RIGHTS AND OBLIGATIONS OF STOCKHOLDERS UNDER THE CORPORATION CODE*

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Like the old,[1] the Corporation Code classifies corporations into stock and non-stock corporations. Stock corporations are those which have capital stock divided into shares and are authorized to distribute to the holders of such shares dividends or allotments of the surplus profits on the basis of the shares held.[1a] All other corporations are non-stock corporations.[2]

The corporations of a stock corporation are called stockholders or shareholders, while those in a non-stock corporation are referred to as members.

This article dwells only with the rights and obligations of stockholders under the Code. Those of members are excluded from the discussion.

The first and larger part of the discussion is devoted to stockholders in all kinds of stock corporations, and the second part to stockholders of close corporations.

STOCKHOLDERS IN GENERAL

I. CLASS OR SERIES OF SHARES AS AFFECTING RIGHTS AND OBLIGATIONS

Under the Code as under the old law — but more so under the Code — one cannot speak of the rights and obligations of a stockholder independently of the classification or class or series of shares held by him.

This mainly stems from two reasons. One is, that Section 6 of the Code expressly provides that the classes or series into which a corporation's shares of stock may be divided may have such rights, privileges or restrictions as may be stated in the articles of incorporation. Another reason is, that the Code specifically sets forth the nature as well as certain rights and restrictions of certain classes of shares, namely, preferred shares, redeemable shares, founders' shares, treasury shares, par-value and no-par-value shares, and voting and non-voting shares.

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1 Act No. 1459 (1906).

1a Batas Pambansa Blg. 68 (1980), sec. 3.

2 *Ibid.*

It is therefore important to examine, at least briefly the nature and incidents of these classes of shares.

Preferred shares

The terms and conditions of preferred shares or any series thereof may be set forth directly in the articles of incorporation. Or, where the articles of incorporations so authorize, they may be fixed by the board of directors. In the latter case, however, the terms and conditions shall be effective only upon the filing of a certificate thereof with the Securities and Exchange Commission.[3]

Regardless of where or how such terms or conditions are fixed — whether in the articles or by the board of directors pursuant to an authority given in the articles — preferred shares of stock issued by any corporation may be given preference in the distribution of the assets of the corporation in case of liquidation and in the distribution of dividends, or other preferences not violative of the provisions of the Code. Such shares may, however, be deprived of voting rights, except in those cases where the Code does not allow such deprivation.[4] And they may be issued only with a stated par value.[5]

Redeemable shares

Redeemable shares may be issued by the corporation when the articles expressly so provide.[6]

It is the special characteristic of these shares — and they owe their name to the fact — that they may be purchased or taken up by the corporation upon the expiration of a fixed period, regardless of the existence of unrestricted retained earnings[7] in the books of the corporation.[8] The articles of incorporation may, of course, impose other terms and conditions for the redemption, in which case such terms and conditions must also be stated in the certificates of stock representing said shares.[9]

These shares may also be deprived of voting rights in the same manner and to the same extent as preferred shares.[10]

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[3] *Id.*, sec. 6, second paragraph.
[4] *Id.*, first paragraph.
[5] *Id.*, second paragraph.
[6] *Id.*, sec. 8.
[7] "Retained earnings" was defined, during the deliberations of the Committee on Revision of Laws and Codes, and Constitutional Amendments, as the accumulated profits realized out of normal and strenuous(?) operations of the business after deducting therefrom distributions to stockholders and transfers to capital stocks or other accounts. (Proceedings of the Committee on Revision of Laws and Codes, and Constitutional Amendments, Part III, March 10, 1980.)
[8] Batas Pambansa Blg. 68, sec. 8.
[9] *Ibid.*
[10] *Id.*, sec. 6, first paragraph.

Founders' shares

The articles of incorporation may classify certain shares as founders' shares and may give such shares certain rights and privileges not enjoyed by the owners of other stocks. There is, however, a limitation with respect to the exclusive right to vote and be voted for in the election of directors. Where this is granted by the articles, it must be for a limited period only. The period shall be subject to the approval of the Securities and Exchange Commission and shall commence only from the date of such approval. And in no case shall it exceed five (5) years.[11]

Treasury shares

Treasury shares are shares of stock which have been issued and fully paid for but subsequently acquired by the corporation that issued them. The reacquisition may be effected by purchase, redemption, donation or through some other lawful means. Such shares may again be disposed of for a reasonable priced by the board of directors.[12] They can be sold at less than par.[12a]

But as long as they remain in the corporate treasury, they shall have no voting right.[13]

Par value and no-par value stocks

Any or all of the shares or series of shares of a corporation may have a par value or have no par value according to what its articles of incorporation may provide.[14] However, no bank, trust company, insurance company, public utility, or loan and building association shall be permitted to issue no-par value shares.[15]

Shares of stock issued without par value are deemed fully paid and non-assessable and the holder of such shares shall not be liable to the corporation or to its creditors in respect thereto.[16] No such share may be issued for a consideration less than the value of five pesos (₱5.00).[17] And the entire consideration received by the corporation for said shares shall be treated as capital and shall not be available for distribution as dividends.[18]

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11 *Id.*, sec. 7.
12 *Id.*, sec. 9.
12a Mosher v. Sinnott, 79 Pac. 742 (1905).
13 Batas Pambansa Blg. 68, sec. 57.
14 *Id.*, sec. 6, first paragraph.
15 *Ibid.*
16 *Id.*, third paragraph.
17 *Ibid.*
18 *Ibid.*

II. VOTING RIGHTS

Voting and non-voting shares

The Code lays down, as a general rule, that no share may be deprived of voting rights.[19] The exceptions are those classified and issued as preferred or redeemable shares.[20] Even these shares — referred to as non-voting shares where the articles of incorporation so provide — are nonetheless entitled to vote on the following matters: (1) amendment of the articles of incorporation; (2) adoption and amendment of the by-laws; (3) sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all the corporate property; (4) incurring, creating or increasing bonded indebtedness; (5) increase or decrease of capital stock; (6) mergers or consolidation of the corporation with another corporation or other corporations; (7) investment of corporate funds in another corporation or business; and (8) dissolution of the corporation.[21]

Apart from these matters, however, the vote necessary to approve a particular corporate act shall be deemed to refer only to stocks with voting rights.[22]

Election of Directors

In accordance with the foregoing rules, only the holders of voting shares may vote at any election of directors. This is so even if Section 24 says that at all such elections there must be present, either in person or by representative authorized to act by written proxy, "the owners of a majority of the outstanding capital stock." For election of directors is not one of the matters enumerated in the penultimate paragraph of Section 6 on which the holders of non-voting shares may vote. Besides, the third sentence of Section 24 itself speaks of "every stockholder entitled to vote."

The election must be by ballot if so requested by any voting stockholder.[23] By implication, if there is no such request, the election may be conducted *viva voce.*

Every stockholder shall have the right to vote, in person or by proxy, the number of shares standing, at the time fixed in the by-laws, in his own name on the stock and transfer books of the corporation.[24] Where the by-laws is silent on the time to be used as basis for determining the stockholder's number of shares, the number of shares standing in his name at the time of the election will control.[25] He may vote such number of said shares for as many person as there are directors to be elected[26]—

19 *Id.*, first pararaph.
20 *Ibid.*
21 *Id.*, penultimate paragraph.
22 *Id.*, last paragraph.
23 *Id.*, sec. 24.
24 *Ibid.*
25 *Ibid.*
26 *Ibid.*

a method which is commonly known as straight voting. Or he may cumulate said shares and give one candiate as many votes as the number of directors to be elected multiplied by the number of his shares shall equal,[27] a method referred to as cumulative voting in favor of one candidate. Or he may distribute them on the same principle among as many candidates as he shall see fit[28] (cumulative voting by distribution). But whatever of these options he may adopt, the total number of votes cast by him must not and cannot exceed the number of shares owned by him as shown in the books of the corporation multiplied by the whole number of directors to be elected.[29] And in no case may a delinquent stock be voted.[30]

The question has been raised whether the by-laws may limit the right to vote to only one way or method or voting. It has been held that any by-law imposing such a restriction would be void for being in contravention with the express provision of the law.[30a]

Removal of directors

Applying the reasoning we followed in regard to the election of directors, the removal of any directors is likewise a power reposed only in the holders of voting shares, although Section 28 speaks of the "vote of the stockholders holding or representing at least two-thirds (2/3) of the outstanding capital stock."

The removal must take place either at a regular meeting or at a special meeting of the corporation called for the purpose.[31] In either case, there must be previous notice to stockholders of the intention to propose such removal at the meeting.[32] Such notice as well as the notice of time and place of the meeting must be given by publication or by written notice as prescribed in the Code.[33] This means that, in case of a regular meeting, the written notice must be sent to all stockholders of record at least two weeks prior to the meeting, unless a different period is required by the by-laws;[34] and, in case of a special meeting, the written notice must be sent at least one week before the meeting, unless otherwise provided in the by-laws.[35] However, any stockholder may waive expressly or impliedly, notice of any meeting.[36]

A special meeting of the stockholders for the purpose of removing the directors or any of them must be called by the secretary on order of the

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27 *Ibid.*
28 *Ibid.*
29 *Ibid.*
30 *Ibid.*
30a Tomlin v. Farmers' & Merchants' Bank, 52 Mo. App. 430; People ex rel. Browne, et al. v. Koenig, 118 N.Y. Supp. 136.
31 Batas Pambansa Blg. 68, sec. 28.
32 *Ibid.*
33 *Ibid.*
34 *Id.*, sec. 50, first paragraph.
35 *Id.*, second paragraph.
36 *Id.*, third paragraph.

president or on the written demand of the stockholders representing or holding at least a majority of the outstanding capital stock.[37] Should the secretary fail or refuse to call the special meeting upon such demand or fail or refuse to give the notice, or should there be no secretary, the call for the meeting may be addressed directly to the stockholders by any stockholder signing the demand.[38]

Removal may be with or without cause.[39] But removal without just cause may not be used to deprive minority stockholders of the right of representation to which they may be entitled under Section 24 of the Code.[40]

The vacancy resulting from removal may be filled by election at the same meeting without further notice.[41] It may also be filled at any regular meeting or at any special meeting called for the purpose, after giving notice in the manner described above.[42]

Filling of vacancies due to other causes

If a vacancy in the board of directors occurs due to a cause other than removal or expiration of term, it may be filled by the vote of at least a majority of the remaining directors if they still constitute a quorum.[43] If they are not enough to constitute a quorum, the vacancy must be filled by the stockholders in a regular meeting or special meeting called for that purpose.[44] A director so elected to fill a vacancy shall serve only for the unexpired term of his predecessor in office.[45]

Any position of director to be filled by reason of an increase in the number of directors shall be filled only by an election at a regular meeting or at a special meeting of stockholders duly called for the purpose.[46] It may also be filled in the same meeting authorizing the increase of directors if so stated in the notice of the meeting.[47]

Voting pledged or mortgaged, jointly owned shares

A stockholder who has pledged or mortgaged his shares has the right to attend and vote at meetings of stockholders.[48] He loses that right only if he has expressly given it, in writing recorded in the appropriate corporate books, to the pledgee or mortgagee.[49]

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37 *Id.*, sec. 28.
38 *Ibid.*
39 *Ibid.*
40 *Ibid.*
41 *Ibid.*
42 *Ibid.*
43 *Id.*, sec. 29, first paragraph.
44 *Ibid.*
45 *Ibid.*
46 *Id.*, second paragraph.
47 *Ibid.*
48 *Id.*, sec. 55, first paragraph.
49 *Ibid.*

In order to vote shares jointly owned by two or more persons, the consent of all the co-owners shall be necessary.[50] Their consent will not be necessary, however, if there is a written proxy, signed by all of them, authorizing one or some of them or any other person to vote such shares.[51]

Shares owned by the holders in an "and/or" capacity can be voted by any one of them.[52] They may also appoint a proxy for the purpose.[53]

Proxies

In all meetings of stockholders, stockholders may vote in person or by proxy.[54]

Proxies must be in writing, signed by the stockholder, and filed with the corporate secretary before the scheduled meeting.[55]

The proxy shall be valid only for the meeting for which it is intended, unless it provides otherwise.[56] But, even if there is contrary provision in this respect, no proxy shall be valid and effective for a period longer than five (5) years at any one time.

Voting trusts

One or more stockholders may create a voting trust for the purpose of conferring upon a trustee or trustees the right to vote and other rights pertaining to his or their shares.[57] This is subject to the condition that it is not entered into for the purpose of circumventing the law against monopolies and illegal combinations in restraint of trade or used for purposes of fraud.[58]

As a general rule, a voting trust, like a proxy, can endure for only five years at any one time.[59] But where the voting trust is specifically required as a condition in a loan agreement, it may last for more than five years; it shall, however, expire automatically upon payment of the loan.[60]

A voting trust must be in writing and notarized.[61] It must further specify its terms and conditions. A certified copy of it must be filed with the corporation and the Securities and Exchange Commission; otherwise, it is ineffective and unenforceable.[62]

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50 *Id.*, sec. 56.
51 *Ibid.*
52 *Ibid.*
53 *Ibid.*
54 *Id.*, sec. 58.
55 *Ibid.*
56 *Ibid.*
57 *Id.*, sec. 59.
58 *Id.*, fifth paragraph.
59 *Id.*, first paragraph.
60 *Ibid.*
61 *Ibid.*
62 *Ibid.*

Once all these requirements have been complied with, the certificate or certificates of stock covered by the voting trust agreement shall be cancelled and new ones shall be issued in the name of the trustee or trustees stating that they are issued in the pursuant to said agreement.[62a] The same statement must be noted in the books of the corporation.[63] The trustee or trustees shall execute and deliver to the transferors voting trust certificates. Such certificates shall be transferable in the same manner and with the same effect as certificates of stock.[64] Any other stockholder may transfer his shares of the same trustee or trustees upon the terms and conditions stated in the voting trust agreement, and thereupon shall be bound by all the provisions of said agreement.[65]

The copy of the agreement filed with the corporation shall be subject to examination by any stockholder of the corporation in the same manner as any other corporate book or record.[66] Both transferor and trustee or trustees may exercise the right of inspection of all books and records in accordance with the Code.[67]

Upon the expiration of the agreed period, all rights granted in the voting trust agreement, unless it is expressly renewed, shall automatically expire.[68] The voting trust certificates as well as the certificates of stock in the name of the trustee or transees shall be deemed cancelled and new certificates of stock shall be reissued in the name of the transferors.[69]

III. Pre-emptive Right

The Code introduces some changes in the matter of pre-emptive right of stockholders. Under the old law, the Securities and Exchange Commission refused to extend the right to the disposition of unissued capital stock of the corporation; it limited the right to increase in capital stock. The Code now makes the right exercisable also with respect to the disposition of unissued capital stock unless the right is denied by the articles of incorporation or an amendment thereto.

The Code also specifically withholds the right as (1) to shares to be issued in compliance with law requiring stock offerings or minimum stock ownership by the public, and (2) to shares issued in good faith with the approval of the stockholders representing 2/3 of the outstanding capital stock in exchange for property need for corporate purposes or in payment of a previously contracted debt.[70]

62a *Ibid.*
63 *Ibid.*
64 *Id.*, second paragraph.
65 *Id.*, fourth paragraph.
66 *Id.*, third paragraph.
67 *Ibid.*
68 *Ibid.*
69 *Id.*, sixth par.
70 *Id.*, sec. 39.

IV. RIGHT TO DISTRIBUTION OF DIVIDENDS

Under Presidential Decree No. 270 and the rules and regulations implementing it, the authorized retention was only up to 50% of paid-up capital; retention of surplus profits in excess of this ceiling had to be explained and if the explanation was not satisfactory, the Securities and Exchange Commission "shall direct the corporation to distribute the excess as dividends." The second paragraph of Section 43 of the Code raises the unauthorized retention to 100% of paid-in capital stock. And it does so without any provision that the Commission can direct distribution of retained profits in excess thereof.

The Code also expands the instances when the prohibition against retention beyond the ceiling does not apply. It enumerates three instances which are so broad and permissive the stockholders' chances of enjoying dividends are indeed very slim and left almost to the sole and absolute discretion of the board of directors. These are: (1) when the retention is justified by definite corporate expansion projects or programs approved by the board of directors; (2) when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its/his consent, and such consent has not yet been secured; (3) when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is a need for special reserve for probable contingencies.[70a]

Definite expansion projects or programs

Something similar to the first exception to the retention prohibition was found in the regulations implementing P.D. No. 270 but it was more restrictive. The regulations required the expansion plans to be approved, not only by the board of directors, but also by the stockholders and, whenever necessary, by the proper government authority.[71] It was also expressly provided that amounts appropriated for such purpose must be segregated from the free surplus and that "[u]pon completion of the expansion program, the reserves established shall be declared as stock dividends." These requirements are not found in the Code.

Loan agreement prohibting declaration of dividends

The second exception in the Code is an exact copy of what was provided in the rules and regulations implementing P.D. No. 270.

There is, however, this difference: it gives statutory status to the exception.

The result is that it legalizes — or, rather, attempts to legalize — a condition embodied in a loan agreement that is otherwise illegal for being

[70a] *Id.*, sec. 43, second paragraph.
[71] SEC RULES AND REGS., August 13, 1973, sec. 2.

unreasonable, oppressive and unfair. It is unreasonable, oppressive and unfair because it deprives the stockholders of the right to enjoy dividends no matter how big the surplus profits are and even if the corporation is well in a position to meet its obligations or commitments under the loan agreement and therefore there is no valid justification for not distributing dividends. This results becomes even more glaring when it is considered that the loan agreements contemplated usually last for long periods of time — in many instances probably coterminous with the life of the corporation or a substantial part thereof. They are not limited to bonded indebtedness, creation of which needs the approval of 2/3 of the outstanding capital stock; they extend to loans which do not need the stockholders' approval.

Being unreasonable, oppressive and unfair, the condition in the loan agreement prohibiting declaration of dividends without the consent of the lender is violative of the due process clause of the Constitution. This clause has been held to guarantee freedom from arbitrariness and to require "fairness or justice, the substance rather than the form being paramount."[72] It has further been described as "the embodiment of the sporting idea of fair play" and as "exact[ing] fealty 'to those strivings for justice' x x x in the light of reason drawn from considerations of fairness that reflect [democratic] traditions of legal and political thought."[73] A statute cannot sanction a contractual condition or stipulation which is contrary to the Constitution. If it does so, the statute itself or its provision giving such sanction is void.[74]

The provision is repugnant to the Constitution in another respect. It likewise violates the equal protection clause. This it does by discriminating, without substantial and valid basis, between two kinds of investors: the financial or lending institutions or individuals and the stockholders of corporations not in the financing or lending business. In this particular case, the discrimination is in favor of the former and against the latter. The former must first be fully paid their capital and the interest thereon before the latter could even be given the chance to have the slightest return on their investment.

Yet, is there a compelling reason for the discrimination? Are we to encourage the first kind of investors at expense of the second? Is there really greater, if at all there is any further, need to give incentives to financing institutions or lending individuals than should be given to investors in corporations? Is not, in fact, the emphasis misplaced? For with or without

[72] Catura v. Court of Industrial Relations, L-27392, January 30, 1971, 37 SCRA 303, 311 (1971).

[73] Ermita-Malate Hotel and Motel Operators Association, Inc. v. City Mayor of Manila, L-24693, July 31, 1967, 20 SCRA 849, 860-861 (1967).

[74] De Agbayani v. Philippine National Bank, L-23127, April 29, 1971, 38 SCRA 429 (1971).

this incentive, considering the rates of interest now allowed to creditors, lending money with all the securities that go with it, does not need further encouragement, especially of the kind extended by the provision in question. What do need incentives are other kinds of investors, such as stockholders. If the corporation is to be encouraged, it must be made to give the most attractive promise to those desired to invest through it. At this stage of our economic development, encouragement must be given to all sectors to invest. This shows that the discrimination granted by the Code's provision in question is unjustified. But, regardless of its constitutional infirmity, it is obviously not good or sound policy to adopt the provision because it discourages other investors, probably the greater number, from participating in the development of the economy.

It has been pointed out that financing or lending institutions almost invariably impose this condition. It may be so. But this is no justification for expressly recognizing its legality or adopting it as a policy enshrined in statute. The question of its legality should not be foreclosed to the prejudice of stockholders who might want or see the need to question it and seek a way out of what may well be an unjust situation. Let the financiers or lenders impose the prohibition as a condition, but do not allow the law to sanction what obviously is unfair to the stockholders. At the very least, leave to the stockholders the chance to challenge such prohibition as illegal.

To sanction by law such a prohibition — even granting, for the sake of argument, its legality — could easily lead to abuse. The corporation's management or its controlling stockholders could well utilize it to prevent the declaration of dividends, while the financing institution or lender would in any case impose it in order to have greater security for its loan.

Special circumstances obtaining in the corporation

The third exception is an entirely new one. It has no counterpart in the rules and regulations issued to implement P.D. No. 270.

The phrase "special circumstances obtaining in the corporation", it should be obvious to anyone, is a catch-all receptacle into which anything may be thrown and contained. All that the board of directors or the controlling stockholders have to do is to claim the existence of such special circumstances, and that does it. The question is one of fact and one can expect the provision to spawn a lot of controversy and litigation that will drain both the resources of the corporation and those of the stockholders.

Policy requiring maintenance and distribution of equitable balance of cash and stock dividends omitted in Code

Under the rules implementing P.D. No. 270, it was required that it "shall be the policy of all corporations whose securities are listed in any

operating stock exchanges or registered and licensed under the Securities Act to maintain and distribute an equitable balance of cash and stock dividends, consistent with the needs of stockholders and the demands for growth or expansion of the business."[75]

This was entirely omitted in the Code. It must be embodied in the Code if it is intended to encourage investors, especially the small ones, to invest in corporations.

V. RIGHT OF INSPECTION

Section 74 of the Code reproduces Sections 51 and 52 of the old law but with some modifications.

Under Section 51 of Act 1459, only *business* corporations are required to keep and preserve a record of all business transactions and minutes of all meetings; under Section 74 of the Code, *every* corporation, business or otherwise, is required to keep and preserve such records. In addition to minutes of meetings of the board of directors and of stockholders or members required under Section 51 of Act 1459, the Code now requires also the minutes of the meetings of the executive committee that may be constituted under Section 35 thereof.

Furthermore, there are three things that Section 51 of Act 1459 does not specify which Section 74 of the Code does with respect to these records and minutes. *First,* the Code specifically requires that they shall be kept at the principal office of the corporation. *Second,* unlike Act 1459, it does not just provide that they shall be open to the inspection of any director, member or stockholder at reasonable hours; it adds that this inspection must be made *on business days. Third,* it expressly grants the director, trustee, stockholder or member wanting to inspect the right to "demand in writing, for a copy of excerpts from said records or minutes, at his expense."

Section 74 of the Code also modifies the provisions of Section 52 of Act 1459 in two important respects. The stock and transfer book that every stock corporation (business corporation under Act 1459) must keep may now be kept in the office of the corporation's stock transfer agent. And the same shall be open for inspection of any director or stockholder of the corporation at reasonable hours, also *on business days.*

The most important amendment introduced by Section 74 of the Code is that which relates to the civil and criminal liability of "(a)ny officer or agent of the corporation who shall refuse to allow any director, trustee, stockholder or members of the corporation to examine and copy excerpts from its records or minutes." Such officer or agent is made liable to such director, trustee, stockholder or member for damages. He is also considered guilty of a criminal offense to which is attached the penalty of a fine

[75] SEC RULES AND REGS., August 13, 1973, sec. 3.

ranging from ₱1,000 to ₱10,000 or imprisonment of from 30 days to 5 years, or both, in the discretion of the court. If the refusal is pursuant to a resolution of the board of directors or trustees, these liabilities shall be imposed upon the directors who voted for such refusal.

It should be noted that these civil and criminal liabilities attach only to a refusal to allow inspection of, and copying of excerpts from, the "records or minutes" of the corporation. They do not seem to apply to a refusal to allow inspection of the stock and transfer books. This conclusion may be drawn from the fact that the paragraph providing for these liabilities follows immediately that which grants the right to inspect and to ask for copy of excerpts from the "records of all business transactions of the corporation and the minutes of any meeting" and precedes that which refers to inspection of the stock and transfer books. This notwithstanding, it does not mean that the officer or agent denying the right to inspect the stock and transfer book cannot be held liable for damages. He will incur such liability under the general principles of tort. But with respect to criminal liability, the same cannot attach in view of the due process requirement that in order that conduct may be considered a criminal offense it must clearly and unequivocably made so by statute. Under Section 74 of the Code, we cannot say this of a refusal to allow inspection of the stock and transfer book of a corporation.

To any action for the enforcement or imposition of these liabilities, however, Section 74 of the Code makes a defense "that the person demanding to examine and copy excerpts from the corporation's records and minutes has improperly used any information secured through any prior examination of the records or minutes of such corporation or of any other corporation, or was not acting in good faith or for a legitimate purpose in making his demand.

This provision has important repercussions on our jurisprudence. It diminishes the force, if it does not throw overboard, the ruling in *Pardo v. Hercules Lumber Co.*[76] that as a general rule the motive or purpose of the stockholder seeking inspection is immaterial. At the same time, it rejects the ruling in *Grey v. Insular Lumber Co.*[77] which, applying New York Law, would make it incumbent upon the stockholder to allege or prove that he has an honest purpose or is acting in good faith in seeking to exercise his right of inspection. In making improper use, lack of good faith, or illegitimate purpose a defense on the part of the corporation's officers or agents, the Code presumes the stockholder to have proper use or a legitimate purpose or to be acting in good faith.

[76] 47 Phil. 965 (1924).
[77] 67 Phil. 139 (1939).

VI. Right to Financial Statements

To the stockholder's right of inspection, the Code, in Section 75, adds his right to be furnished, within ten days from receipt of his written request, the corporation's most recent financial statement. The financial statement shall include a balance sheet as of the end of the last taxable year and a profit or loss statement for said year, showing in reasonable detail its assets and liabilities and the result of its operations.[78]

The same right exists at the regular meetings of the stockholders, at which the board of directors must present a financial report of the corporation's operations for the preceding year, which shall include financial statements duly signed and certified by an independent certified public accountant. However, if the paid-up capital is less than ₱50,000.00, the financial statements may be certified under oath by the treasurer or any responsible officer of the corporation.[79]

VII. Appraisal Right or Right to Withdraw

The Code contains a separate title devoted entirely to the right of a dissenting stockholder to demand payment of the fair value of his shares.

Ground

Section 81 purports to enumerate all the grounds or instances when this right may be exercised but inadvertently omits the case covered by Section 42, which is the equivalent of Section 17½ of Act 1459, referring to investment of corporate funds in another corporation or business or for any other purpose. This ground was included in Section 81 of Cabinet Bill No. 3 as modified by the Committee on Revision of Laws and Codes, and Constitutional Amendments but got dropped sometime during the period of amendments for some unknown reason.

Actually, all these grounds are the same as those provided in Act 1459, except for two, namely, (1) an amendment to the articles of incorporation extending or shortening the term of corporate existence, and (2) merger or consolidation.

Who may exercise right

The Code seems to have changed the rule as to who may exercise this right.

Under Sections 17½, 18 and 28½ of Act 1459, the right is invariably granted to "any stockholder who did not vote to authorize the action of the board of directors." This phraseology has been considered as including a stockholder who was either absent at the meeting where corporate action was approved or was present but did not cast his vote for or against it.

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[78] Batas Pambansa Blg. 68, sec. 75.
[79] *Ibid.*

In the case of Section 18, it was even regarded as including a holder of non-voting stock in view of the phrase "two-thirds of the subscribed capital stock of the corporation."

The Code, however, grants the right only to "any stockholder *who shall have voted against* the proposed corporate action." It does not include one who was absent at the meeting for the approval of the proposal or who was present thereat but abstained from voting on it.

Period to exercise right

The Code shortens the period within which the right may be exercised. Whereas Act 1459 grants forty (40) days, the Code gives only thirty (30) days after the date on which the vote was taken. Failure to exercise it by making a written demand within the period is deemed a waiver thereof under the Code.[80]

When appraisers may be appointed; finality and enforcement of award

Under Act 1459, appraisers may be appointed any time after the demand for payment is made and the corporation and the stockholder cannot agree on the value of his share at the time the corporate action was authorized.[81] Under the Code, appraisers may be appointed only if within sixty (60) days from the date the corporate action was approved, there is such failure of agreement.[82]

Under both Act 1459 and the Code, the committee of appraisers is constituted in the same manner, the findings of the majority thereof is final, and their award is required to be paid by the corporation after it is made. The Code, however, does not provide a right of action if the corporation fails to pay within the period. This is in marked contrast with Act 1459 which expressly provides that the stockholder may bring an action for recovery against the corporation and in Section 17½ thereof expressly prohibits the corporation from taking any action on the approved resolution until after payment shall have been made of said award under pain of the directors being subject to criminal prosecution. The Code seems to have in fact done away with this prohibition as well as with the criminal liability of the directors in this respect. This may be gleaned from two provisions of the Code. Firstly, Section 82 provides that "(i)f the proposed action is implemented or effected, the corporation shall pay to such stockholder. . . ." Secondly, unlike its counterpart,[83] Section 42 is permissive rather than prohibitive. It starts by saying: "Subject to the provisions of this Code, a private corporation may invest its funds in any other corporation or business or for any purpose other than the primary purpose for which it was

[80] *Id.*, sec. 82.
[81] Act No. 1459 (1906), secs. 17½, 18, and 28½.
[82] Batas Pambansa Blg. 68, sec. 82.
[83] Act No. 1459, sec. 17½.

organized"; and it contains no prohibition against the corporation taking any action on the approved resolution until after payment shall have been made on the award. Its predecessor, on the other hand, starts with a prohibitive directive: "No corporation organized under this Act shall invest its funds in any other corporation or business, or for any other purpose other than the primary purpose for which it was organized..." and then goes on to state towards the end that "no action shall be taken by the corporation upon said resolution until after payment shall have been made of said award, which must be made within thirty days thereafter."[84]

Instead of providing for a right to institute an action for recovery, the Code (in Section 83) states that "if the dissenting stockholder is not paid the value of his shares within 30 days after the award,, his voting and dividend rights shall immediately be restored." The question arises: is the restoration automatic or is there need for someone to restore it? If the latter, who will restore these rights?

It should be noted that under the Code all rights accruing to the shares of the withdrawing or dissenting stockholder, including voting and dividend rights, are suspended from the time of demand for payment of their fair value until either the abandonment of the corporate action involved or the purchase of said shares by the corporation.[85] This rule applies regardless of the nature of the corporation act from which the withdrawing stockholder dissents.

Here, the Code again differs from Act 1459. Firstly, the suspension of rights under Act 1459 was not provided with respect to the corporate act treated in Section 17½ thereof, namely, the investment of funds in another corporation or business or for any purpose than the main purpose. Secondly, the suspension under Act 1459 was with respect to the stockholder, not the shares, it being provided that "the stockholder cease to be (such) and shall have not rights with respect to such shares, except the right to receive payment therefor."[86] *Thirdly,* the only mode provided for terminating the suspension was the abandonment of the corporate action involved; the Code adds as such mode the purchase of the shares by the corporation.

Withdrawal of demand and loss of right to payment

The Code disallows the dissenting stockholder to withdraw his demand for payment unless the corporation consents to such withdrawal.

If, however, the corporation consents to the withdrawal or the proposed corporate action is abandoned or rescinded by the corporation or disapproved

[84] *Ibid.*
[85] Batas Pambansa Blg. 68, sec. 83.
[86] Act No. 1459, secs. 18 and 28½.

by the Securities and Exchange Commission where its approval is necessary, or if the Securities and Exchange Commission determines that such stockholder is not entitled to the appraisal right, then the right of said stockholder to be paid shall cease. His status as stockholder shall thereupon be restored, and all dividend distributions which would have accrued on his shares shall be paid to him.

Who bears costs of appraisal

The cost and expenses of appraisal shall be borne by the corporation, unless the fair value ascertained by the appraisers is approximately the same as the price which the corporation may have offered to pay the stockholder, in which case they shall be borne by the latter.[87]

In case of an action to recover such fair value, all costs and expenses shall be assessed against the corporation, unless the refusal of the stockholder for receive payment was unjustified.[88]

VIII. DERIVATIVE SUIT

An individual stockholder is permitted to institute a derivative suit on behalf of the corporation wherein he holds stock in order to protect or vindicate corporation rights, whenever the officials of the corporation refuse to sue, or are the ones to be sued or hold control of the corporation. In such case, the suiting stockholder is regarded as a nominal party, with the corporation as the real party in interest.[89]

The Code does not expressly or directly recognize this stockholder's right, but it impliedly does so. This it does when it provides for the liabilities of corporate directors or officers for damages suffered by the corporation and stockholders due to said directors' or officers' unlawful or tortious acts or violation of their fiduciary duties.

Thus, Sections 31 and 34 provide:

> SEC. 31. *Liability of directors, trustees or officers.* — Directors or trustees who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation or acquire any personal or pecuniary interest in conflict with their duty as such directors or trustees shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons.
>
> When a director, trustee or officer attempts to acquire or acquires, in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed in him in confidence, as to which equity imposes a disability upon him to deal in his own behalf, he shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation.

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87 Batas Pambansa Blg. 68, sec. 85.

88 *Ibid.*

89 Gamboa v. Victoriano, L-40620, May 5, 1979, 90 SCRA 40; citing Republic Bank v. Cuaderno, L-22399, March 30, 1967, 19 SCRA 671.

> SEC. 34. *Disloyalty of a director.* — Where a director, by virtue of his office, acquires for himself a business opportunity which should belong to the corporation, thereby obtaining profits to the prejudice of such corporation, he must account to the latter for all such profits by refunding the same, unless his act has been ratified by a vote of the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock. This provision shall be applicable, notwithstanding the fact that the director risked his own funds in the venture.

IX. RIGHTS AND OBLIGATIONS RELATIVE TO SUBSCRIPTIONS

Subscription contracts

One of the ways whereby a person becomes a stockholder of a corporation is through subscription of its stock.

The Code defines subscription as any contract for the acquisition of unissued stock in an existing corporation or a corporation still to be formed, regardless of the fact that the parties refer to it as a purchase or some other contract.[90]

The Code makes irrevocable for six (6) months from its date a subscription for shares of stock of a corporation still to be formed.[91] Revocation may be made only if all the other subscribers give their consent or the incorporation of the corporation fails to materialize within said period or within a longer period as may be stipulated in the contract of subscription. But in no case may this kind of subscription be revoked after the submission of the articles of incorporation of the Securities and Exchange Commission.[92]

Right to certificate

Under Section 64 of the Code, no certificate of stock shall be issued to a subscriber *until the full amount of his subscription,* together with interest and expenses (in case of delinquent shares), if any is due, has been paid. This provision is indicated as having been adopted from Section 37 of Act 1459 without modification, but actually there is a difference. The provision of Section 37 of Act 1459 reads as follows: "No certificate of stock shall be issued to a subscriber as fully paid up until the full par value thereof, or the full subscription in case of no-par value stock, has been paid by him to the corporation." The words "full par value thereof, or the full subscription in case of no-par stock" has been relied upon by the Supreme Court in *Baltazar v. Lingayen Gulf Electric Power Co., Inc.* for its holding that Section 37 makes payment of the *"par value"* as a prerequisite for the issuance of certificates of par value stocks and makes payment of the *"full subscription"* for the issuance *of no par value stocks.* This holding, it will be recalled, spawned confusion and bitter controversy, considering

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90 Batas Pambansa Blg. 68, sec. 60.
91 *Id.*, sec. 61.
92 *Ibid.*
92a G.R. No. 16236, June 30, 1965, 14 SCRA 522.

that in the earlier case of *Fua Cun v. Summers*[93] the Court had held that subscriber for a certain number of shares of stock does not, upon payment of one-half of the subscription price, become entitled to the issuance of certificates for one-half of the number of shares subscribed for; and that the subscriber's right consists only in equity entitling him to a certificate for the total number of shares subscribed by him *upon payment of the remaining portion of the subscription price.*

In effect, Sec. 64 of the Code reaffirms the ruling in *Fua Cun Case* and discards that of *Lingayen Gulf Case.*

Interest on unpaid subscription.

There is likewise an indication that Section 66 of the Code was adopted from Section 37 of Act 1459 without any change. This, again, is misleading. For in fact there are changes. Firstly, Section 37 requires the payment of interest to be made quarterly, while Section 66 of the Code does not specify a time or period for the purpose. Secondly, Section 37 fixes the interest at six per cent unless otherwise provided in the by-laws, while Section 66 of the Code sets the rate at the legal rate in a similar situation. Thirdly, under Section 37, interest is to be paid and reckoned from the date of subscription even if the by-laws do not so provide; but under Section 66 of the Code, interest is to be paid from the date of subscription only if the by-laws so require.

Payment of balance subscription

There is also a difference between the Code and Act 1459 in the matter of when the balance of stock subscription becomes due and payable and when the stocks covered thereby become delinquent.

The old law required both a notice of call and a notice of delinquency and sale, each of which must be published. The notice of call — which must also be served personally or by mail on the stockholder or stockholders concerned — must be published once a week for four successive weeks in a newspaper of general circulation at the place where the principal office of the corporation is located as well as posted in some prominent place "at the works of the corporation, if any such there be."[94] When published in a daily newspaper, the notice of delinquency and sale must be published in ten successive issues of said newspaper previous to the day of sale; and when published in a weekly newspaper, said notice must be published two weeks previous to the day of sale and the first publication must be fifteen days prior to the day of sale.[95]

[93] 44 Phil. 705 (1923).
[94] Act No. 1459, sec. 40.
[95] *Id.*, sec. 41.

The old law also required the board of directors' notice of call to specify the date of delinquency as well as the date of sale. The date of delinquency must be subsequent to the full term of publication of the notice of call but not less than thirty (30) days nor more than sixty (60) days from the date of call; while the date of sale must not be less than fifteen (15) days nor more than sixty (60) days from the date of stock becomes delinquent.[96]

The Code does not require the publication of the notice of call, although it requires service of such notice by mail to be registered. A call is not even necessary when the subscription contract specifies the date on which payment should be made.[97] The Code itself fixes the time when the stocks become delinuent and thus makes a notice of delinquency and its publication unnecessary.

Under Section 67 of the Code, payment of any unpaid subscription or any percentage thereof, together with the interest accrued, if any, shall be made on the date specified in the contract of subscription or on the date stated in the call made by the board. Failure to pay on such date shall render the entire balance due and payable and shall make the stockholder liable for interest at the legal rate on such balance, unless a different rate of interest is provided in the by-laws, computed from such date until full payment.[98]

If within thirty days from said date no payment is made, all stocks covered by said subscription shall thereupon become delinquent and shall be subject to sale in accordance with the Code, unless the board of directors orders otherwise.[99]

If the board of directors decides to order the sale of the delinquent stock, it shall do so by resolution which shall specifically state the amount due on each subscription plus all accrued interest, and the place, date and time of the sale which shall not be less than thirty (30) days nor more than sixty (60) days from the date the stocks become delinuent.[100] Notice of the sale and a copy of the resolution must together be sent to the delinquent stockholder either personally or by registered mail. In addition, it must be published once a week for two consecutive weeks in a newspaper of general circulation in the province or city where the principal office of the corporation is located.[101]

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[96] *Id.*, sec. 38.

[97] Even under the old law, American decisions were cited holding that no call is necessary when the time for payment of subscription is definitely fixed by the contract of subscription.

[98] Batas Pambansa Blg. 68, sec. 67.

[99] *Id.*, sec. 67, second paragraph.

[100] *Id.*, sec. 68, first paragraph.

[101] *Id.*, second paragraph.

If on or before the date specified for the sale the delinquent stockholder does not pay to the corporation the balance due on his subscription, plus accrued interest, costs of advertisement and expenses of sale, delinquent stock shall, unless the board of directors otherwise orders, be sold at public auction to the bidder offering to pay the full amount of said balance, interest, costs and expenses for the smallest number of shares or fraction of a share.[102] The stock so purchased shall be transferred to the purchaser in the books of the corporation and a certificate therefor shall be issued in his favor. The remaining shares, if any, shall be credited in favor of the delinquent stockholder, who shall likewise be entitled to the issuance of a certificate of stock covering such share.[103]

Should there be no such purchaser, the corporation may, subject to the provisions of the Code, bid for the delinquent stock, and the total amount due shall be credited as paid in full in the books of the corporation.[104] Title to all the shares of stock covered by the subscription shall then be vested in the corporation as treasury shares and may be disposed of by it in accordance with the Code's provisions.[105]

This is, of course, without prejudice to the corporation's right to collect by court action the amount due to the unpaid subscription together with the accrued interest, costs and expenses.[106]

Recovery of auctioned stock

The Code, like the old law, recognizes the stockholder's right to recover by court action his auctioned stock. For this right to be evercised, however, the following requisites must concur: (a) there is an irregularity or defect in the notice of sale or in the sale itself; (b) the stockholder has paid or tenders to pay the party holding the stock the sum for which the same was sold, with interest from the date of sale at the legal rate; (c) he files the complaint within six months from the date of sale.[107]

Rights of unpaid shares before and after delinquency

The Code expressly provides that holders of subscribed shares which are not fully paid but not delinquent shall have all the rights of a stockholder.[108]

But upon becoming delinquent, no stock can be voted for or be entitled to vote or to representation at any stockholder's meeting. Nor shall

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[102] *Id.*, third paragraph.
[103] *Ibid.*
[104] *Id.*, fourth paragraph.
[105] *Ibid.*
[106] *Id.*, sec. 70.
[107] *Id.*, sec. 69.
[108] *Id.*, sec. 72.

the holder of such stock be entitled to any of the rights of a stockholder except the right to dividends in accordance with the provisions of the Code.[109] This means that any cash dividends due him shall first be applied to the unpaid balance on his subscription as well as to the costs and expenses, if any; while stock dividends shall be withheld from him until full payment of his subscription.[110]

STOCKHOLDERS OF CLOSE CORPORATIONS

The stockholders in a close corporation enjoy somewhat greater rights and, in some cases, bear greater responsibilities than the stockholders of other stock corporations.

Under the Code, a close corporation is one whose articles of incorporation provide that:

(1) All the corporation's issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than a specified number of persons, not exceeding twenty;

(2) All the issued stock of all classes shall be subject to one or more specified restrictions on transfer permitted by Title XII of the Code; and

(3) The corporation shall not list in any stock exchange or make any public offering of any of its stock of any class.[111]

Even if all these three elements are present, a corporation shall not be deemed a close corporation when at least two-third (2/3) of its voting stock or voting rights is owned or controlled by another corporation which is not a close corporation as above-defined.[112] Nor may the following be allowed to incorporate as close corporation: mining or oil companies, stock exchanges, banks, insurance companies, public utilities, educational institutions and corporations declared by the Batasang Pambansa to be vested with public interest pursuant to Section 140 of the Code.

Classification of shares or rights

The articles of incorporation of a close corporation may provide for a classification of shares or rights as well as the qualifications for owning or holding the same and restrictions on their transfers.[113] They further provide for a classification of directors into one or more classes, each of whom may be voted for and elected solely by a particular class of stock.[114]

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109 *Id.*, sec. 71.
110 *Id.*, sec. 43.
111 *Id.*, sec. 96.
112 *Ibid.*
113 *Id.*, sec. 97.
114 *Ibid.*

Management of business

The Code further allows a close corporation to provide in its articles of incorporation that its business shall be managed by the stockholders rather than by a board of directors.[115] While such a provision continues in effect, no meeting of stockholders for the election of directors need be called.[116] The stockholders of the corporation shall, unless the context clearly requires otherwise, be deemed to be the directors for the purpose of applying the provisions of the Code. And the stockholders shall be subject to all the liabilities of directors.[117] Consistently with this, the Code expressly provides in Section 100 thereof that to the extent that the stockholders are actively engaged in the management or operation of the business and affairs of the corporation, they shall be held to strict fiduciary duties to each other and among themselves. They shall be personally liable for corporate torts unless the corporation has obtained reasonably adequate liability insurance.[118]

Right in case of deadlock

If the directors or stockholders are so divided respecting the management of the corporation's business and affairs that the votes required for any corporate action cannot be obtained with the result that said business and affairs can no longer be conducted to the advantage of the stockholders generally, any stockholder may in writing petition the Securities and Exchange Commission to arbitrate the dispute.[119] This right subsists notwithstanding any contrary provision in the articles of incorporation or by-laws of the close corporation or any contrary agreement of its stockholders.[120]

In such case the Securities and Exchange Commission shall have the authority to make such order as it deems appropriate. Its order may: (1) cancel or alter any provision contained in the articles of incorporation, by-laws or stockholders' agreement; (2) cancel, alter, or enjoin any resolution or act of the corporation or its board of directors, officers, or stockholders; (3) direct or prohibit any act of the corporation or its board of directors, officers, stockholders, or other persons party to such action; (4) require the purchase at their fair value of shares of any stockholder, either by the corporation, regardless of the availability of unrestricted retained earnings in its books, or by the other stockholders; (5) appoint a provisional director; (6) dissolve the corporation; or (7) grant such other relief as the circumstances may warrant.[121]

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115 *Id.*, sec. 97, second paragraph.
116 *Ibid.*
117 *Ibid.*
118 *Id.*, last paragraph.
119 *Id.*, sec. 104.
120 *Ibid.*
121 *Ibid.*

Right to withdraw or dissolve

A stockholder of a close corporation has two other rights which a stockholder in an ordinary corporation does not enjoy. He may, for any reason, compel the corporation to purchase his shares at their fair value, which shall not be less than their par or issued value, when the corporation has sufficient assets in its books to cover its debts and liabilities exclusive of capital stock.[122] By written petition to the Securities and Exchange Commission, he may further compel the dissolution of the corporation whenever any of the acts of the directors, officers or those in control of the corporation is illegal, fraudulent, dishonest, oppressive, or "unfairly prejudicial" to the corporation or any stockholder, or whenever the corporate assets are being misapplied or wasted.[123]

These rights are in addition to and without prejudice to other rights and remedies available to a stockholder under the Code.[124]

CONCLUSION

It may be observed that the Code has introduced some welcome reforms touching the rights and obligations of stockholders. Of these, probably the most noteworthy are the strengthening of the right of inspection, the rejection of *Lingayen Gulf Case* and reaffirmation of *Fua Cun Case,* and the removal of certain publication requirements relative to delinquent stocks.

On the whole, however, it is quite apparent that the Code inordinately discriminates against small in favor of big investors. Even as it curtails the rights of the former and makes things more difficult for them inside the corporation, it grants the latter incentives that are at the expense of the former.

Indeed, it can be said that the Code bears the thumbmark of foreign monopoly capital as well as the stamp of the policy of subservience to it that has characterized our economic and political life since colonial times — with this difference: that the stranglehold of foreign capital has never been so tight and strong as now and that the policy of subservience to it has reached proportions amounting to economic and political suicide for the nation.

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122 *Id.,* sec. 105.
123 *Ibid.*
124 *Ibid.*