Notes and Comments:

Pledges and Mortgages of Shares of Stock

Introduction—A Bit of History

Pledge is one of the most ancient of legal institutions. We find in the Hebraic law of Moses [1] and Deuteronomy [2] precepts seeking to mitigate the rigor with which the Jewish pledgee enforced his rights under the contract. The Greeks also had it and extended the concept to include real property.[3] The Romans gave this contract special attention; its evolution from the primitive *mancipatio cum fiducia* shows this clearly.[4] The early Spanish codes [5] carried it over almost bodily from the Roman law, the original concept suffering but slight variations. Finally we find that our new Civil Code has reenacted substantially the provisions of the old one on pledge.

From Moses and millstones to Bocobo and shares of stock is a long jump. A juridical institution has to be extremely flexible to survive; it must adjust itself to a changed economic environment, an environment where corporations play a large role. Just how well pledge has adapted itself to the needs of present day finance and commerce it is the task to this inquiry to determine.

While pledge is of venerable antiquity, chattel mortgage is comparatively new. Unknown in Spanish law, it was introduced into our law on July 2, 1906 by Act No. 1508. Because pledge and chat-

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[1] Exodus 22: 26-27. If thou take of thy neighbor a garment in pledge, thou shalt give it him again before sunset. For that same is the only thing wherewith he is covered, the clothing of his body, neither hath he any other to sleep in: if he cry to me, I will hear him, because I am compassionate.

[2] Deuteronomy 24: 6, 10-13. Thou shalt not take the nether, nor the upper millstone to pledge; for he hath pledged his life to thee. When thou shalt demand of thy neighbor anything that he oweth, thou shalt not go into his house to take away a pledge: But thou shalt stand without, and he shalt bring out to thee what he hath. But if he be poor, the pledge shall not lodge with thee that night, but thou shalt restore it to him presently before the going down of the sun: that he may sleep in his own raiment and bless thee, and thou mayest have justice before the Lord thy God.

[3] 12 Manresa 420. The terms "hipoteca" and "anticresis" are Greek in etymology, being derived from hypothehe or hypotitherai and antichresis respectively.

[4] Sandars, *Institutes of Justinian* (1934), p. 331, 135. See Bk. 11, Title XIV 4.

[5] The Fuero Juzgo, Fueros Municipales, Fuero Viejo de Castilla, Fuero Real, Siete Partidas, and the Codigo de las leyes Alfonsinas. See 12 Manresa 421

tel mortgage are, in the ultimate analysis, essentially the same, they will be treated together. Side by side, they exemplify the twin sources of our law—Spanish Civil Law and Anglo-American Common Law.

Shares of Stock as Subject-Matter of Pledge and Mortgage

The Civil Code [6] in describing the things that may be the subject-matter of a pledge, provides for three requisites: first, they must be movables; second, they must be within the commerce of man; third, they must be susceptible of possession. Shares of stock are, by explicit provision of the same Code, movable or personal property.[7] That they are within the commerce of man, no provision of law need be cited. It is the third requisite that raises difficulties, especially to one overly concerned with the refinements of jural logic.

A share of stock is the right which the stockholder has to participate, according to the number of shares, in the surplus profits of the corporation, and in the assets or capital stock remaining after payment of its debts on its dissolution or the termination of its active existence and operation.[8] Shares of stock are therefore incorporeal [9] and intangible property "existing only in abstract legal contemplation." [10] Because of this intangible character, they are not capable of manual delivery,[11] real tradition being limited to corporeal and tangible things, nor of being taken into actual, physical or natural possession.[12]

But tradition is essential in a pledge, for the thing pledged must be placed in the possession of the creditor or of a third person designated by mutual consent; [13] and possession here means physi-

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[6] Art. 2094.

[7] Art. 417 (2).

[8] United States Radiator Corp. v. State, 208 N. Y. 144, 46 LRA (N.S.) 585, 101 NE 783 at 785 quoting Plimpton v. Bigelow, 93 N. Y. 592 and Jermain v. Lake Shore at Mich. So. Ry. Co., 91 N. Y. 483. "A share of corporate stock signifies an aliquot part of the corporation's property, and is thus evidence of the right of the owner thereof to share in the proceeds of such property." Warren v. New Jersey Zinc Co., 116 N. J. Eq. 315, 173 A 128 at 182.

[9] Art. 2095 Civil Code "Shares of stock are not chattels, but are in the nature of choses in action, and are intangible, incorporeal personal property" Norrie v. Kansas City So. Ry. Co., 7 Fed. (2d) 158 at 159.

[10] 11 Fletcher Cyc. of Corp. Sec. 5097.

[11] McAllister v. Kuhn, 96 U. S. 87, 24 L. ed. 615 at 616; Jean v. Jean 207 Cal. 115, 277 Pac. 313 at 315; Presnall v. Stockyards National Bank 151 S. W. 873 at 876. Our Rules of Court recognize their incorporeal nature and provide for a special mode for their attachment. See Rule 59 sec. 7 (d).

[12] Lipscombe's Adm'r v. Condon, 56 W. Va. 416, 67 LRA 670, 49 SE 392 at 392; Dean Rapid Tel. Co. v. Howell, 144 SW 185 at 186; Coffery v. Choctaw Coal & Mining Co., 68 SW 1049 at 1052.

[13] Art. 2093, Civil Code. "Este es un requisito esencialismo y peculiar de la prenda sin el que no puedo estimarse celebrado ó ultimado el contrato, pues precisamente en esa entrega consiste la guarantía que el mismo supone. Por lo tanto, para que queda perfecto el contrato de prenda es indispensable la entrega citada, que á su vez es lo que caracteriza de real dicha convención." 12 Manresa 411.

cal possession.[14] Here then was a problem worthy of the Roman juris consultes, and which would have delighted the disputatious civilian commentators. Quite naturally it was formerly believed that corporate shares could not be the subject matter of a pledge,[15] or at least doubted whether they could be so. However, in one early case[16] (1912) our Supreme Court assumed and took for granted that shares could be pledged and upheld the validity of such a pledge against the attacks of the pledger's successor in interest. In this wise, the Court avoided the question. And rightly so, for it has been reduced to a merely academic one by pressing utilitarian considerations in the commercial world. It can no longer be doubted that shares of stock may be, for they are being, pledged as collateral security.[17] Legal logic yields to the imperious necessities of commercial experience.

A similar doubt existed as to whether shares of stock could validly be made the subject of a chattel mortgage, this notwithstanding the broad scope of the statute's provision [18] that all personal property shall be subject to a chattel mortgage. The difficulty in this case arises not so much from the rigidity of a statutory definition as in the case of pledge, for a chattel mortgage does not require delivery for its validity, nor always for its effectivity against third persons.[19] Rather it is the practical application of the statute to shares of stock, the method of constituting an effective chattel mortgage that presented, and still presents, considerable difficulties.[20] It is a form of mortgage "ill-suited to the hypothecation of shares of stock and rarely used elsewhere." [21]

The doubt was first expressed by our Supreme Court in Fua Cun v. Summers, but was not resolved on the ground that its determination was not essential in the decision of the case. In that case,

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[14] U. S. v. Apilo (Oct. 9, 1900) unpub.; U. S. v. Terrell, 2 Phil. 222, 225; Williams v. McMicking, 17 Phil. 408, 410; Betita v. Ganzon, 49 Phil. 87, 93; Pacific Com. Co. v. Phil. Nat. Bank, 49 Phil. 286, 244.

[15] "Strictly speaking, a share of stock being of an incorporeal nature, is not capable of being pledged as there cannot be a delivery of intangible property." Deuber Watch Case Mfg. Co. v. Daugherty, 62 Ohio 589, 57 NE 455 at 457.

[16] Ibañez de Aldecoa v. Hongkong and Shanghai Bank, 22 Phil. 572.

[17] Commercial Nat. Bank v. May, 187 Iowa 888, 174 NW 646 at 649; Kellog-Mackay Co. v. O'Neal, 177 NE 778 at 781.

[18] Act No. 1508, sec. 2. See Fisher, *Philippine Law of Stock Corps.* (1929) p. 168. "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." Chua Guan v. Samahang Magsasaka, Inc., 62 Phil. 472, 478.

[19] Act No. 1508, sec. 4.

[20] "Though the courts have uniformly held that chattel mortgages on shares of stock . . . are valid as between the parties, an equity in shares of stock is of such an intangible character that it is somewhat difficult to see how it can be treated as a chattel and mortgaged in such a manner that the recording of the mortgage will furnish constructive notice to third parties." Fua Cun v. Summers, 44 Phil. 705, 708.

[21] Chua Guan v. Samahang Magsasaka, Inc., *supra*, at 478.

the plaintiff's predecessor in interest subscribed for a number of shares, making a down payment of half their par value, and obtained a receipt therefor. This receipt was indorsed and delivered to the plaintiff, and a chattel mortgage over the shares executed in his favor. This, said the Court, operated at least as "a conditional equitable assignment" of the assignor's "equity in the shares of stock." It is not clear why the assignor's interest was labelled as a mere equity, for a subscriber's property in the shares subscribed is full and complete, comprehending both legal and equitable title notwithstanding that a balance remains due on his subscription.[22] If shares of stock were at all mortgageable, certainly the owner of partly paid stock is under no disability from so doing. Perhaps the Court wanted to suggest that the assignor's title was less than absolute dominion and so could not have mortgaged the shares.[23] Anyway the issue was left undetermined.

Yet we next find the Court in Monserrat v. Ceron [24] assuming that the question had been answered and that shares of stock could be validly and effectively mortgaged. In later case of Chua Guan v. Samahang Magsasaka, Inc.,[25] the opinion categorically stated that the "long mooted question" of the possibility of hypothecating shares by means of "a chattel mortgage on the certificate of stock" had been settled by Monserrat v. Ceron. The phraseology of the opinion is not as precise as could be desired; for it is the stock itself and not merely the certificate evidencing it that is the subject of the mortgage.[26] The above dictum in the Chua Guan case was reiterated in Bachrach Motor Co. v. Ledesma [27] where the Court remarked that "certificates of stock or of stock dividends under the Corporation Law are quasi-negotiable instruments in the sense that they may be pledged or mortgaged to secure an obligation." It will be noted that this statement is of rather doubtful accuracy. The characteristic of quasi-negotiability imputed to stock certificates rests on the principle of estoppel or implied agency.[28] It seems wholly unrelated to the question of pledging or mortgaging shares of stock. Be that as it may, the dictum is helpful in showing that the question was regarded as definitely decided in this jurisdiction.

Article 2095 of the new Code puts at rest any possible doubt as to the validity of pledges of corporate shares. Although there is no similar provision in the chapter on Chattel Mortgages, article

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22 Fisher, op. cit., page 165.
23 Art. 2085 (2) Civil Code.
24 58 Phil. 469, 474.
25 *Supra*, at 477.
26 Ahern v. Tulare Lake Canal Co., 1 Pac. (2d) 490 at 493 citing Green v. Cavalier, 290 Pac. 548.
27 64 Phil. 681, 695.
28 Bangor Electric Light and Power Co. v. Robinson, 52 Fed. 520; Turnbull v. Long Acre Bank, 249 N. Y. 159, 163 NE 135; Baker v. Davie, 211 Mass. 429, 97 NE 1094. Ballantine on Corporations (1946), p. 756.

2141 makes applicable article 2095 to chattel mortgages. The next inquiry is—how may corporate shares be so pledged or mortgaged as to insure not only the validity of the contract as between the parties but also its effectivity as to third persons?

State of the Law prior to the New Civil Code

The Chattel Mortgage Law provides for two modes of constituting an effective chattel mortgage. There may be either delivery of the chattel or registration of the mortgage instrument in the Chattel Mortgage Registry of the province where the chattel is located, and also in the Registry of the province of the owner's domicile if the owner resides in a province other than the situs of the res.[29] No particular method is provided in case of shares of stock so that the same two modes must be followed. Either delivery or registration is legally sufficient; the two need not concur.

If registration is chosen, the stock certificate may be left in the possession of the mortgagor without any annotation of the encumbrance on the shares. The mortgagor is left free to transfer the certificate to third persons who may be purchasers or other creditors. Such third persons are very likely to be misled in dealing with the mortgagor on the strength of his title apparently complete and unburdened.[30] Purchasers of shares of stock are thus placed under the necessity of being constantly on their guard against such possible mortgages on the shares offered to them. How are they to protect their interests in such cases? Where are they to ascertain whether or not a particular share or shares have been previously hypothecated? Two places logically come to mind: the books of the corporation and the Chattel Mortgage Registry.

In the first place, i.e. the corporate records, a difficulty immediately supervenes. A chattel mortgage on shares of stock is not required by law to be registered in the corporation's books. Section 35 of the Corporation Law requires the notation in the books only of such transactions as involve the absolute conveyance of the ownership of the shares. Since a chattel mortgage does not involve such a transfer of dominion, being merely for the purpose of securing a principal obligation,[31] its notation in the aforesaid books is not necessary for its validity.[32] Even if such registration is required, little benefit would be derived by prospective buyers of stock or creditors of the mortgagor since third persons generally have no access to corporate records.

The other place is, of course, the Chattel Mortgage Registry. But the Registry of what province? In the province of the situs

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[29] Act 1508, sec. 4.

[30] See Fisher, op. cit., page 165.

[31] Bachrach Motor Co. v. Summers, 42 Phil. 3; Bank of the P. I. v. Olutanga Lumber Co., 47 Phil. 21.

[32] Monserrat v. Ceron, supra, at 474; Noble v. Ft. Smith Wholesale Grocery Co. 34 Okla. 662, 46 LRA (NS) 455, 127 Pac. 14 at 17. "If that is the rule with regard to chattel mortgages, it must also be the rule with respect to pledges." Bank of the P. I. v. Caridad Estates, Inc., 40 O. G. No. 8 (48), pp. 265, 268.

of the shares of stock and of the owner's domicile, says the law, but failing to specify where the situs is for purposes of the registration. The situs of the 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.[33] For purposes of attachment and execution, the domicile of the corporation is decisive[34] and generally held to be the situs of the shares.[35] By analogy, our Supreme Court held in the Chua Guan case that for the purpose of Act No. 1508, the property in the shares may be deemed to be situated in the province where the corporation has its principal office or place of business. In arriving at this conclusion, the Court relied on the oft-mentioned distinction between shares of stock and the certificate of stock evidentiary of the ownership of the shares themselves. To have made the location of the certificate or the owner's domicile determinative of the situs of the shares would have raised an "almost prohibitive impediment" on stock transactions. For then a prospective purchaser or mortgagee would be faced with the necessity of searching the records of the Registry in each province wherein the vendor or mortgagor might have been domiciled, and, what is even more difficult, every province in which any former owner of the shares might have resided.[36] This would be unthinkable considering the tremendous volume of business that is daily done on the stock exchange and in banks, and the obvious public interest in the ready transferability of shares of stock and in the prevention of fraud. As it is, the requirement of registration in the province of the corporation's principal office is cumbersome enough, an undesirable and hampering restriction on free trading in, and lending on, shares of stock.

If instead of registration in the proper Registry, delivery and indorsement of the certificate is chosen, less inconvenience is suffered by the mortgagee. He would have some security against a transfer to third persons attempted by the mortgagor if the cor-

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[33] Chua Guan v. Samahang Magsasaka, Inc., *supra*, at 481; Vidal v. South American Securities Co. 276 Fed. 855; Black Eagle Mining Co. v. Conroy, 221 Pac. 425 at 426; Norrie v. Kansas City So. Ry. Co. 7 Fed. (2d) 158 at 159; London Bank v. Aronstein, 117 Fed. 601; Lockwood v. U. S. Steel Corp. 209 N. Y. 375, 103 NE 697 at 699; 2 Cook on Corps. (7 ed.), p. 868.

[34] 11 Fletcher, Cyc. of Corp., Sec. 5106.

[35] Andrews v. Guayaquil & Q. R. Co., 69 N. J. Eq. 211, 60 Atl. 568 at 569; Coffery v. Choctaw Coal & Mining Co., 68 S. W. 1049 at 1052; Warren v. New Jersey Zinc Co. 116 N. J. Eq. 315, 173 Atl. 128 at 133; Harris v. Insurance Co., 75 Okla. 105, 182 Pac. 85 at 86; Freeman on Executions, sec. 172.

[36] Chua Guan v. Samahang Magsasaka, Inc., *supra*, at 481. "Where is he to look in order to ascertain whether or not this stock has been mortgaged? The chief office of the corporation may be at one place today and at another tomorrow. The owner may have no fixed or permanent abode, with his notes in one pocket, and his certificates of stock in the other." Spalding v. Paine's Adm'r., 81 Ky. 416 quoted with approval in Fua Cun v. Summers, 44 Phil. 705 at 708.

poration's by-laws expressly require the surrender of the old certificate for a book transfer to be made. The inability of the mortgagor to deliver the certificate to the purchaser or other mortgagee would be indicative of a previous mortgage or transfer. However, delivery and indorsement, the mode of transfer provided by the Corporation Law, is only permissive and not exclusive. A transfer in some other fashion may quite possibly be made,[37] before or after the mortgage is constituted, leaving the mortgagee's rights insecure in spite of his retention of the stock certificate. In Uy Piaoco v. McMicking,[38] for example, an assignment by a notarial document, without delivery of the certificate, was held sufficient to convey the legal title to the stock. Another source of insecurity to the mortgagee who obtains the indorsed certificate is the fact that the shares remain in the name of the debtor in the corporate books and thus subject to attachment or levy on execution at the instance of other creditors. This difficulty is a result of the doctrine enunciated by our Supreme Court in Uson v. Diosimito,[39] a doctrine that adheres to a literal interpretation of section 35 of the Corporation Law,[40] and which is contrary to that held by a majority of the American Courts.[41]

The Uson ruling may seem in conflict to that of the Monserrat case to the effect that a chattel mortgage on corporate shares is not

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[37] "The company had the right to provide by by-law that stock in the company should only be transferred upon the transfer-books . . . In the absence of such a regulation, any mode or form of conveyance, sufficient in law to transfer the title to any other property or chose in action which by law is transferable, must be held sufficient to vest the legal title in the assignee . . ." People ex rel. Pickering v. Devin, 17 Illinois 84. Even where the by-laws contain such a provision, a transfer by any other method passes legal and equitable title, the provision being primarily for the benefit of the corporation. New York and N. H. R. R. Co. v. Schuyler, 34 N. Y. 30. However, under the Uniform Stock Transfer Act (Sec. 1) delivery of the stock certificate is essential to a transfer of shares.

[38] 10 Phil. 286; Parker v. Bethel Hotel Co., 31 LRA 706, 34 SW 209 at 216: "A sale or transfer of stock to be valid need not be in writing. The certificate need not in fact be delivered. A transfer is perfectly good although the seller of the stock never had a certificate at all, and although no certificate is issued to the transferee."

[39] 61 Phil. 535.

[40] "This Court still adheres to the principle that its function is *jus dicere non jus dare*. To us the language of the legislature is plain to the effect that the right of the owner of the shares of stock of a Philippine corporation to transfer the same by delivery of the certificate whether it be regarded as a statutory or common law right, is limited and restricted by the express provision that no transfer, however, shall be valid, except as between the parties, until the transfer is entered and noted upon the books of the corporation. Therefore the transfer of the 75 shares—made by the defendant Diosimito to the defendant Barcelon was not valid as to the plaintiff on Jan. 18, 1932, the date on which she obtained her attachment lien on said shares of stock which still stood in the name of Diosimito on the books of the corporation." at 540.

[41] *Ibid.*, at 539; 12 Fletcher, Cyc. of Corp., sec. 5513; the same conclusion was reached by Jones, Leonard A., "Unrecorded Transfer of Corporate Shares" 35 Am. L. Rev. 238-251. See also Ballantine on Corporations (1946), p. 753.

required to be registered in the corporation's records. It will be seen, however, that the Monserrat case limited itself to saying that notation was not necessary for the *validity* of a chattel mortgage and did not touch the question of its *effectivity*.[42] Validity and effectivity are distinct juridical concepts. Moreover, the rationale of the Monserrat dictum was that a chattel mortgage was not a transfer, i.e. not an absolute conveyance of ownership. But delivery and indorsement of the stock certificate is in itself, unlike registration in the Chattel Mortgage Registry, a mode of transfer and therefore passes title to the mortgagee subject only to an implied stipulation for reconveyance upon payment of the secured obligation. While failure of the mortgagor to produce the certificate may perhaps be said to give notice to purchasers and other mortgagees, such failure can in no wise serve as notice of the previous mortgage to attaching creditors. The Rules of Court require only notice to the corporation for the attachment to be effective,[43] not the seizure of the stock certificate.[44] While registration of the mortgage in the proper Registry, as constructive notice to all persons, will render it secure as against the attachments subsequent to the date of registration without need of notation in the corporation's books, such notation would be necessary in case of delivery and indorsement to affect attachment and execution creditors.

The case of Bank of the Philippine Islands v. Caridad Estates, Inc.[45] (Court of Appeals), while supporting in part the above last-mentioned conclusion, went farther, too far, in the opinion of the writer, than is warranted by the Chua Guan case which it cited. There Justice Padilla said that a chattel mortgage, whether there be delivery and indorsement of the certificate or registration in the proper Registry, cannot affect third persons unless and until it has been entered on the books of the corporation. In the Chua Guan case, the Supreme Court held superior the liens of attaching creditors to the right of the mortgagee where the attachments were had prior to the entry of the mortgage on the corporate records. But a careful reading of the case will show that this was held, not because a chattel mortgage duly registered in the proper Registry is ineffective without notation in the corporation's records, but rather because the mortgage in that particular case was defectively registered, i.e. it was registered in the domicile of the owner not in the principal office of the corporation, so that no notice, constructive or otherwise, was given to the attaching creditors.[46]

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[42] See footnote 32. The Chua Guan case, quoting and affirming this ruling, added the phrase "and of no legal effect." These words are understandable when it is borne in mind that the Court there dealt with a registered mortgage deed.

[43] See Rule 59, sec. 7(d).

[44] As is required by section 18 of the Uniform Stock Transfer Act.

[45] 40 O. G. No. 8 (4th Supp.), p. 265.

[46] This conclusion is supported by Tolentino. "If the chattel mortgage is registered in the province where the corporation has its principal office and in that of the owner's domicile if he resides in a different province, in other words, if the chattel mortgage is properly registered in accordance with Act No. 1508, it is valid even against third persons, and need not be recorded in

We have seen that in pledge, delivery is absolutely essential for the validity of the contract.[47] Where shares of stock are concerned, this could only mean delivery and indorsement of the stock certificate. Interesting it is to note that while generally a thing given in pledge never becomes the property of the pledgee for the debtor continues to be owner thereof,[48] yet a pledge of shares of stock passes title to the property in the shares so as to constitute the pledgee owner of the shares,[49] subject however to defeasance and a *pacto de reconvención* upon fulfillment of the express condition subsequent. Such a transfer of the title performs the same office as does the possession in a pledge of corporeal property: it constitutes the evidence of the pledgee's right of property in the thing pledged.[50]

Under the old Civil Code, for a pledge to be binding on third persons evidence of its date must appear in a public instrument in addition to the delivery of the thing pledged to the creditor.[51] Our Supreme Court, apparently considering pledge and chattel mortgage as essentially the same juridically, ruled that section 4 of Act No. 1508 had so modified article 1865 that a pledge and a chattel mortgage to affect third persons need not appear in a public instrument provided there is delivery of the thing pledged or mortgaged.[52] Under this ruling, delivery and indorsement of the certificate alone could apparently be said to render a pledge of shares of stock effective; but it was still subject to the same difficulties, and to the same requirement of entry on the books of the corporation,[53] that we observed in the case of a chattel mortgage established by the same method.

The state of our law then prior to the enactment of the new Civil Code was embarrassingly uncertain and unsatisfactory. In-

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the books of the corporation. An attachment levied upon shares standing in the name of the mortgagor after the chattel mortgage has been properly registered in the Registry of Deeds cannot prevail against the chattel mortgage . . ." 2 Commercial Laws, 5th ed., 148.

[47] See footnote 13.

[48] Art. 2103, Civil Code. Meyers v. Thein, 15 Phil. 303, 309.

[49] Phil. Trust Co. v. Phil. National Bank, 42 Phil. 413, 423.

[50] Am. Exchange National Bank v. Fed. National Bank, 226 Pac. 483, 27 LRA (N.S.) 666 at 669 quoting with approval Brewster v. Hartley, 37 Cal. 15, 25, 99 Am. Dec. 237, 241.

[51] Art. 1865, old Civil Code. Ocejo, Perez and Co. v. International Banking Corp., 37 Phil. 631, 641; Tec Bi and Co. v. Chartered Bank, 41 Phil. 596, 603; Te Pate v. Ingersoll, 48 Phil. 394, 396.

[52] Mahoney v. Tuason, 39 Phil. 952, 958; Bachrach Motor Co. v. Ledesma, 64 Phil. 681, 695.

[53] "This provision (art. 1865) being of a general law must yield to the Corporation Law when corporate shares are the subject matter of a pledge. A pledge of corporate shares validly constituted in a public instrument but unrecorded in the books of the corporation can prejudice or affect a third party no more than a chattel mortgage on shares not registered in the books of the corporation can." Bank of the P. I. v. Caridad Estates of Cavite, Inc., *supra*.

deed the "only safe way" to hypothecate shares of stock, apart from the unwieldy methods we have discussed was "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." [54] This method indicated by the Supreme Court is itself burdensome, especially where the loan secured is only a short term one, and *harsh on the debtor who is compelled* to rely *on the honesty and solvency* of the creditor. The way out of the morass of uncertainty and insecurity lay with the legislature.[55] The question then is—did the legislature succeed in settling all these doubts and difficulties harmful to the financial and commercial interests of the country? What effects does the new Code have on this vexing status of the law?

Effects of the New Code on the State of the Law

Article 2095 of the new Code, providing for the pledging of incorporeal rights, requires the delivery of the instrument proving the right pledged to the creditor, and its indorsement if negotiable. However, nothing is said as to whether or not delivery and indorsement of a stock certificate would suffice to render the pledge effective against third persons. The requirement of a public instrument showing the description of the thing pledged and the date of the pledge seems to be a general one,[56] no distinction being made between corporeal and incorporeal things. The public instrument alone, without the notation on the corporate records, cannot affect the rights of third persons, especially attachment and execution creditors. But no mention of the necessity of notation is made. If article 2095 was intended to provide for a valid and effective pledge of shares of stock as a special provision controlling article 2096 which is a general one, then section 35 of the Corporation Law as construed in Bank of the Philippine Islands v. Caridad Estates, Inc. must be held to have been impliedly repealed so far as pledges are concerned. The difficulty here is that the incompatibility or repugnancy necessary for an implied repeal is not present in this case. Until this difficulty is resolved, it would not be advisable for the creditor to omit notation in the corporate records, burdensome though it may be.

Article 2140 is an attempt to settle the general confusion in the law of pledges and chattel mortgages by providing for a handy distinction between the two. If there is delivery of the movable, the contract is a pledge; if there is recording in the Chattel Mortgage Register, it is a chattel mortgage, whether or not delivery is also made. This article clearly modifies section 4 of Act No. 1508

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[54] Chua Guan v. Samahang Magsasaka, Inc., supra, at 481.
[55] *Ibid.*, at 482; see Fisher, op. cit., page 168.
[56] Art. 2096, Civil Code.

so that there is now but one way of constituting an effective chattel mortgage, i.e. registration in the proper Register. As applied to shares of stock this article is woefully inadequate to remedy the unsatisfactory condition of the law. If the certificate of stock is pledged by delivery and indorsement, notation in the books of the corporation is still necessary. If the mortgage deed is recorded in the proper Register, such notation is not necessary, but all the shortcomings and inhibitive impediments and insecurity inherent in such mode remain. The new code has failed to make any substantial improvements on the state of the law on this point. The law is back where it was; the effect of the new code is exactly—nothing.

Conclusion—Possible Remedy.

The remedy suggested by the Supreme Court and Justice Fisher is to make the delivery and indorsement of the stock certificate and the intention to hypothecate the shares legally sufficient and binding upon all persons, without any other formality.[57] The distinction between pledge and chattel mortgage, at least with respect to shares of stock, would be abrogated. This distinction, where the legal effects of the two contracts are concerned, is pointless and without substantial significance. The new code has, in effect, rendered a pledge and a chattel mortgage one and the same act; whatever differences there are, are in name only. The only meaningful difference lay in the creditor's right to recover any deficiency resulting upon foreclosure. Article 2115 expressly denies this right to a pledgee; while Act No. 1508 has no such provision from whence it has been inferred that the right existed.[58] But article 2141 makes article 2115 applicable in chattel mortgages, since the latter is not in conflict with the Chattel Mortgage Law.

The adoption of the suggested remedy would further require the modification of section 35 of the Corporation Law, so as to render a transfer of corporate shares binding on all persons, except the corporation, without entering the transfer on the records. This would only mean bringing the law up to date, and in conformity with the prevailing trend of American jurisprudence. For greater security to the creditor, it may be necessary to limit methods of transfer to only delivery and indorsement, or at least require an accompanying delivery of the certificate as does the Uniform Stock Transfer Act. It is not necessary to amend the Rules of Court and require seizure of the certificate in attaching shares of stock, though much could be said in favor of such a course. All that is necessary

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[57] See footnote 55.

[58] Bank of the P. I. v. Olutanga Lumber Co., 47 Phil. 21, 22; Manila Trading & Supply Co. v. Tamaraw Plantation Co., 47 Phil. 513, 521. This right, however, had been taken away in case of sales of personal property by installment secured by a chattel mortgage on the thing sold. See art. 1484, Civil Code; Bachrach Motor Co. v. Millan, 61 Phil. 409; Manila Trading & Supply Co. v. Reyes, 62 Phil. 461.

is adherence to the general rule that an attaching creditor can reach only the interest of the debtor; if a previous effective transfer has been made, there is nothing to attach on the books of the corporation.[59] Though this remedy is not completely satisfactory, for a simulated hypothecation may possibly defeat an attachment recorded on the corporation's books, still it is the most expeditious. And expediency is surely a legitimate objective of the law.

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[59] Nat. Bank of Pacific v. Western Pacific R. Co., 157 Cal. 573, 108 Pac. 676 at 677; Bailey v. Pierce, 123 Kan. 359, 255 Pac. 37 at 38; Kern v. Day, 45 La. Ann. 71, 12 So. 6 at 7; Everitt v. Farmer's & Merchants Bank, 82 Neb. 191, 117 N. W. 401 at 402; Reilley v. Absecon Land Co., 75 N. J. Eq. 71, 71 AR. 248 at 249; State Banking & Trust Co. v. Taylor, 25 S. D. 577, 127 N. W. 590 at 593; Port Townsend Nat. Bank v. Port Townsend Gas & Fuel Co., 9 Wash. 597, 34 Pac. 155 at 156.