

THE GOVERNMENT OF THE PHILIPPINE ISLANDS, PLAINTIFF AND APPELLANT, VS. THE PHILIPPINE SUGAR ESTATES DEVELOPMENT CO. (LTD.), DEFENDANT AND APPELLANT.

G.R. No. 11789. April 02, 1918

Ponente: JOHNSON, J.

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JOHNSON, J.:

This is an action in the nature of quo warranto. It was brought by the Attorney-General for and on the behalf of the Government of the Philippine Islands for the purpose of having the charter of the defendant corporation declared forfeited. The complaint alleged that the defendant was a corporation duly organized under the laws of the Philippine Islands; that for a period of eighteen months previous to the filing of the complaint (Nov. 21, 1914), it had continuously offended against the laws of the Philippine Islands and had misused its corporate authority, franchises, and privileges and had assumed privileges and franchises not granted; that it had engaged in the business of buying and selling real estate; that on the 31st of May, 1913, it entered into a contract with The Tayabas Land Company for the purpose of engaging in the business of purchasing lands along the right of way of the Manila Railroad Company through the Province of Tayabas with a view to reselling the same to the Manila Railroad Company at a profit. A copy of the contract was made part of the complaint. The plaintiff alleged, that by the acts and omissions of the defendant, it had forfeited its corporate rights, privileges, powers, and franchises and prayed that the court render judgment depriving it of all corporate rights, privileges and franchises, dissolving it as a corporation, and to grant such other and further relief as might seem just and equitable to the court, and for costs.

The defendant appeared on January 18, 1915, and demurred to the complaint upon the ground that it failed to state a cause of action. On April 28, 1915, the court overruled said demurrer and the defendant duly excepted. On May 5, 1915, the defendant answered the complaint. The defendant admitted the first paragraph of the complaint and denied generally the allegations of the second and third paragraphs with the exception that it admitted having entered into the contract set out in paragraph III and alleged that The Tayabas Land Company was an ordinary partnership and not a corporation as alleged in paragraph III. The allegations of paragraph IV were denied generally. The defendant prayed that the complaint be dismissed with costs.

On August 24, 1915, the parties filed a stipulation of facts which appears at page 16 of the bill of exceptions. By said stipulation it was agreed that the defendant was a corporation duly organized; that The Tayabas Land Company was a partnership; that a contract was entered into between the defendant and The Tayabas Land Company by virtue of which the defendant delivered to the said The Tayabas Land Company P304,459.42 which the plaintiff contended amounted to a contribution by the defendant to the capital of The Tayabas Land Company but which the defendant contended amounted to a loan to said concern; that the money thus received was devoted to the purchase of real estate in the Province of Tayabas along the proposed right of way of the Manila Railroad Company in that province; that the purpose of these purchases was for resale to the Manila Railroad Company or any other person offering an acceptable price. Attached to this stipulation are three exhibits which are (a) copies

of the charter of the defendant; (b) the partnership agreement of The Tayabas Land Company; and (c) the contract entered into between the defendant and The Tayabas Land Company. On October 14, 1915, it was further stipulated and agreed that all of the deeds of land executed to The Tayabas Land Company, which had been in the possession of the defendant, had been delivered to the Board of Public Utility Commissioners in obedience to a subpoena duces tecum.

On February 21, 1916, the court rendered judgment ordering the defendant to abstain in the future from engaging in the business of buying and selling lands and to pay the costs of the action. Both parties excepted to this judgment and moved for a new trial which was denied by the court. They appealed and filed one bill of exceptions.

The lower court reduced the issue in this case to two queries: (1) Did the defendant engage in the business of: buying and selling land or was this transaction merely a loan to a partnership, which was engaged in the business of buying and selling land? (2) Assuming that the defendant was engaged in the business of buying and selling land, does the law require that it be dissolved or is the prohibition of future acts of this nature sufficient?

The decision upon the demurrer was to the effect that the contract entered into between the defendant and The Tayabas Land Company constituted an agreement to enter into a partnership. After studying the proof and the evidence the court decided that the contract was not one of partnership but was a contract of *cuentas en participacion*. The court found that the defendant had interested itself in the Tayabas Land Company to such an extent that it was in effect carrying on the business of buying and selling land. The court found that the law did not require that the charter of the defendant be forfeited and it further found that the Government could not be benefited by such 'forfeiture. The court ordered the defendant to abstain from the further prosecution of this class of business.

Certain facts are important in order to make clear the argument of the appellants.

First. The defendant corporation by its charter was authorized, among other things:

"(j) To buy shares of the Compania de Navegacion, Ferrocarriles, Diques, y Almacenes de Depositos, and, in this manner or otherwise, to engage in any mercantile or industrial enterprise.

"(k) With no other restrictions than those provided by law, place funds of the corporation in hypothecary or pignorative loans, in public securities of the United States, in stocks or shares issued by firms, corporations, or companies that are legally organized and operated, and in rural and urban property. It may also contract and guarantee all kinds of obligations, in conformity with existing laws." (Bill of Exceptions, p. 21.)

Second. These powers are necessarily limited by section 75 of the Act of Congress of July 1, 1902, and by section 13 of Act No. 1469, the latter being a reproduction of the former, which is as follows:

"That no corporation shall be authorized to conduct the business of buying and selling real estate or be permitted to hold or own real estate except such as may be reasonably necessary to enable it to carry out the purposes for which it is created, * * *. Corporations, however, may loan funds upon real estate, security, and purchase real estate when necessary for the collection of loans, but they shall dispose of real estate so obtained within five years after receiving the title * * *."

Third. The provisions of the contract between the defendant and The Tayabas Land Company which are pertinent to this case are as follows:

"First. That the Philippine Sugar Estates Development Co., (Ltd.), which hereinafter shall be denominated 'The Philippine Sugar,' shall take part in the business which The Tayabas Land Company has established, and, for this

purpose, brings in the sum of four hundred thousand pesos (P400,000), Philippine currency, which it places at the disposal of the latter concern, through the opening of a credit for said amount, of which credit The Tayabas Land Company may dispose in accordance with the requirements of the business or businesses it at present conducts or in the future may conduct.

"Second. That The Tayabas Land Company agrees that the Philippine Sugar take part in the business of the former, in the amount and manner stated in the preceding clause.

"Third. That the allotments by The Philippine Sugar, up to the amount of the four hundred thousand pesos above specified, shall be the following: 1. (P100,000 already received). 2. (P30,000 already received). 3. Two hundred and seventy thousand pesos (P270,000) which The Philippine Sugar shall deliver from time to time in accordance with the needs of the business of The Tayabas Land Company.

"Fourth. * * * * *

"Fifth. The Philippine Sugar shall have a share of twenty-five per cent (25 per cent) of the net profits derived from any and all the business of The Tayabas Land Company. The Tayabas Land Company shall keep its accounts in proper manner, and shall exhibit to The Philippine Sugar all books, balances, and accounts such as the latter company may require to be shown in order to have complete proof of the correctness of any and all the proper settlements.

"Sixth. The general, actual, and necessary expenses which The Tayabas Land Company may have to defray in the transaction of its business, shall be paid by it and by The Philippine Sugar in the same proportion as they each share in the profits in accordance with the preceding clause. Exception is made of the loss referred to in the fourth clause of this contract, which, as therein set forth, shall be borne solely by The Tayabas Land Company.

"Seventh. All lands bought or which may be bought with the credit, which The Philippine Sugar brings to The Tayabas Land Company and which lie within and without the railway line from Pagbilao to Lopez, shall be held as security for such credit, at their respective cost price, until their alienation, except the part thereof which pertains to D. Mariano Lim in The Tayabas Land Company.

"Eighth. When The Tayabas Land Company is to sell lands and improvements at a price lower than P0.50 per meter, it shall first obtain the consent of The Philippine Sugar Estates Development Co. (Ltd.). Such consent, however, shall not be necessary when the price is more than that fixed above.

"Ninth. The Philippine Sugar shall be the treasurer and depository of the aforementioned credit, shall make all disbursements against it as required from time to time, and shall receive all sums derived from the sale of the lands. The deeds of purchase of the said lands shall be filed in its office.

"Tenth. The proceeds from the first sales of lands and improvements of the line from Pagbilao to Lopez shall be integrally set aside for the total amortization of the capital.

"Eleventh. The Tayabas Land Company binds itself to make use of the credit in its entirety." Bill of Exceptions, p. 41.)

"Fourth. The foregoing contract was made in pursuance of a meeting of the board of directors of the defendant corporation held on May 30, 1913. The minutes, after stating the history of the relations between the defendant and the Tayabas Land Conipany, set out the following authorization:

"In view of the foregoing facts and considerations, unanimously recognized, and for the stability and safety of the business, the board resolved by a majority vote: 1. To grant to The Tayabas Land Company the credit applied for, amounting to four hundred thousand (P400,000) pesos, the one hundred thousand (P100,000) pesos of the original

loan being included in this sum; 2. To change the form of the mortgage, in view of the impossibility of the borrowers to find sufficient and substantial securities wherewith to cover said new credit under the new form of contract, the bases and conditions thereof being as follows:

"CREDIT WITH SECURITY AND IN COPARTNERSHIP,

"Credit which The Philippine Sugar * * * opens in favor of The Tayabas Land Co. up to P400,000. * * *

"With security because all the lands bought with funds from said credit are held as security. * * *

"And in copartnership because the loan applied for shares in the gross profits to the extent of 25 per cent, instead of interest, as being enormously more advantageous. * * *

CONDITIONS.

"1. Share of 25 per cent in the profits.

"2. Reimbursement of all losses which The Philippine. Sugar may suffer in the realization of its securities.

"3. Charge against The Tayabas Land Company for all the general expenses, enumerated under letter %' and other especial expenses of whatever kind which It may incur. This condition is inserted in view of the disproportional share of the capital employed in the business, and as a compensation * * *

"4. To revert this 25 per cent share to the present liabilities of the Tayabas Land Company. * * *

"5. Settlement of the interest, at 12 per cent, of the first loan. * * *

"6. All the lands bought or which may be bought with funds from that credit, within and without the line from Pagbilao to Lopez, shall be held as security, except the share which Mr. Lim has in the Tayabas Land Company.

"7. The Philippine Sugar shall give its approval * * * to the sale of lands to the Railroad Company, whether there be settlement or litigation, whether such sale be made by compromise, or whether suit must be brought. * * *

"8. The Philippine Sugar shall be the depositary-treasurer of said credit, and shall deliver the sums needed from time to time and, in exchange for the deposit in its office, of the deeds of purchase of the lands.

"9. The proceeds from the first and successive sales shall be devoted to the total amortization of the capital * * *

"10. The Tayabas Land Company binds itself to make use of this loan in its entirety, or, in a contrary case, it shall be obliged to reimburse the totality of the loss corresponding to the three hundred thousand (P300,000) pesos which The Philippine Sugar bind itself to place in the market, * * *

"The purchase price agreed upon with the manager of The Tayabas Land Company is at the rate of 95 per cent. * * * (Record, pp. 105-108.)

Said sum of money was turned over to The Tayabas Land Company and land was purchased by it. It must be presumed that the relation between the defendant corporation and the Tayabas Land Company was governed by the contract which has been quoted above.

There are a number of features of this contract which should be noted. (1) There was no period fixed in the contract for the repayment of the money, except that the first returns from the sale of the land was to be devoted to the payment of the capital. There was no date fixed for this payment. (2) The entire amount of the "credit" was not to be turned over at once but was to be used by The Tayabas Land Company as it was needed (3) The return on the capital was not by a fixed rate of interest but 25 per cent of the profits earned by The Tayabas Land Company

in "todos los negocios" was to be paid to the defendant. (4) The defendant corporation agreed to pay 25 per cent of "los gastos generales, reales y necesarios que The Tayabas Land Company tenga que efectuar para el desenvolvimiento de los asuntos" (all general expenditures true and necessary that the Tayabas Land Company must make for the development of its business.) (Artículo sexto of the contract.) (5) The consent of the defendant was necessary when The Tayabas Land Company desired to sell the land at a price under P0.50 per square meter but was not required if the selling price was over that amount. (6) The defendant acted as the treasurer of the enterprise. It paid out the money as it was needed for the purchase of land and received the proceeds of the sale of land as well as acting as the depository of the deeds, covering the land.

The lower court found that the contract entered into was that of "cuentas en participacdn" and that the proper judgment was an order prohibiting a continuance of this relationship.

The defendant-appellant contends that the contract was within its powers; that the contract was in reality merely a loan. It is argued that the board of directors did not authorize Suarez to enter into a partnership agreement or a "cuentas en participacion" but only to negotiate a loan and 25 per cent of the profits to be paid in lieu of interest. Any contract which is not authorized by the board of directors (meeting of May 30, 1913) would, it is argued, be ultra vires on the part of the officer executing it and would not bind the corporation. A comparison of the contract actually entered into with the minutes of the board of directors will show that they are practically identical. Clause decima of the "condiciones" in the minutes of the board of directors is explained as follows: The Philippine Sugar Estates Development Co. in order to raise part of the capital which they "loaned" to The Tayabas Land Company sold P300,000 worth of Japanese bonds. The loss occasioned by this sale was to be paid by The Tayabas Land Company as provided in the 4th section of the contract. (See pp. 14-15, Bill of Exceptions.)

It is difficult to understand how this contract can be considered a loan. There was no date fixed for the return of the money and there was no fixed return to be made for the use of the money. The return was dependent solely upon the profits of the business. It is possible for the defendant to receive a return from the business even after all of the "capital" has been returned. The "capital" was to be returned as soon as the land was sold and apparently, from clause "de"cima," there were to be no profits until this "capital" was returned. The defendant was not to receive anything for the use of said sum until after the capital had been fully repaid, which is not consistent with the idea of a loan. It is not impossible to provide that the capital be repaid first but the usual method is to pay the interest first. In the present instance after sufficient land had been sold to repay the capital the remaining land unsold represented the profit between the defendant and the Tayabas Land Company in the proportion of 25 to 75. The remaining land, under the agreement, must be sold at a profit and the result must be therefore a profit upon the profit. The remaining land was not necessary to guarantee the repayment of the original loan because the original loan had already been paid. Under the contract, even though the 25 per cent of the profit were turned over to the defendant, if The Tayabas Land Company reinvested its share of the profits and continued the business, the defendant would still be entitled to a profit on that investment. The contract provides that the defendant shall be entitled to 25 per cent upon "todos los negocios" of The Tayabas Land Company.

After the capital is returned the land remaining, if any, is profit. It can be nothing else and belongs to both parties in the proportion of 25 to 75. The defendant at least has an equitable interest in the land itself; it has in fact an equitable title to 25 per cent of all the remaininng land. If these lands were to be registered, the defendant could demand that its interest be noted on the register. This being so, can it be denied that the defendant is, at least indirectly, conducting the business of buyihg. and selling real estate? When an individual or a corporation becomes the owner of land by purchase he or it must be a purchaser. The. defendant-appellant argues that it never secured title to any of the real estate purchased and therefore it could not sell it. Does not an equitable title in the real estate come at least within the spirit of the prohibition?

The lower court found that the relation between the defendant and The Tayabas Land Company was that of "cuentas en participaci6n." Whether the relation between the defendant and The Tayabas Land Company was. that of a copartnership or one of "cuentas en participaci6n" is of little importance if under such relation the defendant, as a party to such relation, actually engaged in the business of "holding and owing" real estate which was "unnecessary to carry out the purposes for which it was created."

The plaintiff has appealed upon the ground that the lower court erred in not declaring that the defendant has forfeited its charter. Section 198 of Act No. 190 provides that an action may be maintained by the Government against the corporation: (a) when it has offended against the provision of an act for its creation or renewal or any act altering or amending such act; (b) when it has forfeited its privileges and franchise by nonuser; (c) when it has committed or omitted an act which amounts to a surrender of its corporate rights, privileges, or franchises; (d) when it has misused a franchise, privilege, or right conferred upon it by law, or when it has exercised a franchise, privilege, or right in contravention of law.

Section 212 of Act No. 190 provides a judgment which may be rendered in said cases:

"When in any such action, it is found and adjudged that a corporation has, by an act done or omitted, surrendered, or forfeited its corporate rights, privileges, and franchise, or has not used the same during the term of five years, judgment shall be entered that it be ousted and excluded therefrom and that it be dissolved; but when it is found and adjudged that a corporation has offended in any matter or manner which does not by law work as a surrender or forfeiture, or has misused a franchise or exercised a power not conferred by law, but not of such a character as to work a surrender or forfeiture of its franchise, judgment shall be rendered that it be ousted from the continuance of such offense or the exercise of such power."

It will be seen that said section (212) gives the court a wide discretion in its judgment in depriving corporations of their franchise. High, in his work on Extraordinary Legal Remedies, says at page 606:

"It is to be observed in the outset that the courts proceed with extreme caution in the proceeding which have for their object the forfeiture of corporate franchises, and a forfeiture will not be allowed, except under express limitation, or for a plain abuse of power by which the corporation fails to fulfill the design and purpose of its organization."

In the case of *State of Minnesota vs. Minnesota Thresher Manufacturing Co.* (3 L.R.A., 510) the court said (p. 518):

"The scope of the remedy furnished by it (quo warranto) is to forfeit the franchises of a corporation for misuser or nonuser. It is therefore necessary in order to secure a judicial forfeiture of respondent's charter to show a misuser of its franchises justifying such a forfeiture. And as already remarked the object being to protect the public, and not to redress private grievances, the misuser must be such as to work or threaten a substantial injury to the public, or such as to amount to a violation of the fundamental condition of the contract by which the franchise was granted and thus defeat the purpose of the grant; and ordinarily the wrong or evil must be one remediable in no other form of judicial proceeding.

"Courts always proceed with great caution in declaring a forfeiture of franchises, and require the prosecutor seeking the forfeiture to bring the case clearly within the rules of law entitling him to exact so severe a penalty. (*People vs. North River Sugar Refining Co.*, 9 L.R.A., 33, 39; *State vs. Portland Natural Gas Co.*, 153 Ind., 483.)"

While it is true that the courts are given a wide discretion in ordering the dissolution of corporations for violations of its franchises, etc., yet nevertheless, when such abuses and violations constitute or threaten a substantial injury to the public or such as to amount to a violation of the fundamental conditions of the contract (charter) by which

the franchises were granted and thus defeat the purpose of the grant, then the power of the courts should be exercised for the protection of the people. Under the law the people of the Philippine Islands have guaranteed the payment of the interest upon cost of the construction of the railroad which occupied or occupies at least some of the lands purchased by the defendant. Every additional dollar of increase in the price of the land purchased by the railroad company added that much to the costs of construction and thereby increased the burden imposed upon the people. The very and sole purpose of the intervention of the defendants in the purchase of the land from the original owners was for the purpose of selling the same to the Railroad Company at a profit—at an increased price, thereby directly increasing the burden of the people by way of additional taxation. The purpose of the intervention of the defendant in the transactions in question, was to enrich itself at the expense of the taxpayers of the Philippine Islands, who had, by a franchise granted, permitted the defendant to exist and do business as a corporation. The defendant was not willing to allow the Railroad Company to purchase the land of the original owners. Its' intervention with The Tayabas Land Company was to obtain an increase in the price of the land in a resale of the same to the railroad company. The conduct of the defendant in the premises merits the severest condemnation of the law.

The judgment of the lower court should be modified. It is hereby ordered and decreed that the franchise heretofore granted to the defendant by which it was permitted to exist and do business as a corporation in the Philippine Islands, be withdrawn and annulled and that it be disallowed to do and to continue doing business in the Philippine Islands, unless it shall within a period of six months after final decision, liquidate, dissolve and separate absolutely in every respect and in all of its relations, complained of in the petition, with the Tayabas Land Company, without any findings as to costs. And it is hereby further ordered and decreed that the record be returned to the lower court with direction that a judgment be entered in accordance herewith. And be it further ordered and decreed, upon the presentation of positive proof that the defendant corporation has complied in full with the foregoing order and decree that then and in that case the complaint shall be dismissed, otherwise this decree shall remain in full force and effect. So ordered.

Torres, Araullo, and Street, JJ., concur.

Carson, J., concurs in the result.

CONCURRING OPINION

MALCOLM, J., concurring:

I concur in the result. The defendant corporation has violated the plain provisions of statute law and organic law—the law of its creation. It has performed acts hostile to the policy of the state and detrimental to the public. Consequently, the charter of the Philippine Sugar Estates Development Co. (Ltd.), should be declared forfeited for wilful misuser and the corporation should be immediately dissolved. (Philippine Bill, secs. 75; Corporation Law, sec. 13 [5] ; Code of Civil Procedure, secs. 198, 212; New Orleans Water Works vs. Louisiana [1902], 185 U. S., 336; State vs. New Orleans Gas Light & Banking Co. [1842], 2 Rob. [La.], 529; Commonwealth vs. Commercial Bank of Pennsylvania [1857], 28 Pa. St., 383., etc.)

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