

SHOULD EDUCATIONAL INSTITUTIONS BE NON-STOCK CORPORATIONS?

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The Present Practice

The Philippine Corporation Law, Act No. 1459 as amended, does not specifically provide that colleges and universities may not incorporate as *stock corporations*. Neither does it contain an express provision that colleges and universities may incorporate only in the form of *non-stock corporations*. Because of the apparent silence of our Corporation Law on this point, the government office in charge of accepting and registering articles of incorporation (the Securities & Exchange Commission and its predecessor, the Bureau of Commerce) has taken for granted or assumed that corporations for educational purposes may legally be incorporated in the form of *stock corporations*.

As a matter of fact, several private universities in the country have been organized as stock corporations, and have been distributing and declaring cash and stock dividends on the basis of shares owned by the stockholders. One financial and investment company even advertises to the public that it invests part of its funds in the purchase of stocks of two of these private universities, thereby admitting openly, that in this part of the world, education may legally be engaged in for purposes of business or *profit*.

Effects of the Present Practice

The present practice of permitting colleges and universities to be run like ordinary business corporation, with profit-motive, is one of the causes for the mushrooming of the so-called "diploma mills" in this country. The object of realizing surplus profits for purposes of dividend declaration among the stockholders will naturally cause a desire: (1) to admit as many students as may be willing to register, even if such number of students is grossly disproportionate to the facilities of the school; (2) to engage in extravagant commercial advertising in the same manner that commercial products are being advertised; (3) to devise and practice various ways and means of attracting more students for the purpose of increasing its enroll-

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ment, thereby sacrificing *quality* for *quantity* as the standard of merit; (4) to have as the primary object of a university the mere "topping" by one of its students in a government or board examination, instead of making the university a true "seat of high learning" for all its students.

The efforts of the officials of the Bureau of Private Schools to supervise these universities in business forms may sporadically minimize but cannot permanently eliminate the evils which naturally arise from the present practice of organizing private educational institutions. And, if no immediate positive action is taken and if the Government merely assumes a nonchalant attitude on the matter, then the evil sought to be suppressed may yet increase in extent, until our system of university education ultimately becomes a fake and a farce.

What Our Corporation Law Says

What difference does it make whether a college or a university be organized as stock or non-stock corporation? What is the distinction between a stock corporation and a non-stock corporation?

Stock corporations are those corporations "which have a *capital stock* divided into shares and are authorized to distribute to the holders of such shares dividends or allotments of the surplus profits on the basis of the shares held."¹ Those which have *no capital stock*, and therefore, are not authorized to distribute dividends, are *non-stock corporations*.

A private corporation may have no capital stock but this does not mean that it has no capital. *Capital stock* and *capital* are not synonymous, although some courts use the two terms interchangeably and synonymously. But properly used, the term "capital stock" means the authorized amount of money or number of shares stated in the articles of incorporation and which are to be the object of subscription; this is fixed and does not change, unless the articles of incorporation be amended as to capital stock. Thus, our Corporation Law provides that the following, among others, must be stated in the articles of incorporation:

"If it be a *stock corporation*, the amount of its *capital stock*, in lawful money of the Philippines, and the number of shares into which it is divided and if such stock be in whole or in part without par value then such fact shall be stated; *Provided, however*, That as to stock without par value the articles of incorporation need only state the *number of shares* into which said capital stock is divided; x x x"²

¹ Sec. 3, Corporation Law, Act No. 1459, as amended.

² Sec. 6, pars. 7, 8, *ibid.*

"Capital stock", therefore, is that sum of money or the total number of shares *fixed* in the articles of incorporation; while "capital" is the amount paid in or contributed to the corporation with which the corporation may operate. For example, a corporation may have as its stated capital stock the sum of ₱100,000 divided into 1,000 shares of the par value of ₱100 each share, or in case all its shares are without par value, then its capital stock may be stated only in number of shares, as for example, 1,000 shares without par value, which value may be determined in the articles of incorporation, or, in the absence of fraud in the transaction, for such consideration as, from time to time, may be fixed by the board of directors pursuant to an authority conferred by the articles of incorporation, or, for such consideration as shall be approved by the holders of a majority of the shares entitled to vote at a meeting duly called for the purpose, but in no case may the value of a non-par value share be fixed less than the value of ₱5.00 per share.⁵ If only 20% of the authorized shares have been subscribed and 25% of the subscription have been paid for, then the amount paid in may be termed "capital" of the corporation; it is better to call it "subscribed capital stock." In other words, the "capital stock" of a stock corporation is fixed and does not fluctuate, unless the articles of incorporation are amended according to law, but the "capital" of a corporation fluctuates and changes from time to time.⁶

Non-stock corporations have no capital stock, but they should have *capital* which consists of the money or property contributed to enable them to operate. Thus, when our Corporation Law, in speaking of what shall be stated in the articles of incorporation of *schools, colleges, and other institutions of learning* makes mention of—

"The *amount of money and description of the property* to be devoted to the maintenance and support of the college, school, or other institution of learning"; . . .⁶

it is clear that colleges and universities should be incorporated as *non-stock corporations*.

It is true that stock and non-stock corporations are both *private corporations*, as distinguished from *public corporations*. But to say

⁵ Sec. 5, *ibid.*

⁶ Sec. 9, *ibid.*

⁶ "Capital stock" is the sum fixed by the corporate charter as the amount paid in or to be paid in by the stockholders, for the prosecution of the business of the corporation and for the benefit of corporate creditors". (Cooke v. Marshall, 191 Pa. St. 315 (1899); American, etc. Co. v. State Board, 56 N.J.L. 389 (1894); Markle v. Burgess, 95 N.E. 308 (1911); Trademan Pub. Co. v. Car Wheel Co., 95 Tenn. 634 (1895); Commercial F. Ins. Co. v. Board of Revenue, 99 Ala. 1 (1892). "The *capital* of a corporation is the property or means which the corporation owns, and it may vary in amount, while *capital stock* is fixed, and represents the interests of the stockholders." (Wells v. Green Bay, etc. Co., 90 Wis. 442 (1895).

⁶ Sec. 165, Corporation Law, Act No. 1459, as amended.

that a corporation is *private* does not mean that it is organized always for private gain. Under our Corporation Law, public corporations are those organized for the "government of a portion of the state". All others not so organized are private corporations.⁷

Private corporations, in turn, may be either stock or non-stock corporations. In other words, a non-stock corporation is also a *private* corporation organized *not* for profit. The PRRM (Philippine Rural Reconstruction Movement) is an example of a private, non-stock corporation, organized for a public purpose. *Private corporations*, therefore, may have a *public purpose*. The fact that its *purpose* is "public" does not convert it into a "public corporation" under our Corporation Law.

The individuals composing a private corporation, whether stock or non-stock, are called "corporators". But our law is very particular in the use of terms with regard to the corporators of each kind of corporation. The corporators of a stock corporation are called "*stockholders*", while the corporators of a non-stock corporation are called "*members*", although the corporators of a stock corporation may also be called members if they *do not own* any capital stock in the stock corporation. Says the law:

"The owners of shares in a corporation which has capital stock are called stockholders or shareholders. Corporators of a corporation which has *no capital stock* and corporators of a corporation who do not own capital stock are members".⁸

In other words, when the Corporation Law refers to a non-stock corporation, the word "member" or "membership" is used, and not "stockholders" or "shareholders". This distinction must be noted, in order to find out the real intent and purpose of the provisions of the Corporation Law governing schools, colleges, and other institutions of learning.

There are only six (6) sections in our Corporation Law which are especially applicable to corporations organized as *institutions of learning*.

Section 165 states who may incorporate schools, colleges, or other institutions of learning, and what matters must be specified in the articles of incorporation. As already stated, the law requires that the articles of incorporation of educational institutions must state "*the amount of money and description of the property to be devoted to the maintenance and support of the college, school, or other institution of learning*"; it makes no mention of "*capital stock*", the intent

⁷ Sec. 3, *ibid.*

⁸ Sec. 4, Corporation Law, Act No. 1459, as amended

being that such educational institutions should be incorporated in the form of *non-stock* corporations.

The law also requires that the articles of incorporation of institutions of learning must state

"(4) The qualifications of *trustees* and the number of trustees, which shall not be less than five nor more than fifteen: Provided, however, That the number of trustees shall be some multiple of five".⁹

The fact that the law uses the term "*trustees*" in connection with educational institutions, instead of "directors" as in the case of ordinary business corporations also indicates that colleges and universities shall be managed as a *trusteeship* and not merely as ordinary business corporations. It is true that, in a certain sense, directors even of ordinary business corporations are also regarded as trustees, but this is so only to impress upon the directors of ordinary business corporations the duty to act in good faith. At appropriate times, the courts will regard directors of an ordinary business corporation as trustees. Says one court: "It has *sometimes* been said that directors are trustees. If this means that directors in the performance of their duties stand in a fiduciary relationship to the company, that statement is essentially correct."¹⁰ In other words, directors of an ordinary business corporation are *deemed* to be trustees by legal construction. Those of colleges and universities are not only deemed trustees; they *are* trustees, not only by legal construction but by express legal provision.

Our law specifically uses the terms "*member*" and "*membership*" in referring to corporations organized as *schools, colleges, or universities*. As already explained above, the term "member" is used only in connection with non-stock corporations. The intent of the law is clear.

"Any educational society or organization, by a two-thirds vote of its *membership* had at a regular or at a special meeting called for the purpose, or by the written consent of two-thirds of its *members* without a meeting, and any existing educational corporation or body claiming to be such may, by a unanimous vote of its trustees present at a regular or special meeting called for the purpose or by the written consent of such trustees without a meeting, convey all or any part of its property, rights, and franchise to a corporation organized for educational purposes in conformity with this Act. *Any corporation organized for educational purposes is accordance with this Act* shall have the right by and with the consent of a majority of its *membership* to purchase, hold, mortgage, or sell real estate for educational purposes."

⁹ Sec. 165, *ibid.*

¹⁰ *Bosworth v. Allen*, 168 N.Y. 157, 61 N.E. 163, 85 A.S.R. 667 (1901); *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N.Y. 185, 123 N.E. 148 (1919).

The fact that the law uses the terms "*member*" and "*membership*" in reference to schools and other institutions of learning (whether already existing prior to the enactment of the Corporation Law or to be organized under the present law), shows that the law intends that this kind of corporations should be, as they had always been, in the form of *non-stock corporations*.

The Nature of Educational Corporations

But even granting that the present law is absolutely silent on this point, and that there are no provisions therein from which it can be inferred that colleges and universities must be incorporated in the form of non-stock corporations, still, by the very *nature* of a corporation organized for educational purpose, the same must always be in the form of non-stock corporation; that is to say, it must be organized without any object of business motive.

Since the days of Socrates, Plato, and Aristotle, and of the greatest Teacher of them all—Jesus Christ—teaching has always been an act of sacrifice and altruism. It is true that present-day teachers are entitled to an honorarium or fee, but this fee or honorarium is given by way of compensation to the teacher himself, and not to create a surplus fund out of which dividends may be distributed among the investors. Education is inherently not for business. Education, especially at the primary level, is a governmental function. Private individuals may choose to discharge this noble and governmental duty, but in so doing, the nature of the obligation does not cease to be a public duty. To educate the youth of the land in order to obtain private advantage is inherently absurd. It is a contradiction in terms. It is like organizing a private corporation for social welfare or charity, in order to reap profits for the founders. Just as water and oil cannot mix, so education and private profit cannot stand together. The former will ultimately be subordinated to the latter. The act of engaging in educational work is reserved only for those who have the genuine educational spirit to serve the community, devoid of any materialistic idea to serve their own selves.

It is, however, contended by the advocates of *universities in business forms* that if colleges and universities will not be authorized to distribute dividends, no capitalist would care to risk his capital in this kind of undertaking. So what? If none is willing to be charitable, then there is no charity. If none is willing to be philanthropic, then there is no philanthropy. To allow a person to do philanthropic work or charity and at the same time recognize his right to make business out of his work, is to change the meaning of the term. It is not philanthropy anymore. It is no longer charity. So,

with education. Do the incorporators incorporate a corporation for the primary purpose of educating the youth, or for the primary purpose of private profit? All private corporations are incorporated for one *primary* purpose. The purposes stated in the articles of incorporation may be more than one, provided such other purposes would accomplish the main corporate purpose.¹¹ To mix educational motive with profit-motive will give rise to something far from being genuine. This is the principal reason why the problem of "diploma mills" has arisen. This problem cannot be cured or remedied by mere supervision on the part of the Bureau of Private Schools. The profit-motive, especially if legally sanctioned, will creep in, and defeat the efforts of the Government to raise the standard of our colleges and universities. The remedy must be applied at the very root of the evil sought to be eliminated—the form and manner of organization. "An ounce of prevention is better than a pound of cure." The Government should, from the very beginning, have prevented these colleges and universities to be organized in the form of stock corporations, permitting them to make "*business*" out of a "*non-business*" undertaking.

It is also contended by those who believe in the present practice, that in the Philippines, unlike in the United States and elsewhere, colleges and universities do not receive endowments, grants, subsidies, or donations. For this reason, these institutions of learning must depend upon private capitalists. And private capitalists will not come in, unless they expect returns for their investments. In answer to this argument, perhaps it is better to ask ourselves: Why is it that private universities in the Philippines generally do not receive donations, grants, subsidies, or endowments? The answer is evident. Who would give away his money and property in favor of a private corporation the profits of which find their way to the pockets of private individuals? But let there be first sufficient evidence that a private university is exclusively devoted to the needs of the public and we may see alumni donating their valuable libraries in favor of their Alma Mater, foundations giving grants to improve the facilities of the school, and similar acts of aids. As a matter of fact some institutions of learning not organized for profit have received such grants or aids from private individuals and foundations. It is evident that before private corporations may expect donations and contributions from the people, such corporations must first prove that they have been organized *exclusively* for the benefit of the people. In other words, they must first be incorporated as *non-stock* corporations.

¹¹ Uy Siuliong v. Director of Commerce, 40 Phil. 541 (1919).

The Present Practice Must be Corrected

The present practice of permitting colleges and universities to be incorporated in the form of *stock corporations* is in violation of the present provisions of the Corporation Law. But the fault lies not in the men who have incorporated them, but in the men in charge of giving them legal personality.

Now, if the present law does not permit the incorporation of institutions of learning as stock corporations, what must be done with those that had already been allowed to be incorporated as such? And what must be done with respect to those that seek incorporation henceforth under the law?

Because of what had already been permitted heretofore with respect to some universities in business forms, this is a difficult question.

All existing institutions of learning in the form of stock corporations should be advised either by the Secretary of Education or by the Securities & Exchange Commission to amend their articles of incorporation by changing their form of organization from stock to non-stock corporation, on the ground that under the present law institutions of learning may be organized only in the form of non-stock corporation. The amendment may be done pursuant to Section 18 of the Corporation Law. Such amendment requires the vote or written assent of the stockholders representing at least $\frac{2}{3}$ of the subscribed capital stock, without prejudice to the right of any stockholder who did not vote in favor of the amendment to withdraw from the corporation, surrender his shares, and demand payment for the value thereof. Such right to withdraw and to be paid, however, is subject to the legal limitation that any stockholder withdrawing under the provisions of Section 18 of the Corporation Law shall not be entitled to payment for the value of his shares "unless the value of the corporate assets which would remain after such payment would be at least equal to the aggregate amount of its debts and liabilities exclusive of capital stock".¹²

If the required vote cannot be obtained, or if the college or university refuses to heed the advice of the Secretary of Education or the Securities & Exchange Commission to change their form of organization, what shall be the next legal step to take on the part of the Government? Then in such a case, it is submitted that dissolution proceedings are in order. This may legally be done *judicially* under the authority of Section 190-1/7 upon petition of the Solicitor-

¹² Sec. 18, Act No. 1459, as amended.

General, or by legislative enactment under the authority of Section 76 of the Corporation Law.

If dissolved either under Section 190-1/7 or under Section 76 of the Corporation Law, the stockholders of the corporations cannot validly set up the defense that the Government, by having issued a certificate of incorporation to them as stock corporation, is *estopped* from denying their corporate existence. Although estoppel may apply to the Government in certain cases, as when it acted in a contract involving proprietary rights, yet this defense may not be availed of when the state acts in the exercise of sovereign power. The creation of a corporation is an exercise of sovereign power, and the state cannot be estopped in the exercise of its sovereign power.¹³ Thus, it had been held, that a social club that had been organized and expended money in furnishing and equipping its house, on the faith of a judicial construction of a statute that it would have a right to dispense liquors among its members without a license, which construction had been acquiesced in by the legislature for a period of years, does not estop the state from insisting that its charter shall be annulled because of illegal sale of liquors.¹⁴ The neglect, ignorance, or omission of public officials in the discharge of their official duties will not work an estoppel against the state.¹⁵

Moreover, in case of a conflict between the *law* and the *practice* to the contrary, the former must prevail.

"Laws are repealed only by subsequent ones, and their violation or non-observance shall not be excused by disuse, or custom or practice to the contrary. . . . Administrative or executive acts, orders and regulations shall be valid only when they are not contrary to the laws or the Constitution."¹⁶

"Customs which are contrary to law, public order or public policy shall not be countenanced".¹⁷

Errors of administrative officials in the interpretation and implementation of the law, even if followed for a long time, shall not remain undisturbed when such error is discovered and shown at the proper time. As was said by Justice Villa-Real in his dissenting opinion in an insurance case:

"The fact that for many years it has been the *practice* of the insurance companies to use riders or slips of paper containing express warranties without the signature of the insured *in violation of the law* is no reason why such practice should be permitted to continue when its legality is questioned."¹⁸

¹³ *Chicago, etc. R.Co. v. Douglas County*, 134 Wis. 197, 114 N.W. 511. See also Sec. 76, Act No. 1459, as amended.

¹⁴ *State v. Missouri Athletic Club*, 261 Mo. 576, 170 S.W. 904; *State v. Jahrus*, 117 La. 286, 41 So. 575, 116 A.S.R. 208 (1906).

¹⁵ 10 R.C.L., Sec. 32, p. 705.

¹⁶ Art. 6, Civil Code.

¹⁷ Art. 11, *ibid.*

¹⁸ *Ang Giok Chiu v. Springfield F. & M. Inc. Co.*, 56 Phil. 375, 384 (1931).

If dissolution by judicial proceedings is understandable, dissolution by legislative enactment is unquestionable. The power of Congress to dissolve "any corporation" created by virtue of the Corporation Law is "absolute", and no reason need be given for such dissolution; this is so, on the theory that Section 76 of the Corporation Law automatically becomes a part of every certificate of incorporation issued to a corporation incorporated under the general incorporation law.¹⁹ This is known as the "reservation clause" in every corporate charter or certificate of incorporation. Were it not for this reservation clause, the unconditional dissolution of a private corporation would constitute a violation of a constitutional right against impairment of a contract. But with such a provision in the law of incorporation reserving to the Legislature the right to dissolve *at any time* any corporation incorporated under the law, such clause "*must be held to be a part of the contract itself*, and the subsequent exercise of the right (of dissolution) would be in accordance with the contract, and could not, therefore, impair its obligation".²⁰

If colleges and universities already incorporated as stock corporations may legally be obliged to change their form of organization, or in case of refusal, they may legally be dissolved, then with more reason may those subsequently to be incorporated be legally denied the right of incorporation unless they incorporate as non-stock corporations. The Department of Education may also issue rules and regulations that, henceforth, no colleges or university may be granted a government permit unless such college or university is organized in the form of non-stock corporation.

The Present Law May be Made More Definite

But some people, especially those who had already made big investments in schools in business forms, may still insist that even under the present law, colleges and universities may be incorporated as stock corporations. Inasmuch as this idea is fundamentally wrong from the standpoint of morality and public policy, and in order to erase all doubt that institutions of learning must be organized without any profit motive, then it is suggested that the present Corporation Law be amended, by clearly and explicitly providing that no school, college, or university shall be organized *except* in the form of non-stock corporation, and expressly providing further that the amendment shall have *retroactive effect*.²¹ It is important that the amendment must have retroactive effect, because if it will have only

¹⁹ "*Any or all corporations created by virtue of this Act may be dissolved by legislative enactment*" (Sec. 76, Act No. 1459).

²⁰ *Greenwood v. Union Freight Co.*, 105 U.S. 13, 26 L. Ed. 961 (1881).

²¹ "Laws shall have no retroactive effect, *unless* the contrary is provided." (Art. 5, Civil Code).

prospective effect, then some universities that had already been organized prior to the amendment will continue to enjoy rights and privileges not enjoyed by others of the same class. This is objectionable, first, because it will violate the provisions of the Constitution regarding the right of all persons to equal protection of the law; and second, because it permits education to appear like a double-faced Janus. It destroys the very nature of an educational undertaking; it amounts to a recognition of a being, half man and half beast. In education, there should be no compromise. It is either education, or it is not. It cannot be education *and* business at the same time.* Like Lincoln's Union, it must be one and indivisible.

But in order to accomodate the desires of a few who believe that education and profit-motive can stand together, that a university in the form of a stock corporation is not necessarily a "diploma mill", it is suggested that the amendment to the Corporation Law expressly requiring universities to be incorporated in the form of non-stock corporations may contain a *proviso* to the effect that those who choose the stock corporate form may be allowed to do so, but such college or university shall *not be recognized by the Government*. Such non-recognition by the Government shall have the following effects: The words "Not Recognized by the Government" shall be a part of the corporate name of the school or university; all the diplomas and certificates issued by the school to its graduates shall bear the words "Not Recognized by the Government"; and lastly, its graduates shall not be qualified to take any Government or Board Examination. Any school or university that can still attract students in spite of these effects of non-recognition must really have some merits other than the desire to make money.

The law may except vocational schools from the requirement of being incorporated in the form of non-stock corporations, like a school of stenography and typewriting, radio schools, fashion schools, and the like. These may be run as business enterprises. But a college or a university that claims to be a "seat of high learning" should remain a university and act like one.

What Is a University?

And what is a university? Is it just a big place where thousands of part-time students congregate and listen to dictations of part-time professors? Is it just a place where information about matters which can be read in printed books, or perhaps, mimeographed, are taught and retaught?

* The author suggests that non-stock schools, colleges and universities should be exempt from all taxes.

"An institution of higher learning can hardly deserve the title of a university should it remain a mere teaching center. It may be giving instruction of the most advanced type in literature, philosophy, the sciences, and arts; but that condition by itself does not make it a university. It may offer the most progressive professional courses; but that fact alone cannot yet qualify it as a university as long as it confines its work to teaching and nothing else. x x x A university is distinctively an association of scholars and students engaged in the search for knowledge, in the work of advancing the frontiers of knowledge, in the discovery of new learning, in the exploration of the higher spheres of thought to improve or to replace ideas that have ceased to be valid and true, and, above all, in the creation and cultivation of the spirit of discovery. Research, therefore, is the hallmark of a university."²²

How many of the present stock corporations parading with the title of "university" come under this definition of a university?

Verily, a university must be like a fresh spring where all, regardless of sex, race, or creed, come to drink its water of the purest source, clear and unpolluted, thereby inspiring the recipients thereof with a noble sense of responsibility and service to the community and to humanity. This is possible only if the raw materials—the students—and the artisans—the teachers and professors—are both imbued with the spirit of discovery and research for the attainment of the higher things in life. A community of scholars and students cannot be created in the market place. Education is not commerce.

²² Inaugural Address, V. G. Sinco, Eighth President, University of the Philippines, June 18, 1958. (33 PHIL. LAW JOURNAL, No. 3, p. 335.)