

HENRY FLEISCHER, PLAINTIFF AND APPELLEE, VS. BOTICA NOLASCO CO., INC., DEFENDANT AND APPELLANT.*G.R. No. 23241. March 14, 1925*

Ponente: JOHNSON, J.

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This action was commenced in the Court of First Instance of the Province of Oriental Negros on the 14th day of August, 1923, against the board of directors of the Botica Nolasco, Inc., a corporation duly organized and existing under the laws of the Philippine Islands. The plaintiff prayed that said board of directors be ordered to register in the books of the corporation five shares of its stock in the name of Henry Fleischer, the plaintiff, and to pay him the sum of P500 for damages sustained by him resulting from the refusal of said body to register the shares of stock in question. The defendant filed a demurrer on the ground that the facts alleged in the complaint did not constitute sufficient cause of action, and that the action was not brought against the proper party, which was the Botica Nolasco, Inc. The demurrer was sustained, and the plaintiff was granted five days to amend his complaint.

On November 15, 1923, the plaintiff filed an amended complaint against the Botica Nolasco, Inc., alleging that he became the owner of five shares of stock of said corporation, by purchase from their original owner, one Manuel Gonzalez; that the said shares were fully paid; and that the defendant refused to register said shares in his name in the books of the corporation in spite of repeated demands to that effect made by him upon said corporation, which refusal caused him damages amounting to P500. Plaintiff prayed for a judgment ordering the Botica Nolasco, Inc. to register in his name in the books of the corporation the five shares of stock recorded in said books in the name of Manuel Gonzalez, and to indemnify him in the sum of P500 as damages, and to pay the costs. The defendant again filed a demurrer on the ground that the amended complaint did not state facts sufficient to constitute a cause of action, and that said amended complaint was ambiguous, unintelligible, uncertain, which demurrer was overruled by the court.

The defendant answered the amended complaint denying generally and specifically each and every one of the material allegations thereof, and, as a special defense, alleged that the defendant, pursuant to article 12 of its by-laws, had preferential right to buy from the plaintiff said shares at the par value of P100 a share, plus P90 as dividends corresponding to the year 1922, and that said offer was refused by the plaintiff. The defendant prayed for a judgment absolving it from all liability under the complaint and directing the plaintiff to deliver to the defendant the five shares of stock in question, and to pay damages in the sum of P500, and the costs.

Upon the issue presented by the pleadings above stated, the cause was brought on for trial, at the conclusion, of which, and on August 21, 1924, the Honorable N. Capistrano, judge, held that, in his opinion, article 12 of the by-laws of the corporation which gives it preferential right to buy its shares from retiring stockholders, is in conflict with Act No. 1459 (Corporation Law), especially with section 35 thereof; and rendered a judgment ordering the defendant corporation, through its board of directors, to register in the books of said corporation the said five shares of stock in the name of the plaintiff, Henry Fleischer, as the shareholder or owner thereof, instead of the original owner, Manuel Gonzalez, with costs against the defendant.

The defendant appealed from said judgment, and now makes several assignments of error, all of which, in substance, raise the question whether or not article 12 of the by-laws of the corporation is in conflict with the provisions of the Corporation Law (Act No. 1459).

There is no controversy as to the facts of the present case. They are simple and may be stated as follows:

That Manuel Gonzalez was the original owner of the five shares of stock in question, Nos. 16, 17, 18, 19 and 20 of the Botica Nolasco, Inc.; that on March 11, 1923, he assigned and delivered said five shares to the plaintiff, Henry Fleischer, by accomplishing the form of endorsement provided on the back thereof, together with other credits, in consideration of a large sum of money owed by Gonzalez to Fleischer (Exhibits A, B, B-1, B-2, B-3, B-4); that on March 13, 1923, Dr. Eduardo Miciano, who was the secretary-treasurer of said corporation, offered to buy from Henry Fleischer, on behalf of the corporation, said shares of stock, at their par value of P100 a share, for P500; that by virtue of article 12 of the by-laws of Botica Nolasco, Inc., said corporation had the preferential right to buy from Manuel Gonzalez said shares (Exhibit 2); that the plaintiff refused to sell them to the defendant; that the plaintiff requested Doctor Miciano to register said shares in his name; that Doctor Miciano refused to do so, saying that it would be in contravention of the by-laws of the corporation.

It also appears from the record that on the 13th day of March, 1923, two days after the assignment of the shares to the plaintiff, Manuel Gonzalez made a written statement to the Botica Nolasco, Inc., requesting that the five shares of stock sold by him to Henry Fleischer be not transferred to Fleischer's name. He also acknowledged in said written statement the preferential right of the corporation to buy said five shares (Exhibit 3). On June 14, 1923, Gonzalez wrote a letter to the Botica Nolasco, withdrawing and cancelling his written statement of March 13, 1923 (Exhibit C), to which letter the Botica Nolasco on June 15, 1923, replied, declaring that his written statement was in conformity with the by-laws of the corporation; that his letter of June 14th was of no effect, and that the shares in question had been registered in the name of the Botica Nolasco, Inc., (Exhibit X).

As indicated above, the important question raised in this appeal is whether or not article 12 of the by-laws of the Botica Nolasco, Inc., is in conflict with the provisions of the Corporation Law (Act No. 1459). Appellant invoked said article as its ground for denying the request of the plaintiff that the shares in question be registered in his (plaintiff's) name, and for claiming that it (Botica Nolasco, Inc.) had the preferential right to buy said shares from Gonzalez. Appellant now contends that article 12 of the said by-laws is in conformity with the provisions of Act No. 1459. Said article is as follows:

"Art. 12. Las acciones de la Corporacion pueden ser transferidas a otra persona, pero para que estas transferencias tengan validez legal, deben constar en los registros de la Corporacion con el debido endoso del accionista a cuyo nombre se ha expedido la accion o acciones que se transfieran, o un documento de transferencia. Entendiendose que, ningun accionista transferira accion alguna a otra persona sin participar antes por escrito al Secretario-Tesorero. En igualdad de condiciones, la sociedad tendra el derecho de adquirir para si la accion o acciones que se traten de transferir." (Exhibit 2.)

The above-quoted article constitutes a by-law or regulation adopted by the Botica Nolasco, Inc., governing the transfer of shares of stock of said corporation. The latter part of said article creates in favor of the Botica Nolasco, Inc., a preferential right to buy, under the same conditions, the share or shares of stock of a retiring shareholder. Has said corporation any power, under the Corporation Law (Act. No. 1459), to adopt such by-law?

The particular provisions of the Corporation Law referring to transfer of shares of stock are as follows:

"Sec. 13. Every corporation has the power:

* * * * *

" (7) To make by-laws, not inconsistent with any existing law, for the fixing or changing of the number of its officers and directors within the limits prescribed by law, and for the transferring of its stock, the administration of its corporate affairs, etc.

* * * * *

"Sec. 35. The capital stock of stock corporations shall be divided into shares for which certificates signed by the president or the vice-president, countersigned by the secretary or clerk and sealed with the seal of the corporation, shall be issued in accordance with the by-laws. Shares of stock so issued are personal property and may be transferred by delivery of the certificate indorsed by the owner or his attorney in fact or other person legally authorized to make the transfer. No transfer, however, shall be valid, except as between the parties, until the transfer is entered and noted upon the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of the certificate, and the number of shares transferred.

"No share of stock against which the corporation holds any unpaid claim shall be transferable on the books of the corporation."

Section 13, paragraph 7, above-quoted, empowers a corporation to make by-laws, not inconsistent with any existing law, for the transferring of its stock. It follows from said provision, that a by-law adopted by a corporation relating to transfer of stock should be in harmony with the law on the subject of transfer of stock. The law on this subject is found in section 35 of Act No. 1459 above quoted. Said section specifically provides that the shares of stock "are personal property and may be transferred by delivery of the certificate indorsed by the owner, etc." Said section 35 defines the nature, character and transferability of shares of stock. Under said section they are personal property and may be transferred as therein provided. Said section contemplates no restriction as to whom they may be transferred or sold. It does not suggest that any discrimination may be created by the corporation in favor or against a certain purchaser. The holder of shares, as owner of personal property, is at liberty, under said section, to dispose of them in favor of whomsoever he pleases, without any other limitation in this respect, than the general provisions of law. Therefore, a stock corporation in adopting a by-law governing transfer of shares of stock should take into consideration the specific provisions of section 35 of Act No. 1459, and said by-law should be made to harmonize with said provisions. It should not be inconsistent therewith.

The by-law now in question was adopted under the power conferred upon the corporation by section 13, paragraph 7, above quoted; but in adopting said by-law the corporation has transcended the limits fixed by law in the same section, and has not taken into consideration the provisions of section 35 of Act No. 1459.

As a general rule, the by-laws of a corporation are valid if they are reasonable and calculated to carry into effect the objects of the corporation, and are not contradictory to the general policy of the laws of the land. (Supreme Commandery of the Knights of the Golden Rule vs. Ainsworth, 71 Ala., 436; 46 Am. Rep., 332.)

On the other hand, it is equally well settled that by-laws of a corporation must be reasonable and for a corporate purpose, and always within the charter limits. They must always be strictly subordinate to the constitution and the general laws of the land. They must not infringe the policy of the state, nor be hostile to public welfare. (46 Am. Rep., 332.) They must not disturb vested rights or impair the obligation of a contract, take away or abridge the substantial rights of stockholder or member, affect rights of property or create obligations unknown to the law. (People's Home Savings Bank vs. Superior Court, 104 Cal., 649; 43 Am. St. Rep., 147; Ireland vs. Globe Milling Co., 79 Am. St. Rep., 769.)

The validity of the by-law of a corporation, is purely a question of law. (South Florida Railroad Co. vs. Rhodes, 25 Fla., 40.)

"The power to enact by-laws restraining the sale and transfer of stock must be found in the governing statute or

the charter. Restrictions upon the traffic in stock must have their source in legislative enactment, as the corporation itself cannot create such impediments. By-laws are intended merely for the protection of the corporation, and prescribe regulation and not restriction; they are always subject to the charter of the corporation. The corporation, in the absence of such a power, cannot ordinarily inquire into or pass upon the legality of the transaction by which its stock passes from one person to another, nor can it question the consideration upon which a sale is based. A by-law cannot take away or abridge the substantial rights of stockholder. Under a statute authorizing by-laws for the transfer of stock, a corporation can do no more than prescribe a general mode of transfer on the corporate books and cannot justify an unreasonable restriction upon the right of sale." (4 Thompson on Corporations, sec. 4137, p. 674.)

"The right of unrestrained transfer of shares inheres in the very nature of a corporation, and courts will carefully scrutinize any attempt to impose restrictions or limitations upon the right of stockholders to sell and assign their stock. The right to impose any restraint in this respect must be conferred upon the corporation either by the governing statute or by the articles of the corporation. It cannot be done by a by-law without statutory or charter authority." (4 Thompson on Corporations, sec. 4334, pp. 818, 819.)

"The *jus disponendi*, being an incident of the ownership of property, the general rule (subject to exceptions hereafter pointed out and discussed) is that every owner of corporate shares has the same uncontrollable right to alien them which attaches to the ownership of any other species of property. A shareholder is under no obligation to refrain from selling his shares at the sacrifice of his personal interest, in order to secure the welfare of the corporation, or to enable another shareholder to make gains and profits." (10 Cyc., p. 577.)

"It follows from the foregoing that a corporation has no power to prevent or to restrain transfers of its shares, unless such power is expressly conferred in its charter or governing statute. This conclusion follows from the further consideration that by-laws or other regulations restraining such transfers, unless derived from authority expressly granted by the legislature would be regarded as impositions in restraint of trade." (10 Cyc., p. 578.)

The foregoing authorities go farther than the stand we are taking on this question. They hold that the power of a corporation to enact by-laws restraining the sale and transfer of shares, should not only be in harmony with the law or charter of the corporation, but such power should be expressly granted in said law or charter.

The only restraint imposed by the Corporation Law upon transfer of shares is found in section 35 of Act No. 1459, quoted above, as follows: "No transfer, however, shall be valid; except as between the parties, until the transfer is entered and noted upon the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of the certificate, and the number of shares transferred." This restriction is necessary in order that the officers of the corporation may know who are the stockholders, which is essential in conducting elections of officers, in calling meetings of stockholders, and for other purposes. But any restriction of the nature of that imposed in the by-law now in question, is *ultra vires*, violative of the property rights of shareholders, and in restraint of trade.

And moreover, the by-law now in question cannot have any effect on the appellee. He had no knowledge of such by-law when the shares were assigned to him. He obtained them in good faith and for a valuable consideration. He was not a privy to the contract created by said by-law between the shareholder Manuel Gonzalez and the Botica Nolasco, Inc. Said by-law cannot operate to defeat his rights as a purchaser.

"An unauthorized by-law forbidding a shareholder to sell his shares without first offering them to the corporation for a period of thirty days is not binding upon an assignee of the stock as a personal contract, although his assignor knew of the by-law and took part in its adoption." (10 Cyc., 579; *Ireland vs. Globe Milling Co.*, 21 R. I., 9.)

"When no restriction is placed by public law on the transfer of corporate stock, a purchaser is not affected by any contractual restriction of which he had no notice." (*Brinkerhoff-Farris Trust & Savings Co. vs. Home*

Lumber Co., 118 Mo., 447.)

"The assignment of shares of stock in a corporation by one who has assented to an unauthorized by-law has only the effect of a contract by, and enforceable against, the assignor; the assignee is not bound by such by-law by virtue of the assignment alone." (Ireland vs. Globe Milling Co., 21 R. I., 9.)

"A by-law of a corporation which provides that transfers of stock shall not be valid unless approved by the board of directors, while it may be enforced as a reasonable regulation for the protection of the corporation against worthless stockholders, cannot be made available to defeat the rights of third persons." (Farmers' & Merchants' Bank of Lineville vs. Wasson, 48 Iowa, 336.)

Counsel for defendant incidentally argues in his brief, that the plaintiff does not have any right of action against the defendant corporation, but against the president and secretary thereof, inasmuch as the signing and registration of shares is incumbent upon said officers pursuant to section 35 of the Corporation Law. This contention cannot be sustained now. The question should have been raised in the lower court. It is too late to raise it now in this appeal. Besides, as stated above, the corporation was made defendant in this action upon the demurrer of the attorney of the original defendant in the lower court, who contended that the Botica Nolasco, Inc., should be made the party defendant in this action. Accordingly, upon order of the court, the complaint was amended and the said corporation was made the party defendant.

Whenever a corporation refuses to transfer and register stock in cases like the present, mandamus will lie to compel the officers of the corporation to transfer said stock upon the books of the corporation. (26 Cyc. 347; Hager vs. Bryan, 19 Phil., 138.)

In view of all the foregoing, we are of the opinion, and so hold, that the decision of the lower court is in accordance with law and should be and is hereby affirmed, with costs. So ordered.

Malcolm, Villamor, Ostrand, Johns, and Romualdez, JJ., concur.

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