

**Ateneo de Manila University**  
**PHILIPPINE CORPORATE LAW 2A**

**Chapter 2: Nature and Attributes of a Corporation**

**SEC. 2. Corporation Defined.** – A corporation is an artificial being created by operation of law, having the right of succession and the powers, attributes, and properties expressly authorized by law or incidental to its existence (*Revised Corporation Code [RCC]*).

**Definition** – A corporation is a *medium of conducting* business by which complex commercial activities can efficiently be undertaken (*CLV definition*).

*Critique of RCC definition* – It only looks at one aspect—the relationship between the State and the corporation.

- The corporate setting embodies the principles of *Contract Law, Agency, Trusts, and Labor Law*.

**Two theories on the formation of a corporation**

1. Theory of concession
2. Theory of enterprise entity

*Theory of concession*

- The grant of a juridical personality is only by virtue of a primary franchise given by the state. This is embodied in § 2, RCC.
  - *Tayag v. Benguet*: A corporation is an artificial being created by operation of law, which owes its life to the state, its birth being purely dependent on its will.
  - A corporation as known to Philippine jurisprudence is a creature without any existence until it has received the imprimatur of the state acting according to law.
- It only applies within the juridical entity level, and if there is a controversy arising between it and the state.

*Theory of enterprise entity*

- Hinges itself on the fact that there can be no corporate existence without persons to compose it.
- The corporation is viewed as taking its significance primarily from the reality of the underlying business enterprise, formed or in formation; that the state's approval of the corporate form sets up a *prima facie* case that the assets, liabilities and operations of the corporation are those of the enterprise.
- It covers situations where the courts have either:
  - Erected corporate personality which the state had not granted
  - Disregarded corporate personality where the state had granted it
- The corporate fiction cannot be created unless there is an enterprise or group upon whom it would be conferred. The state cannot prohibit a legal business enterprise.

- Thus, when a corporate entity comes into being, it has certain rights almost independent of the whims of its creator.
  - The underlying relationship is still composed of moral individuals who are not creatures of the state. Thus, corporations have due process rights and even 4th amendment rights (*Bache v. Ruiz*).
  - Basis for de facto corporation doctrine and corporation by estoppel doctrine!

*CLV: Both theories are correct*

- Theory of concession applies at the juridical entity level
- Theory of enterprise entity applies at the intra-corporate level

**Tri-level corporate existence**

1. Assets-only level
  - a. The corporation is an aggregation of property and assets
2. Business enterprise level
  - a. A corporation's primary purpose is to pursue a business enterprise
3. Juridical entity level
  - a. The corporation's juridical personality is primarily a medium through which to pursue a business enterprise

**Tri-level relationships in the corporate setting**

1. **Juridical entity level** – The relationship between the State and the corporation (creator [state]; creature [corporation])
2. **Intra-corporate level**<sup>1</sup>
  - a. The corporation and its agents (directors, trustees, and officers [DTO]), governed by *Agency*
  - b. DTO and shareholders, governed by *Trusts*
  - c. Corporation and the persons composing it (shareholders or members)
  - d. Among the shareholders or members in a common venture
3. **Business enterprise level** (extra-corporate) – The corporation becomes a business economic unit, a business enterprise, or “a going concern”:
  - a. With the members of the public who voluntarily deals with it, governed by *Contract Law*
  - b. With the managers and employees, governed by *Labor Law*
  - c. With the public who are adversely affected, governed by *laws on quasi-delict or torts and the environment*.<sup>2</sup>

<sup>1</sup> In particular for stock corporations, we refer to the *Shareholder Theory*, in which the primary duty of the DTO in pursuit of the business is the maximization of profits to increase the shareholders' value in the corporate enterprise.

<sup>2</sup> *But see*: Doctrine of corporate social responsibility.

*Quarendum: In case of conflict between corporate law and an extra-corporate law, which will prevail?*

- The extra-corporate law, because corporation is a mere tool, means, or medium
- If there's a conflict between the medium and the objective (business venture), the objective will be favored.
- The courts or public policy will always protect those third parties who deal with in good faith (IPV).

### The corporation as a creature of the law

1. Constitutional provisions
  - a. The power to create corporations is an attribute of sovereignty, the exercise of which is legislative in character.
  - b. Congress cannot make a private corporation, except by general law (*i.e.*, RCC) (Const. art. XII, § 16).
    - i. Thus, it is unconstitutional for a law to create a corporation (*NDC v. PVB*).
    - ii. By way of an exception, Congress may create GOCCs (special charters) in the interest of common good and subject to the test of economic viability. What we can infer from this is only chartered GOCCs are subject to the tests!
2. Civil Code provisions
  - a. Corporations for private interest or purpose are granted a juridical personality, separate and distinct from that of each shareholder or member (art. 44).
  - b. Juridical entities organized as public corporations are governed by their charter, while private corporations are regulated by the RCC (art. 45).
    - i. Thus, GOCCs formed under the RCC (nonchartered GOCCs) are really private corporations in a strict sense! They are government owned private corporations.
3. Franchises of corporations
  - a. Primary – The right to exist, which is vested in the members and *not* in the corporation itself. Such as the charter.
  - b. Secondary/special – Vested in the corporation and may be conveyed or mortgaged (subject to exceptions).

### Attributes of the corporation<sup>3</sup>

- From § 2, RCC:
  - Artificial being
  - Creature of the law
  - Right of succession

- Creature of limited powers, attributes and properties

### Artificial being

- It is the fiction of law which creates the “person” of the corporation, with the same juridical capacity of an individual having full capacity to enter into contractual relations and own properties.
- Arises upon the grant of a franchise (*e.g.*, issuance of a certificate of incorporation by the SEC).
  - Cf: Partnership’s juridical personality arises upon meeting of the minds (art. 1767).
- The mere fact that its personality is owing to a legal fiction and that it necessarily has to act thru its agents, does not make the latter personally liable on a contract duly entered into, or for an act lawfully performed by them, for and in its behalf (*Vazquez v. Borja*).
- It is strong because such juridical personality is unaffected by the death, incapacity, withdrawal, or insolvency of any of its shareholders or members.

### Creature of the law

- The juridical existence of a corporation is dependent on the consent or grant of the state (theory of concession).
- However, there must first be an underlying contract among the individuals forming the corporation upon which the state grant may be conferred.
- The phrase “created by operation of law” ensures a strong juridical personality—every corporation receives a particular commission from the state (*i.e.*, SEC certificate of incorporation), and it is only the state that can effect dissolution.

### Right of succession

- A corporation has the capacity for continuous existence, despite the death or replacement of its shareholders or members (due to the separate personality).
- It is within the ability of the corporation to continue living, at its will.

### Creature of limited powers, attributes and properties

- Once a corporation has been granted juridical personality by the state, it is allowed and can legally exercise only such powers granted by the law for its creation.
- A corporation has no power except those expressly conferred on it by the RCC and those that are implied by or are incidental to its existence.
  - In turn, the DTO exercises the corporate powers, because physical acts may only be done by natural persons duly authorized for the purpose by the by-laws or a specific act of the Board of Directors (BOD).
- Consequently, it has a juridical capacity to act (*e.g.*, to sue and be sued).

<sup>3</sup> *Contra*: The attributes of a partnership are: (1) contractual relationship; (2) consensual juridical personality; (3) mutual agency; (4) delectus personae; (5) unlimited liability.

### Essential attributes of a corporation

1. Strong juridical personality
  - a. Countered by the *ultra vires* doctrine.
2. ❤️ Centralized management – The powers are centralized in the BOD/BOT (§ 22, RCC).
3. Limited liability to shareholders – The liability of shareholders is limited to their shares.
  - a. Liability is only to the extent of the investment or promised investment.
4. Free-transferability of units of ownership – A shareholder may assign, transfer, or encumber the shares without the consent of the corporation or other shareholders.
  - a. A pure liberty to do so (*contra delectus personae*)
  - b. It's like a Big Mac 🍔

**Advantages under the RCC**

1. Perpetual succession under its corporate name and in an artificial form
2. Capacity to take and grant property
3. Contract obligations
4. To sue and be sued in its corporate name
5. Capacity to receive and enjoy common grants of privileges and immunities
6. Limited liability

**Disadvantageous features of the corporate medium**

1. Complicated and costly formation and maintenance
  - a. Reportorial and record-keeping obligations
  - b. Regulatory rules on corporate governance
2. Lack of personal element and abuse of corporate management – This has spawned corporate irresponsibility under the theory that those vested with corporate powers have no personal or proprietary stake in the corporate business enterprise
3. Limited liability hits innocent victims – The feature has been abused to avoid having to provide adequate protection and compensation for victims of the business ventures they undertake.
4. Double taxation – The profits of the corporation are subject to corporate income tax (CIT), and when declared and distributed as dividends to the shareholders are again subject to income tax.

**Comparing the corporation with other business media**

Media	Juridical personality	Liability	Succession	Objective or nature
Corporation	Separate and distinct	Limited	Strong	Profit or nonprofit
Sole proprietor	None	Unlimited	None	Individual business endeavor

Joint account	None	Manager		Accidental partnership
Business trust	None	Split (legal, beneficial)		Split ownership of property
Partnership	Separate and distinct	Unlimited	Weak	Profit
JV	Separate and distinct	Unlimited	Weak	Joint commercial project
Cooperatives	Separate and distinct	Limited to investment	Continuous	Self-help

*Quarendum: Does a defective incorporation process result in a partnership? NO<sup>4</sup>*

1. If the parties intended to create a corporation, a partnership cannot be created in its stead since it is not within their intent and does not constitute a part of their consent to the contractual relationship
2. The important differences between the corporation and the partnership cannot lead one to the conclusion that in the absence of the first, the contracting parties would have gone along with the latter:
  - a. Corporate: Limited liability, centralized management, and transferability of the units of ownership
  - b. Partnership: Unlimited liability, mutual agency, and delectus personae
3. In *Pioneer Insurance v. CA*: When parties coming together intending to form a corporation, but no corporation is actually incorporated, then:
  - a. Parties who had intended to participate/actually participated in the business affairs would be *partners of a de facto partnership and liable*
  - b. Parties who took no part except to subscribe to shares *do not become partners and are not liable*

**Entitlement of the corporation to constitutional rights**

1. Due process and equal protection
  - a. Example: Failure to implead the corporation in a suit for recovery of ill-gotten wealth against its *shareholders* will not bind the corporation
  - b. Thus, the court sustained the validity of § 47, General Banking Law which gave

<sup>4</sup> *But see* § 20, RCC.

juridical persons a shorter redemption period (*Zomer v. CA*).<sup>5</sup>

2. Unreasonable searches and seizures
3. But see: No right against self-incrimination
  - a. The privilege against self-incrimination is a personal one, applying only to natural individuals. Thus, a corporation may be compelled to submit to the visitatorial powers of the state
  - b. There is no physical intrusion, because it would only require the production of records and books

#### Liability of corporations for torts – Law on Agency governs

1. A corporation must be held liable for all the contracts and default that arise from those entered into by its agent within the scope of his authority, or even those outside but ratified by the BOD
2. The acting officer is solidarily liable with the corporation for the damages resulting from his negligence as a joint tortfeasor

*PNB v. CA* – A corporation is liable whenever a tortuous act is committed by an officer or agent under express direction or authority from the stockholders or members acting as a body, or, generally, from the directors as the governing body.

- Thus, not every tort committed by an officer can be ascribed to a corporation.
- Only when the tort act arises from an express direction from the BOD, or a necessary incident of the business of the corporation would the damages resulting therefrom be ascribable to the corporation.

#### Liability

- The corporate assets cannot escape enforcement of the claims for damages of the tort victim.
- This is without prejudice to a derivative suit (shareholders vs. BOD) to recover the damages suffered by the corporation.
- The DTO is also liable as joint tortfeasor (personally).
  - But only when they acted in bad faith or with gross negligence (see § 30, RCC).

*Quarendum: Can the corporation be held liable for the tortuous acts of a corporate officer or representative in the absence of a prior express direction from the BOD (or ratified), and the tort act was not a necessary incident in the performance of an authorized transaction? YES*

- The corporate principal would be liable under the premise that when acting in the legal or commercial world, every corporation would rely upon natural persons.

<sup>5</sup> A longer period of redemption is given to natural persons whose mortgaged properties are more often used for residential purposes. A shorter period of redemption is given to juridical persons whose properties are more often used for commercial purposes. The shorter period is aimed to ensure the solvency and liquidity of banks. This helps minimize the period of uncertainty in the ownership of commercial properties and enable mortgagee-banks to dispose of these acquired assets quickly.

- Human imperfection causes loss or damage, as a result of fraud or negligence.
- Thus, the corporate coffers must stand ready to cover when it does arise.
- The remedy of the corporation is to recover the damages from the acting corporate officer who was directly responsible for the tort act (third party suit).

#### Are corporations entitled to moral damages? NO

- The majority school of thought says NO, because corporations are amoral beings not entitled to any form of moral damages, even on the ground of besmirched reputation (*Prime White Cement v. IAC [1993]*).
- *Contra*: *Mambulao Lumber v. PNB (1968)*; *People v. Manero (1993)*.

#### Nationality of corporations

- Why determine? Because it is the legal basis for subjecting the enterprise to the laws, the economic and fiscal powers, and the various social and financial policies of the state to which it is supposed to belong.
- The one that gives teeth: Anti-Dummy Law

#### Tests of nationality

1. Place of incorporation (§ 140, RCC)
  - a. A corporation is a national of the country under the laws of which it has been organized and registered
2. Control test
  - a. The nationality is determined by the nationality of the majority of the shareholders on whom equity control is vested
  - b. All capital stock of the corporation must be included (*SEC op.*)
  - c. It is ancillary to the place of incorporation test
3. Place of principal business test
  - a. The corporation is subject to the jurisdiction of the place where its principal office is located

#### Relevance of nationality

1. Exploitation of natural resources (Const. art. XII, § 2)
  - a. Exploration, development and utilization (EDU) of natural resources may only be done by the state with corporations at least 60% of whose capital is owned by Filipinos.<sup>6</sup>
2. Alienable lands of the public domain (Const. art. XII, § 3)
  - a. Private corporations cannot own alienable lands of the public domain (*i.e.*, agricultural lands), except by lease for a period not

<sup>6</sup> *Register of Deeds v. Ung Sui Si Temple*: The 60% requirement is to ensure that corporations allowed to acquire agricultural land or to exploit natural resources shall be controlled by Filipinos.

exceeding 25 years (renewable), not more than 100,000 ha. in area.

3. Ownership of private land (Const. art. XII, § 7)
  - a. No private lands shall be transferred or conveyed, except to corporations to acquire or hold lands of the public domain
4. Public utilities (Const. art. XII, § 11)
  - a. Franchises for the operation of a public utility may only be granted to corporations at least 60% Filipino-owned *and* organized under the laws of the Philippines
  - b. The provision has *both* the control and place of incorporation tests!
5. Mass media (Const. art. XVI, § 11)
  - a. The ownership of mass media (excludes commercial telecommunications) is limited to wholly-owned and managed Filipino companies.
  - b. It's more stringent—both ownership and management must be 100% Filipino.
6. Advertising industry (*Id.*)
  - a. Only Filipino citizens or corporations or associations at least 70% of the capital of which is owned by such citizens shall be allowed to engage in the advertising industry.
7. War-time test
  - a. In times of war, the nationality is determined by the citizenship of the controlling shareholders (*Filipinas Compañia de Seguros v. Christem*).

#### Subsets of the control test

1. Grandfather test
2. DOJ-SEC test
3. FIA '91 test

#### Grandfather rule

- The control test is applied by looking at the proportionate holdings of those underlying shareholders of the target corporation. The goal is to know whether it would comply with the equity requirement under the constitution.
- The various nationality tests shall first be applied on the shareholders of the holding companies, to determine the nationality of the equity in the target corporation, and thereby arrive at the nationality of such target corporation
- The determination of nationality becomes difficult when the shares are held by other corporations (corporate layering)
  - Thus, the need for the grandfather rule, as a *sub-application under the control test*
- Three-level test:
  - “Grandson” – the target company
  - “Father” – the holding company
  - “Grandfather” – the person or entity holding shares in the holding company
- How many levels?
  - Publicly-held corporations – 2 levels

- Closely-held corporations – 3 levels
- Banking institutions – 4 levels

#### DOJ-SEC Rule

- Shares belonging to corporations at least 60% of the capital of which is owned by Filipino shall be considered as of Philippine nationality
- But if the percentage of Filipino ownership in the corporation is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality

#### Control test under Foreign Investments Act

- “Philippine national” – A corporation organized under the laws of the Philippines of which at least 60% of the capital stock outstanding and entitled to vote is owned and held by Filipino citizens.
- The law limits the test to voting shares, but makes it more stringent when it comes to actual control by making a double 60% rule requirement as to both holding and held companies, as well as their BOD.

#### What is ‘capital’?

- The term capital refers to shares of stock entitled to vote in the election of directors, and the total outstanding capital stock comprising both common and non-voting preferred shares (*Gambova v. Teves*).
- Full beneficial ownership of 60 percent of the outstanding capital stock, coupled with 60 percent of the voting rights, is required.

#### Where do you apply the control test?

- You apply it to the entire outstanding capital stock, both voting and nonvoting, of the target corporation (operating company) (*Roy III v. Herbosa [MR]*).

#### Nationality rules for nonstock corporations

1. If *all* its members are Filipino citizens
2. If at least 60% of its members entitled to vote are Filipino citizens
3. If at least 60% of its members’ total number of votes as broadened in the bylaws are held by citizens of the Philippines

#### Classification of corporations

1. In relation to the state
  - a. Public and private corporations
  - b. Quasi-public corporations
2. As to place of incorporation
  - a. Domestic corporations
  - b. Foreign corporations
3. As to legal status
  - a. Corporation de jure
  - b. Corporation de facto
  - c. Corporation by estoppel
  - d. Corporation by prescription
4. As to existence of shares of stock
  - a. Stock corporations
  - b. Nonstock corporations
5. As to relationship of management and control

- a. Parent and holding companies
- b. Affiliate company
- c. Parent and subsidiary companies

#### *In relation to the state*

#### Public vs. private

- a. Public – Those formed/organized for the government of a portion of the state (e.g., *local government units*)
  - i. Public or governmental character
  - ii. Private, corporate or proprietary character
- b. Private – Those formed for some private purpose, benefit, aim or end.
  - i. Stock or nonstock
  - ii. Also understood to mean those organized under the RCC, even when they fall within the definition of a GOCC
  - iii. Three kinds:
    1. Those organized under the RCC for private ends
    2. Those organized under RCC as GOCCs to achieve certain governmental purposes
    3. Those GOCCs organized with their own charters

#### Distinctions between public and private

- Corporation's charter (chartered vs. incorporated under RCC)
  - Thus, the mere fact that the government happens to be a majority shareholder of a corporation with its *own* charter does not make it a public corporation
- However, it is not the public purpose alone, or the controlling ownership of the state, or the fact that it is a chartered corporation that distinguishes a public corporation from a private one.
- In sum, a *truly* public corporation exists primarily for the government of a portion of the state.

#### Quasi-public corporations

- A "cross" between private and public corporations, such as water districts.
  - Thus, they are not subject to SEC's jurisdiction.
  - But their directors are government personnel subject to Civil Service Laws (CSL) and anti-graft laws (*Marilao Water v. IAC; Feliciano v. COA*).

#### Applicability of CSL

- GOCC created by special charter → CSL
- GOCC created under RCC → Labor Code

#### Jurisdiction of COA

- It is immaterial whether a corporation is private or public for purposes of exercising the audit jurisdiction of the COA (*Oriundo v. COA*).

#### *As to place of incorporation*

#### Domestic

- A domestic corporation is one incorporated under laws of the Philippines.

#### Foreign

- One formed, organized or existing under any laws other than those of the Philippines *and* whose laws allow Filipinos to do business in its own country or state (§ 140, RCC).
- A foreign corporation can have no legal existence beyond the bounds of the state or sovereignty by which it is created
- This principle however, does not prevent a corporation from acting in another state or country with the latter's express or implied consent

#### *As to legal status*

#### Corporation de jure

- There is full/substantial compliance with the requirements of an existing law permitting organization of such corporation (e.g., proper articles of incorporation duly executed and filed)
- Its due incorporation cannot be successfully attacked even in a *quo warranto* proceeding.

#### Corporation de facto

- A corporation has de facto existence where there is a bona fide attempt to incorporate, colorable compliance with the statute, and use of corporate powers.
- Grew out of the necessity of promoting the security of business transactions and to eliminate quibbling over irregularities
  - Because, it would be unfair to allow a claimant against the alleged corporation to insist on the individual liability of innocent investors merely because of some minor flaws in its incorporation

#### Corporation by estoppel

- A group of persons may assume to do business as a corporation without having gone far enough to achieve a de facto corporate existence.
- Thus, all persons who act as a corporation—though in truth and in fact are not—shall be liable as general partners for all debts, liabilities, and damages incurred as a result thereof (§ 20, RCC).

#### Corporation by prescription

- The Roman Catholic Church (*Barlin v. Ramirez*).

#### *As to existence of shares of stocks*

**SEC. 3. Classes of Corporations.** – Corporations formed or organized under this Code may be stock or nonstock corporations. Stock corporations are those which have

capital stock divided into shares and are authorized to distribute to the holders of such shares, dividends, or allotments of the surplus profits on the basis of the shares held. All other corporations are nonstock corporations.

#### Stock corporations

- Those which have capital stock divided into shares and are authorized to distribute to the holders the surplus of profits, on the basis of the shares held.
  - Everything else → nonstock
- Two requisites:
  - A capital stock divided into shares
  - Authority to distribute dividends<sup>7</sup>

#### Nonstock

- A nonstock corporation is one where no part of its income is distributable as dividends to its members (§ 86, RCC).
  - If there are profits, they shall be used for the furtherance of the purpose of the corporation.
- Nonstock corporations may be formed or organized for charitable, religious, educational professional, cultural, recreational, fraternal, literary, scientific, social, civic service, or similar purposes, like trade, industry, agriculture and like chambers, or any combination.

#### *As to relationship of management and control*

#### Parent and holding companies

- Parent – One that controls another as a subsidiary or affiliate by the power to elect its management
- Holding – One which holds stock in other companies for purposes of control rather than for mere investment
  - Basically conducting its business by investing substantially in the equity securities of another company for the purposes of controlling their policies (*Maricalum v. Florentino*).

#### Affiliate company

- A person that directly or indirectly, through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified, through the ownership of voting shares, by contract, or otherwise (SEC op.).
- An entity at least 20% but not exceeding 50% of the voting stock of which is owned by *another* company (AMLA).
- A corporation that directly or indirectly, through one or more intermediaries, is controlled by, or is under the common control of another corporation (FRIA).

#### Parent and subsidiary companies

- Parent – The corporation having control of another company
  - Subsidiary – The company being controlled by the parent
- Subsidiary – An entity more than 50% of the outstanding voting stock of which is owned by the parent (AMLA).

#### *Quarendum: What is control?*

- The power to govern the financial and operating policies of an enterprise for gain from its activities.
  - In short, when more than one-half of the voting power is owned by the parent.
- Control also exists even when the parent owns less than half of the voting power when there is power:
  - Over more than one-half of the voting rights by virtue of an agreement with other investors
  - To govern the financial and operating policies of the enterprise under a statute or agreement
  - To appoint or remove the majority of the BOD
  - To cast the majority of votes at meetings of the board

### Chapter 3: Good corporate citizen

#### **Three views from which to judge the role of corporation**

1. From the viewpoint of the *state*, treating the corporation as its creature and the medium through which large and complex commercial endeavors shall be pursued.
2. From the viewpoint of *businessmen and investors*, who employ the corporation as the medium to pursue commerce and to whom the bottom line is the maximization of profits
3. From the viewpoint of *society*, which realizes that corporations consume resources and their business operations affect the public and the environment, and for which reason corporations are expected to bear some social responsibility or at least behave as good corporate citizens

#### **Corporations vested with public interest**

#### *Common law doctrine of corporate social responsibility (CSR)*

- Corporations vested with public interest owe a fiduciary duty not just to the shareholders but also to the public that they serve or interact with, particularly in the banking industry (*Simex International v. CA*).<sup>8</sup>
- Thus, the following are imbued with a fiduciary duty:
  - Over supervision of their officers and employees

<sup>7</sup> Thus, if there's an express authorization to declare dividends, it is a stock corporation. Where there was none, it is nonstock (*CIR v. Club Filipino Inc. de Cebu*).

<sup>8</sup> Prior to *Simex*, the doctrine was that the relationship between a bank and that of a depositor was that of simply being contractual in character.

- In extending loans and other credit accommodations
- In accepting real estate mortgages, dealing with registered land and other properties given as security
- In general, in handling all their transactions, or dealings with the public
- The recognized fiduciary obligation of banks was characterized to be “of the highest degree.” Highest degree of diligence.<sup>9</sup>

#### *As applied to medical malpractice cases*

- When a hospital holds out a physician as a member of its medical staff, when he is in fact an independent contractor merely using the facilities of the hospital, *then insofar as the patient is concerned*, the hospital has clothed such physician with authority to bind the hospital under the doctrine of apparent authority (*Nogales v. Capitol Medical Center*).
  - *Nogales* began to characterize the “public interest” nature of a corporation operating a hospital.
- Many courts now allow claims for hospital vicarious liability under the theories of *respondeat superior*, apparent authority, ostensible authority, or agency by estoppel (*Professional Services Inc. v. Agana*).
  - This case overturned the long-established exceptions of hospitals from the doctrine of *respondeat superior*.
  - For purposes of apportioning responsibility in medical negligence cases, an employer-employee relationship in effect exists between hospitals and their attending and visiting physicians.
- The high cost of today’s medical and health care should at least exact on the hospital greater, if not broader, legal responsibility for the conduct of treatment and surgery within its facility by its accredited physician or surgeon, regardless of whether he is independent or employed.

#### Doctrine of corporate responsibility

- *Professional Services* also evolved the **doctrine of corporate negligence or corporate responsibility**, which allowed a platform of direct liability of the corporation based on the corporate set-up of a hospital, clearly apart from the doctrine of apparent authority.
- *Definition*: It provides that every corporation which undertakes to operate a business enterprise which is of the kind and nature that it invites the public to

<sup>9</sup> § 2, General Banking Law: The State recognizes the vital role of banks in providing an environment conducive to the sustained development of the national economy and the fiduciary nature of banking that requires high standards of integrity and performance. In furtherance thereof, the State shall promote and maintain a stable and efficient banking and financial system that is globally competitive, dynamic and responsive to the demands of a developing economy.

cater to its services, is bound to ensure that those who avail of its services are duly protected and that the corporation has a duty to exercise reasonable care to protect the availing public from harm when the public use its facilities, including the obligation to oversee and supervise all persons who operate such facilities, as well as the obligation to take an active step in remedying the negligence committed within its premises.

- *Exception to the separate juridical entity*: A hospital in itself cannot practice medicine, and it utilizes doctors. Thus, three relationships crisscross:
  - Hospital-doctor
  - Hospital-patient
  - Patient-doctor
- There exists a “legal relationship” between the hospital and patient, though the professional relationship is really patient-doctor
- Corporations which undertake business enterprises or public facilities that cater and open their facilities to the public inherently owe a certain duty of care and diligence to members of the public who avail of their services or facilities

#### *Corporations vested with public interest under the RCC*

- Under § 22, the BOD of the following corporations must have independent directors constituting at least 20%:
  - Corporations covered by the Securities Regulation Code (SRC):
    - Registered issuers
    - Publicly listed companies
    - Public companies
  - All corporate financial intermediaries including:
    - Banks and quasi-banks
    - Nonstock savings and loans associations
    - Preneed, trust and insurance companies
    - Corporations engaged in money service business
    - Pawnshops
  - Other corporations engaged in business vested with public interest, as may be determined by the SEC.
- Other requirements are also set forth in §§ 23, 24, 29, 31, 91, 95, and 177, RCC.

#### *Legal implications on imposition of fiduciary duty of diligence of the highest degree*

- **Extraordinary diligence** – That extreme measure of care and caution which persons of unusual prudence and circumspection observe for securing or preserving their own property or rights.
- The enforcement of extraordinary diligence has implications on:
  - The burden of proof to make the corporation directly liable to the injured stakeholder

- The personal liability of the directors, trustees, or officers acting for and in behalf of the corporation
- In the case of common carriers, once the accident occurs, a presumption of negligence arises and it becomes the duty of a common carrier to prove that it exercised extraordinary diligence (*Tiu v. Arriesgado*).

### Conclusion

- For all corporations vested with public interests under or pursuant to § 22, they are deemed to be bound to exercise extraordinary diligence in considering and protecting the interests of stakeholders who are affected directly by the nature of their business enterprise
- When they suffer any injury due to the act, contract or pursuit of such business enterprise, then the corporation is *ipso jure* deemed negligent and liable unless it can prove that it has exercised extraordinary diligence in the selection and supervision of its employees and representatives
- In the same manner, the BOD, as the repository of all corporate powers is deemed to have failed to exercise extraordinary diligence in pursuing the corporate affairs and in the selection and supervision of its officers and employees, become solidarily liable with the corporation for the damages sustained by the injured stakeholders.

## Chapter 4: Corporate juridical personality

### Doctrine of separate juridical personality

- The definition of a corporation is the basis of the primary doctrine that a corporation being a juridical person has a personality separate and distinct from the shareholders or members who compose it
- The basis by which limited liability is created (common law)
  - The liabilities of the corporation are its own and it cannot be enforced against the controlling stockholders or members, or *vice versa*
- The granting to the corporate entity of a strong separate juridical personality is considered as the attribute most characteristic of corporations
- The stability of the main doctrine of separate juridical personality is inextricably linked with the attractiveness of the corporation as an efficient medium
- It is a transactional doctrine, i.e., meant to apply in transactions.

### Cascade of the doctrine of separate juridical personality

- A corporation is an artificial being invested by law with a personality separate and distinct from its officers, stockholders or members, as well as from other corporations to which it may be connected, then consequently—

- The corporate property and assets are not the property of its shareholders; nor can the property of the controlling shareholders or the officers be treated as part of the corporate estate
- A parent or holding company has no proprietary interest in the property, rights and interests of its subsidiaries or affiliates—consequently, any suit against the parent company does not bind the subsidiaries, and vice versa
- A corporation may not be held liable for the obligations of the shareholders or members composing it, or those of its officers; and neither can its shareholders be held liable for the obligations of such corporation
- Corporate officers are not personally liable for their official acts in pursuing the affairs and business of the corporation; unless it is shown that they have exceeded their authority
- Substantial ownership in the capital stock entitling the shareholder a significant vote in corporate affairs allows them no standing or claims pertaining to corporate affairs; and a suit against a corporation cannot be considered as a suit against its shareholders, and vice versa
- Since the separate juridical personality is a fiction created by law for convenience and to prevent injustice, it may be disregarded if it is used as a means to perpetuate fraud or an illegal act or as a vehicle for the evasion of an existing obligation, the circumvention of statutes, or to confuse legitimate issues
- However, the following facts by themselves or in combination, would *not* warrant a disregard of the veil of corporate fiction, absence fraud or other public policy consideration:
  - Mere ownership by a single shareholder or by another corporation of all or nearly all of the capital stock
  - Substantial identity of the incorporators of two or more corporations
  - Existence of interlocking directors or officers of two or more corporations
  - Location of head offices or facilities in the same compound or having the same address

### Doctrine of piercing the veil of corporate fiction

- When the fiction is used as a means of perpetrating a fraud or an illegal act or as a vehicle for the evasion of an existing obligation, the circumvention

of statutes, the achievement or perfection of a monopoly or generally the perpetration of knavery or crime, the veil with which the law covers and isolates the corporation from the members or stockholders who compose it will be lifted to allow for its consideration merely as an aggregation of individuals (*San Juan Structural and Steel v. CA*).

- It is an equitable remedy (*i.e.*, not founded on positive law). **It is a doctrine of last resort.**
- The undermining of the separate juridical personality necessarily undermines the other attributes!
- The objective is to create a standing to someone stranger to the corporate act. It removes the principle of relativity between the corporation and the third party.

#### *Some jurisprudential grounds for lifting the veil*

- When used as shield to confuse legitime issue
- Necessary to achieve equity or for the protection of creditors
- Used to evade a just and due obligation or to justify a wrong
- To shield or perpetuate fraud
- To carry out other similar unjustifiable aims or intentions, or as a subterfuge to commit injustice and so circumvent the law
- The corporation is a mere alter ego or business conduit of a person
- Corporation is so organized and controlled and its affairs are so conducted as to make it merely an instrumentality, agency, conduit or adjunct of another corporation

#### *Nature and consequences of the piercing doctrine as an equitable remedy*

- Piercing doctrine applies only to prevent a wrong or injustice, or to achieve equitable ends
- Party invoking the piercing doctrine must be a victim of inequity
- Piercing doctrine is a remedy of last resort
- Piercing doctrine cannot be employed to establish a **right** or a cause of action (*Boyer-Roxas v. CA*)
- Piercing doctrine applies only when the corporate personality was the efficient cause or means
- Piercing application is essentially a judicial prerogative

#### *Legal consequences when the piercing doctrine is applied*

- Treat the corporation, its controlling or accountable officers or shareholders as a mere *association*
  - The courts will look at the corporation as a *mere collection of individuals*
  - Both law and equity will disregard the legal fiction
  - Thus, the limited liability rule will be skirted, making the shareholders or officers *personally liable* for the obligations of the corporation
- Piercing may apply to benefit those within and outside the intra-corporate relations

- Application of the piercing doctrine only has *res judicata* effect (*i.e.*, it's only limited to that particular issue)
- Piercing doctrine applies to nonstock corporations

#### **Classifications of the application of the piercing doctrine<sup>10</sup>**

1. Fraud piercing
  - a. The corporate entity is used to commit fraud or to justify a wrong, or to defend a crime (commercial or social wrongdoings)
  - b. There is always an element of malice, evil motive or a wrong done.
  - c. The corporate entity is used to commit a wrong or to achieve fraud.
  - d. There must be damage.
2. Alter ego piercing
  - a. When the corporate entity is used as a mere alter ego, business conduit or instrumentality of a person or another entity
  - b. Where the stock of a corporation is owned by one person whereby the corporation functions only for the benefit of such individual owner, the corporation and the individual should be deemed the same
  - c. There is a **disrespect** for the fact that the corporation has a separate juridical person and being operated for the benefit of the corporation
3. Defeat public convenience or equity piercing
  - a. When respect for the separate juridical entity would defeat public convenience, or would result in unintended inequity or injustice
  - b. There is no fraud committed, and yet the separate veil of fiction causes an injustice to the public
  - c. If you can prove an injustice but the fraud piercing and alter ego piercing aren't applicable, then public convenience piercing may be done

#### *Probative factors for the application of the piercing doctrine<sup>11</sup>*

- a. Stock ownership by one or common ownership of both corporations
- b. Identity of directors and officers
- c. The manner of keeping corporate books and records
- d. Methods of conducting the business

#### **Tests in determining the applicability of the piercing doctrine<sup>12</sup>**

<sup>10</sup> *General Credit Corp. v. Alsons Dev. and Investment Corp.*

<sup>11</sup> *Concept Builders Inc. v. NLRC.*

<sup>12</sup> The test in determining the applicability of the doctrine of piercing the veil of corporate fiction is as follows: **1.** Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; **2.** Such control

- a. Instrumentality (alter ego) test
  - i. Control, not mere majority of complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked
  - ii. The corporate entity has no separate mind, will or existence of its own
- b. Fraud test
  - i. Such control must have been used by the defendant to commit fraud or wrong, to perpetuate the violation of statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights
- c. Harm test
  - i. The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained off

#### *Fraud piercing cases*

1. Corporate fiction was the very means to commit fraud, or evade the consequences of the wrongful act
  - a. However, it must be shown by clear and convincing proof that the separate juridical entity was purposely employed to evade a legitimate and binding commitment and perpetuate a fraud or similar wrongdoing
  - b. No application to allow persons to allow them to gain advantage (when no wrong or fraud was actually committed)
2. Alter ego elements in fraud piercing cases
  - a. To consider two separate entities as one and the same, there was a need to detail the circumstances which show that the corporate fiction is being used consciously as a means to commit fraud
  - b. The alter ego circumstances may be needed to prove the malicious intent of the parties
3. Tax evasion cases
  - a. Where a corporation is merely an adjunct, business conduit or alter ego of another corporation or when they practice fraud on internal revenue laws, the fiction of their separate and distinct corporate identities shall be disregarded
  - b. The following factors are considered:
    - i. When the owner of one directs and controls the operations of the other, and the payments effected or received by one are for the accounts due from or payable to the other
    - ii. When the properties or products of one are all sold to the other, which in turn immediately sells them to the public, as substantial evidence in support of the finding that the two are actually one juridical taxable personality (*CIR v. Meguito*)
4. Evasion of lawful obligations
  - a. The corporate entity is set-up or used as the very means to escape liability to third parties
5. Employing a shell or fictitious company<sup>13</sup>
  - a. Fictitious companies are by definition fraudulent (e.g., shell companies to join procurement activities)
6. Forum-shopping in fraud-piercing cases
7. Parent-subsidiary scenarios in fraud piercing cases
  - a. The act of creating a corporation to pursue a related or another line of business cannot itself be presumed to be with fraudulent intent, or a scheme resorted to avoid liabilities, absent sufficient showing that the corporate entity was purposely used as a shield to defraud creditors and third persons of their rights (*Umali v. CA*).
  - b. A subsidiary company's separate corporate personality may be disregarded only when the evidence shows that such separate personality was being used by its parent or holding corporation to perpetrate a fraud or evade an existing obligation (*Maricalum v. Florentino*).

#### *Application of the piercing doctrine to impose liability on corporate officers*

- Case law provides that the piercing doctrine may also be applied to make corporate officers liable for contracts or transactions entered into on behalf of the corporation.<sup>14</sup>
- Unless sufficient proof exists on record that an officer has used the corporation to defraud private respondent he cannot be made personally liable just because he 'appears to be the controlling stockholder (*Palay Inc v. Clave*)

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must have been used by the defendant to commit fraud or wrong, to perpetuate the violation of a statutory or other positive legal duty or dishonest and unjust act in contravention of plaintiff's legal rights; and **3.** The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of. The absence of any one of these elements prevents piercing the corporate veil. In applying the "instrumentality" or "alter ego" doctrine, the courts are concerned with reality and not form, with how the corporation operated and the individual defendant's relationship to that operation (*Id.*).

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<sup>13</sup> Shell companies have no significant assets, staff or operational capacity.

<sup>14</sup> This, alongside the particular rules of liability of the officers under the RCC, in relation to their fiduciary duties of diligence and loyalty, and the *Law on Agency* principle where officers become solidarily liable with the corporation in cases of fraud or negligence.

- Thus, an officer acting in good faith and within the scope of his authority cannot be personally liable for damages (*Pabalan v. NLRC*)
- If it is proven that the corporate officer has used the corporate fiction to defraud a third party, or that he has acted negligently, maliciously or in bad faith, then the corporate veil shall be lifted and he shall be held personally liable for the particular corporate obligation involved (*Francisco v. Mejia*)

#### Doctrinal summation of the fraud piercing doctrine

1. There must have been fraud or an evil motive in the affected transaction, and the mere proof of control of the corporation would not authorize piercing
2. The corporate fiction is the very means in the perpetration of the fraud or in the justification of wrong, or to escape a lawful liability
3. The main action should seek for the enforcement of pecuniary claims pertaining to the corporation against corporate officers or shareholders, or *vice versa*

#### Alter ego piercing; doctrine summation

- Even when the controlling shareholder or managing officer intends consciously to do evil, the use of the corporation as an *alter ego* or as a mere instrumentality for a personal agenda, and in some cases as a private checkbook of the controlling shareholders, is in direct violation of the central principle in *Corporate Law* of treating the corporation as a separate juridical entity.
  - Thus, those whose acts and actuations directly violate this central doctrine make themselves personally liable for having cast away the protective characteristic of limited liability
- By disrespecting the separate juridical entity personality of the corporation, others who deal with the corporation are not also expected to be bound by the separate juridical personality of the corporation and may treat the interests of both the controlling shareholder or office and the corporation as the same
  - Rationale: Lack of respect makes it difficult for the public to monitor exactly which assets and funds pertain to the corporation and those that pertain to the shareholders or officers (public policy)
- Alter ego piercing cases may prevail *even when no monetary* claims are sought to be enforced against the shareholders or officers

These all mean that the disrespect happens in the manner in which the business is run. The power of the BOD is disregarded—you run it for your own benefit.

- It's domination at the juridical personality level (not just at the equity level, because 100% ownership of stock does not translate to centralized management)!

#### Defeat public convenience/equity piercing cases

- It covers situations where upholding of the separate juridical personality would cause a “defeat of public convenience”
  - There must be *no case* for fraud or alter ego piercing
- Main feature: To render justice in the situation at hand or to brush aside merely technical defenses

### Chapter 5 Corporate Contract Law

#### Preliminary principles

- The approved articles of incorporation (AI) constitute a *contract* between the State and its creature, and defines the capacities of the corporation within the commercial world.
- Within the *juridical entity*, the corporation is a *creature of limited power*.
- Within the *intra-corporate level*, the articles of incorporation and by-laws (AIBL) embody the contractual terms and conditions between the members of the intra-corporate family.
- Meanwhile, extra-corporate relationships are governed by *Contract Law*.
  - Thus, every member of the public who deals in good faith with a corporation must be protected in his contractual expectations, in that the contract entered into by the corporation shall be valid and binding upon it.
- *Premise*: The issue in corporate contracts is whether the consent given by the corporate representative comes from a valid corporate setup.
  - Consequently, contracts entered into on behalf of defectively formed or nonexistent corporations fall into the realm of “unenforceable contracts.”

#### Pre-incorporation stages: Promoter's contracts

- Promoter – A person who, acting alone or with others, takes initiative in founding and organizing the business or enterprise of the issuer and receives consideration therefor.
- Promoter's contracts are those types of contracts entered into on behalf of a corporation which is in the process of organization and incorporation, and such a fact is acknowledged as an essential ingredient in the process of perfection.
  - They are otherwise known as “pre-incorporation contracts.”
- The *Law on Agency* governs.
- Thus, every promoter of a corporation in the process of incorporation binds himself to ensure that the corporation, *once duly incorporated*, will ratify the contracts entered into its name.
  - Else: The promoter becomes *personally liable* for such contracts, in case of nonratification.

### Liability rules for pre-incorporation contracts

- In *Cagayan Fishing v. Sandiko*: A corporation should have a full and complete organization and existence as an entity before it can enter into any kind of contract.
  - Thus, the court held the contract to be void since it was entered into with a corporation that had no corporate existence.
- CLV: It would seem that the holding in *Cagayan Fishing* is that ratification is the key element in upholding the validity and enforceability of the promoter's contract.
  - Without ratification *after* incorporation, a contract entered into on behalf of a corporation yet to be organized or still in the process of incorporation is *void* as against the corporation.
- Compare with *Rizal Light & Ice Co. v. Municipality of Morong Rizal*, where a franchise in favor of a corporation was sought to be annulled on the ground that at the time the application was filed, the corporation was then only in the process of incorporation.
  - The court dismissed the contention, holding that the *subsequent incorporation* of the corporation *after* the grant and its acceptance perfected the contract and cured the deficiency.
  - Clarifying, the court noted that the acts of promoters may be ratified or accepted by the corporation if and when subsequently organized.
- All the foregoing emphasize under the theory of business enterprise that what is essential is the existence of the business organization upon which a license or grant is pursued.
  - In contrast, *Cagayan Fishing* involved a juridical entity that had not been formally organized even at the time of litigation.

### Promoter personally liable if corporation is not duly incorporated

- Promoter's contracts can be pursued against the investors who were the venture's "moving spirit", but not against those who were merely convinced to invest in the corporate venture based on the feasibility study undertaken by the promoters (*Caram Jr. v. CA*).

### De facto corporation doctrine

**SEC. 19. De facto Corporations.** — The due incorporation of any corporation claiming in good faith to be a corporation under this Code, and its right to exercise corporate powers, shall not be inquired into collaterally in any private suit to which such corporation may be a party. Such inquiry may be made by the Solicitor General in a *quo warranto* proceeding.

- The defect or alleged inexistence of the juridical personality of a corporation cannot be raised collaterally, and can only be pursued in a *quo warranto* proceeding.
- It promotes the policy that a contracting party *cannot* avoid the legal consequences of his contractual commitment under a contract entered into with a corporation by pointing to the technical defects in the person of the contracting corporation.
  - And even if it should be proven that such authority was indeed defective or even non-existent, such defect cannot be used as an excuse to set aside a relationship or transaction entered into in good faith.
- It is meant to protect the enforceability of corporate dealings and contracts, to allow the public to take at reasonable face value the authority of the corporation and its officers to enter into valid and binding contracts, thereby providing a healthy system by which to encourage the public to deal with corporate entities.
- It governs the extra-corporate level.

### Various scopes of the de facto corporation doctrine

*The doctrinal cascade of the de facto corporation doctrine would always commence with the enterprise entering into a contract with an outsider and—*

1. The outsider brings an action against the enterprise as though it were a corporation, and the enterprise is held liable in corporate form
2. The enterprise subsequently brings actions in corporate form against the outsider, the outsider is held liable to the enterprise
3. The outsider brings an action against the component individuals, who are absolved from liability and the outsider is limited to his remedy against the enterprise only
4. The component individuals seek to hold the outsider liable on his contract, where logically the individuals are not allowed to recover, recovery must be by the enterprise

### Requisites for the de facto corporation doctrine:

1. The existence of a valid law under which the corporation may be incorporated
2. An attempt in good faith to incorporate, or existence of a colorable compliance with provisions on incorporation
3. The assumption by the enterprise of corporate powers (*Hall v. Piccio*)

### Corporation by estoppel doctrine

- The application of the doctrine seeks to enforce a contract where clearly the element of consent is lacking because one of the parties thereto, a purported corporation, does not in fact exist at the time of perfection.<sup>15</sup>

<sup>15</sup> Estoppel is a *common law* principle, on the theory that an admission or representation is rendered conclusive upon the person making it, and cannot be denied or disproved as

- Its origin is equity and is based on moral right and natural justice, and is designed to prevent injustice and unfairness.
- The corporation by estoppel doctrine is meant to hold contractual parties to their representations or expectations at the time the contract was perfected.
- It does not allow parties to draw on a basic defect-lack of one contracting party or defect in the essential element of consent to avoid the enforcement of the contract.

#### *Jurisprudential background*

- The general rule is that in the *absence of fraud*, a person who has contracted or otherwise dealt with an association in such a way as to recognize and in effect admit its legal existence as a corporate body is thereby *estopped to deny its corporate existence* in any action leading out of or involving such contract or dealing, unless its existence is attacked for causes which have arisen since making the contract or other dealing relied on as an estoppel and this applies to foreign as well as to domestic corporations (*Asia Banking Corp. v. Standard Products Co.*).
- While as a general rule a person who has contracted or dealt with a corporate body is estopped from denying the same in an action arising out of such transaction or dealing, yet this doctrine may not be held to be applicable where fraud takes a part in the said transaction (*Vda. de Salvatierra v. Garlitos*).
  - It instead applied Agency principles.<sup>16</sup>
  - *Salvatierra* is sufficient only when there is fraud or misrepresentation on the part of one of the contracting parties. It has no application to a situation where both parties to the contract acted in the honest belief that a contracting corporate entity did exist.
- Thus, § 20, RCC came into being.

**SEC. 20. Corporation by Estoppel.** – All persons who assume to act as a corporation knowing it to be without authority to do so shall be liable as general partners for all debts, liabilities and damages incurred or arising as a result thereof: *Provided, however,* That when any such ostensible corporation is sued on any transaction entered by it as a corporation or on any tort committed by it as such, it shall not be allowed to use its lack of corporate personality as a defense. Anyone who assumes an obligation to an ostensible corporation as such cannot resist performance thereof on the ground that there was in fact no corporation.<sup>17</sup>

against the person relying thereon and having changed his position based on such reliance.

<sup>16</sup> That of making the agent of an in-existent or undisclosed principal liable on the contract.

<sup>17</sup> The last sentence is a very powerful statement in *Corporate Law*, because if this is not present, the contract entered into will be void (due to lack of consent).

- § 20, as a fusion of *Albert* and estoppel doctrine, covers both fraud and no-fraud cases.
  - When fraud occurs, it makes the actor personally liable on the contract as a *general partner* (i.e., unlimitedly liable).
  - If there's no fraud, although it does not make persons acting for the purported corporation liable personally, it would prevent both sides from raising the non-existence of the corporation as a means to avoid enforcement of the contract.

*Quarendum: In no-fraud or no-misrepresentation cases, the § 20 would create a corporation when none exists to uphold the validity and enforceability of the contract, but ultimately does it not make the persons acting for the purported corporation liable? If so, how can enforcement be made effectively on a contract against a corporation that does not exist?*

- By using the term general partners, the implication under § 20 is that one who knows a corporation not to exist would be liable not only with what he purported to invest in the venture, but he could be held liable to all his properties, even those not actually invested or promised to be invested in the purported corporate venture.
- Therefore, one who acts for a purported corporation not knowing that it had no authority to do so would be liable, by way of distinction, only as a limited partner; that is, he would be liable only to the extent of his investment or promised investment in the purported corporate venture.
  - In a no-fraud or no-misrepresentation case, the persons acting in good faith for the purported corporation would still be personally liable, but only to the extent of their actual or promised investment in the corporate venture. This logically ties in with the limited liability feature of a purported corporation given legal recognition in the estoppel doctrine.

*Liability, if any, of investors who knew that there was no yet duly registered corporation and did not take active participation*

- All those who benefit from the transaction made by the ostensible corporation, despite knowledge of its legal defects, may be held liable for contracts they impliedly assented to or took advantage of (*Lim Tong Lim v. Philippine Fishing Gear*).
- With respect to *passive investors*, they are completely insulated from any liability, including what they invested or promised to invest (*Pioneer Insurance v. CA*).
- CLV: The resulting doctrine would therefore be that when there was a clear intention to form a partnership venture through a corporate vehicle, which essentially means that the partners had intended to be active participants in the business of

the corporation, then even those who did not directly participate in the contract or transaction being sued upon, but benefited therefrom may be held liable as general partners under the corporation by estoppel doctrine.

- When the investors intended only to invest in a corporate venture with no intention of participating in its corporate affairs, and the corporation was not formed, no partnership relation is deemed established by the failure to incorporate, and such investors cannot even be held liable for the contracts and transaction sued upon even when such contracts and transactions were entered into by the corporate actors in the name of an ostensible corporation.

- It deals with the “corporate capacity” to validly enter into contracts and transactions, and involves either of the following principles:
  - Doctrine of creature of limited powers
  - Doctrine of centralized management

**Types of ultra vires cases**

1. Those entered into or done beyond the powers of the corporation, as provided in the law or its AI<sup>19</sup>
2. Those entered into or done on behalf of the corporation by persons who have no corporate authority<sup>20</sup>
3. Acts/contracts which are illegal *per se* as being contrary to law

**Ultra vires of the third type**

- It concerns contracts of those which are essentially entered into in the name of the corporation, even when so done by its duly authorized officers, which are contrary to laws, morals or public policy
- Status: **void contracts!**
  - Basis: art. 1306, New Civil Code (freedom to contract; limitations)
- However, when *only private wrongs are involved*, the Courts tend to *enforce* the contract or transaction, even if the contract is illegal *per se!*

*Judicial attitude towards the ultra vires doctrine*

- Generally adverse (i.e., it will not be invoked as much as possible)
- CLV: Members of the public who deal in good faith with a corporation have a right to expect that their contracts with the corporation are valid and enforceable
- To rule otherwise (i.e., to strike down the corporate act or contract) would eventually undermine the public’s faith on the corporation

*Comparison with principles on unenforceable contracts*

- Except for the third type, the principles applicable in the 1st and 2nd types are similar to *Contract Law* principles on unenforceable contracts
  - Unenforceable contracts are valid but cannot be enforced or effected, unless there has been ratification
  - Unenforceable contracts cannot be assailed by 3rd persons
  - It is also *waived* when such contracts have been partially or fully executed
- Unauthorized acts that are merely beyond the powers of the corporation under its AI are not void *ab initio*
  - Thus, the act assailed may be enforced if the principal ratified it or allowed the other person to act as if he had full authority to do so

De facto corporation	Corporation by estoppel
Requires the filing of articles of incorporation and the issuance of a certificate of incorporation from the SEC	Does not require formal registration; applies when a non-existent corporation enters into contracts or dealings with third persons
Marks the beginning of corporate existence through the act of registration with the SEC	Founded on principles of equity to prevent injustice and unfairness when parties have dealt with an entity as a corporation
Considered to have corporate personality and the power to acquire and possess property despite certain defects in organization	Affords an unorganized entity corporate fiction and juridical personality for the <i>sole purpose</i> of upholding a specific contract or transaction
Its incapacity cannot be questioned collaterally	A person who assumes an obligation to an ostensible corporation cannot resist performance by denying the corporation's existence

- It’s important to correctly identify the applicable rules, because the liability rules are different.
  - In promoter’s contracts, the *Law on Agency* is applicable.
    - The parties know full well that the corporation does not exist!
  - Whereas in corporation by estoppel doctrine, the liabilities are determined under § 20, RCC.

**Ultra vires doctrine**

**Sec. 44. Ultra Vires Acts of Corporations.** – No corporation shall possess or exercise corporate powers other than those conferred by this Code or by its articles of incorporation and except as necessary or incidental to the exercise of the powers conferred.<sup>18</sup>

<sup>18</sup> This provision pertains to the *ultra vires* of the 1st type.

<sup>19</sup> See chapter 8.

<sup>20</sup> See chapter 9.

## Chapter 6

### Articles of Incorporation

#### Contractual significance

- It is the corporate charter as a a contract between the
  - Corporation and State
  - Shareholders and State
  - Corporation and Shareholders
- Thus, the consent of all three parties contractually bond is required in amending the articles of incorporation:
  - The State, acting through the SEC
  - The corporation as a separate legal entity acting through its BOD
  - The group of shareholders, represented by its qualified majority ratification vote
- The formalities required for the adoption, registration and amendment of the articles of incorporation embodies the principle of *mutuality* and doctrine of *obligatory force*.

#### Articles of incorporation as the charter

- The articles of incorporation constitutes the charter and the basis by which to adjudge whether it exists for legal purposes, and the extent of its powers and capacities (juridical capacity)

#### Registration of the articles of incorporation

- Articles of incorporation do not become binding as the charter of the corporation unless they have been filed and registered with, and certified by, the SEC
- It is a *solemn contract*

**SEC. 13. Contents of the Articles of Incorporation.** - All Corporations shall file with the Commission articles of incorporation in any of the official languages, duly signed and acknowledged or authenticated, in such form and manner as may be allowed by the Commission, containing substantially the following matters, except as otherwise prescribed by this Code or by special law:

- (a) The name of the corporation;
- (b) The specific purpose or purposes for which the corporation is being formed. Where a corporation has more than one stated purpose, the articles of incorporation shall indicate the primary purpose and the secondary purpose or purposes: Provided, That a nonstock corporation may not include a purpose which would change or contradict its nature as such;
- (c) The place where the principal office of the corporation is to be located, which must be within the Philippines;
- (d) The term for which the corporation is to exist, if the corporation has not elected perpetual existence;
- (e) The names, nationalities, and residence addresses of the incorporators;

(f) The number of directors, which shall not be more than fifteen (15) or the number of trustees which may be more than fifteen (15);

(g) The names, nationalities, and residence addresses of persons who shall act as directors or trustees until the first regular directors or trustees are duly elected and qualified in accordance with this Code;

(h) If it be a stock corporation, the amount of its authorized capital stock, number of shares into which it is divided, the par value of each, names, nationalities, and residence addresses of the original subscribers, amount subscribed and paid by each on the subscription, and a statement that some or all of the shares are without par value, if applicable;

(i) If it be a nonstock corporation, the amount of its capital, the names, nationalities, and residence addresses of the contributors, and amount contributed by each; and

(j) Such other matters consistent with law and which the incorporators may deem necessary and convenient.

An arbitration agreement may be provided in the articles of incorporation pursuant to Section 181 of this Code.

The articles of incorporation and applications for amendments thereto may be filed with the Commission in the form of an electronic document, in accordance with the Commission's rules and regulations on electronic filing.

**SEC. 17. Corporate Name.** - No corporate name shall be allowed by the Commission if it is not distinguishable from that already reserved or registered for the use of another corporation, or if such name is already protected by law, or when its use is contrary to existing law, rules and regulations.

A name is not distinguishable even if it contains one or more of the following:

- (a) The word "corporation", "company", "incorporated", "limited", "limited liability", or an abbreviation of one of such words; and
- (b) Punctuations, articles, conjunctions, contractions, prepositions, abbreviations, different tenses, spacing, or number of the same word or phrase.

The Commission, upon determination that the corporate name is: (1) not distinguishable from a name already reserved or registered for the use of another corporation; (2) already protected by law; or (3) contrary to law, rules and regulations, may summarily order the corporation to immediately cease and desist from using such name and require the corporation to register a new one. The Commission shall also cause the removal of all visible signages, marks, advertisements, labels, prints and other effects bearing such corporate name. Upon the approval of the new corporate name, the Commission shall issue a certificate of incorporation under the amended name.

If the corporation fails to comply with the Commission's order, the Commission may hold the corporation and its responsible directors or officers in contempt and/or hold

them administratively, civilly and/or criminally liable under this Code and other applicable laws and/or revoke the registration of the corporation.

#### Purpose clause

- The significance of the purpose clause in the AI is that it *confers* and *limits* the powers that a corporation may exercise
- The purpose clause must specify the primary and secondary purposes
  - The secondary purpose need not be connected to the primary purpose
- The purposes must be lawful
- Per § 41, RCC, if the BOD decides to invest corporate funds into a *nonprimary purpose*, they shall first obtain the ratification vote of the shareholders!

#### Rule on interpretation on purpose clauses

- It is to be construed as including incidental powers *reasonably* necessary to the proper exercise of the enumerated powers and as excluding all other nonenumerated powers

#### Corporate term

**SEC. 11. Corporate Term.** - A corporation shall have perpetual existence unless its articles of incorporation provides otherwise.

Corporations with certificates of incorporation issued prior to the effectivity of this Code, and which continue to exist, shall have perpetual existence, unless the corporation, upon a vote of its stockholders representing a majority of its outstanding capital stock, notifies the Commission that it elects to retain its specific corporate term pursuant to its articles of incorporation: Provided, That any change in the corporate term under this section is without prejudice to the appraisal right of dissenting stockholders in accordance with the provisions of this Code.

A corporate term for a specific period may be extended or shortened by amending the articles of incorporation: Provided, That no extension may be made earlier than three (3) years prior to the original or subsequent expiry date(s) unless there are justifiable reasons for an earlier extension as may be determined by the Commission: Provided, further, That such extension of the corporate term shall take effect only on the day following the original or subsequent expiry date(s).

A corporation whose term has expired may apply for a revival of its corporate existence, together with all the rights and privileges under its certificate of incorporation and subject to all of its duties, debts and liabilities existing prior to its revival. Upon approval by the Commission, the corporation shall be deemed revived and a certificate of revival of corporate existence shall be issued, giving it perpetual existence, unless its application for revival provides otherwise.

No application for revival of certificate of incorporation of banks, banking and quasi-banking institutions, preneed, insurance and trust companies, non-stock savings and loan

associations (NSSLAs), pawnshops, corporations engaged in money service business, and other financial intermediaries shall be approved by the Commission unless accompanied by a favorable recommendation of the appropriate government agency.

- Perpetual existence is *now* the default rule

#### Effect on existing corporations organized under the old Corp. Code

- These corporations shall have perpetual existence, unless it elects to retain a specific corporate term by a vote of the majority of the stockholders' outstanding capital stock

#### Extension of corporate term

- It may be extended by an amendment to the AI, provided that *no* extension can be made earlier than 3 years prior to the original or subsequent expiry date, unless there are justifiable reasons

#### Amendments to, or revisions of, the AI

**SEC. 15. Amendment of Articles of Incorporation.** -Unless otherwise prescribed by this Code or by special law, and for legitimate purposes, any provision or matter stated in the articles of incorporation may be amended by a majority vote of the board of directors or trustees and the vote or written assent of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, without prejudice to the appraisal right of dissenting stockholders in accordance with the provisions of this Code. The articles of incorporation of a nonstock corporation may be amended by the vote or written assent of majority of the trustees and at least two-thirds (2/3) of the members.

The original and amended articles together shall contain all provisions required by law to be set out in the articles of incorporation. Amendments to the articles shall be indicated by underscoring the change or changes made, and a copy thereof duly certified under oath by the corporate secretary and a majority of the directors or trustees, with a statement that the amendments have been duly approved by the required vote of the stockholders or members, shall be submitted to the Commission.

The amendments shall take effect upon their approval by the Commission or from the date of filing with the said Commission if not acted upon within six (6) months from the date of filing for a cause not attributable to the corporation.

## Chapter 7 Bylaws

#### Nature

- Bylaws are essentially intramural documents that govern the relationship between and among the members of a corporate family
- It is a private document, thus, it cannot create rights or be used to restrict rights

- Thus, the court struck down a bylaw provision granting the corporation a ROFR over shares of stock sought to be sold by a shareholder (*Fleischer v. Botica*)
- Implicit in *Fleischer* is that **it is not the function of bylaws to take away or abridge the substantial rights of shareholders**. This may only be done by law or through the articles of incorporation.
- Bylaws are subordinate to the AI (*Loyola Grand Villas v. CA*)
- Bylaws constitute as a binding contract between the corporation and its shareholders, and among the shareholders (*Forest Hills v. Gardpro*)
  - Being an internal document, the SEC's participation is merely to exercise regulatory supervision over its registration
- Since bylaw provisions are intramural in nature and are not meant to bind parties outside the corporate family, it stands to reason that *public dealings with the corporation are not supposed to be interested in the provisions of its bylaws*, and therefore should not be bound thereby
  - Exception: Bylaws bind 3rd parties when such 3rd parties acquired knowledge of the pertinent bylaws at the time the transaction or arrangement was entered into (*China Banking Corp. v. CA*)
- The power to adopt bylaws is inherent in every corporation as one of its necessary and inseparable legal incidents (*Gokongwei Jr. v. SEC*)
  - Thus, it exists even without the express mention in § 35, RCC

#### Common law principles on bylaws

1. Bylaw provisions cannot contravene the law
  - a. Thus, a provision granting someone a permanent board seat is invalid for contradicting the rule that all directors must be elected annually
2. Bylaws cannot contravene the charter
  - a. Thus, any provision in the bylaws that contravenes the provision in the AI must give way to the AI provision, even when the nature of the subject matter is something that would normally be found provided for in the bylaws, rather than the AI
3. Bylaws must be reasonable and nondiscriminatory

#### Adoption of bylaws

**Section 45. Adoption of Bylaws.** - For the adoption of bylaws by the corporation, the affirmative vote of the stockholders representing at least a majority of the outstanding capital stock, or of at least a majority of the members in case on nonstock corporations, shall be necessary. The bylaws shall be signed by the stockholders or members voting for them and shall be kept in the principal office of the corporation, subject to the inspection of the stockholders or members during office hours. A copy thereof, duly certified by a majority of the directors or

trustees and countersigned by the secretary of the corporation, shall be filed with the Commission and attached to the original articles of incorporation.

Notwithstanding the provisions of the preceding paragraph, bylaws may be adopted and filed prior to incorporation; in such case, such bylaws shall be approved and signed by all incorporators and submitted to the Commission, together with the articles of incorporation.

In all cases, bylaws shall be effective only upon the issuance by the Commission of a certification that the bylaws are in accordance with this Code.

The Commission shall not accept for filing the bylaws or any amendment thereto of any bank, banking institution, building and loan association, trust company, insurance company, public utility, educational institution, or any other corporations governed by special laws, unless accompanied by a certificate of the appropriate government agency to the effect that such by laws or amendments are in accordance with law.

#### Basic contents of bylaws

**Section 46. Contents of Bylaws.** - A private corporation may provide the following in its bylaws;

- (a) The time, place and manner of calling and conducting regular or special meetings of the directors or trustees;
- (b) The time and manner of calling and conducting regular or special meetings and mode of notifying the stockholders or members thereof;
- (c) The required quorum in meetings of stockholders or members and the manner of voting therein;
- (d) The modes by which a stockholder, member, director or trustees may attend meetings and cast their votes;
- (e) The form for proxies of stockholders and members and the manner of voting them;
- (f) The directors' or trustees' qualifications, duties and responsibilities, the guidelines for setting the compensation of directors or trustees and officers, and the maximum number of other board representations that an independent director or trustee may have which shall, in no case, be more than the number prescribed by the Commission;
- (g) The time for holding the annual election of directors or trustees and the mode or manner of giving notice thereof;
- (h) The manner of election or appointment and the term of officers other than directors or trustees;
- (i) The penalties for violation of the bylaws;
- (j) In the case of stock corporations, the manner of issuing stock certificates; and
- (k) Such other matters as may be necessary for the proper or convenient transaction of its corporate affairs for the promotion of good governance and anti-graft and

corruption measures.

An arbitration agreement may be provided in the bylaws pursuant to Section 181 of this Code .

*Other matters that may be included in the bylaws*

1. Designation of time and when voting rights may be exercised by shareholders of record
2. Providing for additional officers for the corporation
3. Provisions for the compensation of the directors
4. Creation of an ExeCom, ManCom, and other board committees
5. Date of the ASM
6. Quorum
7. Providing for the presiding officer at meetings of the directors or trustees, and shareholders or members
8. Procedure for the issuance of stock certificates
9. Providing for interest on unpaid subscriptions
10. Entries to be made in the stock and transfer book
11. Providing for meetings of the members in a nonstock corporation outside its principal office

*Matters that may be found both in the AI and bylaws*

1. Providing for an arbitration agreement
2. Providing for cumulative voting in nonstock corporations
3. Providing for a higher quorum requirement for a valid board meeting
4. Limiting, broadening or denial of the right to vote, including voting by proxy, for members in a nonstock corporation
5. Transferability of membership in a nonstock corporation
6. Termination of membership in nonstock corporations
7. Manner of election and term of office of trustees and officers in nonstock corporations
8. Manner of distribution of assets in nonstock corporation upon dissolution
9. Providing for staggered board in educational institutions

*Matters that cannot be provided for in the bylaws*

1. Classification of shares and preferences granted to preferred shares
2. Provisions on founder's shares
3. Providing for redeemable shares
4. Provisions on the purposes of the corporation
5. Providing for a specific term of existence
6. Capitalization of stock corporations
7. Corporate name
8. Denial of preemptive rights

**Amendments to, or revisions of, the bylaws**

**Section 47. Amendment to Bylaws.** - A majority of the board of directors or trustees, and the owners of at least a majority of the outstanding capital stock, or at least a majority of the members of a nonstock corporation, at a regular or special meeting duly called for the purpose, may

amend or repeal the bylaws or adopt new bylaws. The owner of two-thirds (2/3) of the outstanding capital stock or two-third (2/3) of the members in a nonstock corporation may delegate to the board of directors or trustees the power to amend or repeal the bylaws or adopt new bylaws: Provided, That any power delegated to the board of directors or trustee to amend or repeal the bylaws or adopt new bylaws shall be considered as revoke whenever stockholders owning or representing a majority of the outstanding capital stock or majority of the members shall so vote at a regular or special meeting.

Whenever the bylaws are amended or new bylaws are adopted, the corporation shall file with the Commission such amended or new bylaws and, if applicable, the stockholders' or members' resolution authorizing the delegation of the power to amend and/or adopt new bylaws, duly certified under oath by the corporate secretary and majority of the directors or trustees.

The amended or new bylaws shall only be effective upon the issuance by the Commission of certification that the same is in accordance with this Code and other relevant laws.

## Chapter 8

### Corporate Powers and Juridical Capacity to Act

#### Underlying theories

- A corporation has no power except those expressly conferred on it by the Corporation Code and its charter, and those that are implied or incidental to its existence
- In turn, a corporation exercises its powers through its BOD and/or its duly authorized officers and agents

#### Doctrine of creature of limited powers

- Per the *theory of concession*, corporations are completely within the control of the state and, thus, a creature of limited powers
- The treatment of this doctrine finds its jurisprudential application in the classic *ultra vires* doctrine (§ 44, RCC)
- Under the *ultra vires doctrine*, a corporation has only three types of powers that would give rise to the *intra vires* and valid contracts or transactions:
  - Express
  - Implied
  - Incidental

#### Attribute of centralized management

- The source of power of the BOD is therefore primary and directly vested by law
- In the absence of statutory provisions to the contrary, the consent of the corporation in all contracts and transactions that it enters into as a contracting party is effected through its Board under the doctrine of Centralized Management.
- Even in the exercise of express powers of the corporation, in the absence of an authority from the

BOD, no person, not even the officers thereof, can validly bind the corporation

#### *Element of 'consent' in corporate dealings*

- There are specified instances where the particular exercise of corporate power by the BOD, to be binding and effective, requires the consent or ratification of the shareholders or members, and even State's consent
- Shareholders consent is recognized either by their majority vote or qualified two-thirds vote
- Still, the RCC recognizes that in certain instances a dissenting shareholder whose contractual expectation has been frustrated are given to withdraw from the confines of the corporate contractual relationship
  - In such instances, the dissenting stakeholder is granted the right of appraisal

#### **Corporate powers and capacity**

##### *Express powers*

- Juridical persons may acquire and possess property of all kinds, and incur obligations and bring civil/criminal actions (§ 46, RCC)

**Section 35. Corporate Powers and Capacity.** - Every corporation incorporated under this Code has the power and capacity:

- (a) To sue and be sued in its corporate name;
- (b) To have perpetual existence unless the certificate of incorporation provides otherwise;
- (c) To adopt and use a corporate seal;
- (d) To amend its articles of incorporation in accordance with the provisions of this Code;
- (e) To adopt bylaws, not contrary to law, morals or public policy, and to amend or repeal the same in accordance with this Code;
- (f) In case of stock corporations, to issue or sell stocks to subscribers and to sell treasury stocks in accordance with the provisions of this Code; and to admit members to the corporation if it be a nonstock corporation;
- (g) To purchase, receive, take or grant, hold, convey, sell, lease, pledge, mortgage, and otherwise deal with such real and personal property, including securities and bonds of other corporations, as the transaction of the lawful business of the corporation may reasonably and necessarily require, subject to the limitations prescribed by law and the constitution;
- (h) To enter into a partnership, joint venture, merger, consolidation, or any other commercial agreement with natural and juridical persons;
- (i) To make reasonable donations, including those for the public welfare or for hospital, charitable, cultural, scientific, civic, or similar purposes: Provided, That no foreign

corporation shall give donations in aid of any political party or candidate or for purposes of partisan political activity;

(j) To establish pension, retirement, and other plans for the benefit of its directors, trustees, officers, and employees; and

(k) To exercise such other powers as may be essential or necessary to carry out its purpose or purposes as stated in the articles of incorporation.

- Some of the powers are really inherent powers (e.g., power to adopt and amend a set of bylaws), but are regulated powers under the RCC

##### Power to sue and be sued

- The exercise of such power lies within the business discretion of the BOD
  - Thus, a minority stockholder and member of the BOD has no power to sue on behalf of the corporation
  - For a *derivative suit* to prosper, it is required that the minority shareholder suing must allege in his complaint that he is suing on a derivative cause of action

##### Powers to sell, lease, dispose, or encumber assets

- Under these provisions, the power to purchase real property is vested in the board of directors or trustees.
  - While a corporation may appoint agents to negotiate for the purchase of real property needed by the corporation, the final say will have to be with the board, whose approval will finalize the transaction.
  - A corporation can only exercise its powers and transact its business through its board of directors and through its officers and agents when authorized by a board resolution or its by-laws
- investments of a corporation in another corporation in the form of shares of stock constitute part of the assets or property of the investor corporation, and cannot be legally disposed of by mere endorsement of the president, since such shares fall within disposition of property and assets being part of the powers of the Board (*SEC op.*)
- Since sale of land owned by a corporation can only be effected through an agent other than directly by the BOD, the provisions of the *Law on Agency* on sale of land take precedence over corporate doctrines of estoppel and apparent authority
  - Thus, when a sale of land is through an agent, the lack of a written SPA would make the sale void (art. 1874, NCC) and there would be no ratification
- The corporate power to grant/convey its properties is circumscribed by the phrase "as the transaction of the lawful business of the corporation may reasonably and necessarily require."

- Which must be determined in relation to its primary purpose

- What would constitute “reasonable” would remain a business test, in that corporate donations must be of such nature and of such amount that they promote the best interest of the corporation and its shareholders, in the sense that the main purpose is to build the name and goodwill of the company as a good corporate citizen

#### Power to borrow or enter into loans

- It is an inherent/implicit power of every corporation since it flows from it being granted the capacity to contract or to obligate itself as a juridical person
- The express power to enter into the accessory contracts of “pledge” or “mortgage” under § 35 (g) necessarily include the power to enter into the principal contract of loan
- The power of an agent to borrow money on behalf of the principal is one of those cases that require the existence of a special power of attorney (*Yasuma v. Heirs of De Villa*)
  - See art. 1878.
- Generally, the decision to borrow money to finance the operations of the corporate enterprise falls within the business discretion of the BOD of every corporation.
  - Exception: Under § 37 of the Code, when the corporation shall incur or increase a bonded indebtedness.

#### Power to enter into partnerships, JV or any other commercial agreements

- Under the RCC, there is no longer any doubt that private corporations have full power and authority to enter into partnership, joint venture and other commercial arrangements, without need of a specific enabling power in their articles of incorporation.

#### Power to make reasonable donations

- The power of every corporation to make charitable donations nowadays seems like an incidental power, and its enumeration in § 35 may be considered redundant
- The BOD has a fiduciary obligation to the shareholders to operate the corporation and manage its business enterprise for their benefit as beneficial or equitable owners of the corporate property and assets
- It would be a breach of trust on the part of the BOD to appropriate for themselves the benefits arising from the corporate enterprise, or to donate corporate property
- It is recognized that the Board may, in the exercise of its business judgment, discharge certain social responsibilities towards society, to maintain the corporation as a good corporate citizen in a way that does not undermine their main obligations to their shareholders
- “Reasonable donations” embodies the limitation on the part of the BOD in exercising such power
  - Any donation made that is unreasonable would be an abuse of the Board’s business judgment, and a breach of their fiduciary obligations to the corporation and its shareholders

- Thus, if donations constitute merely a wastage or have no reasonable means of enhancing the business enterprise, then they would be unreasonable donations and amount to being *ultra vires* acts

#### Power to grant pension, retirement and other gratuities

- The underlying rationale for the express power of corporation to grant gratuities is that they engender loyalty among the corporation’s officers and employees and grants them motivation to remain with the corporation, and thereby increase their productivity and avoid wastage occurring through unnecessary high turn-over of personnel
  - Such resolution does not also require the ratification of the shareholders
- Exercise of the power to favor directors or trustees<sup>21</sup>
  - When a corporation grants such benefits to its directors or trustees, the corporate decision is really being made by the BOD—a conflict of interest
  - The empowerment under § 35 (j) is contrary to § 29, which provides that directorship is an honorary and nonremunerative position, except for reasonable *per diems*
  - It is doubtful whether directors and trustees, acting as such, will ever be entitled to pension or retirement rights, for they essentially have no employer-employee relationship with the corporation, even when they have been in service for a long period of time
    - There is no security of tenure for directors and trustees (see § 22, RCC)

#### **Implied or necessary powers**

- § 35 (k), RCC covers the implied or necessary powers, which exist as a necessary consequence of the grant to, and/or exercise of the express powers by, the corporation or the pursuit of its purposes as provided for in the articles of incorporation
- The rule may thus be stated that the Board of Directors and/or its duly authorized officers, in absence of express restrictions, have discretionary authority to enter into contracts or transactions which may be deemed reasonably necessary or incidental to its business purposes

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<sup>21</sup> The portion of Section 35 (j) of the Revised Corporation Code that expressly empowers the corporation to establish pension, retirement and other plans for “directors, trustees,” remains controversial.

- For instance, the act of issuing the checks was well within the ambit of a valid corporate act, for it was for securing a loan to finance the activities of the corporation, hence, not an ultra vires act. In another case (*Atrium v. CA*)
- Likewise, a nonrealty corporation has the implied power to lease-out idle real property (SEC op.)

#### Incidental powers

- Incidental powers are those that attach to a corporation at the moment of its creation without regard to its particular primary or secondary purposes, and may be said to necessarily arise from its being a juridical person engaged in business
  - Many of such inherent or incidental powers have been incorporated under § 35
- The powers that go into the very nature and extent of a corporation's juridical entity cannot be presumed to be incidental or inherent powers

#### Ultra vires acts of the first type

- A corporate act, contract or transaction must fall within a corporation's express, implied or incidental powers; otherwise, it would be *ultra vires* and void for being in contravention of a corporate policy
- An act which cannot fall under a corporation's express or necessary or incidental powers is an *ultra vires* act

#### Ultra vires test

- **If that act is one which is lawful in itself, and not otherwise prohibited, is done for the purpose of serving corporate ends, and is reasonably tributary to the promotion of those ends, in a substantial, and not in a remote and fanciful sense, it may fairly be considered within charter powers** (*Montelibano* test).
  - If so, the corporation has the power to do it; otherwise, not (*Montelibano* test).
- When the corporate business enterprise is used as the reference point, much latitude is given to the corporation to enter into various contracts as long as they have a logical relation to the pursuit of such business

#### Supervening policies in ultra vires issues

- If contracts of corporations could be set aside by the mere showing that they do not fall within the language of the purpose clause of the articles of incorporation, then the public dealing with corporations would be wary of entering into contracts with corporate entities
  - More importantly, setting aside the corporate contract on the ground that the corporation has no express authority, would contravene the expectations of both parties, who entered into the contract expecting to be bound
- The defense of ultra vires rests on violation of trust or duty toward stockholders, and should not be

entertained where its allowance will do greater wrong to innocent parties dealing with the corporation

- The trend has been to move away from holding corporate acts and contracts as ultra vires, because of the philosophy underlying the business judgment rule, which provides that courts will not sit in judgment to substitute their business judgment for that of the directors

#### Ultra vires act are not per se illegal

- An act that is illegal<sup>22</sup> *per se* is void, while an act which isn't or is merely prohibited by law is subjected to a test to determine whether it's *intra vires* or *ultra vires*
- *Ultra vires* acts are those that are *not illegal* and are within the scope of the articles of incorporation are merely **voidable** and may be binding and enforceable when ratified by shareholders

#### Doctrine of estoppel or ratification

- Even when a transaction does not pass the *Montelibano* test, the transaction would nevertheless be binding on the corporation based on the doctrine of estoppel

#### Ultra vires of the third type

- Although a contract or transaction may fall within the corporate powers of a corporation, if it is done against the provisions of law, such contract or transaction would be void
- However, even when corporate contracts are illegal *per se*, when only public or government policy is at stake and no private wrong is committed, the courts will leave the parties as they are (see *Harden v. Benguet Consolidated Mining Co.*)
- But when it comes to specific corporate powers governed by the RCC, there must be strict observance of the procedures mandated by the covering provisions, otherwise the act/contract is void—even against a third party who may have acted in good faith (see *succeeding discussions*)

#### Power to sell, dispose, lease or encumber all or substantially all property and assets

**Section 39. Sale or Other Disposition of Assets.** - Subject to the provisions of Republic Act No. 10667, otherwise known as the "Philippine Competition Act", and other related laws a corporation may, by a majority vote of its board of directors or trustees, sell, lease, exchange, mortgage, pledge, or otherwise dispose of its property and assets, upon such terms and conditions and for such consideration, which may be money, stock, bonds, or other instruments for the payment of money or other property or consideration, as its board of directors or trustees may deem expedient.

<sup>22</sup> "Illegal acts" are those that are contrary to law, morals, or public order, or contravene some some rules of public policy or public duty (*Pirovano v. De la Rama Steamship Co.*).

A sale of all or substantially all of the corporation's properties and assets, including its goodwill, must be authorized by the vote of stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or at least two-thirds (2/3) of the members, meeting duly called for the purpose.

In nonstock corporations where there are no members with voting rights, the vote of at least a majority of the trustees in office will be sufficient authorization for the corporation to enter into any transaction authorized by this section.

The determination of whether or not the sale involves all or substantially all of the corporation's properties and assets must be computed based on its net asset value, as shown in its latest financial statements. A sale or other disposition shall be deemed to cover substantially all the corporate property and assets if thereby the corporation would be rendered incapable of continuing the business or accomplishing the purpose of which it was incorporated.

Written notice of the proposed action and of the time and place for the meeting shall be addressed to stockholders or members at their places of residence as shown in the books of the corporation and deposited to the addressee in the post office with postage prepaid, served personally, or when allowed by the bylaws or done with the consent of the stockholder, sent electronically: Provided, That any dissenting stockholder may exercise the right of appraisal under the conditions provided in this Code.

After such authorization or approval by the stockholders or members, the board of directors or trustees may, nevertheless, in its discretion, abandon such sale, lease, exchange, mortgage, pledge, or other disposition of property and assets, subject to the rights of third parties under any contract relating thereto, without further action or approval by the stockholders or members.

Nothing in this section is intended to restrict the power of any corporation, without the authorization by the stockholders or members, to sell, lease, exchange, mortgage, pledge, or otherwise dispose of any of its property and assets if the same is necessary in the usual and regular course of business of the corporation or if the proceeds of the sale or other disposition of such property and assets shall be appropriated for the conduct of its remaining business.

- CLV: The proper interpretation is that in *any* sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of all the corporate properties and assets would still require the shareholders' ratification vote

#### *Nature of power to sell all or substantially all of the assets*

- It is both an inherent and express power and can be exercised by the corporation through its BOD
- Meanwhile, the power to sell all or substantially all is an *extraordinary transaction* and requires—in addition to the majority vote of the BOD—the ratification vote of shareholders representing at least  $\frac{2}{3}$  of the outstanding capital stock

#### *Nature of transactions covered*

- Rationale for ratification vote: The law recognizes the shareholders' common law right to the corporate business enterprise
  - This stems from the theory of business enterprise
- Thus, the transaction is void for lack of shareholders' ratification

#### **Transactions not covered by ratification requirements**

- No ratification required in:
  - Transaction that's necessary in the usual and regular course of business of the corporation
  - The proceeds of the sale or other disposition of such property and assets shall be appropriate for the conduct of its remaining business
- These are transactions within the ordinary course of business—only a majority vote of the board members present is required
- "All or substantially all" – The business enterprise.
  - Because even if most assets remain after the transaction, the ability to earn profit may no longer be present, *i.e.*, the corporation ceases to be a going concern

#### **Tests to determine whether the transaction covers "all or substantially all" of the property/assets**

1. Quantitative test – The determination of whether or not the sale involves all or substantially all of the corporation's properties and assets must be computed based on its net asset value, as shown in its latest financial statements
2. Qualitative test – A sale or other disposition shall be deemed to cover substantially all the corporate property and assets if thereby the corporation would be rendered incapable of continuing the business or accomplishing the purpose of which it was incorporated

#### *Qualitative test*

- CLV: This presents difficulties
- In all transactions, the corporation will always receive proceeds
- The only time when this is clear is when the purpose clause of the business is conditioned upon the corporation having a valuable formula without which the purpose can no longer be achieved
- **Therefore, the qualitative test is one of practicality in being able to pursue the primary purpose of the corporation**

#### *Quantitative test*

- CLV: When the parameters of the quantitative test have been provided for, the quantitative test *prevails* over the qualitative test
- SEC MC No. 12-2020: The sale or disposal of PLC property and assets amounting to at least 51% of the

corporation's total assets shall be considered as sale of all or substantially all of corporate property and assets

- Therefore, shareholders' ratification is required

*Lease or encumbrance of all or substantially all of the assets*

- Why?
  - The encumbrance has the potential of disrupting the pursuit of the corporate business (i.e., if the corporation defaults, foreclosure ensues)
  - It's likely to fall under the same category of incurring or creating bonded indebtedness under § 37

*Legal effects of the lack of ratification vote*

- It's an *ultra vires* of the 2nd type
- The contract or transaction is **void** (*Peña v. CA; Islamic Directorate v. CA*)

**Power to invest corporate funds in another corporation or business enterprise**

- A corporation may invest its fund in any other corporation or business or for any purpose other than its primary purpose when approved by a majority of the BOD *and* ratified by the shareholders representing at least  $\frac{2}{3}$  of the outstanding capital stock

*Rationale of the rule*

- When a corporation invests fund in another corporation or business enterprise other than pursuant to its primary purpose, even if it seeks to pursue a secondary purpose provided
- Whenever the corporation seeks to engage into a secondary purpose allowed under its AI, though *intra vires*, it must seek shareholders' approval

*Investments that may be considered within primary purpose*

- All corporations whatever may be their primary purposes, are deemed to have the power to invest corporate funds in another corporation or business, as a means of obtaining the best returns of their investible funds
  - Thus, shareholders' ratification is not required!
- The exercise of such business judgment on the part of the BOD is consistent with the primary purpose, since even shareholders or members have a right to expect that it is within the ordinary business discretion of the board to place the corporation's investible fund in the form of investment that would yield the best possible return to the corporation, and would not require the ratification of the shareholders each time
- Technically and legally speaking, investing funds, including those in equity shares, constitute incidental powers falling within every corporation's primary purpose, *except when covered by § 41, RCC*

*Investments outside of secondary purposes*

- Investments by the corporation to pursue a business or activity within the secondary purpose are covered by § 41, RCC
- CLV: The ratification vote to legally allow a corporation to invest funds outside of its primary purpose would be limited to pursuing the corporation's secondary purpose!
- In summary:
  - Primary purpose – Only board action
  - Secondary purpose – Board action and shareholders' ratification
  - Others – Not allowed; AI must be amended

*Consequences of nonobtaining ratification vote*

- The transaction is deemed *ultra vires* of the 2nd type, because it is unauthorized
- CLV: It's **void** for lack of "full consent"

**Power to enter into management contract**

**Section 43. Power to Enter into Management Contract. -**

No corporation shall conclude a management contract with another corporation unless such contract is approved by the board of directors and by the stockholders owning at least the majority of the outstanding capital stock, or by at least a majority of the members in the case of a nonstock corporation, or both the managing and the managed corporation, at a meeting duly called for the purpose: Provided, That (a) where a stockholder or stockholders representing the same interest of both the managing and the managed corporations own or control more than one-third (1/3) of the total outstanding capital stock entitled to vote of the managing corporation; or (b) where a majority if the members of the board of directors of the managing corporation also constitute a majority of the members of the board of directors of the managed corporation, then the management contract must be approved by the stockholders of the managed corporation owning at least two-thirds (2/3) of the total outstanding capital stock entitled to vote, or by at least two-thirds (2/3) of the members in the case of a nonstock corporation.

These shall apply to any contract whereby a corporation undertakes to manage or operate all or substantially all of the called services contracts, operating agreements or otherwise: Provided, however, That such service contracts or operating agreements which relate to the exploration, development exploitation or utilization of natural resources may entered into such periods as may be provided by the pertinent laws or regulations.

No management contracts shall be entered into for period longer that five (5) years for any one term.

*Coverage of management contract*

- A contract whereby a corporation undertakes to manage or operate all or substantially all of the business of another corporation

*Cases not covered by § 43*

- § 43 does not expressly cover within its provisions the situation when the managed corporation enters into a management contract with an *individual or group of individuals, or a partnership*

corporation shall be bound only through its BOD, or a duly-authorized representative.

## Chapter 9

### Board of Directors/Trustees and Officers

**SEC. 22.** *The Board of Directors or Trustees of a Corporation; Qualification and Term.* - Unless otherwise provided in this Code, the board of directors or trustees shall exercise the corporate powers, conduct all business, and control all properties of the corporation. [xxx]

#### Theories on the source of power and authority of the BOD

1. Theory of Original Power – The BOD's power and authority to represent the corporation is vested directly by law, and thereby constitutes the Board as the very embodiment or alter ego of the corporation.
2. Theory of Delegated Power – The authority exercised by the BOD is viewed as delegated to them by shareholders or members of the corporation. This prompts the notion of “agency” in a corporate setup.

#### Peculiar agency role of the BOD vis-a-vis the corporation

- Under § 22 (strictly speaking), any other officer designated to represent the corporation is a mere appointee or sub-agent of the BOD
- The delegation of BOD of powers to the officer makes the latter agents of the corporation. Accordingly, the *Law on Agency* applies.<sup>23</sup>
- Thus, in the absence of an authority from the BOD, no person—not even the officers—can validly bind the corporation.
- CLV: The BOD acts both as an agent and the very personification of the corporation in the commercial and legal world.
  - The corporation cannot think. The BOD is the very personification of the corporation itself.

#### Doctrine of centralized management

- A corporation's BOD is understood to be that body which:
  - Exercises all powers provided for under the RCC
  - Conducts all businesses of the corporation
  - Controls and holds all property of the corporation
- Rationale: The doctrine promotes efficiency and prevents confusions arising from diffused corporate powers
  - Investors and creditors can rely upon the statutorily-mandated fact that the

<sup>23</sup> But as between the directors and the shareholders, the relationship is that of *Trusts*. The directors are the trustee, while the shareholders are the trustors and beneficiaries. Thus, the directors owe a fiduciary duty to the shareholders, but *not* the duty of obedience.

#### Ultra vires acts of the second type

- Any contract entered into on behalf of the corporation where consent does *not* emanate from the BOD is *void* (or at least unenforceable), for lack of the essential element of consent.
  - In addition, only an authorized agent binds the principal, the legal consequence is that the acts and contracts entered into by corporate officers on behalf of the corporation would be valid only if they have been so authorized or empowered by the BOD.
- Thus, as a general rule, only the acts of corporate officers within the scope of their authority are binding on the corporation.
  - If the agent acts beyond, their actions cannot bind the corporation, unless it has ratified such acts or is estopped from disclaiming them.
  - The officer acting without proper authority cannot be the basis upon which to bind the corporation through ratification, nor can third parties rely upon such unauthorized act to bind the corporation.
    - Status of contract: Unenforceable
- Nevertheless, the plea of *ultra vires* will not be allowed to prevail, whether interposed for or against a corporation, when it will not advance justice but, on the contrary, will accomplish a legal wrong to the prejudice of another who acted in good faith.

#### Doctrine of estoppel/ratification

- The principle of estoppel precludes a corporation and its BOD from denying the validity of the transaction entered into by its officer with a third party who in good faith, relied on the authority of the former to act on behalf of the corporation
- Subsequent or contemporaneous acts of the BOD relating to the very transaction involved
- The doctrine is premised on a reliance in good faith by a third party that the representative has proper authority aol9os derived from law, corporate by-laws or authorization from the board (either expressly or implied by habit, custom or acquiescence)
- The ratification act that would bind the corporation would have to come from the BOD or a properly authorized representative<sup>24</sup>

<sup>24</sup> However, the corporation may ratify the unauthorized act of its corporate officer. Ratification means that the principal voluntarily adopts, confirms and gives sanction to some unauthorized act of its agent on its behalf. It is this voluntary choice, knowingly made, which amounts to a ratification of what was theretofore unauthorized and becomes the authorized act of the party so making the ratification.] The substance of the doctrine is confirmation after conduct, amounting to a substitute for a prior authority. Ratification can be made either expressly or impliedly. Implied ratification may take various forms — like silence or acquiescence, acts

### Doctrine of apparent authority

- If a corporation knowingly permits one of its officers, or any other agent, to act within the scope of apparent authority, it holds him out to the public as possessing the power to do those acts; and thus, the corporation will, *against anyone who has in good faith dealt with it through such agent*, be estopped from denying the agent's authority
- Contemporaneous or prior acts of the BOD that are not related to this transaction
- Rationale: Because the third person has little/no information as to what occurs in a corporate meeting; and he must necessarily rely upon the external manifestations of corporate consent.
- Ultimately, the doctrine only involves the question of whether the officer has the power or is clothed with the *appearance* of having the power to act for the corporation
- The weight of jurisprudence shows that *when dealing with corporate officers, the doctrine of apparent authority comes into play on the basis of estoppel*<sup>25</sup>
  - The public cannot be required to look beyond the officers acting for a corporation
- For the doctrine of apparent authority to apply, the party invoking it is burdened to prove the following:
  - The acts of the purported corporate officer or agent justifying belief in the agency by the principal corporation
  - Knowledge thereof by the principal corporation which is sought to be held
  - Reliance thereon by the principal corporation consistent with ordinary care and prudence
- The doctrine does not apply if the principal did not commit any act/conduct which a third party knew or relied upon in good faith as a result of the exercise of reasonable prudence, and the agent's act/conduct must have produced a change to the third party's detriment
- **The doctrine cannot apply to benefit a party who deals with the corporation aware of the corporate representative's lack of authority.**

#### *Implied powers covered by the doctrine of apparent authority*

- A corporate officer may represent and bind the corporation to the extent of the authority to do so has been conferred upon him, including powers as, in the usual course of the particular business, are incidental to, or may be implied from the powers intentionally conferred, powers added by custom

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showing approval or adoption of the act, or acceptance and retention of benefits flowing therefrom (*Yasuma v. Heirs of De Villa*).

<sup>25</sup> A private corporation which intentionally or negligently clothes its officers or agents with apparent power to perform acts for it will be estopped from denying that such apparent authority is real as to innocent third parties dealing in good faith.

and usage, as usually pertaining to the particular officer, and such apparent powers as the corporation has caused persons dealing with the officer or agent to believe it has conferred

- In any case, the *ultra vires* doctrine has found very little vindication. It has become more of a technical defense raised by or against the corporation, which courts have readily brushed aside.
  - Still, the *ultra vires* doctrine stands as a principle, and it reigns supreme in a purely intramural setting.
  - So, when the parties remain within the intracorporate setting or when the contract is still executory (no damage yet), the doctrine has been applied by courts *with vigor*.

#### *Timely and proper repudiation of lack of officer's authority*

- If the corporation desires to set up the defense that the contract was executed by one not authorized, it must plead such fact.
  - Thus, a corporation should first prove by clear evidence that its corporate officer is *not* in fact authorized to act on its behalf *before* the burden of evidence shifts to the other party to prove, by previous specific acts, that an officer was clothed by the corporation with apparent authority.

### The business judgment rule (BJR)

- A resolution, contract or transaction pursued within the corporate powers and business operations of the corporation, and adopted in good faith by the BOD, is valid and binding on the corporation; and generally the courts are without authority to review the same or substitute their own judgment, even when it can be proven that the exercise of such power may cause the corporation to incur losses or decrease its profits

#### *Two branches of BJR:*

1. Resolutions approved, and contracts and transactions entered into by the BOD within the powers of the corporation cannot be reversed by the courts, not even on the behest of the shareholders of the corporation
2. Directors and officers acting within such business judgment cannot be held personally liable for the consequences of such acts

*Exceptions to the rules of nonliability (i.e., the directors can be held personally liable):*

1. When the director willfully and knowingly votes for patently unlawful acts of the corporation
2. When he is guilty of gross negligence or bad faith in directing the affairs of the corporation
3. When he acquires any personal or pecuniary interest in conflict with his duty as such director

*Board must act as a body with quorum*

- A majority of the directors as stated in the AI shall constitute a quorum to transact corporate business, and every decision reached by at least a majority of the directors constituting a quorum, except for the election of officers which shall require the vote of a majority of all the members of the board, shall be valid as a corporate act
- Thus, directors cannot act individually to bind the corporation
- Nevertheless, ratification by the board does not need a formal meeting
  - It may be done expressly or impliedly, by the corporation's subsequent course of conduct
- Likewise, directors cannot bind the board in a shareholder' or members' meeting—it must be done in a board meeting
- Directors or trustees cannot attend meetings by proxy or through an alternate
  - This is because the director was elected based on their personal qualifications, business acumen and background

- ii. For violating this Code
- iii. For violating the SRC
- b. Found administratively liable for any offense involving fraudulent acts
- c. By a foreign court or equivalent foreign regulatory authority for acts, violations or misconduct similar in (a) and (b)

*Note:* The bylaws can provide other qualifications and disqualifications in addition to those in the RCC

The institution of independent directors

- 20% of the BOD of corporations vested with public interest must be independent directors
- An independent director is a person who, apart from shareholdings and fees received from the corporation, is independent of management and free from any business or other relationship which could, or could reasonably be perceived to materially interfere with the exercise of independent judgment in carrying out the responsibilities as a director

#### **Executive, management and other special committees**

- If the bylaws so provide, the board may create an ExeCom composed of at least three directors which may act, by majority vote, on such specific matters within the competence of the board, as may be delegated in the bylaws or on a majority of the board, except:
  - Approval of any action for which shareholders' approval is required
  - Filing vacancies in the board
  - Amendment or repeal of bylaws or the adoption of new bylaws
  - Amendment or repeal of any resolution of the board by which its express terms is not so amenable or repealable
  - Distribution of cash dividends

#### **Election of the directors or trustees**

- The RCC strengthened the rights of shareholders, especially minority shareholders in corporate affairs and to make more meaningful the corporate governance principle of accountability
- Each shareholder or member shall have the right to nominate any director or trustee who possesses all the qualifications and none of the disqualifications in the RCC
  - Except: When the exclusive right to nominate is reserved for shareholders of founders' shares under § 7

#### **Qualifications and disqualifications of directors and trustees**

##### *Qualification*

1. Own at least one share of stock

*Note:* For corporate shareholders, the corporation cannot be a director. Likewise, a corporate shareholder or member cannot also designate an individual representative to be voted into the BOD since that person is not a shareholder of the corporation.

- Thus, a workaround is to make the representative own at least one share.

##### *Disqualifications*

If within 5 years prior to the election or appointment as director, the person was:

- a. Convicted by final judgment:
  - i. Of an offense punishable by imprisonment for a period exceeding 6 years

##### *Quorum rule*

- There must be present, either in person or through a representative authorized to act by a written proxy, the owners of majority of the outstanding capital stock or a majority of the members entitled to vote
- A stockholder or member who participates through remote communication or in absentia shall be deemed present for purposes of quorum

##### *Conduct of voting*

1. The election must be by ballot if requested by any shareholder or member entitled to vote
2. When so authorized in the bylaws or a majority vote of the BOD, the shareholders may also vote through remote communication or in absentia
3. Stock: Shareholders shall have the right to cumulative voting
4. Nonstock: Members may cast as many votes as there as trustees to be elected but may not cast more than one vote for one candidate, with nominees for trustees receiving the highest number of votes shall be declared elected

##### *When no election held*

1. Report on nonholding of election
2. SEC may summarily order that an election be held ifL
  - a. No new date has been designated, or
  - b. The rescheduled election is likewise not held but only
    - i. Upon the application of a shareholder, member director or trustee and
    - ii. After verification of the unjustified nonholding of the election
  - c. In addition, the SEC shall have the power to issue such orders as may be appropriate
  - d. Special rule of quorum: The shares of stock or membership represented at such meeting and entitled to vote shall constitute a quorum
    - i. Thus, even when there is no majority, the mere representation at such meeting shall constitute a quorum

#### **Cumulative voting**

- A shareholder may vote such number of shares for as many persons as there are directors to be elected, or he may cumulate said shares and give one candidate as many votes as the number of directors to be elected multiplied by the number of his shares, or he may distribute them on the same principle among as many candidates as he shall see fit, provided that the total number of votes cast by him shall not exceed the number of shares owned by him as shown in the books of the corporation multiplied by the whole number of directors to be elected (§ 22, RCC)
  - *In contrast*, straight voting allows a simple majority of the shareholders to elect the entire BOD
  - The cumulative voting is the *mandatory* rule for stock corporations

#### **Election of BOT**

- The number of trustees shall be fixed in the AI or bylaws which may not be more than 15
- They shall hold office for not more than 3 years
- Unless otherwise provided in the AI or bylaws, members of nonstock corporations may cast as many votes as there as trustees to be elected but may not cast more than 1 vote for 1 candidate
  - Nominees receiving the highest number of votes shall be deemed elected
- It is mathematically impossible for them to elect a minority. It's a winner-takes-all system.
  - No minority representation

#### **Straight voting**

- Unless otherwise provided in the articles of incorporation or in the bylaws, members of nonstock corporations may cast as many votes as there are

trustees to be elected by may not cast more than 1 vote for 1 candidate (§ 22, RCC)

- This is the default rule for nonstock corporations

#### **Election contests**

- Election contest – Any controversy or dispute involving title or claim to any elective office in a corporation, the validation of proxies, the manner and validity of elections, and the qualifications of candidates
- The complaint must be filed within 15 days from the date of the election, if the bylaws do not provide for a procedure of resolution of the controversy, or within 15 days from the resolution of the controversy by the corporation as provided in its BL

#### **Term of office; hold-over principle**

- The term of office of directors in a stock corporation shall be one year and *until their successors are elected and qualified*
- “Hold-over situation” – That which arises when no successor is cleared due to valid and justifiable reasons, and the incumbent holds over and continues to function until another officer is chosen and qualified
  - A holdover situation does not disqualify an incumbent officer from seeking another term
  - In case no new board is elected and qualified after the one-year term, the existing board—if still constituting a quorum—is still legitimate
- In any case, a provision in the AIBL granting a person a permanent seat in the board is void
- The annual election is mandatory

#### **Removal and discipline of directors and trustees**

- Any director or trustee may be removed from office by a vote of the shareholders representing  $\frac{2}{3}$  of the outstanding capital stock, or by a vote of  $\frac{2}{3}$  of the members entitled to vote:
  - Such removal shall take place either at a regular meeting or at a special meeting
  - Such meeting must be called by the Secretary on order of the President or on written demand of the shareholders representing or holding at least a majority of the outstanding capital stock or members
  - Notice of the time and place of such meeting, and the intention to propose such removal, must be given by publication or by written notice
- General rule:  $\frac{2}{3}$  vote is enough to remove, with or without cause
  - Exception: If the director is elected by the minority through cumulative voting, he may not be removed without cause even if there is  $\frac{2}{3}$  vote

- “Cause” – Goes into the **three duties of a director or trustee—loyalty, obedience and diligence**
- This implies that the BOD has no power to discipline its own members
  - If here is such a provision in the AIBL, it is null and void for being contrary to law and public policy
  - Only shareholders or members may remove directors/trustees (*Raniel v. Jochico*)

#### *Removal of a disqualified director or trustee*

- The SEC shall, *motu proprio* or upon verified complaint, after due notice and hearing, order the removal despite the disqualification, or whose disqualification arose/discovered after election
- The removal by SEC is without prejudice to the other sanctions that the SEC may impose on the BOD

#### *Removal of officers*

- The SEC has no power to remove officers
- And the SEC cannot sanction a board that fails to remove a disqualified officer

#### **Vacancy in the BOD**

1. Due to term expiration or removal: The BOD (if quorum present) may fill-up such vacancies from qualified shareholders
  - a. If there’s no quorum, the vacancy shall be filled by the shareholders or members
    - i. In this case, the election shall be held not later than 45 days from the date of vacancy
2. Due to term expiration: An election shall be held no later than the day of such expiration at a meeting called for that purpose
3. Due to removal by shareholders or members: The election may be held on the same day of the meeting authorizing the removal and this fact must be so stated in the agenda and notice of said meeting
4. Due to increase in the board membership: By an election at a regular or at a special meeting of shareholders or members duly called for the purpose, or in the sam authorizing the increase of directors or trustees if so stated in the notice of meeting

#### *Notes:*

- A director or trustee elected to fill a vacancy shall be referred to as “replacement director or trustee” and shall serve only for the unexpired term of the predecessor
- The phrase “may be filled-up” shows that the filling of vacancies is merely permissive, not mandatory

#### *The Emergency Board*

- When vacancies in the Board prevent the remaining directors from constituting a quorum and emergency action is required to prevent grave, substantial, and

irreparable damage to the corporation, the vacancies may be temporarily filled-up from among the officers of the corporation *by unanimous vote* of the remaining directors

- The action by the designated director/trustee shall be limited to the emergency action necessary and the term shall cease within a reasonable time from the termination of the emergency or upon election of the replacement
- The corporation shall notify the SEC within 3 days from the creation of the Emergency Board, stating therein the reason for its creation

#### **Meetings of directors or trustees**

1. Regular meetings – Held monthly, unless the bylaws otherwise provide
2. Special meetings – Those held at any time upon the call of the president, or as provided in the bylaws

**Section 52. Regular and Special Meetings of Directors or Trustees; Quorum.** - Unless the articles of incorporation or the bylaws provides for a greater majority, a majority of the directors or trustees as stated in the articles of incorporation shall constitute a quorum to transact corporate business, and every decision reached by at least a majority of the directors or trustees constituting a quorum, except for the election of officers which shall require the vote of a majority of all the members of the board, shall be valid as a corporate act.

Regular meetings of the board of directors or trustees of every corporation shall be held monthly, unless the bylaws provide otherwise.

Special meetings of the board of directors or trustees may be held at any time upon the call of the president or as provided in the bylaws.

Meetings of directors or trustees of corporations may be held anywhere in or outside the Philippines, unless the bylaws provide otherwise. Notice of regular or special meetings stating the date, time and place of the meeting must be sent to every director or trustee at least two (2) days prior to the scheduled meeting, unless a longer time is provided in the bylaws. A director or trustee may waive this requirement, either expressly or impliedly.

Directors or trustees who cannot physically attend or vote at board meetings can participate and vote through remote communication such as videoconferencing, teleconferencing, or other alternative modes of communication that allow them reasonable opportunities to participate. Directors or trustees cannot attend or vote by proxy at board meetings.

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.

#### *Quorum and vote required in board meetings*

- a. Quorum – A majority of the directors or trustees as stated in the AI shall constitute a quorum to transact corporate business
- b. Vote required – At least a majority of the directors or trustees constituting a quorum shall be valid as a corporate act
  - i. Exception: Except that for the election of officers which shall require the vote of a majority of all the members of the board
- c. Rule on abstention: An abstention is counted in favor of the issue that won the majority votes, since by their act of abstention, the abstaining directors are deemed to abide by the rule of the majority

### Compensation of directors, trustees and officers

**SEC. 29. Compensation of Directors or Trustees.** - In the absence of any provision in the bylaws fixing their compensation, the directors or trustees shall not receive any compensation in their capacity as such, except for reasonable *per diems*: *Provided, however,* That the stockholders representing at least a majority of the outstanding capital stock or majority of the members may grant directors or trustees with compensation and approve the amount thereof at a regular or special meeting.

In no case shall the total yearly compensation of directors exceed ten percent (10%) of the net income before income tax of the corporation during the preceding year.

Directors or trustees shall not participate in the determination of their own *per diems* or compensation.

Corporations vested with public interest shall submit to their shareholders and the Commission, an annual report of the total compensation of each of their directors or trustees.

- Per diem – The reimbursement for expenses incurred in attending meetings
- Thus, the service of directors or trustees is essentially gratuitous and noncompensable, unless otherwise provided in the bylaws or approved by the requisite majority vote of the shareholders/members
- Two ways by which board members can be granted compensation apart from reasonable *per diems*:
  - When there is a provision in the bylaws fixing their compensation
  - When the shareholders representing a majority of the outstanding capital stock agree to give compensation
- Similarly, the board may also create committees and is empowered to determine its members' compensation
- In any case, directors cannot participate in the determination of their own *per diems* or compensation<sup>26</sup>

### Corporate officers; in general

Two levels:

1. The distinction between corporate officers from nonofficers to determine who are bound by the common law duties of obedience, diligence and loyalty
2. Relating to the power of the BOD to appoint and terminate officers in the exercise of its business judgment, as contrasted from nonofficers who are protected by the security of tenure policy

*Power of the board to delegate authority to officers*

- Just as a natural person may authorize another to do certain acts for and on his behalf, the BOD may validly delegate some of its functions and powers to officers, committees, or agents
  - The authority of such agents to bind the corporation comes from the law, bylaws, and authorizations from the BOD, *expressly or impliedly by habit, custom or acquiescence*
- The general principles of the *Law on Agency* govern the commercial relation between the corporation and its officers/agents
  - Needless to say, officers must act within the scope of the authority conferred to them, otherwise, the act is *not* binding on the corporation

*Appointment/election of corporate officers*

**Section 24. Corporate Officers.** - Immediately after their election, the directors of a corporation must formally organize an elect: (a) a president, who must be a director; (b) a treasurer, who must be a resident; (c) a secretary, who must be a citizen and resident of the Philippines; and (d) such other officers as may be provided in the bylaws. If the corporation is vested with public interest, the board shall also elect a compliance officer. The same person may hold two (2) or more positions concurrently, except that no one shall act as president and secretary or as president and treasurer at the same time, unless otherwise allowed in this Code.

The officers shall manage the corporation and perform such duties as may be provided in the bylaws and/or as resolved by the board of directors.

- Note that the president **cannot** concurrently serve as corporate secretary or treasurer
  - Rationale: To prevent an abuse of power and discretion, and to provide a system of checks and balances between and among positions

*Removal of corporate officers*

upon an action by the shareholders or members; (3) If compensation will be set in a bylaw, then BOD approval is necessary before it is submitted for the ratification vote.

<sup>26</sup> CLV disagrees with this for the following reasons: (1) No *per diem* can ever be set because all the directors would be disqualified to participate in the Board vote in setting *per diem* rates; (2) It is unlawful for a director to participate in the determination of their compensation, because this is only

- The terms of office of corporate officers are coterminous with that of the board—it's even said that they serve at the pleasure of the board<sup>27</sup>
- In contrast, ordinary company employees are employed by management officers who determine the compensation to be paid such employees (*Gomez v. PNOOC*)
- A corporate "office" is created by the charter of the corporation and the officer is elected by the directors or shareholders, while an "employee" usually occupies *no* office and generally is employed by the managing officer (*Okol v. Slimmers World*)
- The determination of who are "corporate officers" within the business judgment prerogatives of the board is therefore critical in determining whether such officers would be entitled to security of tenure
- Additionally, the issue of who falls into the category of "corporate officers" is also essential in determining which had proper jurisdiction—NNLRC or RTC (formerly SEC)

#### *Who are corporate officers?*

- The term "corporate officer" when it comes to the power of the BOD to remove refers only to the officers of a corporation who are given that character either:
  - By Corporation Law, or
  - A corporation's bylaws (*Gurrea v. Lezama*)
- In short, corporate officers are the president, corporate secretary, treasurer, and such other officers as may be provided for in the bylaws

#### *Positions created and filled by BOD resolution pursuant to enabling bylaw provision*

- Examples: "And such other officers" or "shall have full power to create new offices and to appoint the officers thereto"
- Any officer appointed to such position does not become a corporate officer but is an employee and the determination of the rights and liabilities relating to his removal are within the NLRC's jurisdiction and is not an intra-corporate dispute (*Matling Industrial v. Coros*)
  - *Matling* also declared void a bylaw provision that vested the president with the power to create a corporate office
  - The power to create a corporate office is vested in the BOD
- However, in *Cacho v. Balagtas*, the Court held that where the bylaws expressly provide for the positions of "one or more vice-president," then the appointment of the EVP made him a corporate officer

#### *Intra-corporate controversy branch of the corporate officer test*

- *Matling* also clarified that just because an officer happens to be a shareholder or BOD member does not necessarily make the controversy relating to his removal from corporate office an intra-corporate dispute
- It must be shown that his removal was connected with his being a shareholder or director
  - Thus, the Court in *Matling* assessed whether Coros's status as director and shareholder had any relation at all to his appointment and subsequent dismissal as vice-president for finance and administration
  - Because Coros was not appointed as vice-president because of his being a stockholder or director, the case was *not* an intra-corporate dispute

#### *BJR vs. security of tenure*

- The BJR supports the power of the BOD to remove corporate officer
  - It's really a jurisprudential exception to the policy of security of tenure
- Firstly, the prerogative of management to hire and fire *all* employees was the prevailing doctrine that encompassed all employees of a business enterprise
- Secondly, the noncoverage of corporate officers from security of tenure is now a well-established principle upholding the doctrine under the aegis of the 1987 Constitution
- Thirdly, decisions of the Court upholding the business judgment prerogatives of the BOD on the termination of corporate officers clearly recognizes that the essential legal relationship prevailing is that of agency
  - Necessarily, a relationship of trust, which is essentially revocable
- Finally, just as the security of tenure clause under the civil service system provides for exemptions, the Court has now begun to fashion similar exemptions applicable to the security of tenure clause for private employees

#### **Statutory corporate officers**

##### *Chairperson*

- It's not mentioned in § 24, but it's mentioned in § 53<sup>28</sup>
  - Thus, it's a statutory officer

##### *President*

- The president, being the highest executive office in the corporate setting, necessarily brings with it

<sup>27</sup> This is indeed a fundamental doctrine in *Corporate Law*, because the ability of the board to appoint and terminate officers lies at the very heart of the operations of the corporation. It's also part of the business judgment of the board.

<sup>28</sup> **SEC. 53. Who Shall Preside at Meetings.** - The chairman or, in his absence, the president shall preside at all meetings of the directors or trustees as well as of the stockholders or members, unless the bylaws provide otherwise.

implied powers and apparent authority upon which the dealing public can rely upon

- In the absence of a charter/bylaw provision to the contrary, the president is presumed to have the authority to act within the domain of the general objectives of the corporation's business and within the scope of his usual duties
- The president of the corporation possesses the power to enter into a contract for the corporation, when the conduct on both the president and the corporation shows that he had been in the habit of acting in similar matters on behalf of the company and the company authorized him so to act, and had recognized, approved and ratified his former and similar actions (*People's Aircargo v. CA*)
- The implied powers of the president of any corporation cover only such acts, contracts and transactions which from their very nature are deemed to be within his competence as the CEO, and based on commercial usage as expected of such offices in the ordinary course of business; and which the BOD expects the president to handle without prior formal authorization (*i.e.*, apparent authority)
- However, transactions that are unusual or extraordinary in character cannot be deemed to be within the realm of the president's implied powers
- Qualifications:
  - A director
  - An owner of at least one share

- It serves as the corporation's official document showing the corporate actions approved by its BOD and the extent and scope of the authority necessarily conferred
  - It's equivalent to a special power of attorney (SPA)
- It must contain:
  - The BOD's collective approval of the sale
  - The BOD's grant of authority to a natural person who would act as the corporation's agent for such sale

*Corporate officer*

- The board of PLCs shall also elect a compliance officer
- It is in charge of compliance function

*Corporate treasurer*

- A statutory corporate officer
- The function is to receive and keep funds of the corporation, and to disburse them in accordance with the authority given him by the board or any properly authorized officer

*Independent or external auditor*

- He's essentially a contractor of service
- He acts as an independent professional, much the same as the role of external counsel of the corporation affecting the standing and operations of the company

*Vice-president*

- It is not a statutory officer
- Jurisprudence provides that unless such position is expressly provided in the bylaws, it's not a corporate officer<sup>29</sup>

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*General manager*

- It's not a statutory corporate officer
- Thus, a 3rd party who deals with the manager of the company has *no* doctrinal basis to assume that the manager has full authority to bind the Board to corporate affairs

*Corporate secretary*

- It's a statutory officer and there are minimum legal expectations from the corporate secretary
- Qualifications:
  - A Filipino citizen
  - A resident of the Philippines
- He is the custodian of corporate records

*Nature and value of the secretary's certificate (SC)*

- When a SC is regular on its face, it can be relied upon by a 3rd person who does not have to investigate the truths of the facts contained in such certification

<sup>29</sup> But see §§ 62 & 77, RCC, where the VP is one of the officers authorized to sign the certificate of stock or articles of merger or consolidation, respectively.