

CHARLES W. MEAD, PLAINTIFF AND APPELLANT, VS. E. C. MCCULLOUGH ET AL., AND THE PHILIPPINE ENGINEERING AND CONSTRUCTION COMPANY, DEFENDANTS AND APPELLANTS.

G.R. No. 6217. December 26, 1911

Ponente: TRENT, J.

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TRENT, J.:

This action was originally brought by Charles W. Mead against Edwin C. McCullough, Thomas L. Hartigan, Frank E. Green, and Frederick H. Hilbert. Mead has died since the commencement of the action and the case is now going forward in the name of his administrator as plaintiff.

The complaint contains three causes of action, which are substantially as follows: The first, for salary; the second, for profits; and the third, for the value of the personal effects alleged to have been left by Mead and sold by the defendants.

A joint and several judgment was rendered by default against each and all of the defendants for the sum of \$3,450.61 gold. The defendant McCullough alone having made application to have this judgment set aside, the court granted his motion, vacating the judgment as to him only, the judgment as to the other three defendants remaining undisturbed.

At the new trial, which took place some two or three years later and after the death of Mead, judgment was rendered upon the merits, dismissing the case as to the first and second causes of action and for the sum of \$1,200 gold in the plaintiff's favor on the third cause of action. From this judgment both parties appealed and have presented separate bills of exceptions. No appeal was taken by the defendant McCullough from the ruling of the court denying a recovery on his cross complaint.

On March 15, 1902, the plaintiff (Mead will be referred to as the plaintiff in this opinion unless it is otherwise stated) and the defendants organized the "Philippine Engineering and Construction Company," the incorporators being the only stockholders and also the directors of said company, with general ordinary powers. Each of the stockholders paid into the company \$2,000 Mexican currency in cash, with the exception of Mead, who turned over to the company personal property in lieu of cash.

Shortly after the organization, the directors held a meeting and elected the plaintiff as general manager. The plaintiff held this position with the company for nine months, when he resigned to accept the position of engineer of the Canton and Shanghai Railway Company. Under this organization the company began business about April 1, 1902.

The contracts and work undertaken by the company during the management of Mead were the wrecking contract with the Navy Department at Cavite for the raising of the Spanish ships sunk by Admiral Dewey; the contract for the construction of certain warehouses for the quarter-master department; the construction of a wharf at Fort McKinley for the Government; the supervision of the construction of the Pacific Oriental Trading Company's

warehouse; and some other odd jobs not specifically set out in the record.

Shortly after the plaintiff left the Philippine Islands for China, the other directors, the defendants in this case, held a meeting on December 24, 1903, for the purpose of discussing the condition of the company at that time and determining what course to pursue. They did on that date enter into the following contract with the defendant McCullough, to wit:

"For value received, this contract and all the rights and interests of the Philippine Engineering and Construction Company in the same are hereby assigned to E. C. McCullough of Manila, P. I.
(Sgd.) "E. C. MCCULLOUGH,
"President, Philippine Engineering and
Construction Company,
(Sgd.) "F. E. GREEN, Treasurer.
(Sgd.) "THOMAS L. HARTIGAN, Secretary."

The contract referred to in the foregoing document was known as the wrecking contract with the naval authorities.

On the 28th of that same month, McCullough executed and signed the following instrument:

"For value received, and having the above assignment from my associates in the Philippine Engineering and Construction Company, I hereby transfer my right, title, and interest in the within contract, with the exception of one-sixth, which I hereby retain, to R. W. Brown, H. D. C. Jones, John T. Macleod, and T. H. Twentyman."

The assignees of the wrecking contract, including McCullough, formed what was known as the "Manila Salvage Association." This association paid to McCullough \$15,000 Mexican currency cash for the assignment of said contract. In addition to this cash payment, McCullough retained a one-sixth interest in the new company or association.

The plaintiff insists that he was to receive as general manager of the first company a salary which was not to be less than \$3,500 gold (which amount he was receiving as city engineer at the time of the incorporation of the company), plus 20 per cent of the net profits which might be derived from the business; while McCullough contends that the plaintiff was to receive only his necessary expenses unless the company made a profit, when he would receive \$3,500 per year and 20 per cent of the profits. The contract entered into between the board of directors and the plaintiff as to the latter's salary was a verbal one. The plaintiff testified that this contract was unconditional and that his salary, which was fixed at \$3,500 gold, was not dependent upon the success of the company, but that his share of the profits was to necessarily depend upon the net income. On the other hand, McCullough, Green and Hilbert testify that the salary of the plaintiff was to be determined according to whether or not the company was successful in its operations; that if the company made gains, he was to receive \$3,500 gold, and a percentage, but that if the company did not make any profits, he was to receive only his necessary living expenses.

It is strongly urged that the plaintiff would not have accepted the management of the company upon such conditions, as he was receiving from the city of Manila a salary of \$3,500 gold. This argument is not only answered by the positive and direct testimony of three of the defendants, but also by the circumstances under which this company was organized and its principal object, which was the raising of the Spanish ships. The plaintiff put no money into the organization, the defendants put but little: just sufficient to get the work of raising the wrecks under way. This venture was a risky one. All the members of the company realized that they were undertaking a most difficult and expensive project. If they were successful, handsome profits would be realized; while if they were unsuccessful, all the expenses for the hiring of machinery, launches, and labor would be a total loss. The plaintiff was in complete charge and control of this work and was to receive, according to the great

preponderance of the evidence, in case the company made no profits, sufficient amount to cover his expenses, which included his room, board, transportation, etc. The defendants were to furnish money out of their own private funds to meet these expenses, as the original \$8,000 Mexican currency was soon exhausted in the work thus undertaken. So the contract entered into between the directors and the plaintiff as to the latter's salary was a contingent one.

It is admitted that the plaintiff received \$1,500 gold for his services, and whether he is entitled to receive an additional amount depends upon the result of the second cause of action.

The second cause of action is more difficult to determine. On this point counsel for the plaintiff has filed a very able and exhaustive brief, dealing principally with the facts.

It is urged that the net profits accruing to the company after the completion of all the contracts (except the salvage contract) made before the plaintiff resigned as manager and up to the time the salvage contract was transferred to McCullough and from him to the new company, amounted to \$5,628.37 gold. This conclusion is reached, according to the memorandum of counsel for the plaintiff which appears on pages 38 and 39 of the record, in the following manner:

Profits from the construction of warehouses for the Government.....

\$6,962.54

Profits from the construction of the wall at Fort McKinley.....

500.00

Profits from the inspection of the construction of the P. O. T. warehouse....

1,000.00

Profits obtained from other projects (according to Mead's calculations)..

1,000.00

Total

9,462.54

In this same memorandum, the expense for the operation of the company during Mead's management, consisting of rents, the hire of one muchacho, the publication of various notices, the salary of an engineer for four months, and plaintiff's salary for nine months, amounts to \$3,834.17 gold. This amount, deducted from the sum total of profits, leaves \$5,628.37 gold.

Counsel for the plaintiff, in order to show conclusively as they assert that the company, after paying all expenses and indebtedness, had a considerable balance to its credit, calls attention to Exhibit K. This exhibit reads as follows:

"Abstract copy of ledger No. 3, folios 276-277. Philippine Engineering and Construction Company."

Then follows the debits and credits, with a balance in favor of the company of \$10,728.44 Mexican currency. This account purports to cover the period from July 1, 1902, to April 1, 1903. Ledger No. 3, above mentioned, is that of the defendant McCullough and not one of the books of the company.

It was upon this exhibit that the lower court based its conclusion when it found that on January 25, 1903, after making the transfer of the salvage contract to McCullough, the company was in debt \$2,278.30 gold. The balance

of \$10,728.44 Mexican currency deducted from the \$16,439.40 Mexican currency (McCullough's losses in the Manila Salvage Association) leaves \$2,278.30 United States currency at the then existing rate of exchange. In Exhibit K, McCullough charged himself with the \$15,000 Mexican currency which he received from his associates in the new company, but did not credit himself with the \$16,439.40 Mexican currency, losses in said company, for the reason that on April 1, 1903, said losses had not occurred. It must be borne in mind that Exhibit K is an abstract from a ledger.

The defendant McCullough, in order to show in detail his transactions with the old company, presented Exhibits 1 and 2. These accounts read as follows:

"Detailed account of the receipts and disbursements of E. C. McCullough and the Philippine Engineering and Construction Company."

Then follow the debits and credits. These two accounts cover the period from March 5, 1902, to June 9, 1905. According¹ to Exhibit No. 1, the old company was indebted to McCullough in the sum of \$14,918.75 Mexican currency, and according to Exhibit No. 2 the indebtedness amounted to \$6,358.15 Mexican currency. The debits and credits in these two exhibits are exactly the same with the following¹ exceptions: In Exhibit No. 1, McCullough credits himself with the \$10,000 Mexican currency (the amount borrowed from the bank and deposited with the admiral as a guarantee for the faithful performance of the salvage contract) ; while in Exhibit No. 2 he credits himself with this \$10,000, and at the same time charges himself with this amount. In the same exhibit (No. 2) he credits himself with \$16,439.40 Mexican currency, his losses in the new company, and charges himself with the \$15,000 Mexican currency, received from said company. Eliminating entirely from these two exhibits the \$10,000 Mexican currency, the \$15,000 Mexican currency, and the \$16,439.40 Mexican currency, the balance shown in McCullough's favor is exactly the same in both exhibits. This balance amounts to \$4,918.75 Mexican currency.

According to McCullough's accounts in Exhibits 1 and 2, the profits derived from the construction of the Government warehouses amounted to \$4,005.02 gold, while the plaintiff contends that these profits amounted to \$6,962.54 gold. The plaintiff, during his management of the old company, made a contract with the Government for the construction of these warehouses and commenced work. After he resigned and left for China, McCullough took charge of and completed the said warehouses. McCullough gives a complete, detailed statement of expenses for the completion of this work, showing the dates, to whom paid, and for what purpose. He also gives the various amounts he received from the Government with the dates of the receipt of the same. On the first examination, McCullough testified that the total amount received from the Government for the construction of these warehouses was \$11,123 gold. The case was suspended for the purpose of examining the records of the Auditor and the quartermaster, to determine the exact amount paid for this work. As a result of this examination, the vouchers show an additional amount of about \$5,000 gold, paid in checks. These checks show that the same were endorsed by the plaintiff and collected by him from the Hongkong and Shanghai Banking Corporation. This money was not handled by McCullough and as it was collected by the plaintiff, it must be presumed, in the absence of proof, that it was disbursed by him. McCullough did not charge himself with the \$2,500 gold, alleged to have been profits from the construction of the wall at Fort McKinley, the inspection of the construction of the P. O. T. warehouse, and other projects. This work was done under the management of the plaintiff and it is not shown that the profits from these contracts ever reached the hands of McCullough. McCullough was not the treasurer of the company at that time. The other items which the plaintiff insists that McCullough had no right to credit himself with are the following:

Date.

To whom paid.

Amount (Mex. currency).

Jan. 30, 1903

Feb. 2, 1903

Feb. 2, 1903

Feb. 19, 1903

May 23, 1905

June 9, 1905

Green.....

McCullough.....

Green.....

P. O. T. Co. note.....

Hilbert.....

Hartigan.....

\$2,000.00

1,300.00

1,027.92

2,236.80

1,856.02

1,225.00

McCullough says that these amounts represent cash borrowed from the respective parties to carry on the operations of the old company while it was trying to raise the sunken vessels. There is no proof to the contrary, and McCullough's testimony on this point is strongly corroborated by the fact that the work done by the company in attempting to raise these vessels was its first undertaking. The company had made no profits while that work was going on under the management of the plaintiff, but its expenses greatly exceeded that of the original \$8,000 Mexican currency. It was necessary to borrow money to continue that work. These amounts, having been borrowed, were outstanding debts when McCullough took charge for the purpose of completing the warehouses and winding up the business of the old company. These amounts do not represent payments or refunds of the original capital. McCullough did not credit himself with any amount for his services for supervising the completion of the warehouses, nor for liquidating or winding up the company's affairs. We think that the amount of \$4,918.75 Mexican currency, balance in McCullough's favor up to this point, represents a fair, equitable, and just settlement.

So far we have referred to the Philippine Engineering and Construction Company as the "company," without any attempt to define its legal status.

The plaintiff and defendants organized this company with a capital stock of \$100,000 Mexican currency, each paying in on the organization \$2,000 Mexican currency. The remainder, \$90,000, according to the articles of agreement, were to be offered to the public in shares of \$100 Mexican currency, each. The names of all the organizers appear in the articles of agreement, which articles were duly inscribed in the commercial register. The purposes for which this organization was effected were to engage in general engineering and construction work, operating under the name of the "Philippine Engineering and Construction Company." During its active existence, it engaged in the business of attempting to raise the sunken Spanish fleet, constructing under contract warehouses and a wharf for the United States Government, supervising the construction of a warehouse for a private firm, and some assay work. It was, therefore, an industrial civil partnership, as distinguished from a commercial one; a civil

partnership in the mercantile form, an anonymous partnership legally constituted in the city of Manila.

The articles of agreement appeared in a public document and were duly inscribed in the commercial register. To the extent of this inscription the corporation partook of the form of a mercantile one and as such must be governed by articles 151 to 174 of the Code of Commerce, in so far as these provisions are not in conflict with the Civil Code (art. 1670, Civil Code) ; but the direct and principal law applicable is the Civil Code. Those provisions of the Code of Commerce are applicable subsidiarily.

This partnership or stock company (*sociedad anonima*) upon the execution of the public instrument in which its articles of agreement appear, and the contribution of funds and personal property, became a juridical person - an artificial being, invisible, intangible, and existing only in contemplation of law - with the power to hold, buy, and sell property, and to sue and be sued - a corporation - not a general co-partnership nor a limited co-partnership. (Arts. 37, 38, 1665, and 1666 of the Civil Code; *Compania Agricola de Ultramar vs. Reyes et al.*, 4 Phil. Rep., 2; and Chief Justice Marshall's definition of a corporation, 17 U. S., 518.)

The inscribing of its articles of agreement in the commercial register was not necessary to make it a juridical person - a corporation. Such inscription only operated to show that it partook of the form of a commercial corporation. (*Compañia Agricola de Ultramar vs. Reyes et al.*, *supra*.)

Did a majority of the stockholders, who were at the same time a majority of the directors of this corporation, have the power under the law and its articles of agreement, to sell or transfer to one of its members the assets of said corporation ?

In the first article of the statutes of incorporation it is stated that by virtue of a public document the organizers, whose names are given in full, agreed to form a *sociedad anonima*. Article II provides that the organizers should be the directors and administrators until the second general meeting, and until their successors were duly elected and installed. The third article provides that the *sociedad* should run for ninety-nine years from the date of the execution of its articles of agreement. Article IV sets forth the object or purpose of the organization. Article V makes the capital \$100,000 Mexican currency, divided into one thousand shares at \$100 Mexican currency each. Article VI provides that each shareholder should be considered as a coowner in the assets of the company and entitled to participate in the profits in proportion to the amount of his stock. Article VII fixed the time of holding general meetings and the manner of calling special meetings of the stockholders. Article VIII provides that the board of directors shall be elected annually. Article IX provides for the filling of vacancies in the board of directors. Article X provides that "the board of directors shall elect the officers of the *sociedad* and have under its charge the administration of the said *sociedad*." Article XI: "In all the questions with reference to the administration of the affairs of the *sociedad*, it shall be necessary to secure the unanimous vote of the board of directors, and at least three of said board must be present in order to constitute a legal meeting." Article XII provides that all of the stock, except that which was divided among the organizers, should remain in the treasury subject to the disposition of the board of directors. Article XIII reads: "In all the meetings of the stockholders, a majority vote of the stockholders present shall be necessary to determine any question discussed." The fourteenth article authorizes the board of directors to adopt such rules and regulations for the government of the *sociedad* as it should deem proper, which were not in conflict with its statutes.

When the sale or transfer heretofore mentioned took place, there were present four directors, all of whom gave their consent to that sale or transfer. The plaintiff was then absent and his express consent to make this transfer or sale was not obtained. He was, before leaving, one of the directors in this corporation, and although he had resigned as manager, he had not resigned as a director. He accepted the position of engineer of the Canton and Shanghai Railway Company, knowing that his duties as such engineer would require his whole time and attention

and prevent his returning to the Philippine Islands for at least a year or more. The new position which he accepted in China was incompatible with his position as director in the Philippine Engineering and Construction Company, a corporation whose sphere of operations was limited to the Philippine Islands. These facts are sufficient to constitute an abandoning or vacating of his position as director in said corporation. (10 Cyc, 741.) Consequently, the transfer or sale of the corporation's assets to one of its members was made by the unanimous consent of all the directors in the corporation at that time.

There were only five stockholders in this corporation at any time, four of whom were the directors who made the sale, and the other the plaintiff, who was absent in China when the said sale took place. The sale was, therefore, made by the unanimous consent of four-fifths of all the stockholders. Under the articles of incorporation, the stockholders and directors had general ordinary powers. There is nothing in said articles which expressly prohibits the sale or transfer of the corporate property to one of the stockholders of said corporation.

Is there anything in the law which prohibits such a sale or transfer? To determine this question, it is necessary to examine, first, the provisions of the Civil Code, and second, those provisions (arts. 151 to 174) of the Code of Commerce.

Articles 1700 to 1708 of the Civil Code deal with the manner of dissolving a corporation. There is nothing in these articles which expressly or impliedly prohibits the sale of corporate property to one of its members, nor a dissolution of a corporation in this manner. Neither is there anything in articles 151 to 174 of the Code of Commerce which prohibits the dissolution of a corporation by such sale or transfer.

"The articles of incorporation must include:

* * * * *

"The submission to the vote of the majority of the meeting of members, duly called and held, of such matters as may properly be brought before the same." (No. 10, art. 151, Code of Commerce.)

Article XIII of the corporation's statutes expressly provides that "in all the meetings of the stockholders, a majority vote of the stockholders present shall be necessary to determine any question discussed."

The sale or transfer to one of its members was a matter which a majority of the stockholders could very properly consider. But it is said that if the acts and resolutions of a majority of the stockholders in a corporation are binding in every case upon the minority, the minority would be completely wiped out and their rights would be wholly at the mercy of the abuses of the majority.

Generally speaking, the voice of a majority of the stockholders is the law of the corporation, but there are exceptions to this rule. There must necessarily be a limit upon the power of the majority. Without such a limit the will of the majority would be absolute and irresistible and might easily degenerate into an arbitrary tyranny. The reason for these limitations is that in every contract of partnership (and a corporation can be considered a partnership for this purpose) there is always something fundamental and unalterable which is beyond the power of the majority of the stockholders, and which constitutes the rule controlling their actions. This rule which must be observed is to be found in the essential compacts of such a partnership, which have served as a basis upon which the members have united, and without which it is not probable that they would have entered into the corporation. Notwithstanding these limitations upon the power of the majority of the stockholders, their (the majority's) resolutions, when passed in good faith and for a just cause, deserve careful consideration and are generally binding upon the minority.

Eixala, in his work entitled "Instituciones del Derecho Mercantil de España," speaking of sociedades anonimas, says:

"The resolutions of the boards passed by a majority vote are valid * * * and authority for passing such resolutions is unlimited, provided that the original contract is not broken by them, the partnership funds not devoted to foreign purposes, or the partnership transformed, or changes made which are against public policy or which infringe upon the rights of third persons."

The supreme court of Spain, in its decision dated June 30, 1888, said:

"In order to be valid and binding upon dissenting members, it is an indispensable requisite that resolutions passed by a general meeting of stockholders conform absolutely to the compacts and conditions of the articles of the association, which are to be strictly construed."

That resolutions passed within certain limitations by a majority of the stockholders of a corporation are binding upon the minority, is therefore recognized by the Spanish authorities.

"Power of private corporation to alienate property. - This power of absolute alienability of corporate property applies especially to private corporations that are established solely for the purpose of trade or manufacturing and in which the public has no direct interest. While this power is spoken of as belonging to the corporation it must be observed that the authorities point out that the trustees or directors of a corporation do not possess the power to dispose of the corporate property so as to virtually end the existence of the corporation and prevent it from carrying on the business for which it was incorporated." (Thompson on Corporations, second edition, sec. 2416, and cases cited thereunder.)

"Power to dispose of all property. - Where there are no creditors, and no stockholder objects, a corporation, as against all other persons but the state, may sell and dispose of all its property. The state in its sovereign capacity may question the power of the corporation to do so, but with these exceptions such a sale is valid. A rule of general application is that a corporation of a purely private business character, one which owes no special duty to the public, and is not given the right of eminent domain, where it is in failing circumstances or is insolvent, and when the exigencies of its business require it or when the circumstances are vSuch that it can no longer continue the business with profit, may sell and dispose of all its property, pay its debts, divide the remaining assets and wind up the affairs of the corporation." (Id., sec. 2417.)

"When directors or officers may dispose of all the property. - It is within the dominion of the managing officers and agents of the corporation to dispose of all the corporate property under certain circumstances; and this may be done without reference to the assent or authority of the stockholders. This disposition of the property may be temporarily by lease, or permanently by absolute conveyance. But it can only be done in the course of the corporate business and for the furtherance of the purposes of the incorporation. The board of directors possess this power when the corporation becomes involved and by reason of its embarrassed or insolvent condition is unable either to pay its debts or to secure capital and funds for the further prosecution of its enterprise, and especially where creditors are pressing their claims and demands and are threatening to or have instituted actions to enforce their claims. This power of the directors to alienate the property is conceded where it is regarded as of imperative necessity." (Id., sec. 2418, and cases cited.)

"When majority stockholders may dispose of all corporate property. - Another rule that permits a majority of the stockholders to dispose of all the corporate property and wind up the business, is where the corporation has become insolvent, and the disposition of the property is necessary to pay the debt; or where from any cause the business is a failure, and the best interest of the corporation and all the stockholders require it, then the majority have clearly the power to dispose of all the property even as against the protests of a minority. It would be a harsh rule that would permit one stockholder, or any minority of the stockholders, to hold the majority to their investment where the continuation of the business would be at a loss and where there was no prospect or hope that the enterprise could be made profitable. The rule as stated by some courts is that the majority stockholders may dispose of the property when just cause exists; and this just cause is usually defined to be the unprofitableness of the business and where its continuation would be ruinous to the corporation and

against the interest of stockholders." (Id., sec. 2424, and cases cited.)

"Nothing is better settled in the law of corporations than the doctrine that a corporation has the same capacity and power as a natural person to dispose of and convey its property, real or personal, provided it does not do so for a purpose which is foreign to the objects for which it was created, and provided, further, it violates no charter or statutory restriction, or rule of law based upon public policy * * *. This power need not be expressly conferred upon a corporation by its charter. It is implied as an incident to its ownership of property, unless there is some clear restriction in its charter or in some statute." (Clark and Marshall's Private Corporations, sec. 152, and cases cited.)

"A purely private business corporation, like a manufacturing or trading company, which is not given the right of eminent domain, and which owes no special duties to the public, may certainly sell and convey absolutely the whole of its property, when the exigencies of its business require it to do so, or when the circumstances are such that it can no longer profitably continue its business, provided the transaction is not in fraud of the rights of creditors. or in violation of charter or statutory restrictions. And, by the weight of authority, this may be done by a majority of the stockholders against the dissent of the minority." (Id., sec. 160, and cases cited.)

The above citations are taken from the works of the most eminent writers on corporation law. The citation of cases in support of the rules herein announced are too numerous to insert.

From these authorities it appears to be well settled, first, that a private corporation, which owes no special duty to the public and which has not been given the right of eminent domain, has the absolute right and power as against the whole world except the state, to sell and dispose of all of its property; second, that the board of directors has this power, without reference to the assent or authority of the stockholders, when the corporation is in failing circumstances or insolvent or when it can no longer continue the business with profit, and when it is regarded as an imperative necessity; third, that a majority of the stockholders or directors, even against the protest of the minority, have this power where, from any cause, the business is a failure and the best interest of the corporation and all the stockholders require it.

May officers or directors of the corporation purchase the corporate property? The authorities are not uniform on this question, but on the general proposition whether a director or an officer may deal with the corporation, we think the weight of authority is that he may. (Merrick vs. Peru Coal Co., 61 111., 472; Harts et al. vs. Brown et al., 77 111., 226; Twin-Lick Oil Company vs. Marbury, 91 U. S., 587; Whitwell vs. Warner, 20 Vt., 425; Smith vs. Lansing, 22 N. Y., 520; City of St. Louis vs. Alexander, 23 Mo., 483; Beach et al vs. Miller, 130 111., 162.)

While a corporation remains solvent, we can see no reason why a director or officer, by the authority of a majority of the stockholders or board of managers, may not deal with the corporation, loan it money or buy property from it, in like manner as a stranger. So long as a purely private corporation remains solvent, its directors are agents or trustees for the stockholders. They owe no duties or obligations to others. But the moment such a corporation becomes insolvent, its directors are trustees of all the creditors, whether they are members of the corporation or not, and must manage its property and assets with strict regard to their interest; and if they are themselves creditors while the insolvent corporation is under their management, they will not be permitted to secure to themselves by purchasing the corporate property or otherwise any personal advantage over the other creditors. Nevertheless, a director or officer may in good faith and for an adequate consideration purchase from a majority of the directors or stockholders the property even of an insolvent corporation, and a sale thus made to him is valid and binding upon the minority. (Beach et al. vs. Miller, supra; Twin-Lick Oil Company vs. Marbury, supra; Drury vs. Cross, 7 Wall., 299; Curran vs. State of Arkansas, 15 How., 304; Richards vs. New Hampshire Insurance Company, 43 N. H., 263; Morawetz on Corporations (first edition), sec. 579; Haywood vs. Lincoln Lumber Company et al., 64 Wis., 639; Port vs. Russell, 36 Ind., 60; Lippincott vs. Shaw Carriage Company, 21 Fed. Rep.,

577.)

In the case of the Twin-Lick Oil Company vs. Marbury, supra, the complainant was a corporation organized under the laws of West Virginia, engaged in the business of raising and selling petroleum. It became very much embarrassed and a note was given secured by a deed of trust, conveying all the property rights, and franchise of the corporation to William Thomas to secure the payment of said note, with the usual power of sale in default of payment. The property was sold under the deed of trust; was bought in by defendant's agent for his benefit, and conveyed to him the same year. The defendant was at the time of these transactions a stockholder and director in the company. At the time the defendant's money became due there was no apparent possibility of the corporation's paying it at any time. The corporation was then insolvent. The property was sold by the trustee and bought in by the defendant at a fair and open sale and at a reasonable price. The sale and purchase was the only mode left to the defendant to make his money. The court said:

"That a director of a joint-stock corporation occupies one of those fiduciary relations where his dealings with the subject-matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts, and may be set aside on slight grounds, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and others. (Koehler vs. Iron Co., 2 Black, 715; Drury vs. Cross, 7 Wall., 299; R. R. Co. vs. Magnay, 25 Beav., 586; Cumberland Co. vs. Sherman, 30 Barb., 553; Hoffman S. Coal Co. vs. Cumberland Co., 16 Md., 456.) The general doctrine, however, in regard to contracts of this class, is, not that they are absolutely void, but that they are voidable at the election of the party whose interest has been so represented by the party claiming under it. We say, this is the general rule; for there may be cases where such contracts would be void ab initio; as when an agent to sell buys of himself, and by his power of attorney conveys to himself that which he was authorized to sell. But even here, acts which amount to a ratification by the principal may validate the sale.

"The present case is not one of that class. While it is true that the defendant, as a director of the corporation, was bound by all those rules of conscientious fairness which courts of equity have imposed as the guides for dealing in such cases, it can not be maintained that any rule forbids one director among several from loaning money to the corporation when the money is needed, and the transaction is open, and otherwise free from blame. No adjudged case has gone so far as this. Such a doctrine, while it would afford little protection to the corporation against actual fraud or oppression, would deprive it of the aid of those most interested in giving aid judiciously, and best qualified to judge of the necessity of that aid, and of the extent to which it may safely be given.

"There are in such a transaction three distinct parties whose interest is affected by it; namely, the lender, the corporation, and the stockholders of the corporation.

"The directors are the officers or agents of the corporation, and represent the interests of that abstract legal entity, and of those who own the shares of its stock. One of the objects of creating a corporation by law is to enable it to make contracts; and these contracts may be made with its stockholders as well as with others. In some classes of corporations, as in mutual insurance companies, the main object of the act of incorporation is to enable the company to make contracts with its stockholders, or with persons who become stockholders by the very act of making the contract of insurance. It is very true, that as a stockholder in making a contract of any kind with the corporation of which he is a member, is in some sense dealing with a creature of which he is a part, and holds a common interest with the other stockholders, who, with him, constitute the whole of that artificial entity, he is properly held to a larger measure of candor and good faith than if he were not a stockholder. So, when the lender is a director, charged, with others, with the control and management of the affairs of the corporation, representing in this regard the aggregated interest of all the stockholders, his obligation, if he becomes a party to a contract with the company, to candor and fair dealing, is increased in the precise degree that his representative character has given him power and control derived from the confidence reposed in him by the stockholders who appointed him their agent. If he should be a sole director, or one of a

smaller number vested with certain powers, this obligation would be still stronger, and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality, and freedom from motives of selfishness. All this falls far short, however, of holding that no such contract can be made which will be valid; * * *."

In the case of *Hancock vs. Holbrook et al.* (40 La. Ann., 53), the court said:

"As a strictly legal question, the right of a board of directors of a corporation to apply its property to the payment of its debts, and the right of a majority of stock holders present at a meeting called for the purpose to ratify such action and to dissolve the corporation, can not be questioned.

"But where such action is taken at the instance, and through the influence of the president of the corporation, and where the debt to which the property is applied is one for which he is himself primarily liable, and especially where he subsequently acquires, in his personal right, the property thus disposed of, such circumstances undoubtedly subject his acts to severe scrutiny, and oblige him to establish that he acted with the utmost candor and fair-dealing for the interests of the corporation, and without taint of selfish motive."

The sale or transfer of the corporate property in the case at bar was made by three directors who were at the same time a majority of the stockholders. If a majority of the stockholders have a clear and a better right to sell the corporate property than a majority of the directors, then it can be said that a majority of the stockholders made this sale or transfer to the defendant McCullough.

What were the circumstances under which said sale was made ? The corporation had been going from bad to worse. The work of trying to raise the sunken Spanish fleet had been for several months abandoned. The corporation under the management of the plaintiff had entirely failed in this undertaking. It had broken its contract with the naval authorities and the \$10,000 Mexican currency deposited had been confiscated. It had no money. It was considerably in debt. It was a losing concern and a financial failure. To continue its operation meant more losses. Success was impossible. The corporation was civilly dead and had passed into the limbo of utter insolvency. The majority of the stockholders or directors sold the assets of this corporation, thereby relieving themselves and the plaintiff of all responsibility. This was the only wise and sensible thing for them to do. They acted in perfectly good faith and for the best interests of all the stockholders. "It would be a harsh rule that would permit one stockholder, or any minority of stockholders to hold a majority to their investment where a continuation of the business would be at a loss and where there was no prospect or hope that the enterprise would be profitable."

The above sets forth the condition of this insolvent corporation when the defendant McCullough proposed to the majority of stockholders to take over the assets and assume all responsibility for the payment of the debts and the completion of the warehouses which had been undertaken. The assets consisted of office furniture of a value of less than P400, the uncompleted contract for the construction of the Government warehouses, and the wrecking contract. The liabilities amounted to at least \$19,645.74 Mexican currency. \$9,645.74 Mexican currency of this amount represented borrowed money, and \$10,000 Mexican currency was the deposit with the naval authorities which had been confiscated and which was due the bank. McCullough's profits on the warehouse contract amounted to almost enough to pay the amounts which the corporation had borrowed from its members. The wrecking contract which had been broken was of no value to the corporation for the reason that the naval authorities absolutely refused to have anything further to do with the Philippine Engineering and Construction Company. They (the naval authorities) had declined to consider the petition of the corporation for an extension of time in which to raise the Spanish fleet, and had also refused to reconsider their action in confiscating the deposit. They did agree, however, that if the defendant McCullough would organize a new association, that they would give the new concern an extension of time and would reconsider the question of forfeiture of the amount

deposited. Under these circumstances and conditions, McCullough organized the Manila Salvage Company, sold five-sixths of this wrecking contract to the new company for \$15,000 Mexican currency and retained one-sixth as his share of the stock in the new concern. The Manila Salvage Company paid to the bank the \$10,000 Mexican currency which had been borrowed to deposit with the naval authorities, and began operations. All of the \$10,000 Mexican currency so deposited was refunded to the new company except P2,000. The new association failed and McCullough, by reason of this failure, lost over \$16,000 Mexican currency. These facts show that McCullough acted in good faith in purchasing the old corporation's assets, and that he certainly paid for the same, a valuable consideration.

But counsel for the plaintiff say: "The board of directors possessed only ordinary powers of administration (Article X of the articles of incorporation), which in no manner empowered it either to transfer or to authorize the transfer of the assets of the company to McCullough (art. 1773, Civil Code; decisions of the supreme court of Spain of April 2, 1862, and July 8, 1903)."

Article X of the articles of incorporation above referred to provides that the board of directors shall elect the officers of the corporation and "have under its charge the administration of the said corporation." Article XI reads: "In all the questions with reference to the administration of the affairs of the corporation, it shall be necessary to secure the unanimous vote of the board of directors, and at least three of said board must be present in order to constitute a legal meeting." It will be noted that Article X placed the administration of the affairs of the corporation in the hands of the board of directors. If Article XI had been omitted, it is clear that under the rules which govern business of that character, and in view of the fact that before the plaintiff left this country and abandoned his office as director, there were only five directors in the corporation, then three would have been sufficient to constitute a quorum and could perform all the duties and exercise all the powers conferred upon the board under this article. It would not have been necessary to obtain the consent of all three of such members which constituted the quorum in order that a resolution affecting the administration of the corporation should be binding, as two votes - a majority of the quorum - would have been sufficient for this purpose. (Buell vs. Buckingham & Co., 16 Iowa, 284; 2 Kent. Com., 293; Cahill vs. Kalamazoo Mutual Insurance Company, 2 Doug. (Mich.), 124; Sargent vs. Webster, 13 Met., 497; In re Insurance Company, 22 Wend., 591; Ex parte Wilcox, 7 Cow., 402; id., 527, note a.)

It might appear on first examination that the organizers of this corporation when they inserted the first part of Article XI intended that no resolution affecting the administration of the affairs should be binding upon the corporation unless the unanimous consent of the entire board was first obtained; but the reading of the last part of this same article shows clearly that the said organizers had no such intention, for they said: "At least three of said board must be present in order to constitute a legal meeting." Now, if three constitute a legal meeting, three were sufficient to transact business, three constituted the quorum, and, under the above-cited authorities, two of the three would be sufficient to pass binding resolutions relating to the administration of the corporation.

If the clause "have under its charge and administer the affairs of the corporation" refers to the ordinary business transactions of the corporation and does not include the power to sell the corporate property and to dissolve the corporation when it becomes insolvent - a change we admit organic and fundamental - then the majority of the stockholders in whom the ultimate and controlling power lies must surely have the power to do so.

Article 1713 of the Civil Code reads:

"An agency stated in general terms only includes acts of administration.

"In order to compromise, alienate, mortgage, or to execute any other act of strict ownership an express commission is required."

This article appears in title 9, chapter 1 of the Civil Code, which deals with the character, form, and kinds of agency. Now, were the positions of Hilbert, Green, Harigan, and McCullough that of agents within the meaning of the article above quoted when the assets of the corporation were transferred or sold to McCullough? If so, it would appear from said article that in order to make the sale valid, an express commission would be required. This provision of law is based upon the broad principles of sound reason and public policy. There is a manifest impropriety in allowing the same person to act as the agent of the seller and to become himself the buyer. In such cases, there arises so often a conflict between duty and interest. "The wise policy of the law hath put the sting of a disability into the temptation; as a defensive weapon against the strength of the danger which lies in the situation."

Hilbert, Green, and Hartigan were not only all creditors at the time the sale or transfer of the assets of the insolvent corporation was made, but they were also directors and stockholders. In addition to being a creditor, McCullough sustained to the corporation the double relation of a stockholder and president. The plaintiff was only a stockholder. He would have been a creditor to the extent of his unpaid salary if the corporation had been a profitable instead of a losing concern.

But as we have said when the sale or transfer under consideration took place, there were three directors present, and all voted in favor of making this sale. It was not necessary for the president, McCullough, to vote. There was a quorum without him: a quorum of the directors, and at the same time a majority of the stockholders.

A corporation is essentially a partnership, except in form. "The directors are the trustees or managing partners, and the stockholders are the cestui que trust and have a joint interest in all the property and effects of the corporation." (Per Walworth, Ch., in *Kobinson vs. Smith*, 3 Paige, 222, 232; 5 *idem*, 607; *Slee vs. Bloom*, 19 Johns., 479; *Hoyt vs. Thompson*, 1 Seld., 320.)

The Philippine Engineering and Construction Company was an artificial person, owning its property and necessarily acting by its agents; and these agents were the directors. McCullough was then an agent or a trustee, and the stockholders the principal. Or say (as the corporation was insolvent) that he was an agent or trustee and the creditors were the beneficiaries. This being the true relation, then the rules of law (art. 1713 of the Civil Code) applicable to sales and purchases by agents and trustees would not apply to the purchase in question for the reason that there was a quorum without McCullough, and for the further reason that an officer or director of a corporation, being an agent of an artificial person and having a joint interest in the corporate property, is not such an agent as that treated of in article 1713 of the Civil Code.

Again, McCullough did not represent the corporation in this transaction. It was represented by a quorum of the board of directors, who were at the same time a majority of the stockholders. Ordinarily, McCullough's duties as president were to preside at the meetings, rule on questions of order, vote in case of a tie, etc. He could not have voted in this transaction because there was no tie.

The acts of Hilbert, Green, Hartigan, and McCullough in this transaction, in view of the relations which they bore to the corporation, are subject to the most severe scrutiny. They are obliged to establish that they acted with the utmost candor and fair dealing for the interest of the corporation, and without taint of selfish motives.

We have subjected their conduct to this test, and, under the evidence, we believe it has safely emerged from the ordeal.

"Transactions which only accomplish justice, which are done in good faith and operate legal injury to no one, lack the characteristics of fraud and are not to be upset because the relations of the parties give rise to suspicions which are fully cleared away." (*Hancock vs. Holbrook*, *supra*.)

We therefore conclude that the sale or transfer made by the quorum of the board of directors - a majority of the

stockholders - is valid and binding upon the minority - the plaintiff. This conclusion is not in violation of the articles of incorporation of the Philippine Engineering and Construction Company. Nor do we here announce a doctrine contrary to that announced by the supreme court of Spain in its decisions dated April 2, 1862, and July 8, 1903.

As to the third cause of action, it is insisted: First, that the court erred in holding the defendant McCullough responsible for the personal effects of the plaintiff; and second, that the court erred in finding that the effects left by the plaintiff were worth P2,400.

As we have said, the plaintiff was the manager of the Philippine Engineering and Construction Company from April 1, 1902, up to January 1, 1903. Sometime during the previous month of December he resigned to accept a position in China, but did not leave Manila until about January 20. He remained in Manila about twenty days after he severed his connection with the company. He lived in rooms in the same building which was rented by the company and where the company had its offices. When he started for China he left his personal effects in those rooms, having turned the same over to one Paulsen. Testifying on this point the plaintiff said:

"Q. To whom did you turn over these personal effects on leaving here? - A. To Mr. Paulsen.

"Q. Have you demanded payment of this sum [referring to the value of his personal effects] ? - A. On leaving for China I gave Mr. Haussermann power of attorney to represent me in this case and demand payment.

"Q. Please state whether or not you have an inventory of these effects. - A. I had an inventory which was in my possession but it was lost when the company took all of the books and carried them away from the office.

"Q. Can you give a list or a partial list of your effects? - A. I remember some of the items. There was a complete bedroom set, two marble tables, one glass bookcase, chairs, all of the household effects I used when I was living in the Botanical Garden as city engineer, one theodolite, which I bought after commencing work with the company.

"Q. How much do you estimate to be the total reasonable value of these effects? - A. The total value would not be less than \$1,200 gold."

Counsel for the plaintiff, on page 56 of their brief, say:

"Mr. McCullough, in his testimony (pp. 39 and 40) admits full knowledge of and participation in the removal and sale of the effects and states that he took the proceeds and considered them part of the assets of the company. He further admits that Mr. Haussermann made a demand for the proceeds of Mr. Mead's personal effects (p. 44)."

McCullough's testimony, referred to by counsel, is as follows:

"Q. At the time Mr. Mead left for China, in the building where the office was and in the office, there were left some of the personal effects of Mr. Mead. What do you know about these effects, a list of which is Exhibit B? - A. Nothing appearing in this Exhibit B was ever delivered to the Philippine Engineering and Construction Company, according to my list.

"Q. Do you know what became of these effects? - A. No, sir. I have no idea. I never saw them. I never heard these effects talked about. I only heard something said about certain effects which Mr. Mead had in his living room.

"Q. Do you know what became of the bed of Mr. Mead? - A. I know there were effects, such as a bed, washstand, chairs, table, and other things, which are used in a living room, and that they were in Mr. Mead's room. These effects were sent to the warehouse of the Pacific Oriental Trading Company, together with the office furniture. We had to vacate the building where the offices were and we had to take out everything

therein. These things were deposited in the warehouse of the Pacific Oriental Trading Company and were finally sold by that company and the money turned over to me.

"Q. How much? - A. P49.97.

"Q. What did you do with this money? - A. I took it and considered it part of the assets of the company. All of the other effects of the office were sold at the same time and brought P347.16.

"Q. Did Mr. Mead leave anyone in charge of his effects when he left Manila? - A. I think he left Paulsen in charge, but Paulsen did not take these effects, so when we vacated the office we had to move them.

"Q. Did Paulsen continue occupying the living room where these effects were and did he use these effects? - A. I do not know because I was not in the office for three months before we vacated.

"Q. Don't you know that it is a fact that Mr. Haussermann, as representative of Mr. Mead, demanded of you and the company the payment of the salary which was due Mr. Mead and the value of his personal effects? - A. Yes, sir."

As to the value of these personal effects, Hartigan, testifying as witness for the defendant, said:

"I think the personal effects were sold for P50. His personal effects consisted of ordinary articles, such as a person would use who had to be going from one place to another all the time, as Mr. Mead. I know that all those effects were sold for less than P100, if I am not mistaken."

The foregoing is the material testimony with reference to the defendant McCullough's responsibility and the value of the personal effects of the plaintiff.

McCullough was a member of the company and was responsible as such for the rents where the offices were located. The company had no further use for the building after the plaintiff resigned. The vacating of the building was the proper thing to do. The office furniture was removed and stored in a place where it cost nothing for rents. When Hilbert, member of the company, went to the office to remove the company's office furniture, he found no one in charge of "the plaintiff's personal effects. He took them and stored them in the same place and later sold them, together with the office furniture, and turned the entire amount over to defendant McCullough.

Paulsen, in whose charge Mead left his effects, apparently took no interest in caring for them. Was the company to leave Mead's personal effects in that building and take the chances of having to continue to pay rents, solely on account of the plaintiff's property remaining there? The company had reason to believe that it would have to continue paying these rents, as they had rented the building and authorized the plaintiff to occupy rooms therein.

The plaintiff knew when he left for China that he would be away a long time. He had accepted a position of importance, and which he knew would require his personal attention. He did not gather up his personal effects, but left them in the room in charge of Paulsen. Paulsen took no interest in caring for them, but apparently left these effects to take care of themselves. The plaintiff did not even carry with him an inventory of these effects, but attempted on the trial to give a list of them and did give a partial list of the things he left in his room; but it is not shown that all these things were there when Hilbert removed the office furniture and some of the plaintiff's effects. The fact that the plaintiff remained in Manila some twenty days after resigning and never cared for his own effects but left them in the possession of an irresponsible person, shows extreme negligence on his part. He exhibited a reckless indifference to the consequences of leaving his effects in the leased premises. The law imposed on every person the duty of using ordinary care against injury or damages. What constitutes ordinary care depends upon the circumstances of each particular case and the dangers reasonably to be apprehended.

McCullough did not have anything personally to do with these effects at any time. He only accepted the money

which Hilbert turned over to him. He, personally, did not contribute in any way whatsoever to the loss of the property, neither did he as a member of the corporation do so.

The plaintiff gave an estimate of the value of the effects which he left in his rooms and placed this value at P2,400. He did not give a complete list of the effects so left, neither did he give the value of a single item separately. The plaintiff's testimony is so indefinite and uncertain that it is impossible to determine with any degree of certainty just what these personal effects consisted of and their values, especially when we take into consideration the significant fact that these effects were abandoned by Paulsen. On the other hand, we have before us the positive testimony of Hilbert as to the amount received for the plaintiff's personal effects, the testimony of Hartigan that the same were sold for less than P100, and the testimony of McCullough as to the amount turned over to him by Hilbert.

So we conclude that the great preponderance of evidence as to the value of these effects is in favor of the contention of the defendant. Their value must therefore be fixed at P49.97.

For these reasons the judgment appealed from as to the first and second causes of action is hereby affirmed. Judgment appealed from as to the third cause of action is reduced to P49.97, without costs.

Arellano, C. J., Torres, Mapa, Carson, and Moreland, JJ., concur.

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