

CANDIDO PASCUAL, PLAINTIFF AND APPELLANT VS. EUGENIO DEL SAZ OROZCO ET AL., DEFENDANTS AND APPELLEES.

G.R. No. 7945. December 01, 1914

Ponente: TRENT, J.

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TRENT, J.:

The plaintiff appeals from a judgment upon the merits in favor of the defendants, and insists that the court erred:

"1. In holding that the interpretation placed upon article 30 of the bank's charter by the decision of the Supreme Court herein is not the law of the case.

"2. In holding that the defendants had a right to deduct their compensation from the gross profits of the bank.

"3. In holding that it was proper for defendants to compute their compensation upon the gross profits before charging against such gross profits the aggregate amount of accounts written off as uncollectible (*dudosa y fallida*) as shown in Exhibits C-1 to C-9, inclusive.

"4. In holding that any of the debit items appearing in Exhibits C-1 to C-9 and especially the industrial and internal revenue taxes, are items that should be charged against capital and not against current profits.

"5. In holding that it was within the power of the stockholders of the bank to ratify the so-called interpretation by defendants of said article 30."

This action was commenced by the plaintiff as a shareholder of the Banco Espanol-Filipino for the benefit of the bank and all of the stockholders thereof. Its purpose is to require the defendants as former directors and councilors of the bank to refund a portion of the compensation paid to them for their services, on the ground that the amounts thereof have been wrongfully computed.

The complaint contains three separate causes of action, of which the first only is here involved. The defendants demurred to this cause of action was sustained upon the ground that the facts alleged therein were not sufficient to entitle the plaintiff to the relief sought. Upon appeal this judgment was reversed and the record returned for further proceedings. (19 Phil. Rep., 82.) The complaint was not thereafter amended.

The question raised by the plaintiff in his first assignment of error requires an examination of the pertinent allegations in the first cause of action. These allegations are as follows:

"X. That, notwithstanding the fact that article 30 of the said by-laws (Exhibit B) clearly and unequivocally prescribes that the net profits of the said bank shall be apportioned as follows: Ten per cent for the board of directors, five percent for the board of managers (composed of counselors and trustees) in compensation for their services as such, and the remainder, eighty-five per cent, integrally for the shareholders of the said bank, the defendants, as such members of the, said boards of directors and managers, respectively, did, during each and all of the years specified, fraudulently and to the great detriment of the said Bank and its shareholders, and without the knowledge, consent or acquiescence of the latter, appropriate to themselves for their own use from the profits of the said Bank sums of money reaching an approximate amount of twenty thousand pesos, or a

total sum of one hundred thousand pesos during the five years aforementioned, by deducting their said ten and five per cent, respectively, from the gross profits instead of deducting them from the net profits of the said bank.

"XI. That the said defendants, during the time mentioned, carefully concealed in all the balances and reports of the said Bank published by them every indication that might give the stockholders of the said Bank the slightest suspicion that the said defendants were fraudulently appropriating to themselves the funds of the same; and that the plaintiff learned of such appropriation, by a mere chance, in the month of November, 1907."

The Banco Espanol-Filipino was a banking corporation which, until January 1, 1908, was controlled by the by-laws Arid regulations annexed to the complaint as Exhibits A and B. On November 13, 1903, the plaintiff acquired 10 shares of the capital stock and has been the registered holder of these shares since that date. The defendants filled, during the time mentioned in the complaint, the offices of director, consiliario, and sindico, and collectively constituted the board of government. The only compensation to which the defendants were entitled for their services is that prescribed by article 30 of the by-laws then in force.

This article reads: "Of the profits or gains which may result from the bank's operations, after deducting all the expenses of its administration and the part, if any, which corresponds to the legal reserve fund, there shall be set apart ten per cent for the directorate and five per cent for the board of government, the distribution of which shall be made as provided in the regulations. The eighty-five per cent remaining shall belong integrally to the shareholders pro rata the number of shares owned by each."

Since the date on which the plaintiff acquired his shares, the earnings of each half-year of the bank have been liquidated in the manner set forth in the Exhibits C-1 to C-9, inclusive, attached to the agreed statement of facts, and the respective defendants have individually collected for their services the sums specified in Exhibit D.

Under date of November 15, 1907, the plaintiff addressed to the defendants a letter alleging that the earnings of the bank had not been apportioned in accordance with the provisions of article 30, *supra*, and making demand upon them for the refund to the bank of a portion of the amounts received by them in compensation for their services. The defendants refused to comply with this demand and on December 7, 1907, the plaintiff commenced an action seeking the same relief herein prayed for. This action was dismissed, and on December 21, 1907, the shareholders of the bank were convened in a special meeting "for the express purpose of discussing and taking action relative to the alleged interpretation of article 30 of the by-laws." At this shareholders' meeting there were present, either in person or by proxy, 183 persons and entities, holding 6,499 shares of the total issue of 7,500. Among those present at this meeting was plaintiff's attorney. The plaintiff's letter, referred to above, was read, as was the complaint which the plaintiff had previously filed, and, after a discussion in which the appellant's attorney took part, a resolution was adopted ratifying and approving the distribution of the bank's earnings as made, and authorizing the defendants to proceed in the same manner with the earnings of the latter half of the year 1907. In favor of this resolution there was a total of 555 votes, representing 5,550 shares. Soon thereafter the present action was commenced.

As will be seen from the plaintiff's first assignment of error and the argument of counsel relating thereto, it is strongly urged that inquiry respecting the interpretation and application of article 30, *supra*, has been closed by the decision of this court rendered upon the demurrer of the defendants to the complaint. Under the doctrine of *stare decisis* the plaintiff insists that "the law of the case" has been established and that it has been necessarily decided that the remuneration received by the defendants for their services was not in accordance with article 30.

The decision relied upon by the plaintiff is that of *Pascual vs. Del Saz Orozco* (19 Phil.Rep., 82). "The law of the case," established by that decision, is the law of the case which was before the court and which the court thereby

decided.

The plaintiff, as will be seen from paragraphs 10 and 11, above quoted, whose sufficiency was then and there under consideration, alleged that the defendants, in violation of article 30, had fraudulently misappropriated to themselves certain funds of the bank by computing their percentages upon the gross earnings of the bank and, by a series of fraudulent concealments, had withheld the knowledge thereof from the shareholders. The demurrer admitted the facts as alleged and raised the question of the right of the plaintiff to recover upon those facts. The ruling of the lower court was to the effect that, even assuming the facts to be as alleged in the complaint, the plaintiff had no right of action. On appeal the Supreme Court considered this very question and necessarily none other, which relates to the point now under consideration, and, in reversing the ruling of the lower court, decided that, assuming the facts to be as alleged in the complaint, the plaintiff did have a cause of action. If these were the facts of the case now under consideration, there would be neither occasion nor opportunity to further discuss the law applicable thereto. But the case which the present appeal presents is not that case at all. Since that decision was rendered the case has been tried and the facts now before the court for consideration are not the allegations that the defendants fraudulently misappropriated to themselves certain funds of the bank, and by a series of concealments withheld the knowledge thereof from the shareholders, but the real facts as they have been stipulated in the agreed statement. These facts are that the defendants did not, as alleged, fraudulently misappropriate certain funds of the bank by computing their percentages upon the gross earnings, but did first deduct the expenses of administration, and that none of the acts of the defendants were tainted in any way with fraud.

In this particular the case now under consideration is clearly differentiated and distinguished from the former case. In that case the court decided that the defendants may not fraudulently compute their percentages upon the gross earnings, and that a complaint which alleges that they have done so states a cause of action. This was the question submitted and decided. The question submitted upon the present appeal is whether the computation really made is in accordance with article 30. This holding is not in conflict with the rule announced in the cases cited and relied upon by counsel for the plaintiff.

For example, in the case of *Heidt vs. Minor* (113 Cal, 385), the court said: "Moreover, the rule of the law of the case only applies when, on a subsequent trial, the issues and the facts found remain substantially the same."

In the case of *Forgerson et al. vs. Smith* (104 Ind., 246), the court laid down this rule: "But where the questions are necessarily involved, * * * the judgment on appeal rules the case throughout all its subsequent stages. The decision is an adjudication concluding the courts and the parties. It is not, of course, conclusive as to other cases, but it is conclusive as to the questions in judgment in the case in which it was rendered, upon the parties and those in privity with them. * * * We regard, the former decision as adjudicating all of the controlling questions in the case, for it was not possible to reach the conclusion there announced without deciding that the property in the promissory notes in controversy was in the administrator of the estate of Mahala Shaw deceased."

In *Standard Sewing Machine Co. vs. Leslie* (118 Fed., 557), the court used this language: "It is a familiar and entirely righteous rule that a court of review is precluded from agitating the questions that were made, considered, and 'decided on previous reviews. The former decision furnishes 'the law of the case' not only to the tribunal to which the cause is remanded, but to the appellate tribunal itself on a subsequent writ or appeal."

Now, has the remuneration of the defendants for their services been computed in accordance with article 30 of the by-laws?

The item of "profit and loss" for each half year, during the entire period covered by the complaint, was made up by crediting to it all the items of net profits produced by the various accounts of the bank, including the accounts

of current debtors, the profits from exchange, the profits in the sale of money, the profits from the discount of bills and notes, the net proceeds from the real properties of the bank after the payment of all the expenses thereof, including taxes, insurance, and repairs, and all other net profits obtained by the bank. To the debit of this "profit and loss" account were entered all sums paid out by the bank as interest upon fixed deposits or credit balances of current accounts. The item of "general expenses" included salaries, light, water, stationery, stamps, attorneys' fees, and all other items of general expenses incurred either by the main office in Manila or by the branch office in Iloilo. In short, it appears that every expenditure of whatever nature made from the funds of the bank, with the exception of the industrial tax (later internal-revenue tax) and amounts set off against bad accounts, was included in the item of "general expenses," or, what amounted to the same thing, deducted from the "profit and loss" account before computing the remuneration received by the respective defendants for their services. Upon this point it might be well to set out in full Exhibit C-1. (Exhibits C-2 to C-9, inclusive, were made up in the same manner.) This exhibit is as follows:

1903.

December 31. Balance of the account of profit and loss.. \$196,580.22

Deduction of surplus of June 30, last..... 7,816.38

188,763.84

Do. General expenses 51,753.77

137,010.07

Compensation for the board of government, 15 per cent..... 20,551.51

116,458.56

Dividend of 4 per cent on \$1,500,000..... 60,000.00

56,458.56

Industrial tax (later internal revenue) 5 per cent of \$60,000..... 3,000.00

53,458.56

Balance on June 30 carried forward..... 7,816.38

61,274.94

Amount for bad accounts..... 60,000.00

Balance for next semester..... 1,274.94

To this method of computing the defendants' remuneration the objection of the plaintiff is twofold:

"(a) That before computing the defendants' remuneration there was not first deducted from the earnings or gains the amount payable as industrial tax (later internal revenue), and

"(b) That before computing the defendants' remuneration there was not first deducted from the earnings or gains the amount retained to cover bad accounts."

From an examination of article 30 it will be seen that only two items from the gross profits of the bank are to be deducted before computing the compensation of the directors and board of government (the defendants constituted both the directors and the board of government), to wit: Expenses of administration and the amount, if

any, corresponding to the legal reserve fund. On December 31, 1903, the legal reserve fund of P225,000 was not only completed, but a voluntary reserve fund of P665,000, authorized by the charter, had accumulated. From the various Exhibits, C-1 to C-9, inclusive, it is apparent that nothing whatever was applied to this legal reserve fund, and, as the correctness of these exhibits is not disputed, it is also apparent that nothing was due this fund at any time during the period covered by the complaint. Unless, therefore, the items of industrial tax (later internal-revenue tax) and the amounts set aside to cover bad debts may be deemed "expenses of administration," it is clear that there is no merit in the plaintiff's contention.

At the outset it may be said that the proper disposition of this case is rendered difficult by the inaccurate language used in article 30. This article provides for a percentage of the profits (*utilidades y ganancias*), and it may be at once said that these are not necessarily net profits, as claimed by counsel for the plaintiff. Profits may be either gross profits or net profits, and there are innumerable methods of computing each of these. Likewise, "expenses of administration" may or may not include all amounts expended in the conduct of business. Indeed, it is somewhat unusual that a provision of the bank's charter, so difficult of exact definition, should be so lacking in precision. Hardly less unusual, from an American point of view, is the incorporation into the bank's charter of the measure of remuneration of the board of government. This, in America, has generally been considered a detail in the internal management of a corporation to be controlled by the shareholders themselves, Who, in many instances, even delegate to the directors the power of fixing their own salaries.

The remuneration received by the defendants is not even alleged to be excessive. The two active managers of the bank received, during the period in question, sums amounting to approximately P15,000 per year, while the other defendants, not participating in the active management of the corporation, received sums amounting in no instance to a salary of P2,500 per year. All of the defendants received, during the four and a half years, P201,825.81, or an approximate yearly average of P45,000 per year. Bearing in mind the magnitude of the business and the fact that the bank prospered under the management of the defendants, there is no wonder that no claim is made of excessive compensation. During all these years the plaintiff, as well as the other shareholders of the bank, remained silent, apparently content with the increased prosperity of the business, although at the end of each fiscal year they had the opportunity to examine the books of the bank and inform themselves of the method by which the defendants computed their compensation. And, furthermore, an extraordinary meeting of the shareholders was duly convened on December 21, 1907, for the express purpose, as we have indicated, of discussing the interpretation placed upon article 30 by the defendants.

The industrial tax, which the appellant insists should be first deducted from the earnings before computing the percentages, was fixed by law at 5 per cent of the dividends distributed among the shareholders of the bank. In order to make the deduction of this tax, its amount must first be a known quantity. Since its amount is a percentage of the dividends, the amount of the latter must likewise be a known quantity before the operation can be made. The amount available as dividends is dependent upon the amount due and payable out of the profits to the defendants for their services. Therefore, this amount due the defendants from the profits must be known before the amount remaining for dividends can be fixed. For example, if the remaining earnings, after deducting from the gross earnings the general expenses, is the sum of P58,000, how much is to be deducted therefrom as internal-revenue tax before computing the percentage of the defendants? The law said that the amount of this tax should be 5 per cent of the dividends distributed. The amount to be distributed depends upon how much may be left after the remuneration of the defendants is paid. It is no reply to this argument to point out that the total profits may be or are usually sufficiently great to permit a declaration of the maximum dividend of P60,000 and that in such cases it is a simple matter to compute 5 per cent of P60,000, for the rule of computation, established by article 30, is a general one, applicable alike in all cases, whether the earnings of the bank be great or small. This article does not establish two rules of computations, one which is only feasible or practicable when the earnings

are sufficiently large to warrant a dividend in the maximum amount and another and different rule when the dividend falls below that amount.

Again, in our opinion the nature of the old industrial tax negatives the idea that it is one of the items of "expenses of administration" referred to in article 30. This tax was levied by law, not upon the earnings or profits of the bank, but only upon such earnings or profits as were actually distributed among the shareholders as dividends. It was purely a dividend tax, collected for convenience in a lump sum from the company, but levied solely and exclusively upon the distributed dividends. To deduct this tax from the amount upon which the remuneration of the defendants was computed would have made the defendants contributors to the tax levied upon the company-shareholders. Article 30 does not require the defendants as employees of the bank to contribute to the payment of the bank's taxes. The discrimination made by article 30 between "expenses of administration" and other disbursements is reasonable and in accordance with the principles of the contract which existed between the bank and the defendants. That was a contract of employment in which one of the contracting parties agreed to supply the capital and the other his services, and to divide in a stipulated proportion the proceeds of the application of the services of the one to the capital of the other. Since it was incumbent upon the bank to furnish the capital, so it was incumbent upon it to maintain the same. Any tax which tended directly to impair the amount of the capital should consequently have been paid by the hirer of the services and not by the servant. There could be no real difference in principle between the failure to furnish the capital in the first place and the failure to replace any part of it which disappears by reason of a tax levied thereon. We, therefore, conclude that the method employed by the defendants for the liquidation of the bank's business, in so far as the industrial tax (internal-revenue tax) is concerned, was strictly in accordance with article 30 of the by-laws.

DEDUCTION OF AMOUNTS TO COVER BAD ACCOUNTS.

When the defendant Orozco took over the management of the bank, he reported to the board of directors its financial situation, embracing among other things a loss from bad accounts for the past of over P500,000. It probably would have been possible to cover this entire amount of losses from funds in the reserve, existing for just such purposes, but to have done so would have left the bank without a present reserve. It was decided to preserve the reserve fund intact, and carry the bad accounts as accounts in suspense until the same could be gradually and conveniently wiped out. Consequently, in each half yearly liquidation the dividends distributed to the shareholders were strictly limited to 4 per cent per semester, and the earnings after payment of the expenses of administration, the remuneration of defendants, the taxes, and the said dividends were applied pro tanto to the extinction of the bad accounts held in suspense. It does not clearly appear whether these funds, which were used for that purpose, first went into the voluntary reserve fund and were then applied to the extinction of the bad accounts in suspense or were applied directly by the semiannual liquidations from the profit and loss accounts. The process followed is immaterial since the result must be the same. The important fact is that in each semester there was an excess of net profits over and above the 4 per cent provided in article 31 of the by laws. This excess of net profits was divisible under that article, one-half to the shareholders and one-half to the legal reserve, voluntary reserve, or additional dividends as the case might be. Instead, the entire excess of net profits went to extinguish bad accounts whose extinction would have exhausted the reserve fund and required its replenishment. To the extent that one-half of the excess of net profits were not distributed as dividends, but were put to the purposes of reserve, the shareholders made a sacrifice for their own welfare. Whether this was valicjly done or not is of no importance at this time for the reason that the remuneration of the defendants was not affected in any way thereby. As to the remaining half of the excess net profits, the application made was in direct accord with the by-laws, since the application of the funds to the purposes of the .reserve fund is exactly the same as if the reserve fund had been employed for the purpose and then replenished by these funds.

According to article 30, the net profits belonged to the shareholders. According to article 31, these net profits, belonging to the shareholders, should be partially divided among them and partially kept intact in the bank, according to the amount thereof, to the status of the legal reserve, and to the wishes of the board of government respecting a voluntary reserve. From the fact that part of the net profits was preserved intact in the bank as part of either the legal or voluntary reserve, it cannot be said that such portion of the net profits had ceased to belong to the share holders. These excess net profits are, in a sense, still in the bank and still belong to the shareholders within the meaning of article 30. To hold that the bad accounts of the bank should have been extinguished by the gross earnings instead of the net profits, would, in effect, compel the defendants, as employees, to contribute to the replenishing of the depleted reserves of the bank.

It would be wholly unjust to include under "expenses of administration" during the time the defendants were in charge, the losses previously sustained by the defendants' predecessors in office. These defendants were in no wise connected with the bank nor were they in any way responsible for those losses. To interpret article 30 so would result in the incoming manager becoming an heir to an insolvent inheritance. Under such conditions no one would be found to accept the office and the bank would have to cease its operations.

As to the responsibility of the defendants for the losses which occurred during the period covered by the complaint, it might be said in the first place that the greater part of these losses constitutes the third cause of action of appellant's complaint and was made the subject of a separate appeal to this court. In the second place, it has not been shown that any part of such losses were written off as bad debts during the period of time in question. And it is upon this fact that we rest our holding on this point. Therefore, we are not now called upon to decide whether the defendants could have treated these losses in the same manner as they did those occurring prior to December 31, 1905.

The judgment appealed from was affirmed.¹ In this opinion it has been our intention to set forth at some length our reasons for affirming this judgment at the close of the last session.

Arellano, C. J., Carson and Araullo, JJ., concur.

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