THE PROPOSED CORPORATION CODE: AN INITIAL SURVEY AND INQUIRY

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INTRODUCTION

The general law which governs all private corporations is Act No. 1459 as amended, otherwise known as the Corporation Law. This was passed by the Philippine Commission and took effect on April 1, 1908. Seventy-two years have passed since that date, but except for a sprinkling of amendments, Act No. 1459 has virtually remained unchanged.

As early as the middle 1950's, the Code Commission realized the inadequacy and obsolescence of the Corporation Law in the face of the growth of Philippine business. A proposal was then made in Congress to replace Act No. 1459 with an updated Corporation Code. Unfortunately, Congress failed to act on the matter and the Corporation Law has been left unchanged.

Shortly after the first session of the present Interim Batasan Pambansa, Cabinet Bill No. 3 entitled "The Corporation Code of the Philippines" passed first reading. The fact that it is one of the first major bills presented in the IBP underscores its urgency and importance. It is not far-fetched to say that this bill will be passed into law, as it can hardly be disputed that a new Corporation Code has been long overdue.

The topic of this paper is Cabinet Bill No. 3, the proposed Corporation Code of the Philippines. To facilitate the treatment of the 139 sections involved, the paper is divided into seven main headings, namely: Formation and Organization of Corporations; Financing the Corporation; Control and Management of the Corporation; Duties of Directors; Stockholders' Powers in Effecting Fundamental Changes; Stockholders' Rights of Pre-emption and Inspection; and Foreign Corporations.

As each heading is discussed, the provisions which contain important amendments and major additions are pointed out and compared with the current law. Whenever necessary, a discussion of their history and significance is made. As the title states, the paper is a survey and an initial inquiry. It is not an ambitious attempt to present an in-depth, detailed study of the proposed code. The purpose is to afford an overview of Cabinet Bill No. 3 and to point out in what manner and to what degree it changes Act 1459. For convenience, the paper refers to Act No. 1459 as the present law and to Cabinet Bill No. 3 as the proposed Code.

FORMATION AND ORGANIZATION

The Code introduces new provisions and substantial amendments to the present law on the formation and organization of corporations. These provisions and amendments deal in particular with the following: qualifications of incorporators, drafting and contents of the articles of incorporation, capital stock requirement, amount of subscribed and paid capital stock, payment of the balance of subscription, commencement of juridical personality, grounds for rejection of the articles of incorporation, corporation by estoppel, and by-laws of the corporation.

Stock and non-stock corporations are organized in almost the same manner under the code, just like under the present law, despite a whole new title[1] devoted to non-stock corporations.

Incorporators

Section 6 of the present law states that five or more persons, not exceeding fifteen, a majority of whom are residents of the Philippines, may form a private corporation. This is still true under Section 10 of the Code except that it qualifies the word persons as "natural" and that they must be "of legal age".

The addition of the word "natural" removes the ambiguity as to the meaning of the word "persons" in the present law. Thus, juridical persons cannot be incorporators.[2]

The present law is silent about the age qualification of incorporators. Although this silence has not resulted in any contentious issue, still the Code adds the phrase "of legal age" to complete the requirements, notwithstanding that it is a well-settled principle in this jurisdiction that minors below 21 years of age cannot enter into contracts.

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[1] Cabinet Bill No. 3, 1st IBP, 1st Sess. (1978), Title X. (Hereinafter cited as the PROPOSED CODE).

[2] Government v. El Hogar Filipino, 50 Phil. 339 at 461 (1927).

Incorporators, under Section 4 of the present law, are defined as "those members or stockholders mentioned in the articles of incorporation as originally forming and composing the corporation". To this definition, Section 5 of the Code adds the phrase "and who are signatories thereof". The addition is necessary because the present law creates the impression that all those who originally form and compose the corporation as mentioned in the articles of incorporation are all incorporators. This, however, is not legally precise, as those who did not sign the articles are not bound by them.

Drafting and Contents of the Articles of Incorporation

Section 14 of the Code introduces new provisions to Section 6 of the present law. The latter enumerates what must be included in the articles of incorporation.

The new provisions are:

First, the articles of incorporation must be written in English, Spanish, or Filipino;

Second, the specific purpose or purposes for which the corporation is incorporated may be classified into primary and secondary purpose, provided that a non-stock corporation may not include a purpose which would change or contradict its nature as such;

Third, in addition to their names and residences, the incorporators' nationalities must also be stated.

The Code, in Section 14, has also fixed the number of directors and trustees to not less than five nor more than fifteen, which number may not be increased or decreased during the existence of the corporation. Under the present law, the minimum number is also five but the maximum is eleven. This number, however, may be decreased or increased provided it does not go below five, or beyond fifteen in case of stock corporations, or eleven in case of non-stock corporations.

Capital Stock Requirement

The Code sets a minimum capital stock of ₱100,000.00 for stock corporations[3] to discourage fly-by-night corporations with insufficient capital, and to safeguard the investing public against said corporations. The present law has no such requirement. It merely requires that the amount of the corporation's capital stock be stated in the articles of incorporation.

[3] PROPOSED CODE, sec. 13.

Amount of Subscribed and Paid Capital Stock

Section 13 of the Code introduces several changes.

First, the amount of the authorized capital stock which must be substantial is increased from twenty per centum (20%) under the present law[4] to twenty-five (25%) per centum under the proposed Code.[5] The minimum paid-up capital stock remains at twenty-five (25%) per centum of the amount subscribed.

Second, the proposed Code corrects the imprecise language of Section 9 of the present law[6] as to the basis of the minimum subscribed capital. In Section 13 the basis is the "authorized capital stock" while in Section 9 the basis is "the entire number of authorized shares of capital stock". A literal interpretation of the latter phrase can lead to an absurd situation whereby a corporation can operate even without sufficient funds.

Assuming that the authorized capital stock of a corporation is ₱100,000.00 divided into 495 shares with a par value of ₱200 each and 1,000 shares with a par value of ₱1.00 each. Twenty per cent of 1,495 shares is 299 shares. This is the minimum number of shares required by law to be subscribed before incorporation. But only twenty five percent of the subscription need be paid in. Literally, therefore, this corporation can be formed with a cash capital of only ₱75.00, if all the 299 shares subscribed for are ₱1.00 each.

The Code eliminates the above possibility by changing the phrase "entire number of authorized shares of capital stock" into "authorized capital stock".

Third, the option of the stockholders to pay the subscribed capital stock is eliminated.

Fourth, the Securities and Exchange Commission (SEC) is no longer required to publish, after the filing of the articles of incorporation, the assets and liabilities of the same.

Fifth, the proposed Code provides that the balance of the subscription shall be payable on a date or dates fixed in the absence of a fixed day or dates, upon call by the Board of Directors. No such requirement exists under the present law.

Commencement of Juridical Personality

The Code designates the time when a corporation assumes juridical personality. In Section 19 it states:

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[4] Act No. 1459 (1906), sec. 9.
[5] PROPOSED CODE, sec. 13.
[6] *In re* Compostela Mining Company, Inc., SEC Order dated January 2, 1958.

> . . . a private corporation commences to have juridical personality from the date the Securities and Exchange Commission issues a certificate of incorporation under its official seal, and thereupon the incorporators and their associates and successors shall constitute a body politic and corporate under the name stated in the articles of incorporation . . .

The present law does not make such categorical designation. Section 11 merely states:

> The Securities and Exchange Commissioner, on the filing of articles of incorporation . . . shall issue to the incorporators a certificate, under the seal of his office, setting forth that such articles of incorporation have been duly filed in his office in accordance with law; and thereupon, the persons signing the articles of incorporation and their associates and successors shall constitute a body politic and corporate, under the name stated in the certificate . . .

Doubt has arisen, under this section, as to whether it is the filing of the articles of incorporation or the issuance of the certificate of incorporation which is the operative act which vests juridical personality.

The Supreme Court in *Hall v. Piccio*[7] resolved this doubt in favor of the issuance of the certificate of incorporation. The Court said that the personality of corporations begins to exist from the moment the certificate of incorporation is issued not before. The Court further stated that an entity cannot claim in good faith to be a *de facto* corporation unless the certificate of incorporation has been issued.

This doctrine laid down in *Hall v. Piccio* is now embodied in Section 19 of the Code.

Grounds for Rejection of the Articles of Incorporation

The Code, unlike the present law, enumerates some grounds[8] upon which the SEC may reject the articles of incorporation. They are: non-substantial compliance with the form prescribed; incomplete, deceptive or confusingly similar name; unspecified, illegal or immoral purposes; misrepresentation as to the amount of capital stock subscribed and paid; violation of the sixty percent Filipino capital requirement; and a provision in the articles of incorporation which violates the Constitution, the Code, other laws, rules or regulations in effect.

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[7] 86 Phil. 603 (1950).

[8] CAMPOS & LOPEZ-CAMPOS, NOTES AND SELECTED CASES ON CORPORATION LAW 629 (1969).

Corporation by Estoppel

Section 21 of the Code deals with corporations by estoppel. It states "all persons who assume to act as or calim to be a corporation, knowing it to be without authority to do so, shall be liable, jointly and severally, for all debts, liabilities, and damage incurred or arising as a result thereof". The present law does not cover corporations by estoppel.

By-Laws of the Corporation

Section 46 of the Code adds a new item, that is, by-laws may be adopted and filed prior to incorporation, and in all cases, by-laws shall be effective upon the issuance of a certificate of filing of the by-laws by the SEC. Under Section 22 of the present law, by-laws are filed after the SEC has issued a certificate of incorporation. The present law is silent as to when the by-laws become effective.

FINANCING OF THE CORPORATION

The capital needed to finance the business of a corporation is derived from three main sources: the contributions of its stockholders, loans or advances by creditors, and the profits which the corporation may earn. The first is often referred to as equity financing. This involves the matter of issuance of stocks. The second is referred to as debt financing, which involves the issuance of bonds or debentures and the consideration involved therein. The third is the determination of the profits which may be capitalized to form part of acorporations capital structure.

This chapter deals with the changes that may be brought about by the Proposed Corporation Code in the area of financing the business of a corporation. Despite the fact that the present Corporation Law deals extensively with the matter of financing the corporation, several questions have arisen regarding its interpretation and sufficiency. The Proposed Code, embodies or abandons several decisions of the Supreme Court with regard the matter of interpretation. At the same time, it has added several provisions in order to fill up existing gaps in the law.

In the field of equity financing, the Proposed Corporation Code makes substantial changes regarding the classification of shares, pre-incorporation and post-incorporation subscriptions, consideration for the issuance of stocks, partial payment of subscriptions and the effects of stock delinquency.

Classification of Shares

The Proposed Code preserves the right of a corporation to divide its shares of stock (in the case of stock corporations) into classes with such rights, privileges or restrictions as may be stated in the articles of incorporation.[9] However, it now permits the corporation to divide its shares of stock into certain specific classes, and lays down the limitations governing each classification.

In Section 7, founders' shares which are classified as such in the articles of incorporation, may be granted the exclusive right to vote and be voted for. When such right is granted, the period must be limited to five years. However, this may be renewed for another five years and in both cases, subject to the approval of the SEC. Furthermore, any other special rights and privileges granted to the owners of founders' shares must be lawful, reasonable and just, and in accordance with sound corporation practice.

Redeemable shares may be issued by the corporation when expressly so provided in the articles of incorporation. According to Section 8, such shares may be purchased or taken up by the corporation at any time or upon the expiration of a fixed period stated in the articles and in the certificate of stock representing such shares.

The proposed law in Section 9, recognizes the power of the corporation to reacquire stocks which have been issued and fully paid for, in the form of treasury shares. Under the present law, this power is expressly granted to the corporation only when the appraisal right is given to dissenting stockholders, (under Sections 17-1/2, 18 and 28-1/2) and in delinquency sales when there is no bidder for the stocks offered for sale (Section 44). Other than in these instances, a corporation's right to purchase its own shares is not expressly recognized but is merely not prohibited. It is for for this reason that in the case of *Steinberg v. Velasco*[10] the Supreme Court is denying the power of a corporation to purchase its own shares in contemplation of insolvency and dissolution, had to rely merely on the doctrine that the directors of a corporation must act in good faith in preserving the assets of the corporation for the benefit of its creditors. To forestall similar problems which may arise, Section 41 of the Proposed Code, expressly authorizes a corporation to purchase or reacquire its own shares subject only to the following limitations: first, the purchase must be for a legitimate corporation purpose and second, the corporation must have an unrestricted earned surplus in its books to cover the shares to be

[9] PROPOSED CODE, sec. 6.
[10] 52 Phil. 953 (1929).

reacquired. The Code further enumerates instances which may be considered as a legitimate corporate purpose. These are:

1. To eliminate fractional shares arising out of the declaration of stock dividends;

2. To collect or compromise an indebtedness to the corporation, arising out of unpaid subscription in a delinquency sale and to purchase delinquent shares sold during said sale;

3. To pay dissenting or withdrawing stockholders entitled to payment for their shares under the provisions of the Code;

4. To redeem or retire redeemable or preferred shares issued by the corporation at a price not to exceed the redemption or issued value thereof.

It must be noted that the law itself recognizes this enumeration as not exclusive.

Pre-Incorporation Subscription

Under Section 9 of the present law, a corporation cannot be formed unless at least 20% of the authorized shares have been paid. It is, therefore mandatory to have pre-incorpartion subscriptions. Despite this, there is no provision in the Corporation Law expressly governing this type of contracts. For this reason, the Supreme Court in the case of *Lusk v. Stevens,*[11] had to bridge this gap by saying that, such contracts constitute continuing offers to the corporation and may be revoked at any time prior to incorporation.

The Supreme Court's ruling in the *Stevens* case will be rendered nugatory by Section 61 of the proposed law. Section 61 lays down the rule that: a subscription for shares of stock of a corporation still to be formed shall be irrevocable for a period of at least six months from the date of subscription, unless all of the other subscribers consent to the revocation, or unless the incorporation of said corporation fails to materialize within said period or within a longer period as may be stipulated in the contract of subscription. The same section also provides that no pre-incorporation subscripof be entitled to any of the rights of a stockholder." The Code, howmitted to SEC.

Post-Incorporation Subscriptions

Under the present law, one can become a stockholder of a corporation after its incorporation either by subscription, or by purchase

[11] 64 Phil. 1053 (1937).

of shares from the corporation or from a stockholder thereof. The Supreme Court in several decisions[12] has made a distinction between subscription and purchase of shares from the corporation. Whether it is one or the other has been made to depend on the intention of the parties and the terms of their agreement. If the contract is intended to be one of purchase, the obligation of the parties are reciprocal and therefore, the corporation cannot sue for the purchase price unless it is ready and able to issue a certificate of stock. On the other hand, if the contract is intended to be one of subscription, the subscriber is liable to pay for the shares even if the corporation is not in the position to issue certificate of stocks, e.g., when the corporation is insolvent.[13]

The Proposed Corporation Code in Section 60, abandons the distinction made by stating that, " . . . any contract for the acquisition of unissued stock in any existing corporation or a corporation still to be formed shall be deemed a subscription within the meaning of this Title, notwithstanding the fact that the parties refer to it as a purchase or some other contract." Thus, the intention of the parties to the contract is rendered irrelevant and the only factor to be considered is whether the contract is one for the acquisition of unissued stock in a corporation.

Consideration for the Issuance of Shares

A corporation, by virtue of Section 16 of the Corporation Law, is allowed to issue stocks only in exchange for cash or property actually received by it or for profits earned by it but not distributed among its stockholders or members. The Proposed Code expands the forms of consideration for which shares of stock may be issued. Section 62 enumerates them as follows:

1. Actual cash paid to the corporation;

2. Property, tangible or intangible, actually transferred to or received by the corporation and necessary or convenient for its use and lawful purposes at a fair valuation equal to the par or issue value of the stock issued;

3. Labor or services actually rendered to the corporation;

4. Previously incurred indebtedness by the corporation;

5. Profits earned by the corporation but not distributed among its stockholders, which may be issued as stock dividends.

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[12] Baluyot v. Banco de las Islas Filipinas, 72 Phil. 17 (1941); Salmon. Dexter & Co. v. Timoteo Unson, 47 Phil. 649 (1925); Bayala v. Silang Traffic Co., Inc., 73 Phil. 557 (1942).

[13] CAMPOS & LOPEZ-CAMPOS, *op. cit., supra*, note 8 at 667.

Furthermore, when property is given as consideration for shares, problems have arisen with regard to the valuation of such property. In case of discrepancies arising between the value of the shares issued and the true value of the consideration given for it, the intent or motives of those evaluating the property have to be looked into in determining the existence of liability for the difference. The Proposed Code minimizes, if not eliminates the problem of having to determine the motives of those valuating the property in order to establish liability by providing in the same section that, " . . . where the consideration is other than actual cash or consists of intangible property, the valuation thereof shall initially be determined by the incorporators or the board of directors, subject to approval by the Securities and Exchange Commission." Under this concept, once the valuation is approved by the SEC, the motives of those evaluating the property become irrelevant.

Partial Payment of Subscriptions

Section 37 of the present law lays down the rule that, "no certificate of stock can be issued to a subscriber as fully paid up until the full par value of the stock, or the full subscription in case of no-par stock, has been paid by the subscriber to the corporation." Because of the manner in which this section has been worded, a problem has arisen as to whether partial payments of subscriptions for par shares should be applied pro rata to the entire subscribed stock or be considered applied to the number of shares which the partial payment may cover. The resolution of this problem is essential in determining whether the entirety or any part of the subscribed stocks shall be considered delinquent in case full payment of the subscription cannot be made.

The Supreme Court, in the case of *Fua Cun v. Summers*[14] held, that in the absence of any express or implied agreement to the contrary, partial payments on a subscription contract are deemed prorated among all the shares, and the stockholder is not entitled to a certificate of stock showing any of his shares to be fully paid up. In the later case of *Baltazar v. Lingayen Gulf Electric Power Co., Inc.*,[15] the Supreme Court recognized that an agreement between the stockholder and the corporation may be entered into in which certificates of shares for partially paid subscriptions may be issued as fully paid.

[14] 44 Phil. 705 (1923).
[15] G.R. No. L-16236, June 30, 1965, 14 SCRA 522 (1965).

The proposed Code abandons the ruling in the *Baltazar* case, and modifies the decision laid down in *Fua Cun* case. Section 64 makes it mandatory that, "no certificate of stock shall be issued to a subscriber until the full amount of his subscription has been paid." Therefore, under this section, partial payments are deemed pro-rated among all the shares following the doctrine in *Fua Cun* and prohibits any agreement whereby stock may be issued for partial payments.

Effect of Stock Delinquency

The Proposed Code adopts the same remedies available to the corporation for the enforcement of subscription contracts, i.e., the sale of delinquent stocks and by court action.[16] There is a difference however, as to the effects of stock delinquency. Section 71 of the proposed Code like Section 50 of the present law, provides that "No delinquent stock shall be voted for or be entitled to vote or to representation at any stockholders' meeting, nor shall the holder thereof be entitled to any of the rights of a stockholder." The Code, however, further provides in Section 43 that, ". . . any cash dividend due on delinquent stock shall first be applied to the unpaid balance on the subscription, plus costs and expenses, while stock dividends shall be withheld from the delinquent stockholder until his unpaid subscription is fully paid." As may be gleaned from the foregoing provisions, the Proposed Code does not deprive the holder of delinquent stocks of all his rights as a stockholder. The delinquent stockholder maintains his right to earn cash dividends. However, the payment is not made to the stockholder but is directly applied to his unpaid subscriptions. This modification would not only benefit the delinquent stockholder, but could save the corporation a lot of time and money in not having to undertake the whole procedure for the enforcement of delinquent stocks.

Debt Financing

The second source of capital from which the corporation finances its business is that derived from loans or advances by creditors. Debt financing is usually represented by the issuance of bonds and debentures from which the corporation raises a great portion of its capital requirements. Both the present law and the Proposed Code expressly grant a corporation the power to incur, create or increase any bonded indebtedness. However, unlike the present law, the Proposed Code[17] requires that at least two-thirds, and not a mere majority,

[16] PROPOSED CODE, secs. 67-71.
[17] Sec. 38.

of the outstanding capital stock should favor the incurring, creation or increasing of any bonded indebtedness. The increase in the vote requirement is for the protection of the corporation's stockholders, whose shares in the corporation may be held liable for the default in the payment of such indebtedness.

More important than the protection given to the stockholders of the corporation, is that afforded by the Proposed Code to the public who may purchase such bonds. Section 38 of the Proposed Code requires that all bonds issued by a corporation shall first be registered with the SEC which will be given the authority to determine the sufficiency of the terms of such bonds. Under the present law, the SEC does not have such power but only the duty to require that a duplicate certificate of the details of the bond issue be filed with said office. This additional requirement certainly affords more protection to the public, who may not be aware of the intricacies of the bond issue.

Dividend Financing

When the corporation has surplus profits, it may distribute such surplus or capitalize the same to form part of its capital stock. In the latter case, the surplus profit is retained by the corporation and serves as added capital to finance the corporation's business.

Both the present law and the Proposed Code expressly grant a corporation the power to declare dividends. However, under the present law, such power is subject to two limitations: no dividend can be declared except from the surplus profits arising from its business, and no distribution can be made of capital stock or property other than actual profits.[18] The main reason behind these limitations is the protection of creditors who can look only to the corporate assets for payment of their claims, as they are precluded from holding the stockholders personally liable therefor.[19]

Under Section 43 of the Proposed Code, only one limitation is provided for, *i.e.*, that dividends be declared only out of unrestricted earned surplus. The Proposed Code removes the second limitation now embodied in the Corporation Law, and unless the drafters of the Proposed Code intend to embody both limitations in the term "unrestricted earned surplus", this omission must be construed as an inadvertence on their part. For without the second limitation, creditors of the corporation can be defrauded by a distribution of the capital stock or property of the corporation other than its actual

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18 Sec. 16.

19 CAMPOS & LOPEZ-CAMPOS, *op. cit.*, *supra*, note 8 at 807.

profits. It is doubtful whether both limitations can be embodied in the term "unrestricted earned surplus" since under the present law, the term "surplus profits" already qualifies the power of the corporation to declare dividends. Furthermore, the term "unrestricted earned surplus" may be interpreted as a more precise term for the phrase "surplus profits." This inadvertence by the drafters of the Proposed Code may become a source of confusion unless corrected before the Proposed Code is passed.

CONTROL AND MANAGEMENT OF THE CORPORATION

Quorum for Board Meeting

Under the Proposed Code, the required quorum will be "a majority of the directors" "unless otherwise provided in the articles of incorporation." This will amend the present law, which sets the quorum at "a majority of the directors" without giving the corporation any power to provide otherwise.[20] The Proposed Code gives the corporation the unlimited power to provide in its articles for any number lesser or greater than the majority of the board members of directors whose presence will be sufficient to hold a board meeting. So that, given a corporation with eleven directors, the necessary quorum needed to transact business is achieved with the presence of six directors. In this case, a vote of four will be enough to approve any board resolution.

However, under the Proposed Code, the same corporation can provide in its articles that the required quorum for its eleven member board be set at, say, only three directors. A vote of only two directors will then be enough to pass a resolution. On the other hand, it may provide for a number greater than a simple majority. The corporation may even require a 100 per cent attendance of the Board if it desires.

The Proposed Code carries an express prohibition disallowing the board members from acting or voting by proxy. Although there is no such provision in the present law, it is a recognized rule because the directors are presumed to have been elected because of their personal qualifications.

Election of Officers

The system of election of board members and officers by the stockholders under the Proposed Code is identical to the present law except for an additional limitation imposed on adjournments

[20] PROPOSED CODE, sec. 26.

upon the stockholder's failure to hold an election. Although the meeting may still be adjourned "day to day or from time to time," it cannot be adjourned "sine die or indefinitely."[21]

Disqualification of Directors

The Proposed Code prevents anyone convicted by final judgment of an offense involving moral turpitude from qualifying as a director, of any corporation, by express provision.[22] There is no such provision in the present law.

Report of Elections and Vacancies

The Proposed Code requires the secretary or any other officer of the corporation to submit to the SEC the names, nationalities and addresses of the board members and officers elected. This must be done within 30 days after the meeting in which they were elected. Aside from this additional requirement the secretary or any responsible officer or the director himself should immediately report to the SEC any death, resignation, or any other cessation of holding office of the directors or trustees.[23] In these cases, where the vacancy has been occasioned by causes other than expiration of director's term or the removal by stockholders, the position may be filled by a majority vote of the remaining directors if they still constitute a quorum. Otherwise, the vacancies must be filled by the stockholders in a regular or special meeting called for the purpose. The person elected will serve only his predecessor's unexpired term.[24]

However, if the cause of the vacancy is an increase in the number of the Board members, this will be filled only by an election at an annual or at a special meeting of stockholders duly called for the purpose or in the same meeting authorizing the increase, if so stated in the notice for that meeting.[25]

Regular & Special Board Meetings

Under the present law, the time, place and manner of calling regular and special board meetings should be provided for by the corporation in its by-laws.[26] Under the Proposed Code, however, unless the by-laws provide otherwise, regular meetings are to be held monthly, special meetings at any time upon the call of the

21 *Ibid.*, sec. 27.
22 *Ibid.*, sec. 28.
23 *Ibid.*, sec. 27.
24 *Ibid.*, sec. 30.
25 *Ibid.*
26 Act No. 1459 (1906), sec. 21.

President. Either may be held anywhere in or out of the Philippines. The notice containing the date, time, and place of such meetings must be sent to each board member at least one day prior to the scheduled meeting. This last requirement of notice may be waived expressly or impliedly by the director or trustee concerned.

DUTIES OF BOARD MEMBERS

Duty to be Diligent

Under the present law, there is no express provision covering the duty of diligence expected of Board members. But in several cases, the Supreme Court has laid down the rule that they may be held liable for damages caused by the lack of diligence in the performance of their duties. This liability is based on their acceptance of office which presumes a competent knowledge and performance of the duties concerned. However, there has been controversy as to the diligence required. In the 1929 case of *Steinberg v. Veloso,*[27] the Supreme Court quoted jurisprudence to the effect that liability will arise from mere "want of ordinary prudence." However, in the 1962 case of *Montelibano v. Bacolod-Murcia Milling Co.,*[28] it was ruled that the Board of Directors is free from liability for their business judgments "so long as it acts in good faith." The Supreme Court reiterated this portion of the Montelibano decision in *Board of Liquidators v. Kalaw*[29] which was decided in 1967, adding that the lack of bad faith clinched the case for the defendants.

The Proposed Code resolves this ambiguity by enumerating the occasions when a director may be held liable. A board member will be liable only if (1) he wilfully and knowingly votes for or assents to patently unlawful acts of the corporation, (2) if he is guilty of gross negligence or bad faith in directing the affairs of the corporation or, (3) if he acquires any personal or pecuniary interest in conflict with his duty as a director.[30]

In these instances, the erring board member will be held jointly and severally liable for all the damages which may be suffered by the corporation, its stockholders or other persons.[31]

In addition to these cases, a director who attempts "to acquire interests adverse to the corporation in respect to any matter involved in the confidence of which equity imposes a disability upon

[27] *Supra*, note 10.
[28] 95 Phil. 407 (1954).
[29] G.R. No. L-18805, August 14, 1967, 20 SCRA 987 (1967).
[30] PROPOSED CODE, sec. 52.
[31] *Ibid.*, sec. 32.

him to deal in his own behalf,[32] will be held accountable for the profits which otherwise would have accrued to the corporation.[33]

Duty of Loyalty

With regard to self-dealing directors, the Proposed Code embodies a provision which renders contracts between the corporation and one or more of its board members voidable unless three conditions are all met:

1) That the presence of such director or trustee in the board meeting in which the contract was approved was not necessary to constitute a quorum of such Board;

2) That the vote of such director or trustee was not necessary for the approval of the contract; and

3) That the contract is fair and reasonable under the circumstances.[34]

This provision introduces a rule which, although recognized by commentators[35] is heretofore not present in this jurisdiction either by provision of law or jurisprudence. The only case[36] decided by the Supreme Court involving an action to nullify a contract between a corporation and one of its directors did not resolve the validity or voidability of the contract on the presence of the above-mentioned grounds. The court merely decided whether the sale of the corporate property to a director made by three directors who, at the same time, constituted a majority of the stockholders, was valid. The court, in upholding the contract's validity, held that "if the majority of the stockholders have a clear and better right to sell the corporate property than a majority of the directors, then it can be said that a majority of the stockholders made this sale or transfer to the defendant (director)". This aspect of the *Steinberg* case was not completely lost as the drafters of the Proposed Code provided for the stockholder's right to ratify such contracts. If any of the first two requisites is absent, the contract may still be ratified by a two-thirds vote of the stockholders representing at least two-thirds of the outstanding capital stock in a meeting called for the purpose, provided that full disclosure of the adverse interest of the Board members involved is made at such a meeting and that the contract is fair and reasonable under the circumstances.[37] (Sec. 33, par. 2).

[32] *Ibid.*
[33] *Ibid.*
[34] *Ibid.*
[35] CAMPOS & LOPEZ-CAMPOS, *op. cit., supra,* note 8 at 513.
[36] Steinberg v. Velasco, *op. cit., supra* note 10.
[37] Sec. 33, par. 2.

A possible case which may arise for future adjudication is the following:

X corporation enters into a contract approved by the directors who are also the holders of two-thirds of the outstanding stock. One of the first two conditions required by Section 33 is missing but the contract is fair and reasonable under the circumstances and a full disclosure of the adverse interests of the Board members involved has been made during the board meeting. Is the contract valid or is it still voidable? The contract will still be voidable. Aside from not following the required lawful procedure outlined by law, it could be dangerous to allow such a short cut procedure as the stockholders' meeting will facilitate the airing of previously unconsidered opinions by stockholders who were not present at the board meeting. There may be new reasons for the rejection of the contract which the stockholders may consider and which the Board may have failed to take into account. These may persuade some of the Board members who initially voted for the contract to change their minds. The ruling may be different in a case where the Board of Directors represent the full stock ownership.

However, Section 33 of the Proposed Code still fails to rule on an important issue. It does not determine if the director who contracted with the corporation be allowed to vote his shares during the election for the ratification of the contract. Although this issue has never been resolved by the local courts, it has given rise to conflicting decisions in American courts. The prevailing view is that the shares of the self-dealing director can be counted.[38]

The present law does not have a provision which deals with contracts executed between corporations which have interlocking directors. The Proposed Code expressly allows these types of contracts, as long as they are fair and reasonable under the circumstances and there is no fraud.[39] However, if the interests of the interlocking director(s) in one corporation is substantial and in the other merely nominal (stockholders exceeding 20% of the outstanding capital stock is considered substantial), the rules on self-dealing directors will apply insofar as the latter corporation is concerned.[40] Again, the question will come up as to whether the shares of the interlocking directors may be counted in case an election for the ratification of the contract is held among the stockholders.

[38] Northwest Transportation Co. v. Beatty, L.R. 12 A.C. 589 (1887).
[39] PROPOSED CODE, sec. 34.
[40] *Ibid.*

The Corporate Opportunity Theory

Under the corporate opportunity theory, a director who acquires for himself by virtue of his office a business opportunity which should belong to the corporation, and who, to the prejudice of the corporation obtains profits therefrom should be made liable. Under the present law, no provision or jurisprudence covers this particular case. However, the Proposed Code[41] will hold the director, even if he risked his own funds, liable to the corporation for all of the profits from the transaction unless stockholders representing at least two-thirds of the outstanding capital stock ratify his act. However, the Code fails to specify whether the concerned director's votes may be counted for the ratification of his own act.

Compensation of Directors

Under the present law the corporation is authorized to enact by-laws providing for the compensation of directors.[42] But it does not specify how the compensation of directors will be fixed in case there is no such provision in the by-laws or even, if they are supposed to receive any compensation at all. The Proposed Code clears up these questions and puts an end to cases like *Lingayen Gulf Electric Power Company, Inc. v. Baltazar*[43] where, because of the present gap in the law, the Supreme Court was constrained to decide questions of this kind by examining the particular corporation's history and accepted manner of operation.

The Proposed Code provides:

> In the absence of any provision fixing their compensation in the by-laws, the directors shall not receive any compensation as such. Any compensation, other than per diems, may be granted to such directors by the vote of the stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholders' meeting.[44]

Unfortunately, although this section clears up the matter of whether directors receive any compensation in the absence of a by-law providing for the same, it raises new questions. First, who is to decide whether or not per diems are to be paid and if so, in what amount? Shall this be left to the people who by normal corporate practice set the amount of per diems? If so, of what use will the safeguard of requiring a by-law provision or stockholders' action providing for directors' compensation as it is also accepted cor-

41 *Ibid.*, sec. 35.
42 Act 1459 (1906), sec. 21.
43 93 Phil. 404 (1953).
44 Sec. 31.

porate practice to set the per diems at amounts which negate any real distinction between per diems and "compensation as such" with regard to monetary levels? If accepted corporate practice were not meant to be followed, then how are per diems to be provided for? Second, in case no by-law provides for directors' compensation, and the stockholders grant it by virtue of the abovementioned section's second sentence, the required majority to sustain their action is only a simple majority of the votes cast in a regular or special meeting. However, under Section 48 of the same Code, any amendment, repeal or adoption of new by-laws, a *two-thirds* majority of the outstanding capital stock should vote favorably in a regular or special meeting *duly called for the purpose.* The stockholder's grant of compensation where the by-laws previously provided for none is in effect an amendment of the by-laws or an adoption of a new by-law. But there are two glaring discrepancies. Section 31 asks only for a simple majority and allows a vote taken at any special meeting in addition to the regular meetings. Section 48 on the other hand, requires a two-thirds majority and allows the taking of a vote in a special meeting only if it has been duly called for the purpose. Why the different requirements for two substantially similar acts of changing the by-laws?

STOCKHOLDERS' POWERS IN EFFECTING FUNDAMENTAL CHANGES

This chapter deals with instances in corporate activities when action by the stockholders is necessary. When "fundamental changes" are to be effected in a corporation, the Board of Directors alone cannot exercise its sole discretion. It has to obtain the approval of the stockholders. The discussion of this chapter is divided into three parts. The first part is on the particular corporate acts which require stockholder action. The second deals with the manner by which the stockholders will exercise their rights, namely through votes at meetings. And the last will involve the appraisal right of stockholders, as this option is granted to dissenting stockholders in certain corporate actions.

INSTANCES WHEN STOCKHOLDER ACTION IS NECESSARY

Amendment of Articles of Incorporation

Under the Proposed Code, amendment of articles of incorporation is listed as one of the powers of a corporation.[45] The formalities by which amendments of articles may be carried out are found in Section 16, Title II — "Incorporation and Organization of Private Corporations." Section 16 states that any amendments may be made,

[45] PROPOSED CODE, sec. 36.

provided it is not contrary to the Code and special laws and that it is for a legitimate purpose. The procedure in the Proposed Code for amendment of articles of incorporation is basically the same as in the present law. But there are a number of differences. The present law requires the approval of two-thirds of the owners of the subscribed capital stock (or two-thirds of the members if a non-stock corporation) whereas the proposed Corporation Code states that the consent of two-thirds of the owners of the outstanding capital stock[46] (or two-thirds of the members if a non-stock corporation) is necessary. The second alteration is on the date of effectivity of the amended articles. Section 18 of the present law marks the time of effectivity of the amendments to the articles as commencing from the filing of a copy of these articles with the SEC. Section 16 changes this, as amendments under the proposed Code shall take effect upon its approval by the SEC.

Section 18 discusses four instances when the appraisal right may be exercised by dissenting stockholders, including the details concerning such right. The Proposed Code does away with this discussion and simply states ". . . without prejudice to the appraisal right of non-assenting stockholders in accordance with the proviisons of this Code."[47]

A minor addition in the Proposed Code is the formality that the amended portions of the articles of incorporation should be indicated by underscoring the change or changes made. The copy should then be duly certified under oath by the corporate secretary and a majority of the directors, stating that said amendments have been duly approved by the required vote of the stockholders or members.[48]

In connection with amendments to the articles of incopration, a new provision, Section 37, which expressly provides for the power to extend or shorten the corporate term by changing it in the articles, is added. The requirements are as follows — approval by the majority of directors, with the ratification by two-thirds of the holders of the outstanding capital stock (or two-thirds of the members if non-stock) and that the extension or shortening of the corporate term should be done prior to the expiration of the original term stated in the articles.

Adoption, Amendment, Repeal of By-Laws

The present and the proposed Codes are basically the same as far as this particular corporate action is concerned. The power to

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[46] Sec. 9 defines outstanding capital stock as "shares of stocks issued to subscribers or stockholders whether or not fully or partially paid, as long as there is a binding subscription agreement except treasury shares."

[47] Sec. 16, first par.

[48] PROPOSED CODE, sec 16, 1st par.

adopt, amend or repeal the by-laws is vested in the stockholders, although it may be delegated by them to the Board of Directors. This delegation may be revoked, though, if a majority of the stockholders so vote. The difference lies in the fact that in the current law a majority of the owners of the subscribed capital stock (or a majority of the members if non-stock) may adopt, amend or repeal the by-laws and the owners of two-thirds of the subscribed capital stock (or two-thirds of members if non-stock) may delegate this power to the Board of Directors. In the Proposed Code, the power is exercised with the consent of the owners of the majority of the outstanding capital stock (majority of members if non-stock) and the delegation to the Board needs approval of two-thirds of the owners of outstanding capital stocks (or two-thirds of members if non-stock).

An addition is made by Section 48 which provides for the effectivity of the amended or new by-laws as starting from the issuance of the certificate of filing thereof by the SEC. The present law is silent as to the date of effectivity of amended or new by-laws.

Increase or Decrease of Capital and Incurring of Bonded Indebtedness

Sections 17 and 18 of the present law embody the requisites for the increase, decrease of capital stock and incurring, creating or increasing, (by the corporation) of its bonded indebtedness. Their counterpart is Section 38 of the Proposed Code. There are a number of amendments in this area which provide for additional requirements for the exercise of the corporate acts concerned, although the general procedure, as outlined in Sections 17 and 18 is preserved in Section 38. The changes are the following: (1) the stockholder approval required by the present law for the increase or decrease of capital stock is two-thirds of the entire capital stock subscribed and for acts relating to bonded indebtedness, a majority of the stockholders must approve; the proposed Code provides that the capital stock may be increased or decreased only with the assent of two-thirds of the entire capital stock outstanding, and for the corporation to create, incur or increase its bonded indebtedness, owners of two-thirds of the outstanding capital stock must approve.

There is also a change as to the percentages in case of increase of capital stock. The proposed Code requires that twenty five percent of the increase must be subscribed and twenty five percent of this amount subscribed must be paid. The current law requires twenty percent subscription of the increase and twenty five percent of this subscription paid up.

Three new requisites are added aside from the changes abovementioned. First, that any increase or decrease of capital stock and any incurring, creating or increasing by the corporation of its bonded indebtedness must be with the prior approval of the SEC. Second, that no decrease of capital stock should be valid if it shall prejudice the rights of corporate creditors. Third, bonds issued by the corporation have to be registered with the SEC. All of them are not found in the present law.

Sale of Assets

Section 40 of the proposed Code makes certain amendments to Section 28 of the present law insofar as the sale or disposition of assets of the corporation are concerned. Section 40 adds the words 'mortgage' and 'pledge' among the acts which the corporation may make with its assets. The present law requires the approval of two-thirds of the voting stock (or two-thirds of the members if non-stock) while the proposed Code provides for consent of two-thirds of the owners of the outstanding capital stock to affect an act substantially affecting the corporate assets. A new paragraph in Section 40 defines "substantially all the corporate assets" as a sale or disposition which would render the corporation incapable of continuing the business or accomplishing the purpose for which it was incorporated. There is also a new express grant of power to the Board of Directors, in its discretion, to abandon such sale or disposition of assets even after it has been ratified by the stockholders, without seeking further stockholder action on the matter. The last paragraph of Section 40 adds a qualification not expressed in Section 28, i.e., that nothing in the section is intended to restrict the power of a corporation, without stockholder authority, to deal with its assets if it is necessary in the usual and regular course of business.

Merger and Consolidation

The Corporation Law does not contain any express provisions on merger and consolidation of corporations. The only provisions which mention merger or consolidation are those that refer to railway corporations and to public service corporations, and even in these cases, no procedures are outlined. The only way that corporations can merge or consolidate under the present law is through Sections 28-1/2, 17-1/2 and 18, following the procedure in the case of *Reyes v. Blouse.*[49]

[49] *Ibid.*, 3rd par.

The Proposed Code however expressly grants corporations the power to merge and consolidate. An entire, new title[50] is devoted to the subject, covering five (5) sections. Briefly, this is the procedure to be followed should a corporation wish to merge or consolidate with another or other corporations. First, the Board of Directors of each corporation, party to the merger or consolidation (called constituent corporations) formulates and approves a plan of merger or consolidation, such plan setting forth certain required information.[61] The plan is then submitted to a vote by the stockholders of the constituent corporations at separate meetings. The vote of at least two-thirds of the outstanding capital stock (or two-thirds of the members if non-stock) of each constituent corporation is necessary for the approval of the plan. Such plan may be amended by the Boards of Directors concerned but they have to be ratified by the same vote requirement. Once the plan has been approved, articles of merger or consolidation are executed by each of the constituent corporations stating the plan of merger or consolidation, the number of shares outstanding (or members if non-stock) of each constituent corporation, and the number of votes for and against the plan. The articles are thereafter submitted to the SEC for approval and if it is satisfied, it issues a certificate of merger or consolidation. If upon investigation, the SEC has reasons to believe that the proposed merger or consolidation is contrary to existing laws, it sets a date for hearing to give the constituent corporations the chance to be heard.

Section 80 of the proposed Code provides expressly for the effects of a valid merger or consolidation and they are the following: (1) The constituent corporations become one single corporation, which shall be the corporation designated in the plan of merger or consolidation; (2) the separate existence of the corporations that merged or consolidated cases, except that of the surviving or consolidated corporation which shall possess all the rights, privileges, immunities and powers, and shall be subject to all the duties and liabilities of a corporation organized under this Code; (3) the surviving or consolidated corporation shall possess all the rights, privileges, immunities and franchises of each constituent corporation and all properties, real or personal and all debts, including subscriptions to shares and other choses in action and all other interests of or belonging to or due to each constituent corporation shall be taken and transferred to and vested in such surviving or consolidated corporation, without further act or deed; (4) the surviving or consolidated corporation shall be liable for all the obligations of each

[50] 91 Phil. 305 (1952).
[61] PROPOSED CODE, Title IX.

constituent corporation, as if such surviving or consolidated corporation had itself incurred such obligations. Any action pending, by or against any of the constituent corporations may be prosecuted by or against the surviving or consolidated corporation. No rights of credits nor any lien shall be impaired by such merger or consolidation.

Dissolution

The causes for dissolution under the present state of the law are found in statutes aside from the Corporation Law. Dissolution may be effected by (1) expiration of the term specified in the articles of incorporation, (2) by legislative enactment[52], (3) by *quo warranto* proceedings instituted by the Solicitor General,[53] (4) by revocation by the SEC of the corporate charter, under PD 902-A, (5) by voluntary surrender of its charter, either extrajudicially[54] or with court approval,[55] (6) by failure to organize and commence business within two years from its incorporation.[56]

Under the Proposed Code, dissolution is discussed under Title XII — (Dissolution) which classifies such act into voluntary[57] or involuntary[58] dissolutions. Section 109 deals with voluntary dissolution where no creditors are affected. In this case, dissolution may be brought about by a resolution adopted by the affirmative vote of at least two-thirds of the outstanding capital stock (or two-thirds of members if non-stock) at a meeting called by the Board of Directors after due publication and notice. A copy of this resolution is then certified by the Board and countersigned by the corporate secretary. After this, the SEC issues a certificate of dissolution. Under the present law, no certificate of dissolution is issued, as the SEC merely records the fact of such dissolution.

In cases of voluntary dissolution where creditors are affected, Section 110, which amends Rule 104, applies. A petition for dissolution is filed with the SEC, such petition setting forth all claims and demands against the corporation and stating that its dissolution was resolved by a vote of at least two-thirds of the outstanding capital stock (or two-thirds of members if non-stock), the SEC then issues an order, fixing the time within which objections to the petition may be filed (of course, with proper notice and publication of the order). The SEC then hears the petition on the fixed date and tries

[52] *Ibid.*, sec. 76.
[53] *Ibid.*
[54] RULES OF COURT, Rule 66, sec. 2.
[55] PROPOSED CODE, sec. 62.
[56] RULES OF COURT, Rule 104.
[57] PROPOSED CODE, sec. 19.
[58] Secs. 109-111.

the issues raised by the objections filed. If no objection is sufficient, the Commission renders judgment dissolving the corporation and directs the disposition of its assets. The SEC may appoint a receiver for this purpose.

Section 111 expressly provides for dissolution by shortening the corporate term. In the present law, this mode of dissolution is merely implied. The articles of incorporation are amended (particularly the term of the corporate existence) and a copy of such amended articles is submitted to the SEC. Upon its approval by the Commission, the corporation is deemed dissolved without any further proceedings, subject to the provisions on liquidation.

Involuntary dissolution is discussed in the proposed Code in Section 112. In this case the SEC may dissolve a corporation upon the filing of a verified complaint and after proper notice and hearing. The grounds of the complaint may be violation of existing laws, rules and regulations or if its continuous existence is against public policy or inimical to public interest.

Other modes of dissolution are provided in the proposed Code which are not mentioned under Title XII (Dissolution). Section 20 provides for the dissolution of *de facto* corporations by a *quo warranto* proceeding filed by the Solicitor General with the SEC. Section 23 provides for corporate dissolution by "non-user". If a corporation does not formally organize and commence transaction of its business or the construction of its works within 2 years from the date of its incorporation, its corporate powers cease and the corporation is deemed dissolved. However, Section 23 goes on to add that if a corporation has commenced the transaction of its business, but subsequently ceases to operate for a period of five years the same shall be a ground for suspension or revocation of its certificate of registration. This latter rule although absent in the Corporation Law is mentioned in Section 12, Rule 66, of the Rules of Court.

The procedure for liquidation of dissolved corporations is unchanged by the proposed Code except for the addition of the last two paragraphs of Section 113 which provides that " . . . upon winding up of the corporate affairs, any assets distributable to any creditor or stockholder who is unknown or cannot be found, shall be escheated to the city or municipality where such are located."

Except as otherwise allowed by this Code, no corporation shall distribute its assets or property except upon lawful dissolution and after payment of all its debts and liabilities.

Investment of corporate funds in another corporation, business or any other purpose, not its main purpose.

This corporate power is present in both the present law and the Proposed Code, Section 17-1/2 in the former and Section 42 in the latter. There are only minor amendments and these are with regards the stockholder votes needed for investment of corporate funds in another corporation, business or purpose. In the present law, the approval required is that of two-thirds of the stocks entitled to vote, whereas in the proposed Code, there should be consent of two-thirds of the owners of the outstanding capital stock (or two-thirds of the members if non-stock) in both cases. Section 42 adds a proviso which is absent in Section 17-1/2, "That where the investment is reasonably necessary to accomplish its purpose or purposes as stated in the articles of incorporation, the approval of the stockholders or members shall not be necessary."

Power to Declare Dividends

Section 43 of the proposed Code provides that no stock dividend shall be issued without approval of stockholders representing not less than two-thirds of all stocks then outstanding and entitled to vote. This does not change Section 16 of the current law as the vote required here is similarly two-thirds of the outstanding stock entitled to vote. However, Section 16 provides "No stock or bond dividend shall be issued . . ." The Proposed Code omits the word "bond" and so, it may be inferred that no stockholder approval is required for declaration of bond dividends.

New Powers

The Proposed Code provides for two new powers of the corporation which require stockholder approval. The first is Section 36, number 9 which gives the corporation the power to make donations, irrespective of corporate benefit, for the public welfare or for hospital, charitable, recreational, scientific, civil or similar purposes. This power is qualified, however. If a non-charitable corporation makes a donation, which amounts to more than the equivalent of 10% of its outstanding capital stock, consent of the stockholders representing at least two-thirds of the outstanding capital stock is necessary. But this corporate power to donate cannot be exercised in favor of a political party, activity or candidate.

Section 44 allows corporations to enter into service or management contracts. However, this needs the ratification of stockholders owning at least a majority of the outstanding capital stock (or majority of members if non-stock).

Meetings and Voting Rights

Whenever stockholder approval is required, such must be expressed by them in a stockholder meeting by votes. In the present law, this is the rule for all fundamental changes except for the amendment of the articles of incorporation as Section 18 allows a "written assent" by the stockholders without a meeting. The proposed Code follows the above rule and exception. There are however, amendments and additions as far as meetings are concerned. The subject, under the proposed Code is under one title[59] which includes Sections 49-59.

Section 49, a new provision, classifies the kinds of meetings into those of directors, stockholders or members and into regular or special. Section 50 amends Sections 21, 24 and 26 of the present law in the following ways. First, Section 50 requires written notice to all stockholders two weeks before a regular meeting and one week prior to a special one. The present law requires notice only for special meetings. Section 50 also adds a "waiver clause", in paragraph 3: "Notice of any meeting may be waived expressly or impliedly by any stockholder or member.".

Under the present law, the Courts of First Instance are empowered to grant authority to a petitioning stockholder or member to call a meeting if there is no one to call it, as provided in Section 26. The present law vests this power on the SEC, instead of on the courts.

As to the place of meeting, the rules are basically unchanged. It is to be held in the city or municipality where the principal office of the corporation is located, and if practicable in the principal office of the corporation. The proposed Code however adds a new proviso considering Metro Manila, as far as this section is concerned, a single city or municipality. A new option is also granted as to where a meeting is to be held. A majority of the owners of the outstanding capital stock (or majority of members if non-stock) may change the place of meeting to a city or municipality within the Philippines other than the place where the principal office is located. Section 94 of the proposed Code grants non-stock corporations the choice of their meetings at any place, even outside the principal place of business, provided there is proper notice.

As to the time of the meeting, the proposed Code provides that regular meetings should be held annually on a date fixed in the by-laws, or if not so fixed, on any date in April as determined by the Board of Directors.

59 Sec. 112.

Under the Title of Meetings, Sections 55-59 discuss voting rights. All these sections are new except for paragraph 2 of Section 55 and Section 59 (which amend Sections 27 and 36 respectively). Section 55 provides that in case of pledged or mortgaged shares, the pledgor or mortgagor retains the right to attend and vote at the meetings unless the pledgee or mortgagee has been expressly given the right. Section 27 of the present law provides for the right to vote, by persons in a position of trust, as stockholders upon stock they hold in their representative capacity. This is qualified by Section 55, second paragraph, as it expressly requires that these persons have to be duly appointed by the courts or the SEC. If they have been granted such authority, they may vote without need of any written proxy.

In case of joint ownership of stock, Section 56 requires the consent of all the co-owners in order to vote such stock. However, the joint-owners may execute a proxy authorizing one or some of them to vote for all. The proviso in Section 56 adds that when shares are owned in an "and/or" capacity, anyone of the joint owners can vote said shares. The present law is silent as to voting rights of joint-owners. Section 57 expressly denies treasury shares any voting rights.

In the present law there is no express, general provision which allows for proxy-voting, although Sections 21, 25, 31 and 36 deal with this mode of voting. Section 58 of the proposed Code expresses a general grant: "Except in the case of non-stock corporations as provided in this Code, stockholders and members may vote in person or by proxy in all meetings of stockholders and members."

Aside from this grant, Section 58 provides for other details. The proxy should be in writing, signed by the stockholder or member and filed before the scheduled meeting with the corporate secretary. The proxy is valid only for the intended meeting unless it is otherwise provided therein. The lifetime of a proxy is fixed at not longer than three years at any one time. This seeks to change the present rule that a proxy, if not limited in its duration by the bylaws or proxy-agreement itself, is valid for all corporate meetings unless revoked prior thereto.

Delinquent stocks are denied their voting rights, expressly by Section 71. However, Section 72 states that shares of stock, though not fully paid, can vote provided they are not delinquent. The last two rules are not new as they are prevailing under the present law.

Section 36 of the present law discusses the voting trust. There are certain minor amendments proposed, which are contained in

Section 59 in the proposed Code. The latter section requires that the trust agreement must be filed with the corporation and the SEC, otherwise the voting trust is ineffective and unenforceable. Filing with the SEC is not required at present. Section 59 also provides for the automatic expiration of the voting trust agreement at the end of the agreed period and cancellation of the voting trust certificates as well as the certificates of stock in the name of the trustee. Thereafter, new certificates will be reissued in the name of the transferors.

The proposed Code attempts to define clearly the right of non-voting shares by expressly listing, in Section 6, the instances wherein even non-voting shares are granted the right to vote. In the present law, as far as fundamental changes are concerned, the rule is that non-voting stocks are allowed to vote. The exceptions are in cases of sale, lease, exchange or other disposition of all or substantially all of the corporate property and in investment of corporate funds in another business, corporation or purpose. In these latter cases the Code requires the approval of the owners of two-thirds of the shares entitled to vote.

The proposed Code however, allows non-voting shares the right to vote in all instances which effect a fundamental change, including the two exceptions mentioned in the present law. Section 6, paragraph four lists down the instances when non-voting shares can vote. In cases other than these eight instances however, the vote necessary to approve a particular corporate act is deemed to refer only to stocks with voting rights.

Appraisal Right

In the present law, the appraisal right of dissenting stockholders is given under Section 18—when the amendment of the articles extends the corporate existence, changes rights of stockholders of any class, authorizes preferences superior to those of outstanding shares or restricts the rights of any stockholders; Section 17-1/2, when a corporation invests its funds in any other corporation or business or purpose, not its main purpose; Section 28-1/2, when the corporation sells, exchanges, leases or otherwise disposes of all or substantially all of its properties. The exercise of the appraisal right in the above sections, although basically the same, differ in certain aspects and effects.

The proposed Code, in an attempt at uniformity and simplicity devotes a title to the appraisal right with provisions which are applicable in all instances when such right is available. The lengthy discussion of the appraisal right whenever it applies to a particular act is done away with. Section 81 lists the instances when the appraisal may be exercised. The proposed Code carries over the same instances wherein the right may be exercised as provided in the present law. However, one more case is added and that is when the corporation decide to merge or consolidate.

Section 82 fixes a uniform procedure for the exercise of the right. It goes as follows. The dissenting stockholders should make a written demand on the corporation, within 30 days after the date on which the vote was taken, for the payment of the fair value of their stocks. If the proposed corporate action is effected, the corporation pays to the stockholder, upon surrender of his certificates, the fair value thereof as of the day prior to the date on which the vote was taken. Failure of the stockholder to make demand within such 30 days is deemed a waiver of the appraisal right. If within 60 days from the date the corporate action was approved, the dissenting stockholders and the corporation cannot agree as to the fair value of the shares, three disinterested persons (one named by the corporation, the other by the stockholder and the third, by those two thus chosen) will determine such fair value. Their findings will be final and the stockholders will be paid, 30 days after such award is made by the appraisers. Upon payment, the stockholder transfers his shares to the corporation.

Once the dissenting stockholder demands payment of the fair value of his shares, all right accruing to such shares, including voting and dividend rights shall be suspended.[60] This demand may not be withdrawn without the consent of the corporation. Section 84 lists down the causes which will remove the dissenting stockholder's right of payment for his shares: (1) when it is withdrawn, with the consent of the corporation, (2) when proposed corporate action is abandoned or rescinded by the corporation or declared void by the SEC or disapproved, when its approval is necessary, (3) if the SEC determines that such dissenting stockholder is not entitled to the appraisal right. If any of these cases arise, the stockholder will not be paid and his status as a stockholder is restored and all dividends which would have accrued on his shares will be paid to him.

Section 85 vests the burden of the costs and expenses of the appraisal on the corporation, unless the fair value ascertained by

60 PROPOSED CODE Title VII.

the appraisers is approximately the same as the prices which the corporation may have offered to pay the dissenting stockholder, in which case, they shall be borne by the latter. Section 86 requires that within 10 days after demanding payment, each dissenting stockholder shall submit the certificate representing his shares to the corporation for notation thereon that such are dissenting shares. If he fails to do so, his rights under this title may be terminated at the option of the corporation. The payment of the fair value is further qualified by Section 87 as no payment may be made to the dissenting stockholder unless the corporation has unrestricted earned surplus to cover such shares.

STOCKHOLDERS' RIGHT OF PRE-EMPTION AND INSPECTION

Right of Pre-emption

Unless the articles or any amendment thereto denies it, all stockholders are granted, by Section 39 of the Proposed Code, the right to subscribe to all issues or dispositions of shares in any class in proportion to their respective shareholdings except where the shares are issued: (1) in exchange for property needed for corporate purposes; (2) in payment of a previously contracted debt, or (3) when public interest so demands.[61]

This provision by granting *all* stockholders a pre-emptive right to *all* issues or disposition of shares in *any* class will clear up the long standing question of whether the pre-emptive right should be granted to the holders of a different class of stocks as those issued or disposed.

The distribution of the rights, powers and duties of the stockholders is dependent not only on the amount of their shareholdings but also, on the class of stocks that they hold. The pre-emptive right is meant to preserve both the proportionate shares of the stockholders not only in ownership but also in the control of the corporation. So that where the pre-emptive right is defined in a manner as to allow stockholders of a particular class to acquire the new issues or other disposition of shares of a different class, the corporate ownership and power structure is altered everytime stockholders of one class pre-empt and acquire shares belonging to another class. Will corporations be left merely to adopt or reject the right of pre-emption as delineated by the Proposed Code? Or, are they given the option to allow or prohibit the exercise of the pre-emptive right as drawn in the Proposed Code and, 2) to provide for a differently defined pre-emptive right in their articles, i.e., one that grants only

[61] *Ibid.*, sec. 3.

stockholders having stocks of the same class the right to pre-empt the issues of a particular class.

Right of Inspection

Section 74 of the Proposed Code amends Section 52 of the present law to the effect that not only business corporations but all stock corporations will be required to keep a stock and transfer book.

Section 75 of the Proposed Code effects more changes in that the stockholders or members will be given the right to receive by mail the corporation's most recent financial statement upon the stockholder's written request. It also requires the Board to present, at the annual stockholders' or members' meeting, a financial report of the corporation's operations of the preceding years which should be signed and certified by an independent certified public accountant. However, if the corporation's paid-up capital is less than fifty thousand, the certification under oath of the treasurer or any other responsible officer will suffice.

The present law does not require either a financial statement or a financial report. Only the rules of the SEC require the preparation of a balance sheet and a profit and loss statement audited by the certified public accountant at the end of each fiscal year.[62]

FOREIGN CORPORATIONS

The provisions of the present Corporation Law deal mainly with the legal requirements before a foreign corporation can be allowed to transact business in the Philippines. The following discussion will deal with the changes in the legal requirements that may be brought about by the proposed Corporation Code.

Definition

The Corporation Law defines a foreign corporation as one "formed, organized, or existing under any laws other than those of the Philippines."[63] The Proposed Code defines it as "one formed, organized, or existing under any laws other than those of the Philippines and whose laws allow Filipino citizens and corporations to do business in its own country or state."[64] This change in the definition of foreign corporations will mean, that unless the requirement of

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[62] *Ibid.*, sec. 39.

[63] SEC Rules as cited in CAMPOS & LOPEZ-CAMPOS, *op. cit.*, *supra*, note 8 at 575.

[64] Act 1459, sec. 68.

reciprocity is met, such foreign corporations cannot be licensed to transact business here except as shall be provided for by special laws.

To ensure that this requirement is met, the foreign corporation applying for a license must attach to its application a duly executed certificate by the authorized official of the jurisdiction of its incorporation attesting to the fact that the laws of the country of the applicant allows Filipino citizens and corporations to do business in that country.[65] However, foreign corporations which on the date of the effectivity of the Code are already authorized to do business in the Philippines may continue to have such authority, even if the requirement of reciprocity is not met.

The Proposed Code expands the definition of foreign corporations, although as in the present law, it does not define the term "transacting business", the definition for which must be derived from other laws (such as Section 9 of Republic Act No. 5455, which defines the phrase "doing business").

Effect of doing business without a license

Under the present law, a foreign corporation by itself or assignee is not permitted to maintain any suit in the Philippines for the recovery of any debt, claim, or demand whatever unless it has the prescribed license.[66] However, the same provision does not specify whether or not such corporations may be sued in the Philippines. For this reason, the Supreme Court in the case of *General Corporation of the Philippines v. Union Insurance Society of Canton Ltd.*,[67] had to rule that, "a foreign corporation actually doing business in this jurisdiction, with or without license or authority to do so, is amenable to process and the jurisdiction of local courts." This ruling of the Supreme Court has been embodied in Section 125 of the proposed Code when it states that, "such corporation may be sued before Philippine courts or administrative tribunals on any valid cause of action recognized under Philippine laws."

Revocation of License

Under the Corporation Law, a license to transact business in the Philippines issued to a foreign corporation, may be revoked only when the Secretary of Commerce & Industry finds that the condition of the corporation is one of insolvency, or that its continuance in

[65] PROPOSED CODE, sec. 114.
[66] *Ibid.*, sec. 116.
[67] 87 Phil. 313 (1950).

business will involve a probable loss to those transacting business with it.[68] In the Proposed Code, the grounds for revocation are expanded such that the SEC may revoke a license on any of the following grounds:

1. Failure to file its annual report or to pay any fees;

2. Failure to appoint and maintain a resident agent in the Philippines;

3. Failure, after change of its resident agent or of his address, to submit to the Securities & Exchange Commission a statement of such change;

4. Failure to submit to the Securities & Exchange Commission amendments to its articles of incorporation or any articles of merger or consolidation within the time prescribed;

5. A misrepresentation of any material matter in any application, report, affidavit or other document submitted by such corporation;

6. Failure to pay all taxes, imposts, assessment and penalties, if any, lawfully due to the Philippine Government or any of its agencies or political subdivisions;

7. Transacting business in the Philippines outside the purpose for which such corporation is authorized under its license;

8. Transacting business in the Philippines in representation of or acting for and in behalf of any foreign corporation or entity not duly licensed to do business in the Philippines; and

9. Any other ground as would render it unfit to transact business in the Philippines or as would make the continuance of its business detrimental to public interest or national security.[69]

Merger or Consolidation

The Proposed Code expressly allows one or more foreign corporations authorized to transact business in the Philippines to merge or consolidate with any domestic corporation or corporations, if such merger or consolidation is permitted under Philippine laws and by the law of its incorporation. However, before such a merger or consolidation can take place, the requirements on merger or consolidation as outlined in the Corporation Code must be followed. The Proposed Code further provides that should such a foreign corporation become a party to a merger or consolidation in its home country, whereby the absorbed corporation is the foreign corporation doing

[68] Act No. 1459, sec. 69.
[69] PROPOSED CODE, sec. 71.

business in the Philippines, the latter must file a petition for the withdrawal of its license.[70]

These provisions constitute a statutory recognition that foreign corporations may merge or consolidate in the Philippines. Under the present law, this authority is merely implied from the fact that this act is not prohibited.

Withdrawal of foreign corporations

Unlike the present law, the Proposed Code expressly allows a foreign corporation authorized to transact business in the Philippines to withdraw from the same. This withdrawal may be accomplished by filing a petition for withdrawal of its license with the SEC, and with the latter's approval. However, SEC will not be allowed to issue a certificate of withdrawal unless the following requirements are met:

1. That all claims which have accrued in the Philippines, have been paid, compromised or settled;

2. All taxes, imposts, assessments, and penalties if any, lawfully due to the government have been paid, compromised or settled; and

3. That the petition for withdrawal of its license has been published once a week for three (3) consecutive weeks in a newspaper of general circulation in the Philippines.[71]

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[70] *Ibid.*, sec. 126.
[71] *Ibid.*, sec. 123.