

PHILIPPINE LAW JOURNAL

Vol. XVI

JULY, 1936

No. 1

CRITICAL ANALYSIS OF SECTION 19 OF THE CORPORATION LAW

By MAKALAYA JAMIR *

I. INTRODUCTION

Every student of law is aware that there are some legal provisions which are not clearly or rightly worded, consequently placing the legitimate intention of the legislature within the so-called "twilight zone of differences". It is not surprising therefore, that courts of different jurisdictions will place their interpretations upon the law according to the light in which they see it together with the attendant circumstances. These criteria of interpretation are naturally productive of different constructions, so that a country copying such a law would find itself in a maze of conflicting precedents.

The analysis of Section 19 of Act 1459 contained hereunder is not limited to only one topic, but to various subjects which the terms of the said section include. The writer believes that it is of capital importance that such wide range of territory be painstakingly covered if he aspires to be faithful to the title of his work. Moreover, the discussions, especially of the first sentence of the section is essential in order to answer the question as to whether or not the law contemplates an *ipso facto* dissolution upon non-compliance with the statute within two years. It is this question which has remained unsettled in our jurisdiction and which has been the subject of conflicting comments by local authorities.

With the conquest of time and the subjection of distance to man's ingenuity, an increase in business and commercial operations has developed. Commercial associations mostly in the form of corporations have become good tools for the ready use of business enterprisers. The importance of organizations for mercantile purposes cannot be overestimated. In the words of President Nicolas Murray Butler of Columbia University "the limited liability corporation is the greatest single discovery of modern times, whether you judge it by its social, by its ethic-

* LL.B., University of the Philippines.

al, by its industrial, or, in the long run—after we understand it and know how to use it,—by its political effects.”¹ A well-known Spanish writer, Cabanillas, was of the belief that the inventions which have contributed to the force and prosperity of nations owe their influence from stock corporations. He went on by saying that a commercial association “es la mas poderosa palanca moderna para fomentar y desarrollar los elementos de riqueza que encierran las naciones, siempre que sean dirigidas con *inteligencia, prudencia, y honradez.*”²

It is because of this new and greater part of corporations in modern business enterprises that a clarification of Section 19 is imperatively necessary in order to be able to proceed in the successful formation of business associations.

II. SECTION 19 OF ACT 1459

As originally enacted by the Philippine Commission on March 1, 1906, Section 19 of Act 1459 reads as follows:

“Sec. 19. If a corporation does not formally organize and commence the transaction of its business or the construction of its works within two years from date of its incorporation, its corporate powers cease. The due incorporation of any corporation claiming in good faith to be a corporation under this Act and its right to exercise corporate powers shall not be inquired into collaterally in any private suit to which the corporation may be a party, but such inquiry may be had at the suit of the Insular Government on information of the Attorney General.”

From that time on up to 1931 the section has remained unchanged. It was only in the first session of the Ninth Philippine Legislature that Senator Teofilo Sison introduced Senate Bill No. 57 which was approved without discussion by both houses on November 7, 1931. The said bill became known as Act 3849. The amendment reads as follows:

“*Provided, however,* That every corporation organized or registered under this Act, shall before the fifth day of January of each year report to the Director of the Bureau of Commerce and Industry any cessation or discontinuance of business or change of address, if any, in such corporation. Any corporation violating the provisions of this section shall be subject to a fine of not less than one hundred pesos nor more than one thousand pesos.”

Although in recent years our Corporation Law has suffered various changes, the section commented upon remains without alteration since the enactment of the penalty proviso.

¹ Quoted by Dionisio Villanueva, *The Corporation Law as Compiled and Annotated.*

² *Ibid.*

The reason for this may be because of the fact that up to the present time no case has arisen in which Section 19 has been brought to the judicial tribunal for application. But when it becomes the object of various litigations our legislators may see something by way of a substitute or an amendment.

(a) *Source.*

Due to the scarcity of the records regarding the enactment of Act 145³ by the Philippine Commission, no definite statement regarding the source of Section 19 of said law could be found. In order to know the real source of the section and the construction placed by its author upon it, the writer has taken the pains of consulting the Public Minutes of the Philippine Commission, September 1, 1904 to August 1, 1905, in the Archive Division of the Department of the Interior, but nothing on the matter could be found. Former Justice Fisher, in his book entitled, "The Philippine Law of Stock Corporations"⁴ said, however, that the "first paragraph" (meaning the first two sentences) of the section commented upon was "copied almost verbatim from Section 358 of the Civil Code of California, as worded prior to the amendment adopted in 1901" The section referred to follows:

"Sec. 358. If a corporation does not organize and commence the transaction of its business, or the construction of its works within one year from the date of its incorporation, or if, after its organization and commencement of its business, it shall lose or dispose of all of its property, and shall fail for a period of two years to elect officers and transact, in regular order, the business of said corporation, its corporate powers shall cease, and the said corporation may be dissolved at the instance of any creditor of the said corporation, at the suit of the state, on the information of the attorney-general, but the resumption of its business in good faith by such corporation prior to the commencement thereof shall be a bar to such suit. The due incorporation of any company claiming in good faith to be a corporation under this part, and doing business as such, or its right to exercise corporate powers, shall not be inquired into collaterally in any private suit to which such *de facto* corporation may be a party; but such inquiry may be had at the suit of the state on information of the attorney-general; provided, however, as to any company claiming in good faith to be, and which has been doing business for ten consecutive years as a corporation, no such inquiry shall be made either by the state or by any person whatsoever."⁴

It is worthy to note that in the first sentence of our law the word "formally" was inserted before "organize". It should also be noted that our law extended the period to "two years"

³ Page 383.

⁴ Deering, Civil Code of California, p. 213; Carter P. Pomeroy, The Codes and Statutes of California, p. 133-134.

instead of "one" and omitted the word "shall" before "cease". Again, attention must be directed to the fact that the provision regarding loss or disposal of property and failure to elect officers and transact business regularly within two years was omitted in our law. It seemed to be the intention of our legislators to bring these latter points to depend wholly on decided cases. But most important of all is the fact that, whereas the California statute requires the dissolution to be at the instance of the creditors of the corporation on the information of the attorney-general, Section 19 of Act 1459 is oppressingly silent on the point. The effect of a resumption of business in good faith before the commencement of dissolution proceedings has been left out, relegating such events again upon the accepted theories of the jurisprudence on the matter.

There is no material variance between the second sentence of the California statute and that of our own. The only difference lies in the fact that the proviso of Section 358 is prescriptive in nature in that it exempts from the inquiry of both the state and any private individual any corporation believing in good faith to be such which has functioned for at least ten consecutive years. The proviso of Section 19 only requires a report to the Director of Commerce and Industry before January fifth of each year any cessation of business or change of address. The above-mentioned proviso of Section 358 is directly opposed to that of our statute, because in our country there is no time limit within which the due incorporation of an association may be inquired into.

Inasmuch as our law on corporations is preponderantly of California and New York origin, it would not be amiss to compare Section 19 of Act 1459 with the provision of the corporation of the latter. Section 36 of the General Corporation Law of New York,⁵ provides:

"Sec. 36. Forfeiture for non-user. If any corporation, except a railroad, turnpike, plank-road or bridge corporation, shall not organize and commence the transaction of its business or undertake the discharge of its corporate duties within two years from the date of its incorporation, its corporate powers shall cease."

The same provision as amended reads as follows:⁶

"Sec. 36. Dissolution for non-user. A corporation, other than a railroad corporation, which shall not organize and commence the transaction

⁵ Birdseye Cumming & Gilbert's Consolidated Laws of New York. Annotated. v. 2, p. 1998-1999.

⁶ White on Corporations, p. 359.

of its business or undertake its corporate duties within two years from the date of its incorporation, may be dissolved in an action by the attorney-general. L. 1890, ch. 563, Sec. 21 as amended by L. 1892, ch. 687 and L. 1927, ch. 424."

It will be noted that like our statute the period of two years has been prescribed for the commencement of corporate transactions. The original provision also used the phrase "shall cease" like the California law, but did not say anything regarding collateral inquiry. While the amendatory law did not say that the corporate organization shall cease upon failure to comply with the said provision, it provided that the corporation "may be dissolved in an action by the attorney-general". The effect of the statute has been softened by adopting a discretionary attitude. As in the former law the question of collateral attack has been left out. Evidently, New York belongs to that group of states which do not expressly forbid collateral inquiry by mandatory legal provision. As will be seen later, no such provision is necessary to authorize the court in holding that such attacks cannot be made. Notice must also be made of the fact that no penalty provision has been included in the section.

(b) Reasons for the Section.

A reading of the different state laws will show that there is a unanimity regarding the enactment of provisions similar to that of Section 19 of our Corporation Law. There may be a difference in phraseology, but the tenor is the same. The reason behind the law is "the injustice of permitting a corporation to retain unused the exclusive right to a power intended to be used for the benefit of the public."⁷ It has been said that such non-user is "so contrary to public policy"⁸ that, were its existence to be tolerated, more harm than good will befall the public. A corporation is so peculiar that there is shown in court decisions that there is a practical oneness in the opinion that the corporate personality is separate and distinct from that of its members. If the unused powers of a corporation were to continue to exist in such condition, frauds of unlimited kinds and numbers will be perpetrated without recourse to the incorporators, taking into consideration the fact that their liability is limited to their shares. The vigilance of the governmental

⁷ Comm. ex rel. Attorney-General v. Lykens Water Co., 110 Pa. St. 391, 392; 2 Atl. 63, 64.

⁸ Ibid.

machinery would be utterly helpless in bringing within the pale of the law such associations of doubtful existence and validity.

The provision regarding the *quo warranto* proceedings at the instance of the attorney-general finds its basis from the original conception of the writ itself. Some writers on the subject of *quo warranto* classifies the writ as a criminal proceeding. Chancellor Kent and other learned judges hold this view. Other authorities, however, are of the opinion that this is a civil writ at the suit of the crown, since the granting of the franchise is purely a prerogative of the sovereign. Any usurpation, misuse, or nonuse of a franchise is therefore a prerogative function where the king is the sole party in interest.⁹ So it develops that it is the crown or the state only who has the right to bring an action against the franchise.

A collateral inquiry by a private person into the due incorporation of an association is expressly denied by our law because proceedings would unnecessarily be delayed by such dilatory pleas. Moreover, such inquiries would put the question of incorporation so often that there would in fact be no repose on the part of the corporation regarding the sanctity of its charter, thus entailing untold sacrifice on the good name and reputation of an association. It would also put to nil the prevailing opinion that such questions are the concern of the state so that they could and should be brought only upon the instance of agents of the state.

The penalty provided for in the section in case of failure to report the cessation of business or the change of address has the tendency of putting added responsibilities on the part of the corporation and to obviate in some way the inability of the government in keeping constant watch over the activities of the association. If this were not done, scrupulous men might take advantage of the name of a non-operating corporation and transact business in representation of the same. In this case the public will be the victim of untold frauds.

III. ANALYSIS OF DIFFERENT PHRASES

In order to understand better the real meaning of the section under consideration, it is necessary to know the import of the different phrases. It is only by doing this, by having a full comprehension of the legal significance of the words and

⁹ Fletcher, *Cyclopedia Corporations*, v. 5, p. 4967.

phrases of the section, that we can hope to have a full grasp of our subject.

(a) *Formally Organize.*

"Formally" has been interpreted to mean "solemnly" or "in a formal manner". The doing of the act must be in accordance with the prescribed form.¹⁰ When the word "formally" is used in a law which provides that the person against whom an act under a private signature is produced is obliged formally to avow or disavow the same it has been held that the disavowal must be made solemnly in writing and signed by the proper person.¹¹ In a case it has been held that when the law requires that the intention must be formally expressed, such must be made in due form as the law requires.¹²

Where the statute provides that certain formalities must be followed in the doing of an act, the proceedings must be in accordance with a set form of manner of doing.¹³ It is obvious, therefore, that when our law inserted the word "formally" before organize, the corporate organization must be done in the form required by the statute. This should be differentiated from a "formal defect" since the latter does not go to the foundation of the matter. A formal defect in no way affects the merit of the question.¹⁴

In the law on private corporations there are two kinds of organization which must be distinguished from one another. The first class deals with organization before incorporation, and the second, with organization after the association has been incorporated. It is in the latter class that we are interested at the moment, since it is the organization under the charter that in fact completes the corporation. Organization for the purpose of obtaining charter is done in order to acquire personality.¹⁵ Although there has been a preliminary organization before the incorporation is made, such cannot be held to continue after the perfection of the incorporation and organization. The officers of such preliminary organization are deemed superseded by those chosen after incorporation has been made.¹⁶

¹⁰ 26 C. J. 983.

¹¹ *Clark's Ex'rs. v. Cochran* (La.), 3 Mart. (O. S.) 353, 360.

¹² *Succession of Abrahms*, 82 So. 727, 145 La. 627.

¹³ 3 Words and Phrases (1st Series) 2912.

¹⁴ *State v. Arnold*, 50 Vt. 731.

¹⁵ 1 Thompson on Corporations (2nd ed.) p. 224.

¹⁶ *Mulhauser v. Cleveland Hospital for Women and Children*, 65 N. E. 1131.

When used with reference to corporations, the words "organize" or "organization" have well-defined meanings.¹⁷ In order that a corporation may be considered organized, there must have been "such acts and doings among associates, as should form and set on foot, in practical existence, a body in which they should have rights, and to which they would owe obligation, and through which they should possess rights against, and incur obligations to, each other."¹⁸ It has been held that in order to have organization, officers must be elected, rules for the subscription and payment of the capital stock must be provided for, by-laws must be adopted, and other steps necessary to transact the legitimate business of the corporation, must be done.¹⁹

It is also necessary that such appointed officers must have taken upon themselves the burden of their office in order to act or exercise the duties conferred upon them by the charter or by-laws. They compose the organs of the corporation endowed with the function of life, and with the qualification of furthering the corporate interests and purposes.²⁰ Without them the corporation cannot proceed in its business—the corporation is in fact a living being that does not function at all.

It is not necessary to have a corporation *de jure* in order to have a formal organization. Provided that the different steps necessary for organization have been done, the corporation can be interpreted as formally organized even if the certificate has not been filed.²¹ "Organized" was interpreted to mean something other than the phrase "licensed to do business".²² It is clear that a company or association that has been licensed to do business, may or may not require a formal organization. Upon the acquisition of the right to do business a company may not need to do any further act of incorporation. But it is different where formal organization is required. The formalities or requirements of law must be complied with before a corporate act can be done validly. Upon the granting of the license to do business, the right to proceed in business operation accrues *eo instanti*. But when formal organization

¹⁷ 14 C. J. 152; 6 Words & Phrases, 5053.

¹⁸ Childs vs. Smith, 46 N. Y. 34.

¹⁹ Commonwealth v. John McGlenn Distilling Co., 108 Atl. 823, 825.

²⁰ Commonwealth v. Wm. Mann Co., 24 Atl. 601, 602.

²¹ Childs vs. Smith, 46 N. Y. 34.

²² Employers' Liability Assurance Co. v. Commissioner of Insurance, 64 Mich. 614; 31 N. W. 542.

is a prerequisite, compliance with the same is necessary in order to do business.

However, the term "formally organize" is often interpreted with a limited meaning. It has sometimes been held as including only those things that are necessary to be done in order to give the corporation power to act and carry out the objects and purposes of the association as stated in the articles of incorporation.²¹

The restricted meaning given to the phrase has been variously stated to include the choice and qualification of directors and officers,²² the adoption of corporate by-laws,²³ and other steps "necessary to endow the legal entity with capacity to transact the legitimate business for which it was created."²⁴

Under our law the choice and qualification of directors ought not to be included in defining the term formal organization, since according to Section 7 the article of incorporation should state the names of the members of the board of directors with their residence. It is clear, therefore, that even before incorporation has been accomplished, the directors are already constituted.

Former Justice Fisher said that the phrase "requires at least a meeting by the directors to elect officers, and perhaps the adoption of by-laws."²⁵ As we have already said above, the election of officers is necessary in order that the corporation may function, since it is through them that the company can act. Although Section 33 of Act 1459 refers actually to cases where formal organization is accomplished, it is worthy to note that it requires the election of officers "immediately" after the directors have been elected.

Even Mr. Fisher was not sure with regards to the adoption of by-laws as a necessary requisite to formal organization. Although the wording of Section 20 of the Corporation Law is mandatory in that it requires the adoption of by-laws within one month after the articles of incorporation had been filed, yet it has been the practice among some of our corporations to go on without by-laws.²⁶ The weight of authority,

²¹ 1 Fletcher, *Cyclopedia Corporations*, p. 476-477.

²² *McCormick v. Market Nat. Bank*, 165 U. S. 538; *Murdock v. Lamb*, 142 Pac. 761; *Taggart v. Western Maryland R. Co.*, 89 Am. Dec. 760; *Ferkins v. Sanders*, 56 Miss. 733; *Second Nat. Bank v. Hall*, 35 Ohio St. 158.

²³ *Watson v. Albany & N. Ry Co.*, 36 S. E. 324; *Nemaha Coal and Mining Co. v. Settle*, 54 Kan. 424, 38 Pac. 483; *Walton v. Oliver*, 33 Am. St. Rep. 355.

²⁴ 14 C. J. 152; 1 Fletcher, *Cyclopedia Corporations*, p. 479-481.

²⁵ *The Philippine Law of Stock Corporations*, p. 383.

however, sustains the requirement of the adoption of by-laws in order to have formal organization. The mandatory requirement of Section 20 is not in any way affected by the provision of one month within which to comply. This has been done as a matter of grace so as to enable the corporation sufficient time for compliance. But this does not give the corporations authority to disregard it totally. The intention of the law is to protect the rights of stockholders from the actions of unscrupulous directors who might trample with impunity upon the rights of others.

(b) Commence the Transaction of its Business.

The Century Dictionary defines the word "commence" as "to cause to begin to be, perform the first act of, enter upon, begin." Webster defines it "to begin, to originate, to do the first act in anything, to take the first step." A reading of the cases on the matter will indicate that in order that there may be a commencement of business, it is not necessary that the purpose or purposes for which the corporation is organized, be the ones commenced. It is enough that the association performs acts leading to the propagation of its avowed purposes.

Thus in one case the court held that proof of user must be shown by evidence of acts showing that business had been done under the charter.²⁹ Keeping open an office with officers acting in the name of the corporation or as agents of the corporation will constitute transaction of business within the meaning of the law.³⁰

Again, if materials necessary to carry out the purpose has been purchased, altho there has been no real construction of the work intended, the court holds that there is already a commencement of the transaction of business. In a case in which a railroad company had been required to commence the transaction of corporate business within a certain period of time, the court held that the mere fact that the company had purchased iron worth \$22,000 and expended over \$30,000 in the prosecution of its enterprise was sufficient to show that business had been commenced.³¹

The acquisition of land where the principal office will be erected and the erection of buildings thereon which will be de-

²⁹ Professor Leoncio B. Monzon.

³⁰ Cahill v. Kalamazoo Mutual Ins. Co., 2 Douglass 124, 43 Am. Dec. 457.

³¹ Ibid.

³¹ People v. The Stockton and Visalia Railroad Co., 45 Cal. 306, 13 Am. Rep. 178, 181.

dedicated to the purposes of the corporation are among the acts belonging to the implied powers of the corporation.³² Although strictly speaking such cannot be considered business transactions, still it would not be utterly unreasonable to hold that, in effect, they signify real commencement of business. This is more so when we take into account the fact that courts have shown a liberal tendency in interpreting acts that savor of the beginning of a business transaction. We should also remember that the nature of such transactions involves a considerably big investment so that the intention of the stockholders to promote their business could be inferred. But if there are tendencies to show that such constructions will be devoted to other purposes, then it is clear that there can be no commencement of business in the broad sense.

The printing of letterheads for the correspondence of the corporation, including bills and invoices (although they bear the name of the association and designed for use in the business for which the same has been created) cannot in itself alone satisfy the idea of a beginning of business operations. These office stationery would be very insignificant indeed to prevent the stockholders from engaging in business other than that applied for. It would not be hard to see that to hold them as evidence of business transaction would open wide the door to frauds and would enable corporations to get around the law, since they can engage in business other than those stated in their purposes under the protection of such insignificant investments.

The criterion, therefore, of the commencement of the transaction of the business for which a corporation has been created should not be such as to include only a direct pursuance of the stated purposes, but one that includes an indirect operation when it will ultimately redound to the fulfillment of the purposes of the corporation.

(c) Date of Incorporation.

The question as to when a corporation is deemed to be incorporated depends upon the terms of the statute and, in the absence thereof, upon the construction that will be placed thereon. It has sometimes been held that such matter may depend upon intention.³³

³² 2 Fletcher, *Cyclopedia Corporations*, p. 1767.

³³ 14 C. J. 114.

When the statute under which a corporation is created designates the manner in which an association shall be organized, such requirements must be followed before there can be an organization.³⁴ It is only upon a compliance with the conditions precedent before the corporation be carry out the objects of its creation. In the meanwhile or before the fulfillment of the required conditions, the franchise is said to be remaining in abeyance.³⁵

It has been held generally that a corporation is "deemed to exist from, and only from, the time when the articles of the certificate of incorporation prescribed by the governing statute is executed, acknowledged, and recorded, or filed for record, in accordance with the governing statute, or when the certificate or charter is issued or approved by the officer or court as required by the statute."³⁶

When there is a general law on corporations its effect is that of a continuing offer of the franchise. When the offer is accepted the prescribed powers, rights, duties and liabilities accrue to the incorporators for them to exercise and fulfill. In such a case, altho there be conditions subsequent, the corporation is deemed created *ipso facto* and *eo instanti*,³⁷ the said conditions notwithstanding. It should, however, be borne in mind that in order that the acceptance may be valid, the persons to sign the articles of incorporation must be those whom the law recognize as capable.³⁸

Section 11 of our Corporation Law as modified by Act 2728, Sec. 3-c provides that on the filing of the articles of incorporation which must substantially comply with the form prescribed in Section 7, the Director of the Bureau of Commerce and Industry shall issue to the incorporators a so-called "Certificate of Incorporation." The certificate shall be under the zeal of his office and shall state that the articles have been duly filed according to law. Then the incorporators and their associates and successors shall constitute a body politic and corporate. It is clear, therefore, that under our law, which is a general one, there is continuing offer on the part of the state, and acceptance by the incorporators will create a body politic and corporate *eo instanti*. This means that upon the issuance of the

³⁴ 14 C. J. 118.

³⁵ 14 C. J. 114-115.

³⁶ 14 C. J. 118.

³⁷ *Ibid.*, p. 115.

³⁸ *Ibid.*, p. 118.

certificate of incorporation, the corporate existence commences. It is the date of incorporation. Mr. Fisher³⁹ concurs with this opinion.

(1) *Persons who may be Incorporators.*

Our discussion of the immediately preceding subsection regarding the capacity of incorporators to be able to make a valid acceptance, forces upon us the question as to who may be considered as capacitated.

Section 6 of Act 1459, as amended by Act 3518, Sec. 3, requires five or more persons, not to exceed fifteen, in order to establish a corporation. The section requires further that a majority of them should be residents of the Philippines. According to the famous case of *Government of the Philippine Islands v. El Hogar Filipino*⁴⁰ the word "persons" in Section 6 should be interpreted to mean "natural persons", so that juridical are not among those who can form a corporation. The same interpretation was given to an identical provision of the Ohio Corporation Law.⁴¹

The agreement existing among the incorporators is contractual in nature, so that those who enter into it should be possessed of the capacity to enter into contracts. From this fact, we could imply that incorporators should necessarily be persons *sui juris*.⁴² In order that a married woman may be qualified to act as an incorporator, it is necessary that the consent of her husband be given. Neither could a minor become an incorporator, because as such he could have no capacity to contract. But the mere fact that a married woman or a minor is included among the list of incorporators is not sufficient authority for the Director of the Bureau of Commerce and Industry to deny the registration of the articles of incorporation. Provided that there are at least five incorporators who are *sui juris*, the requirement of the law as to the persons incorporating the association is satisfied, and the error of including an incapacitated will not affect the validity of incorporation.⁴³

It is of course elementary that the law on incorporations may or may not provide expressly those persons who may be incorporators, together with their necessary qualifications. In

³⁹ *The Philippine Law of Stock Corporations*, p. 383.

⁴⁰ 50 Phil. 399.

⁴¹ *American Ball Bearing Co. v. Adams*, 222 Fed. 967.

⁴² Fisher, *The Philippine Law of Stock Corporations*, p. 14; Witters v. Sowles, 38 Fed. 700; *In re Globe Mut. Ben. Ass'n.*, 17 L. R. A. 547.

⁴³ Fisher, p. 15.

cases of express statutory provision, those who do not fall within the law could not be included.

The right to become an incorporator has been extended by judicial interpretation to alien friends, but not to alien enemies. This is because of that settled principle of public law that there can be no contract between parties who are situated on opposite lines of belligerency.⁴⁴ The authority for alien friends to become incorporators find sanction in the provision of the law itself. The law merely requires that a majority of the incorporators should be "residents" of the state where the incorporation is performed. It does not say that they ought to be "citizens". The conclusion is therefore inescapable that aliens who are not enemies of the grantor of corporate franchise can become incorporators.

A foreign ambassador has been held to be capable of becoming an incorporator, altho by reason of his diplomatic immunities he cannot be sued for assessments.⁴⁵

If the law, however, does not provide that the incorporation should be done by persons who should be residents of the state, or at least a majority of them, an association may be formed by non-residents.⁴⁶

In order that a corporation may become an incorporator there must be express statutory authority therefor. Even if the corporation should seek to do this indirectly through persons acting as its agents or tools, the necessity of legal authority is indispensable.⁴⁷ This requisite is necessary in order to prevent corporations from engaging in business more or less foreign to the purposes stated in the articles of incorporations. Moreover, if a corporation were to become an incorporator in another business company, the former would be greatly restricted in operation because of the activities of the latter.

(d) Corporate Powers Cease.

In proceeding to the discussion of this particular phrase of Section 19, it would be necessary to know what are comprised within the term "corporate powers."

⁴⁴ 14 C. J. 102.

⁴⁵ *Hastings v. Anacortes Packing Co.*, 29 Wash. 224, 69 Pac. 776.

⁴⁶ *People v. McDonough*, 28 Misc. 652, 60 NYS 45; *Magdalena Steam Navigation Co. v. Martin*, 105 ECL 94; *Moxie Nerve Food Co. v. Baumbach*, 32 Fed. 205; *Lancaster v. Amsterdam Imp. Co.*, 24 L. R. A. 322; *Boatmen's Bank v. Gillespie*, 108 S. W. 74.

⁴⁷ *Martin v. Ohio Stone Co.*, 78 Ill. App. 105; *People v. Chicago Gas Trust Co.*, 130 Ill. 268, 8 L. R. A. 497; *Converse v. Gardner Governor Co.*, 124 Fed. 30; *First Nat. Bank v. Converse*, 200 U. S. 425.

It must be remembered that we cannot state in a definite manner what are the corporate powers of a corporation. What they are can only be answered by the particular statute under which an organization has been established, and the purposes for which such has been constituted. This fact could be realized more easily when we take into consideration the fact that a corporate body is a mere creature of the law. Its powers, like its existence, are derived from the grant which the state would care to give. It is in this respect that the corporation differs from a natural person. An individual derives his powers not from any state grant. He possesses them inherently, as a part of his existence.

The powers of a corporation may be divided generally into two classes: first, those expressly granted by its charter or other statutes; and second, those that could be implied from the express powers or those which are incidental to the existence of the corporation.¹ The corporate powers which are expressly conferred may be found either under the statute creating it, statutes containing applicable provisions and to a certain degree from the articles of incorporation.²

Incidental powers are considered to be "those directly and immediately appropriate to the execution of the powers expressly granted, and which exist only to enable the corporation to carry out the purposes of its creation."³ Implied powers are differentiated from incidental ones as "those possessed by a corporation, not indispensably necessary to carry into effect others expressly granted, and comprise all that are appropriate, convenient, and suitable for that purpose, including as an incidental right a reasonable choice of the means to be employed in putting into practical effect this class of powers."⁴ It can be seen from the foregoing definitions that both do not exist on the face of the law or the charter. On the other hand, they could be seen and appreciated from the fact of the corporate existence itself. They do not exist in measured and predetermined amount; rather they vary according to the necessity for the propagation of corporate ends, and the legitimate stretch which the law implies. Only a vain attempt at approximation

¹ 2 Fletcher, *Cyclopedia Corporations*, p. 1756; *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24; *Cumberland Telephone and Telegraph Co. v. Evansville*, 127 Fed. 187; *Bank of California v. San Francisco*, 142 Cal. 276; 64 L. R. A. 918; *Best Brewing Co. v. Kalsner*, 50 L. R. A. 765; *Schab v. E. G. Potter Co.*, 87 N. E. 670.

² 2 Fletcher, *Cyclopedia Corporations*, p. 1761.

³ *Ibid.*, p. 1765.

⁴ *State v. Missouri Athletic Club*, 170 S. W. 904.

could be made by saying that their measure can be made from the facts of the circumstances of a given situation.

Altho a distinction between incidental and implied powers has been made by authorities on the subject, yet it has been the general practice to consider them as one. This is necessary in order to distinguish them from the express powers.

(1) *Effect of Cessation.*

When a corporate existence has been terminated for any cause whatever, the corporation no longer exists for any purpose, unless there is some statutory provision continuing its existence. The corporate entity has no longer any capacity or power to enter into contract, and cannot take, hold, or convey property. It cannot exercise any other franchise or power which its charter may have conferred. In fact its situation is very similar to that of a dead natural person, who, because of the termination of existence, is incapable of performing the functions of life.

There has been a conflict in the views held by the different states regarding the effect in one state of a corporate dissolution in the other. One view maintains that a dissolution in the state where it has been created makes the corporation dissolved everywhere.⁵ The other view, however, holds that the civil death of a corporation in the state of creation, does not conclude a sister state from holding the same corporation within its statute in order to save the legal remedies of its own citizens with respect to the properties of the corporation within its own jurisdiction.⁶ Another case holds that the remedies of the creditors residing in a sister state cannot be abridged by the fact of dissolution in the state of creation until action has been taken in the former state in order to enforce the dissolution.⁷ The latter view that a corporate dissolution in the state of creation cannot abridge the right of creditors in another state, destroys a legal fiction. It is a well established principle that when a corporation is created under a general law or even under a special one, that law alone gives it existence. Whatever transactions it may have in other states are only manifestations of corporate existence that comes from one source. The fact that it has contracted obligations in other states does not lend exist-

⁵ *Marion Phosphate Co. v. Perry*, 74 Fed. 425; *People v. Mercantile Credit Guarantee Co.*, 72 N. Y. Supp. 858.

⁶ *Rodgers v. Adriatic Fire Ins. Co.*, 148 N. Y. 34, 42 N. E. 515.

⁷ *Hammond v. National Life Ass'n.*, 69 N. Y. Supp. 585.

ence to the organization. Otherwise another mode of creating a corporation should be recognized in law. A person whether natural or juridical could only be born once. To hold the contrary would be to go against the well established fact of life. Again, if we are to follow the doctrine in the case of Hammond, supra, we will be led to the conclusion that it is not enough to strike at the roots of life in order to put a stop to existence. The case requires a further step, and that is, the bringing of another action in the sister state. Could this reasoning be due to their concept of multiple creation from which must follow multiple death? This is contrary to the rules of nature.⁵

As I have said before, what was disregarded was only a legal fiction. In more cases than one, legal fictions have been disregarded in order to obviate the absurdities of conclusions and to protect existing rights. This legal fiction contradicts the rights of creditors and obligees abounding in the other states. To this extent it must of necessity be abandoned in order that those who have rights may not be left without remedies.

Section 77 of our Corporation Law grants a dissolved corporation three years within which to prosecute and defend suits by or against it, to settle its property and divide its capital stock. This provision is a happy solution to the conflicting theories regarding the continuity of corporate life. Notice should be taken of the fact that, notwithstanding dissolution, it may still sue and be sued in competent courts.

(c) *Due Incorporation.*

A corporation may either be *de jure* or *de facto*. There is a *de facto* corporation when the incorporators thereof have only made a colorable attempt at compliance with the statutory requirements. In order that a *de jure* corporation may obtain, it is necessary that there should be a substantial compliance with the formal requirements of the statute. It is the latter which is, properly speaking, the end of due incorporation.

However, not all statutory requirements need be fulfilled in order to have due incorporation. Only conditions precedent which are mandatory, not directory in character, should be complied with, so that there may be due incorporation.⁶ Whether a particular legal requirement is a condition precedent or subse-

⁵ Greenwood v. Union Freight R. Co., 105 U. S. 13; Bradley v. Reppell, 133 Mo. 545, 34 S. W. 841; People v. O'Brien, 111 N. Y. 1, 18 N. E. 692; Miami Exporting Co. v. Gano, 13 Ohio 269.

⁶ 1 Fletcher, Cyclopaedia Corporations, p. 371-372.

quent is a question which could be answered only by the intent of the legislature as deduced from the language of the act itself and the purpose of the requirement. A directory provision is one which is not intended by the legislature as essential, so that a failure to comply is an irregularity which is not fatal.¹⁰ But a positive statutory requirement should not be interpreted as directory merely because it is unimportant.¹¹ If the law on corporations require that the creation be made in a certain way and with certain formalities, such requirements are usually regarded as conditions precedent to the existence of a *de jure* corporation.¹² If the organizers fail to comply with the mandatory requirements, a formation of a *de jure* corporation will not take place, but only a *de facto* one will be created.¹³

The formalities required by law in order to incorporate are those which should be done preliminary to the drafting and filing of incorporation papers, and the actual drafting and filing of the same. Under our law, when the Director of Commerce and Industry issues a certificate of incorporation, the organizers thereof are constituted a "body politic and corporate." Acts, therefore, which the law requires to be done after incorporation, do not lend to the due incorporation of the association, but rather to make corporations not liable to a *quo warranto* proceedings by the attorney-general of the state under Section 19.

As to whether a corporation is legally constituted is a question involving both fact and law. The things done under the statute regarding the organization are questions of fact capable of direct proof; but as to whether such acts when performed would be sufficient to establish a legal corporation is a question of law.¹⁴

The present tendency, however, is towards a liberal construction of the acts required to create a legal corporation. Every presumption will be indulged in favor of legal existence after the corporation has gone into operation.¹⁵

Section 7 of our Corporation Law gives the form for articles of incorporation, and requires only a substantial compliance therewith in order to fulfill the desire of the law. The leading

¹⁰ *Hammond v. Straus*, 53 Md. 1; *Bonaparte v. Baltimore, H. & L. R. Co.*, 23 A.L. 784.

¹¹ *Cross v. Pinckneyville Mill Co.*, 17 Ill. 54.

¹² 1 *Fletcher, Cyclopedia Corporations*, p. 372.

¹³ *Brown v. Webb*, 60 Ore. 526, 120 Pac. 387.

¹⁴ *Scanlan v. Keith*, 102 Ill. 634, 40 Am. Rep. 624.

¹⁵ *Memphis and St. F. Plank-Road Co. v. Rives*, 21 Ark. 302; *Spring Valley Water Works v. San Francisco*, 22 Cal. 434.

states of the American Union have in their law similar provisions.¹⁶ The papers of incorporation must be definite in its statement in order that the members thereof may be fully aware of their rights and the interests which they have.¹⁷

The law requires that the name of the corporation must be set forth, otherwise the corporate application for registration will be invalidated.¹⁸ It is not considered sufficient to merely put such name at the head of the application,¹⁹ but must be stated in the body of the articles of association.

The article which is submitted for incorporation should never miss to state the purpose or purposes for which the corporation is created, as this is the most important clause of the incorporation paper.²⁰ However, the statement of the objects need not be very detailed. It is enough if a broad statement has been made which will describe with sufficient certainty the end sought by the organization. But its broadness should not be such as to go more than the elasticity required by law. The statement should not be such as to include within its scope such things as are entirely foreign to the purpose of the corporation. For if this were permissible, it might lead to great fraud and the corporation may perform *ultra vires* acts which the law or the statement of purposes does not countenance.

Section 9 of our law on corporations requires that the treasurer of the company should file together with the incorporation papers a sworn statement that at least 20% of the entire number of authorized shares of the capital stock have been subscribed to. He must also state that at least 25% of the subscription have been paid in actual cash, or else that the property paid in lieu thereof amounts in fair valuation to 25%. This is a mandatory legal requirement and must be complied with in order that there may be due incorporation. The same section also requires the Director of the Bureau of Commerce and Industry to publish in a newspaper of general circulation the assets and liabilities of the association. The submission therefore of a statement with respect to the amount of corporate

¹⁶ *People v. Golden Gate Lodge No. 6*, 128 Cal. 257, 60 Pac. 865; *People v. Cheeseman*, 7 Colo. 375, 3 Pac. 716; *Attorney-General v. Lorman*, 59 Mich. 157, 60 Am. Rep. 287; *New York Cable Co. v. New York*, 104 N. Y. 1, 10 N. E. 332.

¹⁷ *In re National Literary Ass'n.*, 30 Pa. St. 150.

¹⁸ *Rhodes v. Piper*, 40 Ind. 369.

¹⁹ *Ibid.*

²⁰ *State v. Vanderbilt University*, 129 Tenn. 279, 164 S. W. 1151; *Distilling & Cattle Feeding Co. v. People*, 161 Ill. 101, 43 N. E. 779.

assets and liabilities shall be deemed to be mandatory on the part of the proposed corporation. Banks, banking institutions and building and loan associations are also required by Section 91 $\frac{1}{2}$ to file together with its papers the certificate of authority issued by the Bank Commissioner.

In order that a foreign corporation may be licensed to do business in the Philippines, a statement under oath made by the managing agent, should be included in the application. Such statement must state the solvency as well as the soundness of the financial condition of the applicant corporation. The name of an agent residing in the Philippines who is authorized to receive summons and processes should also be included.²¹

The adoption of by-laws is not necessary in order to make an acceptable incorporation paper. As a matter of fact Section 20 of Act 1459 requires that this be done "within one month after the filing of articles of incorporation." It is clear, therefore, that whether the incorporation paper has been approved by the Director of the Bureau of Commerce and Industry or not, the law does not contemplate that such code of by-laws should become a mandatory condition precedent to due incorporation.

(f) Claiming in Good Faith to be a Corporation.

It is necessary to know the meaning of the phrase "good faith" in order to be able to make an intelligent discussion of the subject under consideration. The place of the preposition "in" before "good faith" forms an adverbial phrase which has a settled and well defined meaning in law.²² Good faith has been variously described as the freedom from the knowledge of those circumstances which ought to put a person upon inquiry,²³ free from design to defraud another.²⁴

Good faith means honest lawful intent; the condition of acting without knowledge of fraud, and without intent to assist in a fraudulent, or otherwise unlawful scheme.²⁵ The claimant of good faith must have acted without knowledge nor simulation of pretense, innocently and in an attitude of trust and confidence. He must have acted in the absence of all informations or belief of facts that would render the transaction unconscientious.

²¹ Section 68, Act 1459.

²² Heney v. Sutro, 28 Cal. A. 698, 153 Pac. 972.

²³ Pennington County Bank v. Moorehead First State Bank, 110 Minn. 263, 125 N. W. 119; Cochran v. Fox Chase Bank, 209 Pa. 34, 58 Atl. 117.

²⁴ Tapia v. Williams, 172 Ala. 18, 54 S. 613.

²⁵ Crouch v. First Nat. Bank of Chicago, 156 Ill. 342, 40 N. E. 974.

The act must be done honestly, sincerely, openly, without deceit, covin or any form of fraud.²⁶

The term good faith has been interchangeably used with the phrase *bona fide*, in the sense that both refer to acts done without fraud or deceit, collusion or trust.²⁷ But the latter may mean more when a *bona fide* contract, agreement or covenant is spoken of. In this sense it is meant to be that which is legal, valid, subsisting and is enforceable in the judicial tribunals of the country.²⁸

Lack of diligence, however, does not necessarily mean an absence of good faith.²⁹ To be so, there must be a want of action and diligence which an honest man of ordinary prudence is accustomed to exercise.³⁰

From the foregoing discussion, we can deduce that in order that the incorporators or the stockholders may be able to claim in good faith that they constitute a body politic and corporate, it is necessary that they do not possess knowledge of those circumstances which ought to put a person upon inquiry. They must also be free from any design to defraud others, and are not wanting in the exercise of that diligence which a man of ordinary prudence ought to employ in the prosecution of his business. Short of these requirements they would not be entitled to a claim of good faith that they constitute a corporation which, by force of law, is exempt from a collateral inquiry in any private suit to which it is a party.

(1) *Distinguished from De Facto Corporation.*

The expression *de facto* corporation is generally used to designate associations exercising corporate powers under the color of a more or less legal organization.³¹ The great majority of decisions on the subject of *de facto* corporate existence prescribes the following essential requisites: first, the existence of a charter or law under which a corporation with the powers assumed might lawfully exist; second, an effort in good faith

²⁶ State ex rel. West, Pros. Atty. v. Diemer et al., 255 Mo. 336, 164 S. W. 517.

²⁷ 8 Words and Phrases, 7672; Dartmouth College Trustees v. International Paper Co., 132 Fed. 92.

²⁸ Ware v. Hylton, 3 Dall. (U. S.) 199; 1 L. Ed. 568.

²⁹ Stufflebeam v. De Lashmutt, 101 Fed. 367.

³⁰ Pringle v. Philipps, 7 N. Y. Supp. 157; Jennings v. Lentz, 50 Or. 483, 93 Pac. 327; Burlington State Bank v. Merlin Nat. Bank, 166 S. W. 499.

³¹ Brown v. Atlanta Railway & Power Co., 113 Ga. 462, 39 S. E. 71; Cason v. State, 86 S. E. 644.

to incorporate thereunder; and third, an actual user or exercise of corporate powers.³² There is the existence of such a corporation when the existence of these requisites is shown, notwithstanding irregularities or defects in the organization, or a failure to comply in all respects with the provisions of the charter or statute.

To hold that in order to have a *de facto* corporation, substantial compliance with the statute is necessary, is entirely erroneous. It is obviously opposed to the decided weight of authorities both in reason and in principle to admit of discussion, for it is one of the most established principles of law that substantial compliance will beget a *de jure* corporation. If we are to maintain otherwise, we would be entirely disregarding the doctrine of *de facto* corporation. A colorable or apparent compliance with the statute and nothing more is enough to produce a *de facto* corporation.

When the purpose or purposes for which a corporation is established, are prohibited by positive law or is contrary to public policy, there can be no *de facto* existence.³³ The same case obtains when the statute under which a corporation is created is unconstitutional.³⁴ The reason behind this principle is that an unconstitutional law is not a law at all. It creates no right and does not give validity to an act. Ultimately, it can be said that the proposed organization is created under no law, so that there is in fact no corporation. A corporation is a creation of law, and when there is no creator, there could be no creature.

Altho a case has held that a corporation organized in one state and carries on business entirely in another state is a *de facto* corporation³⁵, yet the preponderance of authority holds that no such corporation is created. On the other hand such action is an attempted fraud upon the law and the incorporators

³² *Tulane Irrigation District v. Shepard*, 185 U. S. 1; *Baltimore & P. R. Co. v. Fifth Baptist Church*, 137 U. S. 568; *Whitney v. Wyman*, 101 U. S. 392; *Bank of Midland v. Harris*, 114 Ark. 344, 170 S. W. 67; *People's Ditch Co. v. '76 Land & Water Co.*, 44 Pac. 176; *Jones v. Aspen Hardware Co.*, 21 Colo. 263, 40 Pac. 457; *State v. Byrne*, 40 Conn. 273; *Imperial Bldg. Co. v. Chicago Open Board of Trade*, 238 Ill. 100; *Jennings v. Dark*, 175 Ind. 232, 92 N. E. 778.

³³ *Oregonian Ry. Co. v. Oregon Ry. & Nav. Co.*, 23 Fed. 232; *La Warne v. Meyer*, 38 Fed. 191; *Workingmen's Accomodation Bank v. Converse*, 29 La. Ann. 369.

³⁴ *Brandestein v. Hoke*, 101 Cal. 131; *Wilmington v. Addicks*, 8 Del. Ch. 310; *People v. Hamill*, 134 Ill. 666.

³⁵ *Burwash v. Ballou*, 230 Ill. 34, 82 N. E. 355.

or stockholders should be treated as partners and liable as such.³⁶

A *de facto* corporation may exist even with the knowledge of its components that some legal requirements have not been met. But it is the farthest that it can go in the way of organization and legal sanction. To be a corporation in good faith an entire absence of knowledge of defects ought to exist among the stockholders. A *de facto* organization may be included within the meaning of corporation in good faith, but the latter can never be comprised within the implications of the former. In clearer language, a *de facto* association will become a corporation in good faith by advancing one step higher—by a want of knowledge of the existing defects in the corporate franchise. A willful non-compliance with the requirements of the statutes, lack of ordinary diligence on the part of the stockholders, the attendance of dishonesty and deceit,—all or any one of these will prevent a *de facto corporation* from attaining the dignity which the law attaches to organization in good faith.

(g) *Inquired into Collaterally.*

The above phrase has the same legal significance as the term "collateral attack." The latter has been defined as a proceeding aside from, or outside of, the regular proceeding in a case.³⁷ If there has been an attempt to impeach a certain question by matters foreign to the issue and *dehors* the record, there is then a collateral attack.³⁸ So that if an action has an independent purpose and contemplates some other relief or result, and evidence has been introduced to impeach or attack the judgment rendered in another case, the act would be classified as collateral.³⁹

It is clear from the foregoing discussion that the "due incorporation of any corporation claiming in good faith to be a corporation" under Act 1459 cannot be the subject of an inquiry in an action for a different purpose. An example will clarify the point. In an action where a corporation sues A for the recovery of a certain sum of money, the defendant cannot

³⁶ Lynch v. Perryman, 29 Okla. 615, 119 Pac. 229; Empire Mills v. Alston Grocery Co., 4 Wilson Civ. Ct. App. Sec. 222; Hill v. Beach, 12 N. J. 31.

³⁷ People v. Norris, 144 Cal. 422; 77 Pac. 998.

³⁸ Parson v. Weis, 144 Cal. 410; 77 Pac. 1007.

³⁹ Peyton v. Peyton, 28 Wash. 278, 68 Pac. 757; Morrill v. Morrill, 20 Ore. 96, 11 L. R. A. 155; Meinert v. Harder, 39 Ore. 609; Cresswell Ranch and Cattle Co. v. Roberts County, 275 W. 737; Cohen v. Portland Lodge No. 142, B. P. O. E., 152 Fed. 357; O'Neill v. Patwin, 93 Pac. 20.

interpose the defense that the plaintiff has no power to sue since the same has not been duly incorporated according to the laws of the Philippines. This is so because the defense interposed collaterally inquires into the due incorporation of the plaintiff.

The reason behind this provision of law is premised upon the broad principles of public policy. If the state were to permit such inquiries, there would be no end to the cropping out of such questions in every case where the corporation may be a party in interest. This will result in undue and unreasonable prolongation of actions which will greatly impair the workings of the judiciary. Another reason for this prohibition is that the business stability of corporations will be greatly injured by frequent controversies as to its corporate existence, for persons in the habit of transacting business with it will naturally look upon the corporation with fearful apprehension to the extent of altogether refusing to contract with the organization. In fine, the law has done away with a rich source of trouble for scrupulous litigants to the detriment of the state and the corporation.

(h) On Information by the Attorney-General.

This phrase is more popularly known in jurisprudence as "information in the nature of a *quo warranto*".⁴⁰ It was originally in the form of a criminal proceeding to punish the usurpation of franchises by either a fine or a seizure of the franchise. In the process of time it has become a civil proceeding to try the mere right to the franchise or office.⁴¹ Its use has been extended to the determination of whether or not the charter or franchise has been abused and if so, to have it forfeited.⁴²

The writ of *quo warranto* is a prerogative writ because of the fiction of the feudal law that the king or the state alone is the source from which all franchises are derived. Without a regal grant, the exercise of a franchise is considered a usurpation.⁴³

There can be no doubt as to the designation above stated regarding the real meaning of information by the Attorney-General, when we read the express terms of our Code of Civil

⁴⁰ Jarman v. Mason, 102 Okla. 278, 229 Pac. 459; Moody v. Lowrimore, 86 S. W. 400; State v. Sengstacken, 61 Ore. 455; State ex inf. Berkeley ex rel. McCormack v. McClain, 86 S. W. 135.

⁴¹ People v. Dashaway Ass'n., 84 Cal. 114, 25 Pac. 277.

⁴² State v. Godfrey, 12 Me. 361.

⁴³ 5 Fletcher, Cyclopedia Corporations, 4968.

Procedure regarding actions for forfeiture of corporate franchise. Section 198 of the said code prescribes the instances under which *quo warranto* proceedings may be brought against the corporation for the forfeiture of its franchise.⁴⁴

IV. QUESTIONS INVOLVED

The first two sentences of Section 19 of the Philippine law on corporations present for discussion two important questions. The first one has not been definitely settled on account of the great conflict of court decisions on the matter. The second question has been more or less definitely settled because of a practical unanimity of court decisions, but which, nevertheless, need be considered for the sake of clarity.

(a) *Is the First Sentence Self-Executing?*

When we speak of a self-executing statute we mean that such law is sufficient in itself to produce the effects contemplated. If some further acts are needed, whether such acts be executive, legislative or judicial in nature, then the law is not self-executory. But if standing alone and unaided by any kind of remedy the desired result is accomplished, then the law is self-enforcing in judicial contemplation. The same query has been expressed in a different way by asking whether the effect of a certain provision of law begets the legal consequences *ipso facto*. For our present purpose we shall frame the question which we seek to answer in the following words: Does the failure of a corporation to organize formally and commence the transaction of business or the construction of its works within two years from the date of its incorporation work an *ipso facto* dissolution of the corporate entity? For the sake of clarity we may add a second question, thus: Is a judicial pronouncement forfeiting the corporate franchise in such events necessary to work a dissolution of the corporation? It is not easy to answer these questions offhand, because of the prevailing conflict in the decisions of various judicial tribunals. Even standard text-writers have not been able to give definite answers to these mooted questions. Even in our own jurisdiction, opinions of authorities on the subject differ. There are some who hold that Section 19 is self-executing, while others refuse to subscribe to such an opinion. We have so far nothing in our jurisprudence in which the question has been answered.

⁴⁴ See Fisher's Code of Civil Procedure.

In some of the leading states of the American Union, like New York, California, Delaware, Missouri, Texas and Pennsylvania, the phrase "shall cease" has been employed by the statute.⁴⁵ The laws of the states of Maine, Virginia, Utah, Massachusetts and South Carolina use the term "void" or "null and void."⁴⁶ The words "*ipso facto*" cease prevail in the statutes of both Louisiana and California.⁴⁷ There are other laws on corporations in the different states which include phrases of similar nature such as, "work a forfeiture," "shall utterly cease and be forfeited," "become forfeited," "deemed forfeited and terminated," "*ipso facto* forfeited and void," "forfeit its corporate existence" and "shall revert to the state."⁴⁸ There are, however, those which employed such terms as "cease to exist", "under forfeiture," and "cease and be void."⁴⁹

It is noticeable that our statute uses the word "cease" only, without prefixing the word "shall."⁵⁰ While the California and New York laws from which our Corporation Law has been mostly copied use the said prefix, yet the comparison among these and our local law reveals conspicuously the fact that Act 1459, Section 19, has abandoned such a word of great significance. The closest counterpart of our law is found in the provision of a Massachusetts law which uses the word "cease" only. Yet the latter law goes one step farther by adding after "cease" the phrase "to exist".⁵¹

There is a strong line of decision which holds that non-compliance with the legal requirements of Section 19 of Act 1459 forfeits the charter.⁵² Two decisions of the Court of Appeals of New York are perhaps the most often cited in support of this view. They are *Brooklyn Steam Transit Co. v. Brooklyn*, 78 N. Y. 524 and *In re Brooklyn, W. & N. R. Co.*, 72 N. Y. 245. These decisions were rendered as early as 1879 and 1878 respectively. These decisions were reaffirmed in 1887 in the case of *Farmham v. Benedict*, 107 N. Y. 159. But even in the same

⁴⁵ 8 Fletcher, 9038; 3 Cook on Corporations, 2357-59.

⁴⁶ 3 Cook on Corporations, p. 2358, 2360-61.

⁴⁷ *Ibid.*, p. 2357.

⁴⁸ 8 Fletcher, *Cyclopedia Corporations*, p. 9038-40.

⁴⁹ *Ibid.*, p. 9040, 9041.

⁵⁰ Act 1459, Sec. 19.

⁵¹ *Bricks v. Cape Cod Ship Canal Co.*, 137 Mass. 71.

⁵² *Brooklyn Steam Transit Co. v. Brooklyn*, 78 N. Y. 524; *In re Brooklyn, W. & N. R. Co.*, 72 N. Y. 245; *Commonwealth v. Lykens Co.*, 110 Pa. St. 391; *Farmham v. Benedict*, 107 N. Y. 159; *People v. National Savings Bank*, (Ill.) 11 N. E. 170; *Newhall v. Western Co.*, (Cal.) 128 Pac. 1040.

year (1887) and in New York also, the court decided in *Day v. Ogdenburg R. R.* 107 N. Y. 129, that failure to commence work within the time specified in the charter and the provision that the company should therefore be dissolved, does not effect a dissolution *ipso facto*. A judgment of forfeiture is necessary. After this followed years of liberal construction of the same or similar statutory provisions. Thus in 1891 in the case of *Re Brooklyn R. R.*, 125 N. Y. 434, a day in court was held to be necessary to forfeit a corporate franchise. In the case of *People v. Equity Gas Light Co.*, 141 N. Y. 232, decided in 1894 the same doctrine was applied. Again in 1896 in *Re New York Bridge Co.*, 148 N. Y. 540, a reaffirmation of the ruling that judicial action is necessary to terminate corporate existence was made.

It would be of interest to note that before the time of the enactment of Act 1459 on March 1, 1906,⁵³ New York has returned from liberal construction to the doctrines of the decisions of 1878 up to 1887. As early as 1902, in *Underground R. R. v. City of New York*, 116 Fed. 952, the court held that the law contemplates a dissolution *ipso facto*. In 1905 in *Matter of Brooklyn R. R.*, 106 N. Y. App. Div. 240, the New York court again adhered to the self-executing doctrine. It will be remembered that our corporation law was first introduced on June 1, 1905.⁵⁴ The fact that most of the provisions of our law on corporations are of New York and California origin⁵⁵ and coincidence of the date of introduction as well as the return of the New York court to the self-enforcing theory, are of the utmost significance. The coincidence may seem strange, but it is nevertheless true. The last two cases cited can not be considered dissenting opinions to the liberal construction trend which prevailed in New York at the time. The departure would be more marked if we take into consideration the fact that in 1906, in the *Matter of Brooklyn R. R.*, 185 N. Y. 171, the immediately preceding case was affirmed. An implied affirmation was also made in 1909 in the case of *City of New York v. Bryan*, 196 N. Y. 158. In the often cited case of *People v. Stillwell*, 157 N. Y. App. Div. 839, decided in 1913, the *ipso facto* dissolution doctrine finds a reaffirmation.

⁵³ Dionisio Villanueva, *The Corporation Law as Compiled and Annotated*.

⁵⁴ *Ibid.*

⁵⁵ Dean Jose A. Espiritu, *College of Law, U. P.*

We shall now turn our attention to the decisions of the courts of California on the matter, inasmuch as Section 19 of our law has been copied almost verbatim from Section 358 of the Civil Code of California prior to its amendment in 1901.⁵⁶ The prevailing opinion regarding the construction given to the provision of Section 358 would be of the greatest significance in solving our present difficulty.

In an early decision rendered in the case of *Oakland R. Co. v. Oakland, B. & F. V. R. Co.*, 45 Cal. 365, 13 Am. Rep. 181, the phrase "shall utterly cease and be forfeited" was held self-executing. Altho the word "utterly" has been omitted in Section 358 before the amendment of 1901, still the legal effect should not be considered as modified, since the additional words "and be forfeited" could be interpreted as neutralizing the absoluteness of the word "utterly."⁵⁷ In clearer language, altho in the later provision of the code there has been an omission of the word "utterly", the quality or import of the phrase has not been in any way diminished or softened, inasmuch as the negation produced by the latter clause "and be forfeited" has also been suppressed. The term "shall cease" of the California Code before 1901 should therefore be interpreted as of similar and equal effect as that of "shall utterly cease and be forfeited."

The California Jurisprudence⁵⁸ citing the cases of *San Diego Gas Co. v. Frame*, 137 Cal. 441, 70 Pac. 295 and *Robinson v. Blood*, 151 Cal. 504, 91 Pac. 258, contended, however, that the term of the life of a corporation is prescribed by law and as such only at the behest of the state could it be questioned. It further cited the case of *McCann v. Children's Home Society*, 176 Cal. 441, 168 Pac. 295, and held that, even in the case of a cessation of corporate functions, the action of the state is required. But in the first two cases cited there had been transactions of the corporate business, altho in an indirect way. In the case of *Robinson v. Blood*, *supra*, the corporation, altho not engaged in the prosecution of its corporate purposes, was at the time involved in a litigation affecting its whole property. It would indeed be unreasonable to hold otherwise. Regarding the case of *McCann v. Children's Home Society*, *supra*, the cessation of corporate activity took place after the transaction of business has been commenced. There is no difference of opinion in matters of this kind, that state intervention is necessary.

⁵⁶ Fisher, *The Philippine Law of Stock Corporations*, p. 383.

⁵⁷ *Wallamet Falls Canal & Lock Co. v. Kittridge*, 5 Sawy. 44.

⁵⁸ Vol. 7, p. 157.

It is not applicable, therefore, to the present situation in which the inaction commences from the beginning, where no visible sign of life could be found.

The trend of judicial thought in California in the question of *ipso facto* dissolution could be realized more easily in the case of *Los Angeles Ry. v. City of Los Angeles*, 152 Cal. 242, which was decided in 1907. There the words used by the statute was "works a forfeiture." Altho it has been held in the case of *Wallamet Falls Canal & Lock Co. v. Kittridge*, 5 Sawy. 44, that the word "forfeit" contemplates judicial action, still the courts of California held that it is self-operating. This fact will show us the leanings of the California judiciary in the matter of dissolutions. The later cases of *Kaiser Land & Trust Co. v. Curry*, 155 Cal. 638 and *Newhall v. Western Co.*, 128 Pac. 1040, decided in 1909 and 1912 respectively, supported the *ipso facto* dissolution theory.

After a reading of the above discussion on the New York and California court decisions, the writer can put a rest to his case and maintain that the first sentence of Section 19 of Act 1459 is self-executing. The writer could base his contention on the well established principle of statutory construction that where a law has been copied from a certain state, the construction placed upon the law by the courts of the jurisdiction from which it originated would constitute the guide. But there are some other objections to such a holding, which I shall presently attempt to answer.

The first objection is that in our country corporations are yet scarce, so that no such strict construction should be placed upon the law. Such reasonings ought not to be countenanced, for they are manifestly contrary to public policy. While it is true that laws should harmonize with the times, still this course should not be pursued in the present situation at least. Private corporations are invested with a public character in the broad sense of the word, for the range of their operations are so wide in extent that a great part of the public are affected. A laxity in the enforcement of statutes at the beginning may produce evil results which may prove fatal and beyond the reach of remedy at the time that compliance is sought. When the damage is an accomplished fact it is true that the remedies provided for by law may be resorted to. But not all harms can be repaired, not all deprivations could be restituted, and injuries may be indemnified only to a certain extent. Then, it would be too late to complain of laxity in the enforcement of legisla-

tive intendments; all that is left to us will be nothing but regret over our past failure.

This contention does not find support in the experiences of the states of the American Union. *Ipsa facto* dissolution has been the theory of the New York courts since 1878;¹ Pennsylvania in 1882;² California in 1873;³ Missouri in 1877;⁴ Illinois in 1887;⁵ Texas in 1889;⁶ and in Virginia in 1876.⁷ Corporations in these states were not many during the times that these decisions were rendered.

A second objection is that "this drastic and dangerous construction of charters does not commend itself to law and justice." ⁸ It is hardly conceivable that a statute based upon public policy and necessity could be construed intelligently and be contrary to law and justice! One of the soundest principles of law is that the construction must always be made in favor of that which will give benefit to the public. It seems to me that this conclusion of Mr. Cook would not be out of place, were it applied to the contrary holding. He further says that "it adds one more to the perils which are attached to all great corporate enterprises." ⁹ But this peril can be obviated by statutory compliance. And such a thing is not hard to perform. To do away with the interpretation that the provision is self-executing would be to open wide the door to frauds, for corporations of all kinds would not hesitate to circumvent the law with such a loose constructions.

Is the statute making a ground of forfeiture self-enforcing constitutionally valid? This is the third objection to the doctrine that the writer is sustaining. The due process clause or the equal protection clause of the constitution may be invoked in order to defeat the theory. Fortunately there are decisions upholding the validity of the law.¹⁰ The Illinois courts, however, require that in order to do this the power to repeal the charter must be vested in the legislature.¹¹ Section 76 of Act

¹ Re Brooklyn R. R., 72 N. Y. 245.

² Chinoelamanche Lumber Co. v. Commonwealth, 100 Pa. St. 438.

³ Oakland R. C. v. Oakland, B. & F. V. R. Co., 45 Cal. 365.

⁴ Atlantic R. R. v. St. Louis, 66 Mo. 228.

⁵ People v. National Savings Bank, 11 N. E. 170.

⁶ Bywaters v. Paris Ry., 73 Tex. 624.

⁷ Silliman v. Fredericksburg R. R., 27 Gratt. 119.

⁸ 3 Cook on Corporations, p. 2358.

⁹ *Ibid.*

¹⁰ Brooklyn Steam Transit Co. v. Brooklyn, 78 N. Y. 524; People v. Rose, 207 Ill. 352, 69 N. E. 762.

¹¹ People v. Rose, *supra*.

1459 reserves to the legislative authority the power to amend the provisions of the same act or to dissolve all corporations by legislative enactment. With this provision the requirement of the courts of Illinois had been met, so that we can now say without hesitation that Section 19 is under no constitutional objection.

There is no doubt that, when the language of the statute is so broad as to admit of several interpretations, that construction which will preserve existing rights must be adopted. Altho there are states which require that the language must be strong and unmistakable as to authorize clearly an *ipso facto* dissolution,¹² yet the better view seems to be that the legislative intent should be sought. If the intention to forfeit is clear, the language does not need to be strong and unmistakable. To disregard the plain mandates of the law or to look beyond what is intended and demand for something more than what the law provides, is to resort to a technicality that tends to defeat honest ends. Finding cover under a mere legal technicality has never been favored. Such acts might be said to be artificial and temporary at best, for they can find no spontaneous support in public conscience. A legal technicality is a shield of brittle glass that crashes in all directions even when slight force is employed.

Altho in most cases the presence of the word "shall" implies a mandate or makes a certain provision unmistakably mandatory, yet there are cases when its inclusion will only serve to add confusion. Under the present topic of discussion, the addition of "Shall", altho useful, is not entirely indispensable. As a matter of fact, "cease" standing alone would better convey the idea of *ipso facto* dissolution. This term suggests abruptness of the termination of existence. It is self-sufficient and, as expressed in Section 19, carries with it a command to stop without delay. "Cease" prefixed with "shall" in a sense seems weak and vacillating. It lacks the tone of finality and sternness which the word "cease" alone carries. To cease means to halt, to stop absolutely, to put to a standstill. It is a command that implies unyielding power. When we say "Kill!" all the pent up desire is unleashed, all the might, all the fury is set loose, all savagery and relentlessness are set forth un-

¹² Nicolai v. Maryland Agricultural & Mechanical Assn.' 96 Md. 323, 53 Atl 965.

hampered. It is in the same tenor that the word "cease" has been used.

From the point of view of precedent, public policy, legislative intent and statutory language, I conclude that the first sentence of Section 19 of Act 1459 is self-executing.

(b) May the Due Incorporation of a De Facto Corporation Be Inquired Into Collaterally in a Private Suit?

As a general rule the existence of a *de facto* corporation cannot be attacked collaterally either by the state or by private individuals. Altho the organization may be defective and irregular only a direct proceeding for ouster from the corporate franchise may be resorted to.¹³ This rule is so well-defined that it has been admitted as among the axioms of law.

The great difficulty in applying the rule to certain state of facts has given rise to various rules which vary greatly in form. Probably, the best statement on the subject of collateral attack is that made by the Indiana court in the case of *Heaston v. Cincinnati & F. W. R. Co.*, 16 Ind. 275, as follows: "mere irregularities in organization cannot be shown collaterally, where there is no defect of power." So that where there is a valid law under which the *de facto* corporation has been colorably organized, the incorporation cannot be the subject of inquiry in a collateral proceeding.

This protection in favor of corporations are usually statutory in character. Altho there may be a difference in phraseology, yet the end sought is the same. There are some laws giving the courts at the instance of private persons the right to inquire into the existence of corporations when the charters are set up in support of acts injurious to the complaining party in his individual capacity. But such laws ought not to be interpreted as permitting inquiries regarding the validity of corporate charters in such proceedings.

In order that laws protecting private corporations from collateral attacks, the organization must claim in good faith that it is such a corporation and has been exercising corporate powers.¹⁴ The requisites necessary to constitute a corporation *de facto* must be shown in order to be placed within the confines of the statutory provision. This does not preclude an inquiry

¹³ *D. R. Wilder Mfg. Co. v. Corn Products Refining Co.*, 236 U. S. 165; *Tulare Irrigation Dist. v. Shepard*, 185 U. S. 1; *McPhee v. Reclamation Dist. No. 765*, 161 Cal. 566; *Hossack v. Ottawa Development Ass'n.*, 244 Ill. 274; *Cox v. State*, 144 N. Y. 396.

¹⁴ *Oroville & V. R. Co. v. Plumas County*, 37 Cal. 354.

as to whether or not there is a corporation *de facto*.¹⁵ The extent of the question may at times involve the question of the legal existence of the corporation.¹⁶

The doctrine of collateral attack does not apply to a case where persons were sued individually and who, in order to escape liability, set up the defense that the acts were done for a corporation. The defendants must prove the existence of the corporation and in so doing no collateral inquiry upon the validity of incorporation has been made.¹⁷ The legal provision cannot be used to defeat the assertion of just, legal rights by the parties, since the reason upon which it is based is founded upon the principles of public policy.¹⁸

As has been said at the beginning of this topic a collateral inquiry cannot be made against the corporation by either a private individual or by the state. The reason is based upon the grounds of public policy,¹⁹ founded upon the prohibition of the common-law against unauthorized corporate action,²⁰ for any other rule will be fraught with serious consequences and great public mischief.²¹ Another reason is that the rights and franchises of a corporation belong to the sovereign and he alone can inquire into the validity of corporate organizations. Before the sovereign attacks the due incorporation of an association the public should and must treat it as valid and exercising corporate powers under color of law. This is essential to the safety of business transactions with corporations.²² If collateral inquiries be permissible, disorder and confusion would be its natural consequence. The rights and interests of all persons dealing with corporations would always be embarrassed and in grave danger if the legality of its existence could be drawn in question in every suit to which the corporation is a party or in which the rights or questions involved springs out of the corporate existence.²³ This doctrine in relation to *de facto* corporations should not be confused with estoppel to deny

¹⁵ *Carey v. Cincinnati & C. R. Co.*, 5 Iowa 357.

¹⁶ *Kinston & C. R. Co. v. Stroud*, 132 N. C. 413.

¹⁷ *Owen v. Shepard*, 59 Fed. 746.

¹⁸ *Parks v. West* 102 Tex. 11 111 S. W. 796.

¹⁹ *Pape v. Capitol Bank*, 20 Kan. 440, 27 Am. Rep. 183; *State v. Honerud*, 66 Minn. 32, 68 N. W. 323; *Society Perun v. Cleveland*, 43 Ohio St. 481, 3 N. E. 357.

²⁰ *Miller v. Newburg Orrel Coal Co.*, 31 W. Va. 836, 8 S. E. 600.

²¹ *Buffalo & A. R. Co. v. Cary*, 26 N. Y. 75.

²² *Duggan v. Colorado Mortg. & Inv. Co.*, 11 Colo. 113, 17 Pac. 105; *Haas v. Bank of Commerce*, 41 Neb. 754, 60 N. W. 85.

²³ *Bibb v. Hall*, 101 Ala. 79, 14 So. 98.

corporate existence. According to the great weight of authority the rules in relation to collateral inquiry may be applied even though the elements of estoppel do not exist.²⁴

V. PENALTY

The penalty clause of Section 19 of our Corporation Law is of comparatively recent origin having been enacted in 1931 at the instance of Senator Teofilo Sison. The requirement that the corporation should report to the Director of the Bureau of Commerce and Industry before the fifth day of January of each year any cessation of business or change of address, established an effective means by which the business operations of companies organized under Act 1459 could be checked. Before the enactment of this amendment there is no way by which to determine the continuance of business operations except by the exercise of visitorial powers provided in Sections 54 of Act 1459 and by the bringing of a suit in court. But such remedies are not regular in character and comes only to the knowledge of the government and the public in rare cases. With the amendment provided by Act 3849 a regular check could be made. Of course a law may be created establishing officers the sole function of whom would be to keep watch over corporate operations, but such a step would mean unnecessary expenses when the same result could be accomplished by the amendment under consideration.

The wisdom of Act 3849 could not be doubted, for it serves as an answer to our long felt needs. In this respect the writer could do no better than to quote the following explanatory note:

"A corporation organized for a period of fifty years may go out of business the year following its incorporation and registration, and during the intervening period until the expiration of its duration, the promoters may and actually deceive the innocent public by selling the stocks of such defunct corporation. This proposed amendment to section 19 of our Corporation Law has for its aim the protection of the investing public from the perpetration of further frauds by unscrupulous business promoters who snare to deprive the innocent and unsuspecting investor of his hard-earned cash. Besides, it will remove one of the causes of the timidity of Filipinos to engage in business in which they do not take active part in its administration."

It is clear that in a complicated organization in which only a few—mostly large stockholders, take active participation the

²⁴ Stout v. Zulick, 48 N. J. L. 599, 7 Atl. 363; Buffalo & A. R. Co. v. Carv, 26 N. Y. 75; Society Perun v. City of Cleveland, 43 Ohio St. 481, 3 N. E. 357.

management of business operations, the small investors will be reluctant to put in his money. It is also clear that the innocent public is liable to become an easy prey to promoters who pretend to represent a successful business venture which in fact is otherwise. A prompt alleviation of any ill that they may create is indispensably necessary. By making corporations subject to the active and regular reach of the governmental arms a certain degree of confidence is inspired and doubting Thomases are lessened.

VI. CONCLUSION

There is no denying the fact that in our jurisdiction as elsewhere corporate existence is one long thorny way. Even before incorporation and up to the extinguishment of corporate life the provisions of legal enactments must always be complied with. This is extremely necessary for the protection of the public. As between the good of the greater number and the good of capitalists and investors, there is no middle ground. The attitude of the latter must be one of uncomplaining concentration in the observance of the laws of the realm to be at peace with the sovereign. The greatness of our Corporation Law lies in the fact that when the components thereof are recklessly oblivious of their task they destroy their own established condition of life. The existence of a corporation is only a lease which the state grants on the implied condition that it shall work no harm upon the common good. The whole theory of corporate polity rests on the assumption that it is a private as well as a public concern.