

CASES NOTED

CORPORATION LAW—STOCKHOLDERS' SUIT—MANDATORY INJUNCTION—WHEN CORPORATE ENTITY IS DISREGARDED—This Civil Case No. 14831 is before the Court of First Instance of Manila, Branch VII, with Hon. Conrado V. Sanchez as Judge, on Plaintiff's petition for a writ of preliminary injunction and mandatory injunction.

Plaintiff, a minority stockholder, inter alia seeks the annulment of Board Resolutions Nos. 71, 77, and 84 of the Binalbagan-Isabela Sugar Co., and the management contract executed by and between the latter and the Philippine Planters' Investment Co. Inc., the refund of all moneys paid under the said contract, and damages. The petition for a writ of preliminary injunction seeks to restrain defendants from enforcing the board resolutions and management contract just adverted to and from making any payment thereunder to defendant Philippine Planters' Investment Co., and by way of mandatory injunction, to direct said defendants to restore to the Binalbagan-Isabela Sugar Co., Inc., (hereinafter known as the BISCOM), any and all sums they might have withdrawn by virtue of said resolutions and contract.

Shortly before March 9, 1951, a group of sugar planters headed by defendants Lopez, Oppen Jr., Soriano, Rivilla and Yusay contributed to a fund totalling ₱2,676,200.00 and formed the Philippine Planters' Investment, Inc., the articles of incorporation of which were registered with the Securities and Exchange Commission. This group then purchased 247,875 of the total 400,000 shares of the BISCOM.

On March 9, 1951, at a stockholders' meeting of the BISCOM a new board of directors was elected. At that time the holdings were, as follows: Isabela Sugar Company approximately 38%, and the planters' group headed by Lopez and others approximately 68%. The Isabela Sugar Co., Inc. procured the election as directors of its nominees E. Montilla, J. Montilla and M. Lichauco. The others elected to the board were defendants Eugenio Lopez, Oppen Jr., J. Soriano, J. Yusay, C. Rivilla and R. Nepomuceno. Ricardo Nepomuceno was elected chairman, Eugenio Lopez as president

and general manager, Oppen Jr., vice-president and Soriano, Treasurer.

On July 6, 1951, at a directors' meeting attended by defendants Eugenio Lopez, Oppen Jr., Soriano, Rivilla, and Nepomuceno and Director Jacinto Montilla (the last representing the minority stockholders), the following resolution was approved:

"RESOLUTION NO. 71. Upon motion of Mr. Oppen, seconded by Mr. Rivilla, it was resolved, that authority be, as it is hereby granted, to pay the group of planters who are managing the business affairs, of this corporation, or to the Planters' Investment Co. Inc., a corporation under process of organization by said group, a *management fee equivalent to five per cent (5%) of the gross income, sales, expenses, purchases and other receipts and disbursements of the BISCOM from March 9, 1951, when the said group assumed the management of the corporation.* The President and General manager is hereby authorized to sign for and in behalf of the BISCOM the management contract with the group of planters or with the Planters' Investment Co. Inc., as he may deem proper. MOTION CARRIED with the dissenting vote of Mr. Jacinto Montilla."

Elected to the board of directors of the Philippine Planters' Investment Co., Inc. were Eugenio Lopez, Oppen Jr., Jose Soriano, Carlos Rivilla and J. Yusay, with four others. Lopez was elected president and Yusay chairman of the board of directors.

On July 18, 1951, defendant Lopez in his capacity as president and general manager of the BISCOM and defendant J. Yusay in his capacity as chairman of the board of the Planters' Investment Co. Inc., signed the original management contract in pursuance of Resolution No. 71 of the BISCOM board, some provisions of which are as follows:

"2. For such services, the manager shall receive from the principal five percent (5%) of all the gross income, sales, expenses, purchases and other receipts and disbursement of the principal from March 9, 1951;

3. All expenses of operation, management, etc., including salaries of personnel, officials as well as employees and laborers, traveling expenses and miscellaneous expenses, shall be borne by the principal;

4. This agreement shall last for a period of five (5) years, extendable for another five years at the option of the manager, after which, the matter shall be subject to a new agreement, between the parties. In case any of the contracting parties violates any of the terms of this agreement, or terminates the same prior to the expiration of the period agreed

upon, the party so violating shall pay to the other the sum of ONE MILLION PESOS (P1,000,000.00) as damages.

Immediately following the BISCOM Stockholders' meeting on July 27, 1951, a special directors' meeting was held. In this latter meeting the Soriano Resolution known as Resolution No. 77 was approved over the objections of Director Marcial Lichauco and with the affirmative votes of defendants Lopez, Oppen Jr., Yusay, Nepomuceno, and Soriano. This resolution confirmed and ratified Resolution No. 71, with the amendment that the fee provided for in said agreement be increased from 5% to 10%, and authorized the President and general manager, defendant Lopez, to execute with the Philippine Planters' Investment Co. Inc., a supplementary agreement to embody said amendment. This said supplementary agreement was subsequently entered into.

At the regular monthly meeting of BISCOM's Board of Directors held on August 1, 1951, defendant Lopez stated that since director Lichauco had previously announced that a suit would be filed against BISCOM by the Isabela Sugar Co., Inc. for the purpose of setting aside the management contract, he proposed to engage the services of Senator Vicente J. Francisco and, for that purpose, asked for authorization to spend the necessary money for legal fees. Defendants Lopez, Nepomuceno, Rivilla and Soriano thereupon approved the following resolution:

"Resolution No. 84.—Upon motion duly made and seconded, it was resolved to approve the action taken by the President in engaging the services of Attorney Vicente J. Francisco and to set aside the sum of P150,000.00 for the payment of attorneys' fees and other expenses in the defense of the BISCOM in any suit which may be filed against it or the members of its board of directors. UNANIMOUSLY APPROVED. (Mr. Lichauco abstained from voting)."

Coming to the operation of the contract the Court of First Instance holds: "Admittedly, during the very short period from March 9, 1951 up to August 31, 1951 BISCOM has already turned over to the Philippine Planters' Investment Co., Inc. by way of management fees, the sum of P1,481,602.58. Intracorporate remedies were unavailing."

Hence the suit.

1. FIRST IN POINT OF INQUIRY is the question of whether or not the Philippine Planters' Investment Co., Inc. and the BISCOM are controlled by the *same set of majority directors*. The directors

of the BISCOM are Lopez, Oppen Jr., Soriano, E. Montilla, J. Montilla, Rivilla, Yusay, Nepomuceno and M. Lichauco. Upon the other hand the directors of the Philippine Planters' Investment Co., Inc. are Lopez, Oppen Jr., Soriano, Yusay, Rivilla and four others. Eugenio Lopez is the president and general manager of the BISCOM. He is also the president and the controlling stockholder of the Philippine Planters' Investment Co., Inc. "The court, therefore, holds that the five majority directors of the Philippine Planters' Investment Co., Inc. are the very same directors who control the majority of the board of the BISCOM. Better yet stated, they perform the dual role of controlling majority directors in both corporations.

2. THE NEXT QUESTION is whether or not the management contract in question is *unfair* to the BISCOM minority stockholders. "For indeed, if said contract is not tainted with unfairness, the resolutions of the BISCOM board now in question must stand and the management contract must be upheld. So long as the said defendant directors act honestly and do not devote the corporate assets or business to the private gain of one group of stockholders or to the prejudice of other stockholders, their acts should receive the imprimatur of the court. *Alejandrino vs. De Leon*, G.R. No. 40943, Dec. 29, 1943."

"What is more, the law exacts of directors the utmost good faith and fair dealing where their individual interests are concerned. *Lofland, et al., vs. Cahall* 118 Atl. p. 3. The Philosophy behind the foregoing postulate is not very difficult to perceive. Desire for gold may benumb the soul with icy hands. The shackles of self-interest may pull a director in a direction opposite that of his being a trustee."

This brings us to an examination of the management contract. Certain observations are in order.

"First. The stipulated management fee is 10% of 'all gross income, sales, expenses, purchases and other receipts and disbursements of the principal'. The original contract of July 18th provides merely for 5%. This increase to 10% was voted by the BISCOM board less than one month thereafter. On the face of the contract of July 18, 1951, providing for the management fee of 5%, no basis for the fixing of the rate of compensation was given. This gives the court the impression that the rate of compensation in each of the agreements was adopted capriciously and without rhyme or reason, and that the majority of the BISCOM directors acted in utter disregard for the interests of the corporation in which they are

the trustees and surrendered their better judgment to the temptation of serving their own private interests."

"From March 9, 1951 up to August 31, 1951, or a *period of barely five months*, admittedly the amount of P1,481,602.58 was paid as management fees by BISCOM to Philippine Planters' Investment Co. Inc. This payment was made at a time when the losses in millions of pesos incurred in the previous years were not yet covered. Compare the expected annual management fees of P2,500,000—or the amount already received of P1,481,602.58 for that matter—with the *actual money* invested in the BISCOM by the planters now composing the Philippine Planter's Investment Co., Inc. amounting to P2,676,200, and, *prima facie*, a case is established whereby an immense, staggering compensation has been voted by the five directors of the BISCOM, namely Lopez, Oppen Jr., Carlos Rivilla, Soriano and Yusay in favor of Philippine Planter's Investment Co. Inc. in which they have heavily invested and are the overwhelmingly controlling majority stockholders. And yet, plaintiff Isabela Sugar Co, Inc., a very substantial minority holding approximately 38% of the stock with an investment of P3,400,113.00 gets nothing out of the corporation".

"Gallin V. National City Bank, 273 NYS 87, is authority for the statement that the compensation should not be" unfair to stockholders" in that it should not diminish dividends properly payable. As was pointed out in *Keenan, et al., vs. Eshlemen et al., 2 Atl. 2d., 904, 908.*

'Finally much is made of the company's success under the appellant's management. It would seem that the theory of this argument is that if the company prospers, compensation which would be illegal if taken when the company was in failing circumstances, is cleansed of the taint of illegality. Their is not merit to this contention.'

"As far as the court's information goes, nothing extant in the records of the sugar centrals in the Philippines will yield a contract similar to the present where millions are to be paid as annual management fees.

"*Second.* The court observes that the contract was retroactive in effect. It is true that a statement was made in Annex A, the management contract of July 18, 1951, that the group of planters forming the Philippine Planters' Investment Co., Inc. assumed the management and operated the business of the BISCOM as early as March 9, 1951. It will be recalled however, that from the start of the reorganization of the BISCOM, defendant Lopez announced

that he would not collect any salary for his services for the sake of economy and urged that the members of the BISCOM RENOUNCE the per diem of P30.00 per session to which they were entitled. Such being the case, it would appear that the compensation voted from March 9, 1951 to July 16, 1951, was for past services voluntarily rendered. Directors cannot legally vote compensation for past services *voluntarily* rendered to the corporation. The reason for the rule is that "a payment of services which have been voluntarily rendered is void as without consideration and is *ultra vires* as a misapplication of the corporate funds."

"*Third.* Another point to which the court directs its attention is the *term* of the contract.

It will be recalled that the management contract is for a term of five years extendible for another five years at the option of defendant. It further provides that in case any of the contracting parties terminates the same prior to the expiration of the period agreed upon, the party so violating shall pay to the other the sum of one million pesos (P1,000,000.00) as damages."

Citing Sections 28, 29, and 21 of the Corporation law, the court continues: "A cursory examination of the foregoing legal provisions will readily show that the five year management contract with option of renewal heretofore referred to would in effect nullify the right of the succeeding board of directors elected each year to appoint a new manager for the corporation. The provisions of Section 21 of the Corporation Law to the effect that the by-laws may provide for the manner of election and term of office of all officers other than the directors and those elected by the directors are significant. They simply mean that in so far as the manager-elected by the directors—is concerned, the by-laws cannot make any provision for his term of office. This is in harmonic consonance with Section 29 to the effect that directors shall hold office for a period of only one year and until their successors are elected and qualified, and section 33 of the same law which provides that every new board of directors must elect the manager who is an officer under section 12, article 111, of the by-laws of the BISCOM."

"A prudent approach to the subject does not necessitate of this court a direct pronouncement on the score of whether or not the contract is void or voidable. The reason is that the case is before the court solely on motion for a preliminary injunction, not on the merits. For present purposes, it suffices to state that it is unfair to bind the corporation and the minority with a management contract which hog-ties future boards. What is more, inequality exists between the two corporations in reference to the provisions cov-

ing the period of the contract. Whether they manage the BISCOM efficiently or not, they would be entitled to exact payment of their fees. And yet, if the BISCOM would want to do away with Philippine Planters' Investment Co., Inc. as manager, it would have to pay heavy damages."

"Fourth. Did the five directors, Lopez, Oppen Jr., Soriano, Yusay and Rivilla vote indirect compensation to themselves?"

"On the basis of the estimated management fee of P2,500,000 per year, the *net* proportionate share corresponding to the five directors who own approximately 81% of the stock of the Phil. Planters' Investment Co. Inc.—exclusive of all expenses—is around P2,025,000. No man or group of men truly considered of the rights of the minority and not overly interested in their own personal profit would have voted for this compensation which would bring about such enormous benefit to themselves."

"And, the Philippine Planters' Investment Co., Inc. cannot be used as a shield to justify a wrong. It cannot be used by the five common majority directors to play hide and seek with the BISCOM minority; it cannot be erected as a roadblock to prevent the working out of equities amongst the stockholders of that corporation; it cannot be used to freeze out the said substantial minority from the corporate benefits. Really, the conception of corporate entity is not a thing so opaque that it cannot be seen through. (*Keenan vs. Eshleman*, 2 *Atl.* 2d 904). In the interest of justice, the corporate entity—Philippine Planters' Investment Co., Inc.—should be disregarded. Fletcher observes that there is a "Growing tendency of courts to do so." (1 Fletcher, 134. See also cases cited on pages 36-56, 1947 Supplement to Vol. 1 Fletcher.)

"It has results that, piercing the shard of corporate fiction, the blunt fact remains that the five defendant directors indirectly voted excessive compensation to themselves at a time when they performed the double role of giver and beneficiary.

"The foregoing points to the conclusion that the contract on its face and as it now operates cannot be dignified with the word 'fair'. Accepted notions of justice which demand that benefits be spread equitably amongst stockholders are sadly wanting. At the speed money finds its way out of the coffers of the BISCOM in the form of management fees, the cash position of the said corporation, it is feared, may funnel down to the vanishing point. This threat plaintiff is called upon to live with."

3. IT IS EVIDENT that plaintiff is entitled to a writ of prelimi-

nary injunction. That a court of equity should step in to prevent further misapplication of the corporate funds cannot be denied. That the Philippine Planters' Investment Co., Inc. will continue to draw respectable sums of the BISCOM treasury by way of compensation is probable. Proof: P1,481,602.58 was paid in so short a time."

"The irreparable injury to plaintiff cannot be underestimated. This case may drag on for years. A judgment that may be entered against defendants may be then be nullified. The injustice to plaintiff cannot be measured in terms of money alone. Plaintiff's stock may depreciate in value. The profits and returns which plaintiff should have otherwise received from the beginning cannot be measured or ascertained.

"On the other hand, no great damage may be caused to defendants. In the final analysis, all that will be stopped is the continuous flow of considerable amount of money from the BISCOM'S coffers in the way of fees. Defendant directors therefore have no reason to fear that the present policy will be curtailed or abandoned; unless, of course, their concept of their trusteeship is miniscule compared to the millions they stand to profit and which will be frozen by the writ of preliminary injunction."

The court, then, holds that as BISCOM is only a nominal defendant, the defense is really for the benefit of Philippine Planters' Investment Co., Inc. and its five directors. Therefore the fees of defendants' counsel and the expenses of the suit should not be paid by the BISCOM. Defendants are directed not to enforce Resolution No. 84 providing for the payment of Attorney's fees and other expenses by the BISCOM. This is a derivative suit, BISCOM is before the court because it is under the control of the defendant majority directors.

"Plaintiff also prays that mandatory injunction issue to order defendants to restore to the BISCOM any and all sums withdrawn by virtue of the resolutions and contract in question. It is the universal principle that acts already consummated cannot be enjoined by preliminary mandatory injunction. And this petition if granted would have the effect of deciding the case on the merits in advance of the actual trial."

The petition of the writ of preliminary injunction is hereby granted and defendants are ordered to desist and refrain from enforcing Resolutions Nos. 71, 77, and 84 and the management contract in question, and from continuing to pay the defendant Philippine Planters' Investment Co., Inc. any sum of money un-

der and by virtue of the said resolutions and contract, until further order from the court. Petition for a writ of mandatory injunction is denied. (*Isabela Sugar Co., as stockholder of the Binalbagan-Isabela Sugar Co., Inc., in its own behalf and in behalf of other stockholders who may desire to join therein, vs. Eugenio Lopez, Ernesto Oppen, Jr., Jose Soriano, Carlos Rivilla, Ricardo Nepomuceno, and Jose M. Yusay; the Planters' Investment Co., Inc.; and the Binalbagan-Isabela Sugar Co., Inc. Court of First Instance of Manila. Promulgated: Oct. 26, 1951*).

The proposition that the corporation has an existence separate and distinct from its membership has its limitations.

Whenever necessary for the protection or enforcement of the rights of the membership, courts will disregard this legal fiction and operate both upon the corporations and the persons composing it. Where the stock of a corporation functions only for the individual should be deemed to be the same. (*Arnold vs. Willitz and Patterson*, 44 Phil. 636). This is also true when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons. Also where the corporation is so organized and controlled, and its affairs so conducted as to make it merely an instrumentality, agency, conduit, or adjunct of another corporation. (*Koppel (Phil.) Inc. vs. Yatco*, 43 O.G. No. 11 p. 4604) The courts will disregard a corporate entity to prevent evasion of law and conversely will regard it as a separate entity to prevent evasion. The corporate entity and distinction from the members may be disregarded more readily where only the members are affected and no right of creditors or third persons or the public is involved. They may be stopped from saying that formal action was not taken. (*Cagayan Fishing Development vs. Sandiko*, 36 O. G. 118, May 1938)

Meynardo A. Tiro

POLITICAL LAW — RIGHT OF CITY OR MUNICIPALITY TO EXPROPRIATE PRIVATE LANDS FOR RESALE TO SQUATTERS OR TENANTS. Under Commonwealth Act No. 539, a City or Municipality has the power to expropriate private lands for resale to squatters or tenants. This statute, however, like any other law, gives rise to inevitable queries, concomitant to the interpretation put on it by attorneys in cases falling under it and the lower courts in which such cases are tried. What area or extent of land must be within

the operative radius of CA 539? What use must a land sought to be expropriated be devoted to? Will previous contracts burdening the land be taken into account in ascertaining its expropriability? The Supreme Court has definitely ruled upon and squarely decided these questions in the following cases.

The leading case of *Justa G. Guido vs. Rural Progress Administration*¹ decided by the Supreme Court on Oct. 31, 1949, sufficiently resolved the foregoing queries. The facts of this case are simple. Two adjoining lots, partly commercial, with an aggregate area of 22,655 sqm., located in Maypajo, Caloocan, Rizal, belonging to Justa G. Guido, were sought to be expropriated under a complaint filed for that purpose in the Court of First Instance of Rizal. While the proceedings was pending, Justa G. Guido filed a petition for Prohibition in the Supreme Court to prevent the Hon. Oscar Castelo of the CFI of Rizal from proceeding with the expropriation. Petitioner relied, among others, on the following grounds: (1) That the lots sought to be expropriated, being small lots, are not embraced within CA 539. (2) That majority of the tenants have a lease contract with petitioner and to allow the expropriation to proceed and terminate would mean an impairment of the obligation of contract which is prohibited by the Constitution.

Sec. 1 of CA 539 states: The President is authorized to acquire private land or any interest therein through purchase or expropriation and to subdivide the same into house lots or small farms for resale at reasonable prices and under conditions as he may fix, to their bona fide tenants or occupants or to private individuals who will work the land themselves and who are qualified to acquire and own land in the Philippines.

Sec. 2 of the same Act says: The President may designate any Department, Bureau, Office or instrumentality of the National Government or he may organize a new agency to carry out the objectives of this Act. For this purpose such body so created or designated shall be considered a public corporation.

The National Assembly approved this enactment on authority of Section 4, Article XIII of the Constitution which reads as follows: "Congress may authorize upon payment of just compensation, the expropriation of lands to be subdivided into small lots and conveyed at cost to individuals."

In granting the Prohibition the Supreme Court ruled that CA 539 contemplates large estates to be the subject of expropriation and not small lots like these. Lots being sought for ex-