THE PHILIPPINE CORPORATION LAW VIEWED FROM THE OUTSIDE

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INTRODUCTION

Our Corporation Law (Act No. 1459) was enacted by the Philippine Commission on April 6, 1906, or more than half a century ago. Since then, to use a commonplace, 'much water has passed under the bridge.' Some amendments had been inserted in the law, notably the 1929 amendments or Act No. 3518 and a few other amendments. But the law has remained substantially the same. It continued to embody provisions which sanction corporate devices too favorable to the incorporators and the management, to the prejudice of subsequent stockholders, the corporate creditors, and the general public.

A re-examination of some of the provisions of our Corporation Law is hereby made, in the light of some other corporation laws, with a view to improving our own.

"PUBLIC CORPORATION" MUST BE RE-DEFINED

Notwithstanding the fact that our law clearly defines a "public corporation" as one organized "for the government of a portion of the state," [1] yet there is a propensity on the part of lawyers, law professors, and the courts who have easy access to *American Reports*, *Fletcher's Cyc. of Private Corporations*, and American law textbooks, to rely on American jurisprudence to explain the meaning of our own statutory provisions.[2] This inclination has given rise to confusion in Philippine jurisprudence.

With a few exceptions,[2a] under the great weight of American authorities, many of our government entities or agencies, like the Central Bank of the Philippines, the Development Bank of the Philippines, the NAWASA, the NAMARCO, the GSIS, and the Univer-

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[1] Sec. 3, Corporation Law, Act No. 1459.

[2] According to American decisions, evidently based on local statutes, a public corporation is one composed exclusively of public officers who have no personal interest either in it or in its concerns and who act only as instruments of the state. (*Whiteman v. Anderson-Cottonwood Irr Dist.*, 60 Cal. App. 234, 212 P. 706 (1922). One organized to control funds belonging to the state or to conduct business in which the state alone is interested is a public corporation. (*City of Louisville v. University of Louisville*, 15 B. Monroe [Ky.] 642). A corporation is public where it is supported by public funds. (*Van Campen v. Olean General Hospital*, 210 App. Div. 204, 205 NYS 554 (1924). A private corporation, as distinguished from a public corporation, is one formed for the benefit of its stockholders exclusively. (*Formes Pioneer Boat Line v. Board of Com'rs. of Everglades Drain. Dist.*, 77 Fla. 742, 82 So. 346 (1919). Public corporations are not limited to those created for municipal purposes only but, strictly speaking, public corporations are all such as are founded for public purposes, where the whole interests belong to the government. (*University of Nebraska v. McConnell*, 5 Neb. 423).

[2a] In jurisdictions which have a definition of a "public corporation" similar to ours, it is held that public corporations are only such as are created for political purposes (*Tinsman v. Belvedere D.R. Co.*, 26 NJL 148, 69 Am. Dec. 565 (1857); they are merely "the auxiliaries of the government in the important business of municipal rule." (*Dean v. Davis*, 51 Cal. 406 (1876).

sity of the Philippines would all come under the category of "public corporations." But, under our Corporation Law, such government entities or agencies are "private corporations" just the same, because they are not organized for the government of a portion of the state.

Events taking place in our midst, where government-owned corporations are treated like privately-owned entities, demand a re-definition of a "public corporation." It should include the above-named governmental agencies. If this suggestion is adopted, then some legal questions, like the right to strike on the part of employees, may be based no longer on the vague and uncertain meaning of corporations performing "governmental functions" or "proprietary functions" but, more sensibly, on whether the persons involved are employees of "private" or "public" corporations, within the new definition or classification. It is indeed unfair that some government employees have no such right, *when all of them belong to the same classification of "government employees,"* whose salaries are paid out of government funds, subject to the same rules of appointment based on merit and fitness, and to the same retirement pay and pension plans under the same Government Service Insurance System. A more sensible distinction on the right to strike on the part of employees should be, not whether they are employed in a corporation performing "governmental functions" or "proprietary functions," but on whether they are employed in the government service or not. In other words, whether they are employed in a "public corporation," as re-defined, which should include not only corporations organized for the government of a portion of the state but also those in which the "whole interest" belongs to the state.[3]

NON-VOTING STOCKS

Shares of stock may be classified as "voting" or "non-voting," as may be provided for in the articles of incorporation.[4] This absolute power to classify shares granted by our Corporation Law is a corporate device of American origin, looked upon with disfavor by many countries of Europe.

The power to classify shares of stock may be granted to the corporation, except the power to deprive any share of voting rights. The corporation laws of Japan, Thailand, Holland, and Egypt guarantee to all shares of stock issued by a corporation the right

[3] Public support or revenues and properties and public control are marks of a public corporation. The whole interests must belong to the government, or at least be subject to governmental control. If the *whole interest* does not belong to the public, or if the corporation is not created for the administration of political or municipal powers, it is a private corporation. (*Fletcher*, Cyc. of Private Corporations, Vol. 1, Sec 58, p. 260 [1931 ed.]).

[4] Sec. 5, Corporation Law, Act No. 1459

to vote. In Illinois, the power to classify shares as "non-voting" is denied by the Constitution of the state.[5]

Because of the absolute freedom to classify shares of stock under our Corporation Law, the control and management of some corporations have been continuously vested in the hands of a privileged few, the original incorporators and subscribers, who subscribed all the stock classified as "voting," offering the remaining "non-voting" stock to the public. Inasmuch as amendments to the articles of incorporation may not be approved without the consent of at least 2/3 of the subscribed capital stock, it is sufficient if the privileged few had subscribed to a little over 1/3 of said capital stock to prevent any subsequent amendment to a reclassification of shares as originally classified by them. This is a corporate device, innocently copied from many American state corporation laws which enables the minority to control the majority.

However, notwithstanding the present provision of our Corporation Law regarding the power of the incorporators to classify shares of stock as "non-voting," yet, it has been contended by the writer,[6] that in some important corporate matters, *all* stockholders, whether they are owners of stock classified as "non-voting," have, notwithstanding, the right to vote. These corporate matters are: (1) increase or decrease in the number of directors (Sec. 6, No. 6); (2) increase or decrease in the capital stock (Sec. 17); (3) amendment of articles of incorporation (Sec. 18); (4) adoption of by-laws (Sec. 20); (5) amendment or repeal of by-laws (Sec. 22); (6) voluntary dissolution of the corporation (Sec. 62); (7) sale or disposition of treasury stock (Sec. 45). The reason why "non-voting" stock may vote in the above cases is that in all these instances the Corporation Law does not limit the right to vote only to stocks "entitled to vote" as specifically provided in other cases.

However, to avoid any possible misinterpretation of the provisions of our Corporation Law regarding the right to vote of "non-voting" stocks in some cases, the law should be amended so as to grant the right to vote in *all* cases. Such an absolute right to vote in all cases is indeed more equitable than a denial of such right in some cases.

BEARER SHARES

Should our Corporation Law contain express provisions, as found in some other corporation laws, authorizing the issuance of "bearer shares"?

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[5] People ex rel. Watseka v. Emmerson, 302 Ill. 300, 134 NE 707 (1922).
[6] *Guevara, S.*, "The Philippine Corporation Law" (1950 ed.), p. 123.

"Bearer shares" are shares of stock issued by a corporation, covered by a certificate of stock transferable by mere delivery, without necessity of registration in the corporate books. The transferee thereby becomes the owner of the stock for all legal purposes, except that when dividends are to be received or the right to vote is to be exercised by the holder, said certificate of stock must be deposited in the office of the corporation and registered therein for such purposes.

It may be commercially advantageous to authorize issuance of "bearer" shares," subject to certain limitations; namely, that they be issued only upon request of a stockholder, and that the stock be fully paid up. At present, all shares of stock issued by Philippine corporations are "registered" or "nominative" shares, such that no transfer thereof shall be valid as against the corporation and third persons unless *registered* in the corporate books.[7]

The corporation laws of Japan, Thailand, Peru, Mexico, Holland, France and other countries of Europe provide for the issuance of "bearer shares." [8]

THE CORPORATE NAME

Among the matters that are required by law to be specified in the articles of incorporation is the NAME of the corporation. But our Corporation Law merely requires the statement of the name, and says nothing more.

Some other corporation laws require that the corporate name must always be followed by the word "Incorporated" or the abbreviation "Inc." [9] This is a good idea, so that the public may readily know, upon seeing a business name, whether it is that of a corporation, a partnership, or a mere single proprietorship using a business name under the Business Names Act.

THE TERM OF EXISTENCE

Our Corporation Law also prescribes that the term of existence

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[7] Sec. 35, Corporation Law, Act No. 1459

[8] The Commercial Code of *Japan* provides: "Art. 227. A share certificate to bearer may be issued only in case where it is so provided for in the articles of incorporation. A shareholder may at any time demand that a share certificate to bearer be converted into a non-bearer share certificate.

"Art. 228. The owner of a share certificate to bearer cannot exercise his right as a shareholder unless he deposits his share certificate with the company."

The Civil and Commercial Code of *Thailand* provides: "Art. 1134. Certificates to bearer may be issued only if authorized by the regulations of the company and for shares which are fully paid-up. In such case, the holder of a nominative certificate is entitled to receive a bearer certificate on surrendering the nominative certificate for cancellation."

The *Dutch* Corporation Law provides: "Share certificates are either non-negotiable or to bearer. Share certificate to bearer may not be issued to the shareholders unless against payment of at least the full par value of those shares." (Art. 38c, *Commercial Code, the Netherlands*).

[9] Corporation Law of Louisiana

of corporations shall not exceed fifty years.[10] This term as originally stated in the articles may not be increased by amending the articles of incorporation.[11]

Why should our law prohibit corporations from doing business for more than fifty years, if able and willing to do so? Common sense dictates that the longer a business concern exists, the more stable financially it becomes, and the better for the economy of the country insofar as collection of taxes and solving unemployment are concerned. Does not a corporation take much pride in advertising itself by announcing to the public that it has been doing business "since 1888"? It does not seem sensible, indeed, that the state should be more concerned in trying to "dissolve" a legitimate corporation than in enabling it to "continue" in prosperity and abundance.

Looking at the corporation laws of many states of the American Union and of other countries, we shall find that corporations may be incorporated "perpetually" or "eternally" until dissolved judicially or extrajudicially.[12]

MAY THE CAPITAL STOCK BE IN U.S. DOLLARS?

It is to be noted that our Corporation Law specifically requires that the capital stock of stock corporations must be stated *"in lawful money of the Philippines."* [13] The U.S. dollar is not evidently a lawful money of the Philippines, and yet, in these days of lack of international dollar reserves, why prohibit the capitalization of a domestic corporation in terms of U.S. dollars, which is one of the most stable currencies in the world?

PREFERRED STOCKS AS TO DIVIDENDS

Our Corporation Law makes no specific provisions as to the rights and preferences of preferred stocks. "Preferred" stocks, ordinarily, are of two kinds: Preferred as to *dividends*, and preferred as to *assets* in case of liquidation. Preferred stock as to dividends may be *"cumulative"* or *"non-cumulative," "participating"* or *"non-participating."*

One of the legal controversies in corporation law is whether preferred stock as to dividends is presumed "cumulative" or "non-

[10] Sec. 6, Corporation Law, Act No. 1459

[11] Sec. 18. *Id.* However, the term of life insurance corporations may now be extended once for another 50 years. (R.A. No. 1932).

[12] Lately, however, our Congress in providing for the organization of "non-agricultural cooperatives" expressly allows such corporations to be incorporated "perpetually." (Sec. 16, R.A. No. 2023).

[13] Sec. 6, Corporation Law, Act No. 1459.

cumulative," or presumed "participating" or "non-participating," *in the absence of express stipulation* in the certificate of stock issued. Courts have given contradictory opinions.[14] To avoid useless lawsuits on this question, an improved corporation law should contain a specific provision that "in the absence of express stipulation," preferred stock as to dividends shall be presumed *non-cumulative* and *non-participating*. This suggestion is based on the fundamental principle that all persons are presumed to have "equal" rights, unless the law or the contract provides otherwise.[15]

NUMBER OF INCORPORATORS

Section 6 of our Corporation Law expressly provides that the "incorporators" must be "*five* or more persons, not exceeding fifteen, a majority of whom are residents of the Philippines." This provision is a modified copy of many state corporation laws in the United States which provide for "three or more incorporators." Some state corporation laws even require only "two or more" incorporators.

Limitations on the *minimum* or *maximum* number of incorporators are capricious in nature, and are not supported by any good and 16, in incorporating a corporation? A lesser number than five and a greater number than fifteen will not make any difference insofar as the "corporateness" of the corporation is concerned. Our Corporation Law itself proves the immateriality of the maximum number of incorporators when, in another section regarding the incorporation of schools and colleges, it provides: "Sec. 165. Any number of persons *not less than five* who have established or who may desire to establish a college, school, or other institution of learning may incorporate themselves by filing with the Securities & Exchange Commissioner articles of incorporation setting forth the following facts: . . .," thereby omitting "*and not more than fifteen*" as required of ordinary corporations.

It is sufficient, therefore, that our improved Corporation Law should provide: "*Any two or more* persons, a majority of whom are residents of the Philippines, may incorporate a corporation under the general incorporation law, for any lawful purpose or purposes."

MUST THE ARTICLES BE DRAFTED IN PHILIPPINE LANGUAGE?

But, although our Corporation Law is quite nationalistic as re-

[14] Presumed non-cumulative. (*Englander v. Osborne*, 261 Pa. 366, 104 A. 614 (1918); Lockwood v. General Abrasive Co, 240 NY 592, 148 NE 719 (1925). Presumed cumulative and participative. (*Fidelity Trust Co. v. Lehigh Valley RR.*, 215 Pa. 610, 64 A. 829 (1906); *Sternbergh v. Brock*, 225 Pa. 279, 133 ASR 877 (1909)

[15] Art. 485, Civil Code of the Philippines.

gards the capital stock to be stated in Philippine money, yet it is absolutely silent as to whether the articles of incorporation must be filed in a language used by the Filipinos. It is interesting to know that the corporation law of The Netherlands requires that articles of incorporation must be drafted and filed in the Netherlands language.[16]

Our improved corporation law may require the articles of incorporation to be filed either in English, Spanish, or Tagalog.

DIRECTORS: QUALIFICATIONS; TERM OF OFFICE

Many state corporation laws provide that the number of directors of a corporation shall be "at least three," and that "at least two of them" must be residents of the state. We tried to "improve" upon these American provisions by providing in our law that the number of directors shall be "at least *five* and not more than eleven" in the case of non-stock corporations; and at least "*two* of them" must be residents of the Philippines. The consequence is a legal absurdity.

By requiring the minimum to be at least FIVE instead of only THREE and further requiring that only TWO of them must be residents of the Philippines, a quorum for the transaction of corporate business can never be obtained if only TWO of the directors are in the Philippines, because our Corporation Law subsequently provides (Sec. 33) that: "A *majority of the directors* shall constitute a *quorum* for the transaction of corporate business, and every decision of a majority of the quorum duly assembled as a board shall be valid as a *corporate act.*"

If only two directors are required to be residents of the Philippines, and a quorum is constituted by at least three, how could there be a quorum if only *two* are in the Philippines? Under the American statutes, the requirement of at least *two* of the *three* to be residents of the state fits in with the other legal requirement that a quorum is constituted by a majority of the directors, which is *two*. This is the tragic effect of hasty legislation by copying verbatim one portion of a foreign law and attempting to "revise" another portion thereof, in order to show some semblance of legislative originality.

It is therefore imperative that this particular portion of our Corporation Law should be so amended so that the number of directors required to be residents of the Philippines must be at least *three*, or better still, that a *majority* of the directors (whether five or eleven or fifteen) must be residents of the Philippines.

[16] Art. 36b, Commercial Code of *The Netherlands*.

And, our law is particular about stock ownership on the part of a director. He must own at least "one share," in his "own right," and registered in his name in the corporate books at the time of his election to the board.[17]

Competence in, and knowledge of, industrial management, rather than mere ownership of stock, are better qualifications for directorship. The stock ownership requirement deprives corporations of the right to elect to the board men reputedly competent in business management, but who because of lack of stock ownership qualification are disqualified to be on the board.[18] It may be alleged that this situation is easy to solve, by registering in his name one share for the mere purpose of qualifying him to the board. But, it is submitted, that if this fact is admitted to be so, he is disqualified just the same under the present provisions of the Corporation Law, because the legal requirement of stock ownership "in his own right" means ownership not only in law but as a *fact*, in good faith. It has been held that a trustee in a voting trust agreement is not a "stockholder" within the meaning of "stockholder" as qualification provided by law.[19] For the same reason, a person to qualify as director under the present law must not be a mere possessor of a share but must own it in his own right: he must be a real "stockholder."

Our Corporation Law, too, contemplates annual election of directors, so that the term of office of a director is limited only to one year, without prejudice, of course, to being re-elected. The Japanese law provides that the term of office of a director "shall not exceed two years." [20] The Japanese law gives the corporation an option to devise a system of election of directors, whereby half or at least two of the first directors elected shall hold office only for one year, and thereafter, all directors shall be elected for two years, thereby maintaining a continuity of experience in the board. The idea is sensible, and is worthy of incorporation in our Corporation Law.

Subscription and Payment of Capital Stock

Except in the case of banks and insurance corporations, our law does not require a minimum amount of authorized capital stock for purposes of incorporation. A private corporation may be incorporated with an authorized capital stock of ₱100 or ₱1,000,000. This indifference of our law as regards the amount of subscription in

[17] Secs. 28, 30, Corporation Law, Act No. 1459.
[18] Under Japanese law, a director need not own shares to qualify as such, unless prescribed by the articles of incorporation. (Art. 259, *Japanese Commercial Code*.)
[19] Gertenbach v. Rodnon *et al.* 12 NYS (2d) 518 (1939).
[20] Art. 256, *Japanese Commercial Code*.

terms of money may be due to the fact that, the "right of incorporation" must not be confused with the "ability to transact corporate business." [21] Our law merely requires that at least 20% of the entire number of authorized *shares* must be subscribed and at least 25% of the subscription must be paid in, and the resulting amount paid in, may, if the amount of the authorized shares is not large, be indeed negligible. This is surprisingly true if we take into account the power of the corporation to classify its shares into different par values as may be prescribed in the articles.[22]

Some American corporation statutes fix a minimum amount of $1,000 to be paid in before the corporation may begin business.[23] The writer is not in favor of fixing a minimum amount of capital which a corporation must have before it can do business, because there could not be a fixed standard for all kinds of businesses. But, it is suggested that if a corporation advertises its capital stock to be so much amount, the said capital stock so advertised must be *fully subscribed* by the incorporators, although it is not necessary that all said capital stock be *fully* paid. Some corporations, in order to sound "big" advertise that their capital stock is, say, ₱1,000,000, but in view of the present provision that only 20% thereof need be subscribed and only 25% of the subscription need be paid, for purposes of incorporation, then in such a one-million-peso corporation, only ₱250,000 need be subscribed and only ₱50,000 need be paid in.

It is suggested that if only ₱250,000 shall be subscribed, its authorized capital stock should only be ₱250,000. In other words, all the authorized capital stock of a proposed corporation must be fully subscribed, although not all of said subscribed capital stock need be paid. For example, in Mexico, *all* the shares must be subscribed, but only 20% thereof need be paid. The Corporation Law of Thailand also provides: "The *whole number* of shares with which the company proposes to be registered must be subscribed or allotted before registration of the company." [24]

Anyway, when new shares are to be issued, the articles of incorporation may be amended at any time.

MAY STOCKS BE ISSUED IN EXCHANGE FOR SERVICES OR CREDITS?

As regards issuance of stock, our law requires that same be issued only in exchange of cash, property, or profits earned but

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[21] *Guevara, S.*, "The Right of Incorporation." 33 Phil. L.J. 349 (1958).
[22] Sec. 5. Corporation Law, Act No. 1459.
[23] See Corporation Law of Louisiana.
[24] Art. 1104, Civil and Commercial Code of Thailand.

not distributed.[25] It will be noted that our law is silent whether stock may lawfully be issued in exchange for *service*.

In New York, where the statute reads substantially like ours the New York Supreme Court held that shares of stock may NOT lawfully be issued in exchange for service, inasmuch as the law allowed only its issuance in exchange for money or property; and service is neither of these.[26]

There seems to be no good reason why service (provided it be actually rendered and its value is equivalent to the value of the stock issued) may not be considered a valid consideration for the issuance of stock.[27]

Even under the present provisions of our law, stock may validly be issued in exchange for service, actually rendered, the worth of which is equal to the value of the stock issued, and the subscriber is willing to take stock instead of cash. The transaction simply abbreviates the payment of cash to the subscriber in giving him stock directly. In other words, instead of the corporation paying the subscriber cash first, and the subscriber giving back the cash so received in exchange for stock, the corporation may abbreviate the transaction by issuing stock directly, provided there is actual service rendered, and the value of such service is equal to the value of the stock issued.

But, certainly, no stock may lawfully be issued in exchange for service to be rendered in the future. To be valid, the service must actually have been rendered to the corporation which, in turn, must have received a benefit equal to the value of the stock issued. In such a case, stock may be issued in exchange for service, although our law is silent about this. It is not "watered stock."

However, to avoid any legal controversy on this matter, it is suggested that the law be so amended as to include service as a valid consideration for the issuance of stock, provided the service has actually been rendered by the subscriber and the value thereof is at least equal to the value of the stocks issued.

May stock be issued in exchange for *credit?* Our law considers credit as property.[28] It seems that stock may lawfully be issued in exchange for credit under the present legal provisions. But it is submitted that credit is merely a contingent right, and is more undesirable than service. In other words, if service is not expressly

[25] Sec. 16, Corporation Law, Act No. 1459.
[26] Herbert v. Duryea, 554 NYS 311 (1898).
[27] The Louisiana Corporation Law expressly authorizes the issuance of stocks for *labor done*.
[28] Art. 417, Civil Code of the Philippines.

recognized by law, why should credit be? It is interesting to know that the Egyptian Civil Code expressly provides that "The credit of a partner cannot alone constitute his contribution." [29]

Our law on partnership and private corporations should contain expressly a similar provision as provided by the Egyptian Civil Code. Credit should not be considered a valid contribution in a partnership. Neither should it be recognized by law as a valid consideration in exchange for issuance of stocks.

DIVIDENDS

The declaration of dividends by a private corporation under our law is limited only to "out of surplus profits arising from its business." [30]

Under many American corporation laws, dividends may be declared by a corporation, so long as its capital or capital stock is not impaired. This means that dividends may be declared even from appreciation of fixed assets, although same did not arise from the operation of the business of the corporation.[31]

Declaring dividends out of surplus profits regardless of their source is not a fraud against creditors. It is suggested that the present law be amended so that the phrase "arising from its business" be stricken out. In such case, dividends may lawfully be declared, not only from surplus profits arising from the business, but also from sale of its fixed assets or from issuance of stock above par. But these profits must be *actual, bona fide* profits. Under the suggested rule, dividends may not also be declared out of mere appreciation of fixed assets.[32]

Some other corporation laws require that a certain percentage of the surplus profits shall first be set aside to make up a "reserve fund," until such reserve amounts to at least a certain percentage of the capital stock of the corporation, before dividends may be declared and distributed. Thus, the Corporation Law of Thailand provides: "The company must appropriate to a reserve fund, at each distribution of dividend, at least one-twentieth of the profits arising from the company, until the reserve fund reaches one-tenth part of the capital of the company or such higher proportion thereof as may be stipulated in the regulations of the company. If shares have been issued at a value higher than the face value, the excess

[29] Art. 509, Egyptian Civil Code.
[30] Sec. 16, Corporation Law, Act No. 1459.
[31] Randall v. Bailey *et al.*, 23 NYS (2nd) 173 (1942).
[32] The Louisiana Corporation Law expressly authorizes declaration of dividends out of surplus profits EXCEPT unrealized appreciation in the value of fixed assets.

must be added to the reserve fund until the latter has reached the amount mentioned in the foregoing paragraph." [33] It will be noted that under the law of Thailand, the profits realized by the corporation in the issuance of shares above par, may not be distributed as dividends but must first go to the reserve fund until the latter has reached a certain percentage of the capital stock, after which the same may be made available as dividends.

The idea of creating a "reserve fund," before dividends may lawfully be declared and distributed, is also required by our existing laws in banks and insurance companies.[34] But outside of banks and insurance corporations, the law allows private corporations to declare and distribute *all* its surplus profits, subject only to the above-mentioned limitation that said profits shall *arise from its business.*

The legal limitation regarding the creation of a reserve fund before declaring and distributing dividends should be applied, not only to banks and insurance companies, but to all other corporations *affected with a public interest,* like public service corporations, public utilities, and above all, incorporated schools. Assuming that schools and colleges may be incorporated as stock corporations under the present Corporation Law, which the writer contends otherwise,[35] the above suggestion regarding the creation of a reserve fund prior to dividend distribution may partly remedy the too materialistic tendencies of some of these institutions of learning incorporated as "stock corporations."

Hence, it is suggested that banks, insurance companies, building and loan associations, public service corporations and public utilities, and all schools, colleges, and institutions of learning incorporated as stock corporations, shall be required to create and maintain a reserve fund up to a certain percentage of its capital stock, before dividends may lawfully be declared and distributed. The reserve fund for banks, insurance companies, building and loan associations shall be that as now expressly provided by law; while the reserve requirement for incorporated schools and colleges shall be at least 10% of its net profits until the reserve surplus amounts to at least 25% of its capital stock.

It is also interesting to note that the law of Thailand makes distribution of dividends only in proportion to the amount paid upon

[33] Art. 1202, Civil and Commercial Code of *Thailand.*

[34] Sec. 22, R.A. No. 337 (regarding commercial banking corporations); Sec. 30, Id. (regarding savings & mortgage banks); Sec. 55, Id. (regarding building & loan associations); Sec. 41, R.A. No. 265 (regarding the Central Bank of the Philippines); Sec. 183, Act No. 2427 (regarding insurance companies)

[35] See *Guevara, S.,* "Should Educational Institutions be Non-stock Corporations " 35 Phil. L.J. 1127 (1960)

each share.[36] Under Philippine law, the right to share in the dividends is based, not on the amount actually *paid* on the subscription, but on the total amount actually *subscribed*, although unpaid. Our law seems to be unjust, discriminatory, promotive of fraud, and, a provision similar to that of Thailand is deemed more equitable for all concerned.

RIGHT TO VOTE BY PROXY

As regards the right of stockholders to vote by proxy in stockholders' meetings, our Corporation Law does not expressly grant such right, except in the case of election of directors,[37] and in the case of trustees in a voting trust agreement.[38]

There is no general grant to vote by proxy in all stockholders' meetings, as is found in some other corporation laws. Section 25 of our Corporation Law which provides that "the proceedings had and the business transacted at any meeting of the stockholders or members of the corporation, if within the powers of the corporation shall be valid even if the meeting be improperly held or called, provided that all the stockholders or members of the corporation are present or *represented at the meeting*," cannot be considered as a general grant of the right to vote by proxy in all cases. The phrase "or represented at the meeting" refers only to those cases specifically authorized by law in Sections 31 and 36 (regarding meetings for the election of directors and the right of voting trustees to vote by proxy). It is also contended by others that voting by proxy is merely an act of agency, and what a person may do himself, he can always do it through another. This argument is true in ordinary acts of individuals, but not to acts relating to corporations which are governed by special laws. It must be remembered that corporations, directors, and stockholders have only limited powers under the Corporation Law, and what the Corporation Law does not expressly or impliedly grant, the same is denied.[39] On the contrary, it has been held that voting by proxy is not inherent or essential to corporate existence, and unless expressly granted by the law or by the by-laws, voting by proxy is not an inherent right.[40]

Hence, the correct rule under the present Corporation Law is that voting by proxy by a stockholder may be lawfully exercised only in the following cases: (a) election of directors; (b) by a

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[36] Art. 1200, Civil and Commercial Code of *Thailand*. See also the Mexican Corporation Law.
[37] Sec. 31, Corporation Law, Act No. 1459.
[38] Sec. 36, Corporation Law, Act No. 1459.
[39] Head v. Providence Ins. Co., 2 Cranch (U.S.) 127, 2 L. Ed. 229 (1804); Central Transp. Co. v. Pullman's Palace Car Co., 139 U.S. 24, 35 L.Ed. 55 (1891).
[40] Commonwealth v. Bringhurst, 103 Pa. 134 (1883).

trustee by virtue of a voting trust agreement; (c) if expressly granted by the by-law.

It is suggested, however, that the right to vote by proxy should be granted by the Corporation Law in all cases. If the power to classify shares as "non-voting" is deemed unfair and unjust, the denial of the right to vote by proxy must be deemed also an undue limitation of one's right to vote. Hence, it is submitted that the Corporation Law be so amended as to contain an express provision that: "All stockholders and members of a corporation shall have the right to vote in person or by proxy in all meetings of the stockholders."

REMOVAL OF DIRECTORS

May a director of a private corporation be removed without cause?

Our Corporation Law does not state the causes for removal of a director. It simply provides that a director may be removed by the stockholders representing two-thirds of the voting stock at a meeting duly called for the purpose.[41] Hence, it has been held that a director may be removed without cause.[42]

But, it is apparent that a director who had been elected by the minority on "cumulative" voting cannot be so removed, if in an election of the *entire board*, the said director can be elected by cumulative voting; otherwise, such absolute rule to remove without cause, would nullify the right of cumulative voting guaranteed by our Corporation Law in the election of directors. For example, director A has been elected by cumulative voting by stockholders representing exactly one-third of the voting stock. Immediately after his election, the majority stockholders representing two-thirds of the voting stock removed him without cause, in order to replace him with one from among themselves. Inasmuch as under our Corporation Law, a director may be removed by a vote of two-thirds of the voting stock, director A may be so removed. Then, they elect one from among themselves to replace director A. It is hereby contended that if the removal of director A is without cause, and A could be elected as director in an election of the entire board, his removal is illegal, because such removal without cause nullifies the right of cumulative voting guaranteed by the law.

Consequently, our Corporation Law (Section 34) governing removal of directors should contain a proviso similar to that found

[41] Sec. 34, Corporation Law, Act No. 1459.
[42] Government v. Agoncillo *et al*, 50 Phil. 348 (1927).

in the California Civil Code, to wit: "*Provided, however*, That no individual director shall be removed in case the votes of a sufficient number of shares are cast against the resolution for his removal, which if cumulatively voted at an election of the full board would be sufficient to elect one or more directors." [43]

VOTING TRUSTEE; RIGHT TO BE DIRECTOR

If a voting trust agreement has been entered into between a stockholder or a group of stockholders and a trustee, whereby voting rights pertaining to the shares are transferred to the trustee, who is qualified to be elected director to the board, assuming that the trustee owns no other stock in his name?

Our Corporation Law specifically requires that "Every director *must own in his own right at least one share* of the capital stock of the stock corporation of which he is a director, which stock must stand in his name on the books of the corporation."[44] It is evident that the trustee in a voting agreement does not OWN the shares transferred to him "in his own right." He merely *holds* them *in trust*. The transferors, who hold *voting trust certificates* given to them by the trustee, continue to be the owners of the stock transferred, because the said voting trust certificates, in the language of the Corporation Law, "are transferable in the same manner and with the *same effect* as *certificates of stock* under the provisions of this Act." [45] A trustee, if at all, is an owner by fiction and not by fact.[46] This being so, the trustee is disqualified to be elected director under the provisions of our Corporation Law, unless he himself, owns in his own right stocks other than those transferred by virtue of a voting trust agreement.[47]

But, there is nothing inherently wrong in allowing a trustee to become a director.[48] So, it is suggested that the present Corporation Law be so amended that a trustee in a voting trust agreement, during the period of the trust agreement (which under our law cannot exceed five years) should equally qualify for directorship as the

[43] Sec. 310, California Civil Code.
[44] Sec. 30, Corporation Law, Act No. 1459.
[45] Sec. 36, Corporation Law, Act No. 1459.
[46] "A trust is a very important and curious instance of duplicate ownership. Trust property is that which is owned by two persons at the same time, the relation between the two owners being such that one of them is under an obligation to use his ownership for the benefit of the other. The former is called trustee, and his ownership is trust-ownership; the other is called the beneficiary, and his is beneficial ownership.

"The trustee is destitute of any right of enjoyment of the trust property. His ownership, therefore, is a matter of form rather than of substance, and nominal rather than real. If we have regard to the essence of the matter rather than to the form of it, a trustee is NOT AN OWNER AT ALL, but a mere agent, upon whom the law has conferred the power and imposed the duty of administering the property of another person. In legal theory, however, he is not a mere agent but an owner. He is a person to whom the property of some one else is *fictitiously* attributed by the law, to the extent that the rights and powers thus vested in a nominal owner shall be used by him on behalf of the real owner." (*Salmond*, Jurisprudence, 10th Ed., p. 275.)
[47] O'Grady v. U.S. Independent Tel. Co., 75 N.J. Eq. 301, 71 A. 1040 (1908).
[48] See Schmidt v. Mitchell, 101 Ky. 570, 72 ASR 427 (1897).

transferors. In other words, the trustees should be deemed "stockholders" within the meaning of the legal provision requiring ownership of at least one share of stock, for purposes of qualification to the board. However, if the Corporation Law would entirely eliminate share ownership qualification, as suggested heretofore, then this amendment would be unnecessary.

DISSOLUTION BY LEGISLATIVE ENACTMENT

Section 76 of our Corporation Law, in part, expressly provides: ". . . and *any* or all corporations created by virtue of this Act may be dissolved by legislative enactment."

The word "any" in the above provision, means that a particular private corporation incorporated under the general incorporation law may be dissolved, without dissolving any other corporation similarly incorporated. And the law is silent whether the dissolution of such particular corporation is for cause or without cause.

So, it has been held that dissolution by legislative enactment of any corporation may be done *without cause;* and this is not an impairment of contracts, because such a provision like Section 76 is deemed to be a part of the charter of every incorporated corporation, and therefore, its dissolution by law is, in reality, done with the consent of the corporation agreed to at the time of incorporation.[19]

There is nothing objectionable in dissolving ALL corporations by the repeal of the Corporation Law, but there seems to be abuse of power when a particular corporation is singled out for dissolution, without cause, and without dissolving the others placed in equal circumstances. For instance, may the Congress dissolve the Far Eastern University without any just cause, by legislative enactment, without dissolving the University of the East and other private universities, even admitting that the "reserved power" to dissolve had been impliedly renounced in advance upon incorporation?

The absolute power to dissolve a private corporation lies only when such corporation has been created by *special charter,* and not when it has been incorporated under a *general incorporation law.* In the latter case, the power to dissolve should apply to ALL corporations incorporated under the general law. Dissolution of a particular corporation, not created by special charter, without reason or without just cause, is obnoxious to a system of "government of laws" or in a democratic society. "Absolute power" belongs to God alone, and is not deemed given to mortal man. Principles of natural

[19] Greenwood v. Union Freight RR., 105 U.S. 13, 26 L. Ed. 961 (1881).

justice and equity are superior to legislative caprice, and no court of justice should go against natural justice and equity. The "equal protection of the laws" and "non-impairment of obligation of contracts," "non-deprivation of property without due process of law" are constitutional precepts which, in turn, are based on natural law, which must be preserved and maintained at all times and in all climes. And yet, it is likely that not all courts will interpret Section 76 of the Corporation Law in such a way that "with cause" is deemed inserted therein; on the contrary, some courts may equally argue that, inasmuch as corporations are mere creatures of the law, so they can only exist by virtue of the law; he who has the power to create has the power to destroy "at any time." Law interpreters will not err by having in mind always one of the wisest provisions in our new Civil Code, which says: "In case of doubt in the interpretation or application of laws, it is presumed that the lawmaking body intended right and justice to prevail." [50]

Hence, to prevent a possible misapplication of Section 76 of the Corporation Law on the part of those who refuse to look beyond the positive provisions of the statute, it is suggested that said Section be so amended as to read: "This Act or any part thereof may be amended or repealed at any time by the legislative authority, and any corporation created by virtue of this Act may be dissolved *for just cause* by legislative enactment. No right or remedy in favor of or accrued against any corporation, its stockholders, or officers, shall be removed or impaired either by subsequent dissolution of said corporation or by any subsequent amendment or repeal of this Act or any part or portion thereof."

INCORPORATED SCHOOLS AND COLLEGES

Contrary to the intent and purpose of the present Corporation Law, schools, colleges, and institutions of learning have been permitted by the Securities & Exchange Commissioner to be incorporated in the Philippines as *stock corporations*, like ordinary business corporation.[51] To dispel any doubt as to what should be the form of organization of this kind of associations, the law should specifically require that such associations may be incorporated only as *non-stock corporations*. Or, as an alternative, they may be allowed to be incorporated as stock corporations, subject to certain limitations; to wit: that no dividends shall be declared in excess of 10% of the net profits in any year, and only after setting aside 10% annually of the profits to surplus fund, until such surplus fund has reached

[50] Art. 10, Civil Code of the Philippines.
[51] See *Guevara, S.*, "Should Educational Institutions be Non-stock Corporations? 35 Phil. L.J. 1127 (1960).

an amount equivalent to 25% of the total capital stock of the corporation. In this way, incorporated educational institutions may be obliged to use a substantial portion of its profits for the improvement of its educational facilities.

RELIGIOUS CORPORATIONS

A corporation sole organized by an alien bishop or minister or presiding elder of a religious denomination is said to be subject to the Constitutional limitation that: "All agricultural, timber, and mineral lands of the public domain, waters, minerals, and mineral lands, coal, petroleum, and other resources of the Philippines belong to the State, and their disposition, exploitation, development, or utilization shall be limited to citizens of the Philippines (or of the United States under the 'Parity Amendment'), or to *corporations or associations at least 60% of the capital of which is owned by such citizens*, subject to any existing right, grant, lease or concession at the time of the inauguration of the Government established under this Constitution." [52] Such corporations are also said to be subject to another Constitutional provision which provides that: "Save in cases of hereditary succession, no private agricultural land shall be transferred or assigned except to individuals, corporations, or associations qualified to acquire or hold lands of the public domain in the Philippines." [53] And, it has been held that "agricultural lands" include all lands other than mineral or timber lands, such as residential lots.[54]

And so, in the case of *Ung Siu Ti Temple*,[55] our Supreme Court held: "The fact that the appellant religious organization has no capital stock does not suffice to escape the Constitutional inhibition, since it is admitted that its members are of foreign nationality. The purpose of the 60% requirement is obviously to ensure that corporations or associations allowed to acquire agricultural land or to exploit natural resources shall be controlled by Filipinos; and the spirit of the Constitution demands that in the absence of capital stock, the *controlling membership* should be composed of *Filipino citizens*."

In the above case, a Chinese protestant religious society was not even allowed to own a piece of land whereon to erect its own chapel for religious worship, a prohibition which appellant alleges to be a denial of "freedom of worship," but to which allegation the same Supreme Court in the same case, replied: "As to the complaint that the disqualification under Article XIII is violative of the free-

[52] Art. XIII, Sec. 1, Constitution of the Philippines.
[53] Art. XIII, Sec. 6, *Id.*
[54] Krivenko v. Register of Deeds, 79 Phil. 461 (1947)
[55] Register of Deeds v. Ung Siu Si Temple, 51 O.G. 2468 (1955).

dom of religion guaranteed by Art. III of the Constitution, we are by no means convinced (nor has it been shown) that the land tenure is indispensable to the free exercise and enjoyment of religious profession or worship; or that one may not worship the Deity according to the dictates of his own conscience unless upon land held by fee simple."

And yet, in another case,[55] a corporation sole organized by a Canadian Catholic bishop was lawfully allowed by the Supreme Court to own a piece of land for religious purpose, holding: "In view of these peculiarities of the corporation sole, it would seem obvious that when the specific provision (Sec. 1, Art. XIII) of the Constitution invoked by respondent Commissioner was under consideration, the framers of the same did not have in mind or overlooked this particular form of corporation. If this were so, then the capable conclusion would be that this requirement of at least 60% Filipino capital was never intended to apply to corporations sole . . ."

As to why a Chinese protestant religious association, not organized as a 'corporation sole' should be denied the right to own a piece of land whereon to erect a temple for religious worship, and a Catholic bishop organized as a 'corporation sole' but which is just as religious as the Chinese protestant association, should be given the right to own a piece of land whereon to erect a church, does not sound well in the ears of men used to living under the "equal protection of the law."

It would seem just and fair that all religious corporations, whether organized as corporations sole or not, should be given the right to own a piece of land whereon to erect a church or a temple. If men can pray better inside a temple or church, than in the open air, why deny this "freedom of religious worship"? What damage is caused to the Filipino people and to Philippine society if a religious society, whether managed by an alien or a Filipino, is allowed to own a piece of land whereon to erect a church or a temple, to be used exclusively for religious worship?

To avoid any legal controversy as to the right of religious corporations to acquire or own real property in the Philippines, the Corporation Law may be clarified by expressly authorizing said corporations to own real estate which is "reasonably necessary" for the purpose of building a church, temple, or convent, solely for religious worship, regardless of the nationality of the incorporators

[55] Roman Catholic Apostolic Adm'r. of Davao v. The Land Registration Commission *et al.*, G.R. No. 8451, Dec. 20, 1957

or members. The 60% Filipino capital requirement of the Constitution applies only to "stock corporations" organized for business purposes, and not to religious corporations or charitable institutions.

FOREIGN CORPORATIONS

A foreign corporation before it may lawfully transact business in the Philippines must first obtain a license for the purpose from the Securities & Exchange Commission, and no such corporation "shall maintain by itself or assignee any suit for the recovery of any debt, claim, or demand whatever, unless it shall have the license prescribed." [57]

But the important question is: Are the contracts entered into by such unlicensed foreign corporation valid and enforceable in Philippine courts upon *subsequent compliance* with our law?

Some courts hold that said contracts, having been done in violation of the law are *void*, and subsequent compliance regarding the obtaining of a license from the Securities & Exchange Commission is immaterial, insofar as the validity of said contracts are concerned.[58] But other courts hold that such contracts are *valid*, unless the law requiring the obtaining of a previous license to transact business in the Philippines itself declares said contracts *void;* and therefore, subsequent compliance with the law by the foreign corporation entitles it to sue on such contracts.[59] And, if the act complained of by the unlicensed foreign corporation is a continuing act committed by a Philippine resident, like the violation of a trade-mark or unfair competition, the suit may be filed at any time upon subsequent compliance by the foreign corporation with the local statute.[60]

It is submitted that the better and more equitable rule should be: Foreign corporations transacting business in the Philippines in violation of the Corporation Law may not file suits on said transactions, unless the act complained of is a continuing act, like violation of a trade-mark or unfair competition, in which cases, suits thereon may be commenced upon subsequent registration of the foreign corporation.

BANKING CORPORATIONS

The special provisions of Republic Act No. 337, as amended, governing commercial, savings and mortgage banks, building and

[57] Secs. 68, 69, Corporation Law, Act No. 1459.
[58] Interstate Construction Co. v. Lakeview Canal Co., 224 P. 850 (1924); Tri-State Amusement Co. v. Forest Park Highlands Amusement Co., 190 Mo. 404, 90 SW 1020, 111 ASR 511 (1905); United Lead Co. v. J. W. Reedy Elevator Mfg. Co., 78 NE 567 (1906.
[59] Peter *et al.* v. Carper, 172 NE 319 (1930).
[60] See Mentholatum Co., Inc. v. Mangaliman *et al.*, 72 Phil. 524 (1941). But see R.A. No. 638.

loan associations, and trust companies, should be integrated and incorporated in the general incorporation law, as a part thereof.

RURAL BANKS

The special provisions of Republic Act No. 720, as amended, governing rural banks, should also be integrated and consolidated with the general incorporation law.

NON-AGRICULTURAL COOPERATIVES

The special law, Republic Act No. 2023, entitled "Non-Agricultural Cooperatives" should also be consolidated with the general incorporation law. A special chapter in the Corporation Law should be exclusively devoted to this kind of corporation and all its provisions shall apply to non-agricultural cooperatives, to the exclusion of the general provisions of the Corporation Law.

FOREIGN INVESTMENT LAW

A special chapter also in the general incorporation law should be devoted to foreign investors, desiring to invest their capital in the Philippines. Such foreign investors should be governed by a special law, to be called "Foreign Investment Law," but for better integration and coordination of all laws on business associations, this special law may reasonably be incorporated as part of the improved Corportion Law.

A foreign investment law should contain special provisions defining the areas or fields of business where foreign investors may be allowed, and the conditions and privileges which may be accorded to them. It should not be a "one-way traffic" law, but should really encourage foreign capital to come into the Philippines for the mutual benefit of the investor and the country where the investment is made.[61]

MERGER AND CONSOLIDATION

Our present Corporation Law contains no specific provisions governing merger and consolidation of corporations; and yet, our taxation laws speak of merger and consolidation of corporations as if such corporate combinations are regularly allowed by existing laws.[62]

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[61] See *Guevara*, S., "The Senate and the House Bills on Foreign Investments," 35 Phil. L.J. 612 (1960)

[62] See R.A. No. 1921. This tax law, in part, provides: "No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation (a) a corporation which is a party to a merger or consolidation, exchanges property solely for stock in a corporation which is a party to the merger or consolidation; (b) a shareholder exchanges stock in a corporation which is a party to the merger or consolidation solely for the stock of another corporation, also a

The fundamental rule is that private corporations may lawfully merge or consolidate only by authority of law. Any attempt to merge or consolidate without statutory authority is *ultra vires* and of no legal effect.[63] Merger and consolidation of railroads, however, is expressly recognized by Act No. 2772, as amended by Act No. 2789. But outside of railroad corporations, there is no express statutory authority for corporations in general to merge or consolidate, within the meaning of these terms as understood in American jurisprudence.

A *merger* is a union effected by the absorbing of one or more existing corporations by another which survives and continues the combined business. A *consolidation* is the union of two or more corporations which become as one.

In *merger*, the absorbed corporation or corporations is or are dissolved and the absorbing corporation continues to exist as a legal entity. In *consolidation*, the consolidated corporations give rise to a new legal entity. But in both cases, there is an automatic dissolution and a continuation of the old, or the creation of a new, corporation. Without specific legal grant, automatic dissolution and incorporation cannot lawfully take place. Our Corporation Law requires formal incorporation and issuance of a certificate of incorporation to acquire juridical personality,[64] and compliance with the Corporation Law in order to dissolve the same.[65] Consequently, except in the case of railroad corporations, merger and consolidation of corporations are not expressly authorized by the Corporation Law.

However, the same legal effects may be obtained by pursuing the following procedure, all based on the provisions of the Corporation Law:

In case of merger: Let Corporation A sell all its assets to Corporation B, pursuant to Sec. 28½ of the Corporation Law. The consideration must be stocks of Corporation B. Corporation A is subsequently voluntarily dissolved pursuant to Sec. 62 of the Corporation Law. The stock of Corporation B which had been given as consideration for the sale of Corporation A's assets are then distributed among all the stockholders of the dissolved corporation as liquidating dividends, in proportion to their respective interests in the corporation. By agreeing to accept such liquidating dividends,

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party to the merger or consolidation; or (c) a security holder of a corporation which is a party to the merger or consolidation exchanges his securities in such corporation solely for stock or securities in another corporation, a party to the merger or consolidation . . . The term "merger or consolidation," when used in this section, shall be understood to mean: (1) the ordinary merger or consolidation; or (2) the acquisition by one corporation of all or substantially all the property of another corporation solely for stock . . ."

[63] Clearwater v. Meredith, 1 Wall. 25, 17 L. Ed. 604 (1864).

[64] Secs. 6 and 11, Corporation Law, Act No. 1459.

[65] Sec. 62, Corporation Law, Act No. 1459.

the stockholders of Corporation A automatically become stockholders of Corporation B. A merger has been effected, with the same consequent results as generally understood under American law.

In the case of consolidation: Let Corporation X be first organized. Then let Corporations A and B sell all their assets to said Corporation X, in consideration of stocks of the latter. After the sale, let the two Corporations A and B be dissolved by the respective stockholders, pursuant to Sec. 62 of the Corporation Law. The stocks of Corporation X now owned by Corporations A and B shall then be distributed among the respective stockholders of A and B, in proportion to their respective holdings, as liquidating dividends. By this procedure, the stockholders of Corporations A and B become automatically stockholders of Corporation X. A consolidation of Corporations A and B has practically been effected, with the same consequent legal results arising out of a consolidation as generally understood.

In other words, although our Corporation Law is silent about merger and consolidation of corporations, yet there are ample provisions in said law, namely, Sections 6, 28½, and 62, which may be availed of, to effect or bring about such merger or consolidation. This procedure is probably what our Supreme Court had in mind, when it said in the case of *Reyes v. Blouse et al.*,[96] that the words "or otherwise dispose of" in Section 28½ of the Corporation Law (which provides that a corporation may "sell, exchange, lease, or *otherwise dispose of* all or substantially all of its property and assets, including its goodwill, upon such terms and conditions and for such considerations, which may be of money, stocks, . . .") is very broad enough and in a sense covers a merger or consolidation.

And the Supreme Court in the Blouse case continued: "As to how the merger or consolidation shall be carried out, our Corporation Law contains ample provisions to this effect (Sections 17½, 18, and 28½). This law does not require that there be an express legislative authority, or a unanimous consent of all stockholders, to effect a merger or consolidation."

The above observation of the Supreme Court is substantially correct, except that the provisions cited by it to sustain a merger or consolidation are not exactly the ones that should have been invoked, but rather Sections 28½ and 62 in the case of *merger*, and Sections 6, 28½, and 62 in the case of *consolidation;* and furthermore, the Supreme Court should have added that any stockholder who did not agree to the "merger" or "consolidation" should be

[96] G.R. No. L-4420, May 19, 1952.

deemed to be stockholders of a *dissolved* corporation in liquidation."[67] No one should be compelled to be a stockholder of another corporation against his will, in the absence of a special law providing for the legal effects of a merger or consolidation.

In view of the foregoing confusion in the legality and feasibility of merger and consolidation of corporations in this jurisdiction, other than railroad corporations, it is suggested that special provisions on this matter be specifically provided for in an improved Corporation Law.

CLOSED CORPORATIONS

May a "closed corporation" be organized under our Corporation Law?

A *closed corporation* may be defined as one where the incorporators pick their own associates as in a partnership, and agree among themselves not to transfer their stock without the consent of all. It is similar to a "one-man" corporation, or a "family corporation," which is common in the Philippines. The Elizaldes, the Puyats, the Teodoros, the Madrigals, and the Rufinos, carry their business interests as "family corporations." Although these corporations may have been incorporated under the Corporation Law, with transferable shares, yet corporate devices may have been previously devised to vest control in the family itself, either by prohibiting transfers of stock to strangers or depriving stocks offered for sale to the public of voting rights.

This kind of corporations are not really corporations in the strict sense of the law, but are merely partnerships in corporate forms. They may be called "incorporated partnerships," taking all the advantages of a partnership as regards management and control of the business but none of the disadvantages of a partnership regarding personal liability to creditors. Although the courts may "lift the corporate veil" in some cases, yet the separate identity of the corporation and the stockholders may not easily be disregarded.

Hence, to prevent possible injustice to creditors and the general public, it is suggested that special provisions governing "closed corporations" be provided for in our Corporation Law. In such case, it is also suggested that at least one of the controlling stockholders in a "closed corporation" be made personally liable as in a partnership.

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[67] See Adams *et al.* v. U.S. Distributing Corporation *et al.*, 184 Va. 144, 34 SE (2d) 244 (1945).

It is interesting to note that the meaning of a "closed corporation" is not the same in different jurisdictions. In Japan, there is the so-called "Yugen-Kaisha" (Y.K.), a closed corporation, composed of members not exceeding fifty, where the liability of the members is limited to the amount of their contribution, the shares are not transferable, and it cannot publicly invite subscriptions to its stock.[68] In Mexico, it is known as "Limited Responsibility Company," where shares are not negotiable, and the members are not personally liable. Another concept of a "closed corporation" is the one proposed for New York, where one man may incorporate and manage the corporation "with all the powers of an individual with respect to all lawful business permitted under the Stock Corporation Law." [69]

The need for special provisions governing "closed corporations" arises because of the attempts of many to put up a business among themselves as partners in corporate garb, thereby giving rise to court litigations. As one writer said: "In the economic sense in which the term is used in the United States, a 'closed corporation' is an enterprise in corporate form in which management and ownership are substantially identical. As a result of that identity, the participants consider themselves 'partners' and seek to conduct the corporate affairs to a greater or lesser extent in the manner of a partnership. Implementation or frustration of that desire has given rise to most of the litigated cases in the United States." [70]

Without special provisions governing this kind of corporation, may a "closed corporation" be effected and be treated as such under the present Corporation Law? If the idea of a "closed corporation" is to prohibit transfers of shares of stock issued by the corporation, it cannot lawfully be enforced, because shares of stock are "legally transferable," and it has been held by our Supreme Court that "the word 'non-transferable' appearing on certificates of stock is illegal on the ground that it constitutes an undue limitation on the right of ownership and is in restraint of trade." [71]

But there is no sound reason why incorporators, in organizing a business association, should not be given the freedom of choosing their own associates in business, whether it be a partnership or a corporation. Hence, our Corporation Law should contain special provisions which should give this right of choice; in which case, the special provisions on 'closed corporation' shall be primarily applicable. It is reiterated that in such case, at least one of the

[68] Arts. 165, 174, 456, *Japanese* Commercial Code.
[69] See *Winer*, N., "Proposing a New York 'Closed Corporation Law'," 28 Cornell Law Quarterly 313 (1943).
[70] *Israels, C. H.*, "The Closed Corporation and the Law," 33 Cornell Law Quarterly 488 (1948).
[71] Padgett v. Babcock & Templeton, Inc., 59 Phil. 232 (1933).

incorporators or stockholders, preferably the controlling stockholder, of the 'closed corporation' must be held personally liable as in a partnership.

A 'closed corporation' therefore may be deemed a business association midway between a partnership and a stock corporation. It possesses some of the characteristics of both. It partakes of the nature of a partnership in the sense that one of the stockholders is personally liable, but it possesses also the characteristic of a private corporation in that shares of stock are issued, although non-transferable. Such a proposed law on 'closed corporations' will be an incentive to many businessmen who would like to run the corporate affairs in their own way, but at the same time, such a law will be a protection to creditors who shall have a right of recourse against the individual property of one or some of the stockholders, thereby empowering the court, in such case, to "lift the corporate veil" at any time.

CONCLUSION

The foregoing is a brief comparative study of the Philippine Corporation Law and other laws on private corporations, with a view, as stated at the beginning, to improving our own. It is a critical survey of our law, by looking at it from the outside. Sometimes, we fail to see the defects of our law until we come to know what others have done on the same subject. Such a comparative study should lead us to a deeper understanding of our own law. If our law can stand the test of comparison, let our law remain as it is; otherwise, comparison may suggest amendments or reforms.