A COMPARISON OF THE CORPORATION LAW AND THE CORPORATION CODE

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The Corporation Code was approved by the President considerably more than thirty days after it had been passed by the National Assembly. Accordingly, prior to its approval, a controversy arose as to whether or not the Code was in effect. For Article X of the Constitution provides that if the Prime Minister (President) fails to act on any bill passed by the National Assembly within thirty days after the date of receipt thereof, it shall become a law as if he had signed it.

One issue of *Business Day* carried two headlines on the Code. One quoted the then Chairman of the Securities and Exchange Commission as saying that he was not sure if the Code was in effect. The other quoted a partner of the country's largest law firm as stating the Code was in effect on the basis of Article X of the Constitution. Only action by the President put the controversy to rest and left to future students of the Code the more difficult task of ascertaining the exact date that it took effect.

Recently, another question arose as to the extent the Code is in effect.[1] Associate Commissioner Rosario Lopez of the SEC, citing the Code's transitory provisions, states that the Code is fully applicable in respect of corporations organized after its approval by the President.[2] In respect of corporations in existence at that time, the articles of incorporation or by-laws of which are in conflict with the Code, she states that these corporations have a period of two years within which to comply with its provisions.

The Corporation Code, which was almost ten years in the making[3], contains many provisions not found in the old Corporation Law. Many of these new provisions, however, do not embody principles radically different from those that were applied under the Corporation Law. They merely formalized rules and regulations that had long been implemented by the SEC. That this is so, is not surprising. For the version of the new law on corporations that was finally approved, was mainly the handiwork of the SEC.

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[1]Commissioner Lopez had been misquoted in the August 30, 1981 issue of the *Bulletin Today* as having stated that the Code was not yet in effect, allegedly because under the Code's transitory provisions, the Code would take effect in 1982.

[2]The transitory provision referred to is Section 148, which provides that any corporation lawfully existing in the Philippines on the date of effectivity of the Code, which is affected by the new requirements of the Code, shall be given two years from effectivity of the Code within which to comply with the same.

[3]The first draft of the Code which was prepared under the auspices of the U.P. Law Center, was presented to the President for signature in 1973. It died a natural death.

Other new provisions restate decisions of the Supreme Court, while others clarify provisions of the Corporation Law which were open to various interpretations. Other provisions repeal certain restrictions in the Corporation Law which were honored more in their breach than in their observance.

We discuss below the salient changes introduced in the Corporation Code.

I. INCORPORATION

Section 18 incorporates existing SEC policy by providing that the name of a corporation must not be identical or confusingly similar to that of any existing corporation or to any other name protected by law and must not be patently deceptive, confusing or contrary to law.

Section 14 requires that where there is more than one purpose, the articles of incorporation shall state which is the primary prupose and which is the secondary purpose. This again reflects SEC policy that the purpose clause should indicate the primary purpose which should cover only activities related to one business understaking.

Section 88 authorizes non-stock corporations to be organized for charitable, religious, educational, professional cultural, fraternal, literary, scientific, social, civic service or similar purposes like trade, industry, agricultural and like chambers or any combination thereof. The failure of Section 88 to include recreational purposes among those for which non-stock corporations may be formed, has been interpreted to mean that country clubs, resorts and sports clubs may only be organized in the form of stock corporations.

Although non-stock corporations may have more than one purpose, it may not include a purpose which would contradict or change its nature as such.

Under the Corporation Law, incorporators of a stock corporation were not required to own any shares of stock. The Code now makes express that incorporators must be signatories of the articles of incorporation, natural persons, of legal age, and in the case of stock corporation, each incorporator must own or be a subscriber to at least one share of the capital stock of the corporation (Section 10).

The Corporation Law did not require any minimum paid up capital. The Code, however, requires a corporation's paid up capital to be no less than five thousand pesos (Section 13).

In the case of the amount of capital stock to be subscribed and paid-in upon incorporation or upon an increase of capital stock the 20%-25% rule, was followed

under the Corporation Law: 20% of the authorized capital stock must be subscribed and 25% of the subscribed capital stock must be paid-in. The Code changes this rule by requiring at least 25% of the authorized capital stock to be subscribed at the time of incorporation and at least 25% of the total subscription to be paid on subscription (Section 13).

The Code introduces a new provision on pre-incorporation subscriptions: a subscription for shares of stock of a corporation still to be formed shall be irrevocable for a period of at least six months from the date of subscription, unless all of the subscribers consent to the revocation, or unless incorporation fails to materialize within six months or within a longer period as may be stated in the subscription contract; provided, that no pre-incorporation subscription may be revoked after the submission of the articles of incorporation to the SEC (Section 61).

Although the Corporation Law authorized the articles of incorporation to classify shares of stock, the Code goes further and authorizes the division of shares of stock into classes or series of shares or both, any of which classes or series of shares may have such rights, privileges, or restrictions as may be stated in the articles of incorporation. Unlike the Corporation Law, the Code empowers the Board of Directors, so long as they are so authorized in the articles of incorporation, to fix the terms and conditions of preferred shares of stock or any series thereof, 'provided that such terms and conditions shall be effective upon the filing of a certificate thereof with the SEC (Section 6).

A "series" is a subdivision of a class of shares. The new provision embodies modern corporate practice followed by large corporations to issue series of shares of stock, each series having such preferences or restrictions as the Board may, from time to time, determine. The provision enables the Board to vary the terms of dividend rates or redemption periods and the like of new series or classes on the basis of the conditions of the business and of the financial and securities markets at the time the classes or series are to be issued.

POWERS OF CORPORATIONS

Power to Amend Articles

The Code makes express the time when amendments to the Articles of Incorporation take effect: upon its approval by the SEC or from the date of filing with the SEC if not acted upon within six months from the date of filing for a cause not attributable to the corporation (Section 16).

The Code clarifies the time during which articles of incorporation may be amended to extend the terms of corporate existence, by stating that no extension

can be made earlier than five years prior to the expiry date, unless there are justifiable reasons for an earlier extension as may be determined by the SEC (Section 11).

In addition, the Code makes express the practice that has been followed in the past of effecting a voluntary dissolution of the corporation by amending the articles of incorporation to shorten the corporate term, rather than following the alternative procedure of having the stockholders approve a dissolution of the corporation (Section 120).

Under the Corporation Law, an increase or decrease in the number of directors could be effected by the formal assent of the stockholders holding a majority of the stock and by merely filing a certificate of increase or decrease in the number of directors, with the SEC' The foregoing provision was deleted in the Code, which has been interpreted to mean that an increase or decrease in the number of directors could be effected only by an amendment of the articles of incorporation which requires the vote or written assent of stockholders representing two-thirds of the outstanding capital stock.

As in the Corporation Law, no formal amendment of the articles is required by the Code to effect an increase or decrease in the authorized capital stock. However, unlike the Corporation Law which provides that the capital stock shall stand increased or diminished from the filing of the certificate of increase or decrease with the SEC, the Code provides that the capital stock shall stand increased or decreased from and after approval by the SEC and issuance of the SEC's certificate of filing (Section 38).

II. DIRECTORS AND TRUSTEES

Qualifications

The Corporation Law required only two of the directors or trustees to be residents of the Philippines. The Code requires a majority of them to be residents (Section 23). In addition, unlike the Corporation Law, the Cod

The Corporation Law required only two of the directors or trustees to be residents of the Philippines. The Code requires a majority of them to be residents (Section 23). In addition, unlike the Corporation Law, the Code provides grounds for disqualifying a director, trustee or officer. Thus, no person convicted by final judgment of an offense punishable by imprisonment for a period exceeding six years, or of a violation of the Code, committed within five years prior to his election or appointment, shall qualify as a director, trustee or officer (Section 27).

Elections

Under the Code, election of directors and trustees shall be by ballot, only if requested by any voting stockholder or any member. Any meeting called for an election may adjourn from day to day or from time to time but not *sine die* or indefinitely if for any reason no election is held or if there is no quorum (Section 24).

Corporate practice under the Corporation Law sanctioned the filling of any vacancy on the board by the vote of a majority of the remaining directors if still constituting a quorum. The Code limits this to vacancies created other than by removal by the stockholders or members or by expiration of term, in which cases the other alternative of filling vacancies in a regular or special meeting called for that purpose, must be followed (Section 29).

To resolve doubts as to when positions created by an increase in the number of directors or trustees could be filled, the Code provides that they shall be filled only by an election at a regular or special meeting of stocholders or members called for that purpose, or in the same meeting authorizing the increase of directors or trustees if so stated in the notice of the meeting (Section 29).

The Code now authorizes the staggering of terms in the case of directors or trustees of non-stock corporations. Thus, the Code provides that unless otherwise provided in the articles of incorporation or by-laws, they shall, as soon as organized, so classify themselves that the term of office of one-third of their number shall expire every year. Subsequent elections of trustees comprising one-third of the board shall be held annually and trustees so elected shall have a term of three years (Section 92).

Removal of Directors/Trustees

The Code restates the requirements in the Corporation Law for removing directors and trustees by stockholders or members. However, to clarify doubts on the matter, it provides that removal may be with or without cause; provided, removal without cause may not be utilized to deprive minority stockholders or members of the right of representation to which they may be entitled through the medium of cumulative voting (Section 28).

Meetings of Directors and Trustees

The Corporation Law did not require the board of directors to conduct meetings any specified number of times, with the exception of their organizational meeting after their election. The Code, however, requires regular meetings of the board to be held monthly, unless the by-laws otherwise provide. Special meetings may be held at any time, upon call of the President or as provided in the by-laws (Section 53).

The Corporation Law contained to express provisions in respect of notices of meetings of directors or trustees. The Code, however, requires that notice of regular and special meetings, stating the date, time and place of the meeting must be sent to every director at least one day prior to the meeting, unless the by-laws provide otherwise (Section 53).

The Code makes express the unstated principle under the Corporation Law that directors or trustees cannot attend or vote at board meetings by proxy (Section 25).

In order to clarify questions that arise under the Corporation Law as to the required number of votes required at the board level, the Code provides that a decision of at least a majority of the directors or trustees present at a meeting at which there is a quorum, shall be valid as a corporate act, except for the election of officers which requires the vote of a majority of *all* the members of the board (Section 25).

Compensation of Directors

The Corporation Law contained no provisions in respect of the compensation of directors. Limitations under the common law were, however, regarded as applicable. Thus, directors were considered to be entitled to compensation, only if so authorized by the by-laws or by the stockholders. The Code restates these limitations, but provides for an exception in the case of reasonable per diems which directors may be granted. An upper limit on directors' compensation is set when the Code provides that in no case shall the yearly compensation of directors, as such, exceed ten percent of the corporation's net income before taxes during the preceding year (Section 30).

Board of Non-Stock Corporations

In order to give flexibility to certain non-stock corporations arising from the nature of the organization, the Code authorizes the articles of incorporation or by-laws of a non-stock corporation to call their governing board by a name other than board of trustees, such as board of governors or Council of Elders (Section 138).

Duties of Directors and Trustees

Although there were no express provisions in the Corporation Law on the matter, the principle that directors had a duty of diligence and loyalty to the corpo-

ration, was long recognized. The extent of a director's duty of diligence and loyalty and his liability for a breach of that duty was, however, a rather nebulous area, in view of the absence of express legislation on the matter. The Code addressed the problem and laid down some well-defined guidelines.

For a breach of the duty of diligence, the Code provides that directors or trustees who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation or acquire any personal or pecuniary interest in conflict with their duty as such directors or trustees, shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons (Section 31).

The Code specifically covers four instances which may result in a breach of a directors' duty of loyalty.

When a director, trustee or officer attempts to acquire in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed to him in confidence, as to which equity imposes a disability upon him to deal in his own behalf, he shall be liable as a trustee for the Corporation and must account for the profits which otherwise would have accrued to the corporation (Section 31).

In the case of dealings of directors and trustees with the corporation, the Code provides that a contract between them is viodable, at the instance of the corporation, unless all these conditions are met: (1) the presence of the director or trustee at the meeting in which the contract was approved, was not necessary to constitute a quorum for such meeting; (2) his vote was not needed to approve the contract and (3) the contract is fair and reasonable under the circumstances. If any of the first two conditions are not met, the contract requires ratification by a vote of two-thirds of the outstanding capital stock or members after full disclosure of the adverse interest of the director or trustee involved is made at such meeting and the contract is fair and reasonable under the circumstances (Section 32).

If two corporations have interlocking directorates, the Code considers as valid contracts between the two corporations, so long as there is no fraud and the contract is fair and reasonable under the circumstances. However, if the interest of the interlocking director in one corporation is substantial, that is, if it exceeds twenty percent of the outstanding capital stock, and his interest in the other corporation is nominal, the conditions under Section 32 of the Code applicable to a self-dealing director must be met (Section 33).

The Code also makes express the doctrine of corporate opportunity which

had been tacitly recognized under the Corporation Law. Thus, if a director, by virtue of his office, acquires for himself a business opportunity which should belong to the corporation and as a result obtains profits to the prejudice of the corporation, he must refund the profits to the corporation, unless his act has been ratified by a two-thirds vote of the outstanding capital stock. This requirement applies even though the director risked his own funds in the venture (Section 34).

Executive Committee

The Code acknowledges the practice of many corporations in the past of creating an executive committee to manage the corporation while the board is not in session. The Code provides that the by-laws of a corporation may create an executive committee composed of not less than three directors appointed by the board. This committee may act, by majority vote of all its members, on such specific matters delegated to it in the by-laws or by majority vote of the board, except with respect to: (1) approval of any action for which separate shareholders' approval is required; (2) the filling of vacancies in the board; (3) the amendment or repeal of by-laws or the adoption of new by-laws; (4) the amendment of any resolution of the board which by its terms is not so amendable or repealable; and (5) a distribution of cash dividends (Section 35).

OFFICERS

Election

The Code increases the number of votes required to elect officers by providing that election of officers shall require the majority vote of *all* the numbers of the Board (Section 25). In the case of non-stock corporations, the Code changes the tacit requirement under the Corporation Law that they be elected by the trustees, by providing that officers of non-stock corporations may be directly elected by the members, unless otherwise provided for in the articles of incorporation or by the by-laws (Section 92).

The Code acknowledges that any two or more positions may be held concurrently by the same person, except that no one shall act as President and Treasurer at the same time (Section 25).

Liability of Officers

The Code disqualifies a person from becoming an officer on the same grounds that have been pointed out applicable to directors and trustees. Moreover, the provisions of Sections 31 and 32 of the Code on self-dealing are applicable to both directos and officers.

Reports to SEC

The Code embodies reporting requirements laid down by the SEC in the past.

Thus, within thirty days from the election of directors, trustees and officers, the directors or any other officer shall submit to the SEC their names, nationalities and addresses. In case they should die, resign or in any manner cease to hold office, his heirs, in case of his death, the secretary or any other officer, or the director, trustee or officer himself, shall immediately report such fact to the SEC (Section 26). Finally, an annual report of the operations of the corporation with a financial statement of its assets and liabilities certified by an independent certified public accountant covering the preceding fiscal year and such other requirements as the SEC may request, should be submitted (Section 141).

III. POWERS OF CORPORATIONS

Power to Adopt By-Laws

Under the Corporation Law, by-laws could not be passed until a certificate of incorporation had been issued. This necessitated going through the formalities of having by-laws approved by the SEC barely after going through the same formalities in connection with the approval of the articles of incorporation. The Code, however, allows by-laws to be adopted and filed prior to incorporation, in which case they could be signed by all the incorporators and submitted to the SEC together with the Articles of Incorporation. Under the Code, moreover, the corporation has up one month after receipt of official notice of the issuance of its certificate of incorporation by the SEC, to submit its by-laws to the SEC, as opposed to the one-month period under the Corporation law computed from the date of filing of the articles of incorporation (Section 46).

Under the Corporation Law, the rule was well-settled, that the by-laws or any amendments thereof, took effect immediately upon their approval by the stockholders, prior to their approval by the SEC, provided only that the by-laws or their amendments were not contrary to law, morals or public policy.[7] The Code however, provides that new or amended by-laws shall be effective only upon issuance of a certification by the SEC that they are not inconsistent with the Code (Section 46).

In view of the absence of an expressed provision in the Corporation Law granting members of a non-stock corporation the right to delegate to the Board of Trustees the power to amend or repeal by-laws or adopt new by-laws, the weight of authority was that only stockholders in a stock corporation could delegate to the directors that power. The Code has equalized the treatment of stock and non-stock corporations in this regard and authorizes two-thirds of the members in a non-stock corporation to delegate to the Board of Trustees the power to amend or repeal by-laws or to adopt new by-laws (Section 48).

Power to Create Bonded Indebtedness

The Code has increased the number of votes required to incur or increase

bonded indebtedness from the simple majority required by the Corporation Law to at least two-thirds of the outstanding capital stock (Section 38). Moreover, under the Corporation Law, the incurring or increasing of bonded indebtedness was allowed from and after the filing of the certificate with the SEC. The Code, however, gives its sanction only from and after approval by the SEC and the issuance by the SEC of its certificate of filing. As an additional safeguard to investors, the Code has imposed a new requirement that bonds issued by a corporation shall be registered with the SEC which shall have the authority to determine the sufficiency of the terms thereof (Section 38).

Power to Invest in Other Corporations

The required vote under the Code to authorize the investment of corporate funds in another business or for a purpose other than the main purpose has been changed to two thirds of the outstanding capital stock in comparison with two-thirds of the voting power under the Corporation Law.

Moreover, the Code has incorporated the rule laid down by the Supreme Court in *de la Rama v. Ma-ao Sugar Central Co., Inc.*, 27 SCRA 247, by providing that "where the investment is reasonably necessary to accomplish its primary purpose as stated in the articles of incorporation, the approval of the stockholders or members shall not be necessary" (Section 42).

Power to Merge and Consolidate

The Corporation Law did not contain any express provisions on merger or consolidation. Thus, the statutory authority had to be inferred from Section 28 1/2 authorizing a corporaton to dispose of all of its corporate assets and the procedure for effecting a merger or consolidation had to be based on that provided in Section 28½ as well as that provided in Section 18 on the amendment of articles of incorporation. Sections 76 to 79 of the Code, however, embody express statutory provisions on merger and consolidation, including those on the procedure for effecting a merger or consolidation and the effects thereof.

Power to Donate

There were lingering doubts under the Corporation Law as to the extent that a corporation could donate corporate property, particularly if the donation had no relevance to the corporation's purposes. The Code, however, expressly confers on corporations the power to make reasonable donations, including those for the public welfare or for hospitable, charitable, scientific, civic or other similar purposes (Section 36[9]). In addition, the Code expressly confers the power to establish pension, retirement and other plans for the benefit of directors, trustees, officers and employees (Section 36[10]).

Power to Dispose of Assets

The Code restates the power of corporations to purchase, receive, convey, lease, pledge, mortgage and otherwise deal with real and personal property as the transaction of the lawful business of the corporation may reasonably and necessarily require, subject to the limitations prescribed by law and the Constitution. The preceding phrase replaced the restrictions imposed on corporations engaged in agriculture and mining found in Section 13 [5]) of the Corporation Law, which have been deleted altogether.

In the case of a sale or other disposition of all or substantially all of the Corporation's property and assets, the Code requires that this be subject to the provisions of existing laws on illegal combinations and monopolies. In addition, the Code clarifies the meaning of a disposition of substantially all assets by stating that "a sale or other disposition shall be deemed to cover substantially all the corporate property and assets if thereby the corporation would be rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated." The Code further clarifies that if the disposition is necessary in the usual and regular course of business of the corporation or if the proceeds are appropriated for the conduct of its remaining business, the same does not require stockholder authorization (Section 40).

Power to Enter into Management Contracts

The Coporation Law did not contain any provisions on management contracts, as management contracts were perhaps unheard of at the time it was enacted. But with management contracts becoming a not too unusual occurence, the Code saw fit to regulate the power of corporations to enter into such contracts with others.

Under the Code, the management contract must be approved by the directors and by the stockholders owning a majority of the outstanding stock of both the managing and the managed corporation. In case of specified relationships between the latter corporations, the required vote is increased. Thus, the approval of the stockholders of the managed corporation who own at least two-thirds of the voting power is necessary where (1) stockholders representing the same interest of both the managing and managed corporations own or control more than one-third of the outstanding stock entitled to vote of the managing corporation; or (2) a majority of the directors of the managing corporation also constitute a majority of the members of the managed corporation.

Finally, the Code limits the term of management contracts by providing that no management contract shall be entered into for a period longer than five years for any one term (Section 44).

Power to Issue Shares

Founders Shares. The Corporation Law did not contain any express authority for a corporation to issue founders shares. The Code, however, provides that shares which are classified as founders shares in the articles of incorporation may be given certain rights and privileges not enjoyed by other stockholders, provided that if the holders of founders shares are given the exclusive right to vote and be voted for in the election of directors, such right must only be for a limited period not exceeding five years (Section 5).

Voting and Non-Voting Shares. The Code imposes some new limitations in respect of voting and non-voting shares. Thus, it provides that there shall always be a class or series of shares with complete voting rights and no share may be deprived of voting rights except preferred shares and redeemable shares. The Code also makes explicit the instances where even non-voting shares are entitled to vote: amendment of the articles; adoption and amendment of by-laws; sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of the corporate property; incurring, creating or increasing bonded indebtedness; increase or decrease of capital stock; merger or consolidation; investment in another corporation or business; and dissolution of the corporation (Section 6).

Redeemable Shares. The Corporation Law did not contain any provisions on redeemable shares. It was the accepted rule, however, that redeemable shares could be redeemed only out of a corporation's surplus profits. Thus, where there were no surplus profits, a corporation could not redeem its shares, even if there had been a provision in the articles requiring it to do so on a certain date. The Code, however, provides that a corporation may issue redeemable shares, when expressely so provided in the articles of incorporation and that they may be purchased by the corporation upon the expiration of a fixed period, regardless of the existence of unrestricted retained earnings, and upon such other terms and conditions stated in the articles, which must also be stated in the certificate of stock representing said shares (Section 8).

Consideration for Shares. The Code makes express that shares of stock shall not be issued in exchange for promissory notes or future services and that where the consideration is other than cash, the valuation thereof shall initially be determined by the incorporators or the board of directors, subject to the approval by the SEC (Section 62).

Unlike the Corporation Law, which contained no provisions on watered stock, the Code defines the liability of directors for watered stock. It states that any director or officer who consents to the issuance of shares for a consideration less than its par or issued value or for a consideration in any form other than cash, valued in excess of its fair value, or who, having knowledge thereof, does not file a

written objection with the corporate secretary, shall be solidarily liable with the stockholders concerned to the corporation and its creditors for the difference between the fair value received at the time of issuance of the stock and the par or issued value of the same (Section 65).

Interest on Subscriptions. The Corporation Law provided that unpaid subscriptions shall bear interest at the rate of six percent per annum unless otherwise provided in the by-laws. The Code reverses the rule and provides that subscribers shall pay interest on unpaid subscriptions, if required by the by-laws, at the rate fixed in the by-laws or if not so fixed, at the legal rate (Section 66).

Subscription Contract. The Supreme Court laid down distinctions between a subscription and a purchase of shares from the corporation, making it necessary at times to inquire into the intention of the parties and the terms of the agreement to determine whether an acquisition was by subscription or purchase. The Code erases the distinction when it provides that any contract for the acquisition of unissued stock in an existing corporation or a corporation still to be formed shall be deemed a subscription contract, whether the parties refer to it as a purchase or some other contract (Section 60).

Issuance of Stock Certificates. Following the rule laid down by the Supreme Court in *Baltazar v. Lingayen Gulf Co., Inc.*, 121 Phil. 1308, a corporation prior to the Code could issue certificates of stocks on subscriptions which were not fully paid, if it applied subscription payments in full payment of shares the certificates of which were to be issued, rather than applying payments pro rata among all the shares covered by a subscription. The Code does away with the rule in the Lingayen Gulf Company case and provides that no certificate of stock shall be issued to a subscriber until the full amount of his subscription together with interest and expenses have been paid (Section 64).

Delinquent Shares. Attempts have been made in the Code to simplify the procedure for the sale of delinquent stock. Moreover, in view of the repeal of the doctrine in the Lingayen Gulf Company case, the Code provides that all stock covered by a subscription shall be subject to sale in case of delinquency and not not merely those for which certificates of stock could not be legally issued (Section 67).

In the event of delinquent shares, the Code makes express that any cash dividends due on delinquent stock shall first be applied to the unpaid balance plus costs and expenses, while stock dividends shall be withheld until the subscription is fully paid (Section 43).

Power to Admit Members

The Code makes membership in a non-stock corporation and all rights arising therefrom, personal and non-transferable, unless the articles of incorporation or the by-laws otherwise provide (Section 90). It also provides that termination of membership shall have the effect of extinguishing all rights of a member in the corporation or in its property, unless otherwise provided in the articles of incorporation or by-laws (Section 91).

IV. STOCKHOLDERS AND MEMBERS

Rights of Stockholders

Voting Rights. The Code contains new provisions as to who may exercise the right to vote.

In the case of proxies the Code requires that they be in writing, signed by the stockholder or member and filed with the corporate secretary before the scheduled meeting and unless otherwise provided in the proxy, it shall be valid only for the meeting for which it is granted. Under the Corporation Law, there was some doubt as to the length of time a proxy could remain valid. The Code resolves the doubt by providing that no proxy shall be valid and effective for a period longer than five years at any one time (Section 58).

In respect of voting trusts, the Code provides that if the voting trust is required as a condition in a loan agreement, the voting trust may extend for a period exceeding five years, but shall automatically expire upon full payment of the loan. Moreover, in order to make a voting trust agreement effective and enforceable, a certified copy of the voting trust agreement shall be filed with the corporation and with the SEC (Section 59).

If shares are pledged or mortaged, the Code gives the pledgor or mortgagor the right to attend and vote at stockholders meetings, unless the pledgee or mortgagee is given this right in writing and this is recorded in the appropriate corporate books by the pledgor or mortgagor (Section 55).

In case of shares held in co-ownership, in order to vote the shares, the consent of all the co-owners is necessary, unless there is a written proxy, signed by all the co-owners, authorizing one or some of them or any other person to vote the shares. This is a departure from the majority rule in the United States which was observed under the Corporation Law, that a proxy signed by any one of the co-owners, was

presumptively valid. However, the Code adds that when shares are held in an "and/or" capacity, any one of the joint owners can vote the shares or appoint a proxy (Section 56).

Right to Dividends

Prior to the Code, it was possible for the by-laws to provide that the basis for distribution of dividends would be the amount paid in by each stockholder on his subscriptions, and not the amount of the subscriptions. The Code, however, now requires that the basis for the participation of the stockholders in the surplus profits is the outstanding capital stock (Section 43). It is thus no longer possible for the stockholders to agree on any other basis for distribution.

Under the Corporation Law, dividends could be declared only from surplus profits arising from the business. The Code, however, furtner limits the fund out of which dividends can be declared, to unrestricted retained earnings (Section 43). Thus, even if a corporation has surplus profits, if there are restrictions on the uses to which the profits could be put, then no dividends can be declared.

In addition, under the Code stock corporations are prohibited from retaining surplus profits in excess of one hundred (100%) percent oftheir paid-in capital stock, except: (1) when justified by definite corporate expansion projects or programs approved by the Board of Directors; or (2) when the corporation is prohibited under any loan agreement with any financial institution or creditor whether local or foreign, from declaring dividends without his consent, and such consent has not been secured; or (3) when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is a need for a special reserve for probable contingencies (Section 43).

Rights of Members

The Code incorporates new provisions on the right to vote of members of a non-stock corporation. Thus, it provides that the voting rights of the members of any class or classes may be limited, broadened or denied to the extent specified in the articles of incorporation or by-laws, and that unless so limited or broadened, each member, regardless of class, shall be entitled to one vote. This clarifies doubts existing under the Corporation Law whether membership could be classified so as to give only members of a particular class the right to vote.

In addition, for practical reasons the Code allows the by-laws of a non-stock corporation to authorize members to vote by mail or other similar means, with the approval of and under such terms and conditions as may be prescribed by the SEC (Section 89).

Stockholders/Members' Meetings

Prior to the Code, a corporation with its principal office in Makati, could not conduct its annual meeting in Manila, since the Corporation Law required stockholders' meetings to be held in the city or municipality where the principal office of the corporation was located. The Code, however, now provides that Metro Manila shall be considered a city or municipality (Section 51).

The rule has become more liberal in the case of non-stock corporations, where the Code states that the by-laws may provide that the members may hold their regular or special meetings at any place, so long as it is within the Philippines (Section 93). The apparent purpose is to authorize conventions and other yearly meetings to be held in various locations.

Under the Corporation Law, notice of regular meetings was not required to be given if the date of the regular meeting was indicated in the by-laws, this on the theory that stockholders and members were presumed to know the contents of the by-laws. The Code, however, now requires that written notice be sent to all stockholders and members at least two weeks prior to the meeting, unless the by-laws provide for a different period. In the case of special meetings, the Code requires that written members at least two weeks prior to the meeting, unless the by-laws provide for a different period. In the case of special meetings, the Code requires that written notice of at least one week be sent, unless otherwise provided in the by-laws (Section 50).

The Code recognizes the right of stockholders and members to waive notice of any meeting, either expressly or impliedly and provides that all proceedings had at any meeting shall be valid even if the meeting is improperly held or called, provided all stockholders or members are present in person or by proxy (Section 51).

Finally, the Code curtails the traditional role of the chairman of the Board by providing that the president shall preside at all meetings of directors, stockholders and members, unless the by-laws provide otherwise (Section 54).

Appraisal Right. The Code has added the following to the instances wherein a stockholder can dissent and demand payment of his shares: amendment of the articles of incorporation to extend or shorten the term of corporate life and merger or consolidation.

Under the Corporation Law, the procedure for exercising the right of appraisal varied, depending on the ground which gave rise to its exercise. The Code provides for a uniform procedure and unlike the Corporation Law, where stockholders absent during a meeting or who abstained, could avail of the appraisal right, the Code grants the right only to a dissenting stockholder.

Under the Code, the dissenting stockholder should make a written demand on the corporation within 30 days after the date on which the vote was taken, for the fair value of his stocks. If the proposed corporate action is effected, the corporation pays to the stockholder, upon surrender of his certificates, the fair value thereof as of the day prior to the date on which the vote was taken. Failure of the stockholder to make such a demand within such thirty days is deemed as waiver of the appraisal right. If within sixty days from the date the corporate action was approved, the dissenting stockholder and the corporation cannot agree as to the fair value of the shares, three disinterested perons (one named by the corporation, the other by the stockholder and a thrid, by the two thus chosen) will determine such fair value. Their findings will be final and the stockholders will be paid within thirty days after the award is made by the appraisers. Upon payment, the stockholder transfers his shares to the corporation (Section 82).

No payment shall be made to any dissenting stockholder unless the corporation has unrestricted retained earnings in its books to cover such payment, provided that if the dissenting stockholder is not paid the value of his shares within thirty days after the award, his voting and dividend rights shall immediately be restored (Section 83).

Right of Pre-emption. In the absence of any express provision in the Corporation Law, the SEC, citing American precedents, took the position that as a rule, stockholders had no pre-emptive right to shares take from the unissued capital stock after incorporation or after an increase of capital stock, unless such a right was expressly granted in the articles of incorporation or by-laws. The Code takes an entirely different position by granting all stockholders pre-emptive rights to subscribe to all issues or disposition of shares of any class, in proportion to their respective holdings, unless such right is denied by the articles of incorporation or an amendment thereto. The Code, however, provides for two instances where there will be no pre-emptive right: first, to shares to be issued in compliance with laws requiring stock offerings or minimum stock ownership by the public and second, to shares to be issued in good faith with the approval of the stockholders representing two-thirds of the outstanding capital stock, in exchange for property needed for corporate purposes or in payment of a previously contracted debt.

Right of Inspection. Under the Corporation Law, a stockholder had the right to inspect the records of all business transactions and the minutes of any meeting, and to make copies thereof himself. However, this right did not extend to requiring the corporation to furnish him copies. The Code, however, now allows a stockholder or member to demand in writing, for a copy of excerpts from records or minutes, at his expense. Moreover, the Code makes it a criminal offense for any officer or agent of the corporation to deny the exercise of this right. (Section 74).

Although theCode has enlarged the right of inspection, it has embodied certain limitations on its exercise. The right may be denied if the stockholder has improperly used any information secured through any prior examination of the records or minutes of the corporation or of any other corporation or was not acting in good fiath or for a legitimate purpose in making his demand (Section 74).

Right to Financial Statements. The Code vests a new right on stockholders to demand copies of financial statements. Thus, within ten days from receipt of a written request, the corporation shall furnish him its most recent financial statement, including the balance sheet and the statement of profit and loss. Furthermore, the directors shall present to the stockholder during their annual meeting, a financial report of operations for the preceeding year, including financial statements certified by an independent certified public accountant or if the paid-up capital of a corporation is less than ₱50,000.00, by the treasurer or any responsible officer of the corporation (Section 75).

V. DISSOLUTION

The Corporation Law contained provisions only on voluntary dissolution, which however, were superseded by Rule 104 of the Rules of the Court on voluntary dissolution of corporations. This, in turn, was modified by Presidential Decree No. 902-A creating the SEC.

The Code contains express provisions on both voluntary and involuntary dissolution.

In case of voluntary dissolution, the Code contemplates three situations:

First, where no creditors are affected, dissolution may be effected by majority vote of the board and by the affirmative vote of the stockholders owning at least two-thirds of the capital stock or at least two-thirds of the members, after the publication of the notice of the meeting. After a certified copy of the resolution is submitted to the SEC, the SEC issues the certificate of dissolution (Section 118).

Second, where creditors are affected, a verified petition for dissolution is filed with the SEC, signed by a majority of the board or other officers having management of its affairs, setting forth all claims and demands, approved by stockholders owning two-thirds of the capital stock or two-thirds of the members at a meeting called for that purpose. The SEC then issues an order fixing a date on which objections may be filed, which order must be published. If, after hearing of the petition the SEC finds the objections not to be meritorious, the SEC renders

judgment dissolving the corporation anddirecting disposition of its assets as justice requires. The SEC may appoint a receiver for such purpose (Section 119).

Third, amendment of the articles of incorporation to shorten the corporate term. Upon approval of the amended articles or expiration of the shortened term, as the case may be, the corporation is deemed dissolved without any further proceedings, subject to liquidation (Section 120).

Involuntary dissolution takes place when the corporation is dissolved by the SEC upon filing of a verified complaint and after proper notice and hearing on grounds provided by existing laws, rules and regulations (Section 121).

The Code further provides that upon winding up of the corporate affairs, any assets to be distributed to any creditor or stockholder who is unknown or cannot be found, shall be escheated to the city or municipality where such are located (Section 122).

The Code has incorporated one of the grounds for quo warranto in Rule 66 of the Rules of Court: non-user of corporate powers. The Code provides that if a corporation becomes inoperative for a period of at least five years, this shall be a ground for the suspension or revocation of its certificate of incorporation (Section 22).

In the case of non-stock corporations, the Code contains new provisions providing for the order in which its assets shall be applied and distributed upon dissolution (Section 94).

VII. CLOSE CORPORATIONS

Perhaps the most radical changes introduced by the Code are embodied in entirely new provisions in Title XII on close corporations. Some of these provisions are in direct conflict with provisions in other Titles of the Code applicable to other corporations. The Corporation Law, in contrast, contained no provisions on close corporations.

Definition

As contemplated by the Code, a close corporation is one whose articles of incorporation provide that: (1) all issued stock of all classes shall be held of record by not more than twenty persons; (2) all issued stock of all classes shall be subject to one or more restrictions on transfer permitted by Title XII; (3) the corporation shall not list in any stock exchange or make any public offering of its shares. However, a corporation shall not be considered a close corporation if at least

two-thirds of its voting stock is owned by another corporation which is not a close corporation.

Any corporation may be incorporated as a close corporation, except mining and oil companies, stock exchanges, banks, insurance companies, public utilities, educational institutions and corporations declared to be vested with public interest (Section 96).

Articles of Incorporation

The articles of incorporation of a close corporation may provide: (1) for a classification of shares or rights and qualifications for holding the same and restrictions on their transfer; (2) for a classification of directors into one or more classes each of which may be voted for and elected solely by a particular class of stock; (3) for quorum or voting requirements in stockholders' and directors' meetings greater than those provided in the Code.

In addition, the articles may provide that the business shall be managed by the stockholders, rather than the directors. So long as such a provision is in effect: (1) stockholders' meeting need be called to elect directors; (2) unless the context clearly requires otherwise, the stockholders shall be deemed directors for purposes of applying the Code; (3) the stokdholders shall be subject to all liabilities of directors. The articles of incorporation may also provide that all or some employees shall be elected or appointed by the stockholders rather than by the directors (Section 97).

Restrictions on Transfer

Restrictions on the transfer of shares must appear in the articles and by-laws as well as on the certificate of stock in order to be binding on a purchaser in good faith. These restrictions shall not be more onerous than granting the existing stockholders or the corporation the option to purchase the shares of the transferring stockholder upon such reasonable terms, conditions or periods stated therein. Upon expiration of the period, the transferring stockholder may sell his shares to any person if the existing stokcholders or the corporation fail to exercise the option to purchase (Section 98).

In the event of the issuance or transfer of stock in breach of qualifying conditions or restrictions on trasfer, the Code lays down certain conclusive presumptions as to when the transferee would be deemed to have notice of the conditions or restrictions, in which event the corporation may, at its option, refuse to transfer the stock in the transferee's name.

Shareholders' Agreements

The Code acknoledges the validity of certain agreements by and among stockholders and provides the following:

1) Pre-incorporation agreements signed by all stockholders of a close corporation, shall survive the incorporation of such corporation and shall continue to be valid and binding, if such be their intent, to the extent such agreements are not inconsistent with the articles of incorporation.

2) A written agreement signed by two or more stockholders may provide that their shares shall be voted as provided in the agreement, as they may agree, or as determined in accordance with a procedure agreed upon by them.

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

4) A shareholders agreement shall not be invalidated on the ground it so relates to the conduct of the business as to interfere with the discretion or powers of the board of directors; provided, that such agreement shall impose on the parties the liabilities for managerial acts imposed by the Code on directors.

5) To the extent that the stockholders are actively engaged in the management or operation of the business and affairs of a close corporation, the stockholders shall be held to strict fiduciary duties to each other and among themselves. Said stockholders shall be personally liable for corporate torts unless the corporation has obtained reasonably adequate liability insurance (Section 100).

Necessity for Board Meetings

It has long been an axiom of Philippine corporate law that a board of directors can exercise its powers only when assembled at a board meeting. The Code, however, provides that unless the by-laws provide otherwise, any action by the directors of a close corporation without a meeting shall nevertheless be deemed valid if: (1) before or after such action is taken, written consent thereto is given by all the directors; or (2) all the stockholders have actual or implied knowledge of the action and make no prompt objection thereto in writing; or (3) the directors are accustomed to take informal action with the express or implied acquiescence of all the stockholders; or (4) all the directors have express or implied knowledge of the action in question and none of them makes prompt objection thereto in writing.

Moreover, if a directors' meeting is held without proper call or notice, an action taken therein within corporate powers is deemed ratified by a director who failed to attend, unless he promptly files his written objection with the secretary of the corporation after having knowledge thereof (Section 101).

Deadlocks

The Code has provided a mechanism to resolve deadlocks in close corporations. Thus, it provides that notwithstanding any contrary provision in the articles of incorporation or by-laws or agreement of stockholders of a close corporation, if the directors or stockholders are so divided respecting the management of the corporation's business that the votes required for any corporate action cannot be obtained, with the consequence that the buiness can no longer be conducted to the advantage of the stockholders generally, the SEC upon written petition by any stockholder, shall have the power to arbitrate the dispute. In the exercise of such power, the SEC shall have authority to make such order as it deems appropriate, including an order: (1) cancelling or altering any provision contained in the articles of incorporation, by-laws, or any stockholders' agreement; (2) cancelling, altering or enjoining any resolution or other act of the corporation or its board of directors, stockholders, or officers; (3) directing or prohibiting any act of the corporation or its board of directors, stockholders, officers, or other persons party to the action; (4) requiring the purchase at their fair value of shares of any stockholder, either by the corporation regardless of the availability of unrestricted retained earnings in its books, or by the other stockholders; (5) appointing a provisional director; (6) dissolving the corporation, or (7) granting such other relief as the circumstances may warrant (Section 104).

Withdrawal of Stockholder/Dissolution

In case a stockholder of a close corporation for some reason no longer deserves to be a stockholder, the Code gives him an out not granted to stockholders of other corporations: that of compelling the corporation for any reason to purchase his shares at their fair value but not less than their par or issued value, when the corporation has sufficient assets in its books to cover its debts and liabilities exclusive of capital stock (Section 105).

VIII. FOREIGN CORPORATIONS

Just as the Corporation Law, the Code requires a foreign corporation to secure a license from the SEC before it can engage in business in the Philippines. The Code, however, for reasons of reciprocity, qualifies the meaning of a foreign corporation by defining it as one formed, organized or existing under the laws of a state other than the Philippines and whose laws allow Filipino citizens and corporations to do business in its own country or state (Section 123), provided, however,

that the definition will not apply toforeign corporations that have already been authorized to engage in business in the Philippines on the date of the effectivity of the Code (Section 124).

Reflecting regulations of the SEC applicable to foreign corporations, the Code requires alicense to be amended in the event the foreign corporation desires to change its name or to pursue purposes other than or in addition to those for which a license shall have already been issued (Section 131). The Code also requires a licensee, other than a foreign banking or insurance corporation, to deposit with the SEC within sixty days from the issuance of its license, securities satisfactory to the SEC, for the benefit of creditors of the licensee in the Philippines (Section 126). The Code goes further and describes the securities acceptable to the SEC.

Under the Corporation Law, a licensee was obliged to appoint a resident agent for service of summons and legal process on the licensee and that in the absence of such agent for service of process, service could be made on the Superintendent of Banks in the case of banking institutions and upon the Secretary of Commerce and Industry, in the case of all other foreign corporations. In lieu thereof, the Code now requires the licensee to execute an agreement to the effect that in the event the licensee should at any time cease to transact business in the Philippines or be without any resident agent for service of process, then service may be made upon the SEC (Section 128).

The Code contains a new provision authorizing the merger or consolidation of the licensee with any domestic corporation if otherwise permitted by Philippine law and by the law of the state of its incorporation (Section 133). Finally, the Code incorporates a new provision enumerating the grounds on the basis of which the SEC may revoke or suspend a license to do business (Section 134).

Conclusion

To our mind, the Code has succeeded in resolving certain problems that arose under the Corporation Law and in making our law on corporations more attuned to the present day realities of the legal and business communities. Notwithstanding the years of brainstorming that preceded its approval, the Code, however, like all laws, is not without flaws. Certain provisions are still open to conflicting interpretations, while some raise doubts as to what is encompassed within their scope.

The SEC, however, shortly after the Code was signed by the President of the Philippines, embarked on the task of drafting the rules and regulations to implement the Code. The SEC is still in the process of crystallizing these rules and regulations. The length of time that has elapsed since the Code was approved, has surely

been sufficient to enable some of the deficiencies of the Code to surface and presumably, to be brought to the SEC's attention. Hopefully, the rules and regulations to be issued by the SEC will, to some extent, remedy some of these deficiencies, in order to better attain the avowed objective of the Batasang Pambansa in passing the Code, to make it more responsive than the Corporation Law to the plans and policies of the Government.