

Chapter 17: One Person Corporation

Concept

- A one person corporation (OPC) is a stock corporation with a single stakeholder who must be:
 - A natural person of legal age;
 - A trust; or
 - An estate
- It is an “incorporated sole proprietorship”
- It is primarily a “for profit” corporate vehicle and generally cannot be employed by a natural person to practice a profession, unless a special law allows it
- Although theoretically there can result a nonstock corporation with a single member, such would not fall under the ambit of an OPC

Persons not allowed to organize an OPC

- a. Corporation, partnership and other juridical entities cannot constitute themselves as a single stockholder
 - i. This does not discount the fact that during the term of an ordinary stock corporation that a single juridical entity may end up being the sole shareholder
- b. Business enterprises vested with public interests cannot be pursued through the OPC
 - i. An OPC cannot be organized to pursue the business of banks and quasi-banks, preneed, trust and insurance companies, public and publicly listed companies or as a nonchartered GOCC
 - ii. This is impossible because an OPC cannot have 20% of the BOD constituted of independent directors

Natural person as the single stockholder

- a. Single stockholder as nominee – There is no requirement under the RCC that such stock corporation would not qualify as an OPC if the single stockholder is holding shares as a nominee for another person (which may not be a natural person)
 - i. A foreign natural person may setup an OPC
- b. ‘Trust’ as the single stockholder – The trustee of the trust properties, when he is a natural person qualified to incorporate the trust estate into an OPC, as the single stockholder.
- c. ‘Estate’ as the single stockholder – Whoever is the fiduciary holding title to the estate, provided he is a natural person, may validly incorporate the estate into an OPC, with himself as the single stockholder

Registration of the OPC

1. No minimum or maximum capitalization imposed for OPCs
 - a. An OPC is considered to be a corporate taxpayer (if its net taxable income is

>P8 million, it will have a lower tax rate than an individual)

2. AIBL (no need to submit and file bylaws)
 - a. Corporate name – The letters “OPC” must be clearly indicated either below or at the end of its corporate name
 - b. OPC under the name of the estate/trustee – The name, nationality, and residence of the trustee together with the proof of such authority to act on behalf of the the trust or estate
 - c. Nominee/alternate nominee – Names, nationality, residences of the nominee and alternate nominee, and the extent, coverage and limitation of the authority
3. Term of existence – Perpetual (general rule)
 - a. Estate OPC – May be dissolved upon partition
 - b. Trust OPC – May be dissolved upon proof of termination of the trust

Organization and management of the OPC

Corporate organization of the OPC

- a. Single stockholder as the sole director and president
- b. Corporate officers:
 - i. Corporate secretary who is not the single stockholder
 - ii. Treasurer who may be the single stockholder
 - iii. Other officers

Management of the OPC

- a. Minutes book – Contains all actions, decisions and resolutions taken by the OPC
- b. Reportorial requirements:
 - i. AFS
 - ii. A report containing explanations or comments by the President made by the auditor
 - iii. A disclosure of all self-dealings and related party transactions between the OPC and the single stockholder
 - iv. Other reports as required by the OPC

Liability of the single stockholder

Section 130. Liability of Single Shareholder. - A sole shareholder claiming limited liability has the burden of affirmatively showing that the corporation was adequately financed.

Where the single stockholder cannot prove that the property of the One Person Corporation is independent of the stockholder's personal property, the stockholder shall be jointly and severally liable for the debts and other liabilities of the One Person Corporation.

The principles of piercing the corporate veil applies with equal force to One Person Corporations as with other

corporations.

To avail of limited liability, the single stockholder has the burden of:

- a. Affirmatively showing that the corporation was adequately financed, and
- b. Proving that the property of the OPC is independent of the single stockholder's separate (noninvested properties)¹

Else: The single stockholder is solidarily liable with the OPC

- The piercing doctrine is equally applicable to the OPC!
 - However, **only the fraud piercing** and the **public convenience piercing** are applicable—never the *alter ego* piercing.

Affirmatively showing that the OPC 'was adequately financed'

- The use of the term "was" indicates that the OPC should be adequately financed at the point of incorporation
- CLV: The "burden of affirmatively showing that the corporation was adequately financed" makes the OPC a more unattractive corporate medium for equity venturers when compared to the close corporation and the ordinary stock corporation.
- Effect on the piercing doctrine: The piercing doctrine of inadequate capitalization as a means to pierce the veil of corporate fiction should only be applied in favor of corporate creditors who are not in a position to determine whether the corporation is adequately capitalized to operate sustainably to answer for its debts and liabilities
 - The piercing should follow the doctrine of "undercapitalized business venture."

Proving that OPC's property "is independent of the single stockholder's personal property"

- This refers to the period of conduct of the business operations
 - More precisely, when the OPC **becomes insolvent** by the fact that debts and liabilities are now greater than its own assets
- It can cover either of the following situations:
 - Alter ego piercing doctrine test: When the assets and properties of the corporation are mixed with those of the acting stockholders, such that a clear delineation of the difference between the two sets of assets and properties can no longer be made by the public for the proper enforcement of the doctrine of limited liability, then the separate juridical personality may be pierced

¹ This only means that the default rule for a one-person corporation is *unlimited liability*. It is up to the single shareholder to prove the ones in § 130, RCC so he can benefit from the limited liability of a corporate setup.

- Company in a state of insolvency: The OPC is insolvent when its debts and liabilities can no longer be paid without the single stockholder putting up some of his noninvested assets and properties into the OPC

Piercing doctrine vis-a-vis OPC

- In OPCs, the burden of proof to avail the limited liability rule is placed upon the shoulders of the single stockholders!
- Conversely, the creditors have to show either that the OPC is undercapitalized at the time of incorporation, or the OPC is insolvent.
 - In such a case, the single stockholder becomes solidarily liable
 - No fraud need be alleged!

Conversion scenarios

Conversion of ordinary stock corporation to an OPC

Section 131. *Conversion from an Ordinary Corporation to a One Person Corporation.* When a single stockholder acquires all the stocks of an ordinary stock corporation, the latter may apply for conversion into a One Person Corporation, subject to the submission of such documents as the Commission may require. If the application for conversion is approved, the Commission shall issue a certificate of filing of amended articles of incorporation reflecting the conversion. The One Person Corporation converted from an ordinary stock corporation shall succeed the latter and be legally responsible for all the latter's outstanding liabilities as of the date of conversion.

- When one shareholder acquires *all* the shares in an ordinary stock corporation, the latter may apply for conversion into an OPC.
 - Once so converted, the OPC shall succeed and be legally responsible for all the latter's outstanding liabilities as of the date of conversion
- There is **no ipso jure conversion when there is a single stockholder in an ordinary stock corporation!**
 - Cf. § 10, if at the point of incorporation there is only one natural-person-stockholder, there is no choice but to incorporate it as an OPC.²

Conversion of an OPC to an ordinary stock corporation

Section 132. *Conversion from One Person Corporation to an Ordinary Stock Corporation.* – A One Person Corporation may be converted into an ordinary stock corporation after due notice to the Commission of such fact and of the circumstances leading to the conversion, and after compliance with all other requirements for stock

² **Section 10.** *Number and Qualifications of Incorporators.* – [...] A corporation with a single stockholder is considered a One Person Corporation as described in Title XIII, Chapter III of this Code.

corporations under this Code and applicable rules. Such notice shall be filed with the Commission within sixty (60) days from the occurrence of the circumstances leading to the conversion into an ordinary stock corporation. If all requirements have been complied with, the Commission shall issue a certificate of filing or amended articles of incorporation reflecting the conversion.

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The ordinary stock corporation converted from One Person Corporation shall succeed the latter and be legally responsible for all the latter's outstanding liabilities as of the date of conversion.

- An OPC may be converted into an ordinary stock corporation after due notice to the SEC, and complying with SEC requirements
- There is **no ipso jure conversion of an OPC into an ordinary stock corporation once it has become constituted of more than one natural-person-stockholder**
 - It remains governed by Ch. III, Tit. XIII, RCC.
 - It must, however, apply for conversion—else, it risks being unlimitedly liable.

Conversion in case of death of the single stockholder

Section 132. *Conversion from One Person Corporation to an Ordinary Stock Corporation.* –

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In case of death if the single stockholder, the nominee or alternate nominee shall transfer the shares to the duly designated legal heir or estate within seven (7) days from receipt of either an affidavit of heirship or self-adjudication executed by a sole heir, or any other legal document declaring the legal heirs of the single stockholder and notify the Commission of the transfer. Within sixty (60) days from the transfer of the shares, the legal heirs shall notify the Commission of their decision to either wind up and dissolve the One Person Corporation or convert it into an ordinary stock corporation.

- In case of death of the single stockholder, the nominee/alternate nominee shall transfer the shares to the duly designated legal heir or estate and notify the SEC
- The language is mandatory—when the single stockholder dies, it is mandatory for the nominee or alternate nominee to transfer the shares of the OPC to the sole heir/estate
- If there's only one heir, the OPC can subsist, with only the sole heir as the new single stockholder
- CLV: When there are several heirs and the shares are transferred to the estate of the decedent, the OPC can continue to subsist with the estate (*i.e.*, the administrator of the estate or the designated trustee of the heirs) as the Single Stockholder

Essence of the close corporation

- Close corporations are those in which the major part of the indicated shareholders to whom the powers have been granted, on the happening of vacancies among them, have the right of themselves to appoint others to fill such vacancies, without allowing to the shareholders any vote/choice in the selection of such new officers; or where the business policy or activities are entirely dominated for practical purposes by the majority stock ownership of a family whose stock is *not* traded in any market and is very infrequently sold
- **Essence of a stock corporation:** The identity of stock ownership and active management, *i.e.*, all/most of the shareholders are active in the corporate business either as directors, officers, or other key men in management.

Statutory definition

- A close corporation is defined as “one whose articles of incorporation provide” that:
 - Clause limiting shareholders to 20: 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 20
 - Right of first refusal clause: All of the issued shares of all classes shall be subject to one or more specified restrictions on transfer (ROFR)
 - No listing or public offering clause: The corporation shall not list in any stock exchange or make any public offering of any class of shares
- Notwithstanding the presence of all three, a corporation shall not be deemed a close corporation when at least $\frac{2}{3}$ of its voting rights is owned or controlled by another corporation which is not a stock corporation

Effects of share transfers in violation of the conditions/requisites of the close corporation

- Under § 98, except when the transfer has been “consented to by all the stockholders” or “if the close corporation has amended its articles of incorporation,” the corporation may refuse to register the transfer, whether onerous or gratuitous in the name of a transferee who has/is conclusively presumed to have notice:
 - Of his ineligibility to be a shareholder of the corporation;
 - That the transfer of share would cause the shares of the corporation to be held by more than the persons permitted under the AI; or
 - That the transfer violates a restriction on transfer of stock
- There is a conclusive presumption to have known the ineligibility of being a stockholder in any of the

following circumstances where the stock certificate conspicuously states the:

- Qualifications of the persons entitled to be holders thereof, and the transferee is ineligible
- Number of persons entitled to be shareholders, and the issuance/transfer to any person would cause the shares to be held by more than such number of persons
- Restriction on transfer of the corporation's share, and the transferee acquires the share in violation of such restriction
- **But: Even if the transfer of shares in a close corporation is made in violation of the restrictions enumerated, such transfer is still valid if it has been consented to by all the shareholders** and the corporation cannot refuse to register the transfer of share in the name of the transferee (*Florete Sr. v. Florete Jr.*)
- A factual transaction that violates a particular requisite does *not ipso facto* convert the corporation to a regular corporation

De facto close corporations

- Those who did not comply with the three requisites in § 95 are “de facto close corporations”
- Compliance with the formalities under § 95 would conclusively bring about the covered corporate entity within the application of tit. XII, and the manner by which management or operations of the corporation are being handled are not necessary to invoke doctrines pertaining to close corporation (*i.e.*, you just have to satisfy the three requirements)
- When the formalities in § 95 are not present, there is a need to prove during trial that the existing corporate structure, management and operation of the corporation do bring it into the fold of what is a ‘close or family corporation”
- Outside the formalities in § 95, the essence of a “close or family corporation” is not simply concentration or control of equity in one family/close group, but rather a convergence into a small group of individuals, usually (but not necessarily) all members of a family group, of both ownership and management of corporate affairs, which would be the same as the informality that would bring about piercing the veil of corporate fiction based on fraud or *alter ego* considerations
- A close corporation that complies with §95 is treated in accordance with tit. XII and would not be considered as a situation where there is a piercing of the veil; whereas a corporation found to be a close corporation outside the formalities of § 95 would be governed by tit. XII but under a premise of piercing the veil of corporate fiction

Impetus for the medium of close corporation

- It is essentially an incorporated partnership
 - The strong juridical personality, limited liability and right of succession are all features of a corporate entity that the law

upholds and which businessmen may avail of.

- The features of *delectus personae*, general management by all partners of business are attractive features of a partnership which the law guarantees and supervise
- Joint venture corporations underpinned by partnership law principles
 - JV arrangements are essentially partnership arrangements, even in situations where the co-venturers organize a separate corporation as a medium
 - The rights and obligations of the co-venturers are not only embodied in a joint venture agreement, but also implemented by certain provisions of the articles of incorporation and bylaws of the joint venture corporation.
 - Under such arrangements, the corporation formed may actually amount to a *de facto* close corporation
- Corporations vested with public interest cannot be pursued through a close corporation:
 - Mining/oil companies
 - Stock exchanges
 - Banks
 - Insurance companies
 - Public utilities
 - Educational institutions
 - Corporations declared to be vested with public interest
 - Quasi-banks
 - Other financial intermediaries (*e.g.*, pawnshops)
 - Preneed companies
 - Trust companies
- Close corporations can be organized only in the form of stock corporations

Tit. XIII on close corporations

Classification of shares and restrictions of transfer

- The AOI may provide for a classification of shares or rights and the qualification for owning or holding the same and restrictions on their transfers as may be stated therein
- Likewise, restrictions on the right to transfers shares must appear in the *articles of incorporation, bylaws, and certificate of stock*, and shall not be more onerous than granting the existing stockholders of the corporation the option to purchase the shares of the transferring stockholder with such reasonable terms, conditions or period stated therein
- The restriction on the transferability of shares in a close corporation is limited to a right of first refusal (ROFR)³

³ **Section 97. Validity of Restrictions on Transfer of Shares.** - Restrictions on the right to transfer shares must appear in the articles of incorporation, in the bylaws, as well as in the certificate of stock; otherwise, the same shall not be binding on any purchaser in good faith. Said restrictions shall not more onerous than granting the

- ROFR is a control scheme that allows the existing shareholders the power to maintain the character of *delectus personae* and prevent an outsider from coming into and interfering with the affairs of the corporation
- The right of first refusal feature in a close corporation setting is meant to provide a default feature
- SEC: In a small/family corporation setting, the existence of the ROFR in the AI would constitute the primary indication that it is a close corporation situation
- ROFR should be available even to *de facto* close corporations provided that the same is delineated in the AI and indicated in the stock certificate (to give notice to third parties) and is reasonable in its operation as not to amount to a deprivation of a shareholders right to ultimately dispose of his shareholdings

Classification of directors

- The AI of a close corporation may provide for a classification of directors into one or more classes, each of which may be voted for an elected solely by a particular class of stock (§ 96 (b))
- This allows the group to parcel out among themselves various management aspects in the corporate enterprise
- The provision indicates an inherent closeness between equity and management

Election of officers by the shareholders

- The officers of the close corporations are appointed by its BOD, but the AI may provide that specified/all officers/employees shall be elected/appointed by the shareholders *instead of the BOD*
 - § 96 embodies the principle that management of the close corporation may be done entirely by the shareholders in lieu of the BOD

Provisions for greater quorum/voting requirements

- The specific grant of authority to allow for super-majority quorum reflects the RCC's policy that in a close corporation setting, the property rights are not only tied with dividend rights; that parties are able to employ the corporate set-up to improve their management prerogatives by having a greater say in the affairs of the corporation
- Since in a close corporation, participation in management may be agreed to be a manner by which corporation profits shall be distributed, therefore the parties are allowed leeway by which minority shareholders are given a say by requiring super-majority requirements for corporate acts

Shareholders as corporate managers

- § 96: The articles of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors
- If so elected/chosen:
 - No meeting of shareholders need be called to elect directors
 - The shareholders shall be deemed to be directors
 - The shareholders shall be subject to all liabilities of directors
- So long as the AI provision providing the business of the corporation shall be managed by the stockholders, the stockholders shall be subject to *all* liabilities of directors (*Bustos v. Millians Shoe Inc.*)
- § 96 embodies the partnership attribute of mutual agency while maintaining the doctrine of limited liability

Agreements among shareholders

- The following agreements among shareholders are valid, binding and enforceable:
 - Agreements executed before the formation of a close corporation, signed by all shareholders, shall survive the incorporation of such corporation and shall continue to be valid and binding between and among such shareholders, if such be their intent, to the extent that such agreements are not inconsistent with the articles of incorporation, irrespective of where the provisions of such agreements are contained, except those required by the Title XII to be embodied in the articles of incorporation
 - Agreement if in writing and signed by the parties thereto, may provide that in exercising 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
 - No provision in any written agreement signed by the shareholders, relating to any phase of the corporate affairs, shall be invalidated as between the parties on the ground that its effect is to make them partners among themselves
 - A written agreement shall not be invalidated on the ground that it so related 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 agreements shall impose on the shareholders who are parties thereto the liabilities for managerial acts imposed on directors

existing stockholders or the corporation the option to purchase the shares of the transferring stockholder may sell their shares to any third person.

- § 99 therefore embodies the partnership attribute that, "First and foremost the partnership constitutes a contractual arrangement among the partners," within the close corporation setting

Board meetings unnecessary

- An action of the BOD is valid, even if:
 - Before or after such action is taken, written consent thereto is signed by all directors
 - All of the shareholders have actual or implied knowledge of the action and make no prompt objection thereto in writing
 - The directors are accustomed to take informal action with the express or implied acquiescence of all the shareholders, or
 - All the directors have express or implied knowledge of the action in question and none of them makes prompt objection in writing (§ 100)

Preemptive rights

SEC. 38. Power to Deny Preemptive Right. - All stockholders of a stock corporation shall enjoy preemptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings, unless such right is denied by the articles of incorporation or an amendment thereto: Provided, That such preemptive right shall not extend to shares issued in compliance with laws requiring stock offerings or minimum stock ownership by the public; or to shares issued in good faith with the approval of the stockholders representing two-thirds (2/3) of the outstanding capital stock, in exchange for property needed for corporate purposes or in payment of a previously contracted debt.

- No preemptive right in the following instances:
 - When shares are issued in compliance with laws requiring stock offering or minimum stock ownership by the public
 - When shares are to be issued in good faith with the approval of the shareholders representing $\frac{2}{3}$ of the outstanding capital stock in exchange for property needed for corporate purposes or in payment of a previously contracted debt
- These preserve the characteristic of *delectus personae* in close corporations

Deadlocks and dissolution

Section 103. Deadlocks. – Notwithstanding any contrary provision in the close corporation's articles of incorporation, bylaws, or stockholders' agreement, if the directors or stockholders are so divided on the management of the corporation's business and affairs that the votes required for a corporate action cannot be obtained, with the consequence that the business and affairs that the votes required for that the business of the corporation can no longer be conducted to the advantage of the stockholders generally, the Commission, upon written petition by any stockholder, shall have the power to

arbitrate the dispute. In the exercise of such power, the Commission shall have authority to make appropriate orders, such as:

- cancelling or altering any provision contained in the articles of incorporation, bylaws, or any stockholders' agreement;
- cancelling, altering or enjoining a resolution or act of the corporation or its board of directors, stockholders, officers, or other person party to the action;
- directing or prohibiting any act of the corporation or its board of directors, stockholders, officers, or other persons party to the action
- requiring the purchase at their fair value of shares of any stockholder, either by the corporation regardless of the availability or unrestricted retained earnings in its, books or by the other stockholder;
- appointing a provisional director;
- dissolving the corporation; or
- granting such other relief as the circumstances may warrant.

A provisional director shall be an impartial person who is neither a stockholder nor a creditor of the corporation or any of its subsidiaries or affiliates, and whose further qualifications, if any, may be determined by the Commission. A provisional director is not a receiver of the corporation and does not have the title and powers of a custodian or receiver. A provisional director shall have all the rights and powers of a duly elected director, including the right to be notified of and to vote at meetings of directors until removed by order of the Commission or by all the stockholders. The compensation of the provisional director shall be determined by agreement between such provisional director and the corporation.

Essence of a deadlock situation

- A deadlock situation is present:
 - If the directors or shareholders are so divided respecting the management of the corporate business and affairs that the votes required for any corporate action cannot be obtained
 - With the consequence that the corporate business can no longer be conducted to the advantage of the shareholders generally
- See Ong Yong v. Tiu.

Piercing the veil of corporate fiction

- Fraud piercing can be done.
- *Alter ego* piercing cannot be done, because such a close corporation is intended merely as an alter ego or conduit of the shareholders
 - Consequently, the corporate defenses of limited liability should still be available to shareholders of such close corporations
- But for *de facto close corporations*, they would be susceptible to the application of the doctrine of being mere conduits or alter ego of their shareholders

- This aspect may prove to be the impetus for incorporators to incorporate a close corporation under § 95

Chapter 19: Nonstock corporations

Essence of nonstock corporations

1. Its primary purpose should be eleemosynary in nature; and
2. There is a prohibition in its AIBL that no part of the income or any form of dividend is distributable to the members, trustees and officers, even though the corporation may incidentally earn profits from its operations

Members of nonstock corporations

- Membership is purely personal (§ 89)
 - Thus, membership may be terminated in the manner and for causes provided in the AIBL
 - Juridical persons may be members of a nonstock corporation
- The right of the members of any class to vote may be modified (even denied). But until so modified, each member is entitled to one vote (§ 88)
- Since membership is generally not a proprietary claim and personal in character, then also rights emanating from membership are also personal in character and cease upon the death of the member

Place of meetings

- The bylaws may provide that the members may hold their regular or special meetings at any place even outside the place where the principal office of the corporation is located, provided it is within the Philippines and that proper notice is sent to all members indicating the date, time and place of the meeting (§ 92)

Quorum requirement

- Only those who are actual, living members with voting rights shall be counted in determining the existence of a quorum during members' meetings, and that dead members shall not be counted

Manner of voting

- Unless otherwise provided in the articles of incorporation or the bylaws, a member may vote by proxy
- The bylaws may likewise authorize voting through remote communication and/or in absentia

Assessment of membership dues

- The BOT may assess membership dues even when nothing has been provided for in the AIBL
- Effects of delinquency: It depends on the AIBL (§ 88)

Trustees and officers

Right and manner of voting for trustees

- Default rule: Straight voting

Number and election of trustees

- Only members may be elected (except for independent trustees)
- No minimum, and may be more than 15, as fixed in the AIBL (§ 91)
- Term of office is up to 3 years until their successors are elected and qualified

Meetings of the BOT

- It may be held anywhere, unless the bylaws otherwise provide
- No proxy, but they may join via teleconferencing

Election of officers

- Officers may be elected directly by members, unless otherwise provided in the AIBL
 - Consequently, only members may remove them

Special rules for nonstock corporations

1. The provisions governing stock corporations, when pertinent, shall be applicable to nonstock corporations, except as may be covered by specific provisions of the Code pertaining to nonstock corporations (§ 86)
2. A nonstock corporation by its very nature cannot be empowered to engage in business with the object of making income or profit; hence, it cannot include a purpose in its articles of incorporation which would change or contradict its nature as such (§ 13 (b))
3. A nonstock corporation may adopt rules and regulations, provided they are not contrary to the provisions of the bylaws, articles of incorporation and the Revised Corporation Code
4. Nonapplicability of the rules on subscription and preemptive rights
5. There is no need to file a formal application with the SEC to reflect an increase in the contributed capital of a nonstock corporation

Dissolution of nonstock corporations

- The rules and procedures for the dissolution and liquidation of nonstock corporations are the same as those provided for stock corporations under Title XIV, except:
 - After dissolution, a nonstock corporation is not prohibited from continuing its operations (as an ordinary association without a juridical personality) (*SEC op.*)
 - Rule on distribution of assets follows § 93
 - Plan of distribution must be voted by the BOT (majority) and $\frac{2}{3}$ ratification vote

Conversion of nonstock corporation to stock corporation

- An existing nonstock corporation cannot be converted into a stock corporation by the simple process of amending its articles of incorporation (*SEC op.*)
- The SEC held that for purposes of transformation, it is fundamental that the nonstock corporation must

be dissolved first under any of the methods allowed by law and thereafter, the members may organize a stock corporation directed to bring profits or pecuniary gains to themselves

Chapter 10: Duties & Liabilities of Directors, Trustees, and Officers

Primary objective of the BOD

- a. Shareholder theory: Maximization of profit
- b. Stakeholder theory: Enhancing the value of the corporation

Liabilities of DTOs

General rule: Directors or duly authorized officers are *not* personally liable for their official acts in pursuing the business of the corporation, unless it is shown that they have exceeded their authority.

- Indeed, when a corporate officer acts in behalf of a corporation pursuant to his authority, it is a corporate act for which only the corporation should be made liable for any obligations arising from them

Thus, **personal liability of a corporate DTO** along with the corporation may so validly attach as a rule, **only when:**

1. He assents—
 - a. To a patently unlawful act of the corporation;
 - b. For bad faith or gross negligence in directing its affairs;
 - c. For conflict of interest, resulting in damages to the corporation, its stockholders or other persons (§ 30, RCC)
2. He consents to the issuance of watered stocks or who, having knowledge thereof, does not forthwith file with the corporate secretary his written objection thereto (§ 64, RCC)⁴
3. He agrees to hold himself personally and solidarily liable with the corporation
4. He is made, by a specific provision of law, to personally answer for his corporate action (§ 170, RCC)

Duties and obligations of directors, trustees, and officers

Relationship of the corporation with DTO

- The relationship between the corporation and its DTO is that of a **principal-agent**, which is fiduciary in character and essentially revocable.

Relationship of the shareholders/members with DTO

- CLV: The relationship between the BOD and the shareholders or members is one based on the concept of business trust

⁴ There is no law that prohibits a corporate officer from binding himself personally to answer for a corporate debt; and that while the limited liability doctrine is intended to protect the shareholder by immunizing him from personal liability for the corporate debts, he may nevertheless divest himself of this protection by voluntarily binding himself to the payment of the corporate debts (*Toh v. Solid Bank Corp.*).

Common law fiduciary duties—in general

- Under the doctrine of creature of limited powers (§§ 2, 44, RCC) – The BOD and management are bounded by the fiduciary duty of obedience
- Under the attribute of centralized management (§ 22, RCC) – The fiduciary relationship of the DTO to the shareholders/members gives rise to the **duties of diligence and loyalty**.
- It is the breach of any common law duties that is the basis by which the DTO becomes personally liable for the resulting damage caused to the corporations, its shareholders or members.
- When it comes to corporations vested with public interest, DTO may be held liable for damages suffered by the members of the dealing public who are adversely affected by a breach of their duty to run the corporate affairs in a prudent manner

Duty of obedience

- § 24, RCC refers to the duty of obedience that the officers owe to the BOD who appointed them
- The courts do not consider DTO to be bound by any duty of obedience to the shareholders or members
- The only relevance of the duty of obedience in the intracorporate level is that **shareholders/members have a right to expect that in the pursuit of the corporate business that DTO must comply with the mandatory provisions of the law.**
 - The duty of obedience is but a subset of the duty of diligence that DTOs owe the corporation and its shareholders or members

Duty of diligence

- DTO must act with the due diligence of a prudent man in pursuing the affairs of the corporation and in looking after the interests of the shareholders or members

Section 30. *Liability of directors, trustee or officers.* – Directors or trustees who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation or acquire any personal or pecuniary interest in conflict with their duty as such directors or trustees shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons.

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Two grounds under § 30:

1. Willfully or knowingly voting for or assenting to patently unlawful acts of the corporation
2. Being guilty of gross negligence or bad faith in directing the affairs of the corporation

Requisites for § 30:

1. The complaint must allege that the DTO:

- a. Assented to patently unlawful acts of the corporation; or
 - b. Were guilty of gross negligence or bad faith in directing the affairs of the corporation; and
2. The complainant must clearly and convincingly prove such unlawful acts, negligence or bad faith

§ 30 duty of diligence ought to apply officers

- Indeed, § 30 cannot be invoked as the basis for making an officer liable for breach of his duty of diligence; but that what can be invoked is the *doctrine of piercing the veil of corporate fiction* to make an officer personally and solidarily liable for fraud committed in behalf of the corporation (*Virata v. Ng Wee*).

Willfully and knowingly voting for or assenting to patently unlawful acts

- Patently unlawful acts are those declared unlawful by law which imposes penalties for commission of such unlawful acts. There must be a law declaring the act unlawful and penalizing the act (*Carag v. NLRC*)
- It must be noted, however, that a director or trustee need not have voted for, but mere assent to a patently wrongful act or contract would make him liable
 - Thus, to escape liability, the director must cast a no vote.
- The corporation would then have a right to be reimbursed from the BOD for any amount that the corporation is adjudged to have to pay to a third party claimant by reason of its unlawful decision (*Benguet Electric Cooperative v. NLRC*)

“Gross negligence”

- Gross negligence, on the other hand, is the want of even slight care, acting or omitting to act in a situation where there is duty to act, not inadvertently but willfully and intentionally, with a conscious indifference to consequences insofar as other persons may be affected.
- It evinces a thoughtless disregard of consequences without exerting any effort to avoid them; the want or absence of or failure to exercise slight care or diligence, or the entire absence of care (*Sanchez v. Republic*)

“Bad faith” amounting to “fraud”

- Rightfully had it been said that bad faith does not simply connote bad judgment or negligence; it imports a dishonest purpose or some moral obliquity and conscious doing of wrong
- It means breach of a known duty through some motive or interest or ill will; it partakes of the nature of fraud (*Board v. Kalaw*)
- An officer-shareholder who is a party signing in behalf of the corporation to a fraudulent contract cannot claim the benefit of separate juridical entity (*Paradise Sauna v. Ng*)

- It also ruled that when the corporate officers and directors are sued merely as nominal parties in their official capacities as such, by that reason alone, they cannot be made personally liable for the judgment against the corporation (*NPC v. CA*)
- To hold a director personally liable for debts of the corporation, and thus pierce the veil of corporate fiction, the bad faith or wrongdoing of the director must be clearly and convincingly shown. Bad faith is never presumed. Bad faith does not connote bad judgment or negligence. Bad faith means [a] breach of a known duty through some ill motive or interest. Bad faith partakes of the nature of fraud (*Carag v. NLRC*)
- Bad faith does not arise just because a corporation fails to pay its obligation, because the inability to pay one's obligation is not synonymous with fraudulent intent not to honor the obligations (*Magaling v. Ong*)

Duty of loyalty: doctrine of corporate opportunity

- The duty of loyalty provides that in the discharge of his responsibilities and management of the property, assets, and business enterprise of the corporation, a **director, trustee, or officer should put the interest of the corporation and the shareholders or members above his personal interests**
 - In the event of conflict-of-interest, it would be a breach of his duty of loyalty to prefer his personal interest to that of his principal-the corporation, and of his beneficiaries-the shareholders or members
- The obligation of the officer who violates his duty of loyalty to reimburse the corporation for profits earned based on the principles of both implied trust and agency principles
 - The doctrine of corporate opportunity is precisely a recognition by the courts that the fiduciary standards could not be upheld where the fiduciary was acting for two entities with competing interests
 - The doctrine rest fundamentally on the unfairness in particular circumstances, of an officer or director taking advantage of an opportunity for his own personal profit when the interest of the corporation justly calls for protection
- Corporate officers are *not* permitted to use their position of trust and confidence to further their private interests (*Gokongwei v. SEC*).

This applies to DTOs

Section 30. Liability of directors, trustee or officers. – [xxx]

A director, trustee or officer shall not attempt to acquire, or any interest adverse to the corporation in respect of any matter which has been reposed in them in confidence, and upon which, equity imposes a disability upon themselves to deal in their own behalf; otherwise, the said director, trustee or officer shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation.

This applies to directors only

SEC. 33. Disloyalty of a Director. - Where a director, by virtue of such office, acquires a business opportunity which should belong to the corporation, thereby obtaining profits to the prejudice of such corporation, the director must account for and refund to the latter all such profits, unless the act has been ratified by a vote of the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock. This provision shall be applicable, notwithstanding the fact that the director risked one's own funds in the venture.

Quarendum: Why does it seem that the self-dealing transactions entered into by a director can be ratified while those entered by a trustee/corporate officer cannot be ratified?

- **First view:** Directors are the direct elected representatives of the shareholders or members. Consequently, when they breach their duty of loyalty, power has been granted to the shareholders to waive any cause of action on their delegates. On the other hand, officers are not generally elected by the shareholders or members, but actually appointed by the Board. Therefore, the Board as mere delegates of the shareholders cannot waive the officer's misfeasance.
- **Second view:** The significant difference between Sections 30 and 33 of the Revised Corporation Code is that in fact it imposes upon the offending director a greater severity, by requiring that a waiver in his favor can only be obtained through shareholders' ratifying vote; while in the case of trustees and officers the determination of whether or not to allow a waiver of recovery in behalf of the corporation falls within the business discretion of the BOD.
 - CLV: This view is more logical. The BOD has no power to remove/discipline its members—such power is with the shareholders. Then, to the same extent, the BOD cannot “forgive” a member who has breached his duty of loyalty, and only the shareholders have the power to waive the obligation of an erring director to give back to the corporation the profits earned from his breach of duty.

Duties on related party transactions (RPT)

SEC. 31. Dealings of Directors, Trustees or Officers with the Corporation. - A contract of the corporation with one (1) or more of its directors, trustees, officers or their spouses and relatives within the fourth civil degree of consanguinity or affinity is voidable, at the option of such corporation, unless all the following conditions are present:

- (a) The presence of such director or trustee in the board meeting in which the contract was approved was not necessary to constitute a quorum for such meeting;
- (b) The vote of such director or trustee was not necessary for the approval of the contract;

(c) The contract is fair and reasonable under the circumstances;

(d) In case of corporations vested with public interest, material contracts are approved by at least two-thirds (2/3) of the entire membership of the board, with at least a majority of the independent directors voting to approve the material contract; and

(e) In case of an officer,⁵ the contract has been previously authorized by the board of directors.

Where any of the first three (3) conditions set forth in the preceding paragraph is absent, in the case of a contract with a director or trustee, such contract may be ratified by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock or of at least two-thirds (2/3) of the members in a meeting called for the purpose: Provided, That full disclosure of the adverse interest of the directors or trustees involved is made at such meeting and the contract is fair and reasonable under the circumstances.

- Tldr: Being the corporation's agents and therefore, entrusted with the management of its affairs, the directors or trustees and other officers of a corporation occupy a fiduciary relation towards it, and cannot be allowed to contract with the corporation, directly or indirectly, or to sell property to it, or purchase property from it, where they act both for the corporation and for themselves. One situation where a director may gain undue advantage over his corporation is when he enters into a contract with the latter (*Agdao Landless v. Maramion*)

Self-dealing contracts under the old Corp. Code

- § 32 of the old code expressed the prevailing policy on self-dealing contracts, embodying the rule that such contracts were not essentially void, *but merely voidable at the option of the corporation*, unless safeguard measures are met. But in all instances, the contracts must be fair and reasonable to the corporation.
 - *Prime White Cement Corp. v. IAC*: Although the general rule when it comes to a President entering into a contract for the corporation is that when the contract is in the ordinary course of business, provided the same is reasonable under the circumstances, the contract binds the corporation; nevertheless the rule does not apply when the contract is entered into with a director who holds a position of trust and as such, he owes a duty of loyalty to his corporation.
 - The unfairness in the contract was also a basis that renders a contract entered into by the President, without authority from the Board of Directors, void or voidable,

⁵ Officers who are not part of the Board.

although it may have been in the ordinary course of business.

- When there is an allegation that the self-dealing contract has not complied with the requisites provided under Section 32 of the old Code, the burden of proof was on the shoulder of the interested director, trustee, or officer to show that the requisite conditions have been complied with; otherwise, the self-dealing contract shall be declared void (*Agdao, supra*)

RPT under the RCC

- Same provision from the old Code, but with the following two additions:
 - It expands the coverage of self-dealing contracts to include RPT by including dealings with spouses and relatives within the 4th civil degree of consanguinity/affinity of DTO
 - It provides that for *corporations vested with public interest*, material RPT⁶ must, in addition, be approved by:
 - $\frac{2}{3}$ of the members of the BOD; and
 - At least a majority of the independent directors voting to approve the material contract

Summary of rules under § 31:

General rule: Every contract of a corporation with any of its DTO, or their spouses and relatives within the 4th civil degree shall be **voidable** at the option of the corporation.

Except: Such contract shall be valid and binding on the corporation (*i.e.*, the corporation has no option to seek the annulment of the contract), when the following conditions are present:

- The presence of the interested director or trustee in the Board meeting in which the contract was approved was not necessary to constitute a quorum for such meeting;
- The vote of the interested director or trustee in such Board meeting was not necessary for the approval of the contract
- The contract is fair and reasonable under the circumstances;
- For corporations vested with public interest*: Material contracts shall, in addition, be approved by:
 - At least $\frac{2}{3}$ of the entire membership of the Board; and
 - At least a majority of the independent directors voting to approve the material contract
- In case of an officer: The contract has been previously authorized by the Board.

⁶ Material RPT is any RPT, either individually or in aggregate over a 12-month period with the *same* related party, amounting to 10% or higher of a company's total assets based on its last AFS or to the consolidated assets for a parent company.

If any of the first two and fourth conditions are not present: In the case of a contract with a DT (not officer), such contract may be ratified by a vote of the shareholders representing at least $\frac{2}{3}$ of the outstanding capital stock or of at least $\frac{2}{3}$ of the members, provided that:

1. Full disclosure of the adverse interest of the DT involved is made at such meeting; and
2. Contract is fair and reasonable under the circumstances

Obligation of interested DT to recuse

- § 31 must be read with § 52: "A director or trustee who has a potential interest in any related party transaction must recuse from voting on the approval of the related party transaction without prejudice to compliance with the requirements of Section 31 of this Code."
- CLV: This does not make the nonrecusing director/trustee criminally liable under § 170.

Contracts between corporations with interlocking directors

SEC. 32. Contracts Between Corporations with Interlocking Directors. — Except in cases of fraud, and provided the contract is fair and reasonable under the circumstances, a contract between two (2) or more corporations having interlocking directors shall not be invalidated on that ground alone: *Provided, That* if the interest of the interlocking director in one (1) corporation is substantial and the interest in the other corporation or corporations is merely nominal, the contract shall be subject to the provisions of the preceding section insofar as the latter corporation or corporations are concerned.

Stockholdings exceeding twenty percent (20%) of the outstanding capital stock shall be considered substantial for purposes of interlocking directors.

- Policy: Dealings between 2 corporations that have interlocking directors are not *per se* deemed fraudulent or voidable. However, if the interest of the interlocking directors is merely nominal, he shall be subject to the same ratification vote required from shareholders/members as in the case of dealings of DTO with their corporations.
- § 32 is inapplicable where fraud is alleged to have been committed on third parties (*DBP v. CA*).

Duty to maintain and allow inspection and/or reproduction of corporate records

- This is the institution of the fiduciary duty to maintain records and to report on significant corporate information.
- The reforms are enforcement of the CG principles of transparency and accountability.

SEC. 161. Violation of Duty to Maintain Records, to Allow their Inspection or Reproduction; Penalties. — The unjustified failure or refusal by the corporation, or by those responsible for keeping and maintaining corporate records, to comply with Sections 45, 73, 92, 128, 177 and

other pertinent rules and provisions of this Code on inspection and reproduction of records shall be punished with a fine ranging from Ten thousand pesos (P10,000.00) to Two hundred thousand pesos (P200,000.00), at the discretion of the court, taking into consideration the seriousness of the violation and its implications. When the violation of this provision is injurious or detrimental to the public, the penalty is a fine ranging from Twenty thousand pesos (P20,000.00) to Four hundred thousand pesos (P400,000.00).

The penalties imposed under this section shall be without prejudice to the Commission's exercise of its contempt powers under Section 157 hereof.

Duty to maintain records and the obligation to report, on beneficial ownership

SEC. 73. Books to be Kept; Stock Transfer Agent. – Every corporation shall keep and carefully preserve at its principal office all information relating to the corporation including, but not limited to:

[xxx]

(b) The current ownership structure and voting rights of the corporation, including lists of stockholders or members, group structures, intra-group relations, ownership data, and beneficial ownership;

[xxx]

Who is a beneficial owner?

- A natural person who:
 - Ultimately owns or controls the corporation; or
 - Exercises ultimate effective control over the corporation

Duties and obligations to creditors and other stakeholders

- The RCC has no provision that expressly impose on DTO any fiduciary duties to suppliers, customers, creditors and other stakeholders
- The relationship of the corporation with creditors and other dealing members of the public is one based mainly on Contract Law
- Generally, any claim for damages against the corporation must be based on the principles of **breach of contract** and those against its DTO must be based in **tort** rather than any breach of fiduciary duty.
- The general rule under the old Corporation Code was that a corporation, and therefore its DTOs, do not owe any fiduciary duties to its creditors.

Corporate fraud or tort

- In § 30, the term “other persons” may cover creditors who sustain damage by virtue of the violation by their duty of diligence.
- § 30 seem to provide that basis of liability to other persons—thus, the following are grounds: fraud, bad faith, gross negligence, or tort that has been

committed by the DTO under the principle that every agent who acts outside the scope of his authority or with fraud, negligence or bad faith would be personally liable for the resulting damage

- The imposition of personal liability on a director, trustee, or officer would also be based on the principles of the piercing doctrine.
 - *Carag*: To hold a director personally liable for the debts of the corporation, and thus pierce the veil of corporate fiction, the bad faith or wrongdoing of the director must be established clearly and convincingly (?).
- While generally directors and officers of a corporation cannot be held personally liable for loans that were extended clearly to the corporation, nevertheless when the officers who extracted the loans on behalf of the corporation acted in bad faith or with gross negligence, they can be made solidarily liable with the corporation (*Aratea v. Suico*)
- **Virata v. Ng Wee**: DTO owe fiduciary duty of diligence to particular creditors of corporations, namely, investors in the corporation’s debt instrument.
 - *Virata* implies the doctrine, that outside of fiduciary duties of diligence and loyalty contained in § 30, RCC, **DTO can be held solidarily liable with the corporation for the damage suffered by creditors** and other stakeholders in their dealings with the corporation **by the application of the fraud piercing doctrine.**
 - The commission of fraud in the pursuit of corporate contracts and transactions by itself constitutes an actionable basis under tort laws to make acting DTO solidarily liable to creditors and other stakeholders suffering injury by reason thereof
 - The BOD is expected to be more than mere rubber stamps of the corporation and its subordinate departments. It wields all corporate powers, including the control over its properties and the conduct of its business. Being stewards of the company, the *board is primarily charged with protecting the assets of the corporation on behalf of its stakeholders.*
 - The gratuitous performance of a director’s duties and functions is not sufficient justification to do a poor job at steering the company away from foreseeable pitfalls and perils. The careless management of corporate affairs, in itself, amounts to a betrayal of the trust reposed by the corporate investors, clients, and stakeholders, regardless of whether or not the board or its individual members are being paid.

Trust fund doctrine

- Under the trust fund doctrine, it would be a violation of the rights of the creditors of the corporation to

allow the return to the shareholders of their capital, or to declare dividends outside of the unrestricted retained earnings.

- Likewise, upon insolvency of the corporation, the BOD of a corporation is duty-bound to hold the assets of the corporation primarily first for the payment of the corporation's liabilities

Chapter 11: Sanctions Against Directors, Trustees and Officers

Overcriminalization of CG practice

1. Reconstituting the SEC as the primary regulatory agency to promote and evolve the CG reforms under the RCC, particularly by institutionalizing its power to impose administrative sanctions for any violation of the Code
2. Retaining the general criminal sanction under § 170 for any violation of the provisions of the RCC not specifically penalized, while also providing for criminal penalties for various broad and specific CG malpractices

Criminal penalties for violation of the RCC

Corporate criminal liability

- Except only when the clear terms of the law imposes the criminal penalty on the corporation itself, corporations cannot be made criminally liable for criminal offenses committed on their behalf and/or in the pursuit of their corporate business.
 - Thus, it would be the acting or approving DTO and/or employees themselves who shall be criminally liable for committing the offense imposed by law.
- Though there were various penal laws which corporations may violate, there were no provisions in the law relating to the practice and procedure in criminal actions whereby a corporation may be brought to court to be proceeded against criminally
- The **primary reason** why corporations cannot be proceeded against as defendants/accused in criminal proceedings is that **there are no existing laws by which to support such a process**, which results from the policy that ultimately a crime committed in the name of a corporation is actually committed by the individuals who act for an in behalf of such corporation
 - Likewise a crime *mala in se* cannot be imputed to a corporation, being a mere artificial being without a mind, since the criminal intent as an essential ingredient of a crime would be missing
- The other reason is the difficulty, if not impossibility, of imposing upon a corporation the penal sanction (imprisonment) to a being that has no corporeal existence, and which cannot therefore be thrown in jail.

Shareholder or members per se cannot be held liable

- Shareholders, being basically investors, and with the management of the business vested in the BOD, cannot be held liable for the criminal offense committed on behalf of the corporation, unless they personally took part in the same (*Espiritu v. Petron*).

DTO who commit criminal acts on behalf of the corporation are the ones liable

- When a penal law forbids the corporation itself from doing an act, the prohibition extends to the BOD, and to each director separately and individually, and upon whom shall befall the criminal penalty for violation thereof (*People v. Concepcion*)
- The acting DTO will become liable for the criminal offense, because a corporation can act only through its officers and agents, and where the business itself involves a violation of the law, the correct rule is that all who participate in it are liable (*People v. Tan Boon Kong*)
- The existence of the corporate entity does not shield from prosecution the corporate agent who knowingly and intentionally causes the corporation to commit the crime (*People v. Chowdury*).
- Unless members of the Board are shown to have participated in the illegal act directly, then their mere position as directors do not warrant being held criminally liable for the offense (*Ty v. De Jemil*).
 - **But See:** The Court affirmed the imposition of a criminal penalty under the law for unfair competition on the members of the Board of Directors of the offending company based on the mere invoking of the doctrine of centralized management by which they have control of the company operations. A corporate officer cannot protect himself behind a corporation where he is the actual, present, and efficient actor. (*Republic Gas v. Petron*).
 - Active participation requires a showing of overt physical acts or intention to commit such acts (*ABS-CBN Corp. v. Gozon*).
- There must be a showing that the accused officers, directors, or shareholders actively participated in or had the power to prevent the wrongful act (*SEC v. Price Richardson*)
- Summary: *Ching v. Sec'y of Justice* (2006)

Policy divergence on the criminal and civil aspects of corporate criminal offenses

- While an officer cannot hide behind the veil of corporate fiction in order to evade the consequence of his criminal act done in behalf of the corporation, **the civil liability arising therefrom is still measured from the determination of whether there is basis to apply the doctrine of piercing the veil of corporate fiction** to make the acting corporate officer personally liable for the debt incurred in behalf of the corporation.
- *Consolidated Bank v. CA*: Corporate personality is a shield against personal liability of its officers (no personal civil liability)

- *Tupaz IV v. CA*: Corporate officers who signed a trust receipt in behalf of the corporation cannot be held personally liable therefor when there is no indication that they guaranteed personally the payment of the corporation's debt.
- **But** in *Cometa v. CA*: Although a criminal case can only be filed against the officers and not against the corporation itself, it does not follow that the corporation cannot be a real-party-in-interest for the purpose of bringing a civil action for malicious prosecution for the damages incurred by the corporation for the criminal proceedings brought against its officer.
- *Ambassador Hotel Inc. v. SSS*: Even if under the SSS Law, it is the head, director, or officer responsible for the nonremittance who shall suffer the personal criminal liability, nonetheless, it is the employer **corporation that is primarily liable** for the non-remittance of SSS contributions of its employees.
 - Therefore, the **employer corporation cannot use its separate juridical personality to escape its civil liability for non-payment** of SSS contributions by pointing to the fact that the criminal liability therefore pertains to the responsible DTO

Criminal sanctions on corporate offenses—in general

SEC. 170. Other Violations of the Code; Separate Liability.

- Violations of any of the other provisions of this Code or its amendments not otherwise specifically penalized therein shall be punished by a fine of not less than Ten thousand pesos (P 10,000.00) but not more than One million pesos (P1,000,000.00). If the violation is committed by a corporation, the same may, after notice and hearing, be dissolved in appropriate proceedings before the Commission: Provided, That such dissolution shall not preclude the institution of appropriate action against the director, trustee, or officer of the corporation responsible for said violation: Provided, further, That nothing in this section shall be construed to repeal the other causes for dissolution of a corporation provided in this Code.

Liability for any of the foregoing offenses shall be separate from any other administrative, civil, or criminal liability under this Code and other laws.

- The prevailing rule is that penal statutes shall not, by what may be thought their spirit and equity, be extended to offenses other than those which are specifically and clearly described and provided for since the law will not allow constructive offenses or arbitrary punishments.
 - This rule does not exclude the application of common sense to the terms used in the law.
- CLV: Not all noncompliance with the RCC would be criminally punishable.
 - Such a construction would seem unreasonably harsh, and effectively discourages competent and well-meaning

individuals from accepting reasonable positions within the corporate setting.

- **CLV: The proper and reasonable interpretation of the coverage of the term “violation of any provisions of this code” should cover only those provisions of the Code which were expressly mandatory in nature to show the Legislative intent to impose a penal sanction for noncompliance therewith.**
- Additionally, provisions which merely imposed civil sanctions⁷ could not come within the coverage of § 140 of the old Code (now § 170)

Defense of good faith

- Violations of the Code were *mala in se*, then the evil intent or malice of the accused is an essential element
- In cases of prosecutions under § 144, the accused DTO would have more than enough legal basis for claim good faith because of the varied interpretations and applications of the principles of Corporate Law
 - Thus, there was every leeway to show that the element of malice does not pertain to an act or a transaction upon which the criminal imputation is based upon!

Affirmation of CLV's view

- See **lent v. Tullett Prebon (Philippines), Inc.** (2017).
- The Corp. Code is a regulatory measure—not a penal statute.

Current § 170, RCC

- Changes:
 - The title has been changed from “violations of this code” to “other violations of this code; separate liability”
 - § 170 has deleted the penalty of imprisonment, and increased the range of fines: P10,000 to P1 million
 - A new paragraph has been inserted (2nd paragraph)
- CLV: Even when it is clear that the intent of Congress under Section 170 is to provide a basis for penalizing violations of any other provisions of the RCC which are not specifically punished, it will be difficult for the SEC, or from complaining directors, trustees, shareholders, or members, to obtain criminal conviction under Section 170 for violations of the RCC which are not specifically punished therein

§170, RCC compared with § 158, RCC

SEC. 158. Administrative Sanctions. — If, after due notice and hearing, the Commission finds that any provision of this Code, rules or regulations, or any of the Commission's orders has been violated, the Commission may impose any or all of the following sanctions, taking into consideration

⁷ See, e.g., §§ 31, 32, and 65, RCC.

the extent of participation, nature, effects, frequency and seriousness of the violation:

(a) Imposition of a fine ranging from Five thousand pesos (P5,000.00) to Two million pesos (P2,000,000.00), and not more than One thousand pesos (P1,000.00) for each day of continuing violation but in no case to exceed Two million pesos (P2,000,000.00);

(b) Issuance of a permanent cease and desist order;

(c) Suspension or revocation of the certificate of incorporation; and

(d) Dissolution of the corporation and forfeiture of its assets under the conditions in Title XIV of this Code.

- § 158 empowers the SEC to impose the administrative sanction of suspension or revocation of the COI, or dissolution where the SEC finds that any provision of the RCC, has been violated
- Section 170 imposes the penalties pursuant to a criminal case, where the evidence of guilt must be beyond reasonable doubt; whereas, Section 158 imposes penalties pursuant to an administrative proceeding where the evidence of violation need only be based on substantial evidence.
 - CLV: It seems clear that with the grant under Section 158 of the power to impose the administrative sanction of dissolution against erring corporations, the first *proviso* under Section 170 (which was taken from Section 144 of the old Code) should have been entirely deleted.

Criminal liability for other violations of provisions not specifically separate from administrative liability

- The 2nd paragraph of § 170 expresses the legislative intent that any § 170 violation shall be without prejudice to the imposition of administrative sanctions by the SEC pursuant to § 158, RCC, or to any other civil or criminal liability under the law
- CLV: The intent in adding the 2nd paragraph was to avoid the application of the *lent* doctrine from the main phrase. This is faulty:
 - The first part of the clause that provides that a § 170 liability is separate from other criminal liability under the RCC contradicts the very essence of the criminal offense sought to be punished under the main provision of § 170, which is to impose criminal penalty for any violation of the Code not specifically criminalized. Thus, if the Code already provides a criminal liability for an offense, how can it still be separately punished under § 170?
 - It is difficult to construe that the last paragraph of § 170 can overcome previous sections where the Code itself limits the imposition of administrative sanctions for violation of a particular provision as to

make it fall within the main provision of § 170⁸

- It is unfortunate that such legislative intent was expressed under § 170, and not provided its own section as to encompass the whole criminal penalty system of the Code. This unfortunate construction can be appreciated from the fact that since the provision appear as the last paragraph under § 170 defining "Other Violations of the Code," it may be *construed to mean that when it comes to violations which are specifically punished by the RCC, no administrative sanction may be imposed*, unless the particular penalizing provision allows the imposition thereof separate and apart from the criminal penalties imposed.

A due process violation?

- The language of § 140, old Corp. Code has already been ruled in *lent* as overly broad as to deny an accused the rudiments of due process of being properly informed of what acts constitute as a criminal offense
- Even the 2nd paragraph could not legalized criminal conviction for any violation of the RCC which are not specifically punished therein since the phrase "violation of any provision of this Code ... not otherwise specifically penalized therein" provides a vague language which is inconsistent with the rights of the accused under the due process clause.
 - Firstly, when it is clear that Congress intends to criminally punish a particular violation of the RCC, it has set out and expanded in specific sections the violations that would constitute criminal offenses.
 - Secondly, there are RCC violations that are clearly administrative in character, rather than constituting criminal offenses.

Limited areas where § 170 can sustain conviction

- There may be a limited area among the RCC where conviction under § 170 can be obtained, and it is where the legislative intent to penalize an act deemed to be mandatory in character and therefore within the coverage of § 170 of the RCC, such as:
 - § 29: Corporations vested public interest shall submit to their shareholders and the SEC, an annual report of the total compensation of each of their directors or trustees
 - § 49: At each regular meeting of shareholders or members, the board of directors or trustees shall endeavor to present to shareholders or members, (i) A

⁸ To illustrate, as Section 27 provides that SEC's removal of a disqualified director or trustee "shall be without prejudice to other sanctions that the [SEC] may impose on the board of directors or trustees who, with knowledge of the disqualification, failed to remove such director or trustee," we doubt whether the members of the board may still be criminally penalized under the broad provisions of Section 170 of the Revised Corporation Code.

director or trustee compensation report prepared in accordance with this Code and the rules of the Commission may prescribe

- § 177: Corporations vested with public interest must also submit the following to the SEC: (1) A director or trustee compensation report; and (2) A director or trustee appraisal or performance report and the standards or criteria used to assess each director or trustee
- The obligation to make an annual report on directors' or trustees' individual compensation under §§ 29 and 49 has two aspects:
 - Reporting to shareholders/members
 - Reporting to SEC
- In turn, § 177 covers the same reporting obligation as it pertains only to the SEC.
 - The annual reporting of the directors' or trustees' individual compensation is clearly an important and obligatory obligation on the part of corporations and their governing boards, since it is specifically covered in three sections of the RCC
 - The criminal violation for nonreporting to the SEC is covered by § 177, and those of annually reporting to shareholders/members would be covered by § 170 in relation to § 177

Final observations

- The worst effect of the criminalization of corporate governance principles and best practices under the RCC is that it sets into statutory stance a hard-handed approach to corporate governance
- When corporate governance principles and best practices are subjected to both administrative and criminal sanctions, then out of a sense of self-preservation, directors, trustees and officers, who are not well-versed on criminal matters, would not dare exercise their business judgment to forge ahead, but in fact be conservative and refer such matters to legal counsel for the determination of what criminal or administrative risks they are venturing on
 - Corporate governance reform therefore no longer constitutes asking the best of what business management may put forth, but becomes primarily the resolution of legal issues revolving upon the overly broad and sometimes confusing letters of the law—a matter **that is best left to the lawyers!**

Doctrine/rule on liabilities

Person/actor	Civil liabilities
Corporation	Yes, for its contract and transactions
Directors or trustees	Generally, no (see <i>Law on Agency doctrine; exceptions</i>). Exceptions: §§ 30, 33, RCC;

	breach of the business judgment rule
Officers	Generally, no. Exceptions: When they act without authority, or they act with fraud, bad faith, or gross negligence.
Other agents or representatives (employees)	Only under the doctrine of estoppel or apparent authority.
Shareholders or members	No, because of the doctrine of centralized management (even if you're the majority stockholder). Exceptions: (1) if authorized to act; (2) if the doctrine of piercing the corporate veil is applied

Person/actor	Criminal liabilities
Corporation	General rule: The corporation does not become criminally liable <ul style="list-style-type: none"> - The <i>acting</i> DTO or person becomes liable Exception: <ol style="list-style-type: none"> 1. The law makes the corporation criminally liable
Directors or trustees	General Rule: The mere fact of being a director or trustee does not per se make one criminally liable Exception: <ol style="list-style-type: none"> 1. Directed the criminal act to be committed (principal by induce), 2. Directly participated in the commission of the criminal offense
Officers	General rule: Corporate officers cannot be held criminally liable merely by virtue of their position or title An officer's criminal liability stems from their active participation, overt physical acts, or intention to commit the specific wrongful act <ul style="list-style-type: none"> - The officer must be specifically identified by the penal statute as the "responsible officer," and the prosecution must prove their direct role in the violation
Other agents or representatives (employees)	An employee who acts with knowledge of the unlawful business, its purpose, and its effect, and consciously

	<p>contributes their efforts to its conduct (however slight the contribution) will be prosecuted as a principal.</p> <p>An employee who is <u>merely acting under the direction</u> of superiors and is unaware that their acts constitute a crime may <u>not be held criminally liable</u> for acts done on behalf of the employer</p>
Shareholders or members	A shareholder or member can only face criminal liability if they personally took part in the commission of the criminal offense (see also § 171)

Chapter 12: Shareholders and Members

Policy approaches on the rights of shareholders/members

Nature of the rights of shareholders

- § 6, RCC provides for **two complementing policy** approaches on the treatment of shareholders as a group of investors:
 - Default rule – In the absence of any provisions in the AOI, each share shall be *equal* in all respects to every other share
 - When preferences or restrictions are made to apply to a class of shareholders, they shall exist and be valid *only when expressly provided in the AOI and stated in the certificate of stock*
- § 6 also contains a “board-enabling clause,” that when authorized by the AOI, the BOD may fix the T&C of preferred shares of stock, or to classify its shares for the purpose of compliance with
 - Nonetheless, such T&C shall be effective upon filing with the SEC
 - Thus, the **third requisite** by which a preference or restriction on shares may be valid and effective is that the same is **registered with the SEC** and becomes public record
- *Cojuangco Jr. v. Roxas*: Rights of shareholders are:
 - The right to vote
 - The right to receive dividends
 - The right to inspect the corporate books
 - The right to receive distributions upon liquidation of the corporation
- *Lim Tay v. CA*: Rights that flow from stock ownership:
 - The registration of shares in the shareholder’s name
 - The issuance of stock certificates
 - The right to receive dividends
- Other rights, such as the *right to transfer or dispose of his fully paid shares of stock and the right to file a derivative suit*, also underscore the proprietary nature of the shares as a medium of investments

- A purely business relationship not focused on any personality relationship
- Since “shareholdership” is proprietary, upon the death of any registered shareholder, his heirs do not automatically become shareholders and acquire the rights and privileges of the deceased shareholder, unless § 62, RCC is complied with
 - § 62, RCC: The stocks must be distributed first to the heirs in the estate proceedings, and the transfer of the stock must be recorded in the books of the corporation
- Only those whose ownership of shares are duly registered in the stock and transfer book (STB) are considered shareholders of record and are entitled to *all* rights of a shareholder

Nature of the membership in a nonstock corporation

- Membership is *eleemosynary in nature*.
- Membership in a nonstock corporation and all rights arising therefrom are *personal and nontransferable*
- In any case, the right of members to vote may be modified in the AOI or bylaws (§ 88, RCC)
- For termination of membership, see § 90, RCC

The pre-emptive right

SEC. 38. Power to Deny Preemptive Right. - All stockholders of a stock corporation shall enjoy preemptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings, unless such right is denied by the articles of incorporation or an amendment thereto: Provided, That such preemptive right shall not extend to shares issued in compliance with laws requiring stock offerings or minimum stock ownership by the public; or to shares issued in good faith with the approval of the stockholders representing two-thirds (2/3) of the outstanding capital stock, in exchange for property needed for corporate purposes or in payment of a previously contracted debt.

- **Preemptive right** grants to shareholders the **first option** to subscribe to any opening for subscription of the unissued capital stock, or to any increase of its authorized capital stock, as well as to the disposition of treasury shares
 - **Purpose:** To protect against dilution of ownership percentage and control when a company issues new stock
- It is a **common law**, not a statutory right—it exists even when § 38 is deleted

Exceptions to preemptive rights

1. When such right is denied in the **AOI**
2. When the issuance of shares from the capital stock is:
 - a. In compliance with laws requiring stock offerings or minimum stock ownership by the public
 - b. In (i) exchange for property needed for corporate purposes; or (ii) payment of

previously contracted corporate debt; provided that such issuance is:

- i. Effected in good faith and
- ii. With the approval of the shareholders representing $\frac{2}{3}$ of the outstanding capital stock

- A majority vote of shareholders waiving the preemptive right would not be valid and binding on the individual shareholders since the right is a **personal** one

Coverage of preemptive rights

- Subscription deposits are excluded
- Old Corporation Law: Preemptive rights of existing shareholders pertained only in cases of increase of the *authorized capital stock* and the right did not cover existing unsubscribed portion of the authorized capital stock
- Under what is now § 38, the preemptive right of shareholders is recognized to exist to all issues or disposition of shares of any class, which clearly provides that the pre-emptive right should now be available even to issues from the existing unsubscribed portion of the authorized capital stock, and even to reissuance, sale or disposition of treasury shares

Rights of first refusal and other restrictions on sale

SEC. 62. Certificate of Stock and Transfer of Shares.

-The capital stock of corporations shall be divided into shares for which certificates signed by the president or vice president, countersigned by the secretary or assistant secretary, and sealed with the seal of the corporation shall be issued in accordance with the bylaws. Shares of stock so issued are personal property and may be transferred by delivery of the certificate or certificates indorsed by the owner, his attorney-in-fact, or any other person legally authorized to make the transfer. No transfer, however, shall be valid, except as between the parties, until the transfer is recorded in the books of the corporation showing the names of the parties to the transaction, the date of the transfer, the number of the certificate or certificates, and the number of shares transferred. The Commission may require corporations whose securities are traded in trading markets and which can reasonably demonstrate their capability to do so to issue their securities or shares of stocks in uncertificated or scripless form in accordance with the rules of the Commission.

No shares of stock against which the corporation holds any unpaid claim shall be transferable in the books of the corporation.

Types of restrictions on shares

1. Right of first refusal (ROFR) – A shareholder who wishes to sell or assign his shares must first offer the shares to the corporation or to the other shareholders, under terms and considerations which are reasonable; and that only when the corporation or the other shareholders do not or fail to exercise

their option, is the offering shareholder at liberty to dispose of his shares to third parties

2. Right of first option – This grants to the corporation the right to buy the shares at a fixed price, and would be valid if the terms and consideration are reasonable
3. Buy-back agreement – This exists in situations when shares are given or assigned to officers or employees under the condition that should they resign or be terminated from employment, the corporation shall be granted the right to buy-back the shares. Such stipulations are valid so long as the terms and the consideration are reasonable.
4. Right of prior consent – This allows a shareholder to sell his shares only when he obtains the consent of the Board of Directors or other shareholders. Such stipulations are void for being undue restraint of the proprietary right of shareholder in the shares, as illustrated in a situation where a shareholder cannot dispose of his shares because of failure to obtain such consent.
5. Absolute prohibition to transfer shares – This would be void since it would violate the provision of § 62 that treats shares of stock as personal property of which the shareholder has the proprietary right to dispose as an incident of his ownership.

Distinguished from the preemptive right

- A pre-emptive right is a common law right and may be exercised by shareholders even when no provision is granted in the law. The right of first refusal arises only by virtue of contractual stipulations.
- While pre-emptive right pertains to unissued shares that are offered for subscription, as well as treasury shares being disposed of, a right of first refusal pertains to issued shares.
- Pre-emptive right therefore is a right claimed against the corporation, while right of first refusal is a right exercisable against another shareholder. Pre-emptive right therefore is a right claimed against the corporation, while right of first refusal is a right exercisable against another shareholder

Jurisprudential rules on ROFR

Contractual stipulations between shareholders

- *Lambert v. Fox* held **valid** an agreement between the two majority shareholders where they mutually agreed not to sell, transfer, or otherwise dispose of any part of their shareholdings until after one year from the date of the agreement
- The stipulation was not illegal or in restraint of trade, and offended no public policy
- *SEC op.*: A shareholder's agreement imposing restrictions on transfer of shares may be **unenforceable against third-party** purchasers without notice thereof, but remains binding upon the shareholders who were parties thereto

Restrictions on shares in the bylaws

- *Fleischer v. Botica Nolasco* declared void the **bylaw** provision which granted a right of first refusal over shares sought to be disposed by other shareholders
 - *Fleischer* relied on US case law that the power to enact bylaws restraining the sale and transfer of stock must be found in the governing statute or the charter
- CLV: The essence of *Fleischer* was not to declare void provisions on rights of first refusal per se, **but was meant to put bylaws in their proper hierarchical place**
 - It is not the function of bylaws to take away or abridge the substantial rights of shareholders
 - In fact, the ruling recognized that the same may be done either pursuant to a legal provision or in the AOI
- In addition, *Fleischer* seems to support the opinion that bylaw provisions are essentially intramural covenants and do not bind the public
 - Bylaws are intended merely for the protection of the corporation, and prescribe relation, not restriction; they are always subject to the charter of the corporation
- Such restrictions may be upheld when not contrary to the public welfare and not greater than is necessary to afford a fair and reasonable protection to the party in whose favor it is imposed, and such reasonableness seem to be present whenever the restraint or prohibition is limited in both time and place
- **Twin test of reasonable restraint:**
 - Has a beneficial purpose, results in the protection of the corporation as well as of the individual parties to the contract
 - Reasonable as to the length of time of the suspension
- The doctrine of § 62 is that shares issued become the personal property of the shareholder and should be within his power to commercially deal with them
- The “reasonableness” of any provision restraining the disposition by a shareholder of his shares in the corporation would be tested or whether such provision in effect would undermine his ability to eventually be able to dispose of such shares
- Thus, a stipulation prohibiting a shareholder from disposing of his shareholdings, even when found in the AOI, is **void**
- Likewise, a provision that invalidates a sale or disposition of shares of stock without the consent of the corporation and/or the other shareholders would be **void**, since, by their withdrawal of such consent, a shareholder would be forced to maintain his shareholdings in the corporation
- A ROFR that grants to the corporation or the other shareholders the first option to purchase the shares of a disposing shareholder is *in principle valid*
 - However, when the term or period upon which the option may be exercised by the corporation or shareholder is unreasonable (e.g., when the option can be exercised within an extended period of more than one year) then it becomes unreasonable restraint of trade (thus, a **void** ROFR)
- SEC parameters on what constitutes reasonable restrictions:
 - The restrictions shall not be more onerous than granting the existing shareholders or the corporation the option to purchase the shares with such reasonable terms, conditions or period stated therein
 - A restriction clause is not valid nor enforceable if it absolutely prohibits the sale or transfer of stock without the consent of the existing shareholders
 - Reasonable option period may range from 30 to 60 days or even more, depending on the circumstances
 - After the option period has expired the shareholder is free to sell his shares of stock to anyone

Restrictions on shares in the Charter

- Once the ROFR is properly provided in the AOI, it becomes a property right in favor of the corporation or the other shareholders in whose favor the option is granted
- The **test** as to *whether a restriction is valid and enforceable* is **whether it is sufficiently reasonable as to justify the overriding of the general policy against restraint on alienation of personal property**
 - SEC op.: A period of 1 month is deemed reasonably sufficient for the existing shareholders within which to signify their desire to exercise the ROFR (30-60 days)

Restrictions must be indicated in the stock certificate

- Considering that shares of stock burdened with restrictions on transferability may fall into the hands of innocent purchasers, the SEC as a matter of policy, requires that restrictions on transfer shares must be printed in the stock certificate

Underlying doctrine in restrictions on transfers of shares

- These restrictions are tied to the **public policy** against **unreasonable restraint of trade**
- *Villa Rey Transit v. Ferrer*: A contract in restraint of trade is valid, provided there is a limitation upon either time or place
 - The test is whether the restraint is reasonably necessary for the protection of the contracting parties
- If a ROFR is on the proper form (*i.e.*, a private contract or in the AOI), the Court’s analysis will turn to determining whether the substantive terms of the ROFR are valid in accordance with the policy against unreasonable restraint of trade
 - It looks at the intrinsic reasonableness

Non-competition clause

- A non-competition clause may be provided for as a condition for being a shareholder in the AOI or bylaws
- Such disqualification provision is a valid and reasonable exercise of corporate authority since a corporation has the inherent right to preserve and protect itself by excluding competitors or hostile interests
- It theorized that shareholders have a fiduciary relation with their corporation for the collective benefit of the shareholders

any business because the meeting is not lawfully called or convened

Right to propose agenda items

- In accordance with corporate governance best practice that promotes the interests of the shareholders, § 49, RCC now provides that a director, trustee, shareholder, or member may propose any other matter for inclusion in the agenda at any regular meeting of shareholders or members
- The BOD's their primary obligation is to give consideration to such proposals on whether they can be included in the agenda

The right to attend shareholders' or members' meetings

Types and notices of meeting

- Meetings may be regular or special

Regular	Special
Held annually on a date fixed in the bylaws; if not so fixed, then on any date after April 15 of every year as determined by the Board	Special meetings may be held at any time deemed necessary or as provided in the bylaws, provided that at least one-week written notice shall be sent, unless otherwise provided in the bylaws, law or regulation

Notice of meetings

- Written notices of regular meetings shall be sent to all shareholders or members of record at least 21 days prior to the meeting, unless a different period is required by the bylaws
 - Thus, it can be shorter than 21 days, if provided in the bylaws
- Each notice of meeting shall be accompanied by the following:
 - The agenda for the meeting;
 - A proxy form which shall be submitted to the corporate secretary within a reasonable time prior to the meeting;
 - When attendance, participation, and voting are allowed by remote communication or in absentia, the requirements and procedures to be followed when a stockholder or member elects either option; and
 - When the meeting is for the election of directors or trustees, the requirements and procedure for nomination and election (§ 50, RCC)

Waiver of notice of meetings

- Waiver may be done expressly or impliedly by any shareholder/member, provided that:
 - General waivers of notice in the AIBL are not allowed
 - Attendance at a meeting shall constitute a waiver of notice of such meeting; except when the person attends for the express purpose of objecting to the transaction of

Closing of the STB or membership books

- Regular meetings – 20 days
- Special meetings – 7 days
 - The bylaws may provide for a longer period

Who can call a shareholders' or members' meeting?

- The person or persons designated in the bylaws to have authority to call shareholders' or members' meeting may validly do so
- In the absence of such a provision in the bylaw, the meeting may be called by a director or trustee, or by an officer entrusted with the management of the corporation unless otherwise provided by law
- § 49, RCC: Whenever for any cause, there is no person authorized or the person authorized unjustly refuses to call a meeting, the SEC, under a petition of a shareholder or member, and on the showing of good cause therefore, may issue an order to the petitioning shareholder or member directing him to call a meeting by giving proper notice required under the Code or by the bylaws
 - The petitioning shareholder or member shall preside thereat until at least a majority of the shareholders or members present have chosen one of their number as presiding officer

Postponement of meetings

- In case of postponement of stockholders' or members' regular meetings, written notice thereof and the reason therefor shall be sent to all stockholders or members of record at least two weeks prior to the date of the meeting, unless a different period is required under the bylaws, law or regulation (§ 49, RCC)
- The stockholders/members of record shall be notified of the new schedule of the regular meeting by written notice to be sent at least 21 calendar days prior to the new date of the meeting

Proceedings in the shareholders' or members' meetings

Proper venue

- Stock: Shall be held in the **principal office** of the corporation as set forth in the articles of incorporation, or, if not practicable, in the city or

municipality where the principal office of the corporation is located:

- Any city or municipality in Metro Manila, Metro Cebu, Metro Davao, and other Metropolitan areas shall, for purposes of this section, be considered a city or municipality.
- SEC op.: It's mandatory, but not when *all* the stockholders or members are present or duly represented (then, it may be held outside).
- Nonstock: The bylaws may provide that the members may hold their regular or special meetings at any place even outside the place where the principal office is located, provided it is within the Philippines

Presiding officer

- The chairperson or, in his absence, the president
 - Unless the bylaws provide otherwise

Quorum

SEC. 51. Quorum in Meetings. - Unless otherwise provided in this Code or in the bylaws, a quorum shall consist of the stockholders representing a majority of the outstanding capital stock or a majority of the members in the case of nonstock corporations.

- Quorum is based on the totality of the shares subscribed and issued, whether it be founders' shares or common shares
 - The STB cannot be used as the sole basis for determining the quorum as it does not reflect the totality of shares which have been subscribed, more so when the articles of incorporation show a significantly larger number of shares issued and outstanding as compared to that listed in the STB (*Lanuza v. CA*)
- For stock corporations, "quorum" is based on the number of outstanding voting stocks. For nonstock corporations, only those who are actual, living members with voting rights shall be counted in determining the existence of a quorum during members' meetings; dead members shall not be counted (*Tan v. Sycip*).

Matters that must be presented by the Board

- See § 49, RCC

Minutes of the meeting

- Such minutes shall set forth in detail, among others:
 - the time and place of the meeting held,
 - how it was authorized,
 - the notice given,
 - the agenda therefor,
 - whether the meeting was regular or special,
 - its object if special,

- those present and absent, and
- every act done or ordered done at the meeting.
- Upon the demand of a director, trustee, stockholder or member, the time when any director, trustee, stockholder or member entered or left the meeting must be noted in the minutes; and on a similar demand, the yeas and nays must be taken on any motion or proposition, and a record thereof carefully made.
- The protest of a director, trustee, stockholder or member on any action or proposed action must be recorded in full upon their demand
- Without the signature of the secretary of the meeting, the minutes have no probative value

Improperly called meeting

- All proceedings and any business transacted at a meeting of the shareholders or members, if within the powers or authority of the corporation, shall be valid even if the meeting is improperly held or called
- Caveat:
 - All shareholders or members are present or duly represented, and
 - Not one of them expressly states at the beginning of the meeting that the purpose of their attendance is to object to the transaction of any business because the meeting is not lawfully called or convened

Right to vote

- The right to vote represents the right of a shareholder to participate in the control and management of the corporation that is exercised through his vote
- Even though by their very nature, common shares have a right to vote, such right does guarantee that the vote of a shareholder would prevail, since in a corporate setting, the rule of the majority prevails
- Only stock actually issued and outstanding may be voted
 - Thus, Treasury Shares cannot be voted (§ 56, RCC)
- When the law speaks of a given proportion of the stock, it must be construed to mean shares that have passed from the corporation, and that may be voted
- It is purely proprietary—you can sell your voting rights, and it happens in three forms:
 - Proxy
 - VTA
 - Shareholders' agreement

Exercise of the right to vote

- The right to vote may be exercised:
 - In person
 - Through a proxy
 - Through remote communication or *in absentia*, when so authorized in the bylaws (§ 49, RCC)

Varying the right to vote

- No share may be deprived of voting rights except those classified and issued as “preferred” or “redeemable” shares (§ 6, RCC)
 - In addition, there shall always be a class or series of shares which have complete voting rights
- The creation of a class of shares with multiple voting rights appears to be effective where the purpose is to unequally distribute voting power so as to confer larger participation in management on a shareholder or class of shareholders
- Where the AOI provide for nonvoting shares, the holders shall be entitled to vote on the following matters:
 - Amendment of the AOI
 - Adoption and amendment of the bylaws
 - Increase/decrease of the capital stock
 - Incurring, creating, or increasing bonded indebtedness
 - Sale, lease, exchange, mortgage, pledge, or other disposition of all or substantially all of the corporate property and assets
 - Investment of corporate funds in another corporation or business not within the primary purpose
 - Merger/consolidation with another corporation or other corporations
 - Dissolution of the corporation
- “**Outstanding capital stock**” – The total shares of stock issued to subscribers or shareholders, whether or not fully or partially paid (as long as there is a binding subscription agreement), except treasury shares (§ 137, RCC)
 - It’s not meant to cover nonvoting shares

Party entitled to vote

- Until challenged in a proper proceeding, a shareholder of record to voting shares has a right to participate and vote in any meeting of the shareholders
- In the absence of fraud, the action of the shareholders at that meeting cannot be collaterally attacked on account of such participation (*Price v. Martin*)
- SEC op.: It’s illegal for a corporation to adopt a rule that a shareholder who fails to attend the meeting or appoint a proxy is deemed to have appointed the Chairman of the meeting as his proxy
 - Proxy voting is governed by § 57, RCC
 - A proxy to vote stock to be valid must have been given by the person who is the legal owner of the stock and entitled to vote the same at the time it is to be voted

Voting on shares jointly owned

SEC. 55. Voting in Case of Joint Ownership of Stock. - The consent of all the co-owners shall be necessary in voting shares of stock owned jointly by two (2) or more persons, unless there is a written proxy, signed by all the

co-owners, authorizing one (1) or some of them or any other person to vote such share or shares: Provided, That when the shares are owned in an "and/or" capacity by the holders thereof, any one of the joint owners can vote said shares or appoint a proxy therefor.

Voting rights of secured creditors

SEC. 54. Right to Vote of Secured Creditors and Administrators. — In case a stockholder grants security interest in his or her shares in stock corporations, the stockholder-grantor shall have the right to attend and vote at meetings of stockholders, unless the secured creditor is expressly given by the stockholder-grantor such right in writing which is recorded in the appropriate corporate books. [xxx]

Voting rights of administrators

SEC. 54. Right to Vote of Secured Creditors and Administrators. — [xxx]

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.

Instances when shareholders/members have voting rights on corporate affairs (*i.e.*, exceptions to the doctrine of centralized management in § 22)

§§	Issue
11	Election to retain the specific corporate term under the AOI for corporations organized under the old Corporation Code; and on the revival of an expired corporation
15	Amendment of AOI
27	Removal of director or trustee
29	Granting of compensation to directors or trustees
36	Extending/shortening of corporate term
37	Increasing/decreasing of capital stock; incurring, creating or increasing bonded indebtedness
38	Exempting from the preemptive right issuances of shares in exchange of property needed for corporate purposes or in payment of a previously contracted debt
39	Sale or encumbrance of all or substantially all of the property and assets of the corporation
41	Investment of corporate funds in nonprimary purpose business
42	Declaration of stock dividends

43	Entering into management contracts
45	Adoption of bylaws
47	Amendment, repeal or adoption of new bylaws
61	Fixing of consideration of no-par value shares
76	Approval of mergers and consolidations
134	Voluntary dissolution when no creditors are affected
135	Voluntary dissolution when creditors are affected
136	Dissolution by shortening corporate term (which requires the amendment of the AOI)
137	Withdrawal of request and petition for dissolution

Agreements affecting the right to vote

Proxies

SEC. 57. Manner of Voting; Proxies. - Stockholders and members may vote in person or by proxy in all meetings of stockholders or members.

When so authorized in the bylaws or by a majority of the board of directors, the stockholders or members of corporations may also vote through remote communication or in absentia: *Provided*, That the votes are received before the corporation finishes the tally of votes.

A stockholder or member who participates through remote communication or in absentia shall be deemed present for purposes of quorum.

The corporation shall establish the appropriate requirements and procedures for voting through remote communication and in absentia, taking into account the company's scale, number of shareholders or members, structure and other factors consistent with the basic right of corporate suffrage.

Proxies shall be in writing, signed and filed, by the stockholder or member, in any form authorized in the bylaws and received by the corporate secretary within a reasonable time before the scheduled meeting. Unless otherwise provided in the proxy form, 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.

Requisites for valid proxy vote:

- a. It must be in writing
- b. Signed by the shareholder or member of record
- c. Filed before the meeting with the corporate secretary

Voting trust agreements

SEC. 58. 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 not exceeding five (5) years at any 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 Commission; otherwise, the 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. The books of the corporation shall state that the transfer in the name of the trustee or trustees is made pursuant to the voting trust agreement.

The trustee or trustees shall execute and deliver to the transferors, voting trust certificates, which shall be transferable in the same manner and with the same effect as certificates of stock.

The voting trust agreement filed with the corporation shall be subject to examination by any stockholder of the corporation in the same manner as any other corporate book or record: *Provided*, That both the trustor 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 the 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 purposes of circumventing the laws against anti-competitive agreements, abuse of dominant position, anti-competitive mergers and acquisitions, violation of nationality and capital requirements, or for the perpetuation of fraud.

Unless expressly renewed, all rights granted in a voting trust agreement shall automatically expire at the end of the agreed period. The voting trust certificates as well as the certificates of stock in the name of the trustee or trustees shall thereby be deemed cancelled and new certificates of stock shall be reissued in the name of the trustors.

The voting trustee or trustees may vote by proxy or in any manner authorized under the bylaws unless the agreement provides otherwise.

- Under a VTA, a shareholder parts with the naked or legal title—including the power to vote—of the shares and only retains the beneficial ownership of the stock
- A voting trustee is a share owner vested with colorable and naked title of the shares covered for the primary purpose of voting upon stocks that he does not own

Requisites for a valid voting trust:

1. It is in writing and notarized
2. Specified therein are the terms and conditions thereof
3. A certified copy of such agreement shall be filed with the corporation and the SEC

VTA vs. proxy

- The voting rights of the stock are separated from the other attributes of ownership
- The voting rights granted are intended to be irrevocable for a definite period of time
- The principal purpose of the grant is to acquire voting control of the publication

	Proxy	VTA
Legal basis	An agency relationship based on personal qualifications and preferences	A contractual relationship based on the Law of Trust, existing by virtue of a property relationship (splitting naked title and beneficial title)
Revocability	Essentially revocable (unless coupled with an interest), as it is a mere representation relationship	Not revocable, although it may be lawfully terminated based on breach of trust. Provides stability due to the binding contractual relationship
Requisites	Need only be in writing and signed by the shareholder to be enforceable	Needs to be notarized and a copy thereof submitted to the SEC
Scope of authority	Generally limited to acting in the specified shareholders' or members' meeting (if not continuing in nature)	The trustee is not limited to any particular meeting
Right to dividends	No right to receive dividends, unless specifically granted such power	Trustee receives dividends declared on shares, with the obligation to dispose of them for the benefit of the beneficial owner
Right to inspect	Does not have the right to inspect corporate books, unless specifically given such power	The trustee is the person entitled to exercise the right to inspect
Appraisal right	No power to exercise appraisal	The trustee, as the naked owner,

	right, unless expressly granted	exercises the appraisal right (subject to trust obligations)
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VTA as part of loan agreement

- § 58 envisions a situation where a corporation obtains a loan from a bank, with the condition that the majority shareholders would be required to execute voting trust agreement over their shares, to ensure that the lending institution would have controlling interests in corporate votes to be taken that may affect the ability of the borrowing corporation to pay the loan
- The voting trust therefore constitutes further security to the lending institution, although it is not the corporation which executes the same since it is not the owner of the shares, but rather its shareholders
- The VTA cannot exceed 5 years, and expires automatically upon full payment of the loan

Pooling and other shareholders' agreement

SEC. 99. Agreements by Stockholders. -

[xxx]

(b) A written agreement signed by two (2) or more stockholders may provide that in exercising any voting right, the shares held by them shall be voted as provided or as agreed, or in accordance with a procedure agreed upon by them. [xxx]

- Pooling or voting agreements are contractual arrangements by which two or more shareholders agree that their shares shall be voted as a unit
 - They are usually concerned with the election of directors to gain control of the management
- They cannot be enforced *via* specific performance (it's an obligation to do)

Right to inspect and/or reproduce corporate records

Common law basis of the right to inspect

- The stockholders' right of inspection of the corporate books and records is based upon their ownership of the assets and property of the corporation.
- It is, therefore, an incident of ownership of the corporate property, whether this ownership or interest be termed an equitable ownership, a beneficial ownership, or a quasi-ownership. This right is predicated upon the necessity of self-protection (*Gokongwei v. SEC*)

Who may not exercise the right to inspect?

1. A requesting party who is not a shareholder or member of record

2. A competitor, director, officer, controlling shareholder, or otherwise represents the interests of a competitor (§ 73, RCC)

Corporate records subject to the right of inspection

SEC. 73. Books to be Kept; Stock Transfer Agent. – Every corporation shall keep and carefully preserve at its principal office all information relating to the corporation including, but not limited to:

- (a) The articles of incorporation and bylaws of the corporation and all their amendments;
- (b) The current ownership structure and voting rights of the corporation, including lists of stockholders or members, group structures, intra-group relations, ownership data, and beneficial ownership;
- (c) The names and addresses of all the members of the board of directors or trustees and the executive officers;
- (d) A record of all business transactions;
- (e) A record of the resolutions of the board of directors or trustees and of the stockholders or members;
- (f) Copies of the latest reportorial requirements submitted to the Commission; and
- (g) The minutes of all meetings of stockholders or members, or of the board of directors or trustees. [xxx]

Right to financial statements

SEC. 74. Right to Financial Statements. – A corporation shall furnish a stockholder or member, within ten (10) days from receipt of their written request, its most recent financial statement, in the form and substance of the financial reporting required by the Commission.

At the regular meeting of stockholders or members, the board of directors or trustees shall present to such stockholders or members a financial report of the operations of the corporation for the preceding year, which shall include financial statements, duly signed and certified in accordance with this Code, and the rules the Commission may prescribe.

However, if the total assets or total liabilities of the corporation are less than Six hundred thousand pesos (P600,000.00), or such other amount as may be determined appropriate by the Department of Finance, the financial statements may be certified under oath by the treasurer and the president.

Annual reports of corporations

SEC. 177. Reportorial Requirements of Corporations. – Except as otherwise provided in this Code or in the rules issued by the Commission, every corporation, domestic or foreign, doing business in the Philippines shall submit to the Commission:

- (a) Annual financial statements audited by an independent

certified public accountant: Provided, That if the total assets or total liabilities of the corporation are less than Six hundred thousand pesos (P600,000.00), the financial statements shall be certified under oath by the corporation's treasurer or chief financial officer; and

- (b) A general information sheet.

Corporations vested with public interest must also submit the following:

- (1) A director or trustee compensation report; and
- (2) A director or trustee appraisal or performance report and the standards or criteria used to assess each director or trustee. [xxx]

Rule on confidential records

- § 73 expressly subjects the right to inspect and to copy corporate records to the confidentiality rules under prevailing laws, such as the rules on trade secrets or processes under Intellectual Property Code of the Philippines, the Data Privacy Act, Securities Regulation Code, and the Rules of Court

Right to inspect covers controlled subsidiaries

- See *Gokongwei Jr. v. SEC*
- It would be more in accord with equity, good faith, and fair dealing to construe the statutory right of petitioner as a shareholder to inspect the corporate books and records as extending to books and records of such wholly-owned subsidiary

Manner of availing of the right to inspect

- Must be exercised at reasonable hours of business days
 - It requires a demand in writing
- Proper motive is an essential element
 - The inspection has to be germane to his interest as a stockholder, and has to be proper and lawful in character and not inimical to the interest of the corporation
 - It is with the officers to discharge the burden of proof to show that the shareholder's action in seeking examination of the corporate records was moved by unlawful or ill-motivated designs which could appropriately call for a judicial protection against the exercise of such right
- Thus, summarizing the three limitations:
 - The right of inspection should be exercised at reasonable hours on business days
 - The person demanding the right to examine and copy excerpts from the corporate records and minutes has not improperly used any information secured through any previous examination of the records of such corporation; and
 - The demand is made in good faith or for a legitimate purpose

Proper purpose for the exercise of the right

- Purposes which would warrant denial of the right of inspection, because the purpose is improper, would be:
 - the obtaining confidential business information, or to assist the revelation of trade secrets;
 - to secure personal business prospects, as when the list of shareholders is requested for the purpose of selling it to an advertising agency;
 - to find technical defects in corporate transactions in order to bring "nuisance" or "strike suits" for purpose of blackmail or extortion;
 - to obtain information to be published so as to embarrass the company business, depress the value of its assets, and cause loss to shareholders; or
 - where the purpose is to create demoralization and dissension among the shareholders and by depressing the value of shares, be able to deal with them profitably, at their expense.

Abuse of the right to inspect

- Any stockholder who shall abuse the rights granted under this section shall be punishable under SEC's administrative sanction power in § 158

Remedies if inspection and/or reproduction denied

SEC. 73. Books to be Kept; Stock Transfer Agent. –

[xxx]

Any officer or agent of the corporation who shall refuse to allow the inspection and/or reproduction of records in accordance with the provisions of this Code shall be liable to such director, trustee, stockholder or member for damages, and in addition, shall be guilty of an offense which shall be punishable under Section 161 of this Code: Provided, That if such refusal is made pursuant to a resolution or order of the board of directors or trustees, the liability under this section for such action shall be imposed upon the directors or trustees who voted for such refusal: Provided, further, That it shall be a defense to any action under this section that the person demanding to examine and copy excerpts from the corporation's records and minutes has improperly used any information secured through any prior examination of the records or minutes of such corporation or of any other corporation, or was not acting in good faith or for a legitimate purpose in making the demand to examine or reproduce corporate records, or is a competitor, director, officer, controlling stockholder or otherwise represents the interests of a competitor.

If the corporation denies or does not act on a demand for inspection and/or reproduction, the aggrieved party may report such denial or inaction to the Commission. Within five (5) days from receipt of such report, the Commission shall conduct a summary investigation and issue an order directing the inspection or reproduction of the requested records. [xxx]

Elements of the offense covered by § 73, RCC:

1. A director, trustee, stockholder or member has made a prior demand in writing for a copy of excerpts from the corporation's records or minutes
2. Any officer or agent of the concerned corporation shall refuse to allow the said director or trustee, stockholder or member of the corporation to examine and copy said excerpts
3. If such refusal is made pursuant to a resolution or order of the board of directors or trustees, the liability under this section for such action shall be imposed upon the directors or trustees who voted for such refusal
4. Where the officer or agent of the corporation sets up the defense that the person demanding to examine and copy excerpts from the corporation's records and minutes has improperly used any information secured through any prior examination of the records or minutes of such corporation or of any other corporation, or was not acting in good faith or for a legitimate purpose in making his demand, the contrary must be shown or proved (*Ang-Abaya v. Ang*)

Defenses

1. The person demanding to examine has improperly used any information secured through any prior examination of the records or minutes of such corporation or for any other corporation
2. The one requesting to inspect was not acting in good faith or for a legitimate purpose in making his demand
3. The requesting party is a competitor, director, officer, controlling shareholder or otherwise represents the interests of a competitor

Right of appraisal

Nature of the appraisal right

- Appraisal right refers to a shareholder's right to demand payment of the fair value of his shares, after dissenting from a proposed corporate action involving a fundamental change in the corporate setting, but only in the specific cases provided for in the RCC
- It is a statutory right
- The shareholder must have voted against the corporate transaction in order to avail of the appraisal right; mere silence or abstention does not entitle such shareholder to the exercise of the right

Instances when appraisal right may be exercised

1. An amendment of the AOI that has the effect of:
 - a. Changing/restricting the rights of any shareholder or class of shares
 - b. Authorizing preferences in any respect superior to those of outstanding shares of any class

2. Extending or shortening the term of corporate existence⁹
3. Sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets
4. Investment of corporate funds for any purpose other than the primary purpose
5. Merger or consolidation

Common denominator: *Rebus sic stantibus*

Denial of appraisal right

- Rights granted by law can be waived individually, unless such waiver would contravene public policy
- When an individual, who is already a shareholder, who is not constrained to waive because he is already a shareholder *enters into a contract knowingly, intelligently waiving his appraisal right*, such waiver is not void
- An article or bylaw provision may be void because it goes against public policy

Rules and procedure for the exercise of the appraisal right

- See §§ 81–85, RCC
- There can be no appraisal right if it will impair the trust fund doctrine, or if there's no unrestricted earnings

Statutory attitude towards the right of appraisal

- The RCC looks with certain disfavor on the exercise of the appraisal right
- The treatment of the appraisal right can be appreciated from the fact that the exercise thereof has the direct effect of diverting resources from corporate coffers and may have serious financial implications on the operations or even survival of the corporation
- Such bias against the appraisal right may be appreciated from the fact that since the essence of shares of stock is their free-transferability, then, the appropriate remedy of a dissenting shareholder would be to dispose of his shareholdings in the corporation

Right to file derivative suits

- **Definition:** A derivative suit is an action brought by minority shareholders in the name of the corporation to redress wrongs committed against the corporation, for which the directors refuse to sue
 - It is a remedy designed by equity and has been the principal defense of the minority shareholders against abuses by the majority
- The ability to file a derivative suit on behalf of the corporation is a common law right of shareholders and members, as well as directors and trustees; it exists by virtue of Philippine jurisprudence adopting from Anglo-American jurisprudence

- Where a majority of the BOD wastes or dissipates the funds of the corporation or fraudulently disposes of its properties, or performs ultra vires acts, the courts, in the exercise of its equity jurisdiction, and upon showing that intra-corporate remedy is unavailing, will entertain a suit filed by the minority members of the board of directors, for and in behalf of the corporation, to prevent waste and dissipation and the commission of a illegal acts and otherwise redress the injuries of the minority stockholders against the wrongdoings of the majority
- An individual shareholder is permitted to institute a derivative suit on behalf of the corporation in order to protect or vindicate corporate rights, whenever the officers refuse to sue, or are the ones to be sued or hold control of the corporation; and that in such actions, the suing shareholder is regarded as a nominal party, with the corporation as the real party in interest
- The suit is an action for specific performance of an obligation owed by the corporation to the stockholders to assist its right of action when the corporation has been put in default by the wrongful refusal of the directors or management to make suitable measure for its protection
- Only available when there is *no* business judgment to be exercised!

Distinguishing from a class suit

- a. Cause of action
 - i. Individual shareholder suits: When a member is denied the right of inspection—the wrong is done to him personally
 - ii. Shareholders' class suits: Where the wrong is done to a group of stockholders, as where preferred stockholders' rights are violated, the suit is brought for the protection of all stockholders belonging to the same group
 - iii. Derivative suit: Where the acts complained of constitute a wrong to the corporation itself, the cause of action belongs to the corporation
- b. Loss suffered: Although in most every case of wrong to the corporation, each stockholder is necessarily affected because the value of his interest therein would be impaired, this fact of itself is not sufficient to give him an individual cause of action since:
 - i. The corporation is a person distinct and separate from him, and can and should itself sue the wrongdoer
 - ii. Otherwise, not only would the theory of separate entity be violated, but there would be multiplicity of suits as well as a violation of the priority rights of creditors
 - iii. Furthermore, there is the difficulty of determining the amount of damages that should be paid to each individual stockholder

⁹ CLV: § 36 provides for appraisal rights only in case of extension of corporate term. This must prevail.

Derivative suits as an exception to the BJR

- The right of a shareholder or member to file a derivative suit is conditioned upon a situation where the BOD are not in a position to exercise business judgment for the benefit of the corporation
- In such actions, the corporation is the real party-in-interest while the suing stockholder, in behalf of the corporation, is only a nominal party
- A derivative action is a suit by a shareholder to enforce a corporate cause of action
 - Thus, if a corporation has a defense to an action against it and is not asserting it, a stockholder may intervene and defend on behalf of the corporation
- Where the corporate directors are guilty of breach of trust—not of mere error of judgment or abuse of discretion—and intra-corporate remedy is futile or useless, a stockholder may institute a suit in behalf of himself and other stockholders and for the benefit of the corporation, to bring about a redress of the wrong inflicted directly upon the corporation and indirectly upon the stockholders
- CLV: Derivative suit is an exception to the business judgment rule, and may be activated only when it is clear that the BOD is not in a position to validly exercise its business judgment for the protection of the corporation, such as:
 - When it is the *Board itself that committed an act that has caused damage* to the corporation, or
 - It is in a *conflict-of-interest situation*, where it cannot be expected that it would use its business discretion, of whether to file a suit or not, for the best interest of the corporation
- When a wrong is committed against the corporation, the determination whether or not to bring a suit for the corporation primarily lies within the discretion and exercise of business judgment of the Board.
 - Consequently, when the Board has in the exercise of its business judgment, decided in good faith that it will not pursue remedies on behalf of the corporation, the use of the derivative suit mechanism by the shareholder would be improper
- It is only when the Board itself is the author of the wrong done or being done to the corporation, where business judgment considerations are not applicable, since in such a conflict it can hardly be expected that the Board or its culprit members would be in a position to exercise proper business judgment to protect the interest of the corporation
- But when the cause of action is against third parties or against some of the members of the Board, *but there remains enough disinterested members for the Board to validly act as a body*, the determination on whether to take corporate action is essentially

still within the BOD in the exercise of its business judgment¹⁰

Jurisprudential requisites for the proper filing of a derivative suit

1. The party bringing suit should be a shareholder as of the time of the act or transaction complained of and at the time of the filing of the suit, the number of his shares not being material
2. The party has tried to exhaust all intra-corporate remedies available, *i.e.*, has made a demand on the BOD for the appropriate relief, but the latter has failed or refused to heed his plea
3. The cause of action actually devolves on the corporation, the wrongdoing or harm having been, or is being caused to the corporation, and not to the stockholder bringing the suit

Requisites under the Interim Rules¹¹

1. The plaintiff was a shareholder or member at the time the questioned act or transaction subject of the action occurred, as well as at the time the action was filed, and remains as such during the pendency of the action
2. The plaintiff exerted all reasonable efforts, and alleges with particularity in the complaint, to exhaust all remedies available under the AOI, bylaws, laws or rules governing the corporation to obtain the relief he desires
3. The relief sought pertain to the corporation
4. No appraisal rights are available for the acts complained of
5. The suit is not a nuisance or harassment suit

Derivative suit instituted on appeal

- The nature of a derivative suit does not necessarily have to begin from the start of the suit, but a suit that is not originally a derivative suit at the onset, may on appeal, when it is shown that the cause of action accrues to the corporation, and that the corporation is impleaded as a party thereto, may ripen into a derivative suit (see *Chua v. CA*)

Proper party to bring derivative suit

- A derivative suit will not proper if it is filed by a person who is not a shareholder or member of the corporation
- The relator in a derivative suit must have been a shareholder of the corporation both:
 - at the time the cause of action took place
 - and
 - at the time of suit

¹⁰ In instances under American jurisprudence, where all or a majority of the directors were accused of being guilty of the fraudulent act, they could still prevent a derivative suit from being filed, by forming a committee with full power to investigate the matters complained of and to give recommendations on whether to sue or not.

¹¹ CLV: The Interim Rules seem to presume that a derivative action is for the benefit of the shareholders or members, when jurisprudence has ruled that a derivative action is essentially for the benefit of the corporation as a separate juridical entity.

- CLV: There seems to be little basis under Philippine laws to require that a relater was a shareholder only at the time of the institution of the action but not at the time the cause of action accrued when it is the corporation that is really the interested party. The main consideration in Pascua/ of forum-shopping holds no merit under Philippine jurisdiction which does not have a federal-state judicial system.

Exhaustion of intra-corporate remedies

- A derivative suit can only be filed when there has been a showing of exhaustion of intra-corporate remedies, and such fact must be specifically alleged for the petition to be complete in form and substance
- **Exception:** When exhaustion would be futile or useless because the Board itself would not bring the suit for the reason that they are also guilty or part of the fraud committed against the corporation

Relief sought must be for the benefit of the corporation

- It is required that the minority shareholder who is suing for and on behalf of the corporation must allege in his complaint that he is suing on a derivative cause of action on behalf of the corporation and all other shareholders similarly situated who wish to join
 - CLV: The ruling is odd, because a derivative suit is *not* a class suit and is brought for the benefit of the corporation
- The action must be brought for the benefit of the corporation
 - Thus, a suit to enforce pre-emptive rights in a corporation is not a derivative suit
 - There must be an allegation of injury done to the corporation due to the assailed acts

Venue and proper forum

- RTC designated as Special Commercial Court which has jurisdiction over the principal office of the corporation

Nuisance or harassment suits

- Guidelines in determining whether a complaint is considered a harassment suit:
 - The extent of the shareholding or interest of the initiating stockholder or member
 - Subject matter of the suit
 - Legal and factual basis of the complaint
 - Availability of appraisal rights for the act/s complained of
 - Prejudice/damage to the corporation in relation to relief sought
- Thus, a derivative suit filed to collect a personal debt from the controlling shareholder is a harassment suit (*Ang v. Ang*)
- Since the damage sought to be recovered did not devolve on the corporation, but mainly on the injury sustained by stockholders who acted as third-party mortgagors for the corporation, the suit was deemed a nuisance suit (*BSP v. Campa Jr.*)

Retained counsel cannot defend the Board in a derivative suit

- See *Hornilla v. Salunat*.

Arbitration agreements

SEC. 181. Arbitration for Corporations. — An arbitration agreement may be provided in the articles of incorporation or bylaws of a corporation. When such an agreement is in place, disputes between the corporation, its stockholders or members, which arise from the implementation of the articles of incorporation or bylaws, or from intra-corporate relations, shall be referred to arbitration. A dispute shall be nonarbitrable when it involves criminal offenses and interests of third parties.

The arbitration agreement shall be binding on the corporation, its directors, trustees, officers, and executives or managers.

To be enforceable, the arbitration agreement should indicate the number of arbitrators and the procedure for their appointment. The power to appoint the arbitrators forming the arbitral tribunal shall be granted to a designated independent third party. Should the third party fail to appoint the arbitrators in the manner and within the period specified in the arbitration agreement, the parties may request the Commission to appoint the arbitrators. In any case, arbitrators must be accredited or must belong to organizations accredited for the purpose of arbitration.

The arbitral tribunal shall have the power to rule on its own jurisdiction and on questions relating to the validity of the arbitration agreement. When an intra-corporate dispute is filed with a Regional Trial Court, the court shall dismiss the case before the termination of the pretrial conference, if it determines that an arbitration agreement is written in the corporation's articles of incorporation, bylaws, or in a separate agreement.

The arbitral tribunal shall have the power to grant interim measures necessary to ensure enforcement of the award, prevent a miscarriage of justice, or otherwise protect the rights of the parties.

A final arbitral award under this section shall be executory after the lapse of fifteen (15) days from receipt thereof by the parties and shall be stayed only by the filing of a bond or the issuance by the appellate court of an injunctive writ.

The Commission shall formulate the rules and regulations, which shall govern arbitration under this section, subject to existing laws on arbitration.

Right to proportionate share of net assets upon dissolution

- No corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities, except:
 - By decrease of capital stock
 - As otherwise allowed in the RCC (e.g., redemption of redeemable shares, and instances when the corporation is allowed to buy back its shares under § 40)
- As a general rule, it is only upon dissolution of the stock corporation that the rights of shareholders to

share proportionately in the net assets of the corporation may arise, and only when the obligations to the creditors of the corporation have been settled

Chapter 13: Shares of Stock

Nature of shares of stock

- The shares of stock issued by a corporation constitute *intangible personal property* in the hands of the shareholders, which shares they can transact with as in any other form of property, like assignment by way of disposition, or mortgage by way of encumbrance.
 - Shares have intrinsic pecuniary value to shareholders tied-up with the commercial value of the corporation's property and assets, as well as its business enterprise.
- Shares of stock, however, do **not** represent a proprietary claim of coownership or tenancy-in-common in the corporation's property and assets.
 - The shareholders do not own any part of the corporate property and assets represented by the capital stock; nor are the shareholders entitled to the possession of any portion thereof
- A shareholder's interest is *indirect, contingent, remote, conjectural, consequential and collateral*
 - It's purely inchoate, or in sheer expectancy
- Shares, whether issued or unissued, do not represent assets/property to the corporation
- Shares of stock, whether issued or unissued, do not constitute part of the "assets" of the corporation
 - Even when issued shares become treasury shares, they are not part of its assets
- In the same manner, shares issued do not constitute debts or liabilities of the corporation

Modes of dealings with shares of stock

1. Level 1: Initial issuance (subscription agreement) vs. subsequent dealings
2. Level 2: Subsequent dealings:
 - a. Sale, transfer, assignment and other acts of **disposition** of shares
 - b. Pledge, mortgage, and other **encumbrances** constituted over shares
 - c. Attachment, levy, and other **legal proceedings** affecting shares

Modes of tradition (delivery) applicable to shares of stock

1. Execution of a public instrument (deed of sale of shares/deed of assignment of shares)
2. Transfer or negotiation of the titles, certificates or other evidence of the incorporeal right, which in the case of shares means the *endorsement and delivery of stock certificates*
3. The use and enjoyment by the buyer of the rights and privileges to the shares, with the knowledge and consent of the selling shareholder

Rights of corporation with respect to shares issued

1. To call for the payment of the unpaid subscription, together with interest accrued (§ 66)
2. To impose interest on the unpaid subscriptions from the date of subscription, if so required by, and at the rate of interest fixed in the bylaws (§ 65)
3. To refuse to issue to the subscriber the stock certificates covering shares where the subscription has not been fully paid (§ 63)
4. To refuse to recognize and register the sale/assignment of any shares where the subscription has not been fully paid (§ 62)
5. To refuse to recognize a sale/assignment of shares which have not been duly registered in the stock and transfer book (STB) (§ 62)

The corporation has not power on its own volition to:

1. Demand for the repurchase of shares it has issued, unless the shares are classified as redeemable shares in the articles of incorporation (§ 8)
2. Refuse to pay to the shareholders dividends declared on shares which have not been declared delinquent, or to apply them to the payment of the unpaid subscription (§ 70)
3. Bid delinquent shares, and thereby to obtain for itself profit, for a value greater than the unpaid subscription, plus accrued interest, costs of advertisement and expenses of sale (§ 67)
4. It has also been ruled that the unpaid subscription of a shareholder which has not become due by call through a formal board resolution cannot be offsetted against a money claim of the employee-shareholder against the employer-corporation (*Apocada v. NLRC*)

Original dealings with shares of stock

Subscription agreement—the root to shareholder standing

- It is the subscription of shares, not the payment of such subscription, that is the **mode which creates the legal relationship between the shareholder and corporation**¹²
 - In other words, the issuance of shares creates ownership over such shares in the person of the subscriber

There can be a "subscription" by a shareholder and "issuance" by the corporation only with reference to the unissued shares in the following cases:

- a. The original issuance from the authorized capital stock at the time of incorporation;
- b. The opening, during the corporate life, of the remaining portion of the original Authorized Capital Stock previously unissued; or
- c. The increase of Authorized capital stock achieved through a formal amendment of the AOI

¹² Holders of subscribed shares not fully paid which are not delinquent shall have all the rights of a stockholder (§ 71, RCC).

Section 59. Subscription Contract. - Any contract for the acquisition of unissued stock in an existing corporation or a corporation still to be formed shall be deemed a subscription within the meaning of this Title, notwithstanding the fact that the parties refer to it as a purchase or some other contract.

- The violation of some of the terms embodied in a subscription agreement do not constitute legal ground to rescind the contract as it would violate the Trust Fund Doctrine (*Ong Yong v. Tiu*)

When shares deemed subscribed

- A subscription agreement has also the same characteristics of a contract of sale over shares:
 - Nominate
 - Bilateral
 - Consensual
 - Onerous
 - Commutative
- A subscription agreement is *not* a mode of creating ownership, but merely constitutes a title at the point of perfection—delivery is still required
- What can be drawn from §§ 59, 62, and 71 is the perfection of any contract for the acquisition of unissued shares (subscription agreement) would constitute tradition by which the subscriber becomes a shareholder, and through which he becomes the owner of the shares subscribed and exercise acts of ownership, subject to the limitations under the RCC.
- In other words, unlike sale, which constitutes merely a title and not a mode by which ownership of the subject matter is transferred, a subscription agreement constitutes the very mode by which the covered shares are thereby issued and then owned by the subscriber.

Nonapplicability of the Statute of Frauds (SOF)

- CLV: Subscription agreements are not covered by the SOF and the corporation has a right to enforce and collect, and to adduce oral evidence, upon an oral subscription agreement
- In any case, since their perfection alone would make the subscribers a shareholder and owner of the covered shares, they would be executed, not executory, contracts, and would be exempted from the prohibition against the presenting of oral evidence to prove and enforce them

Consideration for issuance of shares

Section 61. Consideration for Stocks. - Stocks shall not be issued for a consideration less than the par or issued price thereof. Consideration for the issuance of stock may be:

- (a) Actual cash paid to the corporation;
- (b) Property, tangible or intangible, actually received by the corporation and necessary or convenient for its use and lawful purposes at a fair valuation equal to the par or

issued value of the stock issued;

- (c) Labor performed for or services actually rendered to the corporation;
- (d) Previously incurred indebtedness of the corporation;
- (e) Amounts transferred from unrestricted retained earnings to stated capital;
- (f) Outstanding shares exchanged for stocks in the event of reclassification or conversion;
- (g) Shares of stock in another corporation; and/or
- (h) Other generally accepted form of consideration.

Where the consideration is other than actual cash, or consists of intangible property such as patents or copyrights, the valuation thereof shall initially be determined by the stockholders or the board of directors, subject to the approval of the Commission.

Shares of stock shall not be issued in exchange for promissory notes or future service. The same considerations provided in this section, insofar as applicable, may be used for the issuance of bonds by the corporation.

The issued price of no-par value shares may be fixed in the articles of incorporation or by the board of directors pursuant to authority conferred by the articles of incorporation or the bylaws, or if not so fixed, by the stockholders representing at least a majority of the outstanding capital stock at a meeting duly called for the purpose.

Cash

- In spite of the wording “actually paid,” it is not required that there be actual payment to make the subscription agreement valid and binding—it’s a consensual contract
- Only when there is a call by the Board, or when under the terms of the subscription agreement payment is due, is the shareholder legally obliged to pay actual cash to the corporation, and failure to do so would subject the shares to being declared delinquent and leading to the suspension of the rights of a shareholder
- Subscription receivable – An obligation to pay the corporation cash in the future
 - This is a valid consideration, because its presentation in the balance sheet informs creditors of the actual net amount of capital stock which is truly backed-up by realized and fairly valued assets paid into the corporate coffers

Property as consideration

- It must be property which it may lawfully acquire and hold in carrying out the purposes of its incorporation, and which is necessary or proper for it to own in carrying on its business

- The property must be of substantial nature, having a pecuniary value capable of being ascertained, and must be something real and tangible
- It must also be such as is capable of being applied to the payment of debts and of distribution among the shareholders

Debts and service as consideration

- The transaction must be in good faith and no fraud is perpetrated upon other shareholders
- Compensation payable for services actually rendered to the corporation is credit which is property and the value of which is ascertainable
- An agreement to issue shares for services to be rendered in the future is void under § 61, and the corporation is not estopped to deny that the services constituted payment of the share subscription even though it has received the benefit thereof
- Although a previously incurred debt is a valid consideration for subscription, future services are not allowed as consideration for subscription because the value of such service to the corporation in exchange for shares would again depend on the future performance of the subscriber

Set-off of corporation's indebtedness

- Such previously incurred debt (which may either be an accounts payable or notes payable of the corporation) would be converted to capital and it is likely that having been established at arms-length, they represent the true value to the corporation

Unrestricted retained earnings or existing capital as consideration

- The amounts transferred from unrestricted retained earnings to stated capital cover the **declaration of stock dividends**, which has the effect of "capitalizing" unrestricted retained earnings
- Stock dividends are in the nature of shares being issued from the unissued portion of the authorized capital stock, where the consideration is the amount of unrestricted retained earnings converted into equity in the corporation's books

What if the consideration is disallowed?

- The subscription agreement would be valid and binding on both the corporation and the subscriber, but that the provision on such unlawful consideration is deemed void, such that the subscription agreement would be construed to be for cash and the unpaid amount be treated as part of subscription receivables.
- § 64, on watered stocks, may come into play.

Watered stock

Section 64. Liability of Directors for Watered Stocks. - A director or officer of a corporation who: (a) consents to the issuance of stocks for a consideration less than its par or

issued value: (b) consents to the issuance of stocks for the consideration other than cash, valued in excess of its fair value; or (c) having knowledge of the insufficient consideration, does not file written objection with the corporate secretary, shall be liable to the corporation or its creditors, solidarily with the stockholder concerned for the difference between the value received at the time of issuance of the stock and the par or issued value of the same.

- **Watered stocks** – Shares issued as fully paid when in truth the consideration is known to be less than the par value or issued value of the shares
- Stock watering is prohibited because of the injury it will cause to:
 - The corporation, which is deprived of needed capital and the opportunity to market its securities to its own advantage
 - Existing and future shareholders, who are also injured by the dilution of the proportionate interests in the corporation and who pay full value for their shares
 - Present and future creditors, who are injured as the corporation is deprived of the assets or capital required by law to be contributed by all shareholders as substitute for individual liability for corporate debts
 - Persons who deal with the company or purchase its securities who are deceived because stock watering which are invariably accompanied with misleading corporate accounts and financial statements

Releases from subscription obligations

- A corporation can release a subscriber from his subscription, in whole or in part, only with the express or implied consent of all of the other shareholders, and only when there is no prejudice to corporate creditors

Payment of balance of subscription

Section 65. Interest on Unpaid Subscriptions. - Subscribers to stock shall be liable to the corporation for interest on all unpaid subscriptions from the date of subscription, if so required by and at the rate of interest fixed in the subscription contract. If no rate of interest is fixed in the subscription contract, the prevailing legal rate shall apply.

Section 66. Payment of Balance of Subscription. - Subject to the provisions of the subscription contract, the board of directors may, at any time, declare due and payable to the corporation unpaid subscription and may collect the same or such percentage thereof, in either case, with accrued interest, if any, as it may deem necessary.

Payment of unpaid subscription or any percentage thereof, together with any interest accrued, shall be made on the

date specified in the subscription contract or on the date stated in the call made by the board. Failure to pay on such date shall render the entire balance due and payable and shall make the stockholder liable for interest at the legal rate on such balance, unless a different interest rate is provided in the subscription contract. The interest shall be computed from the date specified, until full payment of the subscription. If no payment is made within thirty (30) days from the said date, all stocks covered by the subscription shall thereupon become delinquent and shall be subject to sale as hereinafter provided, unless the board of directors orders otherwise.

- Any contradiction to modify the condition of the obligation to pay is essentially void. It does not avoid the subscription agreement, but *avoids the condition*.
 - The obligation to pay then becomes a purely simple obligation.

Call on unpaid subscription

Nature of the call

- "Call" is capable of three meanings:
 - The BOD resolution for the payment of unpaid subscription
 - Notification of such resolution made on the shareholders
 - The time when subscriptions become payable
- What is critical is the *date of payment* and not the date of the BOD resolution
- A call must be uniform with respect to all holders of the class of shares on which it is made who have already paid an equal amount on their shares, and must not exceed the balance remaining unpaid on their shares

When call not necessary

- When, under the terms of the subscription contract, subscription is payable not upon call, but immediately, or on a specified day, or when it is payable in installments at specified times
- If the corporation becomes insolvent, which makes the liability on the unpaid subscription due and demandable regardless of any stipulation to the contrary in the subscription agreement

When shares become delinquent

- If within 30 days from the date of payment stated in the call, *no payment is made*, all stocks covered by said subscription shall become delinquent

Effects when shares become delinquent

Section 70. Effect of Delinquency. - No delinquent stock shall be voted for, be entitled to vote, or be represented at any stockholder's meeting, nor shall the holder thereof be entitled to any of the rights of a stockholder except the right to dividends in accordance with the provisions of this

Code, until and unless payment is made by the holder of such delinquent stock for the amount due on the distribution with accrued interest, and the costs and expenses of advertisement, if any.

Delinquency sale

Section 67. Delinquency Sale. - The board of directors may, by resolution, order the sale of delinquent stock and shall specifically state the amount due on each subscription plus all accrued interest, and the date, time and place of the sale which shall not be less than thirty (30) days nor more than sixty (60) days from the date the stock becomes delinquent.

Notice of the sale, with a copy of the resolution, shall be sent to every delinquent stockholder either personally, by registered mail, or through other means provided in the bylaws. The same shall be published once a week for two (2) consecutive weeks in newspaper of general circulation in the province or city where the principal office of the corporation is located.

Unless the delinquent stockholder pays to the corporation, on or before the date specified for the sale of the delinquent stock, the balance due on the former's subscription, plus accrued interest, costs of advertisement and expenses of sale, or unless the board of directors otherwise orders, said delinquent stock shall be sold at a public auction to such bidder who shall offer to pay the full amount of the balance on the subscription together with accrued interest, costs of advertisement and expenses of sale, for the smallest number of shares or fraction of a share. The stock so purchased shall be transferred to such purchaser in the books of the corporation and a certificate for such stock shall be issued in the purchaser's favor. The remaining shares, if any, shall be credited in favor of the delinquent stockholder who shall likewise be entitled to the issuance of a certificate of stock covering such shares.

Should there be no bidder at the public auction who offers to pay the full amount of the balance on the subscription together with accrued interest, costs of advertisement, and expenses of sale, for the smallest number of shares or fraction of a share, the corporation may, subject to the provisions of this Code, bid for the same, and the total amount due shall be credited as fully paid in the books of the corporation. Title to all the shares of stock covered by the subscription shall be vested in the corporation as treasury shares and may be disposed of by said corporation in accordance with the provisions of this Code.

- The bid price is the same for all who participate in the delinquency sale, and the highest bidder is the person who offers the lowest number of shares for the bid price
- If there's no bidder, the corporation may bid and the total amount due shall be credited as paid in full in the books of the corporation
 - It becomes treasury shares
- Remaining shares go to the delinquent shareholder
- Other remedies available for the corporation – To bring a collection case in a court of proper jurisdiction (§ 69)

- The prescription period runs from the time payment becomes due and demandable

Certificate of stock

- Operates in two levels:
 - Intra-corporate level
 - Extra-corporate level

Commercial functions of the certificate of stock

- Stock certificate constitutes the best evidence of the fully paid shares covered
 - As between the corporation and the original subscriber of the shares, the issuance of a stock certificate is **not** necessary to confer upon the subscriber full ownership over the shares and the standing to exercise all rights that pertain to him being a shareholder (see § 71)
- Probative value of the stock certificate
 - No stock certificate shall be issued to a subscriber until the full amount of the subscription together with interest and expenses, if any is due, has been paid (§ 63)
 - Consequently, when a corporation issues a certificate of stock, it can be taken as a conclusive representation for those who receive the certificate that the covered shares are “fully-paid and non-assessable”

Quasi-negotiability of stock certificates intended to promote the free transferability attribute of shares

Section 62. Certificate of Stock and Transfer of Shares. - [xxx] Shares of stock so issued are personal property and may be transferred by delivery of the certificate or certificates indorsed by the owner, his attorney-in-fact, or any other person legally authorized to make the transfer [xxx].

- Properly read, § 62 seeks to promote the attribute of free-transferability of shares of stock primarily through the institution of the certificate of stock by casting them as being freely transferrable through the system of endorsement and delivery
- Three modifiers under § 62:
 - The transfer may be valid as between the negotiating parties, but void as to third parties unless registered in the STB
 - SEC has the power to require corporations whose securities are traded to issue their stock certificates in uncertificated or scriptless form
 - No shares of stock against which the corporation holds any unpaid claim shall be transferable in the STB
- Nevertheless, it is registration in the STB that is considered to be binding on the corporation and the world

Original dealings with stock certificates

- Reading § 71 and § 63: While the issuance of a stock certificate is **not** a condition precedent to render one a shareholder, every shareholder has a right to have a proper certificate issued to him by the corporation upon demand **only** when he has complied with his obligation to fully pay the subscription
- § 63 is the legal basis to back the proposition that when a corporation issues a stock certificate, it certifies to the world that the shares described and covered therein are fully paid
 - The corporation cannot raise the defense that it will refuse the registration in the name of a buyer who takes the shares in good faith and for value on the ground that it has a lien for unpaid subscription under § 62

Remedies available when corporation refuses to issue stock certificates to fully-paid shares:

1. To file a suit for specific performance of an express or implied contract
2. To file for an alternative relief by way of damages where SP cannot be granted
3. To file a petition for *mandamus* to compel the issuance of the certificate
4. To resolve the the contract of subscription if the corporation wrongfully refuses to deliver a certificate, and sue to recover back what has been paid¹³

Subsequent dealings with stock certificates

Right of purchaser of shares to have them registered in his name

- It is an inherent right flowing from his ownership of the stocks, the only limitation being is when the corporation holds any unpaid claim against the shares intended to be transferred
 - The purpose of the prohibition is to prevent the partial disposition of a subscribed shares which is not fully paid

When no inherent right to be issued stock certificate

- No such right to be issued stock certificates exists by the mere fact that a third party has bought the registered shares of a registered shareholder, even when the shares bought are fully paid
 - Rationale: A third-party buyer is a stranger to the corporation
 - Thus, the buyer must establish his rightful purchase before the corporation may be compelled to cancel the covering certificates and issue new ones in the name of the new owner thereof

Negotiation of stock certificates by the registered shareholder

- “Endorsement and delivery” may be for:
 - Sale or outright disposition of the shares

¹³ These remedies apply only to those who are already shareholders of record.

- Pursuant to a trust/nominee agreement
- By way of pledge/encumbrance of the shares
- Endorsement is an essential ingredient in dealing with stock certificates, and generally cannot be dispensed with
- The endorsement of the stock certificate by the owner shall be sufficient to effect the transfer of shares **only if the same is coupled with delivery**
 - Delivery is the operative act of transfer
- Requisites for the valid transfer of shares under a contract of disposition:
 - The certificate must be endorsed by the owner or other persons authorized to make the transfer
 - There must be delivery of the stock certificate
 - To be valid against third parties, the transfer must be recorded in the STB
- Until the transfer is registered, the transferee is not a stockholder but an outsider (*Batangas Laguna v. Bitanga*)
- CLV: As between the parties to the sale, the transfer shall be valid even if not recorded in the books of the corporation
- Two-fold purpose of registration:
 - To enable the transferee to exercise all the rights of a stockholder
 - To inform the corporation of any change in share ownership so it can ascertain the persons entitled to the rights and subject to the liabilities of a stockholder
- From the corporation's point of view, the transfer is not effective until it is recorded
 - Nevertheless, the **transferor serves as trustee of transferee** as the real owner of the dividends, *subject to the contract* between the transferor and transferee as to who is entitled to receive the dividends

Forged and illegal transfers of stock certificates

- The doctrine that emerges with respect to unauthorized or forged negotiation of certificates of stock emphasizes the fact that **since stock certificates are only quasi-negotiable in character, they would not afford the same protection to a holder in good faith and for value who receives them in the course of their being negotiated**, and that the **ownership of the true owner would be preferred**.
 - **Exception:** When the circumstances showed that the true owner was guilty of negligence that directly contributed to the loss

Lost or destroyed stock certificates

- See Sec. 72.

Stock and transfer book

- Under § 73, a stock corporation must keep a stock and transfer book (STB), in which must be kept a record of:
 - All stocks in the names of shareholders alphabetically arranged
 - Installments paid and unpaid for which subscription has been made, and the date of payment of any installment
 - A statement of every alienation, sale or transfer of shares made
 - Such other entries as the bylaws may prescribe
- Only the corporate secretary may make proper entries in the STB

Registration in the STB as the operative fact for disposition of sales

- Sale and other dispositions of shares stock, although valid as between the transferor and the transferee, would not be valid to the corporation and the world unless the transaction is registered in the STB

STB's probative value

- While the STB is evidence of stock ownership, extrinsic evidence of matters which are recorded may be admitted where the original corporate records are lost, mislaid, or destroyed, or inaccessible
- However, the books and records of a corporation are not conclusive even against the corporation but prima facie evidence only
 - Parol evidence may be admitted to supply omissions in the records, explain ambiguities, or show what transpired where no records were kept, or in some cases where such records were contradicted

STB vs. the articles of incorporation

- *On the issue of quorum determination:* Although the STB is considered the main basis to determine what shares have been issued and outstanding, its contents are not conclusive and parol evidence may be introduced to explain ambiguities, or contradict its entries
 - A STB is necessary as a measure of precaution, expediency and convenience since it provides the only certain and accurate method of establishing the various corporate acts and transactions
 - However, it is not a public record and is not exclusive evidence of the matters inscribed therein

STB vs. the general information sheet (GIS)

- *On the issue of whether one is a shareholder:* As between the General Information Sheet and the corporate books, it is the latter that is controlling

Subsequent dealings with shares of stock

Trust relations created over shares

- Oral testimony to show that one is the principal or beneficial owner of shares for which he has allowed a stock certificate to be issued in the name of his alleged nominee will not be sufficient basis to claim rightful ownership over the shares
 - One who claims ownership over the questioned shares of stock must show that the same were transferred to him by proving that all the requirements for the effective transfer of shares of stock in accordance with the corporation's by-laws
 - Alternatively, the certificate must be properly endorsed and delivered!

original subscriber and his transferee, although binding between them, cannot be forced upon the corporation, when it covers not fully paid shares

Disposition of fully-paid shares covered by stock certificates

- *Uson v. Diosomito*: The failure to register a sale or transfer in the STB would render the sale invalid and not binding to all persons.
- Rationale for *Uson*:
 - To enable the corporation to know at all times who the actual shareholders are, because mutual rights and obligations exist between the corporation and its shareholders
 - To afford to the corporation an opportunity to object or refuse its consent to the transfer in case it has any claim against the share sought to be transferred, or for any other valid reason
 - To avoid fictitious or fraudulent transfers
- **Requisites under § 62 (for issuance of a stock certificate):**
 - The certificate must be signed by the president, VP, countersigned by the secretary/assistant secretary, and sealed with the seal of the corporation
 - Delivery of the certificate
 - The par value or full subscription must be fully paid
 - The original certificate must be surrendered where the person requesting the issuance of a certificate is a transferee from a stockholder

Contracts of disposition over shares

- Reasonable restrictions on the transfer of shares must comply with § 97:
 - The restriction must appear in the AIBL and the certificate of stock
 - The restriction shall not be more onerous than granting the existing shareholders or the corporation the option to purchase the shares of the transferor (e.g., a ROFR), with such reasonable terms, conditions or period

Disposition rules for non-fully paid shares

- No shares against which the corporation holds any unpaid claim¹⁴ shall be transferable in the corporate books
 - The rule pertains to shares not fully paid and therefore not bounded by the quasi-negotiable rules pertaining to shares for which a stock certificate has been issued
 - A corporation may therefore refuse to acknowledge and register a sale or assignment of shares which are not fully paid, and may continue to hold the original subscriber liable on the payment of the subscription
- Two cases:
 - Sale of portion of not fully-paid shares
 - Shareholder **cannot transfer** part of his subscription in view of the indivisible nature of a subscription contract
 - Sale of entire not fully-paid shares
 - The entire subscription may be transferred to a single transferee, who as a result of the transfer must assume the unpaid balance
 - Consent of the corporation must be had (it's novation; art. 1293, NCC)
 - Consequently, the contract of sale or assignment between the

Non-exclusivity of Sec. 62

- Under the *Law on Sales*, other modes of constructive delivery are recognized to cover intangible personal properties (e.g., shares):
 - Execution of a public instrument
 - Exercise of the rights of ownership pertaining to the subject matter *with the knowledge and consent of the registered owner*
- However, the corporation itself, acting through its officers, may be estopped from being bound to the sale or disposition of the shares not registered in the STB (*Tan v. SEC*)

Remedies if registration refused

- The registration of a transfer of shares of stock is a ministerial duty on the corporation
- Aggrieved parties may resort to the remedy of *mandamus* to compel corporations that wrongfully or unjustifiably refuse to record the transfer/issue new stock certificate
- But the remedy of *mandamus* is only available to a *bona fide* transferee who is able to establish a clear legal right to the registration of the transfer

¹⁴ Arising from unpaid subscription, and not to any indebtedness which a subscriber or shareholder may owe the corporation arising from any other transactions (*China Banking Corp. v. CA*).

- Thus, mere endorsement of the stock certificates by the owners could not be the basis of an action for *mandamus* in the absence of express instructions from them

Contracts of encumbrances over shares of stock

Pledge, mortgage, and other encumbrances—in general

- The right of a shareholder to pledge, mortgage or otherwise encumber his shares is recognized under § 54
- However, reasonable restrictions are allowed (see § 97)
 - Therefore, if the restriction prohibits pledge or mortgage without the BOD consent, it would be in violation of the statutory right of the shareholders to encumber shares as allowed § 54
 - When the restriction, however, merely allows the corporation or existing shareholders to accept the offer within the option period, and thereafter, if no one accepts the offer, the shareholder is free to pledge or mortgage his shares in favor of any third party, such provision is reasonable, valid and binding

Encumbrance of shares not covered by stock certificates

- An equity in shares of stock may be assigned and that the assignment is valid as between the parties and as to persons to whom notice is brought home

Encumbrance of shares covered by stock certificates

- When it comes to mortgages and other encumbrances covering shares which are not a complete and absolute alienation of the dominion and ownership thereof, their entry and notation upon the books of the corporation is not a necessary requisite to their validity (*Monserat v. Ceron*)
- In encumbrances over shares, *Bachrach Motors* tells us that delivery of the shares, by endorsement and delivery of the certificate of stocks covering them by the mortgagor to the mortgagee, would be valid and would itself create constructive knowledge binding on third parties. Whereas, in the *absence* of such delivery, then *Chua Guan* tells us that double registration with the proper registers of deeds should be complied with to make the encumbrance binding on third parties.

Encumbrance of shares under the Personal Property Security Act

- The double-registration under *Chua Guan* has now been replaced by registration in the Registry maintained by the LRA, but that possession of the stock certificates by way of pledge under *Bachrach Motors* remains to have priority rights

Attachment, levy and other court processes over shares

- Shares or an interest in shares of any corporation shall be attached "by leaving with the president or

managing agent thereof, a copy of the writ, and a notice stating that the stock or interest of the party against whom the attachment is issued is attached in pursuance of such writ

- A Corporate Secretary is under no obligation to record the attachment of the bank consortium, not being a transfer of ownership but **merely a burden** on the title of the owner

(1) Attaching/levying creditors versus other creditors

- Placing priority in the registration in the STB as the determining factor seems to be a good rule-of-thumb
- It is only correct to make the registration in the STB the final arbiter as to priority among several attaching creditors and even as to buyers or assignees of the shares sold or assigned by the seller in good faith being unaware of the application of a writ of attachment or levy upon his shares

(2) Buyer of shares versus attaching creditors

- No law requires that an attachment of shares be recorded in the STB
- Nowhere in *Samahang Magsasaka v. Chua Guan* was it categorically stated that annotation of the attachment in the corporate books is mandatory for its validity for the purpose of giving notice to third persons
- The Supreme Court held that attachment of shares are not included in the term "transfer" as provided in what is now § 62, since only absolute transfers of shares are required to be recorded in the corporation's STB
- In a contest therefore between a buyer of and the attaching creditor over the shares of the seller-judgment debtor, the buyer cannot rely alone on what appears in the STB nor on the fact that the covering certificates have been duly endorsed and delivered to him by the registered owner thereof, since his rights would be defeated by a judgment creditor who has been able to previously serve a writ on the proper corporate officer

Chapter 14: Corporate capital structure

Contrasting equity investments from corporate debts

- Investment in a business enterprise is an expenditure to acquire assets to produce revenue
- As long as the investment is used for legitimate corporate purposes, the investor bears the risk of loss.
 - Thus, the rule is that when equity investment is placed in a business enterprise, the closure of business due to losses or insolvency is equivalent to *force majeure* and cannot be construed to be equivalent to breach of contract as to entitle the investors to damages
- An equity investment in a corporate enterprise is generally not withdrawable for so long as the corporation has not been dissolved, to assure that

the corporate enterprise and its managers will have such resources at their disposal so long as the corporate enterprise remains a going concern. **This is also the legal implication of the application of the trust fund doctrine**

- However, a creditor who extends a loan/debt to the corporation has every right to demand payment of the placement upon its maturity

Power to issue shares

- Stock corporations have the express powers to issue shares, lodged with the BOD (§§ 35 (f) & 61)

Limitations

- Shares cannot be issued for a consideration less than the par or issued price thereof
 - Except: Treasury shares (so long as the price is reasonable)
- Shares cannot be issued in exchange for PNs or future services
- When the consideration is other than actual cash or consists of intangible property, the value thereof shall be initially determined by the incorporators or BOD

Capital stock/outstanding capital stock

- Definition: The total shares of stock issued to subscribers or shareholders, whether or not fully or partially paid, except treasury shares (§ 173)
 - It is the amount fixed in the AOI that may be subscribed by the shareholders
- When shares are subscribed out of the authorized capital stock, that portion referred to as “subscribed capital stock” or “subscribed and outstanding capital stock” becomes the legal capital of the corporation which cannot be returned to the shareholders in any form during the lifetime of the corporation, unless allowed by law—all in accordance with the **trust fund doctrine**
- Capital stock consists of two items:
 - The portion which have been paid by the shareholders, represented by the account “paid-up capital”,¹⁵ and
 - The portion which is to be paid on the subscriptions, represented by the account “subscription receivables”
- The capital stock represents the legal and proportional standing of the shareholders with respect to the corporation and corporate matters
- The capital stock represents the portion of the corporate property and assets and covered by the **trust fund doctrine, which are deemed protected for the creditors, and from which the corporation cannot declare any dividends**
 - It cannot be levied nor attached to enforce a judgment debt of the corporation, nor it

can be subject to levy by corporate creditors

Classification of shares of stock

2 policies under Sec. 6

1. It expressly recognizes the freedom and power of a corporation to classify shares, subject to the following prescriptions:
 - a. No share may be deprived of voting rights except:
 - i. Preferred shares
 - ii. Redeemable shares
 1. Unless otherwise provided in the RCC
 - b. The following corporations cannot issue no-par value shares:
 - i. Banks
 - ii. Trust
 - iii. Insurance and preneed companies
 - iv. Building and loan associations
 - v. Other corporations authorized to obtain or access funds from the public, whether publicly listed or not
 - c. A corporation may furthermore classify its shares for the purpose of ensuring compliance with constitutional or legal requirements
2. Presumption of equality of the rights and features of shares, *when nothing is expressly provided to the contrary*
 - a. Although a corporation has the power to classify its shares, provide for preferences and other conditions, when nothing has been provided for in the AOI, no presumption should exist to distinguish one share from another
 - b. Consequently, where the AOI and the stock certificates **are silent on the matter of voting rights**, all issued shares, **regardless of their class nomenclature**, shall be considered to have **equal voting rights**

Common shares

- Common shares do not have any special contractual rights or preferences
 - Definition: The residual ownership interest in the corporation; a basic class of stock ordinarily a11d usually issued without extraordinary rights or privileges and entitles the shareholder to a pro rata division of profits
 - They generally represent the greatest proportion of the corporation's capital structure and bear the greatest risk of loss in the event of failure of the enterprise

Preferred shares

¹⁵ That portion of the authorized capital stock which has been both subscribed and paid.

- It is one which entitles the holder to certain preferences over holders of common stock, designed to induce persons to subscribe for shares of a corporation, such as:
 - Preferred share as to assets gives the holder thereof preference in the distribution of the corporate assets in case of liquidation
 - Preferred share as to dividends give the holder the right to receive dividends on said shares to the extent agreed upon before any dividends at all are paid to the holders of common shares
- The contractual rights and preferences of an issue of preferred share must be provided for in the AOI
- Preferred shares may be issued only with a stated par value
- *Cf. common shares:* A preferred share is no more a debt than common shares, and until a dividend is declared, the holder of preferred shares is not a creditor of the corporation, and rights to the corporate property and assets is subordinate to the right of the creditors of the corporation
- Still, there is no guarantee that the share will receive any dividends, or that the preferred shareholders will have preference to corporate assets greater than the corporate creditors
 - The declaration of dividends is dependent upon the availability of surplus profit or unrestricted retained earnings
 - Dividends are thus payable only when there are profits earned by the corporation and as a general rule, even if there are existing profits

Cumulative and noncumulative preferred shares

- **Cumulative preferred shares** entitle the holders thereof to payment not only of current dividends but also of back dividends not previously paid, when and if dividends are declared, to the extent agreed upon, before holders of common shares are paid
 - If the preferred dividend is not paid in full in any year, the deficiency must be made up before any dividend may be paid on the common shares
- **Noncumulative preferred shares** entitle the holders merely to the payment of current dividends that are paid from unrestricted retained earnings, and lose whatever agreed rate of return in any year where there are no available unrestricted retained earnings

Participating and nonparticipating preferred shares

- **Participating preferred shares** entitle the holders to participate with the holders of common shares in the retained earnings after the amount of stipulated dividend has been paid to the preferred shares (double-dip!)
- **Non-participating preferred shares** are those that entitle holders of preferred shares only to the stipulated preferred dividends and no more

Redeemable shares

- Redeemable shares may only be issued by the corporation, if so provided in the AOI (§ 8)
- Redeemable shares may be purchased or taken up by the corporation **upon the expiration of a fixed period**, regardless of the existence of unrestricted retained earnings in the corporate books, and upon such terms and conditions as may be stated in the articles of incorporation, which terms and condition must also be stated in the stock certificates representing said shares
 - Essentially, the corporation gets back some of its stock, distributes cash/property to the shareholder in payment for the stock, and continues in business as before
- This is a clear exception to the trust fund doctrine!
 - However, while redeemable shares may be redeemed regardless of the existence of unrestricted retained earnings, this was subject to the condition that the corporation has, after such redemption, assets in its books to cover debts and liabilities inclusive of capital stock
 - Thus, redemption may not be done if the corporation is insolvent, or will cause insolvency
- The redemption to their concurrent value of acquisition would not be subject to tax, as it is merely a return of investment

Founders' shares

Section 7. Founders' shares. – Founders' shares may be given certain rights and privileges not enjoyed by the owners of other stock. 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 from the date of incorporation: Provided, That such exclusive right shall not be allowed if its exercise will violate Commonwealth Act No. 108, otherwise known as the "Anti-Dummy Law"; Republic Act No. 7042, otherwise known as the "Foreign Investments Act of 1991"; and other pertinent laws.

- There can be no founders' share that can be introduced by way of amendment of the AOI during the corporate life
- Upon the expiration of the period within which the founders' shares can exercise their exclusive right to vote and be voted for in the election of directors, such exclusive right would only be transferred to common shareholders who are supposed to exercise such right had there been no founders share (*SEC op.*)

Par and no par value shares

- "Par value share" is one to which is assigned in the AOI and appearing in the covering stock certificate an amount in pesos as the nominal value of shares.

- Such shares cannot be issued at less than such par value, which can be changed only by an amendment of the AOI
- If no par value shares will be issued by the corporation, such fact must be stated in the AOI and the consideration of their issuance cannot be less than the issued value, which cannot be less than P5 each
- The consideration for which no par value shares may be issued is referred to as its issued value, which may be fixed in any of 3 ways:
 - By the AOI
 - By the BOD, when authorized by the AIBL
 - By the shareholders representing at least a majority of the OCS (§ 61)
- A no-par value share does not purport to represent any stated proportionate interest in the capital stock measured by value, but only an aliquot part of the whole number of such shares of the issuing corporation

- The holders of escrow shares are not entitled to the rights of a shareholder until the conditions set forth for the release of such shares are fully met

Trust fund doctrine

- It is a corporate theory that seeks to protect the interest of corporate creditors
- The capital stock of the corporation, especially its unpaid subscription, is a trust fund for the benefit of the general creditors of the corporation
- CLV: The capital stock of a corporation, as well as its other property and assets are generally regarded in equity as a trust fund for the payment of corporate debts, the creditors of the corporation have the right to priority payment over any shareholder thereof
- SEC rules: The OCS of a corporation, including unpaid subscriptions, shall constitute a trust fund held by the corporation for the benefit of its creditors which shall not be returned to the stockholders by repurchase of shares or otherwise, except in the manner as provided for under the Code
- A corporation has no legal capacity to release an original subscriber to its capital stock from the obligation of paying for his shares, in whole or in part, without a valuable consideration, or fraudulently, to the prejudice of creditors (*Halley v. Printwell Inc.*)
- The clearest injunction in the Revised Corporation Code upholding the principles of the trust fund doctrine would be what is now § 139

Treasury shares

- These are shares that have been issued and fully paid for, but subsequently reacquired by the issuing corporation by purchase, redemption, donation, etc. Such shares may again be disposed of for a reasonable price fixed by the BOD
- Treasury shares are shares that a corporation reacquired after it had issued them
- Treasury shares have no effect on the stated capital unless and until they are canceled or retired, in which event the stated capital is reduced by the amount representing the shares (*SEC op.*)
- *Cf. authorized but unissued shares:* The acquisition of treasury shares does not reduce the number of issued shares or the amount of stated capital and their sale does not increase the number of issued shares or the amount of the stated capital
 - Instead, they are property acquired by the corporation (*SEC rules*)
- A corporation may sell treasury shares for any amount that the BOD may determine, even if the shares have a par value that is more than the sale price
- Treasury shares do not have voting rights or preemptive rights. No dividends are paid on treasury shares
- Consequently, although a treasury share, not having been retired by the corporation re-acquiring it, may be re-issued or sold again
- A treasury share, which may be common or preferred, may be used for a variety of corporate purposes, such as for a stock bonus plan for management and employees, or for acquiring another company

Application in four cases:

1. Where there has been a distribution or an attempt to distribute corporate properties, or a return of the capital/portion thereof, to shareholders, without providing for the payment of creditors
2. Where it had released the subscribers to the capital stock from their subscriptions without valuable consideration
3. Where it has transferred the corporate property in fraud of its creditors
4. Where the corporation is insolvent

Coverage of the trust fund doctrine

- A fixed capital must be preserved for protecting the claims of creditors so that dividend distributions to shareholders should be limited to profits earned or accumulated by the corporation
 - The doctrine only encompasses the capital stock, and does not include unrestricted retained earnings
- Thus, dividends must never impair the subscribed capital; subscription commitments cannot be condoned or remitted; nor can the corporation buy its own shares using the subscribed capital as the consideration therefor
 - Until the liquidation of the corporation, no part of the subscribed capital may be returned or released to the shareholder

Escrow shares

- Definition: Those held by a third person to be released only upon the performance of a condition or the happening of a certain event contained in the agreement

(except in the redemption of redeemable shares) without violating this principle

- *When insolvent:* The scope of the doctrine when the corporation is insolvent encompasses not only the capital stock, but **also other property and assets generally regarded in equity** as a trust fund for the payment of corporate debts
 - All assets and property belonging to the corporation held in trust for the benefit of creditors that were distributed or in the possession of the stockholders, regardless of full payment of their subscriptions may be reached by the creditors in satisfaction of its claim

Dividends

Section 42. Power to Declare Dividends. - The board of directors of a stock corporation may declare dividends out of the unrestricted retained earnings which shall be payable in cash, property, or in stock to all stockholders on the basis of outstanding stock held by them: *Provided*, That any cash dividends due on delinquent stock shall be first be applied to the unpaid balance on the subscription plus costs and expenses, while stock holders until their unpaid subscription is fully paid: *Provided, further*, That no stock dividend shall be issued without the approval of stockholders representing at least two-thirds (2/3) of the outstanding capital stock at a regular or special meeting duly called for the purpose. [xxx]

- The fact that profits have accrued in the prosecution of the corporate business does not necessarily impose upon the directors the duty to declare them as dividends
 - If in their business judgment, they reasonably determine that the profits should be kept in the business, generally the courts have no power to compel them to make the distribution in the absence of bad faith or clear abuse of discretion

Policy against retention of excess profits

Section 42. Power to Declare Dividends. - [xxx] Stock corporations are prohibited from restraining surplus profits in excess of one hundred percent (100%) of their paid-in capital stock, except: (a) when justified by the definite corporate expansion projects or programs approved by the board of directors; or (b) when the corporation is prohibited under any loan agreement with financial institutions or creditors, whether local or foreign, from declaring dividends without their consent, and such consent has not yet been secured; or (c) when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is need for special reserve for probable

contingencies.¹⁶

General rule: Stock corporations are prohibited from retaining surplus profits *in excess of 100% of their paid-in capital stock*

Exceptions:

1. When justified by definite corporate expansion projects or programs approved by the BOD
2. When the corporation is prohibited under any loan agreement with any financial institution or creditor from declaring dividends without its consent and such consent has not yet been secured
3. When can be clearly shown that retention is necessary under special circumstances obtaining, such as when there is a need for special reserve for probable contingencies

Nature of dividends

- A dividend is that portion of the profits of a corporation set aside, declared and ordered by the directors to be paid ratably to the shareholders on demand or at a fixed time
- It is payment to the shareholders of a corporation as a return upon their investment
- It is a characteristic of dividends that all shareholders of the same class share in the dividends in proportion to the respective amounts of shares they hold

Dividends vs. profits

- Profits include benefits of any kind, the excess of value over cost, acquisition beyond expenditures, gain or advance, etc.
- Although dividends come from the accumulated profits found in the retained earnings; profits are not dividends until so declared or set aside by the corporation

Right to dividends pertains only to shareholders

- Since the right to receive dividends is peculiar to shareholders, then dividends may be distributed only to shareholders of record

Sources from which dividends may be declared

- "Retained earnings" – Cumulative balance of *periodic net income dividend distributions*, prior period adjustments; it represents the accumulated net income of a corporation from the date of incorporation, after deducting therefrom distribution to stockholders and transfers to capital stock or other accounts
 - Retained earnings represents the accumulation of net profits of the corporation over the years of operations, reduced from the losses sustained, as well

¹⁶ Properly read, § 42 grants a cause of action for shareholders to compel the Board of Directors to declare dividends; but the exceptions expressly provided in the section actually grant a lot of leeway for the Board of Directors to be able to retain funds within the corporate coffers, such as by adopting formally expansion plans for the corporate enterprise.

as deductions made upon previous dividends declared

- Cf. "Deficit" – If the accumulation resulted in a net loss over the years
- "Restricted" or "appropriated" is that portion that is specifically set-aside for a specific purpose

Cash dividends

- A cash dividend may be declared by the BOD under a formal resolution and does not require the approval or ratification of the shareholders
- Any cash dividends due on delinquent shares shall first be applied to the unpaid balance on the subscription plus costs and expenses, While stock dividends shall be withheld from the delinquent shareholder until his unpaid subscription is fully paid
 - In fine, instead of sending a check to the delinquent shareholder, the corporation automatically applies that cash to pay off the shareholder's debt
- Cash dividends are revocable *before* announcement to the shareholders. But upon publicly declared, the shareholders have the right to their *pro rata* shares.
 - When such declaration is made, the corporation becomes a debtor and the right of the shareholder to distribution, unless a record date is specified, becomes fixed by the declaration

Property dividends

- See *SEC Rules Regulating the Issuance of Property Dividends*
 - No dividends in the form of land shall be issued to a foreign individual or entity not qualified to hold land; and
 - No actual distribution of property dividends shall be made without the approval of the SEC

Stock dividends

- Stock dividends may be validly declared by the BOD only with the approval of shareholders representing not less than 2/3 of the OCS
 - Stock dividend declarations may be revoked prior to actual issuance
- Stock dividends are issuance of shares from the unissued portion of the authorized capital stock, the consideration for which is the amount of unrestricted retained earnings converted into equity in the corporation's books
- It is two things:
 - A dividend
 - The enforced use of the dividend money to purchase additional shares of stock at par

Liquidating dividends

- In the liquidating of a corporation, after the payment of all corporate debts and liabilities, the remaining assets, if any, must be distributed to the shareholders in proportion to their interests

- The share of each shareholder in the net assets of the corporation upon liquidation is what is known as liquidating dividend

Purchase by the corporation of its own shares

Section 40. Power to Acquire Own Shares. - Provided that the corporation has unrestricted retained earnings in its books to cover the shares to be purchased or acquired, a stock corporation shall have the power to purchase or acquire, a stock corporation shall have the power to purchase or acquire its own shares for a legitimate corporate purpose or purposes, including the following cases:

(a) To eliminate fractional shares arising out of stock dividends;

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

(c) To pay dissenting or withdrawing stockholders entitled to payment for their shares under the provisions of this Code.

- A corporation can purchase its own shares, provided payment is made out of surplus profits and the acquisition is for a legitimate corporate purpose (see § 40)
- Some examples of legitimate corporate purpose:
 - To eliminate fractional shares arising out of stock dividends
 - To collect or compromise an indebtedness to the corporation, arising out of unpaid subscription, in a delinquency sale, and to purchase delinquent shares sold during said sale
 - To pay dissenting or withdrawing shareholders entitled to payment for their shares under the RCC
- Shares of a corporation once purchased or acquired by it become treasury shares
- § 40 requires that the corporation must have unrestricted retained earnings in its books to cover the shares to be purchased or acquired
 - The reason for this limitation is that the repurchase of shares, like the distribution of dividends, is a method of distribution or withdrawal of assets, and may be subject to abuse
- Safeguarding the trust fund doctrine: The retained earnings is appropriated to the extent of the cost of the treasury shares, and the same can no longer be declared as dividends, *until the treasury shares are resold*

Chapter 15: Acquisitions & transfers, mergers & consolidations

Three levels:

1. Assets-only level
 - a. The transferee shall not be liable for the liabilities of the transferor, except where the transferee expressly or impliedly agrees to assume such debts or when the transfer is effected in fraud of the transferor's creditors
2. Business-enterprise level
 - a. The transferee shall be liable for the liabilities of the transferor arising from the business enterprise transferred
3. Equity level
 - a. The transferee is not liable for the liabilities of the transferor, except:
 - i. where the transferee expressly or impliedly agrees to assume such debts, or
 - ii. where there is proper basis to apply the piercing doctrine

General rule: When a corporation sells or transfers its assets to another corporation, the transferee does *not* thereby become liable for the liabilities of the transferring corporation, except:

1. Where the transferee expressly or impliedly agrees to assume the debts and liabilities of the transferring corporation
 - a. See art. 2047, NCC
 - b. This is covered by the statute of frauds. Thus, it must be in writing. Else, it's unenforceable.
2. Where the transferee acted in collusion with the transferring corporation to defraud its creditors
 - a. See art. 1381, NCC (rescissible contracts)
3. Where the transferee corporation merely continues the business of the transferring corporation
 - a. This is the "business enterprise" level of acquisitions and transfers
 - b. This is purely common law
4. Where the transaction amounts to a consolidation or merger of the corporations (§ 79 (e), RCC)

Assets-only transfer

- Here, the buyer is interested in the "raw assets" of the business, perhaps to be used to establish its own business enterprise, or to be used for its on-going business enterprise
- The purchaser is not interested in the juridical entity of the corporate owner of the assets, nor of the goodwill and other factors relating to the business enterprise of the transferring corporation
- The **Law on Sales** governs
 - Thus, the transferee does not become liable for the liabilities of its transferor since there is no contractual privity existing between the transferee and the transferor's creditors
- The *Bulk Sales Law* must be followed, else the transaction becomes fraudulent and void
- However, when another corporation takes over the assets of a dissolved corporation, the succeeding

corporation is liable for the claims against the dissolved corporation to the extent of the fair value of the assets assumed

Business enterprise transfers

- The acquiring corporation's primary interest is to obtain the earning capability of the venture, otherwise the goodwill or business enterprise of the transferring corporation
 - It's a mix of tangible and intangible property
- When a purchaser buys the business of another as a going concern, he usually wishes to keep it going; he wishes to get the location, the building, the stock in trade, and the customers
- Here, Sec. 39, RCC comes in (sale of all/substantially all)
 - The definition of "all or substantially all of the assets of the corporation" essentially covers the concept of a "business enterprise"
 - But only the transfer as Sec. 39 only contemplates *sale*
- Likewise, this transfer is also contemplated by Sec. 40, RCC (investment to a nonprimary purpose)
- In a business enterprise transfer, **the transferee is liable for the liabilities of the transferring corporation arising from the business enterprise transferred** (*Y-I Leisure v. Yu*)
 - Rationale: To protect the creditors
 - Thus, the transferee and the transferor cannot waive or modify the right or cause of action of the creditors
 - Any free-and-harmless stipulation between them cannot bind noncontracting parties (e.g., creditors)
- The business enterprise transfer establishes a common law lien on the business enterprise, and allows a recovery of the debts extended on the basis of such business enterprise against a transferee to whom such business enterprise is transferred
 - Here, the property transferred has no finite value to which to limit the lien

Equity transfers

- This constitutes at looking at the entirety of the business enterprise as it is owned and operated by the corporation
- The subject matter of this is the controlling interest
 - Thus, mere transfer of shares that does not vest controlling interest is *not* an equity transfer
- The buyer takes control and ownership of the underlying business enterprise by purchasing the controlling equity of the corporate owner
 - The control is indirect since the target corporation remains the direct owner of the business, and what the purchaser has

actually purchased is the ability to elect the members of the BOD

- Thus, if the primary motivation is not to acquire control, it is merely a purchase of shares within the assets-only level
- Here, the transferee is *not* liable for the liabilities of the transferor, except where the transferee expressly or impliedly agreed to assume such debts
 - Logic: By purchasing the shares in a corporation that owns a business, the shareholder does not by that reason alone become the owner directly of the business assets and does not become personally liable for the debts and liabilities of the business
- In an equity transfer, the transferee/buyer does not become personally liable for the obligations of the corporate enterprise (exception: piercing doctrine)
- Statutory basis: Sec. 41, RCC (investment to a nonprimary purpose)
 - The target corporation is not a party in the equity transfer, because the shares are not owned by the corporation, but by the shareholders

Mergers and Consolidations

- Consolidation – The union of two or more existing corporations to form a new corporation called the “consolidated corporation”
 - It’s a combination by agreement between two or more corporations by which their rights, franchises, privileges and properties are united and become those of a single, new corporation
- Merger – A union whereby one or more existing corporations are absorbed by another corporation that survives and continues the combined business

Power to merge or consolidate

- It’s not an inherent power of the corporation
 - Thus, it must be granted by law

Section 75. Plan of Merger or Consolidation. - Two (2) or more corporations may merge into a single corporation which shall be one of the constituents corporations or may consolidate into a new single corporation which shall be the consolidated corporation.

The board of directors or trustees of each corporation, party to the merger or consolidation, shall approve a plan of merger or consolidation, setting forth the following:

- (a) The names of the corporations proposing to merge or consolidate hereinafter referred to as the constituent corporations;
- (b) The terms of the merger or consolidation and the mode of carrying the same into effect;
- (c) A statement of the changes, if any, in the articles of incorporation of the surviving corporation in case of merger; and, in case of consolidation, all the statements

required to be set forth in the articles of incorporation for corporations organized under this Code; and

(d) Such other provisions with respect to the proposed merger or consolidation as are deemed necessary or desirable.

Ipsa jure effects of merger or consolidation

SEC. 79. Effects of Merger or Consolidation. – The merger or consolidation shall have the following effects:

(a) The constituent corporations shall become a single corporation which, in case of merger, shall be the surviving corporation designated in the plan of merger; and, in case of consolidation, shall be the consolidated corporation designated in the plan of consolidation;

(b) The separate existence of the constituent corporations shall cease, except that of the surviving or the consolidated corporation;

(c) The surviving or the consolidated corporation shall possess all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under this Code;

(d) The surviving or the consolidated corporation shall possess all the rights, privileges, immunities and franchises of each constituent corporation; and all real or personal property, all receivables due on whatever account, including subscriptions to shares and other choses in action, and every other interest of, belonging to, or due to each constituent corporation, shall be deemed transferred to and vested in such surviving or consolidated corporation without further act or deed; and

(e) The surviving or consolidated corporation shall be responsible for all the liabilities and obligations of each constituent corporation as though such surviving or consolidated corporation had itself incurred such liabilities or obligations; and any pending claim, action or proceeding brought by or against any constituent corporation may be prosecuted by or against the surviving or consolidated corporation. The rights of creditors or liens upon the property of such constituent corporations shall not be impaired by the merger or consolidation.

- The legal effect of either merger or consolidation is not to disturb the legal continuity of the underlying business enterprises of each of the constituent corporations

Salient advantages of a merger/consolidation from acquisitions and transfers

- Merger or consolidation is able to achieve a flow of the juridical personalities and business enterprises of the constituent corporations
 - There is no legal “break” in such juridical personalities as they end up combined in the surviving or consolidated corporation
- The surviving or consolidated corporation cannot even be treated as the transferee of the constituent corporations, and that for all intents and purposes, the surviving or consolidated corporation is every bit

exactly the same entity as each of the constituent corporations, albeit combined entity

- Taxation: Transfers of assets or business enterprise are generally subject to taxable gains tax
 - However, no gain or loss shall be recognized if in pursuance of a plan of merger or consolidation

De facto mergers or consolidations

- A de facto merger can be pursued by one corporation acquiring all or substantially all of the properties of another corporation in exchange of the shares of the acquiring corporation
 - The acquiring corporation would end up with the business enterprise of the target corporation
 - Whereas, the target corporation would end up with its remaining assets being only the shares of the acquiring corporation
- The separate juridical personalities of the constituent corporations would remain, and consequently, the succession of rights and liabilities provisions of Sec. 79 would not come into play

Statutory provisions applicable to de facto mergers

- A direct de facto merger would not necessarily involve the provisions Sec. 41 of the RCC, especially when the business enterprise acquired is in line with the primary purpose of the acquiring corporation, but more so since the shares used as consideration for the acquisition do not really involve the use of corporate funds, but actually involve capital account transactions
 - Consequently, a *de facto* merger may be achieved by the BOD of the acquiring corporation without having to trigger the $\frac{2}{3}$ ratification vote of the shareholders or members
- For the target corporation, the sale or disposition of all or substantially all of the assets would trigger application of the provisions Sec. 39, RCC, and would require a $\frac{2}{3}$ ratification vote
- If the target corporation is eventually dissolved to effect distribution of the shares consideration coming from the acquiring corporation, there might not be a need for the exercise of the appraisal rights by the dissenting shareholders.
 - Avoid appraisal rights: Structuring the *de facto* merger where the target corporation first spin-off of the assets to a wholly owned subsidiary, and it is the subsidiary that would eventually transfer the assets to the acquiring corporation
 - Since the target corporation would be the only shareholder of the subsidiary, it will not dissent to the transfer of assets and would not thereby trigger the appraisal rights issue

- A spin-off has the opposite effect of merger or consolidation, whereby a department, division or portions of the corporate business enterprise is sold-off or assigned to a new corporation that will arise by the process which may constitute it into a subsidiary of the original corporation
 - It exists when a parent corporation organizes a subsidiary, to which is transferred part of the parent's assets in exchange for all of the capital stock of subsidiary and stock of subsidiary is transferred to the parent's shareholders without surrender of their stock in parent
 - It's also described as one where part of the assets of the corporation is transferred to a new corporation and stock of transferee is distributed to shareholders of transferor without surrender by them of stock in the transferor
 - The nearest provision by which spin-offs may be governed would be Sec. 39

Effects of transfers, mergers and consolidation on employees

Assets-only transfers

- The transferee is not bound to retain the employees of the transferor, since the former does not really step into the shoes of the latter
- The transferee is not liable for any of the claims against the transferor, even if the sale of the business assets of the transferor should result in the shutting down of the transferor's operations and the laying off of the transferor's employees

Business-enterprise transfers

- The transferee should be bound to retain the services of the employees of the business that it has acquired, although it is not liable for the violations that the transferor had committed in the past and for which the transferor remains solely liable
- The change of ownership or management of a business establishment or enterprise is not one of the just causes for lawful termination under the law, and cannot be construed as synonymous with nor analogous to closing or cessation of operation of an establishment or enterprise and therefore cannot exempt the transferor from liability for separation pay (*Central Azucarera del Danao v. CA*)
 - The immediate transferee of the business enterprise has no liability to the employees of the transferor to continue employing them; nor is the transferee liable for past unfair labor practices of the previous owner, except:
 - when the liability therefor is assumed by the new employer under the contract of sale, or
 - when liability arises because of the new owner's participation in

Spin-off

thwarting or defeating the rights of the employees.

- In a *bona fide* business enterprise transfer, the transferor is liable to pay separation pay to the employees, and the transferee is not liable therefor, much less is the transferee legally obliged to retain such employees for the business enterprise bought
- The rule is **different** when the business enterprise transfer is done with **fraud** or when it authorizes the **application of the piercing doctrine** to treat both transferor and transferee as one
 - The successor-employer is deemed to have absorbed the employees and is held liable for the transgressions predecessor-employer
 - *Avon Dale v. NLRC*: For a new company to take over the business concerns of another as not to make the new owner or business entity liable for the labor claims against the predecessor-in-interests, there must be a formal and substantial termination and break from the operations of the predecessor as to constitute the transferee a separate business entity

Equity transfers

- The employees remain with the corporate employer in exactly the same manner as before the equity transfer, and therefore, the purchaser does not assume any personal liability to the employees
- **But See:** Where such transfer of ownership is in good faith, the transferee is under no legal duty to absorb the transferor's employees as there is no law compelling such absorption. The most that the transferee may do, for reasons of public policy and social justice, is to give preference to the qualified separated employees in the filling of vacancies in the facilities of the purchaser (*Manlimos v. NLRC*)
- Because the corporation possesses a personality separate and distinct from that of its shareholders, a shift in the composition of its shareholders will not affect its existence and continuity
 - Thus, notwithstanding the stock sale, the corporation continues to be the employer of its people and continues to be liable for the payment of their just claims
 - Furthermore, the corporation or its new majority shareholders are not entitled to lawfully dismiss corporate employees absent a just or authorized cause

Mergers and consolidations

- Sec. 79 mandates that the surviving or consolidated corporation assumes *all* the liabilities of the constituent corporations
 - Thus, the contractual rights of employees (and any CBA) would have to be absorbed by the surviving or consolidated corporations
- The legal effects of § 79 is that the surviving corporation in a merger would be considered as the

successor employer with respect to the claims of employees of the constituent corporation, even with respect to CBA deadlock situations which existed before the merger

- In other words, when the surviving corporation agrees to absorb all the employees of the other company, then the legal effects under § 80 come into play
- Labor contracts such as employment contracts and collective bargaining agreements are not enforceable against a transferee of an enterprise, labor contracts being *in personam*, thus binding only between the parties
 - A labor contract mere contract merely creates an action in personam and does not create any real right which should be respected by third parties

Spin-offs

- Thus, the employment of the doctrine of piercing the veil of corporate fiction cannot be applied in the case of a spin-off since no fraud attended the transaction

Chapter 16: Dissolution and liquidation

No vested rights to the corporation

- No person who asserts a claim against a juridical entity can claim any constitutional right to the perpetual existence of such entity
 - Nonetheless, that the dissolution of a juridical entity does not imply the diminution or extinction of rights demandable against a juridical entity

Dissolution

Nature

- "Dissolution" signifies the extinguishment of a corporation's franchise and the termination of its corporate existence for the purpose of pursuing its commercial operations
- Dissolution therefore immediately affects a corporation's juridical capacity to pursue its existing business enterprise as a going concern

Methods of dissolution

1. Where no creditors are prejudiced – By an administrative application for dissolution filed with the SEC
2. Where creditors are affected – By a formal petition for dissolution filed with the SEC, with due notice and hearing to be conducted
3. Shortening of corporate term – By the amendment of the AOI
 - a. Another voluntary mode would be allowing the expiration of the specific corporate term in the AOI

Voluntary dissolution

- The juridical entity is never considered a property right of the corporation, since it is a franchise that is within the control of the State. Consequently, the corporation cannot be legally undermined except under the terms provided by the State, or by pursuing the official proceedings mandated by law.
 - Thus, a board resolution to dissolve does not operate to dissolve the juridical entity

Application for dissolution where **no** creditors are prejudiced

Section 134. Voluntarily Dissolution Where No Creditors are Affected. – If dissolution of a corporation does not prejudice the rights of any creditor having a claim against it, the dissolution may be effected by majority vote of the board of directors or trustees, and by a resolution adopted by the affirmative vote of the stockholders owning at least majority of the outstanding capital stock or majority of the members of a meeting to be held upon the call of the directors or trustees.

At least twenty (20) days prior to the meeting, notice shall be given to each shareholder or member of record personally, by registered mail, or by any means authorized under its bylaws, whether or not entitled to vote at the meeting, in the manner provided in Section 50 of this Code and shall state that the purpose of the meeting is to vote on the dissolution of the corporation. Notice of the time, place and object of the meeting shall be published once prior to the date of the meeting in a newspaper published in the place where the principal office of said corporation is located, or if general circulation in the Philippines.

A verified request for dissolution shall be filed with the Commission stating: (a) the reason for the dissolution; (b) the form, manner, and time when the notices were given; (c) names of the stockholders and directors or members and trustees who approved the dissolution; (d) the date, place, and time of the meeting in which the vote was made; and (e) details of publication.

The corporation shall submit the following to the Commission: (1) a copy of the resolution authorizing the dissolution, certified by a majority of the board of directors or trustees and countersigned by the secretary of the corporation; (2) proof of publication; and (3) favorable recommendation form the appropriate regulatory agency, when necessary.

Within fifteen (15) days from receipt of the verified request for dissolution, and in the absence of any withdrawal within said period, the Commission shall approve the request and issue the certificate of dissolution. The dissolution shall take effect only upon the issuance by the Commission of certificate of dissolution.

No application for dissolution of banks, banking and quasi-banking institutions, preneed, insurance and trust companies, NSSLAs, pawnshops, and other financial intermediaries shall be approved by the Commission unless accompanied by a favorable recommendation of the appropriate government agency.

- When no creditors are involved or would be prejudiced by the dissolution of a corporation, and

thereby the tenets of the trust fund doctrine would not be adversely affected

- The SEC will not deny an application for dissolution when there are no creditors prejudiced because of the constitutional prohibition against involuntary servitude or the constitutional guarantee of association and the right to refuse to continue to associate

Withdrawal of request

Section 137. Withdrawal of Request and Petition for Dissolution. – A withdrawal of the request for dissolution shall be made in writing, duly verified by any incorporator, director, trustees, shareholder, or member and signed by the same number of incorporators, directors, trustees, shareholder, or member and signed by the same number of incorporators, directors, trustees, shareholders, or members necessary to request for dissolution as set forth in the foregoing sections. The withdrawal shall be submitted no later than fifteen (15) days from receipt by the Commission of the request for dissolution, the Commission shall withhold action on the request for dissolution and shall, after investigation: (a) make a pronouncement that the request for dissolution is deemed withdrawn; (b) direct joint meeting of the board of directors or trustees and the stockholders or members for the purpose of ascertaining whether to proceed with dissolution; or (c) issue such other orders as it may deem appropriate.

A withdrawal of the petition for dissolution shall be in the form of a motion and similar in substance to a withdrawal of request for dissolution but shall be verified and filed prior to publication of the order setting the deadline for filing objections to the petition.

Petition for disqualification where creditors are affected

Section 135. Voluntary Dissolution Where Creditors are Affected; Procedure and Contents of Petition. - Where the dissolution of a corporation may prejudice the rights of any creditor; a verified petition for dissolution shall be filed with the Commission. The petition shall be signed by a majority of the corporation's board of directors or trustees, verified by its president or secretary or one of its director or trustees, and shall set forth all claims and demands against it, and that its dissolution was resolved upon by the affirmative vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock or at least two-thirds (2/3) of the member at a meeting of its stockholder or members called for that purpose. The petition shall likewise state: (a) the reason for the dissolution; (b) the form, manner, and time when the notices where given; and (c) the date, place and time of the meeting in which vote was made. The corporation shall submit to the Commission the following: (1) a copy of the resolution authorizing the dissolution, certified by a majority of the board of directors or trustees and countersigned by the secretary of the corporation; and (2) a list of all its creditors.

If the petition is sufficient in form and substance, the Commission shall by an order reciting the purpose of the petition, fix a deadline for filing objections to the petition which date shall not be less than thirty (30) days nor more

than sixty (60) days after the entry of the order. Before such date, a copy of the order shall be published at least one week for three (3) consecutive weeks in a newspaper of general circulation published in the municipality or city where the principal office of the corporation is situated, or if there be no such newspaper, then in a newspaper of general circulation in the Philippines, and a similar copy shall be posted for three (3) consecutive weeks in three (3) public places in such municipality or city.

Upon five (5) days' notice given after the date on which the right to file objections as fixed in the order has expired, the Commission shall proceed to hear the petition and try any issue raised in the objections filed; and if no such objection is sufficient, and the material allegations of the petition are true, it shall render judgment dissolving the corporation and directing such disposition of its assets as justice requires, and may appoint a receiver to collect such assets and pay the debts of the corporation.

The dissolution shall take effect only upon the issuance by the Commission of a certificate of dissolution.

- The proceedings are quasi-judicial in nature and conducted to ensure that the rights of the creditors are fully protected
- In such proceedings, the SEC is not mandated to dissolve the corporation, especially when it would be detrimental to the interests of the creditors, who may wish to rehabilitate the operations of the corporation to ensure that it would be able to pay-off all of its debts
- Withdrawal of petition – see § 137

Dissolution by shortening corporate term

Section 136. Dissolution by Shortening Corporation Term. – A voluntary dissolution may be effected by amending the articles of incorporation to shorten the corporate term pursuant to the provisions of this Code. A copy of the amended articles of incorporation shall be submitted to the Commission in accordance with this Code.

Upon the expiration of the shortened term, as stated in the approved amended articles of incorporation, the corporation shall be deemed dissolve without any further proceedings, subject to the provisions of this Code on liquidation.

In the case of expiration of corporate term, dissolution shall automatically take effect on the day of the following the last day of the corporate term stated in the articles of incorporation without the need for the issuance by the Commission of a certificate of dissolution.

- If the proposed shortened term expires before its approval by the SEC, the corporation will not be automatically dissolved, but only upon SEC approval of the amendment
- If SEC gives its approval before such shortened term expires, the dissolution can take effect only upon the expiration of such shortened term (*SEC op.*)

Dissolution by expiration of corporate term

- In the case of expiration of corporate term, dissolution shall automatically take effect on the day following the last day of the corporate term stated in the articles of incorporation, without the need for the issuance by the SEC of a certificate of dissolution
- Under the Revised Corporation Code where the default rule is perpetual corporate term, situations of expiration of corporate term would become rare occurrences

Involuntary dissolution

- A corporation may be dissolved by the SEC, *motu proprio* or upon filing of a verified complaint by any interested party, based on any of the following grounds (§ 138):
 - Non-use of corporate charter (§ 21)
 - This is *ipso jure* dissolution as of the day following the end of the 5-year period
 - Continuous inoperation (§ 21)
 - Not *ipso jure*
 - Upon receipt of a lawful court order dissolving the corporation (§ 138 (c))
 - Upon finding by final judgment that the corporation procured its incorporation through fraud (§ 138 (d))
 - Upon finding by final judgment relating to securities violation, smuggling, tax evasion, money laundering, or graft and corrupt practices (§ 138 (e))
 - Graft and corrupt practices will be related to §§ 166–168
 - If the SEC finds, after due notice and hearing, that any provision of the Code, rules and regulations or any of SEC's orders, has been violated (§ 158)
 - Violations of any of the other provisions of the Code or its amendments not otherwise specifically penalized therein, when committed by the corporation (§ 170)
 - When the corporation is guilty of serious misrepresentation as to what the corporation can do or is doing to the great prejudice of or damage to the general public (PD 902-A)
 - Failure of the corporation to file required reports in appropriate forms as determined by the SEC within the prescribed period (*id.*)
 - When the corporation fails to adopt and file a code of bylaws in the manner provided for by law (*id.*)
 - When on the basis of findings and recommendations of the management committee or receiver, or based on the SEC's own findings, the continuance of the corporate business would not be feasible or profitable nor work to the best interest of the shareholders, parties-litigants, creditors, or the general public (*id.*)

Right of minority shareholders to demand dissolution

- Minority shareholders do not have a common law right, much less a statutory right, to demand for dissolution of the corporation, based on the principle that minority shareholders invest in the corporation fully aware that the corporate affairs would be subject to the control of the majority shareholders

Jurisprudential attitude towards involuntary dissolution

- Dissolution is a serious remedy granted to the courts against offending corporations; and as a general rule, courts should not resort to dissolution when the prejudice is not one against the public, or not an outright abuse or violation of the corporate charter; and that even if the prejudice were public in nature, the remedy is to enjoin or correct the mistake; and only when it cannot be remedied anymore that dissolution can come in (*Republic v. Bisaya Land Trans. Co.*)

Liquidation

Nature

- Liquidation is the settlement of the affairs of a corporation which consists of adjusting the debts and claims, that is, of collecting all that is due the corporation, the settlement and adjustment of claims against it and the payment of its just debts
- It connotes a winding up or settling with creditors and debtors; it is the winding up of a corporation so that assets are distributed to those entitled to receive them; it is the process of reducing assets to cash, discharging liabilities and dividing surplus or loss
- It is a proceeding *in rem* so that all other interested persons, whether known to the parties or not may be bound by such proceedings
- Strictly speaking, dissolution always precedes liquidation, and there is no legal basis to proceed with liquidation without the corporation first having been dissolved
 - This is in accordance with the trust fund doctrine in § 139

Methods of liquidation

1. Liquidation through the BOD/BOT
2. Liquidation through a trustee
3. Liquidation through a receiver

Liquidation through the board

- The Legislature intended to let the shareholders, acting through their BOD, to have the control of the corporate assets upon dissolution in winding up its affairs

Liquidation through a trustee

- Second paragraph of § 139 contemplates the creation of an **express trust** as a means of pursuing the liquidation of the affairs

- After the designation of a trustee to undertake liquidation, the 3-year limitation will no longer apply, *provided that the trustee is designated within said period*
 - Unless the trusteeship is limited in its duration by the deed of trust, there is no time limit which the trustee must finish the liquidation, and he may sue or be sued even beyond the 3-year liquidation period

Liquidation through a receiver

- A receivership is created by means of judicial or quasi-judicial appointment of the receiver
 - The receiver is actually an officer of the court and must therefore be accountable to the court
- When a corporation is dissolved and the liquidation of its assets is placed in the hands of a receiver or assignee, the prescribed 3-year liquidation period cannot be made to apply
- Whether the liquidation of a dissolved corporation is pursued through a trustee or a receiver, the legal effect is the same-the abatement clause under § 139 becomes meaningless

Legal effects of dissolution

- Corporate existence shall remain for 3 years *after* the effective date of dissolution, for the purpose of:
 - Prosecuting and defending suits by or against it and enabling it to settle and close its affairs
 - Dispose of and convey its property, and distribute its assets, but not for the purpose of continuing the business for which it was established

Prosecuting and defending suits by/against the dissolved corporation

- In ***Gelano v. CA***, the Court began to apply the principles of implied trust to the term “trustee” under § 139, in that it should be understood in its general concept which could include the counsel to whom was entrusted in a pending case, the prosecution of the suit filed by the corporation
 - Subsequent cases extended *Gelano* to include the BOD of the dissolved corporation to validly constitute “trustees” to carry on the liquidation process beyond the 3-year period
- ***Alabang Dev. Corp. v. Alabang Hills*** clarified that *Gelano* applies only to pending cases at the time of expiration of the liquidation period, and cannot be extended to allow a dissolved corporation acting through its BOD to commence an action after the expiration of the 3-year liquidation period
- **Summary:** There would be no imperative of having to constitute or appoint either a trustee or receiver within the three-year liquidation period, since the incumbent Board of Directors or the counsel of record can be treated as a trustee to represent the

interests of the shareholders or members and creditors of the completely defunct corporation

- However, no new suit in behalf of the dissolved corporation may be commenced after the expiration of said 3-year liquidation period

Pursuit of the corporate assets against persons having custody thereof

- Even after the 3-year period of liquidation, the creditors of the corporation can still pursue their claims against officers/shareholders who have taken over the assets and property of the corporation (*Tan Tiong Bio v. CIR*)
- *Republic v. Marsman Dev. Co.*: There is nothing in said § 139 which bars an action for the recovery of the debts of the corporation against the liquidator thereof, after the lapse of the said 3-year period
- These rulings are based on the principles of implied trust under the Civil Code

Disposing of an conveying property, and distributing corporate assets, in settlement of corporate affairs

- At the point of dissolution, a corporation ceases to have juridical capacity to enter into any transaction to pursue its business enterprise as a going concern
- A corporation in the process of liquidation has no legal authority to engage in any new business, even if the same is in accordance with the primary purpose stated in the AOI¹⁷
- During the 3-year period, the board may do no more than settle and close the affairs of the corporation
 - The board retains its authority to act on behalf of its members, albeit in a limited capacity

Forfeiture of net assets to the government

Section 138. Involuntary Dissolution. - A corporation may be dissolve by the Commission *motu proprio* or upon filing of a verified complaint by any interested party. The following may be grounds for dissolution of the corporation: [xxx]

(e) Upon finding by final judgment that the corporation:

(1) Was created for the purpose of committing, concealing or aiding the commission of securities violation, smuggling, tax evasion, money laundering, or graft and corrupt practices;

(2) Committed or aided in the commission of securities violations, smuggling, tax evasion, money laundering, or graft and corrupt practices, and its stockholders knew of the same; and

(3) Repeatedly and knowingly tolerated the commission of graft and corrupt practices or other fraudulent or illegal acts by its directors, trustees, officers, or employees.

If the corporation is ordered dissolved by final judgment pursuant to the grounds set forth in subparagraph (e) hereof, its assets, after payment of its liabilities, shall upon petition of the Commission with the appropriate court, be forfeited in favor of the national government. Such forfeiture shall be without prejudice to the rights of innocent stockholders and employees for services rendered, and to the application for other penalty or sanction under this Code or other laws. [xxx]

Escheat to the government

- Except as otherwise provided for in §§ 93–94, any asset distributable to any creditor or stockholder or member who is unknown or cannot be found shall be escheated in favor of the National Government

Chapter 20: Foreign corporations

International law (IL) principles

- **Doctrine of comity** – All states recognize within their territory the existence of a foreign corporation
 - Subject to the regulations that the forum stage may promulgate, e.g., the reciprocity clause

Definition of 'foreign corporation' and the reciprocity rule

Section 140. Definition and Rights of Foreign Corporations. – For purposes of this Code, a foreign corporation is one formed, organized or existing under laws other than those of the Philippines' and whose laws allow Filipino citizens and corporations to do business in its own country or State. It shall have the right to transact business in the Philippines after obtaining a license for that purpose in accordance with this Code and certificate of authority from the appropriate government agency.

- CLV: It's unfortunate that reciprocity wasn't included in § 140 since it could lead to the unintended implication that corporate entities organized in states that do not grant reciprocity rights to Philippine nationals do not fall within the classification of foreign corporation
- The inclusion of the element of reciprocity in defining foreign corporations emphasizes our country's policy that unless our own nationals are granted business access in a foreign state, the corporate entities of such foreign state will not be granted legal and business access within Philippine territory

IL principles on foreign corporations

- Under IL, a corporation is a creature of the state under the laws of which it has been endowed its juridical personality
 - Thus, a corporation has no existence beyond the territories of its creating state, since the effects of the creating laws do not extend beyond the territorial jurisdiction of the state under which it is created

¹⁷ A corporation cannot extend its life by amendment of its AOI to be effected during the liquidation period, when its original term had already expired.

- A foreign corporation is one that owes its existence to the laws of another state and, strictly speaking, has no legal existence within the state in which it is foreign
- Nonetheless, under the principle of comity, a corporation created by the laws of one state is usually allowed to transact business in other states and to sue in the courts of the forum
- The legal standing of a foreign corporation in the host state is founded on its “presence” by “engaging in business in the host state,” or by “consent through the voluntary surrender of jurisdiction over its person in a pending suit before the host state
- A foreign corporation may be subjected to the jurisdiction of the host state by reason of consent, as for example, the filing by a foreign corporation of a suit before Philippine courts, which means that by its voluntary appearance, the local courts have obtained jurisdiction over its person (*Communications Materials v. CA*)
- In other words, outside of consent by voluntary appearance before local courts, a host state has authority over the person of the foreign corporation by its presence in the host state that is determined through the application of the concept of “doing or engaging in business” in the host state.
- When a foreign corporation undertakes civil or commercial activities within the territorial jurisdiction of a host state that constitute “doing or engaging in business,” it thereby ascribes to the host state standing to enforce its laws, rules, and regulations
 - Consequently, without the license, it **cannot sue** before local tribunals by virtue of the express disqualification imposed by the host state, **but it may be sued** by its domestic counterparty because its presence makes it fall within the host state’s legal processes
- When a foreign corporation’s civil or commercial activities within the host state do **not** fall within the concept of “doing or engaging in business,” the requirement of obtaining a license to engage in business is generally **not** applicable—its civil or commercial activities amount only to “casual or isolated transactions.”
 - Nonetheless, such foreign corporation would have legal standing to sue in local courts and administrative tribunals to obtain relief, in which case, the jurisdiction over a foreign corporation would be based on consent by voluntary surrender of personal jurisdiction manifested by the filing of the suit.

Foreign corporations’ juridical capacity to enter into civil and commercial transactions in the Philippines

Foreign corporations are recognized to have juridical capacity to validly pursue civil and commercial activities in Philippine territory, which may be classified as follows:

- a. Doing or engaging in business of the Philippines (§ 140, RCC)
- b. Casual or isolated transactions (not statutory)¹⁸

Why distinguish?

- When a foreign corporation engages in business in the Philippines, such activities constitute presence by which local courts and administrative tribunals may exercise jurisdiction over the person of the foreign corporation through the issuance of summons
 - When a foreign corporation enters into casual or isolated transactions, it has no presence in the Philippines and it would be in violation of the notions of due process for local courts and administrative tribunals to exercise jurisdiction over their persons in the absence of consent or voluntary surrender of personal jurisdiction
- The restrictions imposed by the RCC only applies to foreign corporations engaged in business in the Philippines
 - Thus, the need to obtain a license has no application to foreign corporations that are engaged in isolated transactions in the Philippines
- Additionally, § 150 does not apply to foreign corporations engaged in isolated transactions

Jurisprudential twin-characterization test for “doing business in the Philippines”

- Substance of the transaction test: Whether the foreign corporation performs acts or works, or exercises some of the functions normally incident to, and in progressive prosecution of, the body or substance of the business or enterprise for which it was organized; **and**
- Continuing intent test: Whether it intends the transaction to be part of the “continuing a body or substance of the business or enterprise” or “continuity of commercial dealings and arrangements” in the Philippines, *i.e.*, to pursue its business enterprise in the Philippines as distinguished from a casual or isolated transaction

[1] Substance of the transaction test

- **This pertains to civil or commercial transactions which from their nature, as well as the circumstances under which they are undertaken in the Philippines, are normally incident, reasonable or necessary for the pursuit of the foreign corporation’s business enterprise**
 - It covers acts, contracts and transactions that directly produce revenues, and those that incur expenses but are necessary or normally incident to the foreign corporation’s business enterprise

¹⁸ In such a case, it can sue, but it cannot be sued (except: voluntary surrender of jurisdiction).

- This test is not limited to transaction related to the “primary purpose” provided in its AOI
- The test must be understood from the point of view that the purpose of every foreign stock corporation in its activities in the Philippines is primarily motivated, not necessarily the immediate result, is the earning of profits

For profit-making test

- By and large, to constitute “doing business,” the activity to be undertaken in the Philippines is one that is for profit-making
 - Thus, a foreign company that merely imports goods from a Philippine exporter, without opening an office or appointing an agent in the Philippines, is not doing business in the Philippines
- CLV: The treatment of transactions that have the effect of incurring expenses by foreign corporations as not doing business undermines, leading jurisprudence that held the following as doing business in the Philippines: importing copra from a local company; purchasing scrap metals from locals; importing crude coconut oil from a local company; and purchasing soccer jerseys from a domestic firm.

Proper framework of the for profit-making test

- The proper framework of the for profit-making test should be made in the context that the term “doing business in the Philippines” means that **profits are the ultimate** (not immediate) **objective** of the gamut of business transactions involving the receipts of income and revenues and the incurring of expenses and costs associated in pursuing the business enterprise
- In other words, when a foreign corporation engages in business activities that is integral in its primary business of seeking commercial gains, such as when it sells its products in the Philippines, or it buys commodities from local companies for sale abroad, then all such activities, when they fulfill the territoriality test (*i.e.*, they are pursued by the foreign entity within Philippine territory) should constitute doing business in the Philippines

[2] Intent to pursue continuity of transaction test

- This test characterizes the foreign corporation’s transactions, *i.e.*, whether they fall within the coverage of “pursuit of business enterprise”
 - Equivalent to the **habituality test** under *Commercial Law*
- The continuing intent test is inextricably linked to the substance of the transaction test, such that Supreme Court decisions would pin down the continuing intent test only to a foreign corporation’s transaction which fulfills the substance of the transaction test

[3] Territoriality test

- Even if the twin-test is satisfied, so long as the perfection and consummation of a series of transactions are done outside Philippine territory, the

same would not constitute doing business in the Philippines, even if the products themselves should be manufactured or processed in the Philippines by locals (*Pacific Vegetable Oil Corp. v. Singzon* [*unrep.*])

Doing business under the FIA ‘91

Statutory enumeration of doing business in the Philippines

- Opening offices, whether called “liaison offices” or branches
- Participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines
- Soliciting orders or service contracts
- Appointing representatives or distributors domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totaling 180 days or more
- Any other act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of, commercial gain or of the purpose or object of the business organization (catch-all)

Opening of office, whether called liaison or branch office

- Even when the activities of the Philippine branch office do not fulfill the for profit-making test, the foreign corporation would still be classified as doing business (the very setting up of such office makes the foreign corporation present) in the Philippines for which it needs a license to be able to maintain a suit with local courts and administrative tribunals
- Although the language of FIA 1991 refers to a physical office, *Facilities Management* included the appointment of a local “liaison officer” to constitute foreign corporation as doing business in the Philippines

Participating in the management, supervision, or control of a domestic business, firm, entity, or corporation

- When a foreign corporation, through its representatives, participates in the management, supervision, or control of a domestic business, firm, entity, or corporation, that would be equivalent to opening a branch in the Philippines, and the foreign corporation would be deemed engaged in business in the Philippines
- It’s not engaging in business when a foreign corporation merely invests in the equity of a domestic corporation
 - Being a shareholder does not mean participation in the management of the domestic company under the doctrine of centralized management
 - Likewise, the election by foreign corporations of nominees to the BOD of a domestic corporation is also not doing business, since the directors, once

nominated, act as fiduciaries of the domestic corporation and for all its shareholders

- The exempting clause under FIA '91 should not include investment by foreign corporations in a domestic partnership or joint venture, since the attribute of mutual agency in the partnership setting accords to the foreign partner the act of managing the business of the domestic partnership through the local partners

Soliciting orders or service contracts in the Philippines

- Soliciting orders or contracts of services was meant to complete the full cycle in the stages of the contract under the territoriality test, in situations where the contracts of foreign corporations in the perfection and performance stages were effected *outside* of Philippines, but the negotiation was pursued *within* Philippine territory
- Soliciting orders, apart from the perfection of contracts, themselves fall within the ambit of activities which are "profit-seeking," and so would constitute doing business in the Philippines
- The acts of solicitations can be pursued by foreign corporations in the Philippines only through their officers or some other agents or representatives
 - Consequently, FIA '91 defines the very act of appointing agents or representatives domiciled in the Philippines as a precursor to soliciting orders or contracts of services—as doing business in the Philippines

Appointment of representatives or distributors domiciled in or staying at least 180 days in the PH

- A foreign corporation that appoints representatives or distributors domiciled, or who in any calendar year stay for a total period of 180 days or more in the Philippines, is engaged in business in and must obtain a license to do business
 - The essence of such arrangement is that the local representative or distributor pursues the business of the foreign corporation in the latter's name within Philippine territory

License to do business in the Philippines

- A foreign corporation has the right to transact business in the Philippines *after obtaining a license*
- In spite of its nomenclature, the license issued by the SEC is not the legal basis of such foreign corporation's juridical capacity to enter into civil or commercial transactions in Philippine territory.
 - Rather, every foreign corporation's juridical capacity to enter into civil or commercial transactions arises from the country's adherence to the doctrine of state comity
- The purpose of §§ 140 & 150 is to subject the foreign corporation doing business in the Philippines to the jurisdiction of its courts

- CLV: Strictly speaking, the proper term should be a "license to engage in business to authorize standing to sue in domestic courts or administrative tribunals."

Effects of being issued the license

- It may now commence to transact its business in the Philippines and continue to do so for as long as it retains its authority to act as a corporation under the laws of the country or state of its incorporation, unless such license is sooner surrendered, revoked, suspended, or annulled
- Once a foreign corporation has obtained a license to do business, it is deemed "domesticated" and subject to no harsher rules that are required of domestic corporations

Consequences of doing business without a license

1. It is not the obtaining of a license that makes the foreign corporation present in the Philippines—a foreign corporation engaged in business has presence in the Philippines regardless of whether it has obtained the requisite license.
 - a. The failure to obtain the requisite license has no effect on the exercise by the foreign corporation of its juridical capacity to contract or on the validity of the contracts entered into
2. The failure to obtain the requisite license affects the foreign corporation's juridical capacity to sue, as it deprives the foreign corporation of the juridical capacity "to maintain or intervene in any action, suit or proceeding in any court or administrative agency of the Philippines"
3. The failure to obtain the requisite license does not affect the foreign corporation's juridical capacity to be sued, since being present in the Philippines, it "may be sued or proceeded against before Philippine courts or administrative tribunals on any valid cause of action recognized under Philippine laws"

On the 'presence' of the foreign corporation doing business without a license

- The obtaining of the license is not determinative of whether a foreign corporation is engaged in business in the Philippines
 - Otherwise, a foreign corporation illegally doing business here because of its refusal or neglect to obtain the corresponding license to do business may successfully though unfairly plead such neglect or illegal act so as to avoid service and thereby impugn the jurisdiction of the local courts

On the validity of contracts entered without the requisite license

- Contracts entered into by a foreign corporation doing business in the Philippines without the requisite license remain valid and enforceable since the requirement of registration affects only the

remedy, which is the standing of the foreign corporation to sue before local courts

- Instead, a sanction under § 170 is proper

On standing to sue and be sued

- The legal basis of a foreign corporation's juridical capacity to sue is not the obtaining of the requisite license to do business, but rather the doctrine of state comity
 - Foreign corporations operating within the host state's territory have full juridical capacity to act like domestic corporations, which includes the right to sue, albeit subject to the restrictions and limitations provided by the state
 - Thus, when a foreign corporation sues before domestic courts or administrative tribunals, this is in exercise of its recognized juridical capacity to act under the doctrine of state comity, with the filing of the complaint itself constituting consent by way of voluntary surrender of its personal jurisdiction
- On the other hand, when a foreign corporation is sued locally, jurisdiction over its persons may properly be obtained by local courts or administrative tribunals either by its presence in Philippine territory (*i.e.*, engaging in business in the Philippines), or by its consent, or voluntary surrender of personal jurisdiction, as when it files an answer to the complaint—absence of either renders a foreign corporation beyond the jurisdiction of local courts and administrative tribunals

SEC. 150. Doing Business Without a License. – No foreign corporation transacting business in the Philippines without a license, or its successors or assigns, shall be permitted to maintain or intervene in any action, suit or proceeding in any court or administrative agency of the Philippines; but such corporation may be sued or proceeded against before Philippine courts or administrative tribunals on any valid cause of action recognized under Philippine laws.

- A corporation **without a license**
 - Cannot sue
 - But can be sued
- The legislative intent is to ensure that foreign corporations that engage in business in the Philippines obtain the proper license for the protection of domestic counterparties by linking their standing to sue in local courts and administrative tribunals to the obtaining of such license
- *Rationale*: To compel a foreign corporation desiring to do business within the Philippines to submit itself to the jurisdiction of the courts of the state and to enable the government to exercise jurisdiction over them for the regulation of their activities in this country. If a foreign corporation operates a business in the Philippines without a license, and thus does

not submit itself to Philippine laws, it is only just that said foreign corporation be not allowed to invoke them in our courts when the need arises. The requirement of a license is not intended to put foreign corporations at a disadvantage, for the doctrine of lack of capacity to sue is based on considerations of sound public policy (*NASUTRA v. CA*).

Casual or isolated transactions

- When a foreign corporation engages in civil or commercial activities in the Philippines that constitute casual or isolated transactions, our laws do not require a license to do business
 - **Such casual or isolated transactions are valid and binding, and may be enforced in local courts pursuant to the doctrine of state comity (so the license does not matter?)**
 - Such foreign corporation, however, is not susceptible to being sued as they don't have presence in the Philippines, except by:
 - Voluntary surrender
 - Consent

*Statutory enumeration of isolated transactions*¹⁹

- Mere investment in the equity a domestic corporation duly registered to do business, and the exercise of shareholders' rights;
- Having a nominee director or officer to represent its interests in such domestic corporation;
- Appointing a representative or distributor domiciled in the Philippines who transacts business in his own name and for his own account
- The publication of a general advertisement through any print or broadcast media;
- Collecting information in the Philippines;
- Maintaining a stock of goods in the Philippines for the purpose of having them processed by another entity in the Philippines;
- Consignment of equipment with a local company to be used in the processing of products for export;
- Performing services auxiliary to an existing isolated contract of sale which are not on a continuing basis, such as installing machinery it has manufactured or exported to the Philippines, servicing the same, training domestic workers to operate it, and similar incidental services

Unlicensed foreign corporations may sue on casual/isolated transactions

- Isolated transaction – A transaction or series of transactions set apart from the common business of a foreign enterprise in the sense that there is no intention to engage in a progressive pursuit of the purpose and object of the business organization (*Eriks v. CA*)

¹⁹ The common denominator is that they *per se* do not bring any direct receipt or profits to the foreign corporation.

- An isolated transaction does not fulfill the *Mentholatum* test
- *May a single act by a foreign corporation constitute doing business in the PH?*
 - *Test:* It may be considered as doing business if it implies a continuity of commercial dealings and contemplates the performance of acts or the exercise of functions normally incidental to and in the progressive pursuit of its purpose. Contrarily, it may be considered as an isolated transaction if it is different from or not related to the common business of the foreign corporation in the sense that there is no objective to increasingly pursue its purpose or object (*Magna Ready Mix v. Andersen*)

Non-applicability of the territoriality rule

- The territoriality test does not apply to determine whether a foreign corporation has legal standing to sue in local courts on a casual commercial transaction

Foreign corporations' juridical capacity to sue and be sued

- **When a suit by a foreign corporation is based on a cause of action that constitute doing business in the Philippines without the requisite license, Sec. 150 prohibits such foreign corporation from maintaining such suit (foreign corporation cannot sue)**
- **When the suit is brought on a casual or isolated transaction, the juridical capacity of the foreign corporation to bring the suit is supported by the International Law doctrine of state comity and buttressed by the element of consent or voluntary surrender of personal jurisdiction; Sec. 150 is inapplicable**

The estoppel doctrine

- A party is estopped to challenge the personality of a corporation after having acknowledged the same by entering into a contract with it (*Merrill Lynch v. CA*).
- CLV: A domestic corporation who invokes Sec. 150 does not challenge the juridical capacity of the foreign corporation; nor does it challenge the validity or enforceability of the contract. Rather, what is involved is lack of standing of the foreign corporation to sue in local courts for its failure to obtain the license.
 - The estoppel doctrine effectively renders inutile the sanction provided under Sec. 150 for the failure of a foreign corporation engaged in business in the Philippines to obtain the requisite license
 - Corporations no longer have to get a license, because they can sue anyway on the basis of the estoppel doctrine!
- **Reasonable formula (Eriks):** A suit brought by a foreign corporation, who does not have a license, will be dismissed. However, this dismissal does not

have the effect of *res judicata*. Rather, the foreign corporation must first go through the process of obtaining a license to do business from the SEC, and then file the proper suits before the local courts.

- CLV: Ultimately, the only manner of enforcement of Sec. 150 by the SEC would be to bring criminal suits against foreign corporations engaging in business in the Philippines without the requisite license by invoking Section 170 which punishes "Violations of any of the other provision of this Code ... not otherwise specifically penalized therein...", " as enunciated in *Home Insurance Corp.*

Foreign corporations as defendants and their juridical capacity to be sued

- When a foreign corporation **engages in business** in the Philippines, it has presence and may be sued whether or not it has obtained the proper license to do business
 - In other words, it is the fact of engaging in business in the Philippines, not the obtaining of a license, that places foreign corporations within the ambit of Philippines laws
- When a foreign corporation enters into a casual or isolated transaction, it has no presence in the Philippines and is legally beyond the processes of the local courts
 - Without consent or a voluntary surrender of personal jurisdiction, it would violate notions of international due process in actions in personam for local courts to coercively obtain jurisdiction over the foreign corporation
 - Remedy: Foreign corporation to file a *petition for prohibition* with the appellate court, who will rule on whether the corporation was engaged in business

Consent or voluntary surrender of personal jurisdiction by foreign corporation

- Consent may also authorize local courts and administrative agencies to exercise jurisdiction over foreign corporations not engaged in business in the Philippines
- **Forms of consent:**
 - Voluntary appearance through the filing of an answer or by otherwise invoking relief from the court or administrative tribunal;
 - Through a contractual agreement on jurisdiction of the local courts to hear matters arising from the contract; or
 - By designating a local representative to receive summons and other court processes

Proper service of summons on a foreign corporation hinges on doing business in the Philippines

- Service of summons upon foreign private juridical entities doing business may be done:

- On its resident agent designated in accordance with law
- On the government official designated by law to that effect
- On any of its officers, agents, directors or trustees within the Philippines²⁰
- Service of summons over foreign private juridical entity not registered, or has no resident agent but is doing business (*only for actions in rem/quasi in rem*):
 - By personal service coursed through the appropriate court in the foreign country
 - By publication once in a newspaper of general circulation in the country where the defendant may be found and by serving a copy of the summons and the court order by registered mail at the last known address of the defendant
 - By facsimile
 - By electronic means with the prescribed proof of service
 - By such other means as the court may in its discretion direct

- Since the nationality rules pertain to the commercial pursuits in the Philippines, the SEC has considered that the nationality requirements do not apply to nonstock corporations, such that the provisions against foreigners becoming trustees or officers of corporation engaged in a nationalized business do not apply to them

Juridical capacity to sue

- It may do so, and the act of filing constitutes a voluntary surrender to local jurisdiction
 - Sec. 150 is inapplicable as there are no existing rules for licensing them

Juridical capacity to be sued

- It depends on whether it has presence in the Philippines, and the *Mentholatum test* must be used:
 - Whether the foreign nonstock corporation has undertaken within the Philippines the eleemosynary activities for which it is organized
 - Whether such undertaking show a continuity of dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of, the purpose and object of its organization

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Two schools of thought

1. Classic IL doctrine – A foreign corporation not engaged in business in the Philippines has no presence, and the various types of service of summons would not grant a court jurisdiction over the said foreign corporation. Consequently, the foreign corporation may file a motion to dismiss.
2. (x) *Facilities Management* doctrine – If a foreign corporation, not engaged in business in the Philippines, is not barred from seeking redress from courts in the Philippines, a fortiori, that same corporation cannot claim exemption from being sued in Philippine courts for acts done against a person or persons in the Philippines. When the complaint contains proper allegations that would allow the court to make a *prima facie* finding that the foreign corporation is engaged in business in the Philippines for purposes of service of summons on a local agent or by extrajudicial service thereof, and thereby to even defer resolution of the foreign corporation's motion to dismiss to the trial on the merits.

The case for foreign nonstock corporation

- The operative provisions on the obtaining of license to do business does not seem applicable to foreign nonstock corporations

Foreign nonstock corporations as juridical persons under Philippine law

- They have juridical capacity to act in a host country, per the doctrine of comity
- The reciprocity rule applicable to foreign stock corporations is applicable to foreign nonstock corporations

²⁰ Rule 14.14, Rules of Civil Procedure.