The Revised Code of Corporate Governance: A Reactionary Approach

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I. INTRODUCTION

On 15 July 2009, the Revised Code of Corporate Governance[1] (Revised CG Code) came into effect to replace the 2002-vintage Securities and Exchange Commission (SEC) Code of Corporate Governance,[2] (old SEC Code). The use of the term "Revised" in its title is meant to indicate that the Revised CG Code is primarily based on the existing structure and provisions of the old SEC Code, and therefore, the significance of the additions, deletions, changes and amendments contained in the Revised CG Code are supposed to take their significance by way of comparison with the provisions of the old SEC Code.

The Revised CG Code is supposedly the result of lobbying efforts made by both the Philippine Stock Exchange (PSE) and the Institute of Corporate Directors (ICD), to incorporate reforms in the old SEC Code coming from hard lessons learned by directors and officers of covered corporations, as well as the invaluable experience learned by corporate governance practitioners under the regime of the old SEC Code. Our review of the Revised CG Code, and the initial feedbacks received from the field, are, to say the least, that of disappointment — *Sayang talaga!*

The feeling that one is left with after reading the Revised CG Code is that the great experiment of ushering into our jurisdiction modern principles of good corporate governance, has abruptly come to an end; and that we in the Philippines are retreating back to old familiar grounds — the governance principle espoused under the century-old principles embodied in the Corporation Code. Indeed, what stands out from the provisions of the Revised CG Code is not what new cutting-edge concepts or provisions were introduced, but rather by what seminal provisions had been taken out from the provisions of the old SEC Code.

1. Securities and Exchange Commission, Revised Code of Corporate Governance, SEC Memorandum Circular No. 6, Series of 2009 (June 22, 2009) [hereinafter Revised CG Code].

2. Securities and Exchange Commission, Code of Corporate Governance, SEC Memorandum Circular No. 2, Series of 2002 (Apr. 4, 2002) [hereinafter CG Code].

II. ABANDONMENT OF THE "STAKEHOLDER THEORY"

The primary issue that ought to be settled with the coming into effect of the Revised CG Code is the obvious question — Has there been an abandonment of the stakeholder theory, and a return to the near-exclusive application of the doctrine of maximization of shareholders' value?

A. Coverage of the Revised CG Code

The covered corporations under the Revised CG Code are the same as those in the old SEC Code, thus:

> [T]his Revised Code of Corporate Governance ... shall apply to registered corporations and to branches or subsidiaries of foreign corporations operating in the Philippines that (a) sell equity and/or debt securities to the public that are required to be registered with the Commission, or (b) have assets in excess of Fifty Million Pesos and at least two hundred (200) stockholders who own at least one hundred (100) shares each of equity securities, or (c) whose equity securities are listed on an Exchange; or (d) are grantees of secondary licenses from the Commission.[3]

This means that the principles of corporate governance are made to apply, not to all corporations, but only those — which for lack of a better term, we have dubbed as "public companies" — and which by reason of the impact of their business enterprises on the public, are deemed to be vested with a certain degree of "public interest" beyond those of their shareholders. It is the fact that the business of a public company affects not only the shareholders, but other components in the market or society, by which the principles of the stakeholder doctrine are intended to apply.

Parenthetically, when compared to the original wordings under the old SEC Code, the enumeration under the Revised CG Code for covered corporations seems wrongly sequenced since it seems to indicate that even "branches or subsidiaries of foreign corporations operating in the Philippines that ... have assets in excess of Fifty Million Pesos and at least two hundred (200) stockholders who own at least one hundred (100) shares each of equity securities),"[4] are covered by our Revised CG Code, which would include large American and European corporations having established branches or subsidiaries in the Philippines. Likewise, the sequencing seems to imply that the branches and subsidiaries of foreign corporations operating in the Philippines which "are grantees of secondary licenses from the Commission," are also covered by the mandatory provisions of the Revised CG Code.[5] This would mean all branches of foreign corporations are covered since all such branches have been issued a license to do business in

3. Revised CG Code, opening paragraph.

4. *Id.*

5. *Id.*

the Philippines by the SEC. By virtue of their local operations in the Philippines, foreign companies would have to implement the provisions of the Revised CG Code to matters that are happening in their headquarters, since that is where the Boards and Management of foreign companies are located.

We believe that as correctly enumerated under the old SEC Code, it is only in "branches or subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed,"[6] to which the provisions of the Revised CG Code should apply. This is an important consideration to keep in mind, since the Revised CG Code has imposed a heftier and more encompassing penalty for violation of its provisions, when compared to the old SEC Code.

Finally, because the Revised CG Code has retained within its coverage those companies which "are grantees of secondary licenses from the Commission," then it must stand to reason that the exclusive enumeration of those falling within this category under SEC Memorandum Circular No. 16, Series of 2002,[7] still apply, namely: (a) finance companies; (b) investment houses; (c) brokers and dealers of securities; (d) investments companies; (e) pre-need companies; and (f) stock and other securities exchanges.

The point that must be made is that by retaining the coverage of the principles of corporate governance to public companies, or at least by expressly stating that its mandatory provisions are applicable only to "covered corporations,"[8] the Revised CG Code is making it clear that it recognizes the public interests that pertains to covered corporations, as distinguished from all other private and non-public companies whose business enterprise does not affect public interest, or whose business enterprise only affects the private interests, mainly their stockholders.

B. Dropping All References to Stakeholders

What is truly astounding in the Revised CG Code is the dropping of all reference to "stakeholders" and the "stakeholder theory."

Under the old SEC Code, the term "Corporate Governance" was defined to embody the stakeholder theory, thus corporate governance was understood as referring to "a system whereby *shareholders, creditors and other*

6. *Id.*

7. Securities and Exchange Commission, Guidelines on the Nomination and Election of Independent Directors, SEC Memorandum Circular No. 16, Series of 2002 (Nov. 28, 2002).

8. Revised CG Code, art. 9 provides that "All covered corporations shall establish and implement their corporate governance rules in accordance with this Code."

stakeholders of a corporation ensure that management *enhances the value of the corporation* as it competes in an increasingly global market place."[9]

The recognition that it was not only the shareholders of a public company, but also "creditors and other stakeholders" as having legal and business standing to "ensure that management enhances the value of the corporation," officially ushered within the institution of Philippine public companies the stakeholder theory or the theory of enhancing the value of the corporation on a long-term basis for the benefit of all those affected by its business enterprise, as distinguished from the shareholder theory or the doctrine of maximization of profits.

In its place, the Revised CG Code adopted a process-driven definition similar to that found in the Insurance Commission (IC) Code of Corporate Governance Principles and Leading Practices,[10] but which in addition limits the coverage only to "stockholders." The Revised CG Code states that corporate governance is "the framework of rules, systems and processes in the corporation that governs the performance by the *Board of Directors and Management of their respective duties and responsibilities to the stockholders.*"[11]

Whereas the IC Code specifically refers and defines "stakeholders" to include not only stockholders, but also "to the group of company owners, officers and employees, policyholders, suppliers, creditors and the community,"[12] the Revised CG Code has opted to drop every reference to "stakeholders" found in the old SEC Code.

Thus, the provision under "General Responsibility" of Directors of covered corporations under the old SEC Code which provided that "*a director assumes certain responsibilities to different constituencies or stakeholders, who have the right to expect that the institution is being run in a prudent and sound manner*,"[13] has been entirely deleted in the Revised CG Code. The immediately quoted provision had been lifted by the SEC directly from BSP Circular No. 283, Series of 2001,[14] and we have also criticized its formal

9. CG Code, § I (B) (emphasis supplied).

10. Insurance Commission, Corporate Governance Principles and Leading Practices, IC Circular No. 31-2005 (Sep. 26, 2005) [hereinafter IC CG Code] ("Corporate Governance" under Section I (1) is defined as "the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized.").

11. Revised CG Code, art. I (a) (emphasis supplied).

12. IC CG Code, § I (18).

13. CG Code, § II (5) (a) (emphasis supplied).

14. Bangko Sentral ng Pilipinas, Additional Sections to the Manual of Regulations on the Powers and Authority of the Board of Directors, BSP Circular No. 283, Series of 2001 (May 17, 2001).

adoption into the old SEC Code as being rather dangerous because it ought to apply only to stakeholders of companies that hold the investments and savings of the public (such as banks and insurance companies). However, the deletion in the Revised CG Code may be interpreted to mean that only shareholders have standing with respect to the business operations of covered companies, as the new provision now reads: "It is the Board's responsibility *to foster the long-term success of the corporation*, and to sustain its competitiveness and profitability in a manner consistent with its corporate objectives and *the best interest of its stockholders*."[15]

The use of the term "to foster the long-term success of the corporation," which normally would have the same value and meaning as "enhancing the value of the corporation," is one of the hallmarks of the stakeholder theory to focus Board and Management efforts towards long-term goals that protect the interests of all, if not most stakeholders, rather than the short-term seeking of profits, which only enhances the interests of current shareholders, as they trade their shareholdings in the stock market. The context of the afore-quoted provision that juxtapositions the "long-term success of the corporation" only in line with "the best interest of its stockholders," may be interpreted to mean an abandonment of the stakeholder theory under the Revised CG Code, and a return to the much narrower path offered by the maximization of shareholders' equity as the only object of corporate governance.

Furthermore, under Section II (5) (b) of the old SEC Code (Duties and Functions of the Board), which provided that "to insure a high standard of best practice *for the company and its stakeholders*, the Board should conduct itself with utmost honesty and integrity in the discharge of its duties, functions and responsibilities,"[16] the current Article 2 (F) (2) of the Revised CG Code has limited such duties and functions only "*for the corporation and its stockholders*."[17] The revision effected under the Revised CG Code may be taken to mean that it is the current position of the SEC that the duties and functions of the Board of covered corporations, as well as their fiduciary obligations, now pertain solely to the company and its shareholders, a complete abandonment of the stakeholder theory.

The duty imposed upon the Board of Directors of covered corporations under Section II (5) (b) of the old SEC Code to "[i]dentify the corporation's major and other stakeholders and formulate a clear policy on communicating or relating with them accurately, effectively and sufficiently"[18] and to render

15. Revised CG Code, art. 2 (F) (1) (emphasis supplied).

16. CG Code, § II (5) (b) (emphasis supplied).

17. Revised CG Code, art. 2 (F) (2) (emphasis supplied).

18. CG Code, § II (5) (b).

an accounting regularly in order to serve their legitimate interests[19] has now been rendered to be merely a communication process. Under Article 2 (F) (2) of the Revised CG Code, the duty covers only the following: "Identify the sectors in the community in which the corporation operates or are directly affected by its operations, and formulate a clear policy of accurate, timely and effective communication with them."[20] Such clearly avoids the use of the term "stakeholders."

The duty imposed on the Corporate Secretary of a covered corporation under Section II (9) of the old SEC Code, that "he should work and deal fairly and objectively *with all the constituencies of the corporation, namely, the Board, management, stockholders and other stakeholders.* As such, he should be someone his colleagues *and these constituencies* can turn to, trust and confide with on a regular basis,"[21] has been limited under Article 2 (L) of the Revised CG Code only to the duty to "work fairly and objectively with the Board, Management and stockholders."[22]

The provision under Section IV (Accountability and Audit) in the old SEC Code, referring to the Board's obligation to stakeholders to "[m]aintain a sound system of internal control *to safeguard stakeholders' investment* and the company's assets"[23] has effectively been replaced in the Revised CG Code with the provision that reads:

> Management should formulate, under the supervision of the Audit Committee, the rules and procedures on financial reporting and internal control in accordance with the following guidelines:
>
> . . .
>
> (ii) An effective system of internal control that will ensure the integrity of the financial reports and protection of the assets of the corporation should be maintained.[24]

Finally, the provision of Section VII (Disclosure and Transparency) of the old SEC Code that "[t]he Board shall therefore, commit at all times to full disclosure of material information dealings. *It shall cause the filing of all required information for the interest of the stakeholders*"[25] has been entirely deleted in the Revised CG Code.

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19. *Id.*
20. Revised CG Code, art. 2 (F) (2).
21. CG Code, § II (9) (emphasis supplied).
22. Revised CG Code, art. 2 (L).
23. *Id.* § IV (d) (emphasis supplied).
24. Revised CG Code, art. 5 (A) (ii).
25. CG Code, § VII (emphasis supplied).

All the foregoing indicate that the Revised SEC Code has taken a "rejection tone" of the stakeholder theory, and one may be led to the conclusion that has seen our Supreme Court holding that in the realm of Philippine Corporation Law, the Board of Directors and Management of every corporation owe fiduciary duties to the stockholders, and their main obligation is "to seek the maximum amount of profits for the corporation."[26]

C. Has the Stakeholder Theory been Formally Rejected in Philippine Jurisdiction?

On the broad issue of whether the stakeholder theory no longer has any formal application in Philippine jurisdiction, the answer is easier to give: "Definitely not!" It must be recalled that it was not the SEC that ushered the stakeholder theory in the Philippines with the promulgation of the old SEC Code, but rather the Bangko Sentral ng Pilipinas (BSP), with the promulgation a year earlier of a series of circulars. The first was BSP Circular No. 283, Series of 2001, which defined who the stakeholders are in banking institutions and requiring of such institutions, their Board and Management, to exercise a high degree of diligence, and not just the diligence of a prudent man. The Supreme Court has, for more than a decade before the issuance of the BSP Circulars on Corporate Governance, characterized banking institutions as being "vested with public interest," requiring of them, their Boards of Directors and officers, the exercise of diligence of the highest order, not only to their stockholders, but primarily to their clients, depositors and members of the public who deal with their facilities.

In addition, the IC Code of Corporate Governance Principles and Leading Practices, formally recognizes that "insurance business is imbued with public interest,"[27] and that "[as] a custodian [sic] of public funds, insurance corporations and insurance intermediaries shall ensure that their dealings with the public are always conducted in a fair, honest, and equitable manner,"[28] adheres to the stakeholder theory.

There is no doubt that the stakeholder theory, as a cornerstone of the regime of corporate governance, is very much alive and well for the key banking and insurance sectors of the Philippine capital market.

With the promulgation of the Revised CG Code, do we then take it that as far as all public companies (other than banking institutions, insurance companies, and insurance intermediaries) are concerned, the stakeholder theory has been rejected as the capstone of corporate governance, and that the maximization of shareholders' value has once again become the rule of

26. Prime White Cement Corp. v. Intermediate Appellate Court, 220 SCRA 103, 110 (1993).

27. IC CG Code, § II (B) (4).

28. *Id.* § V.

thumb in measuring the duties, responsibilities and extent of personal liability of directors and officers of covered corporations?

It must be stated formally that with the clear dropping of the stakeholders' theory from the definition of "Corporate Governance," and dropping of all references to stakeholders under the Revised CG Code, there is a strong argument before courts of law that the stakeholder theory as the legal basis of accountability for directors and officers of covered companies (except for banks, insurance companies and insurance intermediaries) can no longer be made to apply; and that "a director of a corporation holds a position of trust and as such, he owes a duty of loyalty to his corporation ... as corporate managers, directors are committed to seek the maximum amount of profits for the corporation."[29]

Nevertheless, it is our proposition that notwithstanding the substantial changes effected in the Revised CG Code, the application of the stakeholder theory as a cornerstone to determine the nature and extent of the duties, responsibilities, as well as the personal liabilities of directors and officers of all public companies, continues to be a viable doctrine.

Firstly, the official and unofficial pronouncements coming out of the responsible officers of the SEC do not indicate that they are pursuing a new corporate governance regime that rejects the stakeholder theory. Commissioner Raul J. Palabrica (who is credited to be the main author behind the revisions), writes in his column that the coverage of the Revised CG Code continues to be the same as under the old SEC Code, and that —

> The common denominator of these companies is *they solicit investments from the public to help sustain their operation.* Hence, their activities are considered imbued with public interest.
>
> The code consists of compulsory and recommendatory guidelines for the protection of the interests of the *stockholders and other investors of covered companies.*[30]

In other words, the coverage of the Revised CG Code to public companies continues to acknowledge that it is the nature of the business enterprises of the covered companies (and not just their corporate medium) that imbues them with public interests, and thereby confirming that it is not just the shareholders who fall within strictly intra-corporate relationships who are affected by the operations of the public companies. It is also those who have invested in the companies in some other form (such as the case of policy holders, depositors, etc.), who have to receive protection under a stricter corporate governance regime. This is affirmed in Article 2 of the

29. *Prime White Cement Corp.*, 220 SCRA at 110.

30. Raul J. Palabrica, *Code of Corporate Governance*, PHILIPPINE DAILY INQUIRER, July 3, 2009, at B5 (emphasis supplied).

Revised CG Code, which provides as part of the "Rules of Interpretation" that: "All doubts or questions that may arise in the interpretation or application of this Code *shall be resolved in favor of promoting transparency, accountability and fairness to the stockholders and investors of the corporation.*"[31]

The only problem created by the total dropping of the stakeholder theory under the provisions of the Revised CG Code, is that it has effectively limited the coverage of "stakeholders" to those who have direct "investments" into the public companies, similar to the financial involvement of stockholders, such as the case of depositors and other debt-holders of banking institutions, policy holders and debt-holders of insurance companies, and plan-holders of pre-need companies. All other stakeholders who do not have a direct financial investment in the companies, such as management and employees, customers, the community site, etc., are deemed to have no direct interest in the corporate enterprise, and the only manner by which they can sustain legal standing as stakeholders is to prove that they pertain to the "public interests" coverage of the particular covered corporation upon which they seek to demand compliance with corporate governance principles.

The net result of the revision effected under the Revised CG Code is to effectively narrow the coverage of who can claim to be stakeholders of a public company to a commercial end — that the directors and officers of a public company owe a special duty to stockholders and other similar investors in the company to maximize profits for the long-term success of the corporation.

Secondly, the revisions effected by the SEC under the final terms of the Revised CG Code may be taken to mean that it has dropped all reference to stakeholders, not as a rejection of the stakeholder theory, but rather as a recognition that their primary jurisdiction over the covered corporations pertains primarily to the corporate medium, and the legal relationship that is created thereby (i.e., the intra-corporate relationship); and that the underlying business enterprise is not for the SEC to supervise, but by the proper government agency so tasked under its charter.

For example, although all banks and insurance companies can be operated under a corporate medium, nevertheless, their underlying operations are primarily under the control and/or supervision, not of the SEC, but of the BSP and the IC, respectively. It may be reckoned, therefore, that with the current version of the Revised CG Code, the SEC has taken the position as the government agency tasked with control and/or supervision of the industry that is rightly vested with the power, and obviously is in the best position, to define the terms of the stakeholder

31. Revised CG Code, art. 2 (B) (emphasis supplied).

theory and the determination of those who are deemed to fall within the coverage of stakeholders.

In other words, the SEC has defined the meaning and coverage of "Corporate Governance" under the Revised CG Code within the parameters that are clearly within its administrative jurisdiction, i.e., within the intra-corporate relationships of every covered corporation:

(a) Between the SEC and the company, represented by its Board of Directors;

(b) Between the Board of Directors and the stockholders;

(c) Between the Board of Directors and Management.

Within the realm of its special administrative jurisdiction, the SEC has, through the Revised CG Code, defined the meanings and essence of Corporate Governance for public companies in the manner and term it knows best — the maximization of shareholders' value. This is embodied in the definition of corporate governance which is "the framework of rules, systems and processes in the corporation that governs the performance by the Board of Directors and Management of their respective duties and responsibilities to the stockholders."[32] In addition, the SEC has described the General Responsibility of the Boards of Directors of covered corporations "to foster the long-term success of the corporation, and to sustain its competitiveness and profitability in a manner consistent with its corporate objectives and the best interests of its stockholders."[33]

The terms of the Revised CG Code have every indication that they recognize, apart from the stockholders of covered corporations, other stakeholders similarly situated — investors, in line with its recognition that under the Securities and Regulation Code[34] (SRC), the SEC is the government agency that has been given direct supervision over public companies, for the protection of stockholders and other debt-holders and securities-holders, thus —

> All doubts or questions that may arise in the interpretation or application of this Code shall be resolved in favor of promoting transparency, accountability and fairness to the *stockholders and investors of the corporation*;[35]
>
> To ensure a high standard of best practice for the corporation and its stockholders, the Board should conduct itself with honesty and integrity in the performance of, among others, the following duties and functions: . . . *Establish and maintain an investor relations program* that will keep the

32. Revised CG Code, art. 1 (a).

33. *Id.* art. 3 (F) (1).

34. The Securities Regulation Code [SRC], Republic Act No. 8799 (2000).

35. Revised CG Code, art. 2 (B) (emphasis supplied).

> stockholders informed of important developments in the corporation. If feasible, the corporation's CEO or chief financial officer shall exercise oversight responsibility over this program.[36]

The point that is being made is that the formal dropping of the stakeholders theory under the Revised CG Code should not be construed to mean that the SEC, as the supervising agency over all corporations in the Philippines, has rejected its application in our jurisdiction. The SEC simply leaves it to the best judgment of the proper government agency of the particular industry or business sectors having jurisdiction to define the nature and extent of how they wish to adopt the theory. As the SEC has defined principles of Corporate Governance within the medium of public companies to cover the duties and obligations of the Board of Directors and Management to mean the maximization of the value of the investments of shareholders and other investors, so therefore other agencies, such as the BSP and the IC, have the right to so define the parameters of what constitute good corporate governance within their industries and sectors that best adopts the stakeholder theory to their own specific circumstances.

This approach — that the corporate medium, apart from the underlying business enterprise, is not deemed to be vested with public interest, beyond those that have a formal or commercial tie to it by way of equity or debt investment — seems to be in conformity with the SEC's mandate contained in its sub-charter, namely Presidential Decree No. 902-A,[37] which provides that:

> WHEREAS, in line with the government's policy of encouraging investments, both domestic and foreign, and more active public participation in the affairs of private corporations and enterprises through which desirable activities may be pursued for the promotion of economic development; and, to promote a wider and more meaningful equitable distribution of wealth, there is a need for an agency of the government to be invested with ample powers to protect such investment [sic] and the public;
>
> WHEREAS, to achieve these national objectives, it is necessary to reorganize and restructure the Securities and Exchange Commission to make it a more potent, responsive and effective arm of the government to help in the implementation of these programs and to play a more active role in nation-building.[38]

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36. *Id.* art. 3 (F) (2) (emphasis supplied).

37. Reorganization of the Securities and Exchange Commission with Additional Power and Placing the said Agency under the Administrative Supervision of the Office of the President [SEC Reorganization Act], Presidential Decree 902-A, Whereas clauses (1976).

38. *Id.*

It also means that the SEC has retreated (when compared to its original stance under the old SEC Code) from a positive role as the government agency that could imbue the corporate medium with the constitutional precept that although we recognize the institution of private ownership and property rights and "the indispensable role of the private sector,"[39] we nevertheless declare that property "bears a social function, and all economic agents shall contribute to the common good," and always "subject to the duty of the State to promote distributive justice and to intervene when the common good so demands."[40]

Thirdly, and perhaps the more important aspect when it comes to corporate practitioners and their clientele, is that apart from the language of the old SEC Code, the Supreme Court has in the field of jurisprudence, began to craft a doctrine of "Corporate Responsibility" that recognizes the existence of the duties and obligations of corporations, their Boards and Management, to sectors of society (apart from their shareholders) who are affected by their operations.

Fairly recently, in its decision in *Professional Services, Inc. v. Court of Appeals*,[41] the Supreme Court held the hospital corporation liable for the medical malpractice or professional negligence of a physician who was a member of its medical staff. The Court stated that:

> The challenged Decision also anchors its ruling on the *doctrine of corporate responsibility*. The duty of providing quality medical service is no longer the sole prerogative and responsibility of the physician. This is because the modern hospital now tends to organize a *highly-professional medical staff* whose competence and performance need also to be monitored by the hospital commensurate with its inherent responsibility to provide quality medical care. *Such responsibility includes the proper supervision of the members of its medical staff. Accordingly, the hospital has the duty to make a reasonable effort to monitor and oversee the treatment prescribed and administered by the physicians practicing in its premises*.[42]

Unfortunately, the term "doctrine of corporate responsibility" was used in *Professional Services, Inc.* to mean the "corporate negligence doctrine .... These special tort duties arise from the special relationship existing between a hospital or nursing home and its patients, which are based on the vulnerability of the physically or mentally ill persons and their inability to provide care for themselves."[43] And that is the essence of what is wrong under the regime of the Revised SEC Code: the stakeholder theory

39. PHIL. CONST. art. II, § 20.

40. PHIL. CONST. art. XII, § 6.

41. Professional Services, Inc. v. Court of Appeals, 544 SCRA 170 (2008).

42. *Id.* at 182.

43. *Id.* n.7 (citing 40 A Am Jur 2d 28).

embodied in the old SEC Code was put to death too young in its life, even before it could be properly treated and allowed to bloom under Philippine corporate jurisprudence!

In our book on Corporate Governance, we have indeed discussed at length the shortcomings of the Stakeholder Theory and the pitfalls that faced the SEC in adopting it formally, but we certainly had not advocated its deletion. In a developing country like ours where the majority of the resources available to our people are in the hands of corporate entities (and also in the hands of government corporations), the great challenge was, and continues to be, that of evolving a doctrine that imbues the corporate medium with the "*burden of a social function, and as an economic agent which should contribute to the common good.*"[44] With the SEC retreating from that challenge under the Revised CG Code, the great social experiment in imbuing Philippine public companies with a social function that goes beyond the interests of their investors has been orphaned into the other fields outside of Philippine Corporate Law.

III. SYSTEM OF "INDEPENDENT DIRECTORS"

Article 3 (A) of the Revised CG Code strengthens the system of independent directors for Philippine public companies as it provides that —

> All companies covered by this Code shall have at least two (2) independent directors or such number of independent directors that constitutes twenty percent (20%) of the members of the Board, whichever is lesser, *but in no case less than two* (2). All other companies are encouraged to have independent directors in their boards.[45]

In Philippine Corporate Law, there are now two systems of promoting good corporate governance and ensuring that there is a check on the dominant role of the majority stockholders.

First is the system of cumulative voting mandatory for all stock corporations under Section 24 of the Corporation Code,[46] which makes it

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44. *See* PHIL. CONST. art. XII, § 6.

45. Revised CG Code, art. 3 (A) (emphasis supplied).

46. The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Blg. 68, § 24 (1980). The section reads:

> At all elections of directors or trustees, there must be present, either in person or by representative authorized to act by written proxy, the owners of the majority of the outstanding capital stock … and said stockholder may vote such number of shares for as many persons as there are directors to be elected or he may cumulate said shares and give one candidate as many votes as the number of directors to be elected multiplied by the number of his shares shall equal, or he may distribute them on the same principle among as many candidates as he shall see fit; Provided, That the total number of votes cast by him shall

mathematically possible for minority shareholders to pool their voting powers to a pre-computed number of nominees to ensure that they would have minority representation in the Board of Directors. Consonant with this principle, Section 28 of the Corporation Code provides that the majority stockholders have no power to remove a director elected by cumulative voting except for cause.[47]

Second is the system of independent directors originally introduced for public companies under Section 38 of the Securities Regulation Code for all public companies to have "at least two (2) independent directors or such independent directors shall constitute at least twenty percent (20%) of the members of such board, whichever is the lesser."[48] The Section defines an independent director as "a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."[49]

In our book, we have discussed the shortcomings of the system of independent directors under the aegis of the old SEC Code which had formally adopted the stakeholder theory; that since all directors of a public company, whether executive, non-executive, minority representing, or independent director, are now bound with duties not only towards the stockholders but all other stakeholders, then the necessity for independent directors did not have a good case.

> not exceed the number of shares owned by him as shown in the books of the corporation multiplied by the whole numbers of directors to be elected.

47. CORPORATION CODE, § 28. The section reads:

> Any director or trustee of a corporation may be removed from office by a vote of the stockholders holding or representing two-thirds (2/3) of the outstanding capital stock, or if the corporation be a non-stock corporation, by a vote of two-thirds (2/3) of the members entitled to vote: ... Provided, That removal without cause not be used to deprive minority stockholders or members of the right of representation to which they may be entitled under Section 24 of this Code.

48. SRC, § 38.

49. *Id.* This is the only other section which treats of independent directors, and requires that the Board of an exchange include:

> [n]o less than fifty one percent (51%) of the remaining members of the Board to be comprised of three (3) independent directors and persons who represent the interests of issuers, investors, and other market participants, who are not associated with any broker or dealer or member of the Exchange for a period of two (2) years prior to his/her appointment. Moreover, such section requires that, "[n]o officer or employee of a member, its subsidiaries or affiliates or related interests shall become an independent director.

With the apparent abandonment under the Revised CG Code of the stakeholder theory, and in fact an affirmation in its various provisions that the duties and responsibilities of directors and Management of public companies is owed to stockholders and other investors, then the strengthening of the role of independent directors, as occupying a quasi-public position (i.e., one that represents the "public good" in Board proceedings) has taken a more meaningful role.

IV. MANUAL OF CORPORATE GOVERNANCE AND THE PENALTY PROVISION

Under Article 9 (Commitment to Good Corporate Governance) of the Revised CG Code, the SEC has continued with the requirement under the old SEC Code[50] that covered corporations must formally submit a manual of corporate governance on which they "shall establish and implement their corporate governance rules in accordance with this Code."[51]

But unlike the old SEC Code, which provided that failure to submit the manual is the only infraction that is penalized by a fine, the Revised CG Code under Article 11 (Administrative Sanctions), has expanded the penalty coverage to all violations of the Code, thus:

> A fine of not more than Two Hundred Thousand Pesos (₱200,000) shall, after due notice and hearing, *be imposed for every year that a covered corporation violates the provisions of this Code*, without prejudice to other sanctions that the Commission may be authorized to impose under the law; provided, however, that any violation of the Securities Regulation Code punishable by a specific penalty shall be assessed separately and shall not be covered by the abovementioned fine.[52]

Fines and other penalties imposed by the SEC are serious matters, not only because of the pecuniary repercussions, but more importantly because under the Corporation Code,[53] and in the Revised SEC Code itself,[54] a

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50. CG Code, § IX. The section reads:

> Failure to adopt a manual of corporate governance as specified therein shall subject a corporation, after due notice and hearing, to a penalty of ₱100,000.00.

51. Revised CG Code, art. 9.

52. *Id.* art. 11 (emphasis supplied).

53. Corporation Code, § 27. The section reads:

> Disqualification of directors, trustees or officers. — No person convicted by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years, or a violation of this Code, committed within five (5) years prior to the date of his election or appointment, shall qualify as director, trustee or officer of any corporation.

violation may constitute as a ground for the disqualification of a director, or constitute as "proper cause," for his removal by the requisite vote of the stockholders.[55]

Although there is no doubt that the failure to comply with the requirement of filing the manual is punishable under Article 11 of the Revised CG Code, it seems difficult to see how any other "violation" thereof may be properly punished by a fine of ₱200,000 "for every year that a covered corporation violates the provisions of this Code."[56]

Firstly, instead of the fine being imposed on every violation of the provisions of the Revised CG Code, the penalty that is imposable is limited to "₱200,000 every year." This would come to the dubious end that a covered corporation may commit various infractions under the Code, and only be liable to a maximum penalty of ₱200,000 per year.

Secondly, corporate governance principles and best practices are primarily to be followed or practiced by the directors and key officers of a covered corporation, and the infraction would be a personal liability on their part. And yet, the provisions of Article 11 of the Revised CG Code apply the penalty only to a violation by the covered corporation, and not on the director or officer guilty of an offense under the Code.

Thirdly, although the non-filing of the manual on corporate governance constitutes a situation that "a covered corporation violates the provisions of this Code," simply because the original provisions of the old SEC Code specifically covered only such violation, it is not clear what other violations may be punishable under Article 11 of the Revised CG Code.

Atty. Gerard M. Lukban, the SEC Secretary, was quoted as saying that "[t]he previous code had provisions that use 'may' ... Here some were

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54. *See* Revised CG Code, art. 3 (E) (1) (iv). The article reads:

> The following shall be grounds for the permanent disqualification of a director: ... (iv) Any person who has been adjudged by final judgment or order of the Commission, court, or competent administrative body to have wilfully violated, or wilfully aided, abetted, counselled, induced or procured the violation of any provision of the Corporation Code, Securities Regulation Code or any other law administered by the Commission or BSP, or any of its rules, regulation or order.

See also Revised CG Code, art. 3 (E) (2) (iii). The article reads:

> The Board may provide for the temporary disqualification of a director for any of the following reasons: ... (iii) Dismissal or termination for cause as director of any corporation covered by this Code. The disqualification shall be in effect until he has cleared himself from any involvement in the cause that gave rise to his dismissal or termination.

55. Corporation Code, § 28.

56. Revised CG Code, art. 11.

changed to 'shall' so they are no longer just recommendatory."[57] That would mean that every provision of the Code that imposes an obligation with the use of the word "shall" would be a violation of the Revised CG Code that would be punishable with the fine under Article 11 thereof.

For example, under Article 2 (F), it is provided that: "The Board should formulate the corporation's vision, mission, strategic objectives, policies and procedures that *shall* guide its activities, including the means to effectively monitor Management's performance."[58]

Obviously, compliance with the above-indicated duty may find its expression in the manual of corporate governance that a covered corporation submits with the SEC. But if the manual duly submitted does not contain one or some of the items enumerated, or what are submitted are not effective or complete, does that constitute a violation of the Revised CG Code, triggering the imposition, after notice and hearing, of the ₱200,000 fine? Who is to judge what is "effective?"

Another example would be Article 6 (B) of the Revised CG Code which reads —

> B) The Board should be transparent and fair in the conduct of the annual and special stockholders' meetings of the corporation. The stockholders should be encouraged to personally attend such meetings. If they cannot attend, they should be apprised ahead of time of their right to appoint a proxy. Subject to the requirements of the bylaws, the exercise of that right *shall not be unduly restricted and any doubt about the validity of a proxy should be resolved in the stockholder's favor.*[59]

In a situation where there are issues in the implementation of by-law provisions on proxy, and the Board, upon advice of counsel, takes a position which is deemed restrictive of the right of a stockholder, would that trigger the imposition of the penalty under Article 11 of the Code? Would the fine be imposable against the covered corporation or against the members of the Board? Who is to say what is "unduly restrictive?"

If we were to presume that the clear intention under Article 11 is that the penalty imposed would be personally against the offending director or officer, it would have a chilling effect on the exercise of business judgment on the part of the Board of Directors, and would even discourage qualified professional directors to accept appointment to public companies simply because they are not certain exactly what action or inaction would constitute punishable offense under said provision.

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57. *SEC Strengthens Corporate Governance Code*, *available at* http://www.bworld online.com /BW062409/content.php?id=005 (last accessed Sep. 17, 2009).

58. Revised CG Code, art. 2 (F).

59. *Id.* art. 6 (B) (emphasis supplied).

There is a similar all-encompassing penalty clause under Section 144 of the Corporation Code,[60] and our comments on whether an imposition of a penalty may be achieved thereunder are worth quoting in this Article:

> Looking at the language of Section 144 of the Corporation Code, it seems all-encompassive [sic] in nature as to impose criminal liability for '[v]iolations *of any* of the provisions of this Code or its amendments not otherwise specifically penalized therein.'
>
> It is difficult to construe Section 144 of the Corporation Code to mean that all non-compliance with the provisions of the Corporation Code would be criminally punishable. For example, under Section 26 of the Corporation Code, it is provided that within thirty (30) days after the election of the directors, trustees and officers of the corporation, the secretary, or any other officer of the corporation, shall submit to the SEC, the names, nationalities and residences of the directors, trustees and officers elected. If a corporate secretary fails to comply with this provision, would he then be subject to a criminal penalty under Section 144?
>
> Such a construction would seem too harsh, and effectively discourages competent and well-meaning individuals from accepting positions within the corporate setting. It would then make the corporation a very unattractive medium for commerce.
>
> . . .
>
> In effect, the broad coverage of Section 144 is meaningless since it is applicable only to Section 74 of the Code. If that is the legal effect, then it could be argued that Legislature, when it enacted Section 144 of part of the Corporation Code, had not intended it to be a practically useless provision since the penal sanctions provided therein could have effectively been stated in Section 74 if it is indeed the only violation applicable to said provision. However, such a position fails to consider that indeed Section 144 was meant to be the over-all penal sanction under the Code, if and when Legislature deems it appropriate to impose a penal sanction for

60. CORPORATION CODE, § 144. The section reads:

> Violations of any of the provisions of this Code or its amendments not otherwise specifically penalized therein shall be punished by a fine of not less than one thousand (₱1,000.00) pesos but not more than ten thousand (₱10,000.00) pesos or by imprisonment for not less than thirty (30) days but not more than five (5) years, or both, in the discretion of the court. If the violation is committed by a corporation, the same may, after notice and hearing, be dissolved in appropriate proceedings before the Securities and Exchange Commission; Provided, That such dissolution shall not preclude the institution of appropriate action against the director, trustee, or officer of the corporation responsible for said violation: Provided, further, That nothing in this section shall be construed to repeal the other causes for dissolution of a corporation provided in this Code.

> violation thereof not only based on the current provisions of the Code, but also 'its amendments' in the future.
>
> It should also be noted that although a penal provision like Section 144 is usual in special laws, nevertheless, the implementation of the principle *dura lex, sed lex* to such penal provisions under most special laws is without controversy because the subject thereof is limited and the acts covered therein are clearly defined. Such position cannot be equated to Section 144, since the Corporation Code, indeed is a 'code' that necessarily covers a broad subject and almost innumerable acts.[61]

V. ADR SYSTEM FOR PUBLIC COMPANIES

The Revised CG Code has introduced as one of the "Duties and Functions" of the Board of Directors of a public company, the setting up of a system of dispute resolution, thus:

> F) Responsibilities, Duties and Functions of the Board
>
> . . .
>
> 2. Duties and Functions
>
> To ensure a high standard of best practice for the corporation and its stockholders, the Board should conduct itself with honesty and integrity in the performance of, among others, the following duties and functions:
>
> . . .
>
> j) Establish and maintain an alternative dispute resolution system in the corporation that can amicably settle conflicts or differences between the corporation and its stockholders, and the corporation and third parties, including the regulatory authorities.[62]

The establishment of an alternative dispute resolution system as part of the features of Philippine public companies is very laudable. The slow grind of the Philippine judicial process which has discouraged investments in the Philippine market, has compelled even the Supreme Court to set up special commercial courts to handle corporate cases and issue special rules of procedure. In addition, the Supreme Court has formally adopted mediation proceedings that must be resorted to by the parties before formal judicial proceedings can be pursued.

Perhaps the best way by which the SEC, being the government agency granted control and supervision over corporate media, to further advance the way towards an ADR system for Philippine public companies, is to set up a formal ADR Panel that can have mandatory enforcement in matters

61. CESAR L. VILLANUEVA, PHILIPPINE CORPORATE LAW 870-73 (2001 ed.).

62. Revised CG Code, art. 3 (F) (2) (j).

pertaining to conflicts or differences between corporations and their shareholders and investors.

In a study done for the Asian Development Bank on the ADR system of the Philippines, it was determined that the most successful system is the Construction Industry Arbitration Council (CIAC), which was mandated through the decree powers of Pres. Ferdinand Marcos, and has become a reliable manner of resolving conflicts in the construction industry. The impetus behind CIAC's success lies on two factors, namely: (a) that it was statutorily mandated, so that construction industry players had no choice but to resort to arbitration and could not rely upon the slow grind of the judicial proceedings to stymie legitimate complaints or claims; and (b) the arbitration process was being overseen by the construction industry's own experts and leading advocates, who understood the business and technical nuances of the industry.

Even well-trained Regional Trial Court Commercial Court judges are really no match for the expertise that SEC officers, corporate and business practitioners have on issues and intricacies arising within the Philippine public companies system. Perhaps the SEC may oversee the establishment and operation of the "Public Companies Arbitration Council (PCAC)" and make resort to PCAC arbitration mandatory through issuing a formal SEC memorandum, pursuant to its vast quasi-legislative powers under Section 72 of the Securities Regulation Code, thus —

> Rules and Regulations; Effectivity. — 72.1. This Code shall be self-executory. To effect the provisions and purposes of this Code, the Commission may issue, amend, and rescind such rules and regulations and orders necessary or appropriate, including rules and regulations defining accounting, technical, and trade terms used in this Code, and prescribing the form or forms in which information required in registration statements, applications, and reports to the Commission shall be set forth. *For purposes of its rules or regulations, the Commission may classify persons, securities, and other matters within its jurisdiction, prescribe different requirements for different classes of persons, securities, or matters, and by rule or order, conditionally or unconditionally exempt any person, security, or transaction, or class or classes of persons, securities or transactions, from any or all provisions of this Code.*
>
> Failure on the part of the Commission to issue rules and regulations shall not in any manner affect the self-executory nature of this Code.[63]

VI. CONCLUSION

In our work on Philippine Corporate Governance, we have demonstrated that authorities in other disciplines, particularly on Economics and Business Management, have pointed out that the philosophical basis of the stakeholders' theory was itself not a perfected system — that it was still a

63. SRC, § 72 (emphasis supplied).

work-in-progress. Therefore, it was very difficult under the old SEC Code to evolve a truly efficient system of corporate governance adopting the stakeholder theory, as contrasted from the maximization of shareholders' value.

One of the fundamental issues arising under the old SEC Code's stakeholder doctrine, apart from recognizing that the Boards of Directors of public companies owe duties and obligations not just to the shareholders but to various stakeholders who are affected by the company's business enterprise as well, was that the old SEC Code found it difficult to provide a hierarchy of values by which directors and Management of a covered corporation could properly measure compliance with their varied duties to their stakeholders. In other words, the old SEC Code was very good on broad principles ushering in the stakeholder theory, but was very short on particulars on how the directors were going to meet their duties and responsibilities under such expanded constituencies.

We thought then that faced with such a challenge, it was ingenious for the SEC to have provided in the old SEC Code that every covered corporation, in its manual of corporate governance, was mandated to identify its considered stakeholder and define the rights they may have against the company in the operation of its business, thus —

> iv. Identify the corporation's major and other stakeholders and formulate a clear policy on communicating or relating with them accurately, effectively and sufficiently. There must be an accounting rendered to them regularly in order to serve their legitimate interests.
>
> Likewise, an investor relations program that reaches out to all shareholders and fully informs them of corporate activities should be developed. As a best practice, the chief financial officer or CEO should have oversight of this program and should actively participate in public activities.[64]

Under the aegis of such provisions in the old SEC Code, it would ensure to covered companies that as the stakeholder theory is formally adopted into Philippine jurisdiction, it did not turn out to be an open-ended affair where the Boards of Directors of public companies were not quite sure of the extent of their duties and responsibilities under a system of expanded constituencies, and would be able to define for themselves precisely what they considered to be the extent of the rights of such identified stakeholders.

The afore-quoted provision, of course, no longer appears in the Revised CG Code, for instead of being able to evolve the system of "stakeholdership" for Philippine public companies, the SEC seems to have lost the heart and just decided to go back to the old corporate maxim that the duty of the Board of Directors of every corporation is to maximize its profits.

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64. CG Code, § II (6) (b) (iv).

What began as a bold venture into a cutting-edge Corporate Governance system has seemed to come to an end, at least insofar as the SEC is concerned. There was no denying that adopting the stakeholder theory as the cornerstone of our system of good corporate governance for Philippine public companies was no easy task; but, considering the scarce resources that we have in this country, most of them in the corporate coffers, it was an adventure worth pursuing to a successful end.