DEVICES AFFECTING CONTROL UNDER THE CORPORATION CODE

By

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> Ownership of wealth without appreciable control and control of wealth without appreciable ownership appear to be the logical outcome of corporate development.[1]

Nothing can be more important to many ordinary stockholders than to gain dividends from their investment. But to some shrewd businessmen this may only be a secondary interest for what matters to them is to obtain control of a corporation.

Control of a corporation is a function of the ownership of shares of stock of such corporation. The general rule is that it is proportional to the number of shares a stockholder owns. Hence, the greater the number of shares owned, the greater the extent of control. Conversely, the less the number of shares owned, the less the extent of control. However, this is not necessarily so for it is possible under the corporate system for the stockholders owning only a minority of the shares to obtain control.

Control consists of the capacity to choose directors, and carries with it a measure of influence over them. It is exercised through the voting franchise. It is exercised by a process of casting votes in the election of directors.

The Election of Directors

Under the Corporation Code[2] an annual stockholders' meeting must be held for the election of a fixed number[3] of all directors.[4] Such election

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1 BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 69 (1932).

2 On May 1, 1980 the President approved Batas Pambansa Bilang 68, under section 1 of which, it shall be known as "The Corporation Code of the Philippines." The Code took effect on the date of its approval. The Code was filed in the Batasan Pambansa as Cabinet Bill No. 3, and is based principally on the old Corporation Law, Act No. 1459, as amended, which was enacted on March 1, 1906 and took effect on April 1, 1906. However, amendments of provisions of said law have been made, and new provisions have been incorporated. According to the explanatory note of the bill, the Code is "intended to supplant the present Corporation Law, Act No. 1459, as amended."

3 CORP. CODE, sec. 14(6). The number of directors shall not be less than five (5) nor more than fifteen (15).

4 Under section 47(6) of the Code it is clear that the meeting for the election of directors shall be held annualy, and under section 23 their tenure of office is one year until their successors are elected and qualified.

usually takes place during the regular stockholders' meeting held annually on a date set in the by-laws, or if not so set, on any date in April of every year as determined by the board of directors.[5] As in other stockholders' meetings, the meeting for the election of directors must be held in the proper place, the requisite notice thereof must be given, and the necessary quorum must exist. The place of the meting shal be in the city or municipality where the principal office of the corporation is located, and if practicable in the principal office of the corporation. For this purpose, Metro Manila is considered a city or municipality.[6] The notice must be given in the mode or manner provided by the by-laws.[7] However, if the by-laws are silent on the mode or manner of notice the statutory rule must be followed. Thus, the notice shall be in writing stating the time and place of the meeting[8] and shall be sent to all stockholders of record at least two (2) weeks prior to the meeting, unless a different period is required by the by-laws.[9] The quorum shall consist of the stockholders representing a majority of the outstanding capital stock,[10] including non-voting stocks but the actual voting is clearly limited in favor of voting stocks. Viva voce or hand-raising would be sufficient unless the by-laws provide[11] or any voting stockholder requests for voting by ballot.[12] The candidates receiving the highest number of votes shall be declared elected.[13] Plurality, and not majority of the votes, is required.

The wielder of corporate powers

Once the directors are elected, the stockholders have to relinquish all corporate powers to the board except those powers requiring the intervention of stockholders by express provision of the Code.[14] It is clearly

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5 CORP. CODE, sec. 50, 1st paragraph. Under section 47(6) the by-laws may provide for the time for holding the annual election of directors. This implies that the by-laws may set a date of the meeting for the election of directors different from that of the regular stockholders' meeting.

6 *Id.*, sec. 51, 1st paragraph.

7 *Id.*, sec. 47(6).

8 *Id.*, sec. 51, 2nd paragraph.

9 *Id.*, sec. 50, 1st paragraph.

10 *Id.*, sec. 24.

11 *Id.*, sec. 47(3).

12 *Id.*, sec. 24.

13 *Ibid.*

14 Aside from the election of the board of directors, the following corporate acts require the intervention of stockholders by express provisions of the Code:

(a) Amendment of the articles of incorporation. sec. 16.
(b) Removal of directors. sec. 24.
(c) Filling of vacancies in the board of directors. sec. 29.
(d) Fixing of compensation of directors as such. sec. 30.
(e) Ratification of directors' contract with their corporation. sec. 32.
(f) Extension or shortening of the corporate term. sec. 37.
(g) The increase or decrease of the capital stock, and the incurring, creation or increase of bonded indebtedness. sec. 38.
(h) Issue of shares without pre-emptive right. sec. 39.
(i) Sale or other disposition of all or substantially all corporate assets. sec. 40.

stated that "unless otherwise provided in this Code, the corporate powers of all corporations formed under this Code shall be exercised, all business conducted and all property of such corporations controlled and held by the board of directors."[15] Under this provision, it is quite clear that the board of directors is the supreme and original authority in matters of regular business management of the corporation.[16] "Within the chartered authority the directors have the fullest power to regulate the concerns of the corporation, according to their best judgment, and contracts, which the corporation could legitimately make, come within the scope of the ordinary powers of corporate management."[17] Thus, they have the sole power to appoint the officers of the corporation,[18] declare cash and property dividends,[19] bind the corporation,[20] purchase and sell property,[21] decide whether the corporation should sue,[22] make reasonable donations,[23] and perform any necessary act.[24] Stockholders' resolutions dealing with matters other than the exceptions are not legally effective nor binding on the board of directors, and may be treated by it as merely advisory.[25] If they are not satisfied with the policies of the board, their remedy is to wait for the next election of directors and select new ones to replace them. The theory of a corporation is that the stockholders may have all the profits but shall turn over the complete management of the enterprise to their representatives and agents, called directors.[26] The reason for making the board the wielder of corporate powers is explained as follows:

> The concentration of the power of control of the business and of the appointing of officers and managers in the board of directors is necessary to efficiency in any large organization. Shareholders are too numerous, scattered and unfamiliar with the business of the corporation to conduct its business directly. It is accordingly the plan of corporate organization that the shareholders shall choose directors who shall control and supervise the conduct of the business.[27]

(j) Investment of corporate funds in another corporation or for a purpose other than the principal corporate purpose. sec. 42.
(k) Declaration of stock dividends. sec. 43.
(l) Approval of management contract with another corporation. sec. 44.
(m) Adoption or amendment of by-laws. secs. 46 and 48.
(n) Approval of the plan of merger or consolidation. sec. 77.
(o) Voluntary dissolution of the corporation. secs. 118 and 119.

15 CORP. CODE, sec. 23, 1st paragraph.
16 BALLANTINE, CORPORATIONS 119 (1946).
17 *Ibid.*, citing Beveridge v. New York El. R. Co., 19 N.E. 489 (1891).
18 CORP. CODE, sec. 25.
19 *Id.*, sec. 43.
20 See Ramirez v. Orientalist Co., 38 Phil. 634 (1918); Torres v. Puzon, C.A.—G.R. No. 4474-R, September 28, 1950; Theaters Supply Corporation v. Libañgan Malolos, C.A.—G.R. No. 2830-R, February 28, 1950.
21 CORP. CODE, sec. 36(1).
22 *Id., sec.* 36(7).
23 *Id.*, sec. 36(9).
24 *Id.*, sec. 36(11).
25 Barretto v. La Previsora Fiipina, 57 Phil. 649 (1932).
26 Ramirez v. Orientalist Co., *supra*.
27 BALLANTINE, *op. cit.*, note 16 at 121-122.

Significance of the Election of Directors

The election of directors is a significant right of a stockholder not only because it is the only way he can have a voice in the management of the regular business of the corporation and thus render more secure his right to get his share in the profits of the business and his proportionate share in the assets of the corporation upon liquidation but also it is a way to gain control of such management. Any stockholder or group of stockholders concerned with having some voice in the board of directors can' be expected to press for at least one seat in the board. And whoever is able to elect a majority of the directors would in effect has control of all corporate and business policies.

Due to the fact that the election of directors is a way to gain control, various devices have been conceived by resourceful businessmen with the aid of their lawyers to achieve such goal. Some of these devices have divorced voting control of the stocks from the ownership thereof and most of these have enabled a person or a group of persons owning only a minority of the shares in a corporation to obtain and/or maintain control of such corporation by successfully electing the majority of the directors. The validity and importance of these devices have long been recognized by the business world as well as by the courts and legal authorities. Modern statutes on corporation, including that of the Philippines, deal on these devices.

This paper shall examine below some of the devices which have been used by stockholder groups to obtain and/or maintain such control. Only those devices embodied in the Code will be discussed. Since the Code incorporates principles in common-law jurisdictions, and our Supreme Court has itself relied heavily on American decisions, common law principles and rulings will be relied upon as far as applicable to Philippine conditions.

PROXY

Definition and Nature

A "proxy" is properly the authority given by a stockholder to another to vote for him at a stockholders' meeting. The term is also used to refer to the instrument or paper which is evidence of the authority of the agent.[28] It is also applied to the person who votes for and thus represents the stockholder.[29] A proxy is thus a special form of agency. They proxy holder is an agent whose authority may be general or limited.[30]

A general or unrestricted proxy gives a general discretionary power of attorney to vote for directors and on all ordinary matters that may properly come before a regular meeting, even specific mention of them

[28] *Id.*, at 407.
[29] 5 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS 205 (1952).
[30] BALLANTINE, *op. cit.*, note 16 at 407.

is not made in the notice of the meeting. A general proxy has no authority, however, to vote for fundamental changes in the corporate charter or for dissolution or a transfer of all of the property to another corporation, or other unusual transactions.[31] A limited proxy may restrict the authority to vote on specified matters only and may direct the manner in which the vote shall be cast.[32]

Existence and Denial of the Right

The right to vote by proxy is expressly recognized by law. The Code provides that "stockholders may vote in person or by proxy in all meetings of stockholders."[33]

The question as to whether the by-laws may deny the stockholder the right to vote by proxy has not yet been ruled upon by our Supreme Court. However, our Securities and Exchange Commission has expressed the opinion that the appointment of a proxy is purely personal and an incident of ownership and, therefore, a by-law provision prohibiting the use of proxy is contrary to law and, hence, null and void.[34]

The by-laws may, however, impose conditions as to the form and manner of voting by proxy.[35] But these conditions must be reasonable. A by-law which imposes unreasonably restrictive conditions is void for it is practically a denial of the right to vote by proxy.

Proxy Giver

Proxies may be given only by those who are entitled to vote in the stockholders' meeting.

The Code provides that "every stockholder entitled to vote shall have the right to vote in person or by proxy the number of shares of stock standing, at the time fixed in the by-laws, in his own name on the stock books of the corporation, or when the by-laws are silent, at the time of the election."[36] This provision has completely altered the theory that the owner of the stock at the time of the election has the right to vote in order to avoid the inevitable confusion and uncertainty that would result from stockholders appearing at the meeting and claiming to be owners of stock. The statutory scheme is to allow the corporation either to close the transfer books a certain number of days before the meeting, or to fix a terminal date for the determination of the record holders entitled to vote. The result of this statutory scheme is that the right to vote is no longer an incident of stock ownership, but an incident of finding the

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31 *Ibid.*
32 *Ibid.*
33 CORP. CODE, sec. 58.
34 SEC Opinion, June 3. 1975, SEC FOLIO, 1960-1976, p. 805 (1977).
35 CORP. CODE, sec. 47(4).
36 *Id.*, sec. 24.

stockholder's name on the list of holders as of the record date.[37] The stockholder who is registered on the books on the record date remains the stockholder of record for the given purpose, although he may cease to be the owner by authorized transfer of his shares upon the books before the meeting.[38]

The Code further provides that "no transfer shall be valid, except as between the parties, until the transfer is recorded in the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of certificate or certificates and the number of shares transferred."[39] This provision reinforces the rule that it is the registered owner who is entitled to vote as it is only when a transfer is registered that it is valid as to the corporation. Accordingly, in the case of *Price v. Martin*[40] the Supreme Court held that as to whether the stock is rightfully the property of a person is a question for the courts and not for stockholders' meeting to decide. "Until challenged in a proper proceeding, a stockholder according to the books of the company has a right to participate in that meeting, and in the absence of fraud, the action of the stockholders' meeting cannot be collaterally attacked on account of such participation. 'A person who has purchased stock and who desires to be recognized as a stockholder, for the purpose of voting, must secure such standing by having the transfer recorded upon the books. If the transfer is not duly made upon request, he has, as his remedy, to compel it to be made'."[41]

If the beneficial owner cannot record the transfer on the stock books of the corporation as when the corporate transfer books are closed at the time of the transfer, he can still protect his right by compelling the record owner to give him proxies to vote the stock standing in his name.[42]

With respect to pledged shares and those registered in the name of deceased or incapacitated persons, the Code provides:

> Sec. 55. Right to vote of pledgors, mortgagors, and administrators. — In case of pledged or mortgaged shares in stock corporations, the pledgor or mortgagor shall have the right to attend and vote at meetings of stockholders, unless the pledgee or mortgagee is expressly given such right in writing which is recorded on the appropriate corporate books by the pledgor or mortgagor.
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> Executors, administrators, receivers and other legal representatives duly appointed by the court may attend and vote in behalf of the stockholders or members without need of any written proxy.

[37] ARANOW & EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 343 (1956).
[38] BALLANTINE, *op. cit.*, note 16 at 398.
[39] CORP. CODE, sec. 63.
[40] 58 Phil. 707 (1933).
[41] *Id.*, at 713, citing Morrill v. Little Falls Mfg. Co., 55 N.W. 547 (1893).
[42] In re Giant Portland Cement Co., 21 A. 2d 697 (1941).

The pledgor or mortgagor retains the right to vote the pledged or mortgaged stock in person or by proxy because he remains the owner thereof. However, if there is an express written agreement recorded on the appropriate corporate books giving the pledgee or mortgagee the right to vote such stock, the pledgor or mortgagor cannot exercise such right. It is the pledgee's or mortgagee's vote in person or by proxy which must be accepted.

The executor, administrator or other representative duly appointed by the court is the one who may vote in person or by proxy in behalf of the stockholder of record even though he has no written proxy and has not effected a formal transfer of the stock into his name on the corporate books because the title to the stock vests in the deceased owner's legal representative.[43] This constitutes an exception to the rule in section 24 of the Code that only record holders may vote. In the absence of any appointment of an administrator by the court or any designation of an executor in the will of the deceased stockholder, no one can represent or vote the shares.[44]

When the shares are owned in common by two or more persons, the Code provides for the manner of voting as follows:

> Sec. 56. Voting in case of joint stock. — In case of share of stock owned jointly by two or more persons, in order to vote the same, the consent of all the co-owners shall be necessary, unless there is a written proxy, signed by all the co-owners, authorizing one or some of them or any other person to vote such share or shares: Provided, That when the shares are owned in an "an/or" capacity by the holders thereof, any one of the joint owners can vote said shares or appoint a proxy therefor.

Under the above provision, the right to vote belongs to all co-owners of the stock jointly, and in order for the shares to be voted, they must all sign a proxy authorizing one of them or any other person to vote such shares. In case of disagreement among them, the shares cannot be voted.[45] The rule is different if the shares are owned in an "and/or" capacity. In this case, any co-owner can vote said shares or appoint a proxy therefor.

Proxy Holder

Any person appointed by the stockholder may act as proxy. A stockholder may act for another. The directors and officers may also act as proxies. A by-law cannot limit the appointment of proxies to stockholders of the same corporation for this is unduly restrictive of the freedom to choose one's representative and therefore invalid.[46]

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[43] ARANOW & EINHORN, *op. cit.*, note 37 at 350-351.
[44] SEC Opinion, February 28, 1967, SEC FOLIO, 1960-1976, pp. 281-282.
[45] Tunis v. Hestonville, M & F. Pass R. Co., 24 A. 88 (1892).
[46] See People's Home Sav. Bank v. Superior Court of City and County of San Francisco, 38 P. 452 (1894).

A proxy holder as an agent has fiduciary obligations to perform. The Delaware court has said:

> A person acting as proxy for another is but the latter's agent and owes to the latter the duty of acting in strict accord with those requirements of a fiduciary relationship which inhere in the conception of agency.[47]

A proxy holder is expected to be present and vote the shares he represents in good faith. If he attends the meeting at which he has authority to vote his principal's shares, it is anticipated that his votes, whether tendered or not, are to be counted to determine whether a quorum is present.[48] Having accepted the agency, he has the legal duty of voting the shares as his authority permits and will be held responsible to his principal, as in other agency cases, where he violates his trust. "An agent can always abandon his agency at the expense of assuming the risk of liability if the circumstances as such that the law attaches liability."[49] But abandonment should not be easily assumed and, as stated in a U.S. case, "...relatively slight circumstances ought to justify the conclusion that a solicited agency when granted was assumed and acted on when the occasion for its exercise arises and the agent is present participating in some way in the business with which the proposed agency is concerned."[50] Thus, the proxies held by the corporation's president were counted to obtain a quorum when he departed from the meeting because he was not chosen to be its chairman.

Form, Duration and Termination

The Code states that "proxies shall be in writing, signed by the stockholder and filed before the scheduled meeting with the corporate secretary."[51] The by-laws may not provide that the proxy may be oral. However, the by-laws may require as an additional requirement the acknowledgment before a notary public of the proxy.[52] The by-laws may also prescribe a reasonable period before the meeting when the written proxy should be filed with the secretary; e.g., not later than two days before the meeting.

The Code states: "Unless otherwise provided in the proxy, it shall be valid only for the meeting for which it is intended. No proxy shall be valid and effective for a period longer than five (5) years at any one time."[53] Under this provision, it is clear that the proxy may fix the period during which it may be used, but it cannot exceed five years, renewable for not more than five years for each renewal. Where the proxy does not fix any

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47 Rice and Hutchins Inc. v. Triplex Shoe Co., 147 A. 317, 322 (1929).
48 Duffy v. Loft, 151 A. 223 (1930).
49 *Id.*, at 227.
50 *Ibid.*
51 CORP. CODE, sec. 58.
52 See SEC Opinion, January 4, 1968, SEC FOLIO, 1960-1976, pp. 305-306; 1 S.E.C. BULL. 38 (Oct. 1967).
53 CORP. CODE, sec. 58.

period, then it expires after the meeting for which it was given. It cannot be used again for a subsequent meeting unless it is renewed.

A proxy, like agency in general, is revocable unless coupled with an interest, even though it may expressly be declared to be irrevocable. Revocation of a proxy need not be made by formal notice in writing to the corporation unless so required by statute. Revocation may be expressed to the proxy holder, by a subsequent proxy to another or by sale of the shares. Thus it may be revoked orally or by conduct. Appearing and asserting the right to vote at a meeting revokes a proxy previously given. Like agency in general, proxy is also terminated by the death of the principal, or of the agent, or by the loss of capacity by either party, unless this is changed by statute.[54]

Where the proxy is coupled with an interest, it is irrevocable even though not so stated at least for the period fixed therein, which the Code limits to five years. At the end of five years, whether or not it is coupled with an interest and even where the period fixed exceeds five years, the proxy automatically loses its effectivity. What constitutes a sufficient interest in the shares to make a power to vote them irrevocable is an unsettled question.[55] Each case has to be decided on its own merits. In one case, the Supreme Court considered the proxy in favor of the pledgee of the shares subject of the proxy as a sufficient interest to make such proxy irrevocable.[56] In a U.S. case, it has been held that where the vendor of stock sells after the corporate transfer books have been closed and gives the purchaser a proxy to vote the stock, such a proxy is "coupled with interest" and, therefore, irrevocable.[57]

SEC Regulation

Under Presidential Decree No. 902-A, the Securities and Exchange Commission is given the power to "pass upon the validity of the issuance and use of proxies for absent stockholders."[58] Furthermore, the Revised Securities Act empowers the Securities and Exchange Commission to issue rules and regulations relating to the unlawful solicitation of proxies by any person as well as the unlawful issuance of proxies by any member of a securities exchange, or any broker or dealer of shares of stock belonging to others, to the end that the interest of the investing public will be protected from negligent or fraudulent acts of such persons.[59]

Proxy Voting System and Its Operation

A proxy may be used in any kind of corporation as a device of control. But in most cases it is useful only in widely-held corporation where the

54 BALLANTINE, *op. cit.*, note 16 at 409.
55 *Id.*, at 410.
56 Alejandrino v. De Leon, G.R. No. 49043, December 29, 1943.
57 Boyer v. Nesbitt, 76 A. 103 (1910).
58 Pres. Decree No. 902-A (1976), sec. 6(d).
59 Batas Pambansa Blg. 178 (1982), sec. 34.

stockholders are numerous and widely dispersed. In this kind of corporation many stockholders do not personally attend the stockholders' meeting due to the fact that they are residing in places far from the principal office of the corporation and/or mainly interested in getting dividends from their investment and indifferent to matters of management. It is therefore of great importance that shareholders who cannot or do not care to personally attend the meeting should appoint proxies to represent them to obtain the necessary quorum so that the election of directors may be held.

This situation has enabled the management who may own only a small portion of the corporation's shares to perpetuate itself in office and control the corporation. When notices of a stockholders' meeting are sent out for the election of directors, the management usually mails with the notice a form of proxy soliciting its signature by the stockholder. The persons suggested as proxies, sometimes referred to as the "proxy committee," are selected by the board of directors or officials in power and can be depended upon to vote for the existing directors or their nominees. Usually there is no active contest or opposition proxy committee, and the stockholders' proxy serves as a consent to a quorum and the application of a rubber stamp to the will of the management.[60]

In case there is an active contest between the management and opposition group, the management has the great advantage in the solicitation of proxies which can become bitter, long-drawn and very expensive.

One of the most important advantages available to a management in a proxy contest is its ready access to the corporate treasury to defray many of the expenses of waging the contest. These expenses tend to become more substantial as campaigns become more intense and elaborate. However, management's right to use corporate funds for such purpose is not unlimited but subject to limitations.

The principles applicable to the right of an incumbent management to use corporate funds in a proxy contest are substantially the same as those generally applicable to the use of corporate property. One of these general principles is that corporate property may be used only for a corporate purpose, that is, in furtherance of the interests or activities of the corporation.[61]

A related principle is that an incumbent management may not use corporate funds for personal as distinguished from corporate purposes, and that the expenditure of corporate funds by a management for the sole or primary purpose of retaining control of the corporation is improper.[62]

[60] BALLANTINE, *op. cit.*, note 16 at 412.
[61] ARANOW & EINHORN, *op. cit.*, note 37 at 491.
[62] *Id.*, at 492.

The nature and extent of the expenses which management, in a proxy contest, may pay out of corporate funds will depend to a certain extent upon the general doctrine applied.

If the "policy" approach is taken, as applied in the *Fairchild* case,[63] "corporate directors have the right to make reasonable and proper expenditures, subject to the scrutiny of the courts when duly challenged, from the corporate treasury for the purpose of persuading the stockholders of the correctness of their position and soliciting their support for policies which the directors believe, in good faith, are in the best interest of the corporation."[64]

On the other hand, if the strict and limited doctrine of the *Lawyers' Advertising* case[65] is applied, management's permissible expenditures would be limited to reasonable sums incurred for the purpose of "informing the stockholders fully and fairly concerning the affairs and policies of the corporation, which may well include an explanation of the reasons on account of which its policies have been undertaken" and employment of solicitors to obtain proxies from apathetic stockholders "so as to insure a quorum."[66]

In both cases, the nature and amount of expenditures must be reasonable. However, the requirement of "reasonableness" is sometimes difficult to determine and each case will have to be taken on its own merits, depending on the size of the corporation, its capitalization, the number of shares outstanding, the number of shareholders, and the benefits flowing to them as a result of the contest.

The opposition group, on the other hand, has to defray its own expenses in conducting a proxy contest which is an uncertain thing. If it loses, there will be no chance to charge the expenses to the corporation. If it wins, there is still the somewhat uncertain answer to the question of whether the elected board of directors may legitimately charge the expenses of the successful dissident group to the corporation, either without or with ratification short of unanimity. There are two U.S. cases in which the succeesful opposition group was allowed to be reimbursed for its reasonable expenses in a proxy contest. In each case, reimbursement was ratified by a majority of the stockholders.

The first case is *Steinberg v. Adams*,[67] decided in 1950 by a federal court in New York on the basis of Delaware Law. This case was the result of the 1947 contest for control of the Thompson-Starret Company, which was won by the insurgent group of stockholders. During the contest,

63 Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E. 2d 291 (1955).

64 *Id.*, at 293.

65 Lawyers' Advertising Co. v. Consolidated Ref. Lightning & Refrig., 80 N.E. 199 (1907).

66 *Id.*, at 201.

67 90 F. Supp. 604 (1950).

the defeated management group spent $20,110 of corporate funds for its expenses. After taking control, the insurgents reimbursed themselves out of corporate funds for $27,755 they had spent in the contest. The action of the new board was ratified by a majority vote of the stockholders. A stockholders' derivative action was filed, seeking judgment in favor of the corporation against both the defeated and elected directors for the amount of the corporate funds thus expended. The court, therefore, was presented with the propriety of the use of corporate funds by both the defeated management and the victorious opposition groups. The court easily disposed of the question of management's expenses by citing the many cases which have upheld management's right to use corporate funds. Noting that none of the precedents relating to expenditure of corporate funds in a corporate election "either allowed or disallowed the reimbursement of an insurgent group for the expenses incurred by it in bringing about a change of management," the court concluded:

> My own choice is to draw no distinction between the "ins" and the successful "outs." I see no reason why the *stockholders* should not be free to reimburse those whose expenditures succeeded in ridding a corporation of a policy frowned upon by a majority of the stockholders. Once we assert that the incumbent directors may employ corporate funds in policy contests to advocate their view to the stockholders even if the stockholders ultimately reject their views, it seems permissible to me that those who advocate a contrary policy and succeed in securing approval from the stockholders should be able to receive reimbursement, at least *where there is approval by both the Board of Directors and a majority of the stockholders.* An analogy may be found in the reimbursement of the successful stockholder who brings a derivative action for the benefit of the corporation. There he is reimbursed regardless of the views of the stockholders.[68] (Underscoring supplied)

The second case is the *Fairchild* case,[69] decided by the New York Court of Appeals in 1955 on the basis of New York Law. In this case, the new board of directors, elected by the insurgents, voted to reimburse the insurgents totalling $127,556. The stockholders approved such reimbursement at the next annual meeting. A stockholder filed a derivative action which challenged the legality of such reimbursement as well as the expenses of the previous management. The plaintiff contended that such reimbursement of the insurgents was ultra vires and that ratification by stockholders, unless unanimous, was immaterial.

The Court of Appeals by a four-to-three decision, affirmed the dismissal of the complaint by the lower courts. Three of the four prevailing judges, without attempting to discuss the legal problems involved, merely stated:

> It is also our view that the members of the so-called new group coud be reimbursed by the corporation for their expenditures in this

[68] *Id.*, at 607-608.
[69] See note 63, *supra.*

> contest by affirmative vote of the stockholders. With regard to these ultimately successful contestants, as the Appellate Division below has noted, there was, of course, "no duty ... to set forth of the facts, with corresponding obligation of the corporation to pay for such expense." However, *where a majority of the stockholders chose*—in this case by a vote of 16 to 1—*to reimburse the successful contestants* for achieving the very end sought and voted for by them as owners of the corporation, *we see no reason to deny the effect of their ratification nor to hold the corporate body powerless to determine how its own monies shall be spent.*
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> The rule then which we adopt is simply this: ... *The stockholders,* moreover, *have the right to reimburse successful contestants for reasonable and bona fide expenses incurred by them in any such policy contest,* subject to like court scrutiny.[70] (underscoring supplied)

On the other hand, the opinion of the three dissenting judges that such reimbursement of successful insurgents was absolutely illegal was based on both legal and public policy grounds. They said:

> The corporation lacks power to defray the expenses of the insurgents in their entirety. The insurgents were not charged with responsibility for operating the company. It would be entirely irrelevant whether the operation is "benefited" by their efforts or by the outcome of such an election. The courts could not indulge in a speculative inquiry into that issue. That would truly be a matter of business judgment, and successful insurgents may confidently be relied upon to reimburse themselves whatever may be the real merits of the controversy.[71]

There is still no definte conclusion on this point, although it certainly appears that in order to have the proxy contest expenses of a successful insurgent group charged to the corporation, minimum requirements would be (1) the presence of a policy issue, (2) the stockholder approval, and (3) reasonableness of such expenses.

VOTING TRUST

Definition and Nature

A voting trust may be comprehensively defined as one created by an agreement between a group of the stockholders of a corporation and the trustees, or by a group of identical agreements between individual stockholders and a common trustee, whereby it is provided that for a term of years, or for a period contingent upon a certain event, or until the agreement is terminated, control over the stock owned by such stockholders, either with or without a reservation to the owners or persons designated by them of the power to direct how such control shall be used.[72] Under this arrangement, the stockholder remains the beneficial or equitable owner of the shares, but legal ownership is transferred to the trustee. The essence

[70] *Id.*, at 292.
[71] *Id.*, at 295.
[72] 5 FLETCHER, *op. cit.*, note 29 at 331-332.

of the voting trust therefore is that the real ownership of the shares is divorced from the voting rights.

The voting trust is a more effective control device than the proxy which in many cases proves to be an unreliable one since the issue of what constitutes sufficient interest to render the proxy irrevocable has to be decided on the merits of the case. "To achieve irrevocable proxies the voting trust was developed."[73] In one leading American case[74] a voting trust has been described as "masterpiece of professional ingenuity which confines absolute and uncontrolled discretion to a group whose personal stake in the success of the company is so insignificant that it may be disregarded entirely; x x x which leaves them free from responsibility for their own mistakes, oversights, forgetfulness or want of prudence, and unhampered by any duty even to supervise the proceedings of their own appointees."

Validity of Voting Trust

The current prevailing view toward voting trusts has become that they are valid even in the absence of statute, except where an improper motive or object is shown. The reason is that this device is the only sure method of binding stockholders to vote as a unit and thus assuring a desirable stability and continuity in management in situations where that is needed.[75]

Voting trust agreement is expressly recognized by law. The Code provides:

> Sec. 59. Voting Trusts. — One or more stockholders of a stock corporation may create a voting trust for the purpose of conferring upon a trustee or trustees the right to vote and other rights pertaining to the shares for a period no exceeding five (5) years at a time: Provided, that in the case of a voting trust specifically required as a condition in a loan agreement, said voting trust may be for a period exceeding five (5) years but shall automatically expire upon full payment of the loan. A voting trust agreement must be in writing and notarized, and shall specify the terms and conditions thereof. A certified copy of such agreement shall be filed with the corporation and with the Securities and Exchange Commission; otherwise said agreement is ineffective and unenforceable. 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 pursuant to said agreement. In the books of the corporation, it shall be noted that the transfer in the name of the trustee or trustees is made pursuant to said voting trust agreement.
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> The trustee or trustees shall execute and deliver to the transferors voting certificates, which shall be transferable in the same manner and with the same effect as certificates of stock.

[73] BALLANTINE, *op. cit.*, note 16 at 424.
[74] Warren v. Pim, 59 A. 773, 781 (1950).
[75] BALLANTINE, *op. cit.*, note 16 at 426.

> The voting trust agreement filed with the corporation shall be subject to examination in the same manner as any other corporate book or record: Provided, that both the transferor and the trustee or trustees may exercise the right of inspection of all corporate books and records in accordance with the provisions of this Code.
>
> Any other stockholder may transfer his shares to 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.
>
> No voting trust agreement shall be entered into for the purpose of circumventing the law against monopolies and illegal combinations in restraint of trade or used for purposes of fraud.
>
> Unless expressly renewed, all rights granted in a voting trust agreement shall automatically expire at the end of the agreed period, and the voting trust certificates as well as the trustee or trustees shall thereby be deemed cancelled and new certificates of stock shall be reissued in the name of the transferors.
>
> The voting trustee or trustees may vote by proxy unless the agreement provides otherwise.

Under the above provisions, the following requisites must concur in order that the voting trust may be valid and effective:

(1) It must be in writing and notarized;
(2) A certified copy shall be filed with the corporation and with the Securities and Exchange Commission;
(3) It shall be for a period not exceeding five years at any one time;
(4) The certificates of stock covered by the voting trust agreement shall be cancelled and new ones shall be issued in the name of the trustees stating therein that they are issued pursuant to said agreement;
(5) The transfer must be on the corporate books with a similar statement;
(6) The trustees shall issue voting trust certificates in favor of the transferring stockholders;
(7) It should not be for an illegal purpose—i.e., it shall not be entered into for the purpose of circumventing the law against monopolies and illegal combination in restraint of trade or used for purposes of fraud.

Under the prevailing view, a voting trust should have a legitimate business purpose to promote the best interests of the corporation.[76] It is therefore not considered valid if it exists only for the benefit of the trustees without any obligation to perform any useful service for the protection of

[76] *Id.*, at 427-428.

the stockholder or creditors of the corporation, or if it unduly restricts the powers of directors.[77] Ballantine lists some purposes which have been regarded as legitimate:

> (1) To aid in reorganization plans and adjustments with creditors in bankruptcy or financial difficulty; (2) to assist financing, to procure loans, and to protect bondholders and preferred shareholders; (3) to accomplish some definite plan or policy for the benefit of the company and to assure stability and continuity of management for this purpose; (4) to prevent rival concerns or competitors from gaining control; (5) to apportion representation and protect minority interests or those with balanced holdings, as in corporations to exploit a patent, by putting the selection of directors in impartial hands; (6) in connection with mergers, consolidations or purchases of a business, in order that the predecessors or constituents, though in the minority, may have representation.[78]

Other Statutory Conditions

Aside from the statutory conditions enumerated above which serve to minimize the possible abuses which may be committed as a result of the transfer of legal ownership to the trustee, the Code further requires that no voting trust agreement may be kept secret among the parties thereto. The copy of the agreement filed with the Securities and Exchange Commission as well as in the corporation must be open to examination by any stockholder. Neither can it be exclusive, since the law gives the right to any other stockholder to transfer his shares to the trustee upon the same terms and conditions in the voting trust agreement. Moreover, as in the case of proxy, the Securities and Exchange Commission has the power to pass upon the validity of voting trust agreements for absent stockholders.[79]

Duration and Termination

The maximum period allowed for the voting trust is the same as that of the proxy. However, in the case of the former, the Code expressly makes an exception where the voting trust is specifically required as a condition in a loan agreement, in which case it may be for a period longer than five years but not beyond the time when the loan is fully paid.

A voting trust agreement, which by its terms is irrevocable, can not be terminated by the beneficial owner without the consent of the trustee. It is irrevocable for the duration of the trust for as long as the trustee has not violated the trust by his misconduct or fraud.[80]

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[77] See Marvin v. Solventol Chemical Products, Inc., 298 N.W. 782 (1941).
[78] BALLANTINE, *op. cit.*, note 16 at 429.
[79] See Pres. Decree No. 902-A (1976), sec. 6(a).
[80] Moore v. Bowes, 64 P. 2d 423 (1937).

Rights Under the Voting Trust

The transferring stockholder receives voting trust certificate as evidence of his right which is transferable in the same manner as certificate of stock. As holder of voting trust certificate, he is the "equitable owner" of shares of stock, with a contract right to receive dividends and a transfer of a certain number of shares on the termination of the trust. His remedies are primarily against the trustee, to cancel the trust for fraud, to remove the trustee if guilty of misconduct or for conflicting interest, or sue for an accounting for secret profits.[81] His status has been thus defined as follows: "In law he is a stranger to the corporation. His rights arise from contract and are limited by its terms."[82] He was accordingly held to have no common law or statutory right to enforce an inspection of the corporate books and records by mandamus. However, the Code now expressly gives the transferring stockholder the right to inspect corporate books and records, which right was not granted by the Corporation Law and is denied to him under common law. And for some purposes, he is treated by some courts as having certain of the rights and interests of a stockholder even though the trust agreement expressly provides that all voting and other rights pertaining to the shares of stock shall be exercised by the trustees.[83] He may sue as a stockholder if the suit is in equity or is of an equitable nature, such as, a technical stockholder's suit in the right of the corporation.[84]

On the other hand, the trustee has the following rights:

(1) The trustee shall possess the right to vote and other rights appertaining to the shares transferred and registered in their names, subject to the terms and conditions of the voting trust agreement.
(2) The voting trustee may vote by proxy unless the agreement provides otherwise.
(3) The trustee is qualified to be a director,[85] because as a registered owner, he fulfills the qualification of the Code that he must own at least one share which "shall stand in his name on the books of the corporation."[86]

Holder of Control in Voting Trust

Voting trust agreement may enable the trustee to have control of the management of the corporation although he is "only a sham owner vested with a colorable and fictitious title for the sole purpose of voting upon stock that (he) does not own."[87] This may happen when the trustee

81 BALLANTINE, *op. cit.*, note 16 at 431-432.
82 *Ibid.*, citing State *ex rel.* Crowder v. Sperry Corp., 15 A. 2d 661, 664 (1900).
83 *Ibid.*
84 5 FLETCHER, *op. cit.*, note 29 at 412.
85 See Kardo Co. v. Adam, 231 F. 950 (1916).
86 CORP. CODE, sec. 23.
87 See note 74, *supra*.

receives the controlling interest or majority of the voting shares of the corporation entrusted individually or collectively by the transferring stockholders. Being the controlling stockholder of record in legal contemplation, he is in a position to elect the directors who are in accord with his views on matters of corporate management and policies. He also has the power to elect himself director and the chairman of the board of directors. He and his selected directors who have control of the board have the authority and discretion to chart the policies and to guide the activities of the corporation as long as the trust continues.

Voting trust agreement may make it also possible for a majority group of shareholders to dispose of the beneficial interest in a large proportion of their shares and still retain control. Thus, suppose that a shareholder owns fifty-one percent of the voting shares of a corporation. By cumulative voting, he can elect three out of five directors and so control its operation. But he may be anxious to sell some of his shares, but he cannot do without changing the controlling vote. By means of the use of the voting trust device, he can transfer all his shares to a trustee, subject to the condition that the voting power shall at all times be exercised by the trustee in accordance with the instructions of the holders of majority of the trust certificates. He may now sell forty-nine percent of the trust certificates and shall retain the power to vote, through the trustee, the whole of the trust shares. By this devise, one who owns beneficially but a fraction more than a quarter of the voting stock of a corporation may elect a majority of the directors and thus control its affairs.[88]

POOLING AND VOTING AGREEMENTS

Definition and Distinctions

Pooling or voting agreements may cover a wide range of matters but they are usually concerned with the election of directors. These are agreements between two or more stockholders that are designed to combine votes as a unit or that specify the names of those to be voted for directors. To insure collective voting and to resolve disagreements, various mechanisms are provided for by the parties. The parties may agree that the stock be voted in accordance with majority decisions[89] or with the decision of an arbitrator in case of disagreement.[90]

Pooling or voting agreement is different from a voting trust. In a voting trust there is separation of voting rights of the stock and ownership thereof such that a trustee acquires legal title to and the voting rights of the stock while the transferring stockholder remains the beneficial owner thereof. In the case of a voting agreement, the parties thereto may remain

88 FISHER, PHILIPPINE LAW OF STOCK CORPORATIONS 210 (1929).
89 Smith v. San Francisco & N.P.R. Co., 47 P. 582 (1897).
90 Ringling Bros. v. Ringling, 53 A. 2d 447 (1946).

the legal owners of the stock with the right to vote it, although they undertake to bargain their right to vote it according to their best judgment.[91] This distinction holds true even if the voting agreement provides that the parties shall be bound by the instructions of the arbitrator as to how they shall vote in case of disagreement.Voting trustee has continuous voting control for the duration of the trust while the right of the arbitrator to direct the vote is limited to those particular cases where the stockholder's vote is called for and the parties cannot agree. In a voting trust as generally understood, the trustee in the very first instance determines policy and implements it by his vote while in a voting agreement, the parties have the initial choice to determine policy and that a third party identified as an arbitrator should only resolve the conflict.[92]

Pooling or voting agreement is also different from an irrevocable proxy. In an irrevocable proxy a relationship between a principal and an agent is created such that the agent called the proxy holder must comply with his fiduciary duties and represent his principal in accordance with the authority given. In a voting agreement, an agency relationship is not necessarily created and the use of proxy need not be involved to make it effective.[93]

Validity

Pooling or voting agreements have been upheld as valid by the prevailing number of courts in the United States. In a leading case,[94] the New York Court has said:

> It is not illegal or against public policy for two or more stockholders owning the majority of shares of stock to unite upon a cause of corporate policy or action, or upon the officers whom they select. An ordinary agreement, among a minority in number, but a majority in shares, for the purpose of obtaining control of the corporation by the election of particular persons as directors is not illegal. Shareholders have the right to combine their interests and voting powers to secure such control of the corporation, and the adoption of and adhesion by it to a specific policy and course of business.

Such agreements to vote for particular persons, or as a majority of the shares in the pool may direct, are valid and binding if they do not tend to limit the discretion of the directors nor create any fraud, oppression or wrong against other stockholders.[95] An agreement therefore that the directors once elected must vote for certain persons as officers would be

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[91] E.K. Buck Retail Stores v. Harkert, 62 N.W. 2d 288 (1954).
[92] Ringling v. Ringling Bros., 49 A. 2d 603 (1946).
[93] See note 90, *supra*.
[94] Manson v. Curtis, 119 N.E. 559, 561 (1918).
[95] BALLANTINE, *op. cit.*, note 16 at 422.

void;[96] since the board of directors is vested by law to have the power to choose the officers of the corporation.[97]

The law expressly recognizes the validity of stockholders' agreements in the case of close corporations as defined by the Code.[98] Section 100 of the Code has the following special provisions:

Sec. 100. Agreements by stockholders. —

1. Agreements by and among stockholders executed before the formation of a close corporation, signed by all stockholders, shall survive the incorporation of such corporation and shall continue to be valid and binding between and among such stockholders, if such be their intent, to the extent that such agreements are not inconsistent with the articles of incorporation, irrespective or whether the provisions of such agreements are contained, except those required by this Title to be embodied, in said articles of incorporation.

2. An agreement between two or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as therein provided, or as they may agree, or as determined in accordance with a procedure agreed upon by them.

3. No provision in any written agreement signed by the stockholders, relating to any phase of the corporate affairs, shall be invalidated as between the partics on the ground that its effect is to make them partners among themselves.

4. A written agreement among some or all of the stockholders in a close corporation shall not be invalidated on the ground that it so relates to the conduct of the business and affairs of the corporation as to restrict or interfere with the discretion or powers of the board of directors: Provided, That such agreement shall impose on the stockholders who are parties thereto the liabilities for managerial acts imposed by this Code on directors.

The foregoing are all new provisions which were not at all covered by the Corporation Law. Paragraph 1 refers to stockholders' agreements

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[96] See McQuade v. Stoneham, 189 N.E. 234 (1934).

[97] See CORP. CODE, secs. 23, 24 and 25. However, section 97 of the Code allows a close corporation to provide in its articles of incorporation that all or specified officers or employees shall be elected or appointed by the stockholders, instead of by the board of directors.

[98] The first paragraph of section 96 of the Code reads as follows:

Sec. 96. Definition and applicability of Title. — A close corporation, within the meaning of this Code, is one whose articles of incorporation provide that: (1) All of 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 (20); (2) All of the issued stock of all classes shall be subject to one or more specified restrictions on transfer permitted by this Title; and (3) The corporation shall not list in any stock exchange or make any public offering of any of its stock of any class. Notwithstanding the foregoing, a corporation shall be deemed not a close corporation when at least two-thirds (2/3) of its voting stock or voting rights is owned or controlled by another corporation which is not a close corporation within the meaning of this Code.

in general, including but not limited to voting and pooling agreements. Under this paragraph, pre-incorporation agreements among the stockholders remain effective even after incorporation if such be their intent, and even if they are not contained in the articles of incorporation, unless the matters involved are required by the Code to be embodied therein. The only limitation imposed is that these agreements should not be inconsistent with said articles. Paragraph 3 follows the modern trend of allowing close corporations to operate as a partnership among the stockholders, but remaining a corporation as far as third parties are concerned. Paragraph 4 qualifies the general rule that no voting ageement may interfere with the discretion of the board of directors, and is an incorporation of the rule followed in a number of American cases involving close corporations.[99]

Paragraph 2 refers to pooling and voting agreement in particular. Does this necessarily imply that these agreements can be valid only in close corporations as defined by the Code? It is submitted that there is no reason for stockholders of corporations other than close ones to be denied the right to enter into voting or pooling agreements to protect their interests, as long as they do not intend to commit any wrong or fraud on the other stockholders not parties to the agreement. Of course, voting or pooling agreements are perhaps more useful and more often resorted to in close corporations. But they may also be found necessary even in widely held corporations. Moreover, since the Code limits the definition of close corporations to those which comply with the requirements imposed by section 96, it is completely possible that a corporation which is in fact a close corporation will not come within the definition. In such case, its stockholders should not be precluded from entering into pooling or voting agreements if these are otherwise valid.[100]

Enforcement

The prevailing view is that a valid voting agreement may be enforced by court action by a party thereto.[101] Since it is a contract between the parties, its breach may give rise to liability for damages in proper cases.[102] The remedy of specific performance is also available if there is a violation of a voting agreement in some cases,[103] and where the circumstances warranted, a violation of the agreement has been enjoined.[104]

CUMULATIVE VOTING

Nature and Purpose

Under the method of cumulative voting, a stockholder entitled to vote "shall have the right to vote the number of shares of stock standing at

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99 CAMPOS & CAMPOS, THE CORPORATION CODE, COMMENTS NOTES AND SELECTED CASES 405 (1981).

100 *Ibid.*

101 See note 91, *supra.*

102 *Ibid.*

103 See note 90, *supra;* Clark v. Dodge, 199 N.E. 641 (1936).

104 Trefethen v. Amazeen, 36 A. 2d 266 (1944).

the time fixed in the by-laws in his own name on the stock books of the corporation for as many persons as there are directors or he may cumulate said shares and give one candidate as many votes as the number of directors to be elected multiplied by the number of his shares shall equal, or he may distribute them on the same principle among as many candidates as he shall see fit."[105]

The following simple example will illustrate cumulative voting. Assume that A has 2 shares of a corporation, registered in his name, and 5 directors are to be elected. In such a case, he has 10 votes, this being the product of 2 (shares) and 5 (directors). He may cast 2 votes for each of the 5 candidates, or the total of 10 votes for only one candidate, or 5 votes for one candidate and 5 for another, or otherwise distribute the 10 votes among as many candidates as he may deem fit.

The objective of cumulative voting is to give the minority the opportunity to elect at least one director to the board.[106] Thus, suppose the majority group owns 501 shares and the minority group owns 499 shares, out of a total of 1,000 shares. If there are five directors to be elected, the majority would have a total of 2,505 votes, obtained by multiplying 501 by 5. The minority group would have a total of 2,495 votes, obtained by multiplying 499 by 5. By cumulative voting, the minority may concentrate its votes on 2 candidates, one receiving 1,248 votes and the other receiving 1,247 votes, while the majority may only elect three of its candidates, the highest possible number of votes for its respective candidates being 836, 835 and 834. Clearly, the minority would elect its two candidates, thereby securing representation in the board. This could not happen under the system of straight voting for the majority could always elect all its five candidates to the board each receiving 501 votes while the minority which could cast the maximum of 499 votes for each of its candidates could have no representation on the board at all though it seems obvious even to the most naive that it is entitled to representation considering that it is holding 49.9% of the voting shares or only 2 shares less than those of the majority.

The right to cumulative voting however, has been held not to insure minority stockholders of proportional representation or of representation in the board of directors under all circumstances.[107] In other words, the right to cumulative voting is not equivalent to an absolute right to have representation in the board. The opportunity to have a representative in the board can only be present where the minority owns a sufficient number of shares to elect at least one director.

Dangers in Cumulative Voting

There is a possible danger that, in the use of cumulative voting, a group holding minority of the shares which properly cumulates its shares

[105] CORP. CODE, sec. 24.
[106] BALLANTINE, *op. cit.*, note 16 at 404.
[107] Bohannan v. Corporation Com., 313 P. 2d 379 (1957).

may obtain more representation than it is entitled to if the group controlling the majority of the shares either fails to cumulate its shares or cumulates them badly. There are a number of reported cases dealing with such elections,[108] but simplified hypothetical cases will best demonstrate how this may happen.[109]

Suppose a corporation has 1,000 shares outstanding, all of which will be voted at the meeting at which five-man board of directors is to be elected. The majority group controls 600 shares and the minority group controls 400 shares. It the majority group fails to cumulate its votes casting 600 votes each for its five nominees and the minority group cumulates its votes on three of its candidates for directors casting 668, 667 and 665 votes respectively, the minority can elect these three and have majority control of the board.

Now assume that the majority group controls 550 shares and the minority group controls 450 shares. Underestimating the strength of the minority, the majority cumulates its votes on four of its nominees casting 689, 688, 687 and 686 votes respectively. The minority group cumulates its votes on only three of its candidates casting 751, 750 and 749 votes respectively. The result is the same as if the majority group had failed to cumulate at all—the minority has the majority control of the board.

In case of a tied vote among some who otherwise might have been elected directors, a U.S. court has stated in an obiter dictum that those receiving the highest number of votes are elected and that another election for the officers for which a tie vote resulted must be held and in that election all shareholders may cumulate just before.[110] Hence, a minority might get a greater representation than it was entitled to if this occurred. By way of illustration of the deleterious results possible under a tie vote, let us assume that 1,000 shares are voted in an election of five directors. The majority group controlling 700 shares casts 700 votes for each of its five nominees while the minority group controlling 300 shares cumulates its votes on two of its candidates with one receiving 751 votes and the other 749 votes. The two candidates of the minority are clearly elected but the five nominees of the majority receive equal votes for the other three positions. Under the doctrine set forth by the Ohio court another election would be necessary for the other three directorships, and at this election the minority could vote again and by cumulating its votes again could elect another director. The result is that the minority secures control of the board of directors.

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[108] Pierce v. Commonwealth, 104 Pa. 150 (1883); Wright v. Commonwealth, 1 A. 794 (1885); Tomlin v. Farmers & Merchants Bank, 52 Mo. App. 430 (1893); Schwartz v. State *ex rel.* Schwartz, 56 N.E. 201 (1900); Chicago Macaroni Mfg. Co. v. Boggiano, 67 N.E. 17 (1903); State *ex rel.* Price v. Dubrul, 126 N.E. 87 (1919).

[109] ARANOW & EINHORN, *op. cit.*, note 37 at 299-300.

[110] State *ex rel.* Price v. Dubrul, *supra*.

A siuation can also develop under which a clear majority of shares is inadequate to elect a majority of the board. This is possible with an even number of directors.[111] To illustrate, suppose a corporation has 1,000 shares outstanding and about 900 shares are expected to be represented at the meeting at which an eight-man board of directors is to be elected. The majority group controls 499 shares and the minority group holds 401 shares. The majority cannot be sure of electing the five directors needed to get the majority of the seats at stake. It has 3,992 votes (499 x 8) to divide over five candidates or 801, 800, 798, 797 and 796 votes respectively. The minority with 3,208 votes (401 x 8), cumulated in support of but four candidates, can give each of them 802 votes and hence elect four of the eight-man board.

Safeguards in Cumulative Voting

To prevent the loss of control by the majority to the minority because of improper cumulation of votes and to enable any block to elect a maximum number of directors, the mathematics of cumulative voting should be studied. There are two basic, relatively simple formulas.[112]

The first formula is used to determine the minimum number of shares needed to elect a particular number of directors:

$$X = \frac{(S \times N)}{D + 1} + 1$$

X = minimum number of shares needed
S = total number of shares that will be voted at meeting
N = number of directors desired to elect
D = total number of directors to be elected

For example, assume there exists a corporation with 1,400 shares outstanding and five directors to be elected. A minority group wants to elect two directors. It is estimated that 1,200 shares will be voted at the meeting. Applying these figures to the formula, the resulting calculation is:

$$\overset{\Lambda}{+} \frac{(1{,}200 \times 2)}{5 + 1} \overset{\Lambda}{+} 1 = 401$$

Thus, the minority must have ownership or control of at least 401 shares in order to elect two directors.

The second formula can be used to determine how many directors can be elected by a group controlling a particular number of shares:

[111] BALLANTINE, CASES AND MATERIALS ON CORPORATIONS 431 (1953).

[112] ARANOW & EINHORN, *op. cit.*, note 37 at 296. For an excellent article on the mathematics of cumulatvie voting, see Cole, *Legal and Mathematical Aspects of Cumulative Voting,* 2 S.C.L. Q. 225 (1950).

$$N = \frac{X x (D + 1)}{S}$$

N = number of directors that can be elected
X = number of shares controlled
D = total number of directors to be elected
S = total number of shares that will be voted at meeting

In the example above, assume that the minority knows it will control 401 shares. Applying the figures to this formula, the resulting calculation is:

$$\frac{401 \times (5 + 1)}{1,200} = 2.005$$

It is known that cumulation will result in the election of two directors.

In order to avoid a possible tied vote, the simple expedient of giving one less vote to each succeeding candidate voted upon must be made, that is, an uneven number of votes to each candidate. Thus, the complexities of another election with the minority again cumulating its votes can be avoided.[113]

The possibility that a clear majority of shares is inadequate to elect a majority of the board can be obviated by having an odd number of directors.[114] In this case the majority group would have at least one director more than the minority and thus avoid a stalemate in the board.

Methods of Minimizing the Effect of Cumulative Voting

Aranow and Einhorn discuss five methods of minimizing the effect of cumulative voting, to wit: (1) elimination of cumulative voting, (2) a classified board of directors, (3) reducing the size of the board of directors, (4) removal of minority directors, and (5) increase in total vote cast.[115]

The elimination of cumulative voting is the desire of most management. Their basic argument against cumulative voting is that it would result in the election of directors who are partisans of particular interest groups, whose role would be inherently inconsistent with the proper function of a director to represent all interest groups in the corporation.[116] This extreme action cannot be done by a corporation under the Code since section 24 mandates cumulative voting in stock corporations. A by-law provision curtailing such right is void[117] even as a contract among the stockholders who voted for it.[118] While a corporation may not deny the stockholders

[113] BALLANTINE, *op. cit. supra,* note 111 at 432-433.
[114] *Id.,* at 431.
[115] ARANOW & EINHORN, *op. cit.,* note 37 at 306-309.
[116] For a summary of the arguments for and against cumulative voting which have been set forth in WILLIAMS, CUMULATIVE VOTING FOR DIRECTORS (1951), see BAKER, CASES AND MATERIALS ON CORPORATIONS 209-210 (1959).
[117] SEC Opinion, August 22, 1967, SEC FOLIO, 1960-1976, pp. 293-294.
[118] Sensabaugh v. Polson Plywood Co., 342 P. 2d 1064 (1959).

the right to vote cumulatively in this jurisdiction, a stockholder may elect not to exercise the right "as he may deem fit." It has been held that such a waiver may be effected by a voting agreement among the stockholders.[119] This agreement does not contravene a mandatory statutory provision for cumulative voting since it amounts to no more than a choice not to exercise the right. The Nebraska Court said:

> But *such provision* (referring to the provision for cumulative voting) *does not purport to limit the right* of the stockholder *to contract with reference to his stock.* It grants him a *right or privilege which he may or may not exercise as he sees fit,* but it is one of which the corporation or any agency thereof cannot deprive him. Neither the constitutional provision nor the statute purports to limit the right of the stockholders to contract with other stockholders with respect to such right.[120] (Underscoring supplied)

A classified board of directors, according to Aranow and Einhorn, is one in which the directors are divided into a number of classes, only one class coming up for election each year.[121] In this case the terms of the directors are staggered and each class would serve for a term of more than one year depending on the number of classes. In our jurisdiction this kind of method is not allowed in stock corporations for it would violate the express mandate of the Code that the directors "shall hold office for one year."[122] However, the classification of directors as a method to minimize the effectiveness of cumulative voting is not totally prohibited by the Code. The Code permits close corporation to classify directors, i.e., each class of directors may be voted for and selected solely by a particular class of stocks.[123] But it must be noted that the permission to classify directors in close corporations does not imply also a permission to stagger directors' terms. Although it may be reasonably argued that cumulative voting is anyway already restricted by the permission to classify directors, the staggering of terms would violate the express requirement of section 23 that the directors "shall hold office for one year."

Another way of restricting the effect of cumulative voting is reducing the size of the board of directors. This method makes it more difficult for a minority group to get representation by the use of cumulative voting, as demonstrated by the following simplified illustration. Suppose a corporation has 1,200 shares outstanding and all of which will be voted at the election. If eleven directors are to be elected, the minority group must control 101 shares to elect one director. If it is a five-man board, the minority must control 201 shares to gain one seat in the board.

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119 See note 91, *supra.*
120 *Ibid.*, quoted with approval in Sensabaugh v. Polson Plywood Co., *supra.*
121 ARANOW & EINHORN, *op. cit.*, note 37 at 310.
122 CORP. CODE, see. 23.
123 *Id.*, sec. 97.

Reducing the size of the board of directors can only be effected by the amendment of the articles of incorporation.[124] This method is subject to the legal requirement that the size of the board cannot be below five members.[125]

The removal of minority directors is an even more blunt method of eliminating the effect of the cumulative voting right. Under the Code any director may be removed from office with or without cause by a vote of the stockholders holding or representing at least two-thirds (2/3) of the outstanding capital stock.[126] However, if there is no cause, the power to remove cannot be used to render nugatory the right of representation of the minority through the use of cumulative voting.[127] Hence, this method can not be effectively used by the majority to eliminate the effect of cumulative voting right in this jurisdiction.

One obvious management strategy to offset the effectiveness of cumulative voting is to make vigorous efforts to increase the stockholder representation at the meeting. The larger the total vote the more difficult it will be for a minority group to cumulate successfully. Take the example of a corporation with a five-man board and 1,000 shares outstanding. If only 600 of the shares will be voted at the meeting, the minority group must control 101 shares to elect one director. But if 900 shares are voted at the meeting, then the minority must control 151 shares to elect one director.

CLASSIFICATION OF SHARES

The Code allows classification of shares in Section 6, which provides in part:

> Sec. 6. Classification of Shares. — The shares of stock of stock corporations may be divided into classes or series of shares, or both, any of which classes or series of shares may have such rights, privileges or restrictions as may be stated in the articles of incorporation: Provided, That no share may be deprived of voting rights except those classified and issued as "preferred" or "redeemable" shares, unless otherwise provided in this Code: Provided further, That there shall always be a class or series of shares which have complete voting rights. xxx
>
> Except as otherwise provided by the articles of incorporation and stated in the certificate of stock, each share shall be equal in all respects to every other share.

As pointed out in the above legal provision, the shares issued by a corporation are presumed to be equal. The statutory rule is important in determining the relative rights of the various classes of issued shares.

124 *Id.*, sec. 16 in relation to sec. 14(6).
125 *Id.*, sec. 14(6).
126 *Id.*, sec. 28.
127 *Ibid.*

Thus, where the articles of incorporation and the certificate of stock are silent regarding voting rule, all issued shares shall be considered to have the right to vote. Consequently, if it is intended that any class of shares shall be deprived of voting rights, a provision to that effect must be inserted in the articles of incorporation and in the certificate of stock representing such shares. Such provision may expressly deny the right to vote. The right to vote may also be denied by implication, such as by a provision that the "sole voting power shall reside in the holders of the common stock."[128]

As quoted above non-voting shares shall be limited to preferred or redeemable shares, unless otherwise provided in the Code, and that threre shall always be a class or series of shares which have complete voting rights. This rule prohibits the practice in some common-law jurisdictions of issuing non-voting common stocks for control. However, this rule is subject to the exception with regard to the founders' shares which may be given the exclusive right to vote and be voted for in the election of directors for a limited period.[129]

Non-voting shares are not completely disenfranchised and may still vote in the instances involving major corporate changes, to wit:

1. Amendment of the articles of incorporation;
2. Adoption and amendment of by-laws;
3. Sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of the corporate property;
4. Incurring, creating or increasing bonded indebtedness;
5. Increase or decrease of capital stock;
6. Merger or consolidation of the corporation with another corporation;
7. Investment of corporate funds in another corporation or business in accordance with this Code; and
8. Dissolution of the corporation.[130]

Moreover, where no dividends are declared for three consecutive years inspite of available profits, the non-voting preferred stocks will be given the right to vote for directors until dividends are declared. This is usually required by the Securities and Exchange Commission to prevent abuses.[131]

The device of having several classes of shares can be used to achieve the allocation of control desired by the parties. The rights attached to different classes of shares are arranged so that most of the suppliers of the capital of the corporation are not permitted to vote for directors and only the owners of very small class of shares, or a class representing a very small investment, are allowed to vote. Ownership of just over half of this

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128 Gottschalk v. Avalon Realty Co., 23 N.W. 2d 606 (1946).
129 CORP. CODE, sec. 7.
130 *Id.*, sec. 6.
131 CAMPOS & CAMPOS, *op. cit. supra*, note 99 at 425.

privileged class is sufficient to give legal control and virtually all the powers of majority ownership. Similarly, a very large number of shares of a class of securities having voting power out of proportion to the capital invested may be issued to the controlling group.[132] Thus, by virtue of this device corporate control depends not on the amount of investment made but on the number of voting shares acquired.

Variations in the number of voting shares allocated to each stockholder can be used in order to obtain the desired proportional representation in the board. For example, in a corporation with five stockholders owning very different amount of stock, if each of them is to have equal voting rights, then the same number of common stocks with full voting rights may be issued to each, and any additional investment would be in the form of preferred non-voting stocks. Another example is the case of two identifiable blocks in a corporation with the agreement that one block may elect three directors and the other two directors, which desired proportional representation in the board may be attained by the proper allocation of the number of voting shares to each block.

CLASSIFICATION OF DIRECTORS

The Code gives a special privilege to close corporations in section 97, which in part provides:

> Sec. 97. Articles of Incorporation. — The articles of incorporation of a close corporation may provide:
>
> 1. xxx.
>
> 2. For a classification of directors into one more classes, each of whom may be voted for and elected solely by a particular class of stock;

This device can be used in order to attain the desired proportional representation in the board. If for example, a close corporation has 600 Class A shares, 300 Class B shares, and 100 Class C shares, the articles of incorporation may provide that each class will be entitled to elect a director regardless of the number of shares within such class. If this corporation has seven directors, then the articles may allocate four directors for Class A, two directors for Class B and one director for Class C. Within each class, cumulative voting may also be exercised by the stockholders of such class to elect their representative or representatives to the board. But to the extent that each class can elect its own director regardless of the number of shares in such class, cumulative voting is in effect restricted.

The above situation would not be possible in corporation which does not qualify under the Code as close corporation, or which qualified as close corporation but does not provide in the articles for a classification of directors, since the number of votes of each stockholder depends on

[132] See BERLE & MEANS, *op. cit.*, note 1 at 75-77.

the number of shares he owns, with the right to exercise cumulative voting in favor of one more of his selected candidates. Thus, the first group, by cumulating their 4,200 votes (600 x 7) and distributing them properly among five candidates, can be assured of five seats in the board. The second group, having 2,100 votes (300 x 7) can elect the remaining two directors. The third group with only 700 votes (100 x 7) cannot elect even one, unless the second group cumulates all their votes in favor of only one candidate or cumulates them badly, allowing the third group to gain one seat.

PRESCRIBING QUALIFICATIONS FOR DIRECTORS

Under section 47(5) of the Code, a corporation is authorized to provide in its by-laws for the qualifications of its directors, provided that they are not inconsistent with the qualifications prescribed by the law.[133] Under this provision, it would be possible to prescribe certain qualifications for directors as a device of control. Thus, a by-law provision that only stockholders with a stated minimum number of shares fully paid up may be elected as directors is valid.[134] This is not inconsistent with the law, because the law requires only that a director must own at least one share of stock, implying that a director may be required to have more than one. A by-law which disqualifies a person who has a substantial interest in a competitor corporation has been upheld as valid, and as a reasonable means of protecting the corporation from the possible adverse effects of conflicting interests of a director.[135] Conceivably, a by-law which requires an elected director to be at least twenty-five (25) years old, or to have had some experience or skill in business, finance or law would be valid, since these qualifications, would promote the efficient management of the corporation. In other words, as long as the qualifications imposed are reasonable and not intended to unjustly or unfairly deprive the minority of their rightful representation in the board of directors, they are within the powers of the holders of the majority of the stocks to provide in the by-laws.[136]

Some corporations provide in their by-laws that only holders of "founders' shares" may become directors. This is allowed by the Code under certain conditions. Section 7 provides:

> Sec.7. Founders' shares. — Founders' shares classified as such in the articles of incorporation may be given certain rights and privileges not enjoyed by the owners of other stocks, provided that where the exclusive right to vote and be voted for in the election of directors is granted, it must be for a limited period not to exceed five (5) years subject to the approval of the Securities and Exchange Commission. The five (5) years shall commence from the date of the approval by the Securities and Exchange Commission.

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[133] SEC may disapprove by-laws which it believes to be inconsistent with law. See CORP. CODE, secs. 46 and 48.

[134] See Gov't. v. El Hogar Filipino, 50 Phil. 399 (1927).

[135] See Gokongwei v. SEC, G.R. No. 45911, April 11, 1979.

[136] CAMPOS & CAMPOS, *op. cit. supra*, note 99 at 427-428.

The above provision is intended to be an exception to the rule in Section 6 of the Code that "no share may be deprived of voting rights except those classified and issued as 'preferred' or redeemable' shares, unless otherwise provided in this Code." In other words, founders' shares may be given the exclusive right to vote for a limited period although all stocks of the corporation are common, non-redeemable shares.

It is interesting to note that the Code does not define the meaning of founders' shares. It is presumed that these are shares which are originally owned by those who founded the corporation, and which may be transferred without losing their character as founders' shares.

The period of five years is not extendable; otherwise, other stockholders may almost perpetually be disqualified to become directors. Without this limitation, the minority stockholders can never hope to be represented in the board of directors although their shares may be sufficient in number to elect, by means of cumulative voting, at least one director.

The approval by the Securities and Exchange Commission is required by the Code. The implication is that the Commission may disapprove, but on what grounds, the law does not state. It is submitted that if the privilege granted to the founders' shares would, under the circumstances, prove manifestly oppressive to the other stockholders, the Commission may disapprove the issuance of founders' shares.[137]

This control device of prescribing qualifications for directors narrows down the choice of directors to those meeting the qualifications. It is thus possible that the largest stockholder in terms of his shares of the capital stock of the corporation may not become a director if he does not possess the qualifications prescribed by the by-laws. The by-laws must first be amended before he can qualify. The minority stockholders may even control the management of the corporation by having a majority of those qualified to become directors.

RESTRICTIONS ON TRANSFER OF SHARES

General Rule

Transferability of shares is one of the great advantages of the corporate form over the partnership. Such transferable units of interest represented by certificates furnish an important facility in raising capital for large undertakings from large and also from many small investors. Transferable certificates for shares facilitate both investment and also speculation on the security market. They give great liquidity to stock investments. The investors may realize upon them promptly, if there is any public market, and may pledge them as security for loans.[138]

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137 *Ibid.*
138 BALLANTINE, *op. cit.*, note 16 at 736.

The right to transfer shares is an incident of ownership. The shares of stock "are personal property and may be transferred by delivery of the certificate or certificates indorsed by the owner or his attorney in fact or other person legally authorized to make the transfer."[139] Thus, in *Fleischer v. Botica Nolasco*[140] our Supreme Court said:

> The jus disponendi, being an incident of ownership of property, the general rule x x x is that every owner of corporate shares has the same uncontrollable right to alienate them which attaches to the ownership of any other species of property. A shareholder is under no obligation to refrain from selling his shares at the sacrifice of his personal interests, in order to secure the welfare of the corporation or to enable another stockholder to make gains and profits.

The Court continued:

> The only restraint imposed by the Corporation Law upon transfer of shares is found in Section 35 of Act No. 1459 (now section 63 of the Code) x x x as follows: "No transfer, however, shall be valid except as between the parties, until the transfer is entered and noted upon the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of the certificate, and the number of shares transferred." This restriction is necessary in order that the officers of the corporation may know who are the stockholders, which is essential in conducting elections of officers, in calling meetings of stockholders, and for other purposes.[141]

The Court accordingly held that the provision of a by-law which creates in favor of the corporation the preferential right to buy, under the same conditions, the shares of stock of a retiring stockholder is ultra vires.

Exception

The rule of free transferability of shares is now modified by the Corporation Code which allows restrictions upon the transfer of shares in a close corporation. The following are the pertinent provisions:

> Sec. 96. Definition and applicability of Title. — A close corporation, within the meaning of this Code, is one whose articles of incorporation provide that: x x x x; (2) All the issued stock of all classes shall be subject to one or more specified restrictions on transfer permitted by this Title; x x x x.
>
> Sec. 97. Articles on incorporation. — The articles of incorporation of a close corporation may provide:
>
> 1. For a classification of shares or rights and the qualifications for owning or holding the same and restrictions on their transfers as may be stated therein, subject to the provisions of the following section;
>
> 2. x x x x.
>
> Sec. 98. Validity of restrictions on transfer of shares. — Restrictions on the right to transfer shares must appear in the articles of incorporation

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139 CORP. CODE, sec. 63.
140 47 Phil. 584, 591 (1925).
141 *Id.*, at 592.

and in the by-laws as well as in the certificate of stock; otherwise, the same shall not be binding on any purchaser thereof in good faith. Said restrictions shall not be more onerous than granting the existing stockholders or the corporation the option to purchase the shares of the transferring stockholder with such reasonable terms, conditions or period stated therein. If upon the expiration of said period, the existing stockholders or the corporation fails to exercise the option to purchase, the transferring stockholders may sell his shares to any third person.

Sec. 99. Effects of issuance or transfer of stock in breach of qualifying conditions. —

1. If stock of a close corporation is issued or transferred to any person who is not entitled under any provision of the articles of incorporation to be a holder of record of its stock, and if the certificate for such stock conspicuously shows the qualifications of the person entitled to be holders of record thereof, such person in conclusively presumed to have notice of the fact of his ineligibility to be a stockholder.

2. If the articles of incorporation of a close corporation states the number of persons, not exceeding twenty (20), who are entitled to be holders of record of its stock, and if the certificate for such stock conspicuously states such number, and if the issuance or transfer of stock to any person would cause the stock to be held by more than such number of persons, the person to whom such stock is issued or transferred is conclusively presumed to have notice of this fact.

3. If a stock certificate of any close corporation conspicously shows a restriction on transfer of stock of the corporation, the transferee of the stock is conclusively presumed to have notice of the fact that he has acquired stock in violation of the restriction, if such acquisition violates the restriction.

4. Whenever any person to whom stock of a close corporation has been issued or transferred has, or is conclusively presumed under this section to have, notice either (a) that he is a person not eligible to be a holder of stock of the corporation, or (b) that transfer of stock to him would cause the stock of the corporation to be held by more than the number of persons permitted by its articles of incorporation to hold stock of the corporation, or (c) that the transfer of stock is in violation of a restriction on transfer of stock, the corporation may, at its option, refuse to register the transfer of stock in the name of the transferee.

5. The provisions of subsection (4) shall not be applicable if the transfer of stock, though otherwise contrary to subsections (1), (2), or (3), has been consented by all the stockholders of the close corporation, or if the close corporation has amended its articles of incorporation in accordance with this Title.

6. The term "transfer", as used in this section, is not limited to a transfer for value.

7. The provisions of this section shall not in any way impair any right which the transferee may have to rescind the transfer or to recover under any applicable warranty, express or implied.

All of these provisions are new. Do these provisions necessarily imply that restrictions on the transfer of stocks, however reasonable they may be, are absolutely prohibited in corporations which do not fall within the definition of the Code of a close corporation? It is submitted that since these provisions are admittedly exceptions to the fundamental rule of free transferability of shares, the logical conclusion would seem to be that such restrictions cannot be valid in other corporations.[142]

As a Method of Control

The incumbent management group maintains control either because the stockholders personally and actively support it or they are indifferent to matters of management and merely sign the solicited proxy by the management. A problem may be faced by the management if the shares owned by these stockholders are transferred to persons who may be interested in the control of the corporation. The transfer of shares to unfriendly hands would be a threat to the stability and continuity of management.

To keep control within the group most interested in the stability and continuity of management or to keep shares out of unfriendly hands, the effective device is to impose reasonable restrictions upon the transfer of shares. However, this method of control is applicable only in close corporations as defined by the Code on the ground explained above.

CONCLUSION

This paper is not an exclusive enumeration of the devices affecting control of a corporation under the Code. Only those devices which enable a group of stockholders to obtain and/or maintain control by successfully electing the majority of directors are covered herein. Management contracts[143] and unusual voting and quorum requirements,[144] the two other devices affecting control which are expressly allowed by the Code, are not covered because they affect control in the management of the corporation not through the election of directors. In management contracts, one corporation called the managed corporation authorizes another corporation called the managing corporation to perform all managerial functions usually pertaining to general manager. In unusual voting and quorum requirements, the voting or quorum requirements in meetings of stockholders or directors are increased beyond the minimum required by law so that the minority is in effect given a stronger veto power in some cases especially in major corporate decisions.

The express provisions of the Code on the abovementioned devices do not imply that all other devices affecting control which are recognized as valid in other jurisdictions are prohibited by the Code. For instance, the Supreme Court had already recognized the validity of management contracts in *Philippine National Bank v. Producers Warehouse Association*[145]

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[142] CAMPOS & CAMPOS, *op. cit. supra*, note 99 at 851.
[143] CORP. CODE, sec. 44.
[144] *Id.*, sec. 97.
[145] 42 Phil. 608 (1922).

even before the advent of the Code. Thus, pyramiding,[146] tender offer,[147] and other corporate control devices conceived and to be conceived by ingenious businessmen and their lawyers may be used in this jurisdiction to achieve their goals even without the express grant by the Code provided they are not contrary to law, morals, good customs, public order, or public policy.

Control is perhaps not as important a phenomenon in the Philippine corporate system as that in the American corporate system where there is concentration of economic power in giant corporations which administer the essential services of supply in the American economy and thereby affect its economic system. But one thing is certain. Control will grow in significance in law and in economic and social fact not only in the American corporate system but also in the Philippine corporate system as the corporation is increasingly acknowledged as an institution of primary significance, an institution which can assemble great amount of wealth, make possible the concentration of economic power in the hands of a few men through the separation of ownership of property from its control, and touch not only the lives of tens or hundreds of employeees and the property of tens or hundreds of thousand investors but the other sectors of the economy as well.

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146 Pyramiding is the use of holding companies or a series of holding companies holding controlling shares of their subsidiaries. The effect of such a series of holding companies, each controlling a bare majority of the shares of the one preceding it as a subsidiary, is to give to the holder of a majority of the shares of the last corporation having perhaps only a small capital investment, the control of the entire system or series with a capital of many millions. BALLANTINE, *op. cit.*, note 16 at 417.

147 Tender offers are now expressly regulated by section 33 of Batas Pambansa Blg. 178, otherwise known as the Revised Securities Act. A tender offer is defined as a bid or request to purchase securities so that a person will become the beneficial owner of more than ten percent (10%) of the equity of a corporation. GOPENGCO, MERCANTILE LAW COMPENDIUM 303 (1983).

Tender offer is an offer to purchase shares made by one company direct to the stockholders of another company, sometimes subject to a minimum and/or a maximum that the offeror will accept, communicated to the shareholders by means of a newspaper advertisements and (if the offeror can obtain the shareholders' list, which is not often unless it is a friendly tender) by a general mailing to the entire list of shareholders, with a view to acquiring control of the second company. BLACK'S LAW DICTIONARY 1316 (5th ed., 1979).

For an extensive discussion and application of this control device, see ARANOW & EINHORN, TENDER OFFERS FOR CORPORATE CONTROL (1973) and DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL (c1977).

Erratum:

Due to printer's error, the pagination for this issue (Vol. 58, Second Quarter) runs from page 1 to 114; it should, instead, run from page 131 to 244.

The pagination for each article should thus be:

To avoid confusion between citations of this issue and the Vol. 58, First Quarter issue, please use the above pagination when citing this issue.

Ex. Reyes, *The Trend Toward Equity Versus Positive Law In Philippine Jurisprudence*, 58 PHIL. L. J. 131 (1983).

We apologize to our readers for the inconvenience.