

HIGINIO ANGELES, JOSE DE LARA AND AGUEDO BERNABE, AS STOCKHOLDERS FOR AND IN BEHALF AND FOR THE BENEFIT OF THE CORPORATION, PARANAQUE RICE MILL, INC., AND THE OTHER STOCKHOLDERS...

G. R. No. 43413. August 30, 1937

Ponente: LAUREL, J.

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LAUREL, J.:

The plaintiffs and the defendants are all stockholders and members of the board of directors of the "Paranaque Rice Mill, Inc.," a corporation organized for the purpose of operating a rice mill in the municipality of Paranaque, Province of Rizal. On September 6, 1932, a complaint entitled "Higinio Angeles, Jose de Lara, Aguedo Bernabe, as stockholders, for and in behalf of the corporation, Paranaque Rice Mill, Inc., and other stockholders of said corporation who may desire to join, plaintiffs, vs. Teodorico B. Santos, Estanislao Mayuga, Apolonio Pascual, and Basilisa Rodriguez, defendants" was filed with the Court of First Instance of Rizal. After formal allegations relative to age and residence of the parties and the due incorporation of the Paranaque Rice Mill, Inc., the complaint avers substantially the following: (a) That the plaintiffs are stockholders and constitute the minority and the defendants are also stockholders and constitute the majority of the board of directors of the Paranaque Rice Mill, Inc.; (b) that at an extraordinary meeting held on February 21, 1932, the stockholders appointed an investigation committee of which the plaintiff Jose de Lara was chairman and the stockholders Dionisio Tomas and Aguedo Bernabe were members, to investigate and determine the properties, operations, and losses of the corporation as shown in the auditor's report corresponding to the year 1931, but the defendants, particularly Teodorico B. Santos, who was the president of the corporation, denied access to the properties, books and records of the corporation which were in their possession ; (c) that the defendant Teodorico B. Santos, in violation of the by-laws of the corporation, had taken possession of the books, vouchers, and corporate records as well as of the funds and income of the Paranaque Rice Mill, Inc., all of which, according to the by-laws, should be under the exclusive control and possession of the secretary-treasurer, the plaintiff Aguedo Bernabe; (d) that the said Teodorico B. Santos, had appropriated to his own benefit properties, funds, and income of the corporation in the sum of P10,000; (e) that Teodorico B. Santos, for the purpose of illegally controlling the affairs of the corporation, refused to sign and issue the corresponding certificate of stock for the 600 fully paid-up shares of the plaintiff, Higinio Angeles, of the total value of P15,000; (f) that notwithstanding written requests made in conformity with the by-laws of the corporation of three members of the board of directors who are holders of more than one-third of the subscribed capital stock of the corporation, the defendant Teodorico B. Santos as president of the corporation refused to call a meeting of the board of directors and of the stockholders; (g) that in violation of the by-laws of the corporation, the defendants who constitute the majority of the board of directors refused to hold ordinary monthly meetings of the board since March, 1932; (h) that Teodorico B. Santos as president of the corporation, in connivance with his co-defendants, was disposing of the properties and records of the corporation without authority from the board of directors or the stockholders of the corporation and without making any report of his acts to the said board of directors or to any other officer of the corporation, and that, to

prevent any interference with or examination of his arbitrary acts, he arbitrarily suspended plaintiff Jose de Lara from the office of general manager to which office the latter had been lawfully elected by the stockholders; and (i) that the corporation had gained about P4,000 during the first half of the year 1932, but that because of the illegal and arbitrary acts of the defendants not only the funds but also the books and records of the corporation are in danger of disappearing.

The complaint prays: (a) That after the filing of the bond in an amount to be fixed by the court, Melchor de Lara of Paranaque, Rizal, be appointed receiver of the properties, funds, and business of the Paranaque Rice Mill, Inc., as well as the books and records thereof, with authority to continue the business of the corporation; (b) that the defendant Teodorico B. Santos be ordered to render a detailed accounting of the properties, funds and income of the corporation from the year 1927 to date; (c) that the said defendant be required to pay to the corporation the amount of P10,000 and other amounts which may be found due to the said corporation as damages or for any other cause; (d) that said defendant be ordered to sign the certificate of stock subscribed to and paid by the plaintiff Higinio Angeles; and (e) that the members of the board of directors of the Paranaque Rice Mill, Inc., be removed and an extraordinary meeting of the stockholders called for the purpose of electing a new board of directors.

On the date of the filing of the complaint, September 6, 1932, the court issued an ex parte order of receivership appointing Melchor de Lara as receiver of the corporation upon the filing of a bond of P1,000 by the plaintiffs-appellees. The bond of the receiver was fixed at P4,000.

Upon an urgent motion of the defendants-appellants setting forth the reasons why Melchor de Lara should not have been appointed receiver, and upon agreement of the parties, the trial court, by order of September 13, 1932, appointed Benigno Agco, as receiver, in lieu of Melchor de Lara. About a month later, or on October 14, 1932, the court, after considering the memoranda filed by both parties, revoked its order appointing Agco as receiver.

On July 12, 1933, the defendants-appellants presented their amended answer to the complaint, containing a general and specific denial, and alleging as special defense that the defendant Teodorico B. Santos refused to sign the certificate of stock in favor of the plaintiff Higinio Angeles for 600 shares valued at P15,000, because the board of directors decided to give Higinio Angeles only 320 shares of stock worth P8,000. The answer contains a counterclaim for P5,000 alleged to have been suffered by the corporation due to the alleged illegal and malicious procurement by the plaintiffs of an ex parte order of receivership. . Damages in the amount of P2,000 are also alleged to have been suffered by the defendants by reason of the failure of the plaintiffs to present their grievances to the board of directors before going to court. The amended answer sets forth, furthermore, a cross-complaint against the plaintiffs, and in behalf of the Paranaque Rice Mill, Inc., based on the alleged failure of the plaintiff Higinio Angeles to render a report of his administration of the corporation from February 14 to June 30, 1928, during which time the corporation is alleged to have had accrued earnings of approximately P3,000. In both the counterclaim and crosscomplaint Paranaque Rice Mill, Inc. is joined as party defendant.

On July 24, 1934, the plaintiffs-appellees renewed their petition for the appointment of a receiver pendente lite alleging, among other things, that defendant Teodorico B. Santos was using the funds of the corporation for purely personal ends; that said Teodorico B. Santos was managing the funds of the corporation in a manner highly prejudicial to the interests of the corporation and its stockholders; that said defendant did not render any account of his management or of the condition of the business of the corporation; that since 1932 said defendant called no meeting of the board of directors or of the stockholders thus enabling him to continue holding, without any election, the position of president and, finally, that of manager; and that, without the knowledge and consent of the stockholders and of the board of directors, the said defendant installed a small rice mill for converting rice husk into "tiqui-tiqui", the income of which was never turned over or reported to the treasurer of the corporation.

The defendants-appellants objected to the petition for the appointment of a receiver on the ground, among others, that the court had no jurisdiction over the Paranaque Rice Mill, Inc., because it had not been included as party defendant in this case and that, therefore, the court could not properly appoint a receiver of the corporation pendente lite.

After hearing both parties, the trial court, by order of October 31, 1934, appointed Emilio Figueroa, as receiver of the corporation, after giving a bond in the amount of P2,000. An urgent motion for the reconsideration of this order, filed by counsel for the defendants-appellants on November 3, 1934, was denied by the court on November 7, 1934.

On November 8, 1934, the trial court, having heard the case on its merits, rendered a decision, the dispositive part of which is as follows:

"Por todo lo expuesto, el Juzgado falia este asunto:

"1. Ordenando al demandado Teodorico B. Santos a rendir cuenta detallada de las propiedades, fondos e ingresos de la corporation Paranaque Rice Mill, Inc., desde el año 1931 hasta la fecha;

"2. Condenando a dicho demandado a pagar a la corporation Paranaque Rice Mill, Inc., cualesquiera cantidad o cantidades que resultare en deber a dicha corporacido; de acuerdo con dicha rendition de cuentas;

"3. Declarando al demandante Higinio M. Angeles con derecho a tener expedido a su nombre 600 acciones por valor par de P15,000.

"4. Destituyendo a los demandados de su cargo como directores de la corporacido hasta la nueva eleccion por los accionistas que se convocara una vez firme esta sentencia; y

"5. Condenando a los demandados a pagar las costas."

On November 21, 1934, the defendants-appellants, moved for reconsideration of the decision and at the same time prayed for the dismissal of the case, because of defect of parties defendant.

On December 6, 1934, the Paranaque Rice Mill, Inc., thru counsel for the defendants, entered a special appearance for the sole purpose of objecting to the order of the court of October 31, 1934, appointing a receiver, on the ground that the Paranaque Rice Mill, Inc., was not a party to the proceedings. And on December 8, 1934, the defendants excepted to the decision of the trial court and moved for a new trial on the ground that the evidence presented was insufficient to justify the decision and that said decision was contrary to law. The motions for reconsideration and new trial and the special appearance were, by separate orders bearing date of December 19, 1934, denied by the trial court. The case was finally elevated to this court by bill of exceptions.

The defendants-appellants submit the following assignment of errors:

"1. The lower court erred in holding that it has jurisdiction to appoint a receiver of the corporation, Taranaque Rice Mill, Inc., on October 31, 1934.

"2. The lower court erred in overruling the motion of the defendants to include the defendant corporation as party defendant and in holding that it is not a necessary party.

"3. The lower court erred in not granting a motion for a new trial because there is a defect of party defendant.

"4. The lower court erred in not dismissing the case because a necessary defendant was not made a party in the case.

"5. The lower court erred in ordering the defendant Teodorico B. Santos to render a detailed accounting of the properties, funds and income of the corporation Taranaque Rice Mill, Inc., from the year 1931 to this date.

"6. The lower court erred in condemning the defendant Teodorico B. Santos to pay the corporation whatever sum or sums which may be found owing to said corporation, in accordance with the said accounting to be done by him.

"7. The lower court erred in ordering the destitution of the defendants from their office as members of the board of directors of the corporation, until the new election of the stockholders which shall be held once the decision has become final.

"8. The lower court erred in declaring that Higinio Angeles is entitled to have in his name 600 shares of stock of the par value of P15,000.

"9. The lower court erred in overruling and denying appellants' motion for the reconsideration and the dismissal of the case dated November 21, 1934.

"10. The lower court erred in denying the motion of these appellants for new trial."

In their discussion of the first, second, third, and fourth assignments of error, the defendants-appellants vigorously assert that the Paranaque Rice Mill, Inc., is a necessary party in this case, and that not having been made a party, the trial court was without jurisdiction to appoint a receiver and should have dismissed the case.

There is ample evidence in the present case to show that the defendants have been guilty of breach of trust as directors of the corporation and the lower court so found. The board of directors of a corporation is a creation of the stockholders and controls and directs the affairs of the corporation by delegation of the stockholders. But the board of directors, or the majority thereof, in drawing to themselves the powers of the corporation, occupies a position of trusteeship in relation to the minority of the stock in the sense that the board should exercise good faith, care and diligence in the administration of the affairs of the corporation and should protect not only the interests of the majority but also those of the minority of the stock. Where a majority of the board of directors wastes or dissipates the funds of the corporation or fraudulently disposes of its properties, or performs ultra vires acts, the court, in the exercise of its equity jurisdiction, and upon showing that intracorporate remedy is unavailing, will entertain a suit filed by the minority members of the board of directors, for and in behalf of the corporation, to prevent waste and dissipation and the commission of illegal acts and otherwise redress the injuries of the minority stockholders against the wrongdoing of the majority. The action in such a case is said to be brought derivatively in behalf of the corporation to protect the rights of the minority stockholders thereof (7 R. C. L., pars. 293 and 294, and authorities therein cited; 13 Fletcher, Cyc. of Corp., pars. 593, et seq., and authorities therein cited).

It is well settled in this jurisdiction that where corporate directors are guilty of a breach of trust—not of mere error of judgment or abuse of discretion—and intracorporate remedy is futile or useless, a stockholder may institute a suit in behalf of himself and other stockholders and for the benefit of the corporation, to bring about a redress of the wrong inflicted directly upon the corporation and indirectly upon the stockholders. An illustration of a suit of this kind is found in the case of Pascual vs. Del Saz Orozco (19 Phil., 82), decided by this court as early as 1911. In that case, the Banco Espanol-Filipino suffered heavy losses due to fraudulent connivance between a depositor and an employee of the bank, which losses, it was contended, could have been avoided if the president and directors had been more vigilant in the administration of the affairs of the bank. The stockholders constituting the minority brought a suit in behalf of the bank against the directors to recover damages, and this over the objection of the majority of the stockholders and the directors. This court held that the suit could properly be maintained.

The contention of the defendants in the case at bar that the Paranaque Rice Mill, Inc., should have been brought in as a necessary party and the action maintained in its name and in its behalf directly states the general rule, but not the exception recognized by this court in the case of Everett vs. Asia Banking Corporation (49 Phil, 512, 527). In

that case, upon invocation of the general" rule by the appellees there, this court said:

"Invoking the well-known rule that shareholders cannot ordinarily sue in equity to redress wrongs done to the corporation, but that the action must be brought by the board of directors, the appellees argue—and the court below held—that the corporation Teal & Company is a necessary party plaintiff and that the plaintiff stockholders, not having made any demand on the board to bring the action, are not the proper parties plaintiff. But, like most rules, the rule in question has its exceptions. It is alleged in the complaint and, consequently, admitted through the demurrer that the corporation Teal & Company is under the complete control of the principal defendants in the case, and, in these circumstances it is obvious that a demand upon the board of directors to institute action and prosecute the same effectively would have been useless, and the law does not require litigants to perform useless acts. (*Exchange Bank of Wewoka vs. Bailey*, 29 Okla., 246; *Fleming and Hewins vs. Black Warrior Copper Co.*, 15 Ariz., 1; *Wickersham vs. Crittenden*, 106 Cal., 329; *Glenn vs. Kittanning Brewing Co.*, 259 Pa., 510; *Hawes vs. Contra Costa Water Company*, 104 U. S., 450.)"

The action having been properly brought and by the lower court entertained it was within its power, upon proper showing, to appoint a receiver of the corporation *pendente lite* (secs. 173, 174, et seq. Code of Civil Procedure): The appointment of a receiver upon application of the minority stockholders is a power to be exercised with great caution. But this does not mean that the rights of the minority stockholders may be entirely disregarded, and where the necessity has arisen, the appointment of a receiver for a corporation is a matter resting largely in the sound discretion of the trial court. Counsel for appellants argue that the appointment of a receiver *pendente lite* in the present case has deprived the corporation, Paranaque Rice Mill, Inc., of its property without due process of law. But it is too plain to require argument that the receiver was precisely appointed to preserve the properties of the corporation. The receivership in this case shall continue until a new board of directors shall have been elected and constituted in accordance with law and the by-laws of the corporation.

The first, second, third, and fourth assignments of error are, therefore, overruled.

The appellants contend in their fifth and sixth assignments of error that the lower court erred in ordering the defendant, Teodorico B. Santos, to render a detailed accounting of the properties, funds and income of the corporation, Paranaque Rice Mill, Inc., from the year 1931 and in condemning him to pay "the corporation whatever sum or sums which may be found owing to said corporation, in accordance with the said accounting to be done by him." We note that the lower court in its decision not only orders the defendant Santos to account for the properties and funds of the corporation, but it also and at the same time adjudges him to pay an undetermined amount which is made to depend upon the result of such accounting. The accounting order was probably intended by the lower court to be filed with it in this proceeding. This requirement will delay the final disposition of the case and we are of the opinion that this accounting should better be filed with the new board of directors whose election has been ordered by the lower court. The decision of the lower court in this respect is therefore modified so that the defendant Santos shall render a complete accounting of all the corporate properties and funds that may have come to his possession during the period mentioned in the judgment of the lower court to the new board of directors to be elected by the stockholders.

In the seventh assignment of error, the appellants contend that the lower court erred in ordering the removal of the defendants from their offices as members of the board of directors of the corporation. The Corporation Law, as amended, in sections 29 to 34, provide for the election and removal of the directors of a corporation. Our Corporation Law (Act No. 1459, as amended), does not confer expressly upon the courts the power to remove a director of a corporation. In some jurisdictions, statutes expressly provide a more or less summary method for the confirmation of the election and for the a motion of the directors of a corporation. This is true in New York, New Jersey, Virginia and other states of the American Union. There are abundant authorities, however, which hold that if the court has acquired jurisdiction to appoint a receiver because of the mismanagement of directors these may

thereafter be removed and others appointed in their place by the court in the exercise of its equity jurisdiction (2 Fletcher, Cyc. of Corp., ftn. sec. 358, pp. 118 and 119). In the present case, however, the properties and assets of the corporation being amply protected by the appointment of a receiver and in view of the statutory provisions above referred to, we are of the opinion that the removal of the directors is, under the circumstances, unnecessary and unwarranted. The seventh assignment of error is, therefore, sustained.

Under the eighth assignment of error, the appellants argue that the lower court erred in deciding that the plaintiff Higinio Angeles is entitled to the issuance in his name of a certificate covering 600 shares of stock of the total par value of P15,000. A review of the evidence, oral and documentary, relative to the number of shares of stock to which Higinio Angeles is entitled, shows that Higinio Angeles brought in P15,000 partly in money and partly in property, for 600 shares of stock. The very articles of incorporation signed by all the incorporators, among whom are the defendants, show that Higinio Angeles paid P5,600 on account of his subscription amounting to P10,000. The amount of P5,600 is the value of Angeles' cinematograph building in Bacoor, Cavite, which he transferred to the municipality of Paranaque where the same was reconstructed for the use of the corporation. The receipts signed by the Philippine Engineering Company and the testimony of Higinio Angeles and Aguedo Bernabe (secretary-treasurer of the corporation) show that Higinio Angeles paid with his own funds the sum of P2,750 to the Philippine Engineering Co. as part of the purchase price of the rice mill bought for the corporation. Angeles' paid a further sum of P2,397.99 to the Philippine Engineering Company. It also appears that for the installation of the rice mill, the construction of a camarin, and the cement paving (cementacion) of the whole area of two camarines, and for the excavation of a well for the use of the rice mill, the plaintiff Higinio Angeles paid with his own funds the amount of P7,431.47. Adding all these sums together we have a total of P18,179.46. At a meeting of the board of directors on December 27, 1931, which meeting was convoked by Angeles, it seemed to have been agreed that Angeles was to be given shares of stock of the total par value of P15,000. Angeles wanted to have P16,000 worth of stock to his credit for having made the disbursements mentioned above, but he finally agreed to accept 600 shares worth only P15,000. The certificate of stock, however, was not issued as disagreement arose between him and the defendant Santos. We, therefore, find no error in the decision of the lower court ordering the issuance of a certificate for 600 shares of stock of the total par value of P15,000 to Higinio Angeles.

It is unnecessary to consider the ninth and tenth assignments of error.

In view of the foregoing, we hold:

- (1) That the action in the present case was properly instituted by the plaintiffs as stockholders for and in behalf of the corporation Paranaque Rice Mill, Inc., and other stockholders of the said corporation;
- (2) That the lower court committed no reviewable error in appointing a receiver of the corporation pendente lite;
- (3) That the lower court committed no error in ordering an election of the new board of directors, which election shall be held within thirty days from the date this decision becomes final;
- (4) That Teodorico B. Santos shall render an accounting of all the properties, funds and income of the corporation which may have come into his possession to the new board of directors;
- (5) That the receiver, Emilio Figueroa, shall continue in office until the election and qualification of the members of the new board of directors;
- (6) That upon the constitution of the new board of directors, the said receiver shall turn over all the properties of the corporation in his possession to the corporation, or such person or persons as may be duly authorized by it; and

(7) That Higinio Angeles, or his successor in interest, is entitled to 600 shares of stock at the par value of P15,000 and the lower court committed no error in ordering the issuance of the corresponding certificate of stock.

On June 10, 1937, counsel for the plaintiffs-appellees filed a motion making it appear of record that Higinio Angeles, one of the plaintiffs and appellees, died on May 4, 1937 and that one of his daughters, Maura Angeles y Reyes, had been granted letters of administration as evidenced by the document attached to the motion as Exhibit A, and praying that said Maura Angeles y Reyes be substituted as one of the plaintiffs and appellees in lieu of Higinio Angeles, deceased. This motion is hereby granted.

Defendants-appellants shall pay the costs in both instances. So ordered.

Avancena, C. J., Villa-Real, Abad Santos, Imperial, Diaz, and Conception, JJ., concur.

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