

GERMAN SALGADO, PLAINTIFF AND APPELLANT, VS. THE ST. LOUIS DRY GOODS STORE (INC.), DEFENDANT AND APPELLANT,*G.R. No. 11775. July 15, 1918*

Ponente: STREET, J.

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These two causes were heard together in the lower court by consent of all the parties and have also by consent been brought to this court by both parties as appellants upon a single bill of exceptions. The causes of action stated in the two complaints are based upon similar grounds and differ with respect to the two plaintiffs only in special details. The plaintiffs allege the breach of a contract by virtue of which they were employed by the defendant to manage for the period of two years the business of a dry goods store in the city of Manila, known as the St. Louis. From a judgment rendered in favor of the plaintiffs both parties have appealed.

It appears that the defendant, The St. Louis Dry Goods Store (Inc.), is a corporation which was organized in the early months of the year 1914 for the purpose of taking over the business of "The St. Louis," which had been acquired by purchase by Lutz & Co., from the Bank of the Philippine Islands in June, 1913. After the formation of the corporation, it took over the business in question subject to its liabilities.

At the time Lutz & Co. first acquired the ownership of the St. Louis, the two plaintiffs herein, German Salgado and Pablo Martinez, were already connected with the business and they were retained by Lutz & Co. in the capacity of "sub-managers," as they were styled. The agreement which determined their relations to the business and the salary they were to draw was at first merely verbal, but after the corporation was formed two written contracts were drawn up and signed by the president of the corporation, as party of the first part, and by the two plaintiffs separately, as parties of the second part. The most material provisions in said contracts (both being identical in terms) were these: The plaintiffs were engaged as sub-managers of the aforesaid store for the calendar years 1914 and 1915, with the understanding that, in the performance of their duties, they should submit themselves unconditionally to the instructions of the president or board of directors of the corporation. The salary of each was to be at the rate of P200 per month; and in addition to this, it was agreed that each should be entitled to a sum equal to 17 1/2 per centum of the actual net profits of the business, after allowing for depreciation of stock, bad, and doubtful debts. In the fifth clause it was stipulated that the plaintiffs should accept unconditionally the yearly or half-yearly balances of the corporation as made up and accepted by the board of directors, and that they should have no right whatever to claim any percentage or any amount of the profits set aside by decision of the board in order to allow for depreciation of stock, bad, and doubtful debts.

The relations of the contracting parties continued as defined in this contract until February 26, 1915, upon which date the plaintiffs quit the employment of the defendant company, alleging that the contract of employment had been infringed by the latter. The action in which German Salgado is plaintiff was instituted upon May 5, 1915, thereafter, and that in which Pablo Martinez is plaintiff upon May 11, 1915. The complaints each state four separate causes of action. The first three causes of action, considered together, consist in effect of a claim for an accounting with respect to the 17 1/2 per centum of the net profits of the business to which each of the plaintiffs was

entitled under his contract,—extending over the period from June 17, 1913 to February 26, 1915. It is insisted for the plaintiffs that the amount of said participation, if properly estimated, would be materially larger than the amount shown upon the books of the company, and in particular it is insisted that the amounts allowed by the directors of the defendant company for depreciation of stock, bad and doubtful debts are excessive. Under this head the plaintiff, German Salgado, asks judgment for the sum of P12,848.15, and the plaintiff, Pablo Martinez, for the same amount.

The fourth cause of action sets forth that upon February 25, 1915, the president of the defendant company notified the plaintiffs of the intention of the management to place a manager in control of the business, in whom would be vested a supervisory authority over the plaintiffs. The plaintiffs conceived this step to be derogatory of their dignity as sub-managers and violative of the terms of their contract with the defendant. They accordingly promptly quit the defendant's service, and in their fourth cause of action seek to recover not only their salary for the unexpired term of the contract but also damages for injury to their reputation as business men. The plaintiff, Salgado, estimates his damages under this cause of action at P12,200 and the plaintiff Martinez at P12,000.

As the principal point in the controversy arises upon the propriety of the amounts set aside by the management for depreciation of stock in the semiannual statements of the business, it is necessary to make a more detailed narration of the facts pertinent to this matter. In this connection it appears that when the business was acquired by Lutz & Co. in June, 1913, an inventory was taken by or under the supervision of Messrs. Salgado and Martinez, and the value of the stock on hand was set down conservatively at P100,186.32. The management then decided to charge, as depreciation of stock, the sum of P17,711.68, leaving the estimated net value of the stock on hand in the statement for June 17, 1913 (though made up later) at the sum of P82,474.64. The plaintiffs allege that this initial appraisal of the stock was unduly conservative and they suppose themselves prejudiced by the allowance of the amount here set aside for depreciation. The court found that the amount so allowed was not excessive and this finding was, in our opinion, correct. We may add, furthermore, that the allowance of depreciation, however exorbitant or unreasonable in its amount, at the initiation of the business, could not be prejudicial to the profits though it would of course affect adversely the showing as to the amount of capital invested. Even if Lutz & Co. had decided to allow a depreciation of 100 per cent, thus apparently beginning without any stock of merchandise, the receipts and profits would not have been adversely affected; and on the contrary the apparent profits would have been swelled unless a corresponding depreciation had been allowed upon the inventory at the next taking of stock. It results that the plaintiffs are mistaken in thinking themselves aggrieved by reason of the conservative estimate placed by the owners upon the value of the stock at the time they took possession and by reason of an amount which was then allowed for depreciation.

When stock was taken upon January 1, 1914, the value of the stock as shown by the inventory was P87,585.12. Upon this the Directors allowed a depreciation of P21,278.72. At the end of the next six months, i. e., upon June 30, 1914, the inventory of the stock showed a valuation of P129,011.04, upon which the Directors allowed a depreciation of P22,504.66. Again, at the end of the next six months, i. e., December 31, 1914, the inventory showed a valuation of P116,008.17, upon which the Directors allowed a depreciation of P17,052.63.

During this period of about one and one-half years, the quantity of goods carried in stock fluctuated by reason of the varying quantity of goods which were bought and sold from time to time. The amount of the sales during each successive period of six months was constant at about P67,000, while the quantity of goods purchased varied as follows: First six months, P22,733.98; second six months, P83,559.20; third six months, P35,331.21.

The stock was taken and inventories made upon each of the several occasions above referred to by the plaintiffs themselves or under their direction, and the inventories show, or should show, the actual cost price of the goods at the date of each inventory.' The plaintiffs were instructed to take the inventory in this manner, and they certify

upon the last balance sheet (of January 1, 1914) that such had been done in that instance. We assume and believe that, as a rule, it was so done, although one of the plaintiffs testified that the values set down in the inventories would run on the average 10 per cent or 12 per cent below the cost price of the goods. As the only result of the failure of the defendants to set down the goods at cost price would be in the end to prejudice their own interests, it must be assumed that the stock was properly taken and that the goods were in each instance set down at cost price.

The consideration just mentioned shows that the amounts allowed for depreciation at the several successive semi-annual stock takings were not in any sense cumulative depreciations. Each amount set aside for depreciation, on the contrary, represents a deduction from the original cost price; and the equitable adjustment of the item of depreciation over any extended period requires, not precisely that the percentage of depreciation should be at any certain point, say 10 per cent or 20 per cent, but that the factor should be as constant as practicable with reference to the amount of the goods in stock. In this connection two facts should be noted, namely, first, that depreciation at the beginning of any period is favorable to the profit and loss account, while depreciation at the end is unfavorable to that account; and secondly, that in estimating the profit and loss over several successive periods of stock taking the intermediate points may be ignored as offsetting each other. For instance, the depreciation at the end of 1913, though unfavorable to the profit and loss account for the closing six months, is in the same degree favorable to the same account for the next ensuing six months.

Bearing these facts in mind, it may be observed that the initial depreciation allowed at the beginning in June, 1913, represented about 17 per cent of the inventoried value of the stock of that date; while the final depreciation allowed upon January 1, 1914, represented about 14.65 per cent of the inventoried value of the stock of the same date. This clearly shows that the amount of depreciation was less at the end than at the beginning of the period and was to that extent favorable to the plaintiffs.

Turning now to the consideration of the actual profit and loss as shown on the books of the company and the balance sheets prepared by the accountants employed for this purpose by the defendant company, it appears that at the end of the first six months (i. e., December 31, 1913), there was a profit of P5,000. Thereafter no further profit was shown on any of the semiannual balance sheets; and the amounts set aside for depreciation at the successive intervals of stock taking were so adjusted as to absorb the profits which would otherwise have appeared.

In the balance sheet submitted by the firm of accountants who had been employed to examine the books and accounts of the company for the year ending December 31, 1914, we find the following statement which, it may be supposed, operated upon the minds of the members of the board of directors as a reason for the appointment of a manager. Say the auditors: "We have not received a satisfactory explanation of the shrinkage in the gross profit earned on cost prices of goods sold during the second half of the year to 38 per cent as against 60 per cent earned during the first half of the year." (Exhibit I.) Attached to this balance sheet is a certificate signed by each of the plaintiffs to the effect that the inventory contained a true statement of the goods in the store upon that date at their cost value.

The judge of the court below, in passing upon the propriety of the amounts set aside for depreciation, assumed that the depreciation allowed at the end of the period, i. e., on December 31, 1914, was cumulative upon the depreciation allowed at the beginning, i. e., in June, 1913; and for this reason only he arrived at the conclusion that the depreciation was excessive. He therefore turned the last depreciation, consisting of the sum of P17,052.63, back into the profit and loss account and rendered judgment in favor of the plaintiffs, for their share in said profit.

In our opinion the court erred in this conclusion. It cannot be fairly maintained that after taking stock at depreciated values in June, 1913, the stock on hand at the end of the period should be appraised at full cost price.

The learned trial judge was furthermore mistaken in supposing that the percentage of depreciation was greater at the end than at the beginning of the period; in fact it fell from over 17 per cent to under 15 per cent, a circumstance which, as we have already observed, was favorable to the plaintiffs. The plaintiffs introduced no evidence from disinterested merchants or accountants to prove what would have been a reasonable percentage to set aside under the head of depreciation, or the usage of mercantile houses with respect to this matter; nor in our opinion have they proved that they were unduly prejudiced by the action in this respect which was in fact taken.

Referring back to the terms of their contract, it will be recalled that they obligated themselves, in the fifth clause, to accept unconditionally the yearly or half yearly balances of the corporation as made up and accepted by the board of directors; and while we do not pretend to say that this clause would protect the defendant if the depreciation had been determined in bad faith, we are nevertheless of the opinion that it is so far binding on the plaintiffs that before they can impeach the action of the board in this respect they must show bad faith on the part of the board in determining the depreciation.

The evidence submitted by the plaintiffs falls short of this. The business was apparently not prosperous during this period,—a circumstance possibly due in part at least to the depressed condition of business in general; and though the item of depreciation was so calculated by the management as to absorb the apparent profits and leave nothing for distribution either in June, 1914, or at the end of the same year, it does not appear that the authority of the board of directors in fixing the depreciation was abused to the prejudice of the plaintiffs.

It results that the action of the trial court must be reversed in giving judgment in favor of the plaintiffs for their percentage of participation in the profits which, as the court erroneously supposed, were concealed under the head of depreciation in the statement of December 31, 1914.

It may be added that in February, 1915, the plaintiff, Martinez, approved a written statement of his personal account submitted to him by the president of the defendant company, in which he was shown to be debtor to it in the sum of P936.74. (Exhibit K.) It is insisted for the defendant that this was an acceptance of the account as correct and that said Martinez is precluded from questioning its correctness.. On the other hand, it is insisted by Martinez that his approval of this statement was obtained by duress and threats, or otherwise under such circumstances that he should not be considered bound by the consent so given. It appears from the evidence that the acquiescence of Martinez was reluctantly given, and his motive in yielding was to have an opportunity to visit Spain, which had been promised him by Zuellig. In view of our finding upon the principal issue, it is unnecessary to pass upon this contention; for supposing that the plaintiffs are not entitled to the profits claimed, the statement of the account which was approved by Martinez is in fact correct.

With respect to the fourth cause of action the court, properly, as we think, held that the defendant company was not liable to the plaintiffs. There was nothing in the articles of agreement which expressly denied the right of the board to place a manager in charge of the business with supervision and authority over the plaintiffs. The use of the term "sub-manager" to describe their function seems to indicate a right in the board to name a manager; and as the contract did not expressly provide that the plaintiffs should have exclusive control, it follows that the right to nominate another with superior authority was reserved by the company. We accordingly hold that the defendant cannot be held liable either for the unearned salary of the plaintiffs during the unexpired period of the contract or for the damages supposed to have been incurred by reason of the supposed injury to their reputation and standing as merchants.

The defendant asserts by way of counterclaim, in its answer to the complaint filed by Salgado, that the latter is indebted to the defendant company for certain sums, indicated in account Exhibit A, for advances, loans, etc., in an amount approximating P3,652.90; and it asserts in its answer to the complaint filed by Martinez, that the latter

is indebted to the defendant upon an account stated in the sum of P936.74, and upon a further loan, in the sum of P92.41, amounting altogether to P1,029.15. Judgment is accordingly asked upon these counterclaims in the two actions, respectively. The court below found that the amount with which Salgado should be thus charged was P3,000, and that the amount with which Martinez should be charged was P975. About the correctness of these findings there is substantially no dispute. The plaintiffs are, however, each entitled to be credited with his respective share (17 1/2 per cent) in the profit of P5,000, shown by the books of the defendant company to have been earned for the period ending December 31, 1913. This amounts to P875 for each. Deducting this amount from the indebtedness of each, as shown above, it results that the plaintiff Salgado is indebted to the defendant company in the sum of P2,125 and that the plaintiff Martinez is indebted to the defendant company in the sum of P100.

The judgment of the lower court is reversed and judgment will here be entered in favor of The St. Louis Dry Goods Store (Inc.) against German Salgado for the sum of two thousand one hundred twenty-five pesos (P2,125) and against Pablo Martinez for the sum of one hundred pesos (P100), without any express finding of costs of this instance. Pursuant to the provisions of section 500 of the Code of Civil Procedure interest will be allowed on both these sums from February 1, 1916, until paid. So ordered.

Torres, Johnson, Araullo, Malcolm, and Fisher, JJ., concur.

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