Regulatory Dualism Through the SEC — Extending the Coverage of the *Maharlika* Rules to Elevate Philippine Corporate Governance Standards

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I. INTRODUCTION

How you do things as a company matters more today than ever.

— *Thomas L. Friedman*[1]

Due to the globalization that occurred in the last century, corporate governance is now at a premium.[2] Globalization, combined with the spread

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Cite as 56 ATENEO L.J. 427 (2011).

1. THOMAS L. FRIEDMAN, THE WORLD IS FLAT (FURTHER UPDATED AND EXPANDED RELEASE 3.0) 467 (2007 ed.).
2. *Id.* at iii.

of capitalism, privatization, deregulation, shareholder activism, the 1998 East Asian financial crisis, and several United States corporate scandals, created global interest on corporate governance.[3] Developing markets around the globe are progressively using corporate governance to attract more foreign investments.[4] In developing countries, "high-corporate governance standards are viewed as a way to make their markets more attractive to international investors."[5]

Unfortunately for the Philippines, its corporate governance standards are perceived by the international community as behind international — in fact, even regional — standards. In a 2010 report on corporate governance practices in Asia,[6] the Philippines ranked last in terms of corporate governance practice and standards.[7] It was observed that, "[m]any codes and securities laws in the Philippines lag international, and even regional, best practices."[8] The observation was made despite the fact that the Revised Code of Corporate Governance (Revised Code of CG)[9] was enacted just a year before the Report.[10]

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3. THE SHADOW ECONOMY, CORRUPTION AND GOVERNANCE 22 (Michael Pickhardt & Edward Shinnick eds., 2008).

4. CORNELIS A. DE KLUYVER, A PRIMER ON CORPORATE GOVERNANCE 177 (2009).

5. *Id.*

6. Amar Gill, et al., CG Watch 2010 (A Report on Corporate Governance in Asia) 5, *available at* www.acga-asia.org/public/files/CG_Watch_2010_Extract.pdf (last accessed Aug. 31, 2011) [hereinafter CG Watch 2010].

7. *Id.*

8. *Id.*

9. Securities and Exchange Commission, Revised Code of Corporate Governance, SEC Memorandum Circular No. 6, Series of 2009 [SEC Memo. Circ. No. 6 (2009)] (July 15, 2009).

10. The Revised Code of Corporate Governance (Revised Code of CG) came as a disappointment to commercial law practitioners. Commercial Law expert, Cesar L. Villanueva, commented, thus:

> The Revised CG Code is supposedly the result of lobbying efforts made by both the Philippine Stock Exchange (PSE) and the Institute of Corporate Directors (ICD), to incorporate reforms in the old SEC Code coming from hard lessons learned by corporate governance practitioners under the regime of the old SEC Code. Our review of the Revised CG Code, and the initial feedbacks received from the field, are, to say the least, that of disappointment[.]
>
> The feeling that one is left with after reading the Revised CG Code is that the great experiment of ushering into our jurisdiction modern principles of good corporate governance, has abruptly come to an end;

The miserable image of corporate governance in the Philippines has taken its toll on foreign investments in the country. It has been noted that, "foreign ownership of the local market has been in steady decline in the past few years and foreign direct investment is the lowest of any of the markets in [Asia]."[11] In a 2008 Philippine Stock Exchange (PSE) survey, it was learned that there were only around 4,713 foreign accounts in the PSE.[12] As observed by PSE Officer JJ Moreno, one of the things that investors look at is safety — and safety is "hinged on corporate governance standards."[13]

In an effort to "promote higher standards of corporate governance among Philippine corporations and encourage local and international investors to invest in the Philippine stock market[,]" the PSE started the conceptualization of the *Maharlika* Board.[14] Inspired by Brazil's *Novo Mercado*, the *Maharlika* Board is envisioned to be a special corporate governance listing in the PSE especially designed for "companies voluntarily subscribing to higher standards of corporate governance practice."[15] While the envisioned *Maharlika* Board will cover only PSE listed companies,[16] many are hopeful that the creation of the said Board will improve the

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> and that we in the Philippines are retreating back to old familiar grounds[.]

Cesar L. Villanueva, *The Revised Code of Corporate Governance: A Reactionary Approach,* 54 ATENEO L.J. 453, 454 (2009).

11. CG Watch 2010, *supra* note 6, at 5.

12. Ian Chrisler Muncada, *Maharlika*: a haven from uncertainty?, *available at* http://www.bworldonline.com/content.php?section=Beyond&title=Maharlika:-A-haven-from-uncertainty?&id=39911 (last accessed Aug. 31, 2011).

13. Judith Balea, PSE readies 'Maharlika' board for 'blue chips of blue chips,' *available at* http://www.abs-cbnnews.com/business/10/29/09/pse-readies-*Maharlika*-board-blue-chips-blue-chips (last accessed Aug. 31, 2011).

14. Philippine Stock Exchange, *Maharlika* Board Listing and Disclosure Rules, Exposure Draft, Jan. 12, 2010, art. I, *available at* http://www.acga-asia.org/public/files/%282010-01-12%29%20Maharlika_Board%20Rules.pdf (last accessed Aug. 31, 2011) [hereinafter *Maharlika* Board Rules].

15 *Id.* art. IV (12). *See* Jonathan Juan DC. Moreno, The *Maharlika* Board: A Special Corporate Governance Listing Segment in the PSE, *available at* http://www.acga-asia.org/public/files/Maharlika%20Board%20Rules%20Vetting_HK(0203 10).pdf (last accessed Aug. 31, 2011) [hereinafter Moreno].

16. *See* Philippine Stock Exchange, *Maharlika* Board Rules, arts. II & V, § 1 (2010). During the writing of the Note, the approval of the final version of the *Maharlika* Board Rules was being undertaken. The Provisions used in the Note are taken from the latest Exposure Draft of the *Maharlika* Board Rules available to the public. The Draft is dated 12 January 2010.

international community's perception of the corporate governance standards in the Philippines.[17]

The Author agrees that the standards provided for in the *Maharlika* Board Rules (*Maharlika* Rules) are more at par with international standards than those currently being enforced under the Securities Regulation Code (SRC),[18] the Corporation Code,[19] and the Revised Code of CG. However, the coverage of the *Maharlika* Rules is limited, considering that the Philippines has been left behind in terms of the corporate governance standards being implemented internationally. Thus, this Note will be an attempt to convince the Government to take action in a manner that will extend the coverage of the *Maharlika* Rules to public companies.[20] Based on the examination that the Author will make in the latter part of the Note, however, it will be discovered that the Government cannot do this through legislation. As a response, the adoption of regulatory dualism in corporate

17. *See, e.g.*, British ambassador lauds PSE on steps toward *Maharlika* Board, *available at* http://balita.ph/2010/11/24/british-ambassador-lauds-pse-on-steps-toward-maharlika-board/(last accessed Aug. 31, 2011); Danessa O. Rivera, *Maharlika Board bid gets backing from IFC*, TRIB., May 23, 2011, *available at* http://www.tribuneonline.org/business/20110323bus3.html (last accessed Aug. 31, 2011); & *IFC backs PSE in corporate governance listing initiative*, MANILA BULL., Mar. 23, 2011, *available at* http://www.mb.com.ph/articles311095/ifc-backs-pse-corporate-governance-listing-initiative (last accessed Aug. 31, 2011).

18. Securities Regulation Code [SECURITIES REGULATION CODE], Republic Act No. 8799 (2000).

19. The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Blg. 68 (1980).

20. For lack of a better term, companies covered by the Revised Code of CG are referred to as "public companies." Villanueva, *supra* note 10, at 455. These companies, "by reason of the impact of their business enterprises to the public, are deemed to be vested with a certain degree of "public interest" beyond those of their shareholders." *Id.*

    Companies covered by the Revised Code of CG are enumerated in the opening paragraph of the Code, to wit:

    > [The] Revised Code of Corporate Governance ... shall apply to registered corporations and to branches or subsidiaries of foreign corporations operating in the Philippines that (a) sell equity and/or debt securities to the public that are required to be registerd with the Commission[;] or (b) have assets in excess of Fifty Million Pesos and at least two hundred (200) stockholders who own at least one hundred (100) shares each of equity securities[;] or (c) whose equity securities are listed on an Exchange; or (d) are grantees of secondary licenses from the Commission.

    SEC Memo. Circ. No. 6 (2009), pmbl.

governance through the Securities and Exchange Commission (SEC) will be offered.

II. LEGISLATING CORPORATE GOVERNANCE STANDARDS IN *MAHARLIKA* RULES

Maharlika is originally "[f]rom the Sanskrit word, *maharddhika*, meaning, 'a man of wealth, knowledge[,] or ability.'"[21] Contemporary society uses the word synonymously with the words nobility and aristocracy.[22] Concededly, listed companies that can adhere to the *Maharlika* Rules may, indeed, be considered as aristocrats in good corporate governance.

In this Part, an overview of the stringent corporate governance standards in the *Maharlika* Rules will be made. The powers of the Congress to adopt these standards in the Philippine legal system — in order to widen its coverage — will also be examined. Thereafter, considerations in addition to the powers of the Congress will be discussed to show that the legislation of the corporate governance standards in the *Maharlika* Rules is very unlikely.

A. Corporate Governance Standards in the Maharlika Rules

The *Maharlika* Board requires participating companies to genuinely adhere to high standards[23] of corporate governance. Some of these corporate governance standards are:

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21. Moreno, *supra* note 15.

22. *Id.*

23. The *Maharlika* Board Rules provide that:

> Section 1. Criteria for Listing in the *Maharlika* Board. The Exchange shall authorize a Company to be listed in the *Maharlika* Board if the Company complies with the following requirements:
>
> (a) It has submitted and complied with all the requirements prescribed by these rules and the Listing and Disclosure Rules;
>
> (b) It has duly registered its securities with the Commission;
>
> (c) It has a minimum authorized capital stock of five (5) billion pesos (₱5 Billion) of which a minimum of Twenty-five percent (25%) must be subscribed, and fully paid;
>
> (d) It has signed the *Maharlika* Board Listing Agreement;
>
> (e) Its Articles of Incorporation and By-laws include the provisions as required by these rules;
>
> (f) It has and will commit to the maintenance of the Minimum Free Float of thirty percent (30%) or higher as may be prescribed by the Exchange and shall include at least one thousand (1,000) minimum number of shareholders each owning securities equivalent to at least (1) board lot;

(1) A one share, one vote provision for at least 80% of the stocks.[24]

(2) At least seven directors in the board, with at least three or 30% but not less than three independent directors. The independent directors are to be nominated by the minority shareholders and will have increased roles in board meetings.[25]

(3) More strict rules on related party transactions.[26]

(4) Arbitration clause in intra-corporate disputes.[27]

These standards are either higher than or absent in the Corporation Code, the SRC, and the Revised Code of CG.

1. One Share, One Vote Scheme[28]

(g) Its capital stock is represented by common shares with a "one-share, one-vote" provision, subject to Article IV, Section 2 (2.2) of these rules;

(h) All voting shares shall be listed;

(i) Its financial records can establish a stable, profitable operations and prospects for continuing and sustained growth;

(j) It has not engaged, presently engaged or intend to engage in activities which are contrary to public interest, public morals, good customs, public order or public policy.

(k) It has complied with the Corporation Code, Securities Regulation Code, and all other relevant laws and regulations.

Maharlika Board Rules, *supra* note 14, art. V, § 1.

24. *Id.* § 2.2 (1)

25. *Id.* § 2.2 (2).

26. *Id.* § 6.2 (c).

27. *Id.* § 2.2 (3).

28. *See Maharlika* Board Rules, *supra* note 14, § 2.2 (1). It requires the company to have

> one class of shares that will have a 'one share, one vote' provision. A company may have another class of voting or non-voting shares provided that in aggregate, these class/es of shares shall only comprise a maximum of twenty percent (20%) of the total outstanding shares of the company.

Id.

Companies that have shares with "super voting rights" could not qualify to be in the *Maharlika* Board. *Id.*

Under the Corporation Code, a "one share, one vote" scheme for at least 80% of the capital stocks is not required. In fact, subject to the provisions of the corporation's Articles of Incorporation, the Corporation Code allows discrimination in and even the deprivation of voting rights, to wit:

> [t]he shares of stock corporations may be divided into classes or series of shares, or both, any of which classes or series of shares may have such rights, privileges or restrictions as may be stated in the articles of incorporation: *Provided*, That no share may be deprived of voting rights except those classified and issued as 'preferred' or 'redeemable' shares, unless otherwise provided in [the] Code[.][29]

Thus, corporations in the Philippines have unrestricted freedom in determining the classes and series of shares to offer.[30] Other than the requirement that there be at least one class of stocks with complete voting rights,[31] corporations can freely discriminate against the voting rights and dividend rights of different classes of stocks.[32]

2. Minimum Number of Independent Directors

Both the SRC[33] and the Revised Code of CG[34] require only a minimum of two independent directors for public companies.

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29. CORPORATION CODE, § 6.
30. HECTOR S. DE LEON & HECTOR M. DE LEON JR., THE CORPORATION CODE ANNOTATED 71 (10th ed. 2010).
31. CORPORATION CODE, § 6, ¶ 1.
32. DE LEON, *supra* note 30, at 71 (citing SEC Opinion 1989).
33. The Securities Regulation Code (SRC) provides:

    > SEC. 38. Independent Directors. — Any corporation with a class of equity securities listed for trading on an Exchange or with assets in excess of Fifty million pesos (₱50,000,000.00) and having two hundred (200) or more holders, at least of [sic] two hundred (200) of which are holding at least one hundred (100) shares of a class of its equity securities or which has sold a class of equity securities to the public pursuant to an effective registration statement in compliance with Section 12 hereof shall have at least two (2) independent directors or such independent directors shall constitute at least twenty percent (20%) of the members of such board, whichever is the lesser. For this purpose, an "independent director" shall mean a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

    SECURITIES REGULATION CODE, § 38.
34. Article 3 (A), ¶ 2 of the Revised Code of CG provides:

3. Related-Party Transactions[35]

The Corporation Code protects stockholders from related-party transactions

> specifically where the directors or officers enter into contracts with the corporation, or when two corporations with interlocking directors transact with each other.
>
> In these cases, the law provides that the vote of the director involved and his presence in the board meeting should not be necessary for the approval of the contract. It also provides that directors, who acquire any personal or pecuniary interest in conflict with their duty as such directors, shall be liable jointly and severally for any resulting damage suffered by the corporation, its stockholders[,] or members[,] as well as other persons.[36]

In addition, the SRC provision on independent directors and the Revised Code of CG's requirement of "a robust internal audit system" are also viewed as measures against related-party transactions.[37]

Despite these provisions, however, Francis Ed. Lim, former president and chief executive officer of the PSE, has noted that improvements may still be had in the country's rule on related party transactions.[38]

4. Arbitration Clause in Intra-Corporate Disputes[39]

> All companies covered by this code shall have at least two (2) independent directors that constitutes twenty percent (20%) of the members of the board, whichever is lesser, but in no case less than two (2). All other companies are encouraged to have independent directors in their boards.

SEC Memo. Circ. No. 6 (2009), art. 3 (A), ¶ 2.

35. *See Maharlika* Board Rules, *supra* note 14, art. VI, § 11.4. This Section provides:

> All related party transactions, including business proposals/opportunities that may be approved or rejected, whenever on a single contract or a series of related contracts, whether or not for the same purpose, within any twelve-month period, when the amount involved is more than two and a half percent (2.5%) of net assets shall be approved by a majority of all independent directors.

Id.

36. Francis Ed. Lim, *Is the Philippines doing enough to address abusive related-party transactions*, PHIL. DAILY INQ., Apr. 27, 2011, *available at* http://business.inquirer.net/money/topstories/view/20110427-333315/Is-the-Philippines-doing-enough-to-address-abusive-related-party-transactions (last accessed Aug. 31, 2011) (citing CORPORATION CODE, §§ 31 & 32).

37. *Id. See* cited provisions of SRC and Revised Code of CG.

38. *Id.*

Currently, resolutions of intra-corporate disputes are within the jurisdiction of special commercial courts.[40] In *Reyes v. RTC Makati*,[41] it has been acknowledged that the SRC vested unto special commercial courts this jurisdiction.[42]

B. Constitutionality of Legislating High Corporate Governance Standards

The Corporation Code defines a corporation as "[a]n artificial being *created by operation of law*, having the right of succession and the powers, attributes and properties expressly authorized by law or incident to its existence."[43] By this very definition, it is clear that a corporation may "only come into existence in the manner prescribed by law."[44]

> General laws authorizing the formation of corporations are, in effect, general offers to any persons who may bring themselves within their provisions; and if condition precedents are prescribed in the statute, or certain acts are required to be done, they are terms of the offer and *must* be

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39. The *Maharlika* Board Rules require companies to adopt an arbitration system to resolve any dispute, controversy, or claim arising out of, or relating to, the company's relations with its shareholders, and other intra-corporate matters under applicable laws and regulation. *See Maharlika* Board Rules, *supra* note 14, art. VI, § 2.2 (3).

40. Jurisprudence provides that:

> To determine whether a case involves an intra-corporate controversy, and is to be heard and decided by the branches of the RTC specifically designated by the Court to try and decide such cases, two elements must concur: (a) the status or relationship of the parties; and (2) the nature of the question that is the subject of their controversy.
>
> The first element requires that the controversy must arise out of intra-corporate or partnership relations between any or all of the parties and the corporation, partnership, or association of which they are stockholders, members or associates; between any or all of them and the corporation, partnership, or association of which they are stockholders, members, or associates, respectively; and between such corporation, partnership, or association and the State insofar as it concerns their individual franchises. The second element requires that the dispute among the parties be intrinsically connected with the regulation of the corporation. If the nature of the controversy involves matters that are purely civil in character, necessarily, the case does not involve an intra-corporate controversy.

Speed Distribution Corp. v. Court of Appeals, 425 SCRA 691, 706 (2004).

41. Reyes v. RTC Makati, 561 SCRA 593 (2008).

42. *Id.*

43. CORPORATION CODE, § 2 (emphasis supplied).

44. DE LEON, *supra* note 30, at 44.

> complied with substantially before legal corporate existence can be acquired.[45]

Therefore, the Congress can enact a law of governance standards for corporations. It is well-settled that the Congress has the power to enact laws that may be burdensome to a class of persons in order to protect the public. As early as 1939, in *People v. Rosenthal*,[46] the government's power to regulate certain business transactions, such as the issuance of securities in this case, has already been recognized.[47]

In addition, the imposition of higher standards of corporate governance contravenes no constitutional provision. While the State recognizes in Article II, Section 20 of the Constitution "the indispensable role of the private sector,"[48] the said recognition is nothing "more than an acknowledgment of the importance of private initiative in building the nation."[49] Further, the above-cited constitutional provision has been declared to be not self-executory.[50]

Thus, the Congress can enact a law that contains the high corporate standards of the *Maharlika* Rules.

C. The Challenge: Olson Problem

Economic considerations, however, make the enactment of a law imposing high corporate governance standards more challenging. It must be noted that existing businesses, upon the passage of a law demanding for higher corporate governance standards, will be forced to restructure some established business practices. For instance, if the "one share, one vote" requirement is enacted into a law, public companies with preferred shares more than 20% of their respective outstanding capital stocks will have to reorganize their capital structure. It must be noted that only preferred shares may be deprived of voting rights under the Corporation Code.[51] Thus, if the "one share, one vote" requirement of the *Maharlika* Rules will be adopted, existing public companies will be greatly affected, both in terms of ownership and control.[52] Surely, the enactment of a law imposing high corporate governance standards on public corporations will meet opposition.

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45. *Id.* (citing 18 C.J.S. 468).
46. People v. Rosenthal, 68 Phil. 328 (1939).
47. *Id.* at 341-47.
48. PHIL. CONST. art. II, § 20.
49. Marine v. Reyes, 191 SCRA 205, 209 (1990).
50. Espina v. Zamora, 631 SCRA 17, 26 (2010).
51. CORPORATION CODE, § 6.
52. Under the *Maharlika* Board Rules, the ownership of shares must not be more that 20% of any other class. *See* Moreno, *supra* note 15, at 11.

Strong resistance may be expected from public corporations existing prior to the enactment of such a law.

The skepticism of existing public corporations to reforms — in this case against higher corporate governance standards — that empower other parties aside from them is not peculiar. This resistance, which has been referred to as the Olson Problem,[53] has already been observed as early as the 1980s.[54] The Authors who coined such a name to explain the Olson Problem in this manner:

> Countries pursuing economic development confront a fundamental obstacle. Reforms that, by stimulating growth, will increase the size of the overall pie are blocked by groups that, having achieved economic success and therefore political influence under the existing regime, believe that their positions will be threatened by the growth-inducing reforms.
>
> ...
>
> [T]he development of effective shareholder protection to support capital market development commonly threatens already-established firms and their controlling owners. First, it shifts both wealth and corporate power (and ultimately political power as well) away from the controlling owners and toward public shareholders. ... Second, effective shareholder protection facilitates the financing of potential competitors, since new firms generally need outside equity financing more than do well-established firms. These threats give the controlling owners and managers of established firms a powerful incentive to resist expansion of the legal protection afforded shareholders. And, because those owners and managers generally have strong influence over the political process, they are frequently in a position to make their resistance to reform effective.
>
> We will call this resistance of the established economic and political elite to growth-promoting reforms the *Olson [P]roblem*, after the economist who has described it most eloquently and insightfully.[55]

Therefore, although the Congress has the power to enact a law imposing high corporate governance standards, the enactment of the said law becomes improbable because of the opposition brought by the Olson Problem. For Gilson, Hansmann, and Pargendler, the best way to address the Olson problem is through regulatory dualism — a term the said Authors coined for a development strategy being adopted in certain countries.[56]

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53. Ronald J. Gilson, Henry Hansmann, & Mariana Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States and the European Union*, 63 STAN. L. REV. 475, 478 (2011).

54. *Id.* at 477.

55. *Id.* (emphasis supplied).

56. *Id.*

III. REGULATORY DUALISM IN THE SEC

As expressed in the immediately preceding Part of the Note, the Olson Problem makes improbable the enactment of a law imposing corporate governance standards as stringent as those provided in the *Maharlika* Rules. In this Part, the concept of regulatory dualism and the probability of using it in the SEC will be examined. Thereafter, an analysis of its desirability and viability will be made.

A. Regulatory Dualism — An Overview

Regulatory dualism refers to the development strategy of "permitting the existing business elite to be governed by the pre-reform regime, while pursuing development by allowing other businesses to be governed by a reformed regime."[57] In effect, regulatory dualism provides a compromise to businesses that are covered by a previous regime. While it does not give them the guarantee of not eventually conforming to the reforms,[58] it avoids them the costs associated in blocking the adoption of an absolute reform, minimizes the costs of major business restructuring, and reduces the clamor for a total reform.[59] Thus, regulatory dualism reduces the costs that existing businesses are to incur. After all,

> the two more extreme alternatives — comprehensive reform and no reform — also impose costs on the elites. Comprehensive reform brings a direct transfer of corporate wealth and power[.] On the other hand, seeking to block all reform can be expensive, not just directly but by upsetting the elites' relationship with previous allies, such as [the] government. ... Worse, extreme intransigence toward reform could lead to general economic decline harmful to all classes, and might ultimately produce a popular backlash that seriously damages the overall economic and political position of the current elites.[60]

B. Regulatory Dualism in the Philippines Through the SEC

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57. *Id.* at 478.

58. Though not required by law, pressure from the private sector may eventually force existing businesses to adopt the new standards. As observed:

> A dual regulatory regime preserves the legal entitlements of incumbents, at least initially, thus avoiding the immediate economic and political costs associated with stronger minority investor rights at the firm level. The immediate economic and political costs associated with a dual regulatory regime are principally those stemming from increased competition.

Gilson, et al., *supra* note 53, at 479.

59. *Id.*

60. *Id.*

Applying the concept of regulatory dualism in increasing the corporate governance standards in the Philippines, the SEC, in accordance with its powers, may provide a set of more strict corporate governance standards that public companies (those covered by the Revised Code of CG) may adopt voluntarily. In effect, it will extend the coverage of the stringent corporate governance standards in the *Maharlika* Rules to companies which are not listed in the exchange but whose businesses are imbued with public interest.[61] Similar to the PSE's plan with the *Maharlika* Board, SEC can make the adoption to these stringent corporate governance standards voluntary and can offer increased reputational value as an incentive to those who can adhere to it.

By providing these stringent corporate governance standards to public corporations, the SEC will be supplementing the deficiency of the Corporation Code, the SRC, and the Revised Code of CG in the areas of related party transactions and anti-takeover measures.[62] It will also provide requirements on the "one share, one vote" scheme, arbitration,[63] and the creation of the investor relations office.[64] Further, since the adoption of the stringent corporate governance standards will be optional, opposition — as explained by the Olson Problem — will be minimized.

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61. *Compare* SEC Memo. Circ. No. 6 (2009), pmbl, *with Maharlika* Board Rules, art. 2.

62. *See Maharlika* Board Rules, *supra* note 14, art. VI, § 11.5. The Section requires that all anti-takeover measures adopted must be approved by majority of all independent directors. *Id.*

    Under Article IV (2) of the *Maharlika* Board Rules, an anti-takeover measure is any measure that:

    > (a) [p]recludes or limits the exercise of any right granted to any shareholder by law, rule or regulation;
    >
    > (b) [p]revents any person or group of persons the exercise, conversion, transfer or receipt of any security on the same terms as other shareholders;
    >
    > (c) [d]ilutes disproportionately the rights and benefits granted to a shareholder or group of shareholders.

    Maharlika Board Rules, *supra* note 14, art. IV (2).

63. *See Maharlika* Board Rules, *supra* note 14, art. VI, § 2.2 (3).

64. The Investor Relation Office "will be accountable for efficiently providing information and addressing concerns of its shareholders" through the Company webpage which provides complete information about the Company in a form that is user-friendly. *See Maharlika* Board Rules, *supra* note 14, art. VI, § 2.6, ¶ 1.

IV. ANALYZING THE VIABILITY OF THE PROPOSAL

The success of regulatory dualism in effecting reforms in corporate governance must not be undermined. For instance, in Brazil, a voluntary set of standards in corporate governance, the Brazilian Code of Best Practices, is being followed despite the fact that "players in the market were used to deal[ing] with hard law and regulations, and it was an unusual initiative to publish a code for voluntary adoption, designed to play an educational role and lay the foundations of good corporate governance practices."[65] In this Part, the practicality of the proposed regulatory dualism in the SEC will be tested.

A. Advantages of Regulatory Dualism in Corporate Governance Through the SEC

1. Voluntary Nature Makes It More Attractive

One of the advantages that regulatory dualisms offer springs from the fact that two systems exist at the same time. As discussed earlier, a regulatory dualism in the SEC will give public corporations the *option* to choose the set of corporate governance standards to adopt. Therefore, a well-grounded expectation that not all public corporations will adopt the rules with higher corporate standards can be made. As a result, public corporations that will adopt the higher corporate standards can be distinguished from those who will choose not to. For the former group, their ability to incorporate these high standards can be used as a selling point to potential investors. As opposed to a reform strategy that will mandatorily require all public corporations to adopt stringent corporate governance standards, the proposal's voluntary nature gives public companies an incentive in the form of an edge against their competitors.

The use of corporate governance as a marketing strategy to attract investors is not new in the Philippines. In fact, the same strategy is used by several companies because of the Top Corporations in Corporate Governance award that is being given by the Institute of Corporate Directors[66] (ICD) and other private organizations. Awardees place in their

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65. Organization for Economic Cooperation and Development, The 2007 Meeting of the Latin American Corporate Governance Roundtable (Country Report on the Voluntary Corporate Governance Code in Brazil) 6, *available at* http://www.oecd.org/dataoecd/4/47/39741021.pdf (last accessed Aug. 31, 2011).

66. The Institute of Corporate Directors is a non-stock, non-profit corporation

> made up mainly of individual corporate directors and reputational agents committed to the professional practice of corporate directorship in the Philippines in line with global principles of modern corporate governance. ICD is working closely with the Organisation for Economic Co-Operation and Development (OECD), the Global Corporate Governance Forum, and the International Corporate

websites — especially the page for investors — all of the recognitions that they have received because of their good corporate governance.[67]

2. A Genuine Commitment for Reform

In contrast to a mandatory rule that requires the adoption of stringent corporate governance standards, public corporations that will adhere to the proposed more stringent corporate governance standards will do so without external compulsion. A more genuine commitment for reform may be expected from these public corporations than those who will simply comply to avoid penalties and sanctions.

Regulatory dualism in corporate governance standards will minimize the possibility of having unwilling public companies that make it appear in paper that they are complying with the rules when in truth they are not, a problem faced by Germany and other countries in Europe. It has been observed that in certain European countries, "[w]hile many companies publish their commitment to good governance principles, this is often formal and masks a lack of true governance quality inside the company and vis-à-vis the shareholders. Extensive disregard of important elements can still be observed."[68]

3. Independence from Political Pressure

While not as totally independent from the government as the PSE, the SEC has more independence in effecting more stringent corporate governance standards than the Congress. As previously explained, it is very improbable for the Congress to enact a law that will provide stringent corporate governance standards as such a law can distort the political alliances of the

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Governance Network on improving actual boardroom practices: moving beyond from principles into actual practices.

Institute of Corporate Directors, About Us, *available at* http://www.icdcenter.org/cg/index.php?option=com_content&view=article&id=45&Itemid=62&lang=en (last accessed Aug. 31, 2011).

67. *See, e.g.*, Energy Development Corporation, About CG, *available at* http://www.energy.com.ph/corporate-governance/about-cg/ (last accessed Aug. 31, 2011); Ayala Land, Investor Relations, *available at* http://ir.ayalaland.com.ph/Awards_and_Recognitions/Corporate_Governance/default.aspx (last accessed Aug. 31, 2011); Metro Pacific Investments, Investor Relations, *available at* http://www.mpic.com.ph/governance.php (last accessed Aug. 31, 2011); & SM Prime, Awards and Citations, *available at* http://smprime.com/smprime/index.php?p=1749 (last accessed Aug. 31, 2011).

68. Christian Strenger, Good Corporate Governance — the relevance for companies and investors (Edited Lecture Notes) 3, *available at* http://www.capital-governance-advisory.com/040120WHUCampusforFinance_EditedLectureNotes.pdf (last accessed Aug. 31, 2011).

Congressmen with existing businesses in the Philippines that are not in favor of a reform in corporate governance. In the last few years, Congressional bills that are related to corporate governance failed to become laws. Thus, a regulatory dualism through the SEC provides a better alternative than waiting for Congressional reforms.

B. Problems of Regulatory Dualism in Corporate Governance Through the SEC

1. Dependence on the Image of the SEC

Perhaps the biggest challenge that the proposal has to overcome is the SEC's poor credibility in the eyes of the local and international investors. In the same 2010 report, opinion has been expressed that the SEC is just a mere cash cow of the Philippine government, to wit:

> The standing of the SEC in government is clearly low, while temporary restraining orders and other legal posturing by market participants limit its scope of action. The Commission sometimes seems to be more of a cash cow for the government than a regulator, as it raises revenue through company registration fees, fines for breaches of rules[,] and other things. In its 2009 annual report, it even boasted, 'the SEC managed to meet, and in fact exceeded, its financial commitments to the national government.' It must be the only securities regulator in Asia that would make such a statement.[69]

With this image, the proposed stringent corporate governance standards and the recognition that will be given to companies that can adhere to it may not be perceived as credible as it should be. Emphasis must be given on the fact that one of the selling points of the proposed regulatory dualism in corporate governance through the SEC is the reputational value that it can give to adhering companies.

2. Success Entirely Dependent on the Market Players

Since the proposal gives public corporations the freedom to choose whether or not they will adopt the more stringent corporate governance rules, its success in elevating the corporate governance standards in the Philippines is highly dependent on the response of these public corporations. While Brazil's *Novo Mercado* is often cited as a very successful development strategy,[70] it must be remembered that such success was because of the

69. CG Watch 2010, *supra* note 6.

70. *See, e.g.*, Neil Stewart, Inside Investor Relations, Brazilian companies blossom on *Novo Mercado*, *available at* http://insideinvestorrelations.com/articles/15923/brazilian-companies-blossom-novo-mercado/ (last accessed Aug. 31, 2011) & Maria Helena Santana, et al., Novo Mercado and Its Followers: Case Studies in Corporate Governance Reformii-77, *available at* http://www.ifc.org

market players' response. In addition, it must also be noted that the inspiration behind *Novo Mercado*, Germany's regulatory dualism, did not obtain the same success and was eventually abandoned due to the unresponsiveness of the market players.[71]

Also, the time of adoption of the more stringent corporate governance standards, due to its voluntary nature, is entirely within the public companies' whim. In Brazil, it took two years before the first company participated in the *Novo Mercado*.[72] Considering that the Philippines is now behind international standards and that the standards of corporate governance in developing markets are continuously evolving, it is possible that higher standards of corporate governance will be in existence by the time the proposed regulatory dualism in the corporate governance is adopted by the companies in the Philippines.

V. SUMMARY AND CONCLUSION

As mentioned in the beginning of this Note, the globalized world requires — especially from developing markets — the adoption of more stringent rules in corporate governance. Developing markets have been addressing this concern to increase their attractiveness to foreign investments. Somehow, the Philippine government failed to keep up with this movement. Thus, reforms in corporate governance must be made to be at par with international standards. Because of the Olson Problem, however, instigating these reforms is a challenge for the government. As illustrated, most reforms in the Philippines have been brought by the private sector — take for instance the Top Corporations in Corporate Governance Award by the ICD and the *Maharlika* Board of the PSE.

However, the government must also do its part to help the Philippines in catching up with international corporate governance standards. As a proposal, the Author submits that, through the SEC, the option of adopting a higher set of corporate governance standards be given to public corporations by extending to them the applicable provisions of the *Maharlika* Rules. The reputational value that the said regulatory dualism can give to these public companies may convince them to adopt the higher set of corporate governance standards.

While the current image of the SEC and the dependability of the proposal's success to the response of the public companies are challenges that

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/ifcext/cgf.nsf/AttachmentsByTitle/Focus+5/$FILE/Novo+Mercado+text+screen+4-21-08.pdf (last accessed Aug. 31, 2011).

71. Gilson, et. al., *supra* note 53, at 481.

72. *Id.* at 488 (citing John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1807-08 (2002).

the proposed regulatory dualism will face, the proposed reform must still be adopted. At this point, where the Philippines has been considered as the doormat of foreign investments, the government has no other choice but to attempt every reform strategy available.