Pledge And Mortgage Of Shares Of Stock In The Philippines

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I

INTRODUCTION

LAW is a progressive sicence. The rate of its progress depends, to a large extent, on the advancement of the state. As time marches, new conditions may arise, and consequently, new laws are enacted to meet them and harmonize them with the proper order of society. In the words of Hon. M. F. Morris, late Associate Justice of the Court of Appeals of the District of Columbia, "the history of law is the history of our race, and the embodiment of its experience." (*Morris, History of the Development of Law, p. 1*).

The development of commercial law in the Philippines is an illustration of this growth. In the early days of our history, trade and commerce were so limited and localized that they were largely governed by local customs and practices. With the advent of western civilization in the Philippines, under the tutelage of Spain, commercial conditions gradually changed; and to cope with these changes, the Code of Commerce of Spain was extended to the Philippines, by the Royal Decree of August 6, 1888 and made effective as law on December 1, 1888. Since the American occupation, great strides have been made in the field of business and commerce. Our legislators, conscious of these changes, and responsive to the demands of modern business methods, have enacted new laws which have repealed, superseded or modified many articles of the Code of Commerce of Spain. The most important of these is the Corporation Law (Act No. 1459) which was enacted in 1906.

In 1906, there were only few stock corporations in the Philippines. Pledges and mortgages of shares were then very rare. Hence, the Philippine Commission might not have thought of inserting any provision in the Corporation Law on this subject. In 1928, their number considerably increased, but still, the Philippine Legislature in Act No. 3518 (which amended many provisions of Act 1459) did not provide anything definite concerning pledges and mortgages of shares. Sub-section 10 of Section 10 (added by the amendatory act of 1928) includes, in the enumerated powers of corporations, the power of pledging and mortgaging shares of stock. Nothing is provided as to how shares of stock are to be pledged or mortgaged.

For a period of three years, from November 11, 1936 to November 11, 1939, after the establishment of the Securities and Exchange Commission, 985 stock corporations have been incorporated and registered.

Shares of stock, as a species of property, have multiplied to such an extent that a very large portion of the capital of the country

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is invested in 'shares'. The daily transactions in large commercial and moneyed centers are of great magnitude. Certificates representing large sums of money, invested in such securities pass from hand to hand with almost the rapidity and ease of commercial paper or money itself. It will thus be seen that the manner in which this species of property may be transferred is a matter of no inconsiderable interest and importance. (*Wood vs. Maitland, 10 Phila. (Pa.) 84, 85*). Yet our law on this point is lamentably inadequate. Our Supreme Court, in the case of *Chua Guan vs. Samahang Magsasaka* (*G. R. No. 4209, 34 O. G. 130*) said: "We are fully conscious of the fact that our decisions in the case of *Monserrat vs. Ceron, supra,* and in the present case have done little perhaps to ameliorate the present uncertain and unsatisfactory state of our law applicable to pledges and chattel mortgages of shares of stock of Philippine corporations."

Due to the rapid growth of stock corporations in the Philippines, there is an imperative necessity for a definite and settled law on the pledges and mortgages of shares. In modern commerce, the sale and pledge of stock form such important factors in financial operations that it is of the utmost consequence that the legal mode of effecting such sales and pledges should be definitely ascertained and freed from doubt. * * * In such matters, a vacillating jurisprudence is more disastrous in its effects than even an erroneous one. (*Pitot v. Johnson, 32 La. Ann. 1286*).

It is, therefore, the purpose of this study to find such law from our statutes and jurisprudence, and if there is room for improvement, to humbly offer some recommendations to our law-making body.

The scope of this work is limited to the determination of the legal mode of effecting pledges and mortgages of shares of stock of Philippine corporations.

II

NATURE OF SHARES OF STOCK

A. IN GENERAL

1. As Personal Property

A share of the capital stock of a corporation is defined as the interest or right which the owner has in the management of the corporation in its surplus profits, and upon dissolution, in all its assets remaining after the payment of its debts. It simply represents his proportional interest in the concern, in the capital and net earnings, and fixes the amount which he has paid or must pay as his contribution to the corporate assets. (*14 C. J. par. 506*).

Although shares of stock "are intangible and rest in abstract legal contemplation," they, nevertheless, are property. The opinion in the early American cases that shares of stock of corporations owning real estate are real property has been abandoned. It is now generally agreed that shares of stock in corporations are personal property whether they are declared to be such by statute, as is sometimes the case, or not, as in the case of mining companies, railroad companies, canal companies, and the like, or only personal. (*14 C. J. par. 510*). Section 35 of the Corporation Law expressly provides that shares of stock are "personal property."

2. Non-negotiability

Certificates of shares of stock are not in a proper sense negotia-

ble instruments either in form or character, even though a form of assignment and power of attorney to make the necessary transfer accompanies the certificates and is signed in blank by the owner; and they are not governed by the laws relating to such instruments; nor are they commercial paper. (*14 C. J. par. 1034*). They are non-negotiable in the sense that a complete transfer of title, good not only between the parties but also against the corporation itself and third parties, can be made only in pursuance of the governing statutes: and in the Philippines, only after "the transfer is entered and noted upon the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of the certificate, and the number of the shares transferred." (*Sec. 35, Corporation Law*).

3. Quasi-negotiability

In view, however, of the fact that certificates of stock, while not negotiable in the sense of the law merchant, like bills and notes, are so framed and dealt with as to be transferable, when properly indorsed, by mere delivery, and as they frequently convey, by estoppel against the corporation or against prior holders, as good a title to the transferee as if they were negotiable, and, inasmuch as a large commercial use is made of such certificates as collateral security, and it is to the public interest that such use should be simplified and facilitated by placing them as nearly as possible on the plane of commercial paper, they are often spoken of and treated as quasi-negotiable, that is, as having some of the attributes and partaking of the character of negotiable instruments, in passing from hand to hand, especially where they are accompanied by an assignment and power of attorney, executed in blank, to transfer them to anyone who may obtain possession as holders, even though such assignment and power are under seal. (*14 C. J. par. 1034*).

B. Distinguished From Other Personal Property

1. As "indebtedness", "credit", "money", etc.

According to the weight of authority, a share of stock or the certificate thereof is not an indebtedness to the owner nor evidence of indebtedness; and therefore it is not a "credit" or within the terms "money and credits"; nor is it "money" or a "security for money", or representative thereof, and it will not pass under a mere bequest of money. In these respects, therefore, a share of stock is distinguished from a corporate bond, the distinguishing feature of which is that it is an obligation to pay a fixed sum with interest (*14 C. J. par. 511*).

2. As chose in action.

Strictly speaking, a share of stock is not, like a note, a chose in action, but is analogous to, and in the nature of, a chose in action and has repeatedly been so classified. (*14 C. J. par. 512*).

C. As a Subject of Pledge and Mortgage

1. As a Subject of Pledge

Being personal property, can shares of stock be a subject of pledge? Since stock is of an incorporeal nature and there cannot be a manual delivery, thereof, strictly speaking, it is not capable of being pledged; but it may be, and frequently is, hypothecated,

which is a pledge in a secondary sense. (*14 C. J. par. 1101*). The Roman hypotheca was a security device without the transfer of possession. It is in this sense that a share of stock is now generally treated as being capable of being pledged as collateral security. (*Germania Nat. Bank vs. Case, 99 U. S. 628, 25 L. ed. 448*).

2. As a Subject of Mortgage

In the United States, shares of stock in a corporation may be mortgaged though it is not often done. (*Fletcher Cyclopedia of Corporations, Perm Ed. Sec. 3944*). In the Philippines, "the practical application of the Chattel Mortgage Law to shares of stock of a corporation presents considerable difficulty and we have obtained little aid from the decisions of other jurisdictions because that form of mortgage is ill suited to the hypothecation of shares of stock and has been rarely used elsewhere. In fact, it has been doubted whether shares of stock in a corporation are chattels in the sense in which that word is used in chattel mortgage statutes". (*Fua Cun vs. Summers, 44 Phil. 705*). But this long-mooted question as to whether or not shares of a corporation could be hypothecated by placing a chattel mortgage on the certificate representing such shares is now regarded as settled in the affirmative by the case of *Monserrat vs. Geron, G. R. No. 37078, 32 O. G. 2041*. Our Supreme Court reiterated this ruling in the case of *Bachrach Motor Co. vs. Ledesma, G. R. No. 42462, Lawyers' Journal, Vol. V, p. 976*, in which the court said: "Un certificado de acciones, o de dividendos de acciones, bajo la ley de corporaciones, son casi documentos negotiables en el sentido de que pueden darse en prenda o hipoteca para garantir una obligacion."

So in the Philippines, as elsewhere, shares of stock of a corporation can be the subject of pledge and mortgage.

III

PLEDGE

A. In General

1. Definition and Nature

In general, pledge is "un contrato accesorio, real y unilateral, celebrando en garantia de una obligacion anterior y perfecta, mediante la entrega que el deudor hace de una cosa al acreedor a la tercera persona, por virtud del cual, y cumplida que sea la obligacion garantizada, debe el acreedor restituir la cosa al deudor con sus frutos y accesiones." (*Sanchez Roman, Derecho Civil, 2nd ed., Vol. IV, pp. 971-972*).

Under the codes of some states of the United States, every contract by which the possession of personal property is transferred as security is held to be a pledge. The contract of pledge or pawn forms one of the most important subdivisions of the general law applicable to bailments, and is included by all modern text writers and judges, following the analogy of the Roman Law, in the class designated as compensated. In the Roman Law, the name applicable to this kind of contract was *pignus*. The difference between a *pignus* and a hypothecation consisted in this: in the former the possession of the thing pledged passed to the pledgee, while in the latter it did not. Under the laws of some states there are two kinds of pledges—the pawn and antichresis. A thing is said to be pawned when a movable is given as a security: the antichresis is when the security given consists

in immovables. The use of the term "collateral security" when the debtor transfers to his creditor an article of value or an evidence of debt, is intended to express that it is not received in payment of the principal debt, and that it is not an additional right to which the creditor is absolutely entitled. It is merely a concurrent security for another debt, whether antecedent or newly created, and is designed to increase the means of the creditor to realize the principal which it is given to secure. It is subsidiary to the principal debt, running parallel with it, collateral to it; and when collected is to go to the credit of the principal debt, or if the principal debt be paid off, the debtor is entitled to the restoration of the collateral security. Though perhaps it is true that every transfer of an article of value for the purpose of securing the payment of an obligation due to the transferee may entitle such article to be called a collateral security, yet the term as generally used is much more limited in its signification and is applied to incorporeal personality. (*21 R. C. L., Pledge, par. 1*).

B. REQUISITES AND FORMALITIES

1. In General

In accordance with the rules which pertain to the requisites and validity of a pledge generally, in order to constitute a pledge of stock, there must be a contract, whereby the stock is held as security. (*14 C. J. par. 1103*). But there is no provision in the Corporation Law, express or implied, as to how shares are to be pledged, so the rules governing the subject must be sought in the law relating to the encumbrance of other personal property. (*Fisher, Philippine Law of Stock Corporations, pp. 159-160*).

Our only law on the contract of pledge is found in the Civil Code (Arts. 1857-1873). According to Art. 1857, the following are the essential requisites of the contract of pledge:

1. That they be constituted to secure the performance of a principal obligation.

2. That the thing pledged is owned by the person who pledges it.

3. That the persons who constitute the pledge have the free disposal of their property, or, should they not have it, they are legally authorized for the purpose.

It is essential that a pledge be constituted to secure the performance of a principal obligation, because, as defined above, a pledge is inherently an accessory contract. The shares of stock pledged must also be owned by the person who pledged it, because to pledge is an exercise of the "jusdisponendi." The pledger must also have the free disposal of the stock pledged, or if he does not have it, he must legally be authorized to do so, because to pledge that which he cannot freely dispose or authorized to dispose may constitute a violation of Art. 319 No. 2 of the Revised Penal Code.

However, the debtor may again pledge his stocks already pledged with the prior authority of the first pledgee. So that where stock is pledged and delivered to another subject to the lien of the first pledgee, the possession of the certificate by the latter may be regarded as the possession of the second pledgee through the agency of the first pledgee. (*14 C. J. par. 1105*).

2. Delivery and Possession

Art. 1863 of the Civil Code provides: "Besides the requisites mentioned in Article 1857, it is necessary, in order to constitute

the contract of pledge, that the pledge be placed in the possession of the creditor or of the third person designated by common consent."

We have heretofore said that shares of stock are intangible property. How can we then effect its delivery? Will symbolic delivery suffice?

In the case of *El Banco Español-Filipino vs. Peterson (7 Phil. 409)*, the court held that: "The symbolic transfer by means of the delivery of the keys of the premises in which are stored the goods pledged is sufficient to consider the creditor, or the depositary appointed by common consent of the parties, in legal possession of the same."

We cannot conclude from this case that symbolic delivery is sufficient, because the transfer of the keys of the "bodega" is, by express provision of Article 1463 of the Civil Code, equivalent to actual delivery. In a much later case (*Pacific Commercial Co. vs. Philippine National Bank, 49 Phil. 236*), it was said that: "To make a written instrument, which is in form and substance a pledge of personal property, valid as to third persons, it is necessary to take the actual possession of the property and to continue in such possession." Again, in the case of *Betita vs. Ganzon (49 Phil. 87)*, the Supreme Court held: "It is of course evident that the delivery of possession referred to in Article 1863 implies a change in actual possession of the property pledged and that a mere symbolic delivery is not sufficient."

From Art. 1863 of the Civil Code and from these decisions, it would seem that in the Philippines, shares of stock cannot be legally pledged. But inasmuch as the Civil Code contemplates the pledge of personal property "capable of being possessed", we should not strictly apply its provisions on this particular subject to the pledge of shares of stock which are not "capable of being possessed" physically.

Shares of stock are evidenced by their corresponding certificates. They are merely the paper representatives of the incorporeal right, and stands on the same forting as other muniments of title. It is not in itself property, but is merely the symbol or paper evidence of property. (*10 Cyc. p. 588*). But as it undoubtedly has a value in itself as a transferable symbol of property and evidence of the holder's right and title as a stockholder, like a negotiable instrument, it has often been held to be in itself property as representing the stock and so treated for many purposes. (*14 C. J. par. 703*). Thus, in some jurisdiction in the United States, stock certificates may be made the subject-matter of a suit in replevin, or if such certificates are dealt with wrongfully by the person having the possession of them, an action may be maintained for conversion thereon, and in some jurisdictions, they are the subject of larceny. (*14 C. J. pars. 703-705, Footnote No. 53-a*). *If the certificate is in itself property representing the stock, we see no reason why it can not be delivered in lieu of the share of stock which is physically impossible of actual delivery.*

The doctrine that there can be no legal pledge without possession of the security resting in the pledgee has to some extent yielded to experience. Complete surrender by the pledgor was found to be inexpedient. Thus the delivery of the goods is no longer absolutely essential. (*Equitable Liens & Pledges, Columbia Law*

Review 37:621-30 Ap'37). So that it is now generally accepted that since shares of stock, like choses in action and other incorporeal property, are not capable of manual delivery, possession can only be delivered, and therefore can only be pledged, by a written transfer of title. (*Fletcher, Encyclopedia of Corporations, Perm. Ed. Sec. 3905*). Such transfer of title performs the same office the delivery of possession does in case of a pledge of corporeal property. The transfer of the title, like the delivery of possession, constitutes the evidence of the pledgee's right of property in the thing pledged. (*Nisbit v. Macon Bank & Trust Co. 12 Fed. 686*).

The certificate of stock which is given by the corporation to the stockholder as the representative of the interest to which the stockholder is entitled has too many characteristics of tangible property, and could too conveniently be treated as the property itself to escape such treatment; and therefore, for all purposes of buying, selling, pledging, and contracting generally between person and person in the open market, the business world has treated these paper certificates, for practical purposes, as actual property. (*Notes, Mapleton Bank v. Standrod, 67 L. R. A. 656*).

We, therefore, come to the conclusion that, delivery of possession of shares of stock pledged can be made only by a written transfer of title, such as by a transfer to the pledgee on the books of the company, or without such transfer by delivery of the certificate with a written assignment and power of attorney to transfer the stocks on the books of the company. (*14 C. J. par. 1104*). In the latter case, mere delivery of the certificate is not sufficient. The pledgee must be expressly a certain amount of control over the stock. In the case of *Misbit v. Macon Bank & Trust Co., supra*, it was held that when the pledgers of stock retain the title and control of the stock pledged, and the power of withdrawal and substitution, so that they can transfer or negotiate the same without consulting the pledgee, while the pledgee could not control the stock, without consulting the pledgors, the mere deposit of the stock certificate (standing in the name of the pledgers) with the pledge does not create a valid pledge thereof. On the other hand, a mere power of attorney authorizing transfer of the stock on the company's books without delivery of the certificate is not sufficient. In the case of *Bidstrup v. Thompson (45 Fed. 452)*, defendant, being the owner of shares of corporate stock, deposited the certificate with a trustee under an agreement with the other shareholders that the stock should not be taken out of his possession or put on the market before a certain time, and took a receipt from the trustee reciting such facts. Afterwards he delivered the receipt to intervenor, with a power of attorney in blank authorizing the transfer of the shares on the company's books; but he gave the intervenor no order for the delivery of the certificate, and no notice was given to the trustee of the transfer. The court held that under Art. 3158 of the Civil Code of Louisiana, providing that "when a debtor wishes to pawn . . . stocks . . . he shall deliver to the creditors the . . . certificates . . . so pawned," was no pledge of shares as against an execution creditor of defendant. *Therefore, to constitute a valid delivery of possession of shares of*

stock pledged, there must be not only an actual delivery of the certificate to the pledgee or bailee, but also a written assignment and power of attorney to transfer the stocks on the books of the company.

This requisite is most essential, and is characteristic of a pledge, without which, the contract cannot be regarded as entered into or completed, because, precisely, in this delivery lies the security of the pledge. Therefore, in order that the contract of pledge may be complete, it is indispensable that the aforesaid delivery takes place. (*12 Manresa, p. 411*).

3. *Date Evidenced by a Public Instrument*

In the United States, it is not essential that the contract of pledge be a formal one, for it may be implied in or inferred from the facts and circumstances of the case; as where the maker of a note, as security, delivered to the payee a certificate of stock, and the payee notified the corporation that he held such certificate as collateral security and requested an assignment on the books of the company, this was sufficient to justify a finding that the payee held the certificate as collateral security; or where a plaintiff, desiring a financially irresponsible person to become a stockholder in a corporation, became surety for money which the latter borrowed to pay for the stock, and plaintiff's testimony that such person agreed to leave his certificaate in the stock book as security for plaintiff, and as to all the circumstances of the transaction, was only denied to the extent of the buyer's testimony that plaintiff never said anything to him about having a lien on the stock, there was evidence to show that the stock was pledged to secure plaintiff. (*14 C. J. par. 1103, Footnote No. 41-a*).

In the Philippines, a pledge may be constituted orally or in private instrument and be valid as between the contracting parties and their assigns provided that the amount of the prestation of one or of the two contracting parties does not exceed ₱300.00. (Art. 1280 Civil Code).

But Article 1865 (Civil Code) provides that: "a third person, when the certainty of the date does not appear in a public instrument."

The Supreme Court, in the case of *Ocejo, Perez & Co. vs. International Bank, 37 Phil. 631* held that "the principle established by Article 1865 of the Civil Code is not adjective in its character, but that it prescribes a condition without which the contract pledge cannot adversely affect third persons." However, in a subsequent case (*Mahoney vs. Tuason, 39 Phil. 952, 958*) the court seems to modify this requirement. It says: "Article 1865 of the Civil Code provides that no pledge shall be effective against a third person unless evidence of its date appears in a public instrument. The provision of this article has, undoubtedly, been modified by section 4 of the Chattel Mortgage Law, in so far as it provides that a chattel mortgage shall not be valid against any person except the mortgagor, his executors or administrators, unless the possession of the property is delivered to and retained by the mortgagee or unless the mortgage is recorded in the office of the Register of Deeds of the province in which the mortgagor resides. * * * From the date the said Act No. 1508 was in force, a contract of pledge * * * shall be deemed legally entered into and should produce all its effects and

consequences, provided it appears to have been in some manner perfected and that the things pledged have been delivered. * * *"

The doubt seems to be set at rest in the latter case of *Te Pate vs. Ingersoll, 43 Phil. 394, 396,* in which the court held: "A pledge, to be valid against third persons, must be evidenced by a public instrument. This is a mandatory condition prescribed by Article 1865 of the Civil Code, which must be met in order to constitute the contract of pledge." The court, in pointing out the wisdom of this provision, quoted Manresa: "Considering the effects of a contract of pledge, it is easily understood that, without the warranty demanded by law, the case may happen wherein a debtor in bad faith from the moment that he sees his movable property in danger of execution may attempt to withdraw the same from the action of justice and the reach of his creditors by simulating, through criminal confabulations. anterior and fraudulent alterations in his possession by means of feigned contracts of this nature; and, with the object of avoiding or preventing such abuses, almost all the foreign writers advise that, for the effectiveness of the pledge, it be demanded as a precise condition that in every case the contract be executed in a public writing, for, otherwise, the determination of its date will be rendered difficult and its proof more so, even in cases in which it is executed before witnesses, due to the difficulty to be encountered in seeking those before whom it was executed.

"Our code has not gone so far, for it does not demand in express terms that in all cases the pledge be constituted or formalized in a public writing, nor even in private document, but only that the certainty of the date be expressed in the first of the class of instruments in order that it may be valid against a third party * * *"

"That is to say, what the law wishes in the precept we are examining is to impose the existence, not only of an efficacious and authentic means of proof of the constitution of a pledge, but also of a security of its certainty and the reality of the pledge in order to avoid frauds and damages to the creditors, arising from the bad faith of the debtor.

"There exists another reason which justifies the precept we are discussing. In fact, from the contract of pledge arises the preference established in No. 2 of Article 1922, respecting the credits guaranteed by the thing pledged which is in possession of the creditor, up to the amount of its value, which preference may be opposed against third parties; and, in order that the latter may not be prejudiced, it is necessary that the date of the contract be expressed in a true, indubitable and authentic manner and that it be certain to the end that even the bare possibility of fraud and of collusion between the creditor keeping the pledge and the debtor owner thereof may be excluded." (*Tec Bi & Co. vs. Chartered Bank of India, 41 Phil. 596, 608-610*).

But in the recent case of *Bachrach Motor Co. Inc., vs. Ledesma, G. R. 42462, August 31, 1937,* the court reaffirmed its ruling in the case of *Mahoney vs. Tuason, supra* said: "En su segundo señalamiento de error la demandante sostiene que la prenda es invalida en cuanto a ella porque la certeza de su fecha no se hizo constar en documento publico, y concluye que su derecho a los 6,300 dividendos en acciones es superior

y preferente. Está admitido que la entrega del certificado y la prenda del mismo no se consignaron en documento publico.

"Es cierto, segun el Articulo 1865 del Codigo Civil, que para que una prenda sea valida contra terceros, además de entregarse el objeto del acreedor, la certeza de su fecha debe constar en documento publico. Y se ha interpretado este precepto en el sentido de que para perjudicar a tercero el contrato debe expresarse en documento publico, además de la entrega del objeto. (Ocejo, Perez & Co. contra international Bank J. F., 656; Tec Bi contra Chartered Bank of India, Australia & China, 41 J. F., 635; Te Pate contra Ingersoll, 43 J. F., 413.) Pero es innegable que el artículo 4 de la ley 1508, conocido por Ley de Hipoteca de Bienes Muebles, enmendó implicítamente el artículo 1865 del Codigo Civil en el sentido de que la prenda y la hipoteca de bienes muebles, para que sean eficaces contra terceros, no necesitan hacerse constar en documentos publicos con tal de que el objeto sea entregado ó puesto en posesión del acreedor. En el asunto Mahoney contra Tuason, 39 J. F., 976, que es donde se sentó esta doctrina, se dijo: 'De las prescripciones de la Ley citada en sus dos artículos preinsertos se infiere que la misma no deroga en absoluto las disposiciones del Código Civil, sino que las modifica en parte y las amplia en otra como es de ver caminando y comparando las disposiciones contenidas en los articulos del Código que tratan de la prenda y las que expresa la citada Ley No. 1508. Dice el artículo 1865 del Código Civil que no surtirá efecto la prenda contra tercero, si no consta por instrumento publico la certeza de la fecha. El precepto de este artículo indudablemente ha sido modificado por el artículo 4.o de la Ley Hipotecaria de Bienes Muebles en cuanto establece que una hipoteca de bienes muebles no será valido contra ninguna persona sino contra el deudor hipotecario, sus albaceas ó administradores, a menos que la posesión de la propiedad sea entregada y conservada por el acreedor hipotecario, o a menos que la hipoteca esté registrada en la oficina del registrador de titulos de la provincia donde reside el deudor hipotecario. Desde la vigencia de la citada Ley No. 1508 debe entenderse celebrado legalmente el contrato de prenda o el de hipoteca de bienes muebles y se ha de presumir todos sus efectos y consecuencias, siempre que conoce perfeccionado de alguna manera el contrato y entregadas las cosas pignoradas, o en otro caso y aunque el acreedor no haya recibido, estas ni estuviere en posesión de las mismas con tal que se haya hecho constar el contrato de prenda o hipoteca de bienes muebles en documento notarial y estuviere inscrito el documento en el registro de titulos de la provincia.' Declaramos, por consiguiente, que la prenda de los 6,300 dividendos en acciones es valida contra la demandante por haberse entregado el certificado al banco acreedor y no obstante no haberse consignado el contrato en documento publico."

Although amendment by implication is not favored, it is, therefore, now settled that the pledge is valid without the date being evidenced in a public instrument, provided the certificates are indorsed and delivered to the pledgee or bailee. We think that so far as pledge of shares of stock is concerned, this rule is more in accord with business needs. Mere contingent fears and bare possibil-

ities of fraudulent pledges of shares of stock, which are not the ordinary course, must give way to the demands of business expediency.

4. *Transfer or Registration on Corporate Books; Notice to Corporation*

We have thus far laid down the undisputed requisites for the validity of a pledge in general, which are also applicable to pledge of shares of stock. But shares of stock are of such an intangible character that it is somewhat difficult to see how it can be treated exactly as other chattels or personal property. In view of the peculiar nature of shares of stock, a serious question arises as to whether or not other requisites are necessary, such as a transfer of the certificate on the books of the corporation to the pledgee or a notice to the corporation of the existence of such pledge. Of course, as between the parties, there is no necessity of further formalities. As between the parties to the transaction, such contract is unquestionably valid. The difficulty arises when it affects third persons. (*Bank of P. I. v. Caridad Estate, etc., CA G. R. No. 16, Lawyers' Journal, Vol. VII, p. 850*).

In the United States, the rule is not uniform. The divergency is "attributable, for the most part, to the peculiar terms of the statute of the various states, bearing upon the question, and to difference in construction of like and similar statutes by the Courts of different states." (*Weber v. Bullock, 19 Colo. 274, 35 Pac. 183*). Some states require transfer on the corporate books by the issuance of a new certificate with a notation that the registrant's interest is that of a pledgee only; while other states require mere notice to the corporation; and still other states do not require either transfer or notice. In the absence of any such statute, the conflicting decisions are caused by the application to the solution of the problem of two principles of law which are well settled and perfectly equitable in and of themselves, and the only uncertainty is as to which one should control the answer to the question under consideration. The first rule is that a man cannot sell what he does not own, and that his creditors are not entitled to apply to the satisfaction of his debts the property of strangers. The other rule is that one man will not be allowed to give another a fictitious credit by making him the ostensible owner of property belonging to the former, and, after credit has been accorded him on the faith of such property, withdraw it from the reach of the creditors by asserting his own claims. (*Notes, Mapleton Bank v. Standrod, 67 L. R. A. 656*). We shall proceed with each one of these questions.

a. Necessity for Transfer

In Massachussets, it was provided that a pledgee of stock transferred as collateral security shall be entitled to a new certificate if the instrument of transfer substantially describes the debt or duty which is intended to be secured thereby and that such new certificate shall express on its face that it is held as collateral security, and that the name of the pledgor shall be stated thereon, who alone shall be liable as a stockholder; and entitled to vote thereon. The purpose of this provision is to enable a pledgee to procure a certificate in his own name without assuming the liability of a stockholder, and also to protect the stock so

transferred against attachments or other accruing claims against the apparent owner of record. (*Fletcher, Cyclopedia of Corps., Perm. Ed. Sec. 3907; Athol Sav. Bank v. Bennet, 203 Mass. 480, 89 N. E. 632; Chase v. Boston, 193 Mass. 522, 69 N. E. 736*). But this rule was subsequently changed by the legislature (*Andrews v. Worchester, 159 Mass. 64*), and the present rule even gives validity to a sale of stock as against a subsequent attaching creditor of transferer, although the transfer of the stock is not made on the books of the company. (*Boston Music Hall Association v. Cory 129 Mass. 435*).

In Iowa, transfer on the corporate books is also required but the statute further provides that "notice to the secretary of the corporation of that fact shall be equivalent to a transfer on the books, although no such transfer is actually made." The statute further requires the secretary to keep a record showing such notice, which shall be open to the public. (*Fletcher, Cyc. of Corp.. Perm. Ed. Sec. 3907; Tierney v. Ledden. 143 Iowa 286, 21 Ann. Cas. 105, 121 N. W. 1050*).

This strict rule, however, is modified by the interpretation made by the courts on the statutory provision. Thus, in *Baldwin vs. Canfield* (*26 Minn. 43*), the court held that statutory provisions that the stock of a corporation shall be transferred only on its books are intended only for the protection and benefit of the company, and a pledge of the certificate is good as against a subsequent purchaser from the pledgor who did not require the certificate to be transferred to him.

In *Masury vs. Arkansas Nat. Bank* (*93 Fed. 603*), the court said: "In a great number of cases it has been held, and such must be regarded as the prevailing rule, that such a provision when found either in a special charter or in a general incorporation act, or in the by-laws of a corporation, is intended to prescribe a method of transfer which shall be deemed effectual, as between the corporation and its stockholders, in all matters relating to the internal government and management of the corporation, rather than to prescribe a method of transfer which must be observed as between a stockholder and third parties. Notwithstanding such a provision in the character of a corporation, a stockholder may divest himself of all beneficial interest in his stock by a written assignment of the same and a delivery of his stock certificate or as some authorities (Cook, pp 308, 375) say, "by the delivery of his stock certificate without indorsement, although no transfer is made on the books of the corporation."

Thus, in those states of the United States where there is a provision requiring a transfer on the corporate books, the courts did not apply it to pledges of shares on the ground that such a provision is intended for the protection of the corporation and persons dealing with it, and not to operate in favor of subsequent purchasers and creditors.

In the Philippines, there is no direct provision of law requiring or not requiring transfer in cases of pledge on the company's books.

Sec. 35 of the Corporation Law provides: "The capital stock of stock corporations shall be divided into shares for which certificates signed by the president or the vice-president, countersigned by the secretary or clerk and sealed with the seal of the corporation, shall be issued in accordance with the

by-laws. Shares of stock so issued are personal property and may be transferred by delivery of the certificate indorsed by the owner or his attorney in fact or other person legally authorized to make the transfer. *No transfer, however shall be valid, except as between the parties, until it is entered and noted upon the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of the certificate, and the number of shares transferred.*

"No shares of stock against which the corporation holds any unpaid claim shall be transferrable on the books of the corporation." (Italicized ours).

Until September 27, 1933 (date of the decision of the case of *Monserrat vs. Ceron, G. R. 37078, 32 O. G. 2041*), the pledgee's safety required not only the execution of a public instrument evidencing the pledge and the delivery of the certificate, but the transfer of the shares to him, as pledgee, on the books of the issuing corporation, if its officers can be induced to register such a conveyance (Fisher, Philippine Law on Stock Corporation, par. 109). But in the case last mentioned, the court said: "The legal provision just quoted (Sec. 35) does not require any entry except of transfers of shares in order that such transfers may be valid as against third persons. Now what did the Legislature mean in using the word 'transfer'?

After a thorough discussion on the meaning of this word, the court concluded that: " Only the transfer or absolute conveyance of the ownership of the title to a share need be entered and noted upon the books of the corporation in order that such transfer may be valid. "

In the case of *Bank of P. I. vs. Caridad Estates, etc., C.A. G.R. No. 16; Lawyers' Journal, Vol. VII, p. 850*, the court said: "A chattel mortgage upon shares delivered to the mortgagee or one registered in the corresponding registry of deeds need not be entered and noted upon the books of the corporation. Registration in the books of the corporation is not necessary for its validity. This rule is applicable to pledges of corporate shares."

The applicability refers to "chattel mortgage upon shares delivered to the mortgagee" only, because in pledge, there is only one way of effecting it. The Court, however, continued: "A chattel mortgage or pledge of corporate shares unregistered in the books of the corporation, though valid as between the parties cannot prejudice or affect a third party unless he had notice or knowledge thereof."

Standing by itself, it would appear that registration in the books of the corporation is necessary in pledges of shares to affect third persons. But this should not be the case, because the preceding part (quoted above) specifically says that "Registration in the books of the corporation is not necessary." Besides, in this particular case, "if the agreement was a pledge of the shares to the corporation, such pledge would not be valid, for the shares were not delivered to the corporation as pledge; if it were a chattel mortgage, this also would not be valid, because it was not registered in the corresponding registry of deeds, nor was there a delivery of the shares to the mortgagee."

A pledge, not being an absolute conveyance of the ownership

of the title, it follows that in the Philippines as in some states of the United States having a similar provision, a transfer of the certificates in the name of the pledgee or its registration in the corporate books is not required for its validity.

b. *Notice to Corporation*

In some states of the United States, where shares of stock are by charter or statutory provision transferrable only on the books of corporation, a pledgee of shares who fails to have the transfer registered takes the risk of a lien acquired by bona fide purchasers or pledgee from the pledger, who appears on the books of the corporation as owner, or at a sale under an execution against him, and, in some jurisdiction, of an attachment or execution by creditors of the pledgor. (*Fletcher, Cyc. of Corp. Perm. Ed. Sec. 3902; Cecil Nat. Bank v. Watsontown Bank 105 U. S. 217; see also Sec. 1626, Statute of Iowa, Sec. 1924, Gen. Stat. of Connecticut.*)

But in the states of the Union where there are no such statutes, the great majority of the courts have acceded to the demand of business interests that an indorsement and delivery of the certificates themselves is sufficient to effect a valid pledge of shares of stock.

In Missouri, it was held that a pledge of capital stock by a transfer in blank on the back of the certificate which is penned to the note secured, is valid in respect to form. (*McClintosh v. Central Bank of Kansas City, 120 Mo. 129, 24 S. W. 1052*).

The New Jersey Courts have held that, by a commercial usage as universally acknowledged by the business community as the law of commercial paper, a certificate of stock accompanied by irrevocable power of attorney, is presumptive evidence of ownership in the holder. And, where he is a holder for value, his title cannot be impeached. Under this well-recognized principle, large amount of property pass from hand to hand; are sold and resold, or hypothecated for loans, without an actual transfer, on the books of the company. (*Prall v. Tilt, 28 N. J. Eg. 480*).

In Pennsylvania, it was held that where the stock of a corporation is assigned to the corporation itself as security for a loan, the title of the assignor to the stock is so far divested that it would not be sold under an execution against him. (*Early's Appeal, 89 Pa. 411; Ely v. Guest, 94 Pa. 160*).

In New York, the delivery of the certificate properly indorsed transfers all the interest of the recorded owner, leaving no interest either legal or equitable, in him which is subject to seizure under attachment. (*Dunn vs. Star F. Inc. Co. 19 N. Y. Week Dig. 531*).

In Ohio, an assignment of stock for the benefit of creditors, although not entered on the books of the company, has precedence over a subsequent attachment against the assignor, since the attachment can reach only the interest which the debtor has. (*Halderman v. Hillsborough & C. R. Co. 2 Handy (Ohio 1101.*) Also in (*Dunster vs. Glenyall; 3 Ir. Ch. Rep. 47*), it was held that the statute permitting the interest of a judgment debtor to be charged operated only upon the interest which he actually had at the time the order was passed; so that in case he had made an assignment of shares of stock as collateral security, a charging order,

even on a judgment previously entered, would not take precedence of the rights of the assignee.

Some states, in response to business demand, have enacted statutes providing that indorsement and delivery of the certificate to the pledgee is sufficient to constitute a valid pledge. An example is Art. 180, p. 370 of 1904 Louisiana statutes which provides: "Be it enacted that the delivery of a stock certificate of a corporation to a bona fide purchaser or pledgee, for value, together with a written transfer of the same in a written power of attorney, to sell, assign, and transfer the same, signed by the owner of the certificate, shall be a sufficient delivery to transfer the title as against all parties."

Under this statute, it was held that a pledge of stock is valid, though the corporation was never notified thereof, since when a thing done is sufficient, there can be no necessity for doing anything more. (*First National Bank of Lake Charles v. Bell 74 S. 628*). To the same effect is the case of *Factors' and Traders' Inc.. Co. vs. Marine Dry Dock and Shipyard Co., 31 La Ann. 149* which held that in order to make the pledge of a certificate of the stock of a corporation valid as to third persons, it is not necessary to give the company notice of the pledge.

In Wisconsin, the law provides: "The delivery of a stock of a corporation to a bona fide purchaser or pledgee for value, together with a written transfer of the same signed by the owner of the certificate, his attorney or legal representative, shall be a sufficient delivery to transfer the title as against all persons."

In the Philippines, there is no provision of law requiring notice of the pledge to the corporation. The stocks and transfer books are open to the inspection of only the directors and stockholders of the corporation and not the public. (Sec. 52, Corporation Law.) We have already alluded to Sec. 35 of the Corporation Law requiring that the transfer be entered and noted upon the books of the corporation, but as already held by the Supreme Court in the case of *Monserrat vs. Ceron (supra)*, such requirement refers only to absolute conveyance and not to assignments for collateral security.

We may, therefore, say that in the Philippines, like most states of the United States, registration or notice to the corporation is not necessary to make a pledge valid as regards third persons.

(To be continued)