

C. H. STEINBERG, AS RECEIVER OF THE SIBUGUEY TRADING COMPANY, INCORPORATED, PLAINTIFF AND APPELLANT, VS. GREGORIO VELASCO ET AL., DEFENDANTS AND APPELLEES.

G.R. No. 30460, March 12, 1929

Ponente: JOHNS, J.

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JOHNS, J.:

It is stipulated that on July 24, 1922, the directors of the corporation approved the purchase of stock as follows:

One hundred shares from S. R. Ganzon for P1,000;

One hundred shares from Felix D. Mendaros at the same price; which purchase was made on June 29, 1922; another

One hundred shares from Felix D. Mendaros at the same price on July 16, 1922;

Ten shares from Dionisio Saavedra at the same price on June 29, 1922.

That during such times, the defendant Gregorio Velasco purchased 13 shares from the corporation for P130; Felix del Castillo—42 shares for P420; Andres Navallo—15 shares for P150; and the defendant Mendaros—10 shares for P100. That during the time these various purchases were made, the total amount of subscribed and paid up capital stock of the corporation was P10,030, out of the authorized capital stock 2,000 shares of the par value of P10 each.

Paragraph 4 of the stipulation also recites:

"Be it also admitted as a fact that at the time of the said purchases there was a surplus profit of the corporation above-named of P3,314.72."

Paragraph 5 is as follows :

"That at the time of the repeatedly mentioned various purchases of the said capital stock were made, the said corporation had Accounts Payable in the total amount of P13,807.50 as shown by the statement of the corporation, dated June 30, 1922, and Accounts Receivable in the sum of P19,126.02 according to the books, and that the intention of the Board of Directors was to resell the stocks purchased by the corporations at a sum above par for each stock, this expectation being justified by the then satisfactory and sound financial condition of the business of the corporation."

It is also stipulated that on September 11, 1923, when the petition for the dissolution of the corporation was presented to the court, according to a statement made June 30, 1923, it has accounts payable aggregating P9,241.19, and accounts receivable for P12,512.47.

Paragraph 7 of the stipulation recites:

"That the same defendants, mentioned in paragraph 2 of this stipulation of facts and in the same capacity, on

the same date of July 24, 1922, and at the said meeting of the said Board of Directors, approved and authorized by resolution the payments of dividends to its stockholders, in the sum of three thousand pesos (P3,000), Philippine currency, which payments were made at different dates, between September 30, 1922, and May 12, 1923, both dates inclusive, at a time when the corporation had accounts less in amount than the accounts receivable, which resolution was based upon the balance sheet made as June 30, 1922, said balance sheet showing that the corporation had a surplus of P1,069.41, and a profit on the same date of P2,656.08, or a total surplus amount of P3,725.49, and a reserve fund of P2,889.23 for bad and doubtful accounts and depreciation of equipment, thereby leaving a balance of P3,314.72 of net surplus profit after paying this dividend."

It is also stipulated at a meeting of the board of directors held on July 24, 1922, as follows:

"6. The president and manager submitted to the Board of Directors his statement and balance sheet for the first semester ending June 30, 1922 and recommended that P3,000—out of the surplus account be set aside for dividends payable, and that payments be made in installments so as not to affect the financial condition of the corporation. That stockholders having outstanding account with the corporation should settle first their accounts before payments of their dividends could be made. Mr. Castillo moved that the statement and balance sheet be approved as submitted, and also the recommendations of the president. Seconded by Mr. Manuel. Approved."

Paragraph 8 of the stipulation is as follows:

"That according to the balance sheet of the corporation, dated June 30, 1923, it had accounts receivable in the sum of P12,512.47, due from various contractor and laborers of the National Coal Company, and also employees of the herein corporation, which the herein receiver, after his appointment on February 28, 1924, although he made due efforts by personally visiting the location of the corporation, and of National Coal Company, at its offices, at Malangas, Mindanao, and by writing numerous letters of demand to the debtors of the corporation, in order to collect these accounts receivable, he was unable to do so as most of them were without goods or property, and he could not file any suit against them that might have any property, for the reason that he had no funds on hand with which to pay the filing and sheriff fees to Malangas, and other places of their residences."

From all of which, it appears that on June 30, 1922, the board of directors of the corporation authorized the purchase of, purchased and paid for, 330 shares of the capital stock of the corporation at the agreed price of P3,300, and that at the time the purchase was made, the corporation was indebted in the sum of P13,807.50, and that according to its books, it had accounts receivable in the sum of P19,126.02. That on September 11, 1923, when the petition was filed for its dissolution upon the ground that it was insolvent, its accounts payable amounted to P9,241.19, and its accounts receivable P12,512.47, or an apparent asset of P3,271.28 over and above its liabilities. But it will be noted that there is no stipulation or finding of fact as to what was the actual cash value of its accounts receivable. Neither is there any stipulation that those accounts or any part of them ever have been or will be collected, and it does appear that after his appointment on February 28, 1924, the receiver made a diligent effort to collect them, and that he was unable to do so, and it also appears from the minutes of the board of directors that the president and manager "recommended that P3,000—out of the surplus account to be set aside for dividends payable, and that payments be made in installments so as not to affect the financial condition of the corporation"

If in truth and in fact the corporation had an actual bona fide surplus of P3,000 over and above all of its debts and liabilities, the payment of the P3,000 in dividends would not in the least impair the financial condition of the corporation or prejudice the interests of its creditors.

It is very apparent that on June 24, 1922, the board of directors acted on the assumption that, because it appeared from the books of the corporation that it had accounts receivable of the face value of P19,126.02, therefore it had a

surplus over and above its debts and liabilities. But as stated, there is no stipulation as to the actual cash value of those accounts, and it does appear from the stipulation that on February 28, 1924, P12,512.47 of those accounts had but little, if any, value, and it must be conceded that, in the purchase of its own stock to the amount of P3,300 and in declaring the dividends to the amount of P3,000, the real assets of the corporation were diminished P6,300. It also appears from paragraph 4 of the stipulation that the corporation had a "surplus profit" of P3,314.72 only. It is further stipulated that the dividends should "be made in installments so as not to affect the financial condition of the corporation." In other words, that the corporation did not then have an actual bona fide surplus from which the dividends could be paid, and that the payment of them in full at that time would "affect the financial condition of the corporation."

It is, indeed, peculiar that the action of the board in purchasing the stock from the corporation and in declaring the dividends on the stock was all done at the same meeting" of the board of directors, and it appears in those minutes that both Ganzon and Mendaros were formerly directors and resigned before the board approved the purchase and declared the dividends, and that out of the whole 330 shares purchased, Ganzon sold 100 and Mendaros 200, or a total of 300 shares out of the 330, which were purchased by the corporation, and for which it paid P8,300. In other words, that the directors were permitted to resign so that they could sell their stock to the corporation. As stated, the authorized capital stock was P20,000 divided into 2,000 shares of the par value of P10 each, of which only P10,030 was subscribed and paid. Deducting the P3,300 paid for the purchase of the stock, there would be left P7,000 of paid up stock, from which deduct P3,000 paid in dividends, there would be left P4,000 only. In this situation and upon this state of facts, it is very apparent that the directors did not act in good faith or that they were grossly ignorant of their duties.

Upon each of those points, the rule is well stated in Ruling Case Law, vol. 7, p. 473, section 454, where it is said:

"General Duty to Exercise Reasonable Care.—The directors of a corporation are bound to care for its property and manage its affairs in good faith, and for a violation of these duties resulting in waste of its assets or injury to the property they are liable to account the same as other trustees. And there can be no doubt that if they do acts clearly beyond their power, whereby loss ensues to the corporation, or dispose of its property or pay away its money without authority, they will be required to make good the loss out of their private estates. This is the rule where the disposition made of money or property of the corporation is one either not within the lawful power of the corporation, or, if within the power of the corporation, is not within the power or authority of the particular officer or officers."

And section 468 which says:

"Want of Knowledge, Skill, or Competency.—It has been said that directors are not liable for losses resulting to the corporation from want of knowledge on their part; or for mistakes of judgment, provided they were honest, and provided they are fairly within the scope of the powers and discretion confided to the managing body. But the acceptance of the office of a director of a corporation implies a competent knowledge of the duties assumed, and directors cannot excuse imprudence on the ground of their ignorance or inexperience; and if they commit an error of judgment through mere recklessness or want of ordinary prudence or skill, they may be held liable for the consequences. Like a mandatory, to whom he has been likened, a director is bound not only to exercise proper care and diligence, but ordinary skill and judgment. As he is bound to exercise ordinary skill and judgment, he cannot set up that he did not possess them."

Creditors of a corporation have the right to assume that so long as there are outstanding debts and liabilities, the board of directors will not use the assets of the corporation to purchase its own stock, and that it will not declare dividends to stockholders when the corporation is insolvent.

The amount involved in this case is not large, but the legal principles are important, and we have given them the consideration which they deserve.

The judgment of the lower court is reversed, and (a), as to the first cause of action, one will be entered for the plaintiff and against the defendant S. K. Ganzon for the sum of P1,000, with legal interest from the 10th of February, 1926, and against the defendant Felix D. Mendaros for P2,000, with like interest, and against the defendant Dionisio Saavedra for P100, with like interest, and against each of them for costs, each on their primary liability as purchasers of stock, and (b) against the defendants Gregorio Velasco, Felix del Castillo and Rufino Manuel, personally, as members of the board of directors of the Sibuguey Trading Company, Incorporated, as secondarily liable for the whole amount of such stock sold and purchased as above stated, and on the second cause of action, judgment will be entered (c) for the plaintiff and jointly and severally against the defendants Gregorio Velasco, Felix del Castillo and Rufino Manuel, personally, as members of the board of directors of the Sibuguey Trading Company, Incorporated, for P8,000, with interest thereon from February 10, 1926, at the rate of 6 per cent per annum, and costs. So ordered.

Johnson, Street, Malcolm, Ostrand, Romualdez., and Villa-Real, JJ., concur.

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