law or to adopt new by-laws shall be considered as revoked whenever a majority of the *stockholders* of the corporation shall so vote at a regular or special meeting. This is the only example in which the power of voting in the stock corporation is given to the individual stockholders instead of to the amount of stock owned or represented by them; and I do not see any reason why the law was amended in this way, thereby defeating entirely the principle that in stock corporations the power should always be given to the capital represented by the stockholders rather than to the stockholders individually. The more capital a person has invested in a corporation, the more has he to lose and, for this reason, the one who has invested, for instance, ₱10,000.00 should be given 10 times more power than that one who has invested only ₱1,000.00. In all the provisions of the

Corporation Law, this is the principle recognized. The only exception is this revocation of the power in which the authority to adopt by-laws is given to the Board of Directors where every stockholder, regardless of the amount represented by him, has only one vote. As I have stated, I do not understand the reason why the Legislature has seen fit to deviate in this particular instance from the principle before stated. I do not think, however, that the legislature has simply made a mistake, and that its intention was not to amend the law in that regard, thus leaving the power in the hands of the subscribed capital stock as the law was originally drafted. Justice Fisher, however, is of the opinion that this provision should be taken in its literal sense.

Another ambiguity or defect, rather, of the Corporation Law is that which refers to the cumulative voting in connection with the power of the corporation to expel members of the Board of Directors. The law provides that, in the election of directors every stockholder shall have as many votes as shares of stock are registered in his name in the books of the corporation multiplied by the number of directors to be elected. Thus, for instance, if a stockholder has five shares of stock in his name and the number of directors is five, he shall have twenty-five votes which he may distribute among the candidates or give them all to one, two or three as he pleases. This provision of the law was intended for the protection of the minority so as not to deprive them of the right to have a representation on the Board of Directors. For instance, let us suppose that a corporation is organized with a capital stock of ₱100,000.00 divided into shares of ₱1,000.00 each; let us suppose also that those holding the majority of the stocks control 80 shares against 20 shares in the minority. The majority should be controlling. If the directors to be elected are five, by the procedure of cumulative voting, the majority should control 400 votes. On the other hand, the minority stockholders should have only 100 votes. If this minority would cast their votes for only one candidate out of the five to be elected, they could never be deprived of one member on the Board because this one would be elected with 100 votes and the majority could only have at most four directors elected with 100 votes each. On the other hand, the law provides that any member of the Board may be expelled from such board by the vote of two-thirds of the subscribed capital stock. In the

case of Government of the Philippine Islands v. Agoncillo, 50 Phil. 349, our Supreme Court said that this expulsion of any member of the Board may be obtained with or without cause, provided that the majority required by law votes affirmatively. This being the case, the majority may always be able to have the full Board in their hands by expelling the minority members and then holding again another election to substitute those expelled in which, as we can see, the minority will be powerless to defeat the power of the majority because the votes must be cast only in favor of one candidate, as in the case cited in which 100 votes of the minority will never be able to defeat the 400 votes of the majority. The result will be obviously that the purpose of the law for the protection of the minority with this cumulative voting would be absolutely done away with.

PLEDGE AND MORTGAGE OF SHARES

The law is absolutely silent on the effect and the procedure of pledging and mortgaging shares, especially as regards third persons. Justice Fisher, in his book entitled "The Philippine Law of Stock Corporations" entertains great doubt as to the effect of the pledge and mortgage of stock against third persons, in view of the defects of the law and in view of the fact that we have no provisions regarding the procedure as to how the rights of the pledgee and mortgagee in these classes of contracts could be asserted. He advises that the surest way to protect their interests is to register the stock in the name of the pledgee (See pages 159-168); but I do not believe that this procedure would be acceptable if we consider the rights of the pledgor. I believe, however, that the only remedy is to amend the law by prescribing a new way of executing pledges and mortgages of stocks for the protection of the pledgee and mortgagee even as against third persons.

VOTING TRUST AND POOLING AGREEMENT

For the first time in our Corporation Law, the voting trust was recognized. The voting trust is simply the voluntary surrender of the right to vote stocks by the stockholders to another called the trustee. The law provides that this surrender may be made irrevocable for a number of years not to exceed five. The reason of the law is to permit the unification of a policy

in the administration of a corporation during a certain period of time which could not otherwise be obtained by executing a power of attorney in such a way as to empower the attorney-in-fact to vote for the stock because, as a general rule, powers of attorney are always revocable even though there is a stipulation to the contrary. But now this question arises: Who has the right and privilege to be elected a Director? Is it the one who executes the voting trust or he in whose favor such trust is executed? The law is once again silent on this point although, I believe that the trustee should be the one favored with that privilege instead of the trustor. The law provides that no one can be elected a director unless he owns at least one share of stock in his own name and in his own right. If such is the case, neither the trustor nor the trustee could be elected director in view of the fact that neither of them owns the stock in his own right and in his own name. The name of the trustor disappears from the books of the corporation as his stock is transferred in the name of the trustee. The trustee, on the other hand, does not own the stock in his own right because he merely holds the stock in trust for the number of years agreed upon between the parties to the trust. The law, however, provides that the trustee shall enjoy and exercise, in addition to the right to vote, all other rights pertaining to the stocks during the term of the trust. From this I may infer that the trustee may be elected a member of the board, and there are authorities holding this view, as in the case of the so-called dummy director, although I believe that this is a very doubtful question in view of the ambiguity in the law.

STOCK DIVIDENDS

Prior to the 1928 amendments to the Corporation Law, the Jones Law provided that "all franchises or rights granted under this Act shall forbid the declaring of stock of bond dividends."

A great doubt was entertained by prominent lawyers in the Philippines as to whether this prohibition was intended for all corporations or only for those corporations enjoying special privileges for the construction of works of public utility and service. The cause of the doubt was the double meaning of the word "franchise." This may mean the creation of a corporation in the general sense, or it may mean only the special privilege

granted to a corporation which, in general, does not belong to individuals as for instance, the right of eminent domain granted to railroad corporations.

The doubt, however, may be solved in the sense that the word "franchise" as used in the Jones Law meant the special privilege of which I have just spoken. The 1928 amendments to the Corporation Law provide that "no stock or bond dividend shall be issued without the approval of stockholders representing not less than two-thirds of all the stocks", thus authorizing the corporation to issue stock dividends, provided the power is exercised by the stockholders. This amendment was sent to the Congress of the U. S. which ratified all the provisions of the Amendatory Act.

The same 1928 amendment provides that upon the approval by Congress of the amendatory act, all the provisions which are in conflict with the Jones Law shall have force and effect, and provides further that all the provisions of the amendatory act "shall be applicable to all corporations now or hereafter organized under the Corporation Law and to all franchise, rights and privileges heretofore granted by the Philippine Legislature."

Justice Fisher believes that, in view of the language of the new law, only those corporations with special privileges organized before the amendment could issue stock dividends but not those organized afterwards. I cannot agree with such a prominent author on this point as I believe that in view precisely of the plain language of the law which provides that it refers to all corporations "now existing or hereafter organized under the corporation law", all corporations are included whether with or without privilege.

RIGHT TO LOCATE MINING CLAIM

Our constitution provides that mineral deposits in public lands shall be opened to occupation and purchase only by citizens of the U. S. or of the Philippine Islands. Foreigners, therefore, are excluded from this right. Let us suppose, however, that a group of foreigners organized a corporation under the laws of the Philippines. May this corporation be considered as a citizen of this country and be allowed to locate a mining claim and purchase the same? Similar laws in the U. S. have been construed by the Federal Supreme Court that the word "citizen" includes a corporation, irrespective of the ownership of stock

which may be held by foreigners. In view of this interpretation, I may conclude that in the Philippines an individual alien cannot locate a mining claim, but a corporation organized under the laws of this country although the stock is entirely owned by foreigners may locate such a claim. This may seem to be anomalous, but that is the law of the land.

MARRIED WOMEN

As you may now, a married woman may now alienate, mortgage or dispose of her paraphernal properties without her husband's consent. Let us suppose that a married woman purchases stock from a corporation with her own money, converting such stock in paraphernal property. Can she exercise the right to vote and enjoy the other rights pertaining to ownership of such as, for instance, the right to be elected a director without the necessity of the consent of her husband?

A married woman cannot act as agent without the consent of her husband, and a director of a corporation, in a way, is an agent of the stockholders. By the amendment of the law authorizing married women to dispose and mortgage the paraphernal properties, the law of agency was not amended. On the other hand, if the law has given her the exclusive power to dispose, mortgage and alienate her own paraphernal property, how can the husband stop her from being a director of a corporation in which she has invested her paraphernal property? This is a very doubtful question, although I am inclined to believe that the wisest and the most reasonable opinion should be that she could enjoy all the rights and privileges of the stock including the right to be elected a director, in view of the fact that she always had the right to administer her own property even before the amendment, in accordance with Art. 1384 of the Civil Code.

VOTING IN CASES OF INCREASE OR DIMINUTION OF CAPITAL STOCK

The law provides that the capital stock of a corporation can not be increased or diminished unless stockholders representing 2/3 of the capital stock vote affirmatively in a general meeting called for that purpose. The same law prescribes that the articles of incorporation may provide for the different rights and privileges of the different classes of stock issued by the corporation. Let us suppose that a certain class of stock is deprived

of the right to vote. Are the stockholders owning this kind of stock to be allowed to vote in case of the increase or diminution of the capital stock in favor of the proposition, notwithstanding the fact that in accordance with their agreement with the corporation they are not entitled to vote? Justice Fisher believes that they are not entitled to vote. I strongly dissent from this opinion. It would be a flagrant breach of a contract. When the law provides that 2/3 of the stock should vote affirmatively, it means that the 2/3 must be obtained from the stockholders with the right to vote. If the 2/3-vote from this class of stock cannot be obtained, then it means that the corporation cannot increase or diminish its capital stock. To allow stockholders deprived of such right to vote for the purpose of obtaining the required majority would be tantamount to a flagrant violation of the rights of the minority.

INSOLVENT CORPORATIONS

The Insolvency Law provides that insolvency proceedings may be had at the instance of the debtor or at the instance of three creditors when the debtor is a natural person. However, as to corporations, the Insolvency Law provides that insolvency proceedings may be had at the instance of or upon *a creditor's petition.* I can not see why only one creditor may apply for the insolvency of a corporation, and I cannot understand why corporations are placed on a different footing from natural persons in this regard. Justice Fisher believes that this might have been a clerical error by placing the apostrophe before, instead of after, the letter "s" in the word "creditor's", and I believe that this might have been the case, although as it now stands, the law permits one creditor to throw a corporation into insolvency. This can only be remedied by amending the law, or by a decision of our Supreme Court construing the law as to mean that one creditor is not allowed to commence insolvency proceedings against a corporation. On the other hand, in accordance with the Insolvency Law, if the by-laws of the corporation provide for another method for the insolvency proceedings, such method shall be followed. This is a very questionable provision. Matters of procedure are for the legislative authority to establish and this

power cannot be delegated. On the other hand, it may be contended that this is a class legislation as it is only permitted in favor of corporations or associations but not in favor of individuals or natural persons.

I have noted also a decided defect in the law giving the power of forcing a corporation into insolvency to the majority of the Board of Directors instead of to the stockholders. In cases of voluntary dissolution the power has to be exercised by the stockholders. What, then, is the purpose of the law in giving the power to throw a corporation into insolvency to the Board of Directors?

FOREIGN CORPORATIONS

A foreign corporation cannot do business in the P. I. unless it obtains a license from the Chief of the Mercantile Register of the Bureau of Commerce upon order issued either by the Secretary of Finance or by the Secretary of Commerce & Labor. No order for a license may be issued except upon a statement from the foreign corporations giving general requisites provided in the Corporation Law. Foreign corporations cannot bring any suit in the P. I. courts unless they have previously obtained a license to do business here. However, in accordance with decisions of the Supreme Court of the United States of America a foreign corporation doing exclusive interstate business cannot be required to obtain any license before bringing suits in the State courts, and in accordance with the decision of the Supreme Court of this country, commerce between the United States of America and the Philippines can only be regulated by Congressional legislation and not by the Philippine Legislature. The requiring of a license as above stated before a foreign corporation can engage in business here has been declared to be a regulation of interstate commerce and, therefore, this Philippine Law as it now stands cannot be applied to any foreign corporation doing exclusive business between the Philippines and the United States. The conclusion, therefore, is that such corporations may do business in the Philippine Islands disregarding the Law in its entirety and may also bring suits here as if the law were not in force with respect to them.

LIABILITY OF CORPORATION FOR TORTS OF ITS OFFICERS AND AGENTS

In the early cases of Bahia v. Litonjua, 30 Phil. 654, and Chaves v. Manila Electric Co., 31 Phil. 47, it was held by the Supreme Court that the master was responsible for acts committed by its servants or employees, unless it was shown that the master had exercised the diligence of a good father of a family in the choice of its servants, in accordance with Article 1903 of the Civil Code. This defense can only be availed of in the case of *culpa aquiliana* as opposed to *culpa contractual.* Later on, however, our Supreme Court, held that in cases of the City of Manila v. Manila Electric Co., 52 Phil. 586, Arambulo v. Manila Electric Co., 29 Official Gazette, p. 2605, and Francisco v. Onrubia, 46 Phil. 327, that the master is responsible even if he can show diligence of a good father of a family the latter being only a defense available in civil cases and not to responsibilities arising from criminal acts, in which case the Penal Code is to be applied.

LIEN OF CORPORATION ON ITS OWN SHARES

Is there any lien in this jurisdiction in favor of a corporation upon its own shares held by other persons for any claim or debt that the stockholder may have in favor of the corporation?

There is nothing expressly provided for in our law to that effect. Section 13, subsection 8, of the Corporation Law provides that every corporation has power to "sell stock or shares of the stockholders for the payment of any indebtedness of the stockholders to the corporation". Section 35, on the other hand, provides that "no transfer shall be valid except as between the parties, until the transfer is entered and noted upon the books of the corporation" and "no share of stock against which the corporation holds any unpaid claim shall be transferable on the books of the corporation".

On the strength of this language of the law, may we draw the conclusion that the corporation has any lien upon shares of stock even against an innocent holder-transferee for any indebtedness of the transferor in favor of the corporation? In the case of Fua Cun v. Summers, 44 Phil. 705, the Supreme Court held that "at common law a corporation has no lien upon the

shares of stockholders for any indebtedness to the corporation and our attention has not been called to any statute creating such lien here". This conclusion was merely an obiter, as it was not necessary to make that statement in order to decide the question at issue in that case. In an earlier case, unreported, on the othed hand, (Hagan v. Bryan, G. R. No. 6430), the Supreme Court used the following language in refusing to grant a mandamus to compel an official of a corporation to transfer shares in the books of the corporation:

> "To permit the writ of mandamus to issue for the purpose of compelling the officers of a corporation, in cases like the present one, to transfer stock upon the books of the corporation, might, under certain circumstances, require such officers to transfer stock against which the corporation holds unpaid claims. These claims might easily arise between the time of the issuance of the writ and the service of the same upon such officers. If the court should issue the writ, it might require an officer to transfer stock under conditions where the law expressly prohibited such transfer".

There is a line of American decisions upholding the view that there is a lien in favor of the corporation, construing provisions of statutes more or less similar to ours. The language of the Pennsylvania statute, however, is the one more similar to ours. It says:

> "No certificate shall be transferred so long as the holder thereof is indebted to the said company".

This law was construed by the Pennsylvania Supreme Court that it created a lien in favor of the corporation upon the shares of stock. This question of lien in favor of the corporation has never been brought squarely before our Supreme Court, and it is still open to argument. It would be very interesting to bring a test case in the courts of this country for the purpose of having a definite doctrine on this important question.