Pledge And Mortgage Of Shares Of Stock In The Philippines

By PRAX R. VELONO *

(Continued from last month)

C. EFFECT OF BY-LAWS REQUIRING TRANSFER OR REGISTRY ON BOOKS

1. Definition and Nature

By-laws are the relatively permanent and continuing rules of action adopted by the corporation for its own government and that of the individuals composing it and having the direction, management and control of its affairs, in whole or in part, in the management and control of its affairs and activities. (*Fletcher, Cyc. of Corps., Perm. Ed. Sec. 4161*).

Every corporation has the power to make by-laws, not inconsistent with existing law, for the fixing or changing of the number of its officers and directors within the limits prescribed by law, and for the transferring of its stock, the administration of its corporate affairs, the management of its business, and *the care, control, and disposition of its property.* (*Sec. 13, par. 7, Corporation Law;* underscores supplied).

Although the by-laws of a corporation may provide for the disposition of property, such by-laws, to be valid, must not only be reasonable, but must also be consistent with the articles of association as well as the Corporation Law or charter, as the case may be.

2. Effects upon Third Person.

Persons dealing with a corporation or with its stockholders are chargeable with notice of, and are bound by, all by-laws which are in express terms authorized by the charter of the corporation. They are also bound by by-laws of which they have actual notice. But they are not chargeable with notice of by-laws not expressly authorized, and are not bound thereby unless they have actual notice of them. This is true, for example, of by-laws imposing limitations upon the apparent powers of particular officers of a corporation with respect to the making of contracts, the issue of certificate stock, *transfers of stock, etc., by-laws not expressly authorized, reserving a lien on shares of stocks for debts from the stockholders, etc.* As a rule, by-laws merely regulating the management of a corporation and duties of its officers, etc. are not intended to and do not affect the rights of third persons dealing with the corporation. If a person contracts with a corporation with reference to a by-law, the by-law becomes a part of his contract, and he may enforce the same; but it is otherwise if he does not contract with reference to or on the faith of the by-laws. (*Ballantine, Manual of Corporation Law and Practice, pp. 604-605.*)

Some Philippine corporations provide in their by-laws the requirement to register notice of any lien on the books of the corporation. A typical example of these

* LL.B., College of Law, University of the Philippines.

by-laws is that of the Syndicate Investment, Inc. which is also quoted in its certificate of stock. It provides:

"Art. V. Sec. 4: Transferees, mortgagees, and pledgees of stock of the corporation, or of any interest therein, shall promptly transfer the same or register notice of their lien, upon the books of the corporation, and their failure to do so shall estop them from making any claim against the corporation by reason of the issuance of another certificate in the name or to the order of the owner or registered holder of the original certificate, either because of purported loss, theft, or destruction of the original certificates, or from any other reason. Transferees, mortgagees, and pledgees of the stock of the corporation, or any interest therein, are required to ascertain from the stock certificate and stock transfer books of the corporation that the corporation has no claims or defenses against the holder or registered owner of the certificates subject to all such claims or defenses noted therein. This section shall not be construed as a limitation or waiver of any rights, claims, or defenses not noted on the stock certificates and stock transfer books of the corporation."

There is no doubt that although the pledgee has secured a good title, he may be estopped by his conduct from asserting it against claims which subsequently accrue. If the assignee permits an actual transfer on the books of the corporation under a title secured by execution sale against the assignor, he cannot recover damages from the corporation for failure to recognize his title. (*Littel vs. Scranton Gas & Water Co., 2 Luzerne Legal Obs. 82*).

In Noble vs. Tuner, 169 Md. 519, 16 Atl. 124, the shares in question had been transferred by the Sheriff under an attachment levy, and the pledgee had permitted the transferee to act as stockholder for seven years without giving notice of his right. The Court said that by reason of the laches of the pledgee, the corporation had been compelled to recognize the rights of the execution purchaser. As against the company the pledgee is clearly and conclusively estopped from asserting his claim In this case, there are no circumstances excusing or explaining the delay in asserting the pledgee's right.

But the overwhelming weight of authority is to the effect that a by-law requiring transfer on the books of the corporation does not prevent a pledgee of the stock from acquiring a good title as against a subsequent attachment by creditors of the pledgees. (*Seeligson vs. Brown, 61 Tex. 114; Tombler vs. Palestine Ice Co. 17 Tex. Civ. App. 596; 43 S. W. 896; South Texas Nat. Bank vs. Texas & L. Lumber Co. 30 Tex. Civ. App. 412, 70 S. W. 768; Hamilton vs. San Antonio Foundry Co. 51 S. W. 1104*).

In Pennsylvania, failure to record a transfer required by the by-laws of the corporation does not subordinate the rights of the transferee to subsequent attachment, or execution against the transferor. (*Telford & F. Turnip Co. vs. Cerhob [Pa.] 13 Atl. 90*).

In Louisiana, where stock was pledged as collateral and subsequently claimed by assignee for the benefit of the creditors of the pledgor, the court held that although it is true that the stock is transferrable only on the books of the corporation in accordance with its by-laws, this simply means that the corporation will not recognize anyone as the owner of the stock who is not the transferee on its books of the person to whom the certificate was issued. But this has nothing to do with the rights which other persons may acquire as between themselves and the stockholders by the pledge and delivery of the certificate; and

it was held that the pledge prevailed as against the claims of the assignee. (*Blowin vs. Hart, 30 La. Ann. 714*).

Therefore, failure to register or to give notice to the corporation of a pledge of its stocks, when its by-laws so require, does not prejudice the rights of the pledgee as against subsequent transferees or creditors of the pledgor.

D. SUMMARY

From the foregoing, the following are the essential requisites and formalities of a pledge of shares of stock, in order to be valid not only as between the parties, but also against third persons:

1. That the pledge is constituted to secure the performance of a principal obligation.
2. That the shares of stock pledged are owned by the pledgor.
3. That the pledgor has the free disposal of his shares of stock, or, should he not have it, he is legally authorized for that purpose.
4. That the possession of the stock pledged be delivered to the pledgee by means of:

(a) An indorsement in blank on the back of the certificate of the share pledged, and,

(b) The actual delivery of such certificate to the pledgee.

5. Date of pledge need not be evidenced by a public instrument.
6. Transfer or registration on corporate books is not necessary.
7. Notice to the corporation of the existence of such pledge is not necessary.

MORTGAGE

A. IN GENERAL

1. Definition

Section of Act No. 1508, entitled "The Chattel Mortgage Law," reads:

> "A chattel mortgage is a conditional sale of personal property as security for the payment of a debt on the performance of some other obligation specified therein, the condition being that the sale shall be void upon the seller paying to the purchaser a sum of money or doing some other act named. If the condition is performed according to its terms the mortgage and sale immediately become void, and the mortgagee is thereby divested of his title."

A chattel mortgage is a contract which purports to be, and in form is a sale of personal property, intended as security for the payment of a debt, or in the performance of some other obligation specified therein, upon the condition subsequent that such sale shall be void upon payment of the debt or performance of the specified obligation according to the terms of the contract. (*Bachrach Motor Co. vs. Summers, 42 Phil. 3*).

A chattel mortgage, like a pledge, is an accessory contract. The debt is the principal thing. The mortgage is but an incident to the debt. (*Bachrach Motor Co. vs. Esteva and Teal Motor Co., G. R. No. 402233*).

2. Chattel Mortgage and Pledge Dstinguished.

The distinctions between a pledge and a mortgage of personal property are (1) in the former the title is retained by the pledgor, while in the latter it passes to the mortgagee; (2) the delivery of the possession of the property to the pledgee is absolutely essential to a pledge, while between the parties, but not against creditors or purchasers, such delivery is not necessary to the validity of the mortgage.

The pledgee acquires only a special property, which is not enlarged by the mere fact that the pledgor fails to pay the debt at the time specified; whereas by such

a failure the legal estate of the mortgagee becomes *ipso facto* complete and absolute. A mortgage of goods is something more than a pledge. It is a pledge to become an absolute interest, if not redeemed at the specified time. After the condition is forfeited, the mortgagee acquires absolute interest in the thing mortgaged; whereas a pledgee has but a special property in the goods to detain them for his security. Upon a pledge of property as security for a debt the pledgee has only special property. The general property is in the pledgor, subject to the rights of the pledgee. In brief, a pledge differs from a mortgage in that the pledgee must have possession and the pledgor retains the legal title to the property, while a mortgage passes the legal title to the mortgagee and may allow the possession to remain in the mortgagor. (*5 R. C. L. Chattel Mortgage, par. 7*).

Strictly, a chattel mortgage is not a pledge of personal property as that term is defined in the Civil Code. Where a pledge of personal property exists the title remains in the pledgor and does not pass to the pledgee. Moreover, where there is a pledge the property pledged is liable for any debts which the pledgor may create in favor of the pledgee during the existence thereof. This is not the case with a chattel mortgage. Furthermore, in case of pledge, the property pledged must be delivered to the pledgee or to some third person in his behalf; in case of a chattel mortgage such delivery is not necessary. Finally, the act of pledging creates a preference in favor of the pledgee which gives him certain advantages over the other creditors of the pledgor. Such is not the case in a chattel mortgage. A chattel mortgage creates no preference in favor of the mortgagee, as the word preference is used in the Civil Code. It is rather a sale of property by which the vendor divests himself of the title in favor of the vendee subject to the possibility of such title being defeated by the payment of the money or the performance of the act required by the terms of the mortgage. A chattel mortgage relates to specific personal property. A preference does not refer to specific property but is simply a prior right to share in the assets of the debtor after they have been marshalled and converted into money. A chattel mortgage has nothing to do with the marshalling of the assets of the debtor or with the money into which those assets are converted. It deals exclusively with the specific property described in the mortgage and for that reason is wholly different from the right of preference. No one can take the title away from the mortgagee except the mortgagor and he only in the manner prescribed by the mortgage itself. Generally, therefore, after the execution of a chattel mortgage and its registration as required by law, nobody can obtain an interest in that property adverse to that of the mortgagee. As a necessary result it is clear, as we have already stated, that a chattel mortgage cannot be considered a pledge of the property which it covers. Nor does it give a preference with regard to the general property of the debtor as that word is defined in the Civil Code. It would be contradictory and absurd to say that a mortgagee has a preference with regard to property which he himself owns. A preference can exist only with respect to property

which is owned by the debtor. (*In re Du Tec Chuan, 34 Phil. Phil. 488*).

It is often difficult to determine whether a certain transaction is a mortgage or a pledge, when possession of the property is delivered to the creditor. The question is one of construction, and depends upon the intent of the parties. In case of doubt the law favors the conclusion that the transaction is a pledge rather than a mortgage. And it has been said that "the general rule is that an assignment and transfer of shares of stock in a corporation by a debtor as security for a debt is a pledge and not a mortgage." If shares of stock are transferred on the books of the corporation or by assignment and delivery of the certificate, with the intention that they shall be held merely as collateral security, and returned on payment of the debt, the courts will give effect to the intention of the parties, and hold the transaction a pledge and not a mortgage. Although the apparent legal title may be vested by the transfer in the pledgee, the general property as between the parties, will remain in the pledgor. If there is no delivery, the transaction will be held to be a mortgage. The two forms of security may be combined into one, and the same transaction may partake the nature of both. (*Fletcher, Cyclopedia of the Law of Private Corporations, par. 3814*)

3. Chattel Mortgage and Sale with "Pacto de Retro" Compared.

In the case of *Meyers v. Thein, 15 Phil. 303*, the Court held that: "* * * (2) that, under Act No. 1508, a chattel mortgage is a sale with "pacto de retro", almost equivalent to that under the same name in the Civil Code; (3) that as a contract of sale with "pacto de retro" where the juridical dominion and possession of the thing sold pass to the purchaser as soon as the sale is consummated, so also in a chattel mortgage the dominion and possession of the mortgaged personal property pass to the creditor-pledgee, because, as the law provides, it is nothing more than a conditional sale; (4) that, in the same manner that a contract of sale is consummated by the delivery, either actual or symbolic, of the thing sold, which symbol of the delivery may be the inscription of the instrument in the registry, so also a chattel mortgage is consummated by a similar delivery, actual or symbolic, by means of an analogous inscription in the registry."

B. REQUISITES AND FORMALITIES

1. In General

There is no provision in the Corporation Law as to how shares of stock can be mortgaged. Hence, we have to refer to the Chattel Mortgage Law for the legal method of effecting a mortgage of stock.

The necessary elements of a valid contract must, of course, be present. But such contract must be made substantially in accordance with the form prescribed in Sec. 5 of Act 1508, and must be signed by the person or persons executing the same, in the presence of two witnesses, thereof, and the mortgagor and mortgagee, or, in the absence of the mortgagee, his agent or attorney, shall make and subscribe an affidavit that the mortgage is made for the purpose of securing the obligation

specified in the conditions thereof, and for no other purpose, and that the same is a just and valid obligation, and is not entered into for the purpose of fraud, which affidavit, signed by the parties to the mortgage as stated, and the certificate of oath signed by the authority administering the same, shall be appended to such mortgage and recorded therewith. (*Sec. 5, Act 1508*).

Failure to comply substantially with this form is fatal to the validity of a mortgage as against third persons. Our Supreme Court, in the case of *Betita vs. Ganson, 49 Phil. 87,* referring to certain document purporting to be a chattel mortgage, said: "That it is not a sufficient chattel is evident; it does not meet the requirements of section 5 of the Chattel Mortgage Law (Act No. 1508), has not been recorded, and, considered as a chattel mortgage, is consequently of no effect as against third parties."

The lack of the affidavit of good faith is likewise fatal to the validity of the mortgage. In the case of *Giberson vs. A. N. Jureidini Bros., 44 Phil. 216,* the court said: "The trial judge held, and properly, that Exhibit I was invalid because the oath required by law did not appear therein, and because the subject-matter was not described therein with sufficient particularity. The Chattel Mortgage Law, in its section 5, in describing what shall be deemed sufficient to constitute a good chattel mortgage, includes the requirement of affidavit of good faith appended to the mortgage, and recorded therein. It has been held by reputable courts that the absence of the affidavit vitiates a mortgage as against creditors and subsequent encumbrances."

Such affidavit must also be made by both the mortgagor and the mortgagee. One made by the mortgagor only is insufficient and does not entitle the instrument to be recorded. (*Lovell v. Osgood, 60 N. H. 71*).

Sec. 4 of the Chattel Mortgage Law provides:

"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 same, or if he resides within the Philippine Islands, in the province in which the property is situated. Provided, however, That if the property is situated in a different province from that in which the mortgagor resides, the mortgage shall be recorded in the office of the register of deeds of both province in which the mortgagor resides and that in which the property is situated, and for the purpose of this Act the City of Manila shall be deemed to be a province."

There are therefore two ways of executing a chattel mortgage, valid against third persons, the possession of the property mortgaged must be delivered to and retained by the mortgagee; or, without such delivery, the mortgage must be recorded in the proper office or offices of the register or registers of deeds (*E. C. McCullough & Co. v. Zoboli, 28 Phil. 301*).

2. Mortgage by Delivery of Possession

We have already seen that because of the intangible character of the shares of stock, actual delivery of the same is impossible. Hence, like a pledge, the delivery of possession in a chattel mortgage of shares of stock must consist in the actual delivery of the certificate of the stock pledged, indorsed in blank, together with the mortgage deed.

The execution of the mortgage deed is essential, although the possession of the shares is delivered to the mortgage, because Sec. 5 of Act 1508 does not make any distinction. Hence, an omission of the mortgage deed would make the transaction a mere pledge, if the certificates are delivered.

But the possession by the mortgagee dispenses with the necessity of an affidavit. The purpose of the statute in requiring the affidavit is to guard against the making of fraudulent or fictitious mortgages, which would enable the mortgagor to retain possession of the property and set his creditors at defiance. Therefore the omission of the affidavit does not invalidate the mortgage as against a subsequent purchaser or mortgagee, or an attaching creditor, provided the mortgagee has taken and retained possession of the property. Such possession is notice of the mortgagee's interest. (*Gording vs. Riley, 50 N. H. 400; Clark v. Tarbell, 57 N. H. 328; overruling dictum to the contrary in Janurin vs. Fogg 49 N. H. 340*).

3. Mortgage without Delivery of Possession

When a chattel mortgage of shares is made without the delivery of possession of the certificates of the stock pledge, registration is necessary.

In passing, it must be noted that the registration of a chattel mortgage in the office of the corporation is not necessary and of no legal effect.

In the case of *Monserrat vs. Ceron, supra,* the Court said: "The chattel mortgage is not the transfer referred to in section 35 of Act No. 1459 commonly known as the Corporation Law, which transfer should be entered and noted upon the books of a corporation in order to be valid, and which means the absolute and unconditional conveyance of the title and ownership of a share of stock. If, in accordance with said section 35 of the Corporation Law, 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, therefore, inasmuch as a chattel mortgage of the aforesaid title is not a complete and absolute alienation of the dominion and ownerships thereof, its entry and notation upon the books of the corporation is not a necessary requisite to its validity."

Again, 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 of a chattel mortgage of shares is not necessary for its validity."

The proper place of registration of such a mortgage is fully explained by the Supreme Court in the case of *Chua Guan vs. Samahang Magsasaka, Inc., supra*: "Section 4 provides that in such a case the mortgage shall be registered in the province in which the mortgagor resides at the time of making the same or, if he is a non-resident, in the province in which the property is situated, and it also provides that if the property is situated in a different province from that in which the

mortgagor resides the mortgage shall also be recorded in the province where the property is situated.

"If with respect to a chattel mortgage of shares of stock of a corporation, registration in the province of the owner's domicile should be sufficient, those who lend on such security would be confronted with the practical difficulty of being compelled not only to search of every province in which the mortgagor might have been domiciled but also every province in which a chattel mortgage by any former owner of such shares might be registered. We cannot think that it was the intention of the Legislature to put this almost prohibitive impediment upon the hypothecation of shares of stock in view of the great volume of business that is done on the faith of the pledge of shares of stock as collateral.

"It is a common but not accurate generalization that the situs of shares of stock is at the domicile of the owner. The term situs is not one of fixed or invariable meaning or usage. Nor should we lose sight of the difference between the situs of shares and the situs of the certificates of shares. The situs of shares of stock for some purposes may be at the domicile of the owner and for others at the domicile of the corporation; and even elsewhere. (*Cf. Vidal vs. South American Securities Co., 276 Fed. 855; Black Eagle Min. Co. vs. Conroy, 94 Okla., 199; Norris vs. Kansas City Southern Ry. Co., 7 Fed. (2d)* 159). It is a general rule that for purposes of execution, attachment and garnishment, it is not the domicile of the owner of the certificate but the domicile of the corporation which is decisive. (*Fletcher, Cyclopedia of the Law of Private Corporations, Vol. 11, par. 5108. Cf. sections 430 and 450, Code of Civil Procedure.*)

"By analogy with the foregoing and considering the ownership of shares in a corporation as property distinct from the certificates which are merely the evidence of such ownership, it seems to us a reasonable construction of section 4 of Act No. 1508 to hold that the property in the shares may be deemed to be situated in the province in which the corporation has its principal office or place of business. If this province is also the province of the owner's domicile, a single registration is sufficient. If not, the chattel mortgage should be registered both at the owner's domicile and in the province where the corporation has its principal office or place of business. In this sense the property mortgaged is not the certificate but the participation and share of the owner in the assets of the corporation."

C. SUMMARY

From the foregoing, we see that under the Chattel Mortgage Law as applied to shares of stock, the following are the essential requisites and formalities of a chattel mortgage of shares of stock in order to be valid, not only as between the parties, but also as against third persons:

A. Mortgage by delivery of possession.
   1. Indorsement in blank certificates of shares mortgaged.
   2. Delivery of said certificate to mortgagee.
   3. Mortgage deed substantially in accordance with the form prescribed in Sec. 5, (Act 1508).

(a) Affidavit of good faith may be dispensed with.

B. Mortgage without delivery of possession.

1. Mortgage deed substantially in accordance with the form prescribed in Sec. 5, (Act 1508).

(a) Affidavit of good faith is indispensable.

2. Registration of mortgage deed in the registry of deeds of the

(a) Province in which the mortgagor resides at the time of making the same, and

(b) Province in which the corporation has its principal office or place of business. If this province is also the owner's domicile, a single registration is sufficient.

(c) Registration in the office of the corporation is not necessary and of no legal effect.

V

CRITICISM OF OUR PRESENT LAW

A. PLEDGE

If our conclusions on the requisites and formalities for the validity of a pledge of shares of stock can be sustained as the definite law on the subject, we think that business demands will be served. But inasmuch as even our Supreme Court hesitates to interpret the Law definitely, we deem it necessary to make certain criticisms with the view of suggesting a few changes on our law on the pledge and mortgage of shares of stock.

1. Requirement for Transfer on Books of Company.

Transfer of the stock to the lender as security for the loan against the right of attaching or execution creditors will at once destroy the pledger's character as corporator. He forfeits his share of control of the business of the corporation. Why should the owner of stock be deprived of the privilege of mortgaging or pledging his stock for the security of a loan, without stripping himself of all his rights of ownership? (*Broadway Bank v. McElrath 13 N. J. Eq. 24.*)

In the case of *Com. v. Watmough, 6 Wheat 117,* in response to the argument that the same rule should be applied as is applicable to actual transfer of possession of personal property, and that the only mode of effecting a notorious transfer is to effect it on the books of the corporation, the Court said: "Stock from its very nature, is incapable of such possession so as to make it known or notorious who has the use or benefit of it, and thus raise a general belief in regard to the ownership thereof; even its existence may be unknown, excepting comparatively to but few persons. The only evidence of it that can be safely treated as to this is the books of the bank or the corporation; but they, being of a private nature, are not open to public inspection. Hence, it is, that the ownership of such stock, though held by the owner in his own name on the books of the corporation is not supposed to have given him a general credit with the world. And for the same reason, if held by another in trust for him, the trustee is never supposed by reasons of its standing in his own name on the

books of the corporation, to have obtained a general credit on account of it. It is not, therefore, to apprise the world and prevent it from giving a false credit to the apparent owner of stock that the transfer thereof is required be made on the books of the bank in the presence of one of its officers."

2. *Requirement of Notice to Corporation.*

Many courts of the United States have criticized this rule. In *Cormick v. Richard, 3 La. 1,* the Court said: "In adopting a rule as to the transfer of this peculiar kind of property, we should look to the nature of the property, the uses to which it is put in the transaction of the business of the country, and at the same time not be unmindful of the established habits of dealing with the same among businessmen: this last should have an influence in this question of full weight, because we may be assured that what has been universally agreed on and established as the custom of such merchants is the result of a felt need that has been met by the keenest practical sagacity dealing with the question. * * * The universal practice is to transfer the certificate of stock with a power of attorney in blank to be filled up authorizing a transfer by the corporations on its books to the purchaser, on the presentation of which power, properly authenticated, the corporation transfers the stock to the purchaser or holder, and, when the sale is absolute, it is usual to issue new certificate to the party, taking up the old. Such a practice facilitates the easy use of this property in commercial transactions. The requirement that the title could alone be transferred in the books of the corporation, or by notice to the corporation would greatly tend to trammel this use; and as far as we can see, notice to the corporation can serve no practical end, and has no appropriate place in the transaction so far as passing the title from a holder to a purchaser, or the right of creditor as a purchaser, for he can, as he will always do, protect himself by requiring an assignment of the certificate, and then a transfer on the books of the corporation. The rule requiring transfer on the books of the corporation can only be served to give credit on the faith of the stocks, over the other who has advanced his money on them and taken the evidence of his security by a transfer of the certificate. In such contest, the equities are altogether in favor of the assignee, who has advanced his money on the faith of the collateral."

In *Masury v. Arkansas Nat. Bank, 93 Fed. 603,* the Court said that: "If the section of the act now under consideration is construed so as to embrace a pledge of stock certificates, as well as absolute sales of stock, such requirement will needlessly embarass and restrict the circulation of such securities and prevent their use for legitimate business purposes. It is a well-known fact that stock certificates frequently circulate in places far remote from the home of the corporation by which they were issued, that in all commercial centers they are commonly transferred from hand to hand like negotiable paper, and that they are hypothecated for temporary loans by a single indorsement and delivery thereof, the latter being perhaps the most

common use to which such securities are put. In the great majority of cases where stock is merely pledged for a loan no record of the transfer is made on the books of the corporation, and in the judgment of laymen, the making of such a record seems to be needless formality. The trend of modern decisions has been to encourage the free circulation of stock certificates in the mode last indicated, on the theory that they are valuable aid to commercial transactions, and that the public interest is best subserved by removing all restrictions against their circulation, and by placing them as nearly as possible on the plane of commercial paper. In the state of Massachusetts, where a different rule once obtained and was for a long time adhered to (*Foster v. Bank, 3 Gray 373; Newell v. Williston 138 Mas 240*), a law has been enacted which makes the delivery of a stock certificate, with a written assignment indorsed thereon, effectual to convey a title to the stock as against all parties, thereby confirming the law as it has been established by the great weight of judicial opinion is most of the other states." Cook (*Cook on Corporation, 5th Ed. Art. 49*) closes his discussion on this question as follows:

"It may be added, in regard to this whole subject that the decisions and statutes of the various states show clearly that public policy and the legitimate demands of trade have gradually caused the courts and legislatures of the various states to establish the rule that a sale or pledge of certificate of stock has precedence over a subsequent attachment levied on that stock for the benefit of the vendor or pledgor, and that the failure of the pledgee or purchaser of the certificate to obtain a registry on the corporate books is not fatal to his interest in the stock. In the great commercial centers, where certificates of stock pass from hand to hand, and are pledged to bank and financial institutions daily to secure sums of money, the necessity of such a rule is imperative."

Corporate books are usually kept secret, and the mere fact that a person's name appears in such books as a stockholder has no tendency to give him a fictitious credit, except with persons who have a right of access to the books. Moreover, persons intending to purchase or extend credit on the faith of stock usually require the production of the certificates, and do not institute a search through the offices of the numerous corporations of the country to ascertain the financial standing of the one with whom they are to deal. It is only when a creditor is searching for property on which to levy that he looks into the corporate books, and it is no fraud upon him, when he has found property apparently belonging to his debtor, to compel him to recognize the rights of persons who have advanced money on the property, and taken the shares into their possession. (*Notes, Mappleton Bank vs. Standrod, 67 L. R. A. 656*).

B. MORTGAGE

As to the first mode of constituting a mortgage of shares of stock, that is, by delivery of certificates of the stock mortgaged, this has been criticized as leaving the mortgagee without remedy in case the shares have been transferred to subsequent innocent purchasers. The Court in the case of *Chua Guan vs. Samahang Magsasaka, supra*, said: "Apart from

the cumbersome and unusual method of hypothecating shares of stock by chattel mortgage, it appears that in the present state of our law, *the only safe way to accomplish the hypothecation of shares of stock of a Philippine corporation is for the creditor to insist on the assignment and delivery of the certificate and to obtain the transfer of the legal title to him on the books of the corporation by the cancellation of the certificate and the issuance of a new one to him.* From the standpoint of the debtor this may be unsatisfactory because it leaves the creditor as the ostensible owner of the shares and the debtor is forced to rely upon the honesty and solvency of the creditor. Of course, the mere possession and retention of the debtor's certificate by the creditor give some security to the creditor against an attempted voluntary transfer by the debtor, provided the by-laws of the corporation expressly provide that transfer may be made upon the surrender of the certificate. It is to be noted, however, that Section 35 of the Corporation Law (Act No. 1459) provides that shares of stock 'may be transferred by delivery of the certificate endorsed by the owner or his attorney in fact or other person legally authorized to make the transfer.' The use of the verb 'may' does not exclude the possibility that a transfer may be made in a different manner, thus leaving the creditor in an insecure position even though he has the certificate in his possession. Moreover, the shares still standing in the name of the debtor on the books of the corporation will be liable to seizure by attachment or levy on execution at the instance of other creditors. (*Cf. Uy Piaco vs. McMicking, 10 Phil. 286, and Uson vs. Diosomito, 33 Off. Gaz. 1635*)" (*underscores supplied*).

With due respect, we beg to differ from the opinion of the Honorable Court. It is admitted that the suggestion of the court is a safer way but it is not "*the only safe way.*" In the first place, the Supreme Court, in the prior case of *Monserrat vs. Ceron, supra,* held that "the notation upon the aforesaid books of the corporation, of a chattel mortgage instituted on the shares of stock in question is not necessary to its validity." In the case of *Bank of P. I. vs. Caridad Estates, etc., supra,* the court reiterated that ruling. It said: "A chattel mortgage 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 of a chattel mortgage of shares is not necessary for its validity." Now, if this is the rule, is the mortgagee bound to go beyond where the law stops?

If the law says 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 . . " (Sec. 4), and if delivery of possession has been construed, so far as the shares of stock are concerned, to consist in the indorsement in blank and delivery of the certificate to the mortgagee, why should he be required further to obtain the transfer of the legal title to him on the books of the corporation by the cancellation of the certificates and the issuance of a new one to him? When a transaction done is sufficient, there can be no necessity for

doing anything more. Whatever more might be done would be mere surplusage. (*First National Bank of Lake Charles vs. Bell, 74 S. 628*).

Furthermore, the creditor-mortgagee is not entirely insecure. Suppose the shares have been transferred to a subsequent transferee. The creditor has no recourse against the corporation if the corporation had no knowledge of the pledge, but he may have recourse against the subsequent transferee, and that depends as to who between them has the better right. Inasmuch as our law is silent on this point, the better right should be determined by priority. In the case of *Everett vs. Farmer's, etc. Bank, 82 Neb. 191, 117 N. W. 401,* the Court said: "Our own statute failing to provide the manner of bringing about a transfer of capital stock, and failing to prescribe the rights of the parties when there is failure to indorse the assignment upon the books of the company, we need only to consider those decisions treating of similar cases and conditions, and to determine the priority of the parties in the absence of legislation."

Reasoning by analogy, since our Corporation Law is silent as to how shares of stock can be mortgaged, and consequently, as to the rights of the parties thereto and third persons, we may apply then the principle we have already referred to: that a man's creditors are not entitled to apply to the satisfaction of his debts the property of strangers, and as to whether such property belongs to a stranger can only be determined by the priority of each other's right. If his right is prior, he is not insecure. In Chapter III of this work, we have cited cases giving preference to the mortgagee-creditor.

The Court also attributed the insecurity to the possibility of the shares mortgaged to being attached and, in support of this statement, cited the case of *Uson vs. Diosomito, 33 O. G. 1635.* We believe that this case is not in point. In this case, the defendant was a prior purchaser of the shares in question but he failed to register the same, and, consequently, the court awarded the shares to the purchaser at the execution sale. The transaction is a purchase and sale, in which the law expressly requires registration on the books of the corporation, being an absolute conveyance. But in a case of mortgage, in which the Corporation Law is silent, and in which the Chattel Mortgage Law, if applicable, provides only for a delivery of possession as a requisites to affect third persons for the first mode, the same ruling, certainly, cannot be applied. Granting that the shares mortgaged are attached, the creditor-mortgagee may timely intervene, and his prior right cannot be disregarded, in the absence of statute giving to the attachment creditor the better right.

Therefore, a mortgage of shares of stock by delivery of possession is not an unsafe way of effecting mortgage under the present law. It is, of course, much safer than the second mode, in which the certificate is left in the possession of the mortgagor.

As to the second mode (mortgage without delivery of possession but by registration), we submit the same objections as in the requirement of transfer or notice to the corporation in the case of pledge. The only difference lies in the place of registration, and that in the case of mortgage the

books of the register of deeds are open to public inspection. But the principle is the same. Such requirement curtails the business utility of shares of stock as we have pointed out.

RECOMMENDATIONS AND CONCLUSIONS

In the previous chapters, we have tried to determine our present law on the pledge and mortgage of shares of stock. Likewise, efforts have been made to determine the business needs and expediencies as to the control and disposition of shares of stock. We find that the two do not lie on the same plane. Business needs have considerably increased. On the other hand instead of growing correspondingly, our law on this particular subject has not progressed.

The need for new legislation on this matter is not very recent. (*Fisher, par. 109*). Our Supreme Court has joined the call for legislation. In the case of *Chua Guan vs. Samahang Magsasaka, supra*, it says: "Loans upon stock securities should be facilitated in order to foster economic development. The transfer by indorsement and delivery of a certificate with intention to pledge the shares covered thereby should be sufficient to give legal effect to that intention and to consummate the juristic act without registration.

"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. The remedy lies in the legislature."

It is submitted that our findings as to the requisites and formalities for the pledges of shares of stock be given effect by a definite provision of law.

It is likewise submitted that since the capital stock of a corporation is not 'goods and chattels,' within the meaning of the act covering chattel mortgages, a mortgage of such stock need not be filed in accordance with the provisions of that act. (*Williamson vs. New Jersey S. R. Co., 26 N. J. Eg. [11 C. E. Green] 398*), but the same requisites and formalities as in pledges of shares of stock should be required in the mortgage of the same, the only difference being in the intention of the parties and in their legal effect.

It is therefore respectfully recommended that the National Assembly amend Section 35 of Act 1459 so as to read as follows:

"SEC. 35. 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 *ARE TRANSFERRABLE ONLY* BY DELIVERY OF THE CERTIFICATES INDORSED BY THE OWNER OR HIS ATTORNEY IN FACT OR OTHER PERSON LEGALLY AUTHORIZED TO MAKE THE TRANSFER. NO TRANSFER, HOWEVER, SHALL BE VALID, *AS AGAINST THE CORPORATION*, UNTIL 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 SHARES TRANSFERRED.

"THE DELIVERY OF A CERTIFICATE OF STOCK TO A BONA FIDE

PLEDGEE OR MORTGAGEE OR HIS AGENT, FOR VALUE, TOGETHER WITH AN INDORSEMENT IN BLANK AT THE BACK OF THE CERTIFICATE AUTHORIZING TRANSFER OF THE SAME, SIGNED BY THE OWNER OF THE CERTIFICATE, HIS ATTORNEY, OR LEGAL REPRESENTATIVE, SHALL BE SUFFICIENT TO MAKE THE PLEDGE OR MORTGAGE VALID AS AGAINST ALL PERSONS.

"NO SHARES OF STOCK AGAINST WHICH THE CORPORATION HOLDS ANY UNPAID CLAIMS SHALL BE TRANSFERABLE ON THE BOOKS OF THE CORPORATION."

The change from *"may be transferred"* to *"are transferable only"* is intended to limit the mode of transfer to the delivery of the certificate only, and to forestall the possibility that a transfer may be made in a different manner. Thus, this protects whoever is the holder of the certificate.

The omission of the words *"except as between the parties"* is intended to make valid all transfers by delivery as against all persons except the corporation. Although this has not been dealt with directly in the previous chapters, this is also suggested in consonance with the general principles we have discussed and to follow the "trend of modern decisions to encourage the free circulation of stock certificates . . . on the theory that they are valuable aid to commercial transactions, and that the public interest is best subserved by removing all restrictions against their circulation, and placing them as nearly as possible on the plane of commercial paper." (*Masonry vs. Arkansas, supra*). The exception to the validity of the transfer *"as against the corporation"* is intended to protect the claims of the corporation against the stockholder on record and to enable the corporation to know who are its stockholders for the purposes of its internal government and distribution of dividends.

The second paragraph of the proposed amended article is an answer to the demands of the business world, so far as pledges and mortgages of shares are concerned. The possibility of fraud is minimized by the words *"to a bona fide pledgee or mortgagee for value."*

It is hoped that should this proposed amendment be enacted into law, the present ambiguities will be definitely settled, and the interest of all concerned will be best protected and promoted.