

THE NATIONAL EXCHANGE CO., INC., PLAINTIFF AND APPELLEE, VS. I. B. DEXTER, DEFENDANT AND APPELLANT.

G.R. No. 27872. February 25, 1928

Ponente: STREET, J.

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STREET, J.:

This action was instituted in the Court of First Instance of Manila by the National Exchange Co., Inc., as assignee (through the Philippine National Bank) of C. S. Salmon & Co., for the purpose of recovering from I. B. Dexter a balance of P15,000, the par value of one hundred fifty shares of the capital stock of C. S. Salmon & Co., with interest and costs. Upon hearing the cause the trial judge gave judgment for the plaintiff to recover the amount claimed, with lawful interest from January 1, 1920, and with costs. From this judgment the defendant appealed.

It appears that on August 10, 1919, the defendant, I. B. Dexter, signed a written subscription to the corporate stock of C. S. Salmon & Co. in the following form:

"I hereby subscribe for three hundred (300) shares of the capital stock of C. S. Salmon and Company, payable from the first dividends declared on any and all shares of said company owned by me at the time dividends are declared, until the full amount of this subscription has been paid."

Upon this subscription the sum of P15,000 was paid in January, 1920, from a dividend declared at about that time by the company, supplemented by money supplied personally by the subscriber. Beyond this nothing has been paid on the shares and no further dividend has been declared by the corporation. There is therefore a balance of P15,000 still unpaid upon the subscription.

As the case reaches this court the sole question here presented for consideration is one of law, namely, whether the stipulation contained in the subscription to the effect that the subscription is payable from the first dividends declared on the shares has the effect of relieving the subscriber from personal liability in an action to recover the value of the shares. The trial court held, in effect, that the stipulation mentioned is invalid.

In discussing this problem we accept as sound law the proposition propounded by the appellant's attorneys and taken from Fletcher's Cyclopedia as follows:

"In the absence of restrictions in its charter, a corporation, under its general power to contract, has the power to accept subscriptions upon any special terms not prohibited by positive law or contrary to public policy, provided they are not such as to require the performance of acts which are beyond the powers conferred upon the corporation by its charter, and provided they do not constitute a fraud upon other subscribers or stockholders, or upon persons who are or may become creditors of the corporation." (Fletcher, Cyc. Corp., sec. 602, p. 1314.)

Under the American regime corporate franchises in the Philippine Islands are granted subject to the provisions of section 74 of the Organic Act of July 1, 1902, which, in the part here material, is substantially reproduced in section 28 of the Autonomy Act of August 29, 1916. In the Organic Act it is, among other things, declared: "That

all franchises, privileges, or concessions granted under this Act shall forbid the issue of stock or bonds except in exchange for actual cash or for property at a fair valuation equal to the par value of the stock or bonds so issued; * * *." (Act of Congress of July 1, 1902, sec. 74.)

Pursuant to this provision we find that the Philippine Commission inserted in the Corporation Law, enacted March 1, 1906, the following provision: "* * * no corporation shall issue stock or bonds except in exchange for actual cash paid to the corporation or for property actually received by it at a fair valuation equal to the par value of the stock or bonds so issued." (Act No. 1459, sec. 16, as amended by Act No. 2792, sec. 2.)

The prohibition against the issuance of shares by corporations except for actual cash to the par value of the stock or its full equivalent in property is thus enshrined in both the organic and statutory law of the Philippine Islands; and it would seem that our lawmakers could scarcely have chosen language more directly suited to secure absolute equality among stockholders with respect to their liability upon stock subscriptions. Now, if it is unlawful to issue stock otherwise than as stated it is self-evident that a stipulation such as that now under consideration, in a stock subscription, is illegal; for this stipulation obligates the subscriber to pay nothing for the shares except as dividends may accrue upon the stock. In the contingency that dividends are not paid, there is no liability at all. This is a discrimination in favor of the particular subscriber, and hence the stipulation is unlawful.

The general doctrine of corporation law is in conformity with this conclusion, as may be seen from the following proposition taken from the standard encyclopedic treatise, *Corpus Juris*:

"Nor has a corporation the power to receive a subscription upon such terms as will operate as a fraud upon the other subscribers or stockholders by subjecting the particular subscriber to lighter burdens, or by giving him greater rights and privileges, or as a fraud upon creditors of the corporation by withdrawing or decreasing the capital. It is well settled therefore, as a general rule, that an agreement between a corporation and a particular subscriber, by which the subscription is not to be payable, or is to be payable in part only, whether it is for the purpose of pretending that the stock is really greater than it is, or for the purpose of preventing the predominance of certain stockholders, or for any other purpose, is illegal and void as in fraud of other stockholders or creditors, or both, and cannot be either enforced by the subscriber or interposed as a defense in an action on the subscription." (14 C. J., p. 570.)

The rule thus stated is supported by a long line of decisions from numerous courts, with little or no diversity of opinion. As stated in the headnote to the opinion of the Supreme Court of the United States in the case of *Putnam vs. New Albany, etc. Railroad Co.* as reported in 21 Law. ed., 361, the rule is that "Conditions attached to subscriptions, which, if valid, lessen the capital of the company, are a fraud upon the grantor of the franchise, and upon those who may become creditors of the corporation, and upon unconditional stockholders."

In the appellant's brief attention is called to the third headnote to *Bank vs. Cook* (125 Iowa, 111), where it is stated that a collateral agreement with a subscriber to stock that his subscription shall not be collectible except from dividends on the stock, is valid as between the parties and a complete defense to a suit on notes given for the amount of the subscription. A careful perusal of the decision will show that the rule thus broadly stated in the headnote is not justified by anything in the reported decision; for what the court really held was that the making of such promise by the agent of the corporation who sold the stock is admissible in evidence in support of the defense of fraud and failure of consideration. Moreover, even if the decision had been to the effect supposed, the rule announced in the headnote could have no weight in a jurisdiction like this where there is a statutory provision prohibiting such agreements.

We may add that the law in force in this jurisdiction makes no distinction, in respect to the liability of the subscriber, between shares subscribed before incorporation is effected and shares subscribed thereafter. All alike are bound to pay full par value in cash or its equivalent, and any attempt to discriminate in favor of one subscriber

by relieving him of this liability wholly or in part is forbidden. In what is here said we have reference of course primarily to subscriptions to shares that have not been previously issued. It is conceivable that the power of the corporation to make terms with the purchaser would be greater where the shares which are the subject of the transaction have been acquired by the corporation in course of commerce, after they have already been once issued. But the shares with which we are here concerned are not of this sort.

The judgment appealed from must be affirmed, and it is so ordered, with costs against the appellant.

Malcolm, Ostrand, Johns, Romualdez, and Villa-Real, JJ., concur.

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