

SWAN, CULBERTSON & FRITZ, PETITIONER, VS. THE SECURITIES AND EXCHANGE COMMISSION AND VICENTE GALIAN, RESPONDENTS.

G.R. No. 45792. November 22, 1938

Ponente: DIAZ, J.

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DIAZ, J.:

On April 10, 1937, Vicente Galian, desiring to sell 20,000 shares of Gumaus Goldfields, Inc., of which he was the absolute owner, placed in the hands of the petitioner, a broker, certificate No. 3818 of said corporation, representing the 20,000 shares in question. He then gave said broker the necessary authority, agreed between them to be valid until cancelled, to sell the shares at P0.185 per share. Upon learning on the 13th of said month and year that said shares had not been sold to that date, Vicente Galian cancelled its authority. Instead of returning his original certificate, the petitioner, on that same date, turned over to him certificates Nos. 3789 and 3554, each representing 10,000 shares also of Gumaus Gold fields, Inc., issued in the names of Mackay & McCormick, and Leo Schnurmacher, Inc., respectively. This was done by the petitioner because, shortly before, it had caused the former certificate to be exchanged in the clearing house of the Manila Stock Exchange for the two certificates above-mentioned, which are called street certificates in the stock market, claiming that it would make them more rapidly negotiable.

Before the petitioner accepted Vicente Galian's order, the latter executed in its favor the document containing, among others, the following clauses:

"Only actual purchases or sales are contemplated and all orders shall be executed subject in all respects to the regulations and usages of the New York Stock Exchange or other exchange or market where executed;

* * * * *

"All securities or commodities, contracts for commodities or other contracts, now held or hereafter purchased by the brokers for, or now or hereafter deposited with the said brokers by the customer, are to be held by the brokers as security for the payment of all liabilities of the customer to the brokers however and whenever arising, and the brokers are hereby authorized, without further notice to the customer and without regard to whether the brokers have in their possession or subject to their control at the time thereof other securities, commodities or contracts for commodities of the same kind and amount, in the usual course of business, to repledge, rehypothecate (either for the amount due to the brokers from the customer, or for a greater sum) and loan the same from time to time, separately or together with other securities; and the brokers shall not be required to deliver to the customer the same certificates or securities deposited or received but only certificates or securities of the same kind and amount."

At that time Vicente Galian owed nothing to the petitioner in connection with said certificate of shares No. 3818 of the Gumaus Goldfieds, Inc., which was delivered by him to said petitioner for the above-stated purpose, that is, to be sold, and said certificate was not subject to any obligation, it being therefore an absolutely free certificate.

Notwithstanding the fact that Galian had accepted from the petitioner, without protest, the two street certificates in question in lieu of his own (certificate No. 3818), on the occasion and under the circumstances above-stated, he filed with the Securities and Exchange Commissioner, on April 19, 1937, a complaint against the petitioner, charging it with having violated Rule A-6 of the provisional rules and regulations of the Securities and Exchange Commission, which reads as follows:

"Securities in which a broker has not extended any credit to a customer shall be kept separate for the particular customer who owns them and, except with the written consent of the latter, shall not be loaned, pledged, or commingled with other securities owned by the broker himself or by other customers, or otherwise disposed of as his own. In case they should be loaned, pledged, or otherwise disposed of as his own by the broker, by virtue of the customer's written consent, the broker shall report it to the latter, stating the name of the person or persons to whom they were loaned or pledged or disposed of, and the amount for which they were disposed of, and the date of maturity of the loan."

The Securities and Exchange Commissioner, after having heard and considered the reasons which Vicente Galian and the petitioner deemed convenient to adduce in support of their respective claims, decided the question against the petitioner, finding it guilty of having violated, at least, the last part of said Rule A-6. The pertinent portion of the dispositive part of the decision of the commissioner reads as follows:

"In the present case, considering that the violation committed by the respondent is its first offense, and neither the complainant's interests nor that of the public has been damaged thereby, the commission is of the opinion that the respondent should merely be given a warning. The respondent is, therefore, hereby warned that a repetition of this offense or any other offense in the future would be punished with much greater severity."

The petitioner asked for reconsideration of the decision, and as the commissioner refused to reconsider the same, it interposed this appeal, alleging now that said commissioner committed the four errors assigned by it in its brief, which are substantially as follows:

"I. The respondent commission erred in holding that in changing Gumaus Goldfields certificate No. 3818, issued in the name of respondent Vicente Galian, into 'street' certificates of the same company and representing the same number of shares, the petitioner thereby disposed of said certificate as its own within the meaning of Rule A-6 of the provisional rules and regulations promulgated by said respondent commission.

"II. The respondent commission erred in holding that the petitioner was required by the above-mentioned Rule A-6 to report to its customer, the respondent Vicente Galian, the changing of said Gumaus Goldfields certificate No. 3818 into 'street' certificates, in spite of the fact that said respondent Vicente Galian had accepted without protest, when delivered to him, the said 'street' certificates in lieu of his certificate No. 3818, thus terminating any relationship of customer and broker that might have existed between said respondent Vicente Galian and the petitioner, in spite of the fact that no damage of any kind was sustained by respondent Vicente Galian, as expressly admitted by him and as declared by the commission, and notwithstanding the fact that upon the face of said Rule A-6, such report is only required when a certificate is 'loaned, pledged, or otherwise disposed of by the broker as his own,' and when the relation of broker and customer still remains and there is some account to be settled between them.

"III. The respondent commission erred and grossly abused its discretion in taking for granted, in its decision, certain facts which have not been admitted or agreed upon by the parties, and in ignoring certain facts that are apparent from the letters of the parties attached to the records of the case.

"IV. The respondent commission erred and grossly abused its discretion in not making a finding on certain material facts affecting the transaction, and in refusing to allow the petitioner a hearing to establish said facts, inasmuch as it had no knowledge of them and it was duty bound to know them in order to better act and render its decision."

- From the time the petitioner had the certificate in question changed for those of Mackay & McCormick, and Leo Schnurmacher, Inc., nothing more has been heard about it. It may have been transferred to another or most probably, it may have been cancelled. Whatever may have been done, the fact is that it has ceased to be of any benefit to Galian, the original owner thereof. Galian was not able and could not have been able to avail himself of the advantages accruing to him as owner from the time the exchange was made, because it was the existence, or rather, the continuation of said certificate in his name in the books of the Gumaus Goldfields, Inc., that entitled him to said advantages or privileges. Had there been dividends to be distributed among the stockholders, he would not have thereafter received any and would not have been entitled to claim those which otherwise would have belonged to him. Had meetings of stockholders been held, or had reports or memoranda for the benefit of said stockholders been drafted, he not only would not have been able to vote at said meetings either in person or by proxy, but he would not have been able even to take part in the deliberations.

Neither would he have received copies of such reports or memoranda nor could he have had access to the books of the corporation, a privilege enjoyed by every stockholder by the mere fact of being such a stockholder, and he would not have been notified of any of said proceedings, even if he had requested it, because he lacked the condition or the necessary and indispensable means of establishing his right to claim said advantages or privileges. It is inferred from the foregoing that the petitioner really disposed of the certificate in question in the sense of Rule A-6 of the Securities and Exchange Commission, because to dispose of a thing, or using the same phrase employed in said rule, "otherwise disposed of," is neither more or less than "(a) to determine the fate of; to fix the condition, employment, etc. of; (b) to get rid of; to put out of the way; to finish with; as, to dispose of rubbish; * * * (c) to transfer to the control of some one else, as by selling; to alienate; to part with; to relinquish; to bargain away" (Webster's New International Dictionary, 1934 ed., page 644); or "to exercise finally a person's powers of control over; * * * to pass over into the control of another; * * * to alienate or direct the ownership of property; to barter; to convey; * * * to exchange for other property; * * * to part with the right to or ownership of property, in other words, a change of property; to put into the hands of another; to put into another's power and control; * * * to transfer to any person, * * *" 18 C. J., 1280, 1281), in all of which senses the act performed by the petitioner perfectly fits, all the more so because, as the above-stated phrase "otherwise disposed of" used in the rule under consideration is preceded by the phrases: "shall not be loaned", "pledged" and "commingled with other securities", it necessarily means that it should be given an interpretation or meaning not confined to the strict meanings of said phrases "loaned", "pledged" and "commingled", it not being a synonym or even a periphrasis thereof. If not, the adverb "otherwise", which accompanies the verb "dispose of not for any meaningless purpose but precisely to qualify and give it a greater and wider scope, would be completely nullified.

- The next question raised, which this court, by resolution of August 12, 1938, ordered the parties to discuss—which they did—because of its importance, although the Securities and Exchange Commissioner, rather than overlooked it, took it for granted, is whether or not the power given by Galian to the petitioner under the contract, some of the clauses of which already appear quoted on pages 2 and 3 of this decision, authorized it to change the original certificate in question for the street certificates Nos. 3789 and 3554 of Mackay & McCormick, and Leo Schnurmacher, Inc., respectively.

The petitioner claims the affirmative and cites in its support that part or clause of said contract which reads: 'the broken shall not be required to deliver to the customer the same certificates or securities deposited or received but only certificates or securities of the same kind and amount.' The petitioner, together with the Securities and Exchange Commissioner, claims that under said clause, the former was authorized to make the change or substitution in the manner done by it, because the authority granted it to sell, rehypothecate, or repledge Galian's certificate of shares in its possession was not confined to those certificates on which it had a lien of some kind for advances or loans made to him, or for any other credit, but it extended even to those that were entirely free,

emphasizing the fact that the clause in question is in itself independent of the others, with no substantial relation whatsoever to them. It further contends that, even without said authority, it would have been lawful for it to do what it did because, according to it, it did not dispose of Galian's certificate of shares, but merely confined itself to changing it for two certificates of the same kind and for the same number of shares. It cites in its support the case of *Drake-Jones Co. vs. Grogseth* (188 Minn., 133; 246 N. W., 684, cited in volume 2, page 130, of Meyers book entitled "The Law of Stock Brokers and Stock Exchanges"), wherein it was really stated that: "In the absence of an agreement to the contrary, a custom permitting the broker to make delivery to the customer in a 'street name' would control." It forgets, however, that the practice followed in the Philippines is different, it being precisely that prescribed in Rule A-6 above-stated. Said rule prohibits not only the lending or hypothecating of a certificate of shares without the written consent of the owner, but also the commingling thereof with other securities belonging to the broker or to other persons. If this is so, therefore, it should be understood that it is prohibited to change or substitute a free certificate for street certificates issued in the names of other persons, without the consent of the owner thereof, because if something less is prohibited, the greater should be so with more reason. The authority granted the petitioner was not as general and absolute as it claims. It was confined to those certificates of shares belonging to Galian, which, being in some way subject to an obligation he had with the petitioner by reason of some loan, advance or commission, or any other credit, might have been delivered to it for sale in its name. It did not extend to the certificate in question (No. 3818) which was absolutely free, and was exclusively owned outright by Galian. Of this there would be no doubt, if it is taken into consideration that in the power of attorney granted the petitioner, it is stated that it may rehypothecate or repledge Galian's certificate, because to rehypothecate and repledge are acts which necessarily imply that the certificate to be rehypothecated or repledged is previously hypothecated or pledged to other persons, and the certificate under consideration was not so at all.

The Supreme Court of Massachusetts, in the case of *Parsons vs. Martin* (11 Gray, 111-118), which was reaffirmed in that of *Somerville National Bank vs. Hornblower* (199 N. E., 918-921), held that:

"A broker, to whom a certificate of shares in a corporation has been intrusted by their owner, with written directions to sell under circumstances specified, has no right to transfer the shares for any other purpose to the name of another person or to his own name * * *."

And the author, Meyer, in his book entitled "The Law of Stock Brokers and Stock Exchanges" states as follows:

"The right to substitute certificates does not exist with respect to securities which the customer owns outright, and which have been deposited by him with the broker for the purpose of safekeeping, or for the purpose of securing a marginal account which the customer expects to open but does not in fact open. Stocks and bonds do not lose their earmark and become fungibles until they become collateral for marginal transactions. And if they have never become such collateral, they may be recovered by their true owner either from the broker or from third parties who are not bona fide holders for value." (Vol. I, page 823, paragraph 67.)

"Securities which are owned outright by a customer and which have not been deposited with the broker as margin may not be hypothecated by the broker at all. This principle applies to securities which have been bought through the broker and for which he has been paid in full; to securities which have been deposited by the customer with the broker for safekeeping; and to securities which have been deposited with the broker by a customer who contemplates making marginal commitments but who has not yet done so. The hypothecation of any of such securities constitutes a conversion.

"If the broker has rightfully repledged securities which he is carrying for a customer on margin he must withdraw them from the repledge whenever the customer's indebtedness to him has been paid in full. The repledge, although rightful in the first instance, becomes wrongful if continued after the customer's debt has been satisfied, and the

continuation of the repledge constitutes a conversion." (Vol. I, pages 343, 344, paragraph 74.)

All the foregoing seems to warrant the conclusion that the only authority granted the petitioner in the case under consideration was to sell Galian's shares at the price fixed, and not to change them for other certificates registered in the names of other persons.

The petitioner, to insist in its allegation that in exchanging Galian's certificate for those of Mackay & McCormick, and Leo Schnurmacher, Inc., it acted under the authority granted it, and that it did not dispose of said certificate in the sense of Rule A-6 of the office of the Securities and Exchange Commissioner, invokes, among others, the cases of *Cleminshaw vs. Meehan* (236 App. Div., 185; 258 N. Y. Supp., 225; *Stewart vs. Drake*, 46 N. Y., 449, 453; *Horton vs. Morgan*, 19 N. Y., 170, 173; *Sprague vs. Currie*, 133 App. Div., 18, 20; *Richardson vs. Shaw*, 209 U. S., 365, 378, 379; and *McBride vs. Chisholm* 144 Misc., 447; 258 N. Y. Supp., 225). The foregoing citations, however, with the exception of the first one, are not applicable to the case under consideration because they refer to cases wherein the certificates exchanged for or substituted by others were not free, they having been in some way subject to an obligation previously contracted by the owners thereof with the brokers to whom they had been delivered. In the case of *Cleminshaw vs. Meehan*, supra, it was really held that to transfer a free certificate to street certificates, for the purpose of insuring immediate delivery in case of sale, is not a pledging or disposing of said certificate, but then the court was merely trying to determine whether or not what Meehan and his co-accused had done constituted an act punishable under the provisions of section 956, subdivision 1, of the Penal Law of New York, arriving at the conclusion that if they made the transfer of the certificate delivered to them with the request to sell it upon receipt of an order to that effect from the owner thereof, it was because they were of the opinion that in doing so they would be in a better position to comply with the instructions of their client; and it was not proven, on the other hand, that in making the transfer, they did so with a malicious intent, or that they have obtained thereby any benefit for themselves. In the same case of *Cleminshaw vs. Meehan* the case of *Parsons vs. Martin*, supra, has been cited with certain approval, the court having expressed itself therein as follows:

"We find no stipulated facts showing that defendants converted the certificate to their own use, or that they did any act with a wrongful intent. (26 R. C. L., p. 1111, par. 21; *Rogers vs. Huie*, 2 Cal., 571; 56 Am. Dec, 363.) The broker is bound to obey his client's instructions, and is responsible for any loss resulting from a breach of duty. In 9 C. J., p. 528, sec. 29, are cited *Picard vs. Beers* (195 Mass., 419; 81 N. E., 246); *Day vs. Holmes* (103 Mass., 306); *Parsons vs. Martin* (11 Gray [Mass.], 111), as holding that a broker to whom a certificate of shares has been intrusted by the owner with written directions to sell under specified circumstances has no right to transfer the shares for any other purpose to the name of another person or to his own name. We do not think those authorities apply to the instant case. Here the transfers were made by the brokers to facilitate as they understood the direction of the client."

For the foregoing reasons, this court holds that the contract entered into between the petitioner and the respondent Vicente Galian did not authorize the former to change Galian's original certificate No. 3818 for the street certificates Nos. 3789 and 3554 of Mackay & McCormick, and Leo Schnurmacher, Inc., respectively.

- As to the question whether or not the petitioner complied with the provisions of the second part of Rule A-6 of the office of the Securities and Exchange Commissioner by informing Vicente Galian of the name of the person or persons to whom it had disposed of his certificate of shares (certificate No. 3818), and the amount for which it had disposed of said certificate, or the date of maturity of the loan in case it had loaned the same, the established facts show that the petitioner substantially did so, because on the same date on which it substituted said certificate for the street certificates of Mackay & McCormick, and Leo Schnurmacher, Inc., Vicente Galian asked for the return thereof and the petitioner turned over to him the two street certificates in question, without any protest on his part. Under said circumstances, it was not necessary for it to supply him the data enumerated by the rule, inasmuch as

Galian then had them before him and had knowledge of them by means of said two certificates accepted by him without the least protest.

- Having arrived at the foregoing conclusions, this court deems it unnecessary to discuss the other assignments of error made by the petitioner, the questions raised therein being of no importance and the same having been satisfactorily decided in the resolution of the Securities and Exchange Commissioner of October 13, 1937, denying said petitioner's motion for reconsideration. This court makes its own the reasons then taken into account and stated by the commissioner in its resolution in question.

In resume, this court holds that the petitioner violated the first part of Rule A-6 of the office of the Securities and Exchange Commissioner and that the warning given it is sufficient correction for its act, being its first offense. It cannot be said that it is improper for this court to affirm a decision upon a ground distinct from that taken into consideration by the lower court (the Securities and Exchange Commissioner in this case), because on appeal this court may correct any error that may be discovered after considering a question from all angles.

The appealed decision is affirmed, with the costs to the petitioner. So ordered.

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

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