

DOLORES M. VIUDA DE BARRETTO ET AL., PLAINTIFFS AND APPELLANTS, VS. LA PREVISORA FILIPINA, MUTUAL BUILDING AND LOAN ASSOCIATION, DEFENDANT AND APPELLEE.*G.R. No. 38084. December 21, 1933*

Ponente: IMPERIAL, J.

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On February 11, 1926, La Previsora Filipina, a mutual building and loan association, was organized and incorporated by Antonio Ma. Barretto y Rocha, Alfonso Rocha, Antonio M. Opisso, Jose A. Barretto y Moratinos, Vicente L. Legarda, Henry Herman, George C. Sellner, Vicente Delgado, Enrique Massip, Alexander Bachrach and Pedro Mata, in accordance with the provisions of the Corporation Law. On the said date the incorporators had subscribed for 1,560 accumulative shares, series A, E and I of the par value of P200 each, paying a total sum of P337 on account of their subscriptions, which was the sum required to be paid by the articles of incorporation. The aforesaid incorporators were appointed directors of the association at the same time. On February 25th of the same year, a general meeting of the stockholders was held, during which there was submitted a draft of the proposed by-laws of the association, prepared by Antonio Ma. Barretto y Rocha, which were approved. It appeared later that said Antonio Ma. Barretto y Rocha was the largest shareholder and, as such, was almost in absolute control of the affairs of the corporation. A copy of the said by-laws of the corporation is marked in the records of the case as Exhibit A. Article 68 thereof, as translated, reads as follows:

"Art. 68. Taking into account the preliminary work performed by Mr. Antonio Ma. Barretto and considering the acquisition of the 'Combined Tables of Triple Transaction', prepared by him and which were the result of his labors, indispensable to the operation of its business, and inasmuch as Mr. Barretto has consented to transfer all his property rights over the aforesaid tables for its exclusive use and benefit, the corporation, in consideration of such sale, cession and transfer of the aforesaid tables in its favor by said Mr. Antonio Ma. Barretto, and in return for all other services rendered by him in the founding and organization thereof, obligates and binds itself to pay to said Mr. Barretto, his heirs and successors in interest, the sum of two hundred thousand pesos (P200,000), Philippine currency. This sum shall not bear interest and shall appear on the books of the corporation as organization expenses, to be paid to Mr. Barretto in installments, under the following conditions:

At the end of the operation for the first year

P20,000.00

At the end of the operation for the second year

30,000.00

At the end of the operation for the third year

50,000.00

At the end of the operation for the fourth year

50,000.00

At the end of the operation for the fifth year

50,000.00

"Notwithstanding the periods above stipulated, no payment for any year shall be made to Mr. Barretto, his heirs and successors in interest, unless the corporation declares a dividend of not less than 12 per cent of the paid-up capital in favor of the accumulative shares during such year. Provided, however, That in case said Mr. Barretto, his heirs and successors in interest fail to receive payment, either full or partial, of the sum corresponding to him for any of the periods above stipulated, the sum uncollected by him shall be carried over to the year following and thus successively until the aforesaid amount of two hundred thousand pesos (P200,000), Philippine currency, is paid."

Article 72, the translation of which appears below, bears a close relation to the foregoing article inasmuch as it prohibits modification or discussion of the aforesaid article 68.

"Art. 72. These by-laws shall only be modified or amended in whole or in part by resolutions approved at general or special meetings by a concurrence of a majority vote representing not less than 4/5 of the total number of shares issued: Provided, however, That article 68 hereof shall never be subject to modification or discussion."

The amount of P200,000 thus granted to Antonio Ma. Barretto y Rocha was immediately entered on the books of the corporation as part of the assets thereof under the item "Organization Expense" and said Barretto was credited with the same amount, which thenceforth appeared on the books as a contingent obligation of the corporation. The Insular Treasurer, who has supervision of all corporations, under the law, became aware of such transaction and of articles 68 and 72 of the by-laws, and without loss of time notified the officers of the corporation that the said entries in the account books as well as the afore-cited articles were null and void and in violation of the clear and express provisions of the Corporation Law, relative to mutual building and loan associations. Antonio Ma. Barretto, who had already assumed office in his multiple capacity as founder, stockholder, and managing director, called another general meeting of stockholders on July 22, 1926, which, after being informed of the objections of the Insular Treasurer, proceeded to amend article 72 by substituting it with the following:

"Art. 72. These by-laws shall only be modified or amended in whole or in part by resolutions approved at general or special meetings, by a concurrence of a majority vote of not less than one half plus one of the total number of votes corresponding to the shares of stock issued and entitled to vote." On that same date, the same stockholders assembled at a general meeting, repealed the original article 68 and substituted it with the following:

"Art. 68. Beginning with the second year of the existence of the corporation until the dissolution thereof, as provided for in the by-laws, there shall be set aside annually an amount equal to 2½ per cent of the net profits of the corporation, to be paid to Mr. Antonio Ma. Barretto or his heirs by way of just compensation as agreed

upon by the corporation and said Mr. Barretto, for the services rendered by him in founding and organizing the corporation and in consideration of the assignment and transfer of the 'Combined Tables of Triple Transaction', which serves as a basis for its operation, made by him in favor of the corporation. Provided, however, That during the first ten (10) years of the existence of the corporation, Mr. Barretto or his heirs shall not be entitled to the annual compensation established in this article, for every year in which the net profits to be credited to holders of accumulative shares A, E, I, O and U, do not reach an amount equivalent to 10 per cent of the capital of the corporation as defined in section 174 of Act No. 1459, deducting therefrom that part of the capital which earns a fixed dividend; And provided, further, That if after an amount equivalent to ten per cent (10%) of the capital has been set aside from the profits of the corporation, to be paid to the holders of accumulative shares, the balance thereof is less than 2½ per cent of the said profits, Mr. Barretto shall not be entitled to collect an amount greater than the aforesaid balance. Inasmuch as this article constitutes a contract between the corporation and Mr. Barretto, it shall not be susceptible of alteration or amendment except by mutual consent of the parties."

In 1926 the operations of the corporation registered a loss amounting to P6,073.79 and in 1927 it suffered another loss of P3,427.42. In view of this somewhat discouraging result, no dividend could be distributed as expected, contrary to the repeated assurances given the public by the general manager. In order to force the situation, said officer paid the expenses of the corporation for the year 1926, amounting to P6,296.56, and those of the year 1927, amounting to P6,154.42, out of his own pocket. These two amounts were ordered by him to be entered in the books as assets of the corporation. Through the liberality of the general manager and the irregular transactions just stated, the said officer entered a fictitious profit of P222.77 in the balance sheet for the year 1926, and with such imaginary figures as a basis, likewise declared a dividend of 15.0673.52 per cent on the paid-up accumulative shares. The same thing happened in 1927 when a fictitious profit of P2,727 was made to appear and a dividend of 17.2451.24 per cent declared on the same kind of shares. Having been apprised of these objectionable transactions, the Insular Treasurer called the attention of the general manager thereto and informed him that the forced dividends, which he had entered in the books, were in violation of the provisions of article 16 of the Corporation Law, on the alleged ground that they did not come from the net profits derived from the business. As a result only dividends on accumulative shares, not exceeding 12½ per cent, were declared in subsequent years.

On February 23, 1929, article 68 of the by-laws was once more amended at a general meeting of stockholders, and in lieu thereof, the following, copy of which is Exhibit 1, was substituted:

"Art. 68. Beginning January 1, 1929, and during the existence of 'La Previsora Filipina', Mutual Building and Loan Association, a sum equivalent to four per cent (4%) of the net profits of the corporation during the year shall be paid to Mr. Antonio Ma. Barretto or his heirs at the end of every fiscal year. The payment of such remuneration shall be deemed a just compensation agreed upon by the corporation and Mr. Antonio Ma. Barretto (1) for the services rendered by him in founding and organizing the association; (2) for disbursements and other financial sacrifices made by him for the benefit of the association during the first two years of its existence, that is, during the period from February 25, 1926, to December 31, 1927; (3) for the assignment and transfer to the association by Mr. Antonio Ma. Barretto, of the 'Combined Tables of Triple Transaction', invented and perfected by him, which are actually serving as a basis for the business operations of the corporation. On his part, Mr. Antonio Ma. Barretto assures that as long as he is the general manager of the corporation, the same shall realize a profit of not less than twelve and one-half per cent (12½%) of the accumulative shares of series A, E, I, O and U at the end of every fiscal year, and that during each and every year of his incumbency as such general manager, wherein the dividends declared on the accumulative shares of series A, E, I, O and U do not reach twelve and one-half per cent (12½%) on the accumulated capital, Mr. Antonio Ma. Barretto shall not receive the aforesaid four per cent (4%) from the association, but only whatever excess resulting therefrom after adjudication of the 12% per cent in favor of the accumulative shares of series

A, E, I, O and U. It is hereby understood that this article of the by-laws constitutes a formal contract between the corporation and Mr. Antonio Ma. Barretto, which contract shall not be susceptible of modification except by mutual agreement of the parties."

The board of directors of La Previsora Filipina never authorized payment of the sum of P200,000 to Antonio Ma. Barretto, until he died on March 9, 1929. In fact, no amount was paid him to that effect. Inasmuch as all the conditions imposed therein had been allegedly complied with, according to the claim of the judicial administrators of the deceased Antonio Ma. Barretto y Rocha and his heirs, they brought this action demanding payment by the association of the sum of P150,000 which represents the first four installments specified in the original article 68, and corresponding to the first four years during which the said deceased rendered services to the corporation. Inasmuch as judgment was rendered dismissing the complaint as well as the cross-complaint filed therein, with costs against the plaintiffs, said plaintiffs took the present appeal. The defendant respected the judgment thus rendered.

The appellants assign the following alleged errors as committed by the trial court in its decision appealed from, to wit:

"I. The trial court erred in sustaining the opposition of defendant to the testimony of plaintiffs' witness the Honorable Antonio M. Opisso, incorporator, stockholder, director and first president of defendant corporation, on the ground that the said witness being also the attorney for the defendant corporation, his knowledge as to facts pertinent to the case, was privileged.

"II. The trial court erred in finding that the adoption of articles 68 and 72 of the by-laws of defendant corporation on the 25th day of February, 1926, was not the voluntary act of the stockholders and directors of defendant corporation, but was due to the dominating influence of the late Antonio Ma. Barretto.

"III. The trial court erred in finding that no step was taken by the board of directors of defendant corporation, in relation to the agreement evidenced by article 68 of its by-laws (Exhibit A).

"IV. The trial court erred in finding that article 68 of the by-laws of defendant corporation was not evidence of a contract between the late Antonio Ma. Barretto and defendant.

"V. The trial court erred in finding that there was no consideration for the payment of P200,000 to the late Antonio Ma. Barretto, as provided for in article 68 of the by-laws of defendant corporation.

"VI. The trial court erred in finding that the 'Combined Tables of Triple Transaction' referred to in article 68 of the by-laws of defendant corporation, never existed, nor were they sold, conveyed or delivered to defendant corporation, nor used by the same.

"VII. The trial court erred in finding that article 68 of the by-laws of defendant corporation is null and void for the reason that same is in conflict with, and in contravention to, the Corporation Law regarding mutual building and loan associations.

"VIII. The trial court erred in finding that articles 50 and 72 of the by-laws of defendant corporation, Exhibit A, were from their adoption null and void, being in conflict with sections 21 and 22 of the Corporation Law.

"IX. The trial court erred in finding that article 68 of Exhibits I and B had the lawful concurrence of the shareholders of defendant corporation.

"X. The trial court erred in failing to find that defendant corporation was obligated to pay plaintiffs the full amount due under article 68, by-laws of defendant corporation, Exhibit A.

"XI. The trial court erred in not granting plaintiffs' motion for a new trial."

In view of the conclusion to be arrived at later, the first assignment of error is left to be discussed last.

Inasmuch as assignments of error Nos. II to VII, inclusive, are correlated with the validity of article 68 of the original by-laws of the defendant corporation, upon which the plaintiffs' action is based, we shall discuss them jointly. Before entering into a full discussion thereof, it is not amiss to state that in invoking the provisions of the aforesaid original article 68, the plaintiffs are sustaining inconsistent and antagonistic theories inasmuch as they are fully aware of the fact that the article in question has been repealed several times and substituted by other articles from which the provision relating to the P200,000 has been completely eliminated. We do not mean to insinuate herein that the amendments thereto were valid. Our only purpose in referring to them is to show clearly the inconsistency of the plaintiffs' claim for the reason that if the original article was valid then the amendments thereto, which were adopted in like manner, would have to be equally binding, in which case the original article 68 in question would have ceased to exist.

We deem it unnecessary to pay special attention to the multiple intervention of the deceased in the affairs of the association and the powerful influence which, according to the findings of the trial court, he exerted over the directors and stockholders thereof during the four years of his incumbency. It is our aim to confine the discussion to the validity of the provision relating to the sum of P200,000 specified in article 68 of the original by-laws of the corporation.

It is unquestionable that the provision in question is null and void and without force and effect on the ground that article 68 in question does not constitute a contract between the deceased and the corporation. All the by-laws and the amendments thereto were adopted and ratified at the regular meetings of stockholders who, under the Corporation Law, were not authorized to enter into a contract for and bind the corporation. From this point of view, the provision relating to the sum in question constituted an ultra vires act. It is of no consequence that the by-laws and the amendments thereto were likewise signed by the directors of the association in their capacity as such. The truth is that, at that time, all of them attended the meeting as stockholders and, strictly speaking, it was a stockholders' and not a directors' meeting. On this same ground, the appellants' claim that said act of the directors, in connection with the by-laws, constitutes a ratification or confirmation of the alleged contract, is untenable.

There is another truly fundamental reason which compels us to hold that the original article 68 is illegal, null and void. It is obvious that the provision in question was due to the desire of the stockholders to compensate the services rendered by the general manager before the incorporation. From the findings of the trial court, it seems that all that had been said relative to the "Combined Tables of Triple Transaction" was a mere pretext in order to give the intended act of liberality all the semblance of a legal transaction. In this respect, we agree with the conclusion of the trial court that such invention was not what it purported to be and that it was never delivered nor placed at the disposal of the corporation, inasmuch as the documents seeming to have had some similarity thereto were found locked in the private wardrobe of the deceased, together with his other private papers. Bearing this in mind, it is obvious that the assignment stated in the article in question is in conflict with the spirit of the law creating mutual building and loan associations and completely destroys the cooperation and mutuality among the stockholders, which characterize associations of this kind.

Fortunately, this is not the first time that the question under consideration is raised in this jurisdiction. In the case of *Barretto vs. La Previsora Filipina* (57 Phil., 649), the same question had been decided adversely against the claim of the plaintiffs. In the said case, the then plaintiffs sought to recover from the association 1 per cent of the net profits thereof, basing their claim on the provisions of article 68-A of the same by-laws. We then held as follows:

"After a careful consideration we fully agree with the appellant. Article 68-A of the amended by-laws of the defendant corporation upon which the action is based, does not under the law as applied to the express

provisions thereof create any legal obligation on its part to pay to the persons named therein, including the plaintiffs, such a life gratuity or pension out of its net profits. A by-law provision of this nature must be regarded as clearly beyond the lawful powers of a mutual building and loan association, such as the defendant corporation.

"While such associations are expressly authorized by the Corporation Law to adopt by-laws for their government, section 20, of that Act, as construed by this court in the case of *Fleischer vs. Botica Nolasco Co.* (47 Phil., 583), expressly limits such authority to the adoption of by-laws which are not inconsistent with the provisions of the law. The appellees contend that the article in question is merely a provision for the compensation of directors, which is not only consistent with but expressly authorized by section 21 of the Corporation Law. We cannot agree with this contention. The authority conferred upon corporations in that section refers only to providing compensation for the future services of directors, officers, and employees thereof after the adoption of the by-law or other provision in relation thereto, and cannot in any sense be held to authorize the giving, as in this case, of continuous compensation to particular directors after their employment has terminated for past services rendered gratuitously by them to the corporation. To permit the transaction involved in this case would be to create an obligation unknown to the law, and to countenance a misapplication of the funds of the defendant building and loan association to the prejudice of the substantial right of its shareholders.

"Building and loan associations are peculiar and special corporations. They are founded upon principles of strict mutuality and equality of benefits and obligations, and the trend of the more recent decisions is that any contract made or by-law provision adopted by such an association in contravention of the statute is ultra vires and void. It stands in a trust relation to the contributors in respect to the funds contributed, and there is an implied contract with its members that it shall not divert its funds or powers to purposes other than those for which it was created. The fundamental law of building and loan associations organized under the different statutes throughout the American Union is that all members must participate equally in the profits and bear the losses, if any, in the same proportion, and any diversion of their funds to purposes not authorized by the law of their creation is violative of the principles of mutuality between the members. (See *Bertche vs. Equitable Loan, etc. Association*, 147 Mo., 343; 71 A. S. R., 571.) As correctly stated in the case of *McCauley vs. Building and Saving Assn.* (97 Tenn., 421; 56 A. S. R., 813, 818), 'Strict mutuality and equality of benefits and obligations must be kept the groundwork and basis of these associations, and if they are not so founded, they are not truly building and loan associations, entitled to the protection given such associations by the statute.' When we consider the fundamental nature and purposes of building and loan associations, as above stated, in relation to the subject matter of this by-law, it is obvious that the provisions thereof are entirely foreign to the government of defendant corporation, inconsistent with and subversive of the legislative scheme governing such associations, and contrary to the spirit of the law, and cannot therefore be the basis of a cause of action against the defendant corporation.

"Irrespective of our conclusion that the provision in question is ultra vires, we are of the opinion that said by-law cannot be held to establish a contractual relation between the parties to this action, because the essential elements of a contract are lacking. The article which the appellees rely upon is merely a by-law provision adopted by the stockholders of the defendant corporation, without any action having been taken in relation thereto by its board of directors. The law is settled that contracts between a corporation and third persons must be made by or under the authority of its board of directors and not by its stockholders. Hence, the action of the stockholders in such matters is only advisory and not in any wise binding on the corporation. (See *Ramirez vs. Orientalist Co. and Fernandez*, 38 Phil., 634.) There could not be a contract without mutual consent, and it appears that the plaintiffs did not consent to the provisions of the by-law in question, but, on the contrary, they objected to and voted against it in the stockholders' meeting in which it was adopted. Furthermore, the said by-law shows on its face that there was no valid consideration for the supposed obligation mentioned therein. It is clearly an attempt to give in the future to certain directors compensation for past services gratuitously rendered by them to the corporation. Such a provision is without consideration, and imposes no obligation on

the corporation which can be enforced by action at law. (4 Fletcher on Corporations, p. 2762, and cases cited.)"

In view of the foregoing considerations, we do not hesitate to reiterate that the aforesaid original article 68 is illegal and without force and effect, to the extent that it cannot serve as a ground for the action brought by the plaintiffs.

The plaintiffs claim that the question relative to the validity of a similar clause had already been settled and upheld by this court in the case of *El Hogar Filipino vs. Rafferty* (37 Phil., 995). In the said case, question was raised against the validity of the clause in the by-laws, which reads as follows:

"5 per cent of net profits as per annual accounting, to founder, or his heirs during the existence of the society, as compensation for his studies, labors and sacrifices made by him to establish 'El Hogar', and executed on January 11, 1911."

The same argument was employed in the case of *Barretto vs. La Previsora Filipina*, supra, wherein the following was held:

"The appellees in their brief refer to the cases of *El Hogar Filipino vs. Rafferty* (37 Phil., 995), and *Government of the Philippine Islands vs. El Hogar Filipino* (50 Phil., 399), and contend that those decisions are authority for sustaining the validity of the by-law in this case. We have carefully examined those decisions, and find that those cases are clearly distinguishable from the present action. It is sufficient to say that the causes of action are not of the same nature, and the facts upon which those decisions are based are entirely different from the facts of the present case."

Aside from the difference stated in the aforesaid decision, it may be added also that in the case of *El Hogar* the gratuity appropriated in favor of the founder had been converted into a formal contract on the ground that it had been adopted by the board of directors thereof, and furthermore, it was granted him in consideration of future services which he was to render to the association, for having defrayed the expenses for the organization thereof, rendered free service as general manager for the period of one year, granted the association a loan of P6,000 without interest, and finally, having bound himself to the effect that the capital of the corporation would increase to P400,000 within one year from the date of incorporation.

Having arrived at the foregoing conclusions, it becomes unnecessary to discuss the VIII and IX assignments of error, and much less the last two which are mere corollaries of the former ones.

The arguments advanced in support of the first assignment of error are of no consequence or importance. Even taking for granted that the witness Opisso could legally testify on the facts as maintained by the counsel for the plaintiffs, nevertheless, the error committed in preventing him from testifying would not be sufficient to justify modification of our conclusions or change the result of the case in the least. For this reason, we prefer to refrain from discussing it extensively and to leave it undecided.

Wherefore, the judgment appealed from is hereby affirmed, with the costs against the appellants. So ordered.

Malcolm, Villa-Real, Hull, and Diaz, JJ., concur.

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