

THE PEOPLE OF THE PHILIPPINES, PLAINTIFF AND APPELLEE, VS. VICENTE T. FERNANDEZ AND JOAQUIN TRINIDAD, DEFENDANTS AND APPELLANTS.

G.R. No. 45655. June 15, 1938

Ponente: CONCEPCION, J.

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CONCEPCION, J.:

This case involves the meaning and interpretation of "speculative securities" under the provisions of Act No. 2581. The defendants were charged with a violation of said statute and were tried and convicted in the Court of First Instance of Manila from whose judgment they appealed.

It was established by the prosecution and admitted by the appellants that they, together with other persons, organized a corporation which was registered in the Bureau of Commerce on January 7, 1936 under the name of Philippine Mutual Cooperative Society, Inc. The purposes of this association, according to its articles of incorporation and by-laws, are to promote the social, moral and economic well-being of its members by extending to them aid in the form of benefit payments or in any other form allowed by the laws of the Philippines. An attempt has been made to show that the object is purely cooperative by relieving and helping the unemployed, the needy, and people of moderate means in particular and all those who need material aid in general.

In order to carry out these purposes, the corporation has established and admitted two classes of members, namely, class O and class S. Each member in class O must pay a due of P5 which entitled him to a regular benefit aid of P40. The payment of all and each of these benefit aids should be made whenever 16 new members had been admitted. The second member would receive said aid of P40 after 12 new members had been admitted. The third member and each of those following would receive their respective benefit aids of P40 after the admission of each group of eleven new members. Those of class S had to pay a due of P2 each, which was later increased to P2.50, and they would be entitled to a benefit aid of P12, which was subsequently increased to P20 as soon as sixteen new members were admitted. The second member and each of those following would receive their corresponding benefit aids after the admission of every group of ten new members. The members of both classes, who may have received the benefit aids of the corporation, were bound to renew their subscriptions by paying every time they received said aid the amount of P5 or P2.50, according to the class to which they belonged. The corporation would and did issue to each member a certificate of membership which specified the class to which he belonged. The benefit aids were due and payable to the members strictly by turns according to the respective dates of their enrollment. If after two years from the date of his admission, no benefit aid had been paid a member, the corporation promised to refund him, on demand, the dues paid by him plus 25 per cent of the same. In order to obtain more members and carry out its purpose, the corporation offered to each member, who secured new members, a commission of 10 per cent for each new member, which was payable from the dues collected from the new members. Said commission was later reduced to 5 per cent, but an additional 5 per cent for traveling expenses was allowed.

To prevent a shortage in the funds of the corporation due to its expenditures and the fact that the benefit aids paid by it were larger than the membership dues, it would hold public literary contests, etc., and other benefit performances, the net proceeds of which would be exclusively devoted to the payment of benefit aids. The cost of holding these performances would be paid from the allotment of the association for expenses in order not to disturb the reserve funds devoted to the payment of benefit aids.

From November 28, 1935, or prior to its incorporation, up to January 11, 1936, the corporation, without having previously obtained a license from the Insular Treasurer as required by law and through the distribution of 20,000 prospectuses, known as Exhibit V, to the public, secured and admitted 477 members of class O and 278 members of class S. Of these 32 and 29, respectively, received benefit aids, and from January 12, 1936 to the date of trial, the corporation admitted 18,294 members of class O and 4,351 members of class S, of whom 1,399 and 323, respectively, received benefit aids. Between November 28, 1935 and May 31, 1936, the corporation received dues from its members in the amount of P103,514; and after deducting commissions (P4,765), traveling expenses (P4,765), operating and general expenses (P7,066.66), administrative and management fees (P4,400), sundry accounts (P1,002.94), and benefit aids (P63,052), there only remained as cash account the sum of P18,461.45 (Exhibit W-1); and on May 12, 1936, the receipts amounted to P97,780.23, and deducting therefrom the disbursements amounting to P77,628.25, there was a cash balance of P20,151.98 (Exhibit W).

The lower court having found the certificates of membership issued by the corporation as speculative securities, convicted Vicente T. Fernandez and Joaquin Trinidad, president and general manager, respectively, of the Philippine Mutual Cooperative Society, Inc., of a violation of section 2 of Act No. 2581, and sentenced each to pay a fine of P5,000, with the corresponding subsidiary imprisonment in case of insolvency, and the costs.

Appellants assign in their brief five errors which the trial court is alleged to have committed: First, in declaring that the membership certificates issued by the Philippine Mutual Cooperative Society, Inc., are securities within the meaning of Act No. 2581; second, in holding that they are speculative; third, in not holding Act No. 2581 unconstitutional because it is vague and because it confers legislative and judicial powers upon the Insular Treasurer; fourth and fifth, in not interpreting the law strictly in favor of the accused and dismissing the charge against them.

Act No. 2581, better known as the Blue Sky Law, is patterned after similar laws enacted in various states of the Union, one of the oldest of which, if not the oldest, is that of the State of Kansas, which was amended in 1913 and 1915 (Fletcher, vol. 7 [1919], p. 7714). The purpose of these laws, as was said by Justice McKenna, is to protect the public against the imposition of unsubstantial schemes and the securities based thereon. It is said that the name given the law indicates the evil against which it is directed, namely, speculative schemes which have no more basis than a few feet of the blue sky (Fletcher, *supra*).

Section 1 of Act No. 2581, as amended by Act No. 2817 (which amendment does not affect the present case), provides :

"Section 1. Terms defined.—The term 'securities' as used in this Act shall be taken to mean stock certificates, shares, bonds, debentures, certificates of participation, contracts, contracts or bonds for the sale and conveyance of lands on deferred payments or on the installment plan, or other instruments in the nature thereof, by whatsoever name known or called. The term 'speculative securities' as used in this Act shall be deemed to mean and include:

"(a) All securities to promote or induce the sale of which profit, gain, or advantage unusual in the ordinary course of legitimate business is in any way advertised or promised;

"(b) All securities the value of which materially depends upon proposed or promised future promotion or

development rather than on present tangible assets and conditions;

"(c) All securities for promoting the sale of which a commission of more than five per cent is offered or paid;

"(d) The securities of any enterprise or corporation which has included, or proposes to include in its assets as a material part thereof patents, formulae, good-will, promotion or other intangible assets, or which has issued or proposes to issue a material part of its securities in payment for patents, formula, good-will, promotion or other intangible assets."

The certificates of membership issued by the Philippine Mutual Cooperative Society, Inc., are truly speculative securities within the meaning of Act No. 2581.

First. In order to encourage and induce their sale, profit unusual in the ordinary course of business has been advertised or promised, for through the payment of the sum of P5 by a member appertaining to class O, or that of P2.50 by a member belonging to class S, each will receive profits of P40 and P20, respectively, which represent the fabulous and extraordinary gain of 800 per cent.

Second. The speculative character of said certificates is also shown by the fact that such profit or advantage of 800 per cent does not depend upon the actual tangible assets or conditions of the corporation, but upon its growth and development which would be attained through the admission of new groups of 16 or 12 members so that each original member could receive the benefit aids of P40 or P20, as the case may be. Therefore, if there were no enrollment of 16 or 12 new members, according to the class, a member of class O or class S would not receive the corresponding benefit aid of P40 or P20, respectively.

Third. Another proof of their speculative nature is that even if a member of class O or class S should be able to secure a group of 16 or 12 new members, as the case may be, this fact would not necessarily entitle him to receive immediately the benefit aid of P40 or P20, respectively, for according to the by-laws of the corporation, he would have to wait for his turn before he could receive his benefit aid. And it is possible that his turn may never come because notwithstanding the admission of 16 or 12 members, according to the class, there may be no funds with which to pay his benefit aid, for before the coming of his turn, the funds of the corporation might have been exhausted by the payment of the dues of the old members in accordance with the strict rotation, while no new members may have been admitted in the meantime.

Fourth. The certificates of membership in question also come within the purview of paragraph (c) of section 1 of Act No. 2581 because to promote their sale, the corporation has offered and paid a commission of 10 per cent which, though later on reduced to 5 per cent, was in fact more than 5 per cent because the corporation has paid another 5 per cent for traveling expenses.

Fifth. The speculative character of the membership certificates issued by the corporation is also shown by the fact that when a member, whether belonging to class O or to class S, has not received his benefit aid after two years from the date of his enrollment, he cannot expect anything more than the refund of the dues paid by him plus 25 per cent of the same. But it is possible, as the by-laws of the corporation themselves provide, that there are no funds with which to reimburse the member or members, who have not been able to collect any benefit aid, the dues paid by them. To avoid such an eventuality, it is provided that the corporation hold public contests and benefit performances, the net proceeds of which will be applied to the payment of benefit aids. It may, however, happen that, even by these means, the corporation will not be able to raise the necessary funds to pay the members, who ask for reimbursement of their dues, as would undoubtedly occur should no new members enroll in the corporation.

The following decisions show the various and distinguishing features which may be found in the membership

certificates in question:

"In re Lamb ([1923], 61 Cal. App., 321; 215 Pac., 109), the court said: 'The "securities" which may not be issued or sold without the permission of the corporation commissioner are * * * "any instrument issued or offered to the public by any company", evidencing any right to participate in the profits or earnings or the distributions of assets of any business carried on for profit by the company * * *'"

" 'Certificates' providing 'that, in consideration of the certificate holder's promise to render such assistance and in further consideration of \$50 paid by him, defendant will divide pro rata among all the holders of like certificates who reside at a specified place, 10 per cent of the net price of such tires and tubes as may be sold by defendant's representative at such place, such division to be made quarterly for the period of twenty years; that the holder is entitled to a discount of 10 per cent on all its goods which he may purchase from defendant for his personal use, and that defendant will annually set aside as a bonus to certificate holders all of its excess earning after paying operating expenses, fixed charges, and dividends to stockholders, the same to be distributed at its option in the form of preferred stock,' have been held to be security within the meaning of the Minnesota Blue Sky Law, where the certificates were transferable on notice to the company, although they contained a clause stating that they were not to be construed to be certificates of stock, or security or investment contracts. (State vs. Gopher Tire & Rubber Co. [1920], 146 Minn., 52; 177 N. W., 937.)"

"Speculative securities include those the value of which materially depends on proposed or promised future promotion or development, rather than on present tangible assets or conditions. (Moos vs. Landowners Oil Asso. [1932], 136 Kan., 424; 15 Pac. [2d], 1073.)"

" 'Investment contract', within the meaning of the Blue Sky Law, includes certificates issued in consideration of cash and services entitling the holder to share in the profits of the business. (State vs. Gopher Tire & Rubber Co., supra.)"

"Certificate of membership in corporation selling sick and death benefit insurance is a 'security' within the meaning of Blue Sky Law. (Stevens vs. Atlantic & Security Mut. Ass'ns., 116 N. J. Eq., 584; 174 Atl., 744.)"

The appellants contend that the Philippine Mutual Cooperative Society, Inc., is purely a civic association and does not engage in business. The truth is that the members pay dues and the association gives them benefit aids which represent a profit of 800 per cent. Do ut des.

They further point out that the membership certificates issued by the corporation are not contracts, nor certificates of participation, bonds, debentures, etc. The fact, however, is that said certificates represent obligations to pay a sum of money or securities of payment so that they are in reality investment contracts. It is not true that one becomes a member without any expectation of gain. In fact, the contrary is evident, and the association itself admits members with a like intention to gain.

The appellants argue that the Blue Sky Law is unconstitutional on two grounds: First, because it is vague and indefinite; and second, because it delegates legislative and judicial powers to the Insular Treasurer. The ambiguity of the statute—the appellants insist—is shown by the inability of both the City Fiscal's and Insular Treasurer's office to determine within a reasonable time whether the scheme of the corporation comes under Act No. 2581. We find no merit in this contention.

The argument that the statute delegates legislative and judicial powers to the Insular Treasurer is founded on the fact that, according to the appellants, the law vests authority in the Insular Treasurer to cancel a permit granted a person or corporation to enter into transactions without establishing any fixed rule or guide in the exercise of such discretion. In the first place, the question involved herein is whether or not the Philippine Mutual Cooperative Society, Inc., should have applied for a permit from the Insular Treasurer to issue and sell certificates of its membership. It is, therefore, immaterial whether the Insular Treasurer can withdraw a permit which he may have

already given. In the second place, the purpose of the law being to avoid ruinous speculations, it is obvious that the public interest is and should be the reason on which the Insular Treasurer should base his decisions.

It has, nevertheless, been proved that Attorney Jose Moreno, on behalf of the Philippine Mutual Cooperative Society, Inc., consulted the offices of the City Fiscal and the Insular Treasurer for the purpose of obtaining a statement as to the legality of the schemes of the association and whether they came within the scope of Act No. 2581. He began his inquiry in November, 1935, and it was while expecting the decisions of said offices that the information in this case was filed in May, 1936 without any previous notice or answer to said inquiry. Good faith and lack of intention to violate the law may, in this case, be considered as mitigating circumstances in the imposition of the penalty; but they do not constitute a valid defense. (People vs. McCalla [1923], 63 Cal. App., 783; 220 Pac., 436.) The same may be said of the argument that the members, who had the right to the benefit aids of P40 or P20, as the case may be, did receive such aids, and that it has not been proved that the association has committed any fraud, or is in imminent danger of insolvency.

Wherefore, the appealed judgment is modified and the accused are sentenced each to pay a fine of P100 or suffer the corresponding subsidiary imprisonment prescribed by law, in case of insolvency, and to pay the costs. So ordered.

Avanceña, C. J., Villa-Real, Abad Santos, Imperial, Diaz, and Laurel, JJ., concur.

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