*F*ROM *M*ERIT TO *D*ISCLOSURE *R*EGULATION: *T*HE *S*HIFTING *B*ASES OF *P*HILIPPINE *S*ECURITIES *L*AW

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I. INTRODUCTION

The laws to regulate the Philippine securities market have existed in the statute books since 1916. In 1936, the Philippines became the first among Asian countries to constitute a Securities and Exchange Commission. Actual regulation of the securities industry, however, has been very weak, owing to the Philippine Securities and Exchange Commission's (SEC) focus on corporate recording[1] (i.e., making sure that corporations file their general information sheets and financial statements annually). As a result, the industry has developed much faster than the legal system set up to regulate it.

A. *Dormant Private Sector Activity*

The disparity between industry practice and the regulatory framework did not really present a serious problem until the late 1980's. Private sector participation in the economy in general, including stock market activity, was negligible during the Martial Law period, because of the "dominant position of the [Marcos] government during the 1970's and early 1980's when public investment and an import substituting industrial sector financed by external and behest loans fueled economic growth . . . ."[2] This situation changed when Cory Aquino took hold of the reins of government. Article II of the new Philippine Constitution, ratified during her second year as President, even declared strengthened partnership between private sector and government state policy.

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1 Chairman Perfecto R. Yasay, Jr. speech at the Manila Peninsula (27-28 Feb. 1996); Interview with Eduardo de los Angeles (19 March 1997).

2 THE PHILIPPINES: THE NEXT ASIAN TIGER 59 (1996).

> [T]he stronger participation of the private sector in the overall economic expansion has been due largely to the government's opening of new investment opportunities through privatization and the involvement of private capital in large scale infrastructure undertakings. The privatization program alone involves the disposal of a total of 301 government-owned and controlled corporations, as well as the sale of nearly 400 non-performing assets that state financing agencies had been forced to acquire during the recession of the early 1980's. More recently, the opening up of domestic industries to foreign investors has further widened these opportunities to the global economy.[3]

The Aquino government's initiatives were continued and brought closer to fruition by her successor Fidel V. Ramos. First among Philippine presidents to peg the success of his government on the performance of the Philippine economy, Ramos articulated his vision of "Philippines 2000" in 1992, and "the country's capital market development [is considered as] one of the pillars that undergird"[4] this vision.

B. *The Post-Marcos Stock Market: Pressure on the Existing Legal Framework*

Stock market growth in the last ten years has been dramatic. In the past, companies listed on the exchanges to gain tax advantages. Very wealthy families which owned corporations found it cheaper to transfer shares by crossing them on the exchange rather than by effecting a private transfer. Private stock transfers were imposed a capital gains tax of 10% on the first P100,000.00 and 20% on the next P100,000.00 gain. By way of contrast, the old transaction tax on shares crossed on the exchange was 1/4 of 1% of the gross selling price. Since the 1990's, however, companies have increasingly accessed the capital markets as a cheaper source of capital.[5]

1. INADEQUATE AND CUMBERSOME LEGAL FRAMEWORK

The tremendous increase in capital markets activity exerted great pressure on the inadequate regulatory framework. While Philippine securities law is based on American federal and state securities law, the Philippine SEC, unlike its American counterpart, did not generate detailed rules to regulate the activity over the years. There did not exist any rules on what the prospectus should contain, nor rules on what kind of information to disclose. Neither were there any rules on the timing of disclosures. Practitioners borrowed heavily from the forms and practices of American lawyers and securities industry participants.

3 *Id.*

4 President Fidel V. Ramos, speech at the Asia-Pacific Forum Securities Market Regulation in 1993, Annual Report of the Philippine Stock Exchange, at 3.

5 Interview with Eduardo de los Angeles (19 March 1997).

In addition, many features of Philippine securities law were found anachronistic and cumbersome. Foremost among these were the merit powers of the SEC, particularly the prominent role the SEC played as a public investment adviser, seen in its review process for registration statements and, significantly, its power to fix the price of an offering, to wit:

> [T]he SEC requires the pricing of a new issue to be justified if it is set above the par value. The concern of the SEC is to avoid an offering price based on a high p/e ratio. Thus, the SEC will at times direct a lower offering price to "protect" the public, or to prevent a failure in the public offering because the issue is priced too high.[6]

2. LACK OF PROFESSIONALISM IN THE STOCK EXCHANGE

Likewise, problems existed in the heretofore under-regulated stock exchanges. There were two exchanges – the Manila[7] and Makati[8] stock exchanges – which were trading the same set of stocks but at different prices:

> Price levels on either exchange usually differed, a fact which many local investors exploited by way of arbitrage trade. Foreign investors stayed out of the market unless they preferred long-term investments in a small number of blue chips.[9]

Since 1988, the Philippine SEC had been trying to force a merger of the two exchanges but found the decades-old rivalry between the two bourses difficult to surmount. Unification was finally achieved in 1992 when, on the occasion of the Philippine SEC's 53rd anniversary, Manila Stock Exchange Chairman Robert Coyiuto and Makati Stock Exchange Chairman Eduardo Lim signed the Joint Declaration on the Unification of the Stock Exchanges in the presence of President Ramos and then-SEC Chairman Rosario N. Lopez. Notwithstanding unification and more modern facilities, the Philippine Stock Exchange (PSE) was still run like an old boys' club.[10]

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[6] Eduardo de los Angeles, *Rules on Disclosure and Enforcement in the Philippines*, 4 PACIFIC RIM & POLICY JOURNAL 691, 709 (July 1995), quoting Securities and Exchange Commission, Financial Requirement for Registration of Securities.

[7] The Manila Stock Exchange was established on 8 August 1927 by five American businessmen, W. Eric Little, Gordon W. Mackay, John J. Russell, Frank W. Wakefield, and W.G. Elliot. It was originally located in downtown Manila then transferred to Pasig in 1992. Quoted from *Appendix A*, PHILIPPINE STOCK EXCHANGE FACT BOOK, (1995).

[8] The Makati Stock Exchange was organized on 27 May 1963 by five businessmen, namely, Hermenegildo Reyes, Bernard Gaberman, Eduardo Ortigas, Aristeo Lat, and Miguel Campos. Due to several difficulties encountered from those who opposed its creation, MkSE's operations started only on 16 November 1965. It was located in Makati, the financial district of the Metro Manila. *Id.*

[9] THE PHILIPPINES: THE NEXT ASIAN TIGER 95 (1996).

[10] The Philippine Stock Exchange was incorporated in 1993. At present, the Manila and Makati factions of the PSE are still physically separated: there is one exchange but two trading floors. The Manila faction occupies the Tektite Towers trading floor, while the Makati faction occupies the Ayala Avenue trading floor.

Because of the crucial role the capital market was designated to play in the Philippines' economic future, the Philippine government, with the help of the Asian Development Bank (ADB) and the US Agency for International Development (USAID), began the comprehensive reform of the Philippine capital markets. Called the "Capital Markets Development Program," the reform centered on the following objectives:

- the transformation of the Philippine Stock Exchange into a self-regulating organization and putting a limit on the SEC's jurisdiction over the exchange
- *a shift from merit regulation for companies applying for IPO's, which will allow the firms to determine themselves, depending on existing market conditions, the price levels for shares being offered*
- the implementation of a "workcell concept" of management at the SEC, to streamline operations and processing of applications. This plan involves the realignment of personnel along with certain changes that will lead to faster processing of corporate applications.[11]

C. *Objectives*

This paper will examine more closely the second objective in the light of the historical evolution of Philippine securities law. It intends, in particular, to clarify what precisely the philosophy and nature of current and proposed Philippine securities regulation is. It is said, for instance, that Philippine securities law is essentially "blue sky legislation," but in the same breath, it is claimed that the law is based on the Securities Act of 1933 and the Securities Exchange Act of 1934, both of which create disclosure regimes.

In addition, this paper attempts to evaluate whether this intended shift in philosophy is truly in the best interests of the Philippine capital markets.

II. HISTORICAL BACKGROUND OF PHILIPPINE SECURITIES LAW

A. *The Influence of Spanish Law on Philippine Business Law in General*

Philippine law is a curious mix of Spanish civil law and American common law tradition. Commercial activity was initially regulated under the Spanish Code of Commerce. This Code was ordered published as law in Spain by the Spanish Cortes on 22 August 1885, entered into force on 1 January 1886, and extended to the Philippine Islands by Royal Decree on 6 August 1888. Hence, business

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[11] *Supra* note 2, at 100 (emphasis supplied).

organizations during the Spanish era were created under and regulated by this Spanish Code of Commerce. During the Spanish period, the business form closest in nature to the corporation was the *sociedad anonima*, but this form existed more in the statute books rather than in actual practice. Consequently, legal provisions applicable to the *sociedad anonima* "were seldom interpreted by Philippine courts."[12] Emilio M. Javier explains that:

> Business on a corporate basis was not very popular in the Islands during the Spanish regime. The usual form of conducting corporate business then was by general co-partnerships and limited co-partnerships. The Spanish colonial policy of monopoly and restriction and the discouraging state of affairs then prevailing undoubtedly contributed materially to the backwardness of business and commerce during those years.[13]

Apart from Spanish colonial policy, social conditions made capital scarce and hindered the development of industry and commerce in the Islands. Finally, the Church perpetuated an attitude among the people "to consider the benefits of the ultra-mundane life rather than the temporal material progress in the world."[14]

B. *The Influence of American Law on Philippine Business Law in General*

The Philippines was formally ceded to the United States by Spain on 11 April 1900, under the terms of the Treaty of Paris which ended the Spanish-American War. Many changes were introduced to Philippine law during the American regime. While civil and criminal laws basically stayed the same, many changes were wrought on political law, procedure, and business law.

Because there was no commercial entity corresponding the American corporation in Spanish law,[15] the Philippine Commission enacted the Corporation Law (Act 1459) on 1 March 1906. This law was similar to various state general incorporation statutes in operation throughout the United States during the time and was interpreted by Philippine courts using American precedents. Ordinarily,

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[12] EMILIO M. JAVIER, PHILIPPINE AMERICAN LAW ON PRIVATE CORPORATIONS 2 (1933).

[13] *Id.* at 2-3.

[14] Juan T. Santos, *Suggested Reforms on the Philippine Corporation Law*, 8 PHIL. L.J. 145 (1928).

[15] Harden v. Benguet Consolidated Mining Co., 58 Phil. 14, *cited* in 1 EDUARDO CAGUIOA, THE CORPORATION LAW AND THE SECURITIES ACT 3-4 (1951): "When the Philippine Islands passed to sovereignty of the United States, the attention of the Philippine Commission as early drawn to the fact that there is no entity in Spanish law exactly corresponding to the notion of the corporation in English and American law . . . The evident purpose of the Commission was to introduce the American Corporation into the Philippine Islands as the standard of commercial entity and to hasten the day when the *sociedad anonima* of the Spanish law would be obsolete. The Corporation Law is a sort of codification of American corporate law."

as in civil or criminal law cases, Philippine courts during the American period would look to Spanish precedents for guidance in legal interpretation and application. In the absence of prior interpretation, the courts would look to the American common law. The same was true of the Corporation Law, especially since the *sociedad anonima*, the entity closest to the corporate form, was hardly in use during the Spanish period and consequently, Philippine courts seldom had the opportunity to interpret the provisions of law applicable to it.

C. *Philippine Securities Law Through the Years*

Oddly enough, the first securities law case decided in the Philippines during the American period involved, not the application of a securities statute, but of the civil law on contracts. Significant also is the fact that *Strong v. Repide*[16] is the first and last insider trading case ever decided or prosecuted in the Philippines.

In this case, defendant Repide was president and majority shareholder of the Philippine Sugar Estates Development Company, Ltd. and plaintiff Strong was a minor shareholder owning 800 shares. The Company was in the middle of negotiations with the Philippine government for the sale of its sole asset, land, which formed part of the friar estates. During negotiations, defendant hired an agent to purchase plaintiff's stock through plaintiff's agent without disclosing his identity or the status of negotiations between the Company and the Philippine Government. Plaintiff's agent sold her shares for $16,000.000 Mexican currency. Two months later, the shares were worth $76,256.00 U.S. currency. Plaintiff sought to annul the sale based on two grounds: (1) her agent's lack of authority and (2) defendant's fraud. The Court of First Instance and the Philippine Supreme Court annulled the sale based on the first ground, but not on the second.

On appeal, the US Supreme Court decided in favor of the plaintiff, but on a different ground. It based its decision on Article 1261 of the Philippine Civil Code which avoids a contract if consent was obtained through error, under violence, by intimidation, or by deceit. In this case, the sale was void because plaintiff's consent was obtained through deceit:

> Thus the deceit which avoids the contract need not be by means of misrepresentations in words. It exists where the party who obtains consent does so by means of concealing or omitting to state material facts, with intent to deceive, by reason of which omission or concealment the other party was induced to give a consent which he would not otherwise have given (Article 1269). This is the rule of the common law, but in both cases, it is based upon the proposition that, under all circumstances of the case, it was the duty of the party who obtained the consent, acting in good faith, to have disclosed the facts which he concealed.[17]

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[16] 213 U.S. 419, 430 (1908).

[17] *Id.* Strong v. Repide, 213, U.S. 419 (1908).

The first statute enacted to regulate the issuance and sale of securities was Act No. 2581, "An Act to Regulate the Sale of Certain Corporation Shares, Stocks, Bonds, and Other Securities." Passed in 1916 by the Philippine Assembly, it was referred to as the "Blue Sky Law" and, like the Corporation Law, was similar to various state securities statutes existing in the United States at that time. This Blue Sky Law was ineffective, because it failed to address crucial problems like the "over-issuance of stocks, watered stocks, price manipulations, churning and artificial markets caused by false information:"[18]

> Some of us today will still remember the unbridled speculation that characterized securities transactions in and out of our organized stock exchanges during the middle '30's. It was a bonanza period for fly-by-night and fake corporations and get-rich-quick wallingfords.
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> . . .
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> The deplorable situation brought about by the mining boom, and the attendant mushrooming of irresponsible issuers of corporate securities became so alarming that Government was rudely jolted into the realization that there was a pressing and urgent need to create an office technically manned and adequately clothed with power to protect investors, both actual and potential, and safeguard public interest.[19]

As a result, the First National Assembly under the Philippine Commonwealth passed in 1936 Commonwealth Act No. 83, "An Act to Regulate the Sale of Securities, To Create a Securities and Exchange Commission To Enforce the Provisions of the Same, and To Appropriate Funds Therefor." This law was likewise flawed. Thus, in 1982, the Batasan Pambansa passed Batas Pambansa Blg. 178, "The Revised Securities Act of the Philippines." The features and flaws of the above three laws will be discussed in detail and compared with each other in the third chapter of this paper.

III. The Philosophies of Securities Regulation

A. *The Process of Securities Regulation*

Securities regulation generally involves the registration and licensing of securities – or exemption from registration – and the corresponding review of the features of the company and the offering before the sale of said securities to the public. At this point, it would be helpful, for description and classification purposes, to identify the different kinds of registration as well as the different levels of review employed.

[18] De los Angeles, *supra* note 6, at 691, 692.

[19] *Id.* quoting Arcadio E. Yabyabin, *The Securities Act and Trading*, in Aspects of Philippine Corporation Law: Proceedings of 1966, 281-82 (1966).

1. KINDS OF REGISTRATION

The Report on State Merit Regulation of Securities (hereinafter, the "Report") identifies three types of registration, employed in both merit and disclosure systems.[20]

a. Registration by Notification

Registration by notification becomes effective automatically after the lapse of the required period of time after filing; thus, serious merit review is unlikely. On the one hand, state securities statutes which adopt this mode of registration impose stiff or rigorous quality criteria on issuers to be eligible for this kind of registration in the first place. The Securities Act of 1933, on the other hand, adopts this mode without imposing quality criteria on applicant issuers, but subject to the issuer's compliance with the disclosure requirements of the Act. Another term for this type of registration is registration by publication:

> The law makes the registration effective . . . after period of publication and this for the purpose of not only giving the Commission time to investigate the security but also of giving the public a chance to give their views on the proposed sale. However, the right to sell the security arises immediately after the lapse of the . . . period and does not require any positive action on the part of the Commission.[21]

b. Registration by Coordination

Registration by coordination becomes effective at the moment the federal registration statement becomes effective, provided that no stop order is in effect, that the registration statement has been on file with the administrator for a specific period, and that the pricing amendment has been on file for at least two days or for such shorter period as the administrator may permit. Automatic effectiveness, however, does not mean registration by coordination will avoid merit review. During the waiting period, the administrator can, and often does, review the offering in light of the applicable merit criteria. This type of application can be converted or withdrawn and be resubmitted as an application for registration by qualification.

c. Registration by Qualification

Registration by qualification refers to "the licensing of . . . securities before their sale to the public. However, the permit or license issued . . . is not a guarantee or endorsement of the security but is merely to show that the object

[20] *Report on State Merit Regulation of Securities Offerings*, 41 The Business Lawyer 785, 798-801 (May 1986).

[21] 2 Eduardo Caguioa, The Corporate Law and the Securities Act 752-53 (1951).

of selling the security is not for a fraudulent purpose."[22] Registration by qualification is employed in most states which have adopted the model statute called the "Uniform Sales of Securities Act" or the "Uniform Act." The most important feature of this type of registration is that the registration statement becomes effective only when the administrator so orders. Hence, positive action by the administrator is necessary for registration to be effective. The Report notes that it is difficult to generalize the level of merit review that is generally used for this kind of registration, because this mode is availed of by a broad variety of offerings – from companies required to report under the Securities Exchange Act of 1934 to small offerings.

2. KINDS OF REVIEW

The Report identifies three levels of review employed to scrutinize registration statements.[23]

a. Technical Review

This kind of review is the least rigorous and the most superficial. It determines whether or not the correct form has been used, the appropriate information provided, and the necessary fees paid.

b. Disclosure Review

The administrator in this type of review examines whether or not the disclosures are adequate, based on the requirements of the statute. There is an objective criteria for gauging whether or not disclosures are adequate.

c. Merit Review

The administrator in this type of review examines the substantive terms of the offering and underlying transactions. It is employed after technical review and disclosure review.

B. The Two Philosophies in General

US securities regulation has two levels – federal and state – and each has its own, very different regulatory philosophy. Federal securities law set up a disclosure regime and state securities statutes are generally said to be merit statutes. The philosophy often determines the kind of registration process as well as the level of review involved.

[22] *Id.*

[23] *Supra* note 19, at 785, 801-04.

1. MERIT REGULATION

a. Definition

The Report defines "merit regulation" in this manner:

> [A] regulatory system that authorizes state administrators to deny registration to a securities offering unless the substantive terms of the offering and the associated transactions (i) ensure a fair relation between promoters and public investors, and (ii) provide public investors with a reasonable relation of risk to return. While merit and disclosure regulation should not be regarded as antitheses, *merit regulation differs from disclosure regulation in its direct regulation of the internal structure of securities issuer, of the relations among insiders and outsiders, and of the terms of the offering.*[24]

b. Background

Merit regulation is associated with state securities statutes or "blue sky laws." Significantly older than the federal securities laws, state blue sky laws "originated in Kansas in 1911 and, prior to World War I, spread rapidly throughout the Midwest, West, and South in response to a perceived increase in securities fraud."[25] Described as "highly paternalistic statutes," state blue sky laws imposed stringent substantive requirements, allowed very few exemptions from registration, and established administrative agencies with broad authority to implement and enforce these statutes:

> As a group, these statutes reflected a complex set of assumptions about the capital markets and government's responsibilities toward them. They reflected, primarily, a strong sense of the ordinary person's vulnerability to securities fraud. The image constantly invoked by the early administrators is that of the unfortunate widow or the naive farmer gulled by persons who "would sell building lots in the blue sky in fee simple."
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> The blue sky laws drew on the sense of victimization associated with the populist unrest as they created a regulatory scheme designed to protect the innocent not only from the local confidence men, but from the investment bankers, the broker-dealers, and the corporations operating out of eastern financial centers. The blue sky law's preoccupation with fairness, which dates from its earliest days, stemmed from this vivid sense of the disparity in bargaining power between those who issued securities and controlled the securities markets, on the one hand, and public investors on the other.[26]

[24] *Id.* at 785, 829.

[25] *Id.* at 785, 791-792.

[26] *Id.*

c. Statutory Standards

The standards embodied in blue sky laws are either general or specific.

(1) General Standards

The following are examples of general standards found in blue sky laws: "fair, just, equitable," "the issuer is of bad business repute," "the affairs of issuer are in unsound condition," "the enterprise or business of the issuer is not based upon sound business principles." One important consequence of the existence of these broadly formulated standards in the law is that it grants the administrator . . .

> the authority to impose, in the name of fairness, a wide variety of restrictions and standards on all aspects of an offering and on the underlying transactions. The administrators have used this general authority to create a complex network of specific merit requirements.[27]

(2) Specific Standards

Some blue sky laws, like those patterned after the Uniform Act, do not articulate general standards, but have a full-disclosure requirement with specific articulation of the most important merit criteria. Over the years, states have evolved very specific merit criteria depending on the type of issuer (e.g., real estate, investment company, mining, etc.) and nature of offering (corporate equity offerings, etc.). In the case of initial public offerings, for example, specific statutory standards address the following concerns: offering price; amount of cheap stock; limitations on options and warrants as to value, duration, and persons entitled to subscribe; conflicts of interest among participants; commissions of underwriters; existing capitalization; the extent of promoters' investment; voting rights; the issuer's loans; and the expenses of the offering.[28]

d. Goals

Merit regulation has four general concerns: fairness, risk, fraud prevention, and investor confidence:[29]

(1) Fairness

The Report states that the first goal of merit regulation is to ensure fair treatment of the public investor by the promoters of the corporation. Thus, merit statutes attempt at a systematic definition of the proper relations between insiders

[27] *Id.* at 785, 805-806.

[28] *Id.* at 785, 810-811.

[29] *Id.* at 785, 824-829.

and public investors, the aspects of which include the following: (1) fair offering price, i.e., administrators try to see if the offering price is justified by, among others, the price to earnings ratio and the performance of comparative stocks; (2) the administrator tries to ensure that promoters and the public are equally subject to the risk of the enterprise; (3) the administrator tries to enhance the public investor's ability to exercise control over the entity after the offering is completed and throughout the duration of the venture, usually achieved by assigning corporate shareholders with certain voting rights.

(2) Risk

The administrator functions as a public investment adviser by registering only those offerings which provide public investors with what the administrator considers a reasonable possibility of return or by restricting the class of offerees to those persons the administrator deems able to bear the risk. The Report notes that there are *no express merit standards* of appropriate risk.

(3) Fraud Prevention

This goal is similar to the goal of federal securities laws, i.e., to prevent fraud before its damage is wrought. It is argued, however, that merit review has a more general prophylactic effect than SEC disclosure review because: (1) it covers a broader range of facts and issues, (2) properly conducted merit review is more likely to find problems than SEC review, and (3) many offerings are never reviewed by SEC.

(4) Investor Confidence

While opponents would say merit review hinders capital formation because of cumbersome procedures, advocates would say merit regulation facilitates capital formation by bolstering investor confidence in the securities markets. The Report notes, however, that this goal assumes that merit standards are industry standards.

2. DISCLOSURE REGULATION

a. Background

Federal Securities Laws were not the first to recognize the information needs of shareholders. State securities laws did contain provisions giving shareholders the right to examine corporate books and records. Most of these codes, however, provided ineffective access and imposed no affirmative disclosure requirements. In addition, even this very limited right to examine was curtailed by corporations which tended to treat the information as proprietary.

Some state blue sky laws and the New York Stock Exchange (NYSE) did impose affirmative disclosure requirements, such as the submission of an annual report, but these were largely ineffective because they provided only a

momentary glimpse of a company's financial condition, and were rendered virtually useless due to easily manipulated non-uniform accounting standards.

But while accurate and complete disclosure by publicly traded companies was not the order of the day, this inadequacy "became more glaring with the explosion of stock ownership after the turn of the century."[30]

b. Federal System Adopts Disclosure Philosophy

The stock market crash of 1929 and the Great Depression exacerbated the deficiencies of the *status quo* and provided the impetus for new legislation:

> In the aftermath of the greatest economic downturn this country has known, Congress set out to uncover and correct the causes of the crash. The securities markets represented one area demanding swift and thorough attention . . . Congressional hearings uncovered a myriad of abuses. Insiders took advantage of non-public information, profiting handsomely. Stock prices often gyrated up and down through the deliberate manipulation of investors. Companies sold stock to the public at inflated prices. The hearings gave the distinct impression that sophisticated investors and insiders manipulated the market, usually to the detriment of less savvy shareholders.[31]

(1) The Securities Act of 1933

In 1933, Congress passed the Securities Act of 1933. The 1933 Act sought to ensure the provision of adequate information during public offerings. Absent an applicable exemption, securities could only be sold if covered by an effective registration statement which fully described the company and set forth all the risks of the investment. The 1933 Act also created the Securities and Exchange Commission (US SEC) as the agency tasked with overseeing the implementation of laws regulating the securities industry.

Significantly, this law did not follow the regulatory scheme of the states but embraced the disclosure philosophy articulated by Justice Brandeis: "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[32] Thus,

> [i]n enacting the Securities Act of 1933, Congress declined to approve a regulatory scheme that called for a system of merit review. Instead, Congress enacted a system of regulation based upon disclosure. As long as the risks of an investment were set forth in the registration statement, the sec rities could be sold, no matter how speculative.[33]

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[30] J. ROBERT BROWN, REGULATION OF CORPORATION DISCLOSURES § 2.01 at 2-3 (1995).

[31] *Id.* at 2-4.

[32] Louis Brandeis, *What Publicity Can Do,* OTHER PEOPLE'S MONEY (1914).

[33] BROWN, *supra* note 29, at 2-4.

(2) The Securities Exchange Act of 1934

Because the 1933 Act only governed initial public offerings, Congress passed the Securities Exchange Act in 1934 and extended information requirements to secondary markets through a system of continuous disclosure. Under the 1934 Act, the SEC had authority to require companies to file periodic reports and made these filings available to shareholders in order to effect the broader purpose of protecting not just shareholders, but all investors in the market. The 1934 Act also contained provisions governing the proxy process. The 1934 Act was animated by same philosophy as that of the 1933 Act:

> No investor, no speculator, can safely buy and sell securities . . . without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of the security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operations of the markets as indices of real value. There cannot be honest markets without honest publicity.[34]

(3) System of Integrated Disclosures

Prior to 1980, the two Acts had two distinct disclosure systems, each with their own requirements; hence, there was a lot of duplication and overlap. In 1980, the SEC commenced a program of integrated disclosure under the two Acts in order to achieve a more uniform and simplified disclosure system. The goal was to provide investors and the market with meaningful, nonduplicative information both periodically and when securities are sold, and to decrease the cost of compliance for public companies.

c. State Statutes Not Preempted

The enactment of the Federal Securities Laws did not spell the end of state blue sky statutes, as these Acts were not meant to replace or supplant the latter. Indeed, the Acts contain language expressly saving said laws from preemption. Hence, there are two layers of securities regulation and, consequently, two regulatory philosophies, existing in the United States. Nonetheless, over the years, a large number of SEC-registered offerings have come to be exempted from state merit review (safe harbors): (1) offerings by issuers listed on national exchanges; (2) secondary distributions of securities listed in certain securities manuals; (3) over-the-counter (OTC) offerings that meet blue-chip criteria, or those included on the Federal Reserve Margin list, or those traded on some part of the National Association of Securities Dealers Automated Quotations (NASDAQ) system.

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[34] BROWN, *supra* note 29, at 2-5, *citing* H.R. Rep. No. 1383, 73d Congress, 2d. Session 11 (1934).

c. Registration and Disclosure Obligations Under Federal Securities Laws

As earlier noted, the 1933 Act's mode of registration is registration by publication. Applicant issuers are required to file a registration statement covering all significant aspects of an issuer's business: thorough description of the issuer's business, property, management; management analysis and review of issuer's capital needs, solvency, and financial performance, including analysis of any variances in revenues or profits from the preceding year; a detailed description of the rights, privileges, and preferences of the offered security and capital structure of firm; and risk factors.[35] The 1933 Act also requires that a prospectus containing essentially the same information as that required to be included in the registration be delivered to the investors prior to sale.

As a general rule, the Federal Securities Laws imposes no duty to disclose material[36] developments affecting the issuer. There are exceptions, however: (1) mandatory filing requirements (which are the focus of this study); (2) the company must disclose or abstain from trading its own shares when in possession of material non-public information; (3) the company must disclose if necessary to make a statement, in the light of the circumstances under which it is made, not misleading (i.e., completeness); (4) Exchange (NYSE, NASDAQ, Amex) disclosure obligations; and (5) the company may have a duty to disclose material developments to the entire market following leaks to select individuals who trade on the information.

Extensive civil, criminal, and administrative liabilities ensue for selling a security without an effective registration statement and for inaccurate or inadequate disclosures. Sec. 24 of the 1933 Act and Sec. 32 of the 1934 Act penalize willful violations of their respective provisions of their respective Acts and their accompanying rules and regulations by criminal sanctions. Sec. 12(1) of the 1933 Act grants a rescissionary remedy to a purchaser against the seller[37] if the latter offers or sells securities in violation of Sec. 5, i.e., without an effective registration statement. Under Sec. 11 of the 1933 Act "a director of the issuer at the time the registration statement was signed, even if not a signatory thereto, along with every accountant, engineer, or appraiser who prepared or certified any part of the registration statement, and every underwriter involved in the

[35] *See* JAMES D. et al. SECURITIES REGULATION: CASES AND MATERIALS 45 (1991).

[36] The Probability/Magnitude states that: "[I]nformation is material if there is a 'substantial likelihood' that a 'reasonable shareholder would consider it important' in making an investment decision." *See* BROWN, *supra* note 29, at 5-3 (1995).

[37] According to the Wilson v. Saintine Exploration and Drilling Corp., 872 F.2d. 1124 (2d. Cir. 1989), the notion of "seller" was expanded after the case of Pinter v. Dahl, 486 U.S. 622 (1988): "Persons who are not in privity with the plaintiff but who would have been collateral participants under our former caselaw will now be *statutory sellers within the meaning of Pinter if they solicited sales in question for a financial gain.*" Quoted from Brown et. al, *supra note* 34, at 657 (1991) (emphasis supplied).

distribution, could be held liable for material misstatements or omissions in the registration statement."[38] Sec. 12(2) of the 1933 Act also grants a rescissionary remedy to those who purchase securities, registered or unregistered, from sellers, if they relied on false or misleading representations in the prospectus and oral communications. Most significant among the civil remedies is Rule 10b-5, enacted pursuant to Sec. 10 of the 1934 Act, which grants actual damages to a defrauded party against persons who make material misstatements or omissions or who fail in a material way to meet duties to disclose in connection with the purchase or sale of a security. It is necessary to prove scienter or recklessness on the part of the defrauding party and reliance[39] on the part of the defrauded party.

3. THE PHILIPPINE VIEW ON MERIT v. DISCLOSURE DEBATE

While the merit v. disclosure regulation debate is no longer as significant in US securities law, it has gained recent prominence in the Philippines due to reform efforts aimed towards eliminating merit standards and review in Philippine securities law. As understood by the Acting Chairman Perfecto R. Yasay, Jr. of the Philippine Securities and Exchange Commission,

> Full disclosure refers to the obligation of a corporation that proposes to raise capital through the sale of shares to the public to reveal all material information about its operations on a full and timely basis. This obligation to disclose continues throughout the life of a corporation and is essential to enable the public to make informed investment decisions. It requires a corporation coming to the capital market for the first time to include in their registration statement filed with the SEC and the prospectus delivered to investors, all material information about their past business history and present operations. It also requires them to be honest in disclosing all of the risks of investment in their corporation. They must continue that same level of disclosure in their quarterly reports and their annual reports to the SEC and their shareholders.
>
> While full disclosure is an obligation of the issuing corporation, merit regulation on the other hand is an obligation of the regulator. Under a merit regulation scheme, the regulator is obligated to determine whether a particular corporation should be allowed to raise capital from the public. Merit regulation includes such things as determining whether or not the corporation is in sound financial condition, whether or not its management

[38] De los Angeles, *supra* note 6, at 691, 695. *See also* Pelagio T. Ricalde, *Liabilities for Misrepresentations and Omissions in the Registration Statement under Section 30 of the Securities Act*, 55 PHIL. L.J. 159 (1980) and Pelagio T. Ricalde, *Towards a New Securities Act*, 56 PHIL. L.J. 306, 316-19 (1981).

[39] In Basic Inc. v. Levinson, 485 U.S. 224 (1988), the Supreme Court explains the reliance requirement (fraud on the market theory): "We agree that reliance is an element of a Rule 10b-5 cause of action . . . Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury . . . There is, however, more than one way to demonstrate a causal connection." Quoting In Re LTV Securities Litigation, 88 F.R.D. 134, 143 (ND Tex. 1980):

is honest, whether or not the corporation conducts its business in accordance with the law or according to sound business principles as well as other factors. Under a merit regulation scheme, the regulator presumably is in a position to make these judgments based on information filed with it by the corporation as well as information in the public domain.[40]

Comparing the underlying assumptions of the two systems, Yasay points out that merit regulation assumes that investors are unsophisticated and unknowledgeable, while full disclosure assumes that securities salesmen are required to know their customers and to make certain that investments are suitable for them. Second, merit regulation holds the government responsible for protecting investors from unsuitable investments, while full disclosure considers institutional investors sophisticated and able to determine the appropriateness of particular companies for investment. Finally, merit regulation assumes that the regulator is an expert in determining which companies are good investments and thus should be responsible for screening out those companies that do not merit access to the capital markets, while full disclosure holds the regulator responsible for ensuring that investors have all the information they need to make sound investment decisions including the degree of risk they desire in their investments.

Yasay examines the above assumptions:

What is the purpose of merit regulation? Since it assumes that the investor is unknowledgeable, the regulator is put in a position to protect the investor from bad investments. Is this possible? Can the regulator insure that investors are not burned? Does the regulator have all the information as well as the necessary expertise to make such judgments for investors? As a regulator myself, I must profess a resounding NO! Regulators are not investment advisors. We are not in a position to know which corporations are operating under sound business principles. Like you, we can only make judgments based on available information. Should we be responsible for protecting unsophisticated investors from risky investments? I don't think so . . . .

[The full disclosure system] rejects the notion that the regulator can or should protect the investor from making poor investment decisions. Institutional investors don't need that and, in fact, resent a system which allows government to limit which corporations can raise capital from the public. The full disclosure system also recognizes that the small investor is not left out in the cold without any guidance. The broker's securities representative or salesman is charged with the responsibility of knowing his customer. He should not recommend nor allow his customer to buy a security which is inappropriate or too risky for his financial situation and objectives.

"Thus the market is performing a substantial part of the valuation process performed by the investor in a face-to-face transaction. The market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price." *Cited* in Cox et al, *supra* note 34, at 791-92.

[40] Perfecto R. Yasay Jr., Full Disclosure v. Merit Regulation, speech on file with the writer.

Finally, the full disclosure system places an obligation on both the corporation and the regulator to insure that all material information on the corporation is available to the public in making investment decisions. *Rather than making judgments on the quality of the company, the regulator is charged with ensuring that the company disseminates material information on their operations and financial status in a timely and complete manner. Where they do not, the regulator must take appropriate enforcement action.*[41]

IV. THE PHILOSOPHY OF PHILIPPINE SECURITIES LAW

Philippine securities law is rather schizophrenic. As earlier mentioned, Philippine law commentators like to describe it as "blue sky legislation," therefore implying that it embodies a merit philosophy. Nonetheless, commentators also claim that the said laws are patterned after *both* US Federal Securities laws (a disclosure system) and the Uniform Sale of Securities Act (a merit system). It is interesting to note how freely US precedents interpreting both the Uniform Act and Federal Securities statutes are used to interpret Philippine securities law, despite differences in the regulatory philosophies, thereby adding to the confusion in the process. Because of this confusion, an examination of the history of Philippine securities law might help in determining exactly what kind of regulatory philosophy animates Philippine securities law. Identifying the regulatory philosophy adopted will help in better assessing whether the mechanisms designed by the different laws are effective.

A. *Philippine Securities Law*

1. BLUE SKY LAW

The Philippine Blue Sky Law is very clearly a merit regulation statute. It employs registration by qualification and the administrator is required to issue a certificate or permit licensing the securities for sale. The only standard articulated in the law is a general merit standard of "in the public interest." This law contains very limited disclosure provisions. Sec. 2 of the Blue Sky Law requires only the following information: (1) name and location of company; (2) an itemized account of actual financial condition of the issuer; (3) the selling document; (4) the plan of proposed business. The liability for selling securities without registration and for false and misleading disclosures is the same: a fine of P10,000.00 and up to seven years imprisonment.

Just like American state blue sky laws, the Philippine Blue Sky Law was subjected to constitutional challenge. In the case *People v. Rosenthal*,[42] it was

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[41] *Id.*

[42] 68 Phil. 328 (1939). Summarized in Ephraim Tahir R. Mella, *The Proposed Stock Market Unification*, 35 ATENEO L.J. 168, 177, n. 19 (1990). This case cites People v. Fernandez, 65 Phil. 675 (1938) and

argued that the very broad standard "in the public interest" constituted an undue delegation of legislative power to the Insular Treasurer. The Philippine Supreme Court rejected this argument and ruled:

> In view of the intention and purpose of Act No. 2581 – to protect the public against 'speculative schemes which have no more basis than so many feet of blue sky' and against the 'sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines, and other like fraudulent exploitations,' the Tribunal held that 'public interest' in this case is a sufficient standard to guide the Insular Treasurer in reaching a decision on a matter pertaining to the issuance and cancellation of certificates or permits.

2. SECURITIES ACT

Combining the 1933 and 1934 Acts as well as the Uniform Act,[43] the purposes of the Securities Act reflect both merit and disclosure philosophies. It is said that the law "was enacted primarily 'to prevent exploitation of the public by the sale of *unsound*, fraudulent, and *worthless* securities through misrepresentation; to place *adequate and true information* before the investor; and to protect *honest enterprise* seeking capital by honest presentation, against competition afforded by *dishonest securities* offered to the public through crooked promotion.' "[44] Like older state blue sky laws and the Philippine Blue Sky Law, but unlike the Uniform Act on which it is purportedly based, the Securities Act articulates general standards but does not enumerate specific merit criteria.[45]

a. *Primarily a Merit Regime*

Annotations to the Securities Act cite US authorities used to annotate the blue sky laws. Like the blue sky laws which were enacted to protect the poor farmer of the Mid-West from exploitation by the businessmen of the Northeast,

the following US cases: Hall v. Gerger-Jones, 242 U.S. 539, 37 S. Ct. 217 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559, 37 S.Ct. 224 (1917).

43 Pelagio T. Ricalde, *Liability for Misrepresentations and Omissions in the Registration Statement under Section 30 of the Securities Act*, 55 PHIL. L.J. 159 (1980).

44 Pelagio T. Ricalde, *Towards a New Securities Act*, 56 PHIL. L.J. 306 (1981), quoting VICENTE FRANCISCO, UNDERSTANDING THE SECURITIES ACT 1.

45 In *Report on State Merit Regulation of Securities Offerings*, 41 THE BUSINESS LAWYER 785, 806-09 (May 1986), Uniform Act draftsman Louis Loss explains why no general standard was included among grounds for denial, suspension, or revocation of effectiveness of the registration statement (§ 306[a]) – inherent lack of specificity, BUT permits denial:

* when the offering has worked or tended to work a FRAUD upon purchasers or would so operate (§ 306[a][2][E]).
* when the registration statement is incomplete in any material respect or contains any statement which was false, misleading with respect to any material fact. (§ 306[a][2][A]).

the enactment of the Securities Act was motivated by a strong concern to protect the ignorant investor from unscrupulous businessmen. In a leading text, the commentator Caguioa quotes from Thompson:

> Of the purpose of these laws Mr. Justice McKenna observes: "It will be observed that the law is a regulation of business, constraining conduct only to that end, the purpose being to protect the public against the imposition of unsubstantial schemes and the securities based upon them. Whatever prohibition there is, is a means to the same purpose, made necessary, it may be supposed, by the persistence of evil and its insidious forms and the experience of the inadequacy of penalties, or other repressive measures. The name that is given to the law indicates the evil at which it is aimed; that is, to use the language of a cited case, 'speculative schemes which have no more basis than so many feet of blue sky' or as stated by counsel in another case, 'to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines, and other like fraudulent exploitations.' " Even if the descriptions be regarded as rhetorical, the existence of evil and a belief of its detriment is indicated; and we shall not pause to do more than state that the prevention of deception is within the competency of government, and that the appreciation of the consequences of it is not open to our review."[46]

Caguioa concludes that:

> The statute is essentially a Blue Sky which is the generic title of all statutes which relate to security frauds. The term "Blue Sky" originated from the state of Kansas where the legislature sought to regulate the sale of securities because otherwise, security dealers would be selling to the people an interest in the blue sky above them.[47]

b. *Features of Securities Act*

The Securities Act differs greatly from the Blue Sky Law. Apart from requiring the registration and/or licensing of securities (Sec. 4-13), it also: (1) required the registration of brokers and salesmen (Sec. 14-15); (2) required the registration of stock exchanges (Sec. 16-17); (3) provided rules for margin requirements (Sec. 18), borrowings by brokers and dealers (Sec. 19), manipulation of prices (Sec. 20), other manipulative devices (Sec. 21), artificial measures of price control (Sec. 21[a]), transactions of unregistered securities (Sec. 23), giving of proxies (Sec. 24), and over-the-counter markets (Sec. 25).[48]

The flaws of this law are numerous, but for the purposes of this paper, we will discuss only the flaws found in following: the registration process, the disclosure provisions, and the liability provisions.

46 CAGUIOA, *supra* note 21, at 733 *citing* 6 Thompson, Sec. 4145.

47 *Id.* at 734.

48 Summarized in Eduardo de los Angeles, *Rules on Disclosure and Enforcement in the Philippines*, 4 PACIFIC RIM LAW & POLICY JOURNAL 691, 694 (July 1995).

Non-speculative securities are registered by publication or notification, and in such case, the administrator employs only disclosure review. Speculative securities, however, are registered by qualification, and in this case, general merit standards are employed. Examples of these are "protection of investors," "good repute," "business is not based on unsound business principles," "issuer is not dishonest," and the affairs of the issuer are not "in unsound condition." It was argued that this scheme was faulty for the following reasons:

> First of all, is our SEC capable of determining whether a security is speculative? . . . Secondly, can our SEC assure the public that the issuer is "of good repute" or that the issuer's business or enterprise is not based upon *"unsound business principles?"*[49]

The registration statement required under Sec. 7 of the Securities Act enumerates more information than that required under the Blue Sky Law, but is still rather thin.

> [U]nlike the 1933 Act, the Securities Act did not require a statement of the securities covered by options; the full particulars of the nature and extent of the interest, if any, of every director, principal executive officer and of every stockholder holding more than ten percent of any class of stocks of the issuer; the dates of and parties to every material contract made, not in the ordinary course of business; any management contract; and the names and addresses of counsels who have passed upon the legality of the issue.[50]

Furthermore, unlike Federal Securities Law, the Securities Act did not require the disclosure of all material facts related to an offering but only "certain information." There were no prospectus delivery requirements, and issuers were only asked to submit financial statements once a year. One innovation from the Blue Sky Law, which is not present in the Securities Act, is the report to be submitted by directors, officers, and principal stockholders. Under Sec. 26 of the Securities Act, said parties must file a statement with the exchange and the SEC, specifiying the amount of all securities of an issuer of which he is the beneficial owner, at the time he becomes a director, officer, or beneficial owner and within ten days after the close of each calendar month. The Report must indicate changes in ownership.

By far the worst flaws of the Securities Act, however, are its liability provisions. Under Sec. 30 of the Securities Act. the issuer (or dealer), director, officer, or agent of the issuer could be held solidarily liable to a purchaser of securities if the former personally participated or aided in the sale. In addition, the purchaser must prove privity of contract and reliance upon the statement. This requirement in Sec. 30 is in contrast with Sec. 11 of the 1933 Act, discussed in the preceding chapter, which does not require personal participation or aiding

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[49] Ricalde, *supra* note 43, at 306, 309.

[50] De los Angeles, *supra* note, 6 at 691, 694.

and dispenses with proving privity and reliance. It is sufficient under Sec. 11 that the registration statement contain material misstatements or omissions.

3. REVISED SECURITIES ACT

a. Rationale

To remedy the flaws in the Securities Act, the Batasang Pambansa enacted the Revised Securities Act in 1982, which expanded the meaning of 'securities,' increased disclosure requirements, broadened the SEC's rule-making authority, contained new anti-fraud provisions to counter insider trading and short swing profits, and contained a number of other provisions designed to strengthen overall enforcement.[51]

b. Features

The Revised Securities Act no longer distinguished between speculative and non-speculative securities. Registration of all securities required to be registered was by qualification. Identical merit standards existed, and were accompanied by a strong exhortation to watch out for the public interest and to protect investors. Like the Philippine Blue Sky Law and the Securities Act, the Revised Securities Act adds but articulates only general merit standards: "conditions for the protection of investors have been met," issuer is "dishonest" or "not of good business repute," business is "not based on sound business principles," and the issuer has not shown to the SEC's satisfaction that the sale would not work to the prejudice of public interest or as a fraud upon purchasers or investors.

Disclosure provisions, however, were improved by making them more detailed. Section 8, which enumerates the contents of the registration statement, contained more or less the same requirements as Schedule A of the 1933 Act. Nonetheless, there were no prospectus delivery requirements, and post-offering disclosures were still inadequate. The Report to be filed by directors, officers, and principal shareholders was made more specific. The information to be submitted now include: (1) background, identity, residence, and citizenship of, and nature of beneficial ownership by, such person; (2) if the purpose of the purchases or prospective purchases is to acquire control, state any plans or proposals that will effect a major change in the issuer's business or corporate structure; (3) the number of shares beneficially owned; (4) information as to contracts, arrangements, or understanding with any person with respect to any securities of the issuer.[52]

Liability provisions were strengthened. There now existed both administrative and criminal liability. Civil liability provisions were strengthened; in particular, Sec. 11 of the 1933 Act was adopted as Sec. 13 of the Revised Securities Act.

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[51] *Id.* at 691, 695.

[52] Batas Pambansa 178, Revised Securities Act, § 32 (a)(1)(i) to (iv).

B. *The Philosophy and Nature of Philippine Securities Law*

1. THE SCHEME OF PHILIPPINE SECURITIES REGULATION

The philosophy of past and present securities law is merit regulation. While Philippine securities statutes copy some of the disclosure requirements of Federal Securities Law, it is misleading to conclude that the statutes adopt the disclosure philosophy of Federal Securities Law. In truth, however, the Securities Act and Revised Securities Act bear greater similarity to the Uniform Act. The Report describes how the Uniform Act attempted to achieve a modest reform of the merit regulatory system.

> The draftsman was apparently uncomfortable with the open-ended character of the general merit standards included in many of the state statutes. He did not propose abandoning the merit philosophy then characteristic of most blue sky laws. Apparently, no such fundamental rethinking of the economic goals of state securities regulation was possible if the conference's goal of uniformity was to be achieved. Instead, a *lawyerly solution* was reached: *express adoption of a full-disclosure standard combined with specific articulation of what were deemed the most important merit criteria.* This solution was acceptable to some of the states that adopted the Uniform Act and thus can be found in some of the blue sky laws today.[53]

It appears, therefore, that Philippine securities law adopts the scheme of the Uniform Act, which combines a full-disclosure standard with an articulation of the most important specific merit criteria. But the Securities Act and Revised Securities Act differ from the Uniform Act in that they contain a very broad, as opposed to highly specific, articulation of general merit criteria. In addition, disclosure requirements of both laws are highly inadequate, especially with respect to the prospectus and post-offering reports.

2. COMMENTS

a. *Demerit in Merit Regulation*

A product of borrowing and blending foreign statutes of two very different regulatory philosophies and two different resulting regulatory systems, Philippine securities law adopts the merit philosophy of blue sky laws, but its scheme combines a very broad articulation of highly general merit criteria with weak and inadequate disclosure requirements. Such a scheme would leave a lot of discretion to the SEC. State blue sky law administrators used broad authority to develop more specific standards in the practice. Absent more objective and specific guidance from the law and having failed to evolve more detailed rules in practice, the Philippine counterpart's administration of the law has been arbitrary and uneven.

[53] *Supra* note 19, at 785, 806-808 (emphasis supplied).

When the Philippine stock market became more active beginning the early 1990s, this severe lack of specific and objective rules and standards and the inconsistent application of said rules became more glaring. Thus, Philippine securities regulation, and consequently, its underlying philosophy, was perceived as not conducive to capital formation, in particular, and to the growth of the Philippine capital markets, in general. To reform the system and to achieve the goals of Philippines 2000, it was deemed necessary to adopt a new regulatory philosophy:[54]

> *These goals, however, cannot be achieved without adoption of a new regulatory philosophy* which will also require a change in regulatory approach and refocusing of SEC's securities market responsibilities. The main thrusts of the new philosophy in the SEC are the following:
>
> 1. *Cease all merit regulation where the SEC is somehow involved in determining the investment merit of securities;*
>
> . . . .
>
> Consistent with these thrusts and having in mind our desired goals, we have proposed legislative changes in various laws being implemented by the SEC. We realized that no matter what we do to strengthen the capabilities of the SEC, there are existing limitations along the way like statutory provisions that need to be amended. We have . . . proposed substantial and significant amendments to the Revised Securities Act, some of which are the following:
>
> 1. *Repeal of all merit regulations provisions and strengthening of the full disclosure mechanisms;*

b. *The Merits of Merit Philosophy*

This writer is not totally convinced that merit regulation is inappropriate for Philippine capital markets. The writer, however, would like to suggest that perhaps it is not the law's merit philosophy *per se* that is the root of all the arbitrariness in the administration of Philippine securities laws, but the problems have a lot to do with the scheme designed to implement the philosophy. As the Report suggests:

> The best approach to merit regulation is recognition, tempered by a healthy skepticism, of its positive goals. The skepticism should result from an awareness of the structural constraints upon merit regulation, the limited benefits it provides, and its costs. We should, however, appreciate how merit regulation can help prevent managerial self-dealing in certain transactions and in the absence of other regulatory or market mechanisms. The problem in defining a role for merit regulation is to determine when skepticism is more appropriate than respect.[55]

[54] Yasay, Jr. *supra* note 1.

[55] *Supra* note 19, at 785, 751.

Eduardo de los Angeles, former President of the Philippine Stock Exchange, acknowledges that it would not be wise to make the abrupt shift from merit regulation to a full disclosure system and believes that a combination of the two systems would be more suitable, at least until the market becomes more sophisticated.[56] He also notes:

> To be sure, the regulatory system in the Philippines includes many meritorious regulation practices. For instance, the SEC requires the pricing of a new issue to be justified if it is set above the par value. The concern of the SEC is to avoid an offering price based on a high p/e ratio. Thus, the SEC will at times direct a lower offering price to "protect" the public, or to prevent a failure in the public offering because the issue is priced too high. Examples of this are the Benpres and Petron offerings where the SEC wanted the issuers and the underwriters to reduce the offering price.[57]

Executive Director Eugenio Reyes of the Securities and Exchange Commission believes that a full disclosure system might just result in the SEC accumulating a lot more paper that the Filipino investor will not read anyway; thus, he bemoans the pressure from international experts to adopt an American-style system – lock, stock, and barrel.[58]

The Report notes that merit regulation is most useful in three situations: first, when market forces are inadequate to protect the public investor from promoters' unfair behavior (usually seen in the case of first-time issuers) and to prevent promoter overreaching;[59] second, "when it is confined to what it does best: promoting a fairer relation between promoters and public investors;"[60] and third, when it strikes an appropriate balance between ensuring fair treatment of the public investor and the diminishing incentives of entrepreneurs and venture capitalists."[61] However, the Report warns that merit regulation is "significantly less justifiable when the administrator functions as a kind of public investment adviser."[62]

Perhaps what might work for the Philippine situation is not abandoning on the wholesale merit concerns, but designing a system that incorporates the advantages of important merit criteria with a full disclosure standard. Perhaps

[56] De los Angeles, *supra* note 5.

[57] De los Angeles, *supra* note 6, at 691, 709.

[58] Interview with Executive Director Eugenio E. Reyes, Securities and Exchange Commission (25 Mar. 1997).

[59] *Supra* note 19, at 785, 851.

[60] *Id.*

[61] *Id.*

[62] *Id.*

merit criteria such as "unfairness" and "unsound business practices" can be objectified or spelled out in measurable terms. The SEC, for example, looks into details in the underwriting agreement which grants too many advantages to the underwriters or ties the issuer's hands too much. The market is as yet not sophisticated and transparent enough to be self-policing. Thus, maybe the Philippines is not yet ready for such a drastic change. It might be unwise at this point to discard merit concerns completely, because:

> [m]erit can play a useful, although limited, role in regulating a finite class of transactions in which market forces, private incentives, and federal and state disclosure requirements do not suffice to protect certain investors. Since merit regulation is not without cost, however, and because its benefits are limited, modesty of purpose and flexibility of means should not be built into it.[63]

c. *Non-Philosophical Problems*

But more important than the philosophy is the enforcement of the law. Insider trading is a serious problem in the Philippine capital markets, but, to date, there has not been a single insider trading case prosecuted either at the SEC level or in the courts. The first and last insider trading case was *Strong v. Repide*, decided in 1908 and discussed in Chapter Two of this paper.

Despite vast powers granted to it by the Revised Securities Act, the SEC does not use the said powers to discipline the brokers. In March 1997, some kind of *coup* was staged by staff members of the Philippine Stock Exchange. The PSE's Compliance and Surveillance Department monitored trading activity and found irregularities in the practices of some of the brokers. This report was supposed to have been submitted to the SEC for investigation. For some reason, the brokers prevailed upon the one non-broker member of the PSE's board of directors, Mr. Vitaliano Nanagas, and the report was buried. Mr. Nanagas demoralized and lost the support of PSE staffers, and he eventually resigned from the PSE, not without a generous golden parachute. To date, the SEC has decided to adopt a wait-and-see attitude rather than pursue the investigation.[64]

Reflecting on his own experience as PSE president, de los Angeles describes the Philippine brokers as "very myopic – they cannot see that if they clean up their act, more investors will come in. The problem is that, with many blue chip companies listed, the exchange will not perform badly, but it can perform better." Worse is that, despite the modern facilities, the PSE still functions like an old boys' club, with the members protecting each other. Thus, de los Angeles acknowledges that dealing with the brokers requires a great deal of political will, balanced with flexibility and an ability to compromise. He cautions that "you cannot afford to isolate yourself." He recalls the best piece of advice he received

[63] *Id.* at 785, 852.

[64] De los Angeles, *supra* note 5.

as PSE president: the President of the Madrid Stock Exchange advised him to "act like a fisherman." Like a fisherman, an exchange president must know when to tighten the line and when to loosen it, but always, drawing the fish closer, until they are caught.[65]

As for the Philippine SEC, this situation recalls a similar event in the early years of American securities regulation. One of the greatest achievements of then-US SEC Chairman, William O. Douglas was industry self-regulation under the close supervision of a government agency. In Douglas's view,

> [i]ndustry . . . had to retain the initial responsibility for preventing fraud or unfairness, both because it could act swiftly and more subtly than a government bound by due process standards and could avoid "the bureaucratic blight of a too intrusive government police force." But an agency like the SEC had to move aggressively when industry self-discipline failed to maintain high ethical standards.[66]

Douglas outlined the approach he would apply to the stock exchange and over-the-counter markets in a letter to Willis Ballinger, describing how he would have regulated investment bankers:

> I proposed that the investment bankers and issuers be forced to police their own industries. I suggested a code authority for that purpose. I believed that the bankers were among the least socially minded groups in society. I had seen them either wink at or close their eyes to the practices of their brethren for years. My idea was to force them to approve or disapprove in public fashion the practices in their field. I felt this would accomplish two things: (1) it would help to clean up some of the worst practices which could not stand the light of public endorsement; and (2) it would make the bankers more vulnerable at the hands of the commission and other agencies of the government. They would so to speak be on the spot.[67]

It was a difficult struggle from the onset. Similar to the problems encountered when the Manila and Makati Stock Exchanges were merged, Douglas experienced great resistance from the New York Stock Exchange's Old Guard. Slowly, through a combination of public and private pressure, the Old Guard was replaced by a faction of more progressive brokers and SEC-endorsed rules were adopted. But what provided Douglas the biggest break was the Whitney Scandal,[68] when Douglas seized the initiative and was successful:

[65] *Id.*

[66] JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 158 (1995).

[67] *Id.*

[68] In March 7, 1938, the new NYSE board, applying newly ratified Exchange rules, voted charges of misconduct against Richard Whitney, a prominent broker, who later pleaded guilty to indictments for grand larceny and misappropriating $105,000 of securities from a trust fund established by his late father-in-law. JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 167-70 (1995).

> The scandal offered him and the SEC a once-in-a-lifetime opportunity. As long as Douglas could protract and publicize the revelations of the Whitney scandal, he would neutralize the ability of the financial community to oppose SEC efforts further to reform the Exchange or seek additional enabling leglislation.[69]

The Nanagas resignation and the chaos that ensued in the PSE afterwards similarly offers a momentous opportunity to this Philippine SEC, and it must act, lest it lose the initiative for years to come.

V. PROPOSED REFORMS: THE SECURITIES REGULATION AND ENFORCEMENT ACT

Part of the Capital Markets Development Program was an intensive review of the Revised Securities Act. To date, five separate bills have been filed in both houses of Congress which are intended to repeal the current law. Below is a description of one of the bills, Senate Bill No. 901, The Securities Regulation and Enforcement Act. While not representative of all the other bills, its provisions help give an idea of the direction which Philippine Securities Law will probably take.

A. Features

One of the biggest differences between this bill and past laws is the registration process. Rather than registration by qualification, the bill employs registration by publication. A registration statement becomes effective 45 days after filing, the waiting period to be stopped only when more disclosures are required.[70] The bill adds to current disclosure requirements. It imposes a prospectus delivery requirement[71] and spells out the general contents of periodic filings. For example, the law adds a balance sheet, profit/loss statement and a management discussion and analysis.[72] As in the Revised Securities Act, liability is of three types: administrative, criminal, and civil, but the provisions are clearer. General penalties include Sec. 59, an administrative penalty subjecting the offender to the suspension or revocation of the registration statement, a fine of P10,000 to P1,000,000, and disqualification; and Sec. 70, a criminal penalty subjecting the offender to a fine of P50,000 to P5,000,000 and seven to 21 years imprisonment.

[69] SELIGMAN, *supra* note 65, at 169.

[70] Senate Bill No. 901, Securities Regulation and Enforcement Act, § 4.

[71] *Id.* § 4(b).

[72] *Id.* § 13 and 14.

Significant, however, is the deletion of the general merit criteria contained in previous laws, such as "good business repute" or "unsound business principles." Criteria for ineffectivity or suspension and/or revocation now include: incompleteness; misleading and untrue statements in the registration statement; insolvency; violation of securities laws and rules; conviction, injunction, or order against corporate insiders.[73] Merit criteria which remain are the following: (1) that the issuer engages or is about to engage in fraudulent transactions; and (2) that the "requirements and conditions for the protection of investors have not been complied with."[74]

B. *Comments*

By deleting most merit criteria and by implementing a scheme of registration by publication rather than registration by notification, the Securities Regulation and Enforcement Act is an attempt to move towards the direction of Federal Securities Laws. It removes from the regulator the discretion to look into merit concerns and the power to disapprove registration for failure to address said concerns. In effect, the law strips the SEC of its role as public investment adviser by making registration automatic and by limiting its review to ascertaining the adequacy of disclosures. Issuers and underwriters welcome this change since they feel that the SEC is not equipped to fulfill this role. In particular, it is the common sentiment that the SEC does not have the competence to pass upon the fairness of the offering price.[75] Neither does the SEC believe that it is competent to perform this function:

> Can the regulator insure that investors are not burned? Does the regulator have all the information as well as the necessary expertise to make such judgments for investors? As a regulator myself, I must profess a resounding NO! Regulators are not investment advisors. We are not in a position to know which corporations are operating under sound business principles. Like you, we can only make judgments based on available information. Should we be responsible for protecting unsophisticated investors from risky investments? I don't think so . . . .[76]

Some sectors, however, feel that registration should not be automatic. Eduardo de los Angeles suggests that when the non-disclosure is highly material, said non-disclosure is an indication of an intent to defraud. Thus, the SEC should have the power to deny or reject registration. He recalls the PSE's experience with the initial public offering (IPO) of Liberty Telecoms when it was discovered that its Chief Executive Officer, Raymond Moreno, had been convicted of gun-running in a court in the state of Hawaii. Likewise, the Greensquare IPO was halted when

[73] *Id.* § 8.

[74] *Id.* § 4(c).

[75] Interview with Ramon Arnaiz, Peregrine Capital Philippines, Inc. (25 Mar. 1997).

[76] Yasay, Jr., *supra* note 39.

investigation revealed that the company was selling properties off a cliff in Tagaytay. A similar situation arose with the Puerto Azul IPO when investigation revealed that a large number of properties owned by the corporation either formed part of the public domain as forest lands or were sequestered by the Presidential Commission on Good Government. In situations such as the above three cited, de los Angeles believes that the SEC should retain the power to deny or reject registration.[77] His view is similar to that adopted by Louis Loss who did not include a general merit standard in the Uniform Act, but instead adopted a "lawyerly solution" by embracing a full-disclosure standard, yet permitting denial, suspension, or revocation of the effectiveness of a registration statement when the offering would tend to work a fraud on investors, or when the registration statement is incomplete in any material respect or contains any statement which was false or misleading, with respect to any material fact.[78]

Will there, therefore, be a shift in regulatory philosophy? The writer believes so; however, she also notices a limited attempt to spell out merit concerns in objective, measurable terms. For instance, Moreno's gun-running conviction, which under the Revised Securities Act would have been covered under bad reputation, would be addressed specifically by Sec. 8(a)(3)(A) of the bill, to wit:

> (3) The issuer, any officer, director, or controlling person of the issuer, or person performing similar functions, or any underwriter,
>
> (A) has been convicted by a competent judicial or administrative body, after trial, upon plea of guilty, or otherwise, of an offense involving moral turpitude, fraud, embezzlement, counterfeiting, theft, estafa, misappropriation, forgery, bribery, false oath, or perjury, or of a violation of securities, commodities, banking, real estate, or insurance laws; . . .

In certain respects, the bill embraces the approach of the Uniform Act, i.e., it adopts a full disclosure standard and articulates and objectifies some of the most important merit criteria. In this way, it would make the review process easier for the regulator and the compliance easier for industry participants. Arbitrariness would be reduced, as the rules are clearer and more objectified. Nonetheless, the bill still exhorts the SEC to protect investors; hence, this merit role has not been completely abandoned. Since the bill allows the SEC to evolve more particular rules in practice, perhaps the ball would now be in the SEC's court to develop these particular requirements in the practice.

While this bill has not yet been enacted into law, the SEC has already drafted rules spelling out disclosure requirements. Surprisingly, issuers have not complained about these new rules. According to de los Angeles, issuers are cooperative because "they have no choice, really." Compliance is an incentive for

[77] De los Angeles, *supra* note 5.

[78] *Supra* note 19, at 785, 798-801.

those who want to access the capital markets for cheaper sources of capital. Also, listed companies have noticed that, even if they now pay more in income taxes post-IPO, they have enjoyed an increase or improvement in revenues. It appears that having more order in the books, being analyzed by researchers, and having pride in keeping the stock price high, all contribute to better performance. One problem, however, is that increased disclosure requirements create a disincentive to strong companies who do not need the capital but "should be listed."[79]

Once again, however, it must be pointed out that having clear and consistent rules is only part of the solution. Equally important, as discussed in the previous chapter, is the enforcement of these rules.

VI. CONCLUSIONS

A. Shift in Regime

The scheme to be employed by the Securities Regulation and Enforcement Act diminishes, but does not completely abandon, merit concerns. The SEC is still exhorted to protect investors, but what has changed is the implementing scheme. Rather than contain general, broad merit standards, the proposed bill, like the Uniform Act, increases and clarifies disclosure requirements and spells out and objectifies merit concerns. Admittedly, however, the SEC's ability to act as public investment adviser is greatly diminished.

The writer agrees with de los Angeles and Executive Director Reyes that the Philippines is probably not prepared for a full disclosure system which totally abandons merit concerns. The SEC, for example, should retain the power and prerogative to step in cases where fraud is blatant. Likewise, until the market becomes more sophisticated, perhaps the assumption that disclosure is sufficient to appraise investors of risks will not really hold true. Finally, one must not overlook the all-important problem of lack of enforcement. If securities law is to facilitate the growth of the Philippine capital markets, more resources ought to be devoted to law enforcement; otherwise, all these paper reforms would be meaningless.

B. Borrowing Laws

The Philippines' colonial experience introduced the practice of borrowing laws from its colonizer's jurisdictions. This is not necessarily an unsound practice. According to Alan Watson, the transplantation of laws from jurisdiction to another is the most common and the richest mode of legal development all over the world.[80] Why reinvent the wheel, after all?

[79] De los Angeles, *supra* note 5.

[80] *See generally* ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW (2d ed. 1993).

What has not been helpful to the Philippines, however, is that transplanting laws from other countries, especially the United States, seems to have become such an unconscious and unquestioning habit. Often, statutes are borrowed without careful examination of the experiences that necessitated regulation. Sometimes statutes regulating the same activity, but having totally different intentions and approaches, are combined. As the second and fourth chapter demonstrate, through its effort to clarify the nature of Philippine securities law, the legal system that results is a little confused, with the philosophy not always being reflected in the chosen framework and vice versa. While it would perhaps be best for Philippine legislators and administrators to exercise more caution, and to adopt a healthy skepticism of international consultants and experts, the Philippines may not have this luxury with respect to its securities and business laws, because of the tremendous pressure, from both domestic and international actors, to design a legal system that would modernize its economy and get it up to speed.

Chart No. 1
UNITED STATES FEDERAL SECURITIES LAW

Registration by Publication
Review is technical and disclosure
Criteria is adequacy of disclosures
Output is effectivity of R/S

Liability for selling without complying with Sec. 5 – Sec. 12(1) rescission available to purchaser

Registration of Securities
What is a Security?
1. Enumeration in Sec. 2(1), 1933 Act and Sec. 3(a)(10), 1934 Act
2. Even if not on list, some tests used by US SC:
   a. Investment Contract under *SEC v. Howey*, 328 U.S. 293 (1946)
      1) invests his money
      2) in a common enterprise
      3) is leu to expect profits
      4) solely from the efforts of a third party
   b. Economic Reality Test, *United Housing Foundation Inc. v. Forman*, 421 U.S. 837 (1975)
   c. Family Resemblance Test, *Reves v. Ernst & Young*, 110 S.Ct. 945 (1990)

What is the prohibition?
- Under Sec. 5 : Can't sell/offer to sell, buy/offer to buy, deliver for sale a security:
  - without R/S in effect, or when there is refusal order, stop order, public proceeding
  - without delivering a 10(a) prospectus
- If R/S is filed but not effective, can't deliver prospectus, unless it is a 10(b) prospectus

Exempt Securities
1. government securities (Sec. 3[a][2])
2. short-term notes (Sec. 3[a][3])
3. non-profit corporations (Sec. 3[a][4])
4. savings and loan associations (Sec. 3[a][5])
5. insurance policies (Sec. 3[a][8])
6. railroad equipment trust (Sec. 3[a][6])
7. small business investment companies (Sec. 3[c])

Exempt Transactions
1. bankruptcy certificates (Sec. 3[a][7])
2. issuer exchanges with security holders (Sec. 3[a][9])
3. corporate reorganizations (Sec. 3[a][10]), Rule 145
4. intrastate offerings (Sec. 3[a][11] and Rule 147)
5. small offering exemptions (Sec. 3[b])
6. private offering exemption – transactions by an issuer not involving any public offering (Sec. 4[2], Regulation D: Rule 504, 505, 506)
7. secondary distributions – transactions by any person other than an issuer, underwriter, or dealer (Sec. 4[1], Sec. 4[1 1/2], Rule 144, Rule 144A)

Chart No. 2
DISCLOSURE REQUIREMENTS UNDER U.S. FEDERAL SECURITIES LAWS

Disclosure Obligations
General Rule: FSL imposes no general duty to disclose material developments.
Exceptions:
1. Mandatory filing requirements (see below).
2. Company must disclose or abstain from trading its own share when in possession of material non-public information.
3. Company must disclose if necessary to make a statement, in the light of the circumstances under which it is made, not misleading (i.e., completeness).
4. NYSE, NASDAQ, Amex disclosure obligations.
5. Company may have a duty to disclose material developments to the entire market following leaks to select individuals that trade on the information.

Mandatory Disclosures	Liabilities
IPO (1933 Act) *Registration Statement*[1] Schedule A, Schedule B (foreign companies)	Sec. 11, 1933 Act (civil) • material misrepresentation in R/S • treble damages to purchaser • strict liability for issuer, due care defense for those who signed Sec. 12(1), 1933 Act (civil) • rescission • privity required between buyer and seller (expanded notion) Sec. 8(3), 1933 Act, stop order (administrative) Sec. 24, 1933 Act (criminal)
Prospectus,[2] Sec. 10, 1933 Act Forms S-1, S-2, and S-3	Sec. 12(2), 1933 Act • rescission for false/misleading prospectus and oral communications • employed in offer/sale of securities — must prove reliance • privity required between buyer and seller (expanded notion) • due care defense
Continuous Disclosures[3] *10-K annual reports* business disclosures, audited F/S MDA	Sec. 12(2) - not clear if applicable Rule 10(b)(5) - Sec. 10, 1934 Act (civil) • actual damages to defrauded party • based on material misstatements and omissions in purchase/sale of securities • must prove scienter

	• and reliance (fraud on the market, can rely on stock price – *Basic v. Levinson*)
10-Q quarterly reports unaudited F/S MDA	Sec. 15(c)(4), 1934 Act (administrative) • SEC can take steps to effect compliance Sec. 32, 1934 Act (criminal)
8-K reports material developments	
Integrated Disclosures (Basic Information Package)	Rule 10(b)(5), 1934 Act (civil) Sec. 15(c)(4), 1934 Act (administrative)
General audited F/S selected financial info, 5-years MDA trading market info.	Sec. 32, 1934 Act (criminal)
Transaction Specific	
Proxy Process	(Sec. 14, 1934 Act) Rule 10(b)(5), 1934 Act (civil)
Proxy/Information Statement re: proposals to be considered during annual meeting	Sec. 15(c)(4), 1934 Act (administrative) Sec. 32, 1934 Act (criminal)
Tender Offers (The Williams Act)	Rule 10(b)(5), 1934 Act (civil) Sec. 15(c)(4), 1934 Act (administrative) Sec. 32, 1934 Act (criminal)

[1] Covers all significant aspects of an issuer's business: thorough description of the issuer's business, property, management; management analysis and review of issuer's capital needs, solvency, and financial performance, including analysis of any variances in revenues or profits from the preceding year; a detailed description of the rights, privileges, and preferences of the offered security and capital structure of firm; risk factors. *See* James D. Cox, Robert W. Hillman, and Donald C. Langevoort, Securities Regulation: Cases and Materials 45 (1991).

[2] Essentially same information as R/S, but directed at investors. *See* James D. Cox, Robert W. Hillman, and Donald C. Langevoort, Securities Regulation: Cases and Materials 45 (1991).

[3] Applies to the following companies: (1) listed on exchange; (2) more than 500 shares, $5M (3) IPO companies.

Chart No. 3
PHILIPPINE SECURITIES LAW REGISTRATION PROCESS

BLUE SKY LAW	SECURITIES ACT	REVISED SECURITIES ACT	PROPOSED REFORMS
Registration by Qualification (Sec. 2) – need a written permit from the Insular Treasurer to sell *speculative securities* (i.e., promise unusual gain in the ordinary course of business, future development, more than 5% commission, assets include intangibles like patents, goodwill) **Review** is technical, disclosure, and merit **Criteria** "is in the public interest;" It can fix amount of commissions **Output** is a *certificate* or *permit* reciting that applicant has complied with Act and is entitled to offer securities for sale **Liability** for selling without permit • Fine P10,000 • Imprisonment – 5 years	*For Non-Speculative Securities* **Registration** by Publication **Review** is technical and disclosure **Criteria** is adequacy of disclosure **Output** is effectivity of R/S and right to sell arises immediately *For Speculative Securities* **Registration** by Qualification **Review** is technical, disclosure, and merit **Criteria** "protection of investors," "in the public interest," "good repute," "sale would not be fraudulent," "business is not based on unsound business principles;" "dishonest," "affairs are in unsound condition" SEC can fix amount of commissions – 10% of offer **Output** is a *license to* sell to the issuer or dealer and a *certificate of permit* to issuer – entitled to offer securities for sale **Liability** – voidable sale (Sec. 30), but prove reliance and personal participation of offender	**Registration** by Qualification **Review** is technical, disclosure, and merit (even price) **Criteria** for approval (1) complete disclosures; (2) conditions for the protection of investors have been met; (3) no grounds to reject, e.g.: (a) issuer is insolvent; (b) violated any provision of RSA; (c) failed to comply with conditions to protect investors; (d) fraudulent transactions; (e) dishonest/not of good business repute; (f) business is illegal; (g) business is not based on sound business principles; (h) has not shown to SEC's satisfaction that sale would not work to prejudice of public interest or as a fraud upon purchasers/investors; **Output** is an *order* stating R/S is effective and a *certificate of permit to sell* stating that issuer is entitled to offer securities in certificate with such terms and conditions as it may impose in the public interest and for the protection of investors **Liability** – Sec. 13(a)(1) – rescission and damages	**Registration** by Qualification **Review** is technical, disclosure, and merit **Criteria** for effectivity: (1) on its face complete (2) requirements and conditions for the protection of investors have been complied with Other grounds: insolvency, fraudulent transactions, violation of laws/rules, but adds • insiders – conviction, injunction, order, violation of rules/laws • misleading, untrue statements in R/S **Output** is an order declaring R/S to be effective, but SEC can impose such terms and conditions as may be necessary or appropriate in the public interest and for the protection of investors. Pending SEC determination – R/S not effective **Liability** – Sec. 16(a)(1) – rescission and damages

Chart No. 4: MANDATORY DISCLOSURES

Filings	Blue Sky Law	Securities Act	Revised Securities Act	Proposed Reforms
Registration Statement	Sec. 2	Sec. 7	Sec. 8	Schedule A
Company Information				
name of company	/	/	/	/
location	/	/	/	/
articles of incorporation and by-laws	X	/	/	/
Business Information				
character of business	X	/	/	/
material contracts	X	X	/	/
risk factors	X	X	X	/
Information Re: Insiders				
directors	X	/	/	/
10% beneficial owners	X	X	/	/
amount held by insiders	X	X	/	/
executive compensation	X	X	/	/
nature and extent of insider interest	X	X	/	/
legal/administrative /financial events affecting directors and officers	X	X	X	/
Shares Structure				
capitalization	X	/	/	/
sample certificate	X	/	/	/

Filings	Blue Sky Law	Securities Act	Revised Securities Act	Proposed Reforms
options on securities	X	X	/	/
consideration record for securities	X	X	/	/
promo fees for promotion of stock	X	X	/	/
trust agreements	X	X	/	/
underlying agreements affecting stocks, bonds, etc.	X	X	/	/
Financial Information				
balance sheet	itemized account of	/	/	/
profit/loss statement	actual financial condition	X	/	/
debt/ liabilities	property, debt, liabilities	X	/	/
Offering Information				
underwriters	X	/	/	/
prospectus /selling document	/	/	/	/
offer shares	X	X	/	/
work program	plan of proposed business	/	/	/
amount of issue	X	/	/	/
estimated net proceeds	X	/	/	/
offer price	X	/	/	/
UW commissions	X	/	/	/
offering expenses	X	/	/	/
net proceeds	X	X	/	/

Filings	Blue Sky Law	Securities Act	Revised Securities Act	Proposed Reforms
amounts paid to promoters	X	/	/	/
property/ goodwill to be bought	/	/	/	/
counsel's name and location	X	X	/	/
counsel's opinion	X	X	/	/
UW agreement	/	X	/	/
any and all other information	/	/	/	/
Prospectus	Sec. 4 circulars, prospectuses, other advertisements filed while in business but not required to be delivered	Sec. 11 /	Sec. 11(a)(3) same, but set forth amount/ nature of fees/ expenses	Sec. 4(b) - deliver before sale file with R/S
Periodic Reports	X	Sec. 11 annual statement under oath of assets and liabilities	Sec. 11(a)(2) annual reports and periodic reports - update info on operation	Sec. 13 - annual report balance sheet, P/L, cash flows, MD&A and such other periodic reports for interim fiscal periods to update operation information
10% Holders	X	file at reg. and monthly or when there is any change ownership	Sec. 32(a) file 10 days after acquisition • personal info (name, etc.) • purpose • no. of shares • contracts with issuer	Sec. 14

Filings	Blue Sky Law	Securities Act	Revised Securities Act	Proposed Reforms
Tender Offers	X	X	Sec. 33 send request /invitation to SH file same as 10% report	Sec. 22
Proxies	X	X	Sec. 34 — file proxy with SEC and send proxy statements to all SH	Sec. 24 — SEC authority to draft specifics
Others			Sec. 11(a)(1) info/documents — reasonably current — R/S	Sec. 13(a)(2)

Chart No. 5
LIABILITIES FOR FALSE/MISLEADING FILINGS

Filings	Blue Sky Law	Securities Act	Revised Securities Act	Proposed Reforms
Registration Statement	Sec. 7 (criminal) • P10,000 fine • 5 years imprisonment	Sec. 8 – Suspension Sec. 12 – Revocation Sec. 30 – Voidable Sale • personally participated or aided • reliance • privity	Sec. 12 – identical to Sec. 11 of 1933 Act double and exemplary damages (civil) Sec. 56 (criminal) P5,000-P500,000 fine 7-21 yrs. imprisonment Sec. 16 – Suspension or Revocation (admi)	Sec. 15, double exemplary damages (civil) Sec. 59 – (administrative) • suspend/revoke • P10,000-P1M fine • disqualification Sec. 70 (criminal) P50,000-P5M fine 7-21 yrs. imprisonment
Prospectus	Sec. 7 P10,000 fine 5 yrs. imprisonment	Voidable sale (Sec. 30)	Sec. 13(a)(1) – consideration plus interest, exemplary if bad faith, fraud, etc. Sec. 56	Sec. 16(a)(2) – consideration plus interest, with damages Sec. 59 Sec. 70
Periodic Reports	not required	Voidable sale (Sec. 30)	Sec. 13(b) – damages, attorney' fees, costs Sec. 56	Sec. 16(a)(2) Sec. 59 Sec. 70
10% Holders	not required	Voidable sale (Sec. 30) For short-swing – can keep profits if acquired in good faith with previous commercial debt (Sec. 26)	no specific provision	Sec. 16(a)(2) Sec. 59 Sec. 70
Tender Offers	not required	not required	no specific provision	Sec. 16(a)(2) Sec. 59 Sec. 70
Proxies	not required	not required	no specific provision	Sec. 16(a)(2) Sec. 59 Sec. 70

*P*EOPLE V. *P*OMAR *R*EVISITED: *S*UBSTANTIVE *D*UE *P*ROCESS AND THE *E*MERGENCE OF THE *A*FFORD *P*ROTECTION TO *L*ABOR *C*LAUSE

HANS LEO J. CACDAC*

INTRODUCTION

If *stare decisis* provides stability, continuity, and predictability to the legal profession, it follows that a legal practitioner and academician must, to maintain stability, continuity, and predictability, generally adhere to precedent. Because *stare decisis* has never been thought to extend so far as to prevent the courts from correcting their own errors,[1] these errors so discarded must perforce fall by the wayside, and the well-dressed advocate and professor must, before temples of justice and learning, preach settled and correct doctrine.

In labor law practice, litigation, and academics, the ruling of the Philippine Supreme Court in *People v. Pomar*[2] has long fallen by the wayside, buried below all discredited judicial doctrine that followed its demise. Why *Pomar* met such fate is not beyond easy comprehension. In this 1924 decision, Court proclaimed the Maternity Leave Act of 1916 to be an unreasonable exercise of the police power of the State, and therefore unconstitutional. The law required employers to grant a pregnant employee thirty days vacation with pay before and after confinement.

Speaking through Mr. Justice E. Finley Johnson, the Court held that the law violated the substantive due process guarantee of the supreme law governing the Philippine Islands. In adherence to the doctrine of economic substantive due process as developed by the American Supreme Court, the Philippine Supreme Court explained that by virtue of a "liberty of contract," an employer could not be forced to enter into a contract to provide maternity leaves to female employees.

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1 *See* Mr. Justice Black's opinion in Green v. United States, 356 U.S. 165 (1958).

2 46 Phil. 440 (1924).