ATENEO DE MANILA LAW SCHOOL

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OUTLINE ON PHILIPPINE CORPORATE LAW[1]

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I. HISTORICAL BACKGROUND

1. Philippine Corporate Law:[2] *A-sort-of codification of American Corporate Law*

When attention was drawn to the fact that there was no entity in Spanish law corresponding to the notion of the American "corporation", the Philippine Commission enacted the Corporation Law (Act No. 1459), to introduce the American corporation in the Philippines as the standard commercial entity and to hasten the day when the *sociedad anónima* of the Spanish law would be obsolete. The statute is a sort of codification of American Corporate Law. *Harden v. Benguet Consolidated Mining*, 58 Phil. 141 (1933).

2. The Corporation Law (Act No. 1459)

The first corporate statute, the Corporation Law became effective on 01 April 1906. It had piece-meal amendments during its 74-year history, but became antiquated and not adapted to the changing times.

3. The Corporation Code (Batas Pambansa Bilang 68)

The current Corporation Code of the Philippines took effect on 01 May 1980, adopting various corporate doctrines enunciated by the Supreme Court under the old Corporation Law; clarified the obligations of corporate directors and officers; expressed in statutory language established principles and doctrines; and provided for a chapter on close corporations.[3]

4. Proper Treatment of Philippine Corporate Law

Although we have a Corporation Code that provides for statutory principles, since Philippine Corporate Law comes from the U.S. common law system, Philippine Corporate Law is essentially, and continues to be, a common law system and subject to developments in commercial developments, much of which can be expected to happen in the world of commerce, and some expressed jurisprudential rules that try to apply and adopt corporate principles into the changing concepts and mechanism of the commercial world.

II. CONCEPTS

1. Definition (**Sec. 2**; **Articles 44(3), 45, 46, and 1775, Civil Code**)

A corporation is an artificial being created by operation of law, invested by law upon coming into existence with a personality separate and distinct from the persons composing it, and from any other legal entity to which it may be related. *PNB v. Andrada Electric & Engineering Co.*, 381 SCRA 244 (2002).[4]

2. FOUR (4) CORPORATE ATTRIBUTES BASED ON SECTION 2:

(a) An Artificial Being: "*It has juridical capacity to contract and enter into legal relationships*."

(b) Creature of the Law: "*It is created by operation of law and not by mere agreement.*"

(c) Strong Juridical Personality: "*It has a right of succession.*"

(d) Creature of Limited Powers: "*It has only such powers, attributes and properties as are expressly authorized by law or incident to its existence.*"

A corporation has no powers except for those which are expressly conferred on it by the Corporation Code, found in its charter, and those that are implied by or are incidental to its existence. It exercises its powers through its Board of Directors and/or its duly authorized officers and agents. *Pascual and Santos, Inc. v. The Members of the Tramo Wakas Neighborhood Assn. Inc.*, 442 SCRA 438 (2004).[5]

3. "TRI-LEVEL EXISTENCE" OF THE CORPORATION:

(a) "Assets-Only" Level: "*The corporation is an aggregation of Assets and Resources"*

(b) "**Business Enterprise" Level:** *"The corporation's primary purpose is to pursue business."*

(c) "**Juridical Entity" Level:** "*The corporation is a **medium** of pursuing a business enterprise."*

4. "TRI-LEVEL RELATIONSHIPS" IN THE CORPORATE SETTING:

(a) JURIDICAL ENTITY LEVEL, which treats of the aspects of the State-corporation relationship.

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[1]Unless otherwise indicated, all references to sections pertain to the Corporation Code of the Philippines.

[2]The whole body of statutory and jurisprudential rules pertaining to corporations is referred to as "Corporate Law" to differentiate it from the old statute known as "The Corporation Law," or Act No. 1459.

[3]Corporation Code applies even to corporations organized under the old Corporation Law. *Castillo v. Balinghasay*, 440 SCRA 442 (2004).

[4]*Construction & Dev. Corp. of the Phils. v. Cuenca*, 466 SCRA 714 (2005); *EDSA Shangri-La Hotel and Resorts, Inc. v. BF Corp.*, 556 SCRA 25 (2008).

[5]*De Liano v. Court of Appeals*, 370 SCRA 349 (2001); *Monfort Hermanos Agricultural Dev. Corp. v. Monfort III*, 434 SCRA 27 (2004); *United Paragon Mining Corp. v. Court of Appeals*, 497 SCRA 638 (2006); *Cebu Bionic Builders Supply, Inc. v. DBP*, 635 SCRA 13 (2010).

(b) INTRA-CORPORATE LEVEL, which considers that the corporate setting is at once a contractual relationship on four (4) levels:

- Between the corporation and its agents/representatives to act in the real world, i.e., directors and officers, which is governed also by the Law on Agency
- Between the corporation and its shareholders or members
- Between the shareholders and the corporate directors, trustees and officers
- Between and among the shareholders in a common venture

(c) EXTRA-CORPORATE LEVEL, which views the relationship between the corporation and third-parties or "outsiders", essentially governed by Contract Law and Labor Law.

- Between the corporation and its employees, governed by Labor Laws
- Between the corporation and those it contracts and transacts with, govern by Contract Laws
- Between the corporation and the publics it affects with its enterprise, governed essentially by Torts or *Quasi*-Delict Laws.

5. THEORIES ON THE FORMATION OF CORPORATION

(a) *Theory of Concession:* ✓*Tayag v. Benguet Consolidated*, 26 SCRA 242 (1968).

To organize a corporation that could claim a juridical personality of its own and transact business as such, is not a matter of absolute right, *but a privilege* which may be enjoyed only under such terms as the State may deem necessary to impose. *cf. Ang Pue & Co. v. Sec. of Commerce and Industry*, 5 SCRA 645 (1962).

"It is a basic postulate that before a corporation may acquire juridical personality, the State must give its consent either in the form of a special law or a general enabling act," and the procedure and conditions provided under the law for the acquisition of such juridical personality must be complied with. Although the statutory grant to an association of the powers to purchase, sell, lease and encumber property can only be construed the grant of a juridical personality to such an association . . . nevertheless, the failure to comply with the statutory procedure and conditions does not warrant a finding that such association acquired a juridical personality, even when it adopts constitution and by-laws. *Int'l Express Travel & Tour Services, Inc. v. CA,* 343 SCRA 674 (2000).

All corporations, big or small, must abide by the provisions of the Corporation Code; even a simple family corporation cannot claim an exemption nor can it have rules and practices other than those established by law. *Torres v. Court of Appeals*, 278 SCRA 793 (1997).

(b) Theory of Enterprise Entity: ✓BERLE, 47 COLUMBIA LAW REV. 343 (1947)

A corporation is but an association of individuals, allowed to transact under an assumed corporate name, and with a distinct legal personality. In organizing itself as a collective body, it waives no constitutional immunities and perquisites appropriate to such a body. *PSE v. Court of Appeals,* 281 SCRA 232 (1997).

Corporations are composed of natural persons and their separate corporate personality is not a shield for the commission of injustice and inequity, such as to avoid the execution of the property of a sister company. *Tan Boon Bee & Co. v. Jarencio*, 163 SCRA 205 (1988).

6. ADVANTAGES AND DISADVANTAGES OF CORPORATE FORM:

(a) Four Advantageous Characteristics of Corporate Medium:

(i) STRONG AND SOLEMN JURIDICAL PERSONALITY (Sec. 2)

"A corporation is an entity separate and distinct from its stockholders. While not in fact and in reality a person, the law treats the corporation as though it were a person by process of fiction or by regarding it as an artificial person distinct and separate from its individual stockholders." *Remo, Jr. v. IAC*, 172 SCRA 405 (1989).

The transfer of the corporate assets to the stockholders is not in the nature of a partition among co-owners but is a conveyance from one party to another. Stockholders are not co-owners of corporate assets and properties. *Stockholders of F. Guanzon and Sons, Inc. v. Register of Deeds of Manila*, 6 SCRA 373 (1962).

Execution pending appeal may be allowed *when* "the prevailing party is already of advanced age and in danger of extinction," but not in this case where the winning party is a corporation. "[A] juridical entity's existence cannot be likened to a natural person—its precarious financial condition is not by itself a compelling circumstance warranting immediate execution and does not outweigh the long standing general policy of enforcing only final and executory judgment." *Manacop v. Equitable PCIBank*, 468 SCRA 256 (2005).

(ii) CENTRALIZED MANAGEMENT (Sec. 23)

As can be gleaned from Sec. 23 of Corporation Code "It is the board of directors or trustees which exercises almost all the corporate powers in a corporation." *Firme v. Bukal Enterprises and Dev. Corp.*, 414 SCRA 190 (2003).

The exercise of corporate powers rest in the Board of Directors, save in those instances where the Corporation Code requires stockholders' approval for certain specific acts. *Great Asian Sales Center Corp. v. Court of Appeals*, 381 SCRA 557 (2002).

(iii) LIMITED LIABILITY TO INVESTORS AND OFFICERS

One of the advantages of the corporation is the limitation of an investor's liability to the amount of investment, which flows from the legal theory that a corporate entity is separate and distinct from its stockholders. *San Juan Structural and Steel Fabricators, Inc. v. CA*, 296 SCRA 631 (1998).

It is hornbook law that corporate personality is a shield against personal liability of its officers—a corporate officer and his spouse cannot be made personally liable under a trust receipt where he entered into and signed the contract clearly in his official capacity. *Consolidated Bank and Trust Corp. v. Court of Appeals,* 356 SCRA 671 (2001).[6]

Obligations incurred by the corporation acting through its directors, officers and employees, are its sole liabilities. *Malayang Samahan ng mga Manggagawa sa M. Greenfield v. Ramos,* 357 SCRA 77 (2001).

Where the creditor of the corporation sues not only the company but also all stockholders to reach their unpaid subscription which appear to be the only visible assets of the company, then the controlling doctrine is that "a stockholder is personally liable for the financial obligations of the corporation *to the extent of his unpaid subscription.*" *Halley v. Printwell, Inc.* 649 SCRA 116 (2011).

(iv) FREE-TRANSFERABILITY OF UNITS OF OWNERSHIP (SHARES) FOR INVESTORS (Sec. 63)

It is the inherent right of the stockholder to dispose of his shares of stock (which he owns as any other property of his) anytime he so desires. *Remo, Jr. v. IAC*, 172 SCRA 405 (1989); *PNB v. Ritratto Group, Inc.*, 362 SCRA 216 (2001).

Authority granted to regulate the transfer of its stock does not empower the corporation to restrict the right of a stockholder to transfer his shares, but merely authorizes the adoption of regulations as to the formalities and procedure to be followed in effecting transfer. *Thomson v. Court of Appeals*, 298 SCRA 280 (1998).

(b) Disadvantages of the Corporate Medium:

(1) Abuse of corporate management; breach of trust

(2) Abuse of limited liability feature

(3) High cost of maintenance of the corporate medium

(4) Double taxation

- Dividends received by individuals from domestic corporations are subject to final 10% tax for income earned on or after 01 January 1998 (Sec. 24(B)(2), 1997 NIRC)
- Inter-corporate dividends between domestic corporations, however, are not subject to any income tax (Sec. 27(D)(4), 1997 NIRC)
- There is re-imposition of the 10% "improperly accumulated earnings tax" for holding companies (Sec. 29, 1997 NIRC)

7. COMPARED WITH OTHER BUSINESS MEDIA

(a) Sole Proprietorships

A sole proprietorship is not vested with juridical personality to file or defend an action. *xExcellent Quality Apparel, Inc. v. Win Multiple-Rich Builders, Inc.*, 578 SCRA 272 (2009).

(b) Partnerships and Other Associations (**Arts. 1768 and 1775, Civil Code**)

- ***Can a Defective Attempt to Form a Corporation Result at Least in a Partnership?***
  - ✓***Pioneer Insurance v. Court of Appeals*, 175 SCRA 668 (1989)**.
  - ✓***Lim Tong Lim v. Philippine Fishing Gear Industries, Inc.*, 317 SCRA 728 (1999)**.

(c) Joint Ventures

Joint venture is an association of persons or companies jointly undertaking some commercial enterprise; generally all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and duty, which may be altered by agreement to share both in profit and losses. *Kilosbayan, Inc. v. Guingona, Jr.*, 232 SCRA 110 (1994).

(d) Cooperatives (Art. 3, R.A. No. 6938)

Cooperatives are established to provide a strong social and economic organization to ensure that the tenant-farmers will enjoy on a lasting basis the benefits of agrarian reforms. *Corpuz v. Grospe,* 333 SCRA 425 (2000).

(e) Business Trusts (Article 1442, Civil Code)

[6] *Ever Electrical Manufacturing, Inc. (EEMI) v. Samahang Manggagawa ng Ever Electrical/NAMAWU Local 224*, 672 SCRA 562 (2012); *Gotesco Properties, Inc. v. Fajardo*, 692 SCRA 319 (2013).

(f) *Sociedades Anónimas*

A *sociedad anónima* was considered a commercial partnership "where upon the execution of the public instrument in which its articles of agreement appear, and the contribution of funds and personal property, becomes a juridical person—an artificial being, invisible, intangible, and existing only in contemplation of law—with power to hold, buy, and sell property, and to sue and be sued—a corporation—not a general copartnership nor a limited copartnership . . . The inscribing of its articles of agreement in the commercial register was not necessary to make it a juridical person; such inscription only operated to show that it partook of the *form* of a commercial corporation." *Mead v. McCullough*, 21 Phil. 95 (1911).

The *sociedades anónimas* were introduced in Philippine jurisdiction on 01 December 1888 with the extension to Philippine territorial application of Articles 151 to 159 of the Spanish Code of Commerce. Those articles contained the features of limited liability and centralized management granted to a juridical entity. But they were more similar to the English joint stock companies than the modern commercial corporations. *Benguet Consolidated Mining Co. v. Pineda*, 98 Phil. 711 (1956).

The old Corporation Law recognized the difference between *sociedades anónimas* and corporations and the Court will not apply legal provisions pertaining to the latter to the former. *Phil. Product Co. v. Primateria Societe Anonyme*, 15 SCRA 301 (1965).

(g) *Cuentas En Participacion*

A *cuentas en participacion* is an accidental partnership constituted in a manner that its existence was only known to those who had an interest in the same, there being no mutual agreement between the partners, and without a corporate name indicating to the public in some way that there were other people besides the one who ostensibly managed and conducted the business, governed under Article 239 of the Code of Commerce. Those who contract with the person under whose name the business of such partnership of *cuentas en participacion* is conducted, shall have only a right of action against such person and not against the other persons interested, and the latter, on the other hand, shall have no right of action against third person who contracted with the manager unless such manager formally transfers his right to them. *Bourns v. Carman*, 7 Phil. 117 (1906).

III. NATURE AND ATTRIBUTES OF A CORPORATION

1. Nature of Power to Create a Corporation (**Sec. 16, Article XII, 1987 Constitution**)

Congress cannot enact a law creating a private corporation with a special charter, and it follows that Congress can create corporations with special charters only if such are GOCCs. *Feliciano v. Commission on Audit*, 419 SCRA 363 (2004).

The Constitution explicitly prohibits the creation and regulation by special laws of private corporations, except for government-owned or controlled corporations (GOCCs). *Veterans Federation of the Philippines v. Reyes*, 483 SCRA 526 (2006).

P.D. 1717 creating New Agrix, Inc. violated the constitutional prohibition on the formation of a private corporation by special legislative act which is not a GOCC, since NDC was merely required to extend a loan to the new corporation, and the new stocks of the corporation were to be issued to the old investors and stockholders of the insolvent Agrix upon proof of their claims against the abolished corporation. *NDC v. Philippine Veterans Bank,* 192 SCRA 257 (1990).

PNRC which was constituted under a special law, is not a GOCC because it is not by its charter owned by the Government, although it is intended to do public functions, it is owned by the private sector. Consequently, the PNRC Charter, insofar as it creates the PNRC as a private corporation and grants it corporate powers, is void for being unconstitutional. The other provisions of the PNRC Charter remain valid as they can be considered as a recognition by the State that the unincorporated PNRC is the local National Society of the International Red Cross and Red Crescent Movement, and thus entitled to the benefits, exemptions and privileges set forth in the PNRC Charter. *Liban v. Gordon*, 593 SCRA 68 (2009).

2. CORPORATION AS A PERSON:

(a) Entitled to Due Process and Equal Protection

The due process clause is universal in its application to all persons, and covers private corporations within the scope of the guaranty insofar as their properties are concerned. *Smith Bell & Co. v. Natividad*, 40 Phil. 136, 144 (1920).

(b) Unreasonable Searches and Seizure

A corporation is protected by the constitutional guarantee against unreasonable searches and seizures, but its officers have no cause of action to assail the legality of the seizures, regardless of the amount of shares of stock or of the interest of each of them in said corporation because the corporation has a personality distinct and separate from those of said officers. *Stonehill v. Diokno*, 20 SCRA 383 (1967).

A corporation is but an association of individuals under an assumed name and with a distinct legal entity. In organizing itself as a collective body it waives no constitutional immunities appropriate for such body. Its property cannot be taken without compensation; can only be proceeded against by due process of law; and is protected against unlawful discrimination. *Bache & Co. (Phil.), Inc. v. Ruiz*, 37 SCRA 823 (1971).

(c) Not Entitled to Privilege Against Self Incrimination

"It is elementary that the right against self-incrimination has no application to juridical persons." *Bataan Shipyard & Engineering v. PCGG*, 150 SCRA 181 (1987).

While an individual may lawfully refuse to answer incriminating questions unless protected by an immunity statute, it does not follow that a corporation, vested with special privileges and franchises, may refuse to show its hand when charged with an abuse of such privilege. *Hale v. Henkel*, 201 U.S. 43 (1906).[7]

3. Practice of Profession

Corporations cannot engage in the practice of a profession since they lack the moral and technical competence required by the PRC. *ULEP v. The Legal Clinic*, 223 SCRA 378 (1993).

A corporation engaged in the selling of eyeglasses and which hires optometrists is not engaged in the practice of optometry. *Samahan ng Optometrists v. Acebedo International Corp.,* 270 SCRA 298 (1997); *Alfafara v. Acebedo Optical Company,* 381 SCRA 293 (2002).

COUNTER-REVOLUTION: "Architectural professional corporations" allowed under Rep. Act No. 9266.

4. Liability for Torts

A corporation is civilly liable in the same manner as natural persons for torts, because the rules governing the liability of a principal for a tort committed by an agent are the same whether the principal be a natural person or a corporation, and whether the agent be a natural or artificial person. That a principal is liable for every tort which he expressly directs or authorizes, is just as true of a corporation as a natural person. *PNB v. Court of Appeals*, 83 SCRA 237 (1978).

"*Corporate tort*" consists in the violation of a right given or the omission of a duty imposed by law; a breach of a legal duty. The failure of the corporate employer to comply with the duty under the Labor Code to grant separation pay to employees in case of cessation of operations constitutes tort and its stockholder who was actively engaged in the management or operation of the business should be held personally liable. *Sergio F. Naguiat v. NLRC*, 269 SCRA 564 (1997).

While in theory a hospital as a juridical entity cannot practice medicine, in reality it utilizes doctors, surgeons and medical practitioners in the conduct of its business of facilitating medical and surgical treatment. Within that reality, three legal relationships crisscross: (1) between the hospital and the doctor practicing within its premises; ***(2) between the hospital and the patient being treated or examined within its premises***; and (3) between the patient and the doctor. Regardless of its relationship with the doctor, the hospital may be held directly liable to the patient for its own negligence or failure to follow established standard of conduct to which it should conform as a corporation. ✓***Professional Services, Inc. v. Court of Appeals*, 611 SCRA 282 (2010).**

5. Corporate Criminal Liability (Articles 102 and 103, Revised Penal Code):

Corporations cannot be held criminally liable within Philippine jurisdiction since there is no law relating to the practice and procedure in criminal actions whereby a corporation may be brought to court to be proceeded against criminally. ✓***West Coast Life Ins. Co. v. Hurd*, 27 Phil. 401 (1914)**.

A corporate officer who signs the trust receipt in behalf of the corporation cannot be held criminally liable for the crime of estafa punished under the Revised Penal Code and prior to the promulgation of the Trust Receipts Decree under the doctrine that "the corporation was [not] directly required by law to do an act in a given manner, and the same law makes the person who fails to perform the act in the prescribed manner expressly liable criminally." ✓***Sia v. Court of Appeals*, 121 SCRA 655 (1983)**.

BUT: The Trust Receipts Law recognizes the impossibility of imposing the penalty of imprisonment on a corporation, hence, if the entrustee is a corporation, the law makes the officers or employees or other persons responsible for the offense liable to suffer the penalty of imprisonment. *Ong v. Court of Appeals*, 401 SCRA 6478 (2003).

No criminal suit can lie against a corporation*:** *Times, Inc. v. Reyes*, 39 SCRA 303 (1971). ***BUT: A corporation can be a real-party-in-interest for the purpose of bringing a civil action for malicious prosecution for the damages incurred by the corporation for the criminal proceedings brought against its officer. *Cometa v. Court of Appeals*, 301 SCRA 459 (1999).

When a criminal statute forbids the corporation itself from doing an act, the prohibition extends to the Board of Directors, and to each director separately and individually. *People v. Concepcion,* 44 Phil. 129 (1922).

The existence of the corporate entity does not shield from prosecution the corporate agent who knowingly and intentionally causes the corporation to commit the crime. The corporation obviously acts, and can act, only by and through its human agents, and it is their conduct which the law must deter. The employee or agent of a corporation engaged in unlawful business naturally aids and abets in the carrying on of such business and will be prosecuted as principal if, with knowledge of the business, its purpose and effect, he consciously contributes his efforts to its conduct and promotion [illegal recruitment in this case], however slight his contribution may be. ✓***The Executive Secretary v. Court of Appeals*, 429 SCRA 81 (2004); ✓*People v. Tan Boon Kong*, 54 Phil. 607 (1930)**.

[7] *Wilson v. United States,* 221 U.S. 361 (1911); *United States v. White,* 322 U.S. 694 (1944).

If the crime is committed by a corporation, the directors, officers, employees or other officers thereof responsible for the offense shall be charged and penalized for the crime, precisely because of the nature of the crime and the penalty therefor. A corporation cannot be arrested and imprisoned; hence, cannot be penalized for a crime punishable by imprisonment. However, a corporation may be charged and prosecuted for a crime if the imposable penalty is fine. Even if the statute prescribes both fine and imprisonment as penalty, a corporation may be prosecuted and, if found guilty, may be fined. ✓***Ching v. Secretary of Justice*, 481 SCRA 602 (2006);**

When a criminal statute designates an act of a corporation or a crime and prescribes punishment therefor, it creates a criminal offense which, otherwise, would not exist and such can be committed only by the corporation. But when a penal statute does not expressly apply to corporations, it does not create an offense for which a corporation may be punished. On the other hand, if the statute, defines a crime that may be committed by a corporation but prescribes the penalty therefor to be suffered by the officers, directors, or employees of such corporation or other persons responsible for the offense, only such individuals will suffer such penalty. Corporate officers or employees, through whose act, default or omission the corporation commits a crime, are themselves individually guilty of the crime. ✓***Ching v. Secretary of Justice*, 481 SCRA 602 (2006). *BUT SEE:* ✓*Consolidated Bank v. Court of Appeals*, 356 SCRA 671 (2003).**

The "owners" of a corporate organization are its stockholders and they are to be distinguished from its directors and officers. Stockholders, being basically investors in the corporation, and with the management of its business generally vested in the Board of Directors, cannot be held liable for the criminal offense committed on behalf of the corporation, unless they personally took part in the same. *Espiritu v. Petron Corp.*, 605 SCRA 245 (2009).

Apart from its sweeping allegation that respondents misappropriated or converted its money placements, petitioner failed to establish the particular role or actual participation of each respondent in the criminal act; neither was it shown that they assented to its commission. It is basic that only corporate officers shown to have participated in the alleged anomalous acts may be held criminally liable. *Cruzvale, Inc. v. Eduque*, 589 SCRA 534, 546 (2009).

6. Recovery of Moral and Other Damages

A corporation, being an artificial person, cannot experience physical sufferings, mental anguish, fright, serious anxiety, wounded feelings, moral shock or social humiliation which are basis for moral damages under Art. 2217 of the Civil Code. *However, a corporation may have a good reputation which, if besmirched, may be a ground for the award of moral damages*. *Mambulao Lumber Co. v. Philippine National Bank,* 22 SCRA 359 (1968); *APT v. Court of Appeals,* 300 SCRA 579 (1998).

BUT: The statement in *People v. Manero* and *Mambulao Lumber Co. v. PNB*, that a corporation may recover moral damages if it "has a good reputation that is debased, resulting in social humiliation" is an *obiter dictum. Recovery of a corporation would be under Articles 19, 20 and 21 of the Civil Code, but which requires a clear proof of malice or bad faith. ABS-CBN Broadcasting Corp. v. Court of Appeals*, 301 SCRA 589 (1999).

NONETHELESS: Likewise, an educational corporation's claim for moral damages arising from libel falls under Article 2219(7) of the Civil Code, which expressly authorizes the recovery of moral damages in cases of libel, slander or any other form of defamation, and does not qualify whether the plaintiff is a natural or juridical person. Therefore, a juridical person can validly complain for libel or any other form of defamation and claim for moral damages. *Filipinas Broadcasting Network v. Ago Medical and Educational Center*, 448 SCRA 413 (2005).

PREVAILING RULE: A corporation, being an artificial person and having existence only in legal contemplation, has no feelings, emotions nor senses; therefore, it cannot experience physical suffering and mental anguish. Mental suffering can be experienced only by one having a nervous system and it flows from real ills, sorrows, and griefs of life—all of which cannot be suffered by an artificial person. *Prime White Cement Corp. v. IAC*, 220 SCRA 103 (1993).[8]

7. CORPORATE NATIONALITY: *UNDER WHOSE LAWS INCORPORATED* (Sec. 123)

EXCEPTION*: *TEST OF CONTROLLING OWNERSHIP

Domestic corporations which are under the control of nationals of the enemy country are deemed foreign enemy corporations. *Haw Pia v. China Banking Corp*., 80 Phil. 604 (1948).[9]

The 1987 Constitution "provides for the Filipinization of public utilities by requiring that any form of authorization for the operation of public utilities should be granted only to 'citizens of the Philippines or to corporation or associations organized under the laws of the Philippines at least sixty per centum of whose capital is owned by such citizens.' The evident purpose of the citizenship requirement is to prevent aliens from assuming control of public utilities, which may be inimical to the national interest. This specific provision explicitly reserves to Filipino citizens control of public utilities, pursuant to an overriding economic goal of the 1987 Constitution: to "conserve and develop our patrimony" and to ensure a "a self-

[8] *LBC Express, Inc. v. Court of Appeals,* 236 SCRA 602 (1994); *Acme Shoe, Rubber & Plastic Corp. v. Court of Appeals*, 260 SCRA 714 (1996); *Solid Homes, Inc. v. Court of Appeals*, 275 SCRA 267 (1997); *NPC v. Philipp Brothers Oceanic, Inc.*, 369 SCRA 629 (2001); *Flight Attendants and Stewards Association of the Philippines v. Philippine Airlines,* 559 SCRA 252 (2008); *Employees Union of Bayer Phils. V. Bayer Philippines, Inc.*, 636 SCRA 473 (2010).

[9] *Filipinas Compania de Seguros v. Christern, Huenefeld & Co., Inc.*, 89 Phil. 54 (1951); *Davis Winship v. Philippine Trust Co.*, 90 Phil. 744 (1952).

reliant and independent national economy ***effectively controlled*** by Filipinos." We rule that the term "capital" in Sec. 11, Art. XII of the Constitution refers only to shares of stock entitled to vote in the election of directors, and thus in the present case only to common shares, and also preferred shares that are entitled to vote, and not the total outstanding capital stock comprising both common and non-voting preferred shares. ✓***Gamboa v. Teves*****, 652 SCRA 690 (2011)**; *affirmed in* ✓***Heirs of Gamboa v. Teves*****, 682 SCRA 397 (2012)**.

(a) Exploitation of Natural Resources (**Sec. 140; Sec. 2, Art. XII, 1987 Constitution**)

(b) Ownership of Private Land (**Sec. 7, Art. XII, 1987 Constitution**)

Radstock, a foreign corporation with unknown owners whose nationalities are also unknown, is not qualified to own land in the Philippines, and therefore also disqualified to own the rights to ownership of lands in the Philippines—it is basic that an assignor or seller cannot assign or sell something he does not own at the time the ownership, or the rights to the ownership, are to be transferred to the assignee or buyer. The assignment by PNCC of the real properties to a nominee to be designated by Radstock is a circumvention of the constitutional prohibition against a private foreign corporation owning lands in the Philippines. ✓***Strategic Alliance Dev. Corp. v. Radstock Securities Ltd.*****, 607 SCRA 413 (2009)**.

The registration of the donation of land to an ***unincorporated religious organization***, whose trustees are foreigners, would violate constitutional prohibition and the refusal would not be in violation of the freedom of religion clause. The fact that the religious association "has no capital stock does not suffice to escape the constitutional inhibition, since it is admitted that its members are of foreign nationality. . . *and the spirit of the Constitution demands that in the absence of capital stock, the controlling membership should be composed of Filipino citizens*." *Register of Deeds of Rizal v. Ung Sui Si Temple*, 97 Phil. 58 (1955).

BUT: A corporation sole being a creature prior to the constitution, has no nationality. If a nationality is sought to be determined, the same depends of the nationality of the majority of the lay members and not on the nationality of the sole corporator. ✓***Roman Catholic Apostolic Administrator of Davao, Inc. v. LRC and the Register of Deeds of Davao*****, 102 Phil. 596 (1957)**.

If the foreign shareholdings in a landholding corporation exceed 40%, it is not the foreign stockholders' ownership of the shares which is adversely affected by the capacity of the corporation to own land—that is, the corporation becomes disqualified to own land. *J.G. Summit Holdings, Inc. v. Court of Appeals*, 450 SCRA 169 (2005).

The prohibition in the Constitution applies only to ownership of land; it does not extend to immovable or real property as defined under Article 415 of the Civil Code. Otherwise, we would have a strange situation where the ownership of immovable property such as trees, plants and growing fruit attached to the land would be limited to Filipinos and Filipino corporations only. *J.G. Summit Holdings, Inc. v. Court of Appeals*, 450 SCRA 169 (2005).

(b) Public Utilities (**Sec. 11, Art. XII, Constitution**)

The nationality test for public utilities applies not at the time of the grant of the primary franchise that makes a corporation a juridical person, but at the grant of the secondary franchise that authorizes the corporation to engage in a nationalized industry. ✓***People v. Quasha*****, 93 Phil. 333 (1953**).

The primary franchise, that is, the right to exist as such, is vested in the individuals who compose the corporation and not in the corporation itself and cannot be conveyed in the absence of a legislative authority to do so. The secondary franchises are vested in the corporation and may ordinarily be conveyed or mortgaged under a general power granted to a corporation to dispose of its property, except such special or secondary franchises as are charged with a public use. *J.R.S. Business Corp. v. Imperial Insurance*, 11 SCRA 634 (1964).

The Constitution requires a franchise for the operation of a public utility; however, it does not require a franchise before one can own the facilities needed to operate a public utility so long as it does not operate them to serve the public. There is a clear distinction between "operation" of a public utility and the ownership of the facilities and equipment used to serve the public. ✓***Tatad v.Garcia, Jr.*****, 243 SCRA 436 (1995).**

(c) Mass Media (**Sec. 11(1), Art. XVI, 1987 Constitution**)

Sources: P.D. 36, amended by P.D.s 191 and 197; DOJ Opinion No. 120, s. of 1982; Sec. 2, P.D. 576; SEC Opinion, 24 March 1983; DOJ Opinion 163, s. 1973; SEC Opinion, 15 July 1991, XXV SEC QUARTERLY BULLETIN, (No. 4 - December, 1991), at p. 31.

(i) Cable Industry: "Cable TV operations shall be governed by E.O. No. 205 (s.1987). If CATV operators offer public telecommunications services, they shall be treated just like a public telecommunications entity." (NTC Memo Circular No. 8-9-95)

Cable TV is "a form of mass media which must, therefore, be owned and managed by Filipino citizens, or corporations, cooperatives or associations, wholly-owned and managed by Filipino citizens pursuant to the mandate of the Constitution." (DOJ Opinion No. 95, s. 1999, *citing Allied Broadcasting, Inc. v. Federal Communications Commission,* 435 F.2d 70).

(d) Advertising Business (**Sec. 11(2), Art. XVI, 1987 Constitution**)

(e) Investment Test as to "*Philippine Nationals*" (**Sec. 3[a] & [b], R.A. 7042, Foreign Investments Act of 1992**)

Under Sec. 3 of the FIA '91, a corporation organized under the laws of the Philippines of which at least 60% of the *capital stock outstanding and entitled to vote is owned* and held by citizens of the Philippines, is considered a Philippine National. ✓***Unchuan v. Lozada,* 585 SCRA 421 (2009)**.

(g) Grandfather Rule:

DOJ-SEC Rule: Opinion of DOJ No. 18, s. 1989, 19 January 1989; SEC Opinion, 6 November 1989, XXIV SEC QUARTERLY BULLETIN (No. 1- March 1990); SEC Opinion, 14 December 1989, XXIV SEC QUARTERLY BULLETIN (No. 2 -June 1990)

BUT SEE: SEC-OGC Opinion No. 10-31, dated 09 December 2010, addressed to Mr. Leonardo A. Civil, Chairman of the Board of Co-O Small Scale Miners Association, Inc., penned by General Counsel Vernette G. Umali-Paco.

The grandfather rule can only extend to such limited as to those who have actual control of the affairs of the corporation. *Palting v. San Jose Petroleum Inc.*, 18 SCRA 924 (1966).

(h) Special Classifications of Corporations (**Sec. 140**)

IV. *x* CLASSIFICATIONS OF CORPORATIONS

1. In Relation to the State:

(a) Public Corporation (**Sec. 3, Act No. 1459**).

(b) Quasi-public Corporation. *Marilao Water Consumers Asso. v. IAC*, 201 SCRA 437 (1991).

(c) Private Corporation (**Sec. 3, Act 1459**).

Government's majority shares does not make an entity a public corporation. *National Coal Co., v. Collector of Internal Revenue*, 46 Phil. 583 (1924).

But being a GOCC makes it liable for laws and provisions applicable to the Government or its entities and subject to the control of the Government. *Cervantes v. Auditor General*, 91 Phil. 359 (1952).

Although Boy Scouts of the Philippines does not receive any monetary or financial subsidy from the Government, and its funds and assets are not considered government in nature and not subject to audit by the COA, the fact that it received a special charter from the government, that its governing board are appointed by the Government, and that its purpose are of public character, for they pertain to the educational, civic and social development of the youth which constitute a very substantial and important part of the nation, it is not a public corporation in the same sense that municipal corporation or local governments are public corporation since its does not govern a portion of the state, but it also does not have proprietary functions in the same sense that the functions or activities of government-owned or controlled corporations, is may still be considered as such, or under the 1987 Administrative Code as an instrumentality of the Government, and it employees are subject to the Civil Service Law. *Boy Scouts of the Philippines v. NLRC*, 196 SCRA 176 (1991).

The doctrine that employees of GOCCs, whether created by special law or formed as subsidiaries under the general corporation law are governed by the Civil Service Law and not by the Labor Code, has been supplanted by the 1987 Constitution. The present doctrine in determining whether a GOCC is subject to the Civil Service Law *is the manner of its creation*, such that government corporations created by special charter are subject the Civil Service Law, while those incorporated under the general corporation law are governed by the Labor Code. *PNOC-Energy Dev. Corp. v. NLRC*, 201 SCRA 487 (1991); *Davao City Water District v. Civil Service Commission*, 201 SCRA 593 (1991).

Sec. 31 of Corporation Code (*Liability of Directors and Officers*) is applicable to corporations which have been organized by special charters since Sec. 4 of Corporation Code renders the provisions supplementarily applicable to all corporations, including those with special or individual charters, such as cooperatives organized under P.D. 269, so long as those provisions are not inconsistent with such charters. *Benguet Electric Cooperative, Inc. v. NLRC*, 209 SCRA 55 (1992).

A corporation is created by operation of law under the Corporation Code while a government corporation is normally created by special law referred to often as a charter. *Bliss Dev. Corp. Employees Union v. Calleja,* 237 SCRA 271 (1994).

The test to determine whether a corporation is government owned or controlled, or private in nature is simple. Is it created by its own charter for the exercise of a public function, or by incorporation under the general corporation law? Those with special charters are government corporations subject to its provisions, and its employees are under the jurisdiction of the Civil Service Commission, and are compulsory members of the GSIS. *Camparedondo v. NLRC*, 312 SCRA 47 (1999)

While public benefit and public welfare may be attributable to the operation of the Bases Conversion and Development Authority (BCDA), yet it is certain that the functions it performs are basically proprietary in nature—the promotion of economic and social development of Central Luzon, particularly, and the country's goal for enhancement. Therefore, the rule that prescription does not run against the State will not apply to BCDA, it being said that when title of the Republic has been

divested, its grantees, although artificial bodies of its own creation, are in the same category as ordinary persons. *Shipside Inc. v. Court of Appeals,* 352 SCRA 334 (2001).

Beyond cavil, a GOCC has a personality of its own, distinct and separate from that of the government, and the intervention in a transaction of the Office of the President through the Executive Secretary does not change the independent existence of a government entity as it deals with another government entity. *PUP v. Court of Appeals*, 368 SCRA 691 (2001).

Water districts can validly exists as corporate entities under PD 198, and provided they are government-owned or controlled, and their board of directors and other personnel are government employees subject to civil service laws and anti-graft laws. *Feliciano v. COA*, 419 SCRA 363 (2004).

When the law vests in a government instrumentality corporate powers, the instrumentality does not become necessarily a corporation. A government-owned or controlled corporation must be organized as a stock or non-stock corporation. The MIAA is not a government-owned or controlled corporation because it is not constituted of capital divided into shares of stock, and neither is it a nonstock corporation because it has no members. MIAA is a government instrumentality vested with corporate powers to perform efficiently its government functions. *Manila International Airport Authority v. Court of Appeals*, 495 SCRA 591 (2006).

Although PNRC has its special charter, the Chairman of PNRC is not appointed by the President or any member of the Executive Branch. Although *Camporendodo v. NLRC* had ruled that PNRC is GOCC because it is constituted under a special charter, it failed to consider the definition of a GOCC as provided under Sec. 2(13) of the Administrative Code of 1987, which requires that a GOCC to be such must be **owned** by the government, and in the case of a stock corporation, at least a majority of its capital stock must be owned by the government. *Liban v. Gordon*, 593 SCRA 68 (2009).

2. As to Place of Incorporation:

(a) Domestic Corporation

(b) Foreign Corporation (**Sec. 123**)

3. As to Purpose of Incorporation:

(a) Municipal Corporation

(b) Religious Corporation (**Secs. 109 and 116**)

Since in matters purely ecclesiastical the decisions of the proper church tribunals are conclusive upon the civil tribunals, then a church member who is expelled from the membership by the church authorities, or a priest or minister who is by them deprived of his sacred office, is without remedy in the civil courts. *Long v. Basa*, 366 SCRA 113 (2001).

(c) Educational Corporations (**Secs. 106, 107 and 108; Sec. 25, B.P. Blg. 232**)

(d) Charitable, Scientific or Vocational Corporations

(e) Business Corporation

4. As to Number of Members:

(a) Aggregate Corporation

(b) Corporation *Sole* (**Secs. 110 to 115**)

A corporation sole has no nationality being an institution that existed prior to the Republic. But if any nationality is to be accorded to a corporation sole it is to be judged from the nationality of the majority of the faithfuls thereof. *Roman Catholic Apostolic Administrator of Davao, Inc. v. LRC and the Register of Deeds of Davao City*, 102 Phil. 596 [1957]).

The doctrine in *Republic v. Villanueva*, 114 SCRA 875 (1982) and *Republic v. Iglesia ni Cristo*, 127 SCRA 687 (1984), that a corporation sole is disqualified to acquire/hold alienable lands of the public domain, because of the constitutional prohibition qualifying only individuals to acquire land and the provision under the Public Land Act which applied only to Filipino citizens or natural persons, has been ***expressly overturned*** in *Director of Land v. IAC*, 146 SCRA 509 (1986).[1]

5. As to Legal Status:

(a) *De Jure* Corporation

(b) *De Facto* Corporation (**Sec. 20**)

(c) Corporation by Estoppel (**Sec. 21**)

6. As to Existence of Shares (**Secs. 3 and 5**):

(a) Stock Corporation

(b) Non-Stock Corporation

V. SEPARATE JURIDICAL PERSONALITY AND DOCTRINE OF PIERCING THE VEIL OF CORPORATE FICTION

[1] *Overturning affirmed in Republic v. Iglesia ni Cristo*, 127 SCRA 687 (1984); *Republic v. IAC*, 168 SCRA 165 (1988).

A. MAIN DOCTRINE: *A Corporation Has A Personality Separate and Distinct from its Stockholders or Members.* (Sec. 2; Article 44, Civil Code)

1. Importance of Main Doctrine:

A corporation, upon coming into existence, is invested by law with a personality separate and distinct from those persons composing it as well as from any other legal entity to which it may be related, with the following consequences:

(i) The first consequence of the doctrine of legal entity of the separate personality of the corporation may not be made to answer for acts and liabilities of its stockholders or those of legal entities to which it may be connected or *vice versa*. *General Credit Corp. v. Alsons Dev. and Investment Corp.*, 513 SCRA 225 (2007);[2]

(ii) This separate and distinct personality is, however, merely a fiction created by law for conveyance and to promote the "*ends of justice*." *LBP v. Court of Appeals,* 364 SCRA 375 (2001).[3]

2. APPLICATIONS:

(a) Majority Equity Ownership and Interlocking Directorship:

Mere ownership by a single stockholder or by another corporation of all or nearly all of the capital stock of a corporation is not of itself sufficient ground for disregarding the separate corporate personality. *Sunio v. NLRC* , 127 SCRA 390 (1984).[4]

Ownership of a majority of capital stock and the fact that majority of directors of a corporation are the directors of another corporation creates no employer-employee relationship with the latter's employees. *DBP v. NLRC*, 186 SCRA 841 (1990).[5]

Having interlocking directors, corporate officers and shareholders is not enough justification to pierce the veil of corporate fiction in the absence of fraud or other public policy considerations. *Velarde v. Lopez*, 419 SCRA 422 (2004).[6]

(b) Being Corporate Officer:

Being an officer or stockholder of a corporation does not by itself make one's property also that of the corporation, and *vice-versa*, for they are separate entities, and that shareholders who are officers are in no legal sense the owners of corporate property which is owned by the corporation as a distinct legal person. *Good Earth Emporium, Inc. v. CA*, 194 SCRA 544 (1991).[7]

The mere fact that one is President does not render the property he owns the property of the corporation, since the president, as an individual, and the corporation are separate entities. *Cruz v. Dalisay*, 152 SCRA 487 (1987); *Booc v. Bantuas*, 354 SCRA 279 (2001).

It is hornbook law that corporate personality is a shield against personal liability of its officers—a corporate officer and his spouse cannot be made personally liable under a trust receipt where he entered into and signed the contract clearly in his official capacity. *Intestate Estate of Alexander T. Ty v. Court of Appeals,* 356 SCRA 61 (2001).[8]

The President of the corporation which becomes liable for the accident caused by its truck driver cannot be held solidarily liable for the judgment obligation arising from *quasi*-delict, since the fact alone of being President is not sufficient to hold him solidarily liable for the liabilities adjudged against the corporation and its employee. *Secosa v. Heirs of Erwin Suarez Fancisco*, 433 SCRA 273 (2004).

When the compulsory counterclaim filed against corporate officers for their alleged fraudulent act indicate that such corporate officers are indispensable parties in the litigation, the original inclusion of the corporation in the suit does not thereby allow the denial of a specific counter-claim being filed to make the corporate officers personally liable. A corporation has a legal personality entirely separate and distinct from that of its officers and cannot act for and on their behalf, without being so authorized. *Lafarge Cement Phils.*, *Inc. v. Continental Cement Corp.*, 443 SCRA 522 (2004).

(c) Dealings Between Corporation and Stockholders:

The fact that the majority stockholder had used his own money to pay part of the loan of the corporation cannot be used as the basis to pierce: "It is understandable that a shareholder would want to help his corporation and in the process, assure that his stakes in the said corporation are secured." *LBP v. Court of Appeals,* 364 SCRA 375 (2001).

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[2] *McLeod v. NLRC*, 512 SCRA 222 (2007); *Uy v. Villanueva*, 526 SCRA 73 (2007); *Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009); *Shrimp Specialists, Inc. v. Fuji-Triumph Agri-Industrial Corp.*, 608 SCRA 1 (2009).

[3] *Martinez v. Court of Appeals*, 438 SCRA 139 (2004); *Prudential Bank v. Alviar*, 464 SCRA 353 (2005); *EDSA Shangri-La Hotel and Resorts, Inc. v. BF Corp.*, 556 SCRA 25 (2008); *Siain Enterprises, Inc v. Cupertino Realty Corp.*, 590 SCRA 435 (2009).

[4] *Asionics Philippines, Inc. v. NLRC,* 290 SCRA 164 (1998); *Francisco v. Mejia,* 362 SCRA 738 (2001); *Matutina Integrated Wood Products, Inc. v. CA*, 263 SCRA 490 (1996); *Manila Hotel Corp. v. NLRC*, 343 SCRA 1 (2000); *Secosa v. Heirs of Erwin Suarez Fancisco*, 433 SCRA 273 (2004); *EDSA Shangri-La Hotel and Resorts, Inc. v. BF Corp.*, 556 SCRA 25 (2008); *Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009).

[5] *Also Suldao v. Cimech System Construction, Inc.*, 506 SCRA 256 (2006); *Union Bank of the Philippines v. Ong*, 491 SCRA 581 (2006); *Shrimp Specialists, Inc. v. Fuji-Triumph Agri-Industrial Corp.*, 608 SCRA 1 (2009); *Hacienda Luisita, Inc. v. Presidential Agrarian Reform Council*, 660 SCRA 525 (2011).

[6] *Also Sesbreno v. Court of Appeals*, 222 SCRA 466 (1993); *"G" Holdings, Inc. v. National Mines and Allied Workers Union Local, 103 (NAMAWU)*, 604 SCRA 73 (2010).

[7] *Bautista v. Auto Plus Traders, Inc.* 561 SCRA 223 (2008); *Prisma Construction & Dev. Corp. v. Menchavez*, 614 SCRA 590 (2010).

[8] *Consolidated Bank and Trust Corp. v. Court of Appeals*, 356 SCRA 671 (2001).

Use of a controlling stockholder's initials in the corporate name is not sufficient reason to pierce, since by that practice alone does it mean that the said corporation is merely a dummy of the individual stockholder, provided such act is lawful. *LBP v. Court of Appeals,* 364 SCRA 375 (2001).

Just because two foreign companies came from the same country and closely worked together on certain projects would the conclusion arise that one was the conduit of the other, thus piercing the veil of corporate fiction. *Marubeni Corp. v. Lirag,* 362 SCRA 620 (2001).

(d) On the Properties of the Corporation: The creation by DBP as the mother company of the three mining corporations to manage and operate the assets acquired in the foreclosure sale lest they deteriorate from non-use and lose their value, does not indicate fraud or wrongdoing and will not constitute application of the piercing doctrine. *DBP v. Court of Appeals,* 363 SCRA 307 (2001).

(e) On Privileges Enjoyed: The tax exemption clause in the charter of a corporation cannot be extended to nor enjoyed even by the controlling stockholders. *Manila Gas Corp. v. Collector of Internal Revenue*, 62 Phil. 895 (1936).

(f) Obligations and Debts:

Debts incurred by directors, officers, and employees acting as corporate agents are not their direct liability but of the corporation they represent. *Crisologo v. People*, 686 SCRA 782 (2012); *Heirs of Fe Tan Uy v. International Exchange Bank*, 690 SCRA 519 (2013).

Corporate debt or credit is not the debt or credit of the stockholder nor is the stockholder's debt or credit that of the corporation. *Traders Royal Bank v. CA*, 177 SCRA 789 (1989).

A corporation has no legal standing to file a suit for recovery of certain parcels of land owned by its members in their individual capacity, even when the corporation is organized for the benefit of the members. *Sulo ng Bayan v. Araneta, Inc*., 72 SCRA 347 (1976).

Stockholders have no personality to intervene in a collection case covering the loans of the corporation since the interest of shareholders in corporate property is purely inchoate. *Saw v. CA*, 195 SCRA 740 (1991); *and vice-versa Francisco Motors Corp. v. Court of Appeals,* 309 SCRA 72 (1999).

The majority stockholder cannot be held personality liable for the attorney's fees charged by a lawyer for representing the corporation. *Laperal Dev. Corp. v. CA*, 223 SCRA 261 (1993).

The obligations of a stockholder in one corporation cannot be offset from the obligation of the stockholder in a second corporation, since the corporation has a separate juridical personality. *CKH Industrial and Dev. Corp v. Court of Appeals,* 272 SCRA 333 (1997).

A corporate defendant against whom a writ of possession has been issued, cannot use the fact that it has obtained controlling equities in the corporate plaintiffs to suspend enforcement of the writ, for they are separate juridical persons, and thus their separate business and proprietary interests remain. *Silverio, Jr. v. Filipino Business Consultants, Inc.*, 466 SCRA 584 (2005).

B. PIERCING THE VEIL OF CORPORATE FICTION:

1. Source of Incantation: ✓*U.S. v. Milwaukee Refrigerator Transit Co.*, 142 Fed. 247 (1905).

The notion of corporate entity will be pierced or disregarded and the individuals composing it will be treated as identical if the corporate entity is being used as a cloak or cover for fraud or illegality; as a justification for a wrong; or as an alter ego, an adjunct, or a business conduit for the sole benefit of the stockholders. *Gochan v. Young*, 354 SCRA 207 (2001).[9]

As a general rule, a corporation will be looked upon as a legal entity, unless and until sufficient reason to the contrary appears. When the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons. Also, the corporate entity may be disregarded in the interest of justice in such cases as fraud that may work inequities among members of the corporation internally, involving no rights of the public or third persons. In both instances, there must have been fraud and proof of it. For the separate juridical personality of a corporation to be disregarded, the wrong-doing must be clearly and convincingly established. It cannot be presumed. *Suldao v. Cimech System Construction, Inc.*, 506 SCRA 256 (2006).

The legal fiction of separate corporate existence is not at all times invincible and the same may be pierced when employed as a means to perpetrate a fraud, confuse legitimate issues, or used as a vehicle to promote unfair objectives or to shield an otherwise blatant violation of the prohibition against forum-shopping. While it is settled that the piercing of the corporate veil has to be done with caution, this corporate fiction may be disregarded when necessary in the interest of justice. *Rovels Enterprises, Inc. v. Ocampo*, 391 SCRA 176 (2002).

2. Objectives and Effect of the Application of the Doctrine

Under the doctrine of "*piercing the veil of corporate fiction*," the courts look at the corporation as a mere collection of individuals or an aggregation of persons undertaking business as a group, disregarding the separate juridical personality of the corporation unifying the group. ***✓Traders Royal Bank v. Court of Appeals*, 269 SCRA 15 (1997)**.[10]

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[9] *DBP v. Court of Appeals*, 357 SCRA 626, 358 SCRA 501, 363 SCRA 307 (2001); *Velarde v. Lopez*, 419 SCRA 422 (2004); *R & E Transport, Inc. v. Latag*, 422 SCRA 698 (2004);.*Secosa v. Heirs of Erwin Suarez Fancisco*, 433 SCRA 273 (2004); *Martinez v. Court of Appeals*, 438 SCRA 139 (2004); *McLeod v. NLRC*, 512 SCRA 222 (2007); *Siain Enterprises, Inc v. Cupertino Realty Corp.*, 590 SCRA 435 (2009).

[10] *Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009)

"The rationale behind piercing a corporation's identity in a given case is to remove the barrier between the corporation from the persons comprising it to thwart the fraudulent and illegal schemes of those who use the corporate personality as a shield for undertaking certain proscribed activities. However, in the case at bar, instead of holding certain individuals or person responsible for an alleged corporate act, the situation has been reversed. It is the petitioner as a corporation which is being ordered to answer for the personal liability of certain individual directors, officers and incorporators concerned. Hence, it appears to us that the doctrine has been turned upside down because of its erroneous invocation." ✓***Francisco Motors Corp. v CA*, 309 SCRA 72 (1999)**.

Another formulation of this doctrine is that when two (2) business enterprises are owned, conducted and controlled by the same parties, both law and equity will, when necessary to protect the rights of third parties, disregard the legal fiction that two corporations are distinct entitled and treat them as identical or one and the same. *General Credit Corp. v. Alsons Dev. and Investment Corp.*, 513 SCRA 225 (2007).[11]

The attempt to make the security agencies appear as two separate entities, when in reality they were but one, was a devise to defeat the law [i.e., in this case to avoid liabilities under labor laws] and should not be permitted. *Enriquez Security Services, Inc. v. Cabotaje*, 496 SCRA 169 (2006).

(a) *Recent Attempts to Narrow the* Objectives for Availing of Piercing: Piercing is not allowed unless the remedy sought is to make the officer or another corporation pecuniarily liable for corporate debts. (?)✓***Indophil Textile Mill Workers Union-PTGWO v. Calica*, 205 SCRA 697 (1992)**.

***BUT SEE*: ✓*La Campana Coffee Factory v. Kaisahan ng Manggagawa*, 93 Phil. 160 (1953)**.

(b) Applicable to "Third-Parties": That respondents are not stockholders of the sister corporations does not make them non-parties to this case, since it is alleged that the sister corporations are mere alter egos of the directors-petitioners, and that the sister corporations acquired the properties sought to be reconveyed to FGSRC in violation of directors-petitioners' fiduciary duty to FGSRC. The notion of corporate entity will be pierced and the individuals composing it will be treated as identical if the corporate entity is being used as a cloak or cover for fraud or illegality; as a justification for a wrong; or as an alter ego, an adjunct, or a business conduit for the sole benefit of the stockholders. ✓***Gochan v. Young*, 354 SCRA 207 (2001)**.

3. Nature of the Piercing Doctrine as an Equitable Remedy: The doctrine of piercing the corporate veil is an equitable doctrine developed to address situations where the separate corporate personality of a corporation is abused or used for wrongful purposes. ✓***PNB v. Ritratto Group, Inc.,* 362 SCRA 216 (2001)**. ***CONSEQUENTLY*:**

(a) It is a Remedy of Last Resort: Piercing the corporate veil is remedy of last resort and is not available when other remedies are still available. ✓***Umali v. Court of Appeals*, 189 SCRA 529 (1990)**.

(b) Can Be Availed-of Only to Prevent Fraud: Piercing doctrine is meant to prevent fraud, and cannot be employed when the net result would be to perpetrate fraud or a wrong. *Gregorio Araneta, Inc. v. Tuason de Paterno and Vidal*, 91 Phil. 786 (1952).

The theory of corporate entity was not meant to promote unfair objectives or otherwise, nor to shield them. *Villanueva v. Adre*, 172 SCRA 876 (1989).

(c) Piercing Doctrine Not Applicable to Theorizing or to Advance/Create New Rights or Interest: Piercing of the veil of corporate fiction is not allowed when it is resorted under a theory of co-ownership to justify continued use and possession by stockholders of corporate properties. ✓***Boyer-Roxas v. Court of Appeals*, 211 SCRA 470 (1992)**.

BUT SEE*:** Where clear evidence presented support the fact that a corporation's affiliates have received large amounts which became the consideration for the company execution of a real estate mortgage over its properties, then the piercing doctrine shall be applied to support the fact that the real estate mortgage was valid and supported by proper consideration. ✓Siain Enterprises, Inc v. Cupertino Realty Corp.*, 590 SCRA 435 (2009)**.

The piercing cannot be availed of in order to dislodge from SEC's jurisdiction a petition for suspension of payments filed under P.D. 902-A, on the ground that the petitioning individuals should be treated as the real petitioners to the exclusion of the petitioning corporate debtor: "doctrine only applies when such corporate fiction is used to defeat public convenience, justify wrong, protect fraud or defend crime." *Union Bank v. Court of Appeals,* 290 SCRA 198 (1998).

Application of the piercing of the subsidiary company to merge it with the holding company cannot be allowed to support a theory of set-off or compensation, there being no allegation much less any proof of fraud. *Nisce v. Equitable PCI Bank, Inc.*, 516 SCRA 231 (2007).

An employee who has officially retired from the company and availed of her retirement benefit, but who continued to be employed as a consultant with affiliate companies, cannot employ piercing in order to treat her stint with the affiliate companies as part of her employment with the main company she retired from—there is no fraud or employment of unfair shielding. *Rivera v. United Laboratories, Inc.*, 586 SCRA 269 (2009).

(d) Basis Must Be Clear Evidence

[11] *Marques v. Far East Bank and Trust Co.*, 639 SCRA 312 (2011); *Sarona v. NLRC*, 663 SCRA 394 (2012); *PNB v. Hydro Resources Contractors Corp.*, 693 SCRA 294 (2013).

To disregard the separate juridical personality of a corporation, it is elementary that the wrongdoing cannot be presumed and must be clearly and convincingly established. Application of the doctrine of piercing the corporate veil should be done with caution. A court should be mindful of the milieu where it is to be applied. It must be certain that the corporate fiction was misused to such an extent that injustice, fraud, or crime was committed against another, in disregard of its rights. The wrongdoing must be clearly and convincingly established; it cannot be presumed. Otherwise, an injustice that was never unintended may result from an erroneous application. *PNB v. Andrada Electric & Engineering Co.*, 381 SCRA 244 (2002).[12] Thus:

- The organization of the corporation at the time when the relationship between the landowner and the developer were still cordial cannot be used as a basis to hold the corporation liable later on for the obligations of the landowner to the developer under the mere allegation that the corporation is being used to evade the performance of obligation by one of its major stockholders. *Luxuria Homes, Inc. v. Court of Appeals,* 302 SCRA 315 (1999).
- In this case, the Court finds that the Remington failed to discharge its burden of proving bad faith on the part of Marinduque Mining and its transferees in the mortgage and foreclosure of the subject properties to justify the piercing of the corporate veil. *DBP v. Court of Appeals*, 363 SCRA 307 (2001).[13]
- Neither has it been alleged or proven that Merryland is so organized and controlled and its affairs are so conducted as to make it merely an instrumentality, agency conduit or adjunct of Cardale. Even assuming that the businesses of Cardale and Merryland are interrelated, this alone is not justification for disregarding their separate personalities, absent any showing that Merryland was purposely used as a shield to defraud creditors and third persons of their rights. *Francisco v. Mejia*, 362 SCRA 738 (2001).[14]
- The mere assertion by a Filipino litigant against the existence of a "tandem" between two Japanese corporations cannot be the basis for piercing, which can only be applied by showing wrongdoing by clear and convincing evidence. *Marubeni Corp. v. Lirag,* 362 SCRA 620 (2001).

The party seeking to pierce has the burden of presenting clear and convincing evidence to justify the setting aside of the separate corporate personality rule. The question of whether a corporation is a mere alter ego is a purely one of fact, and the burden is on the party who alleges it. *PNB v. Andrada Electric & Engineering Co.*, 381 SCRA 244 (2002).[15]

(e) Piercing is a power belonging to the court and cannot be assumed improvidently by a sheriff. *Cruz v. Dalisay*, 152 SCRA 482 (1987); *D.R. CATC Services v. Ramos*, 477 SCRA 18 (2005).

(f) ***Piercing Has Only Res Judicata Effect*:** Application of the doctrine to a particular case does not deny the corporation of legal personality for any and all purposes, but only for the particular transaction or instance, or the particular obligation for which the doctrine was applied. *Koppel (Phil.) Inc. v. Yatco*, 77 Phil. 496 (1946).[16]

3. CLASSIFICATION OF PIERCING CASES:

- **DEFEAT OF PUBLIC CONVENIENCE (EQUITY PIERCING)**: When the application of the separate corporate personality would be inconsistent with the business purpose of the legal fiction, or when piercing the corporate fiction is necessary to achieve justice or equity for those who deal in good faith with the corporation, or when the use of the separate juridical personality is used to confuse legitimate issues.
- **FRAUD PIERCING:** When corporate entity used to commit a crime, to undertake fraud or do a wrong, or that the corporate veil is used as a means to evade the consequences of one's criminal or fraudulent acts
- **ALTER-EGO PIERCING:** When corporate entity merely a farce since the corporation is merely the alter ego, business conduit, or instrumentality of a person or another entity

Authorities are agreed on at least three (3) basic areas where piercing the veil, with which the law covers and isolates the corporation from any other legal entity to which it may be related, is allowed. These are: 1) defeat of public convenience, as when the corporation is used as vehicle for the evasion of existing obligation; 2) fraud cases or when the corporate entity is used to justify wrong, protect fraud, or defend a crime; or 3) *alter ego* cases, where the corporation is merely a farce since it is a mere alter ego or business conduit of a person, or where the corporation is so organized and controlled and its affairs are so conducted as to make it merely an instrumentality, agency, conduit or adjunct of another corporation. ✓***General Credit Corp. v. Alsons Dev. and Investment Corp.*, 513 SCRA 225 (2007)**[17] *citing* VILLANUEVA, COMMERCIAL LAW REVIEW (2004 ed), at p. 576.

(a) Rundown on Piercing Application*:* This Court pierced the corporate veil to ward off a judgment credit, to avoid inclusion of corporate assets as part of the estate of the decedent, to escape liability arising for a debt, or to perpetuate fraud and/or confuse legitimate issues either to promote or to shield

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[12] *General Credit Corp. v. Alsons Dev. and Investment Corp.*, 513 SCRA 225 (2007); *Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009); *Halley v. Printwell, Inc.* 649 SCRA 116 (2011).

[13] *Also McLeod v. NLRC*, 512 SCRA 222 (2007); *Uy v. Villanueva*, 526 SCRA 73 (2007).

[14] *Also Ramoso v. Court of Appeals,* 347 SCRA 463 (2000); *Guatson Int'l Travel and Tours, Inc. v. NLRC,* 230 SCRA 815 (1990).

[15] Also *Concept Builders, Inc. v. NLRC,* 257 SCRA 149 (1996); *Heirs of Ramon Durano, Sr. v. Uy,* 344 SCRA 238 (2000); *MR Holdings, Ltd. V. Bajar*, 380 SCRA 617 (2002); *Ramirez v. Mar Fishing Co., Inc.*, 672 SCRA 137 (2012).

[16] *Tantoco v. Kaisahan ng Mga Manggagawa sa La Campana*, 106 Phil. 198 (1959); *Francisco v. Mejia*, 362 SCRA 738 (2001).

[17] *Also Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009); *Prisma Construction & Dev. Corp. v. Menchavez*, 614 SCRA 590 (2010); *Sarona v. NLRC*, 663 SCRA 394 (2012).

unfair objectives to cover up an otherwise blatant violation of the prohibition against forum shopping. Only is these and similar instances may the veil be pierced and disregarded. *PNB v. Andrada Electric & Engineering Co.*, 381 SCRA 244 (2002).

(b) Summary of Probative Factors*: ✓Concept Builders, Inc. v. NLRC*, 257 SCRA 149 (1996).[18] The absence of these elements prevents piercing the corporate veil. *Lim v. Court of Appeals*, 323 SCRA 102 (200).[19]

(c) Distinction Between Fraud Piercing and Alter-ego Piercing: ✓*Lipat v. Pacific Banking Corp.*, 402 SCRA 339 (2003).

4. DEFEAT OF PUBLIC CONVENIENCE (EQUITY PIERCING): Juridical Personality Cannot Be Employed:

(a) *To Confuse Legitimate Issues: ✓Telephone Engineering and Service Co., Inc. V. WCC*, 104 SCRA 354 (1981).

(b) *To Raise Legal Technicalities: ✓Emilio Cano Enterprises v. CIR*, 13 SCRA 291 (1965).

One cannot evade civil liability by incorporating properties or the business. *Palacio v. Fely Transportation Co.*, 5 SCRA 1011 (1962).[20]

Where a debtor registers his residence to a family corporation in exchange of shares of stock and continues to live therein, then the separate juridical personality may be disregarded. *PBCom v. CA*, 195 SCRA 567 (1991).

Where corporate fiction was used to perpetrate social injustice or as a vehicle to evade obligations or confuse the legitimate issues (as in this case where the actions of management of the two corporations created confusion as to the proper employer of claimants), the two corporations would be merged as one. *Azcor Manufacturing, Inc. v. NLRC,* 303 SCRA 26 (1999).

The corporate veil cannot be used to blatantly violate the prohibition against forum-shopping. Where the corporation itself has not been remiss in vigorously prosecuting or defending corporate causes and in using and applying remedies available to it, then shareholders, whether suing as the majority in direct actions or as the minority in a derivative suit, cannot be allowed to pursue the same claims. *First Philippine International Bank v. Court of Appeals*, 252 SCRA 259 (1996).

(c) *The Case for Thinly-Capitalized Corporations*: ✓*McConnel v. CA*, 1 SCRA 722 (1961).

The DOJ Resolution explicitly identified the false pretense, fraudulent act or fraudulent means perpetrated upon the investing public who were made to believe that ASBHI had the financial capacity to repay the loans it enticed petitioners to extend, despite the fact that "it had an authorized capital stock of only P500,000.00 and paid up capital of only P125,000.00)," with the deficient capitalization evidenced by its articles of incorporation, the treasurer's affidavit, the audited financial statements. "Moreover, respondent's argument assumes that there is legal obligation on the part of petitioners to undertake an investigation of ASBHI before agreeing to provide the loans. There is no such obligation. It is unfair to expect a person to procure every available public record concerning an applicant for credit to satisfy himself of the latter's financial standing. At least, that is not the way an average person takes care of his concerns." *Gabionza v. Court of Appeals*, 565 SCRA 38 (2008).

Where the corporation was under the control of its stockholders who ran-up quite a high obligation with the printing company knowing fully well that their corporation was not in a position to pay for the accounts, and where in fact they personally benefited from the operations of the company to which they never paid their subscription in full, would constitute piercing of the veil to allow the creditor to be able to collect what otherwise were debts owed by the company which has no visible assets and has ceased all operations. **✓*Halley v. Printwell, Inc.* 649 SCRA 116 (2011)**.

(d) *Avoidance or Minimization of Taxes*: ✓*Yutivo Sons Hardware v. Court of Tax Appeals* 1 SCRA 160 (1961); *Liddell & Co. v. Collector of Internal Revenue*, 2 SCRA 632 (1961).

Use of nominees to constitute the corporation for the benefit of the controlling stockholder who sought to avoid payment of taxes. *Marvel Building v. David*, 9 Phil. 376 (1951).

The plea to pierce the veil of corporate fiction on the allegation that the corporations true purpose is to avoid payment by the incorporating spouses of the estate taxes on the properties transferred to the corporations: "With regard to their claim that [the companies] Ellice and Margo were meant to be used as mere tools for the avoidance of estate taxes, suffice it to say that the legal right of a taxpayer to reduce the amount of what otherwise could be his taxes or altogether avoid them, by means which the law permits, cannot be doubted." *Gala v. Ellice Agro-Industrial Corp.*, 418 SCRA 431 (2003).

HOWEVER: The mere existence of parent-subsidiary relations, or the fact that one corporation is affiliated with another corporation does not justify piercing based on serving public convenience. *Comm. of Internal Revenue v. Norton and Harrison*, 11 SCRA 704 (1954).[21]

5. FRAUD CASES:

[18] *PNB v. Ritratto Group, Inc.*, 362 SCRA 216 (2001); *Velarde v. Lopez*, 419 SCRA 422 (2004); *Jardine Davies, Inc. v. JRB Realty, Inc.*, 463 SCRA 555 (2005); *Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009).

[19] *Child Learning Center, Inc. v. Tagorio*, 475 SCRA 236 (2005); *General Credit Corp. v. Alsons Dev. and Investment Corp.*, 513 SCRA 225 (2007); *Nisce v. Equitable PCI Bank, Inc.*, 516 SCRA 231 (2007).

[20] *Also Mendoza and Yotoko v. Banco Real Dev. Bank*, 470 SCRA 86 (2005).

[21] *Tomas Lao Construction v. NLRC*, 278 SCRA 716 (1997). *Marques v. Far East Bank and Trust Co.*, 639 SCRA 312 (2011).

When the legal fiction of the separate corporate personality is abused, such as when the same is used for fraudulent or wrongful ends, the courts have not hesitated to pierce the corporate veil. ✓***Francisco v. Mejia,* 362 SCRA 738 (2001).**

The general rule is that obligations incurred by a corporation, acting through its directors, officers or employees, are its sole liabilities. However, there would be piercing of the veil when the corporation is used by any of them as a cloak or cover for fraud or illegality or injustice. Here, the fraud was committed by petitioners to the prejudice of respondent bank. *Mendoza v. Banco Real Dev. Bank*, 470 SCRA 86 (2005).

Fraud and bad faith on the part of certain corporate officers or stockholders may warrant the piercing of the veil of corporate fiction so that the said individual may not seek refuge therein, but may be held individually and personally liable for his or her actions. *Lafarge Cement Phils., Inc. v. Continental Cement Corp.*, 443 SCRA 522 (2004).

However, mere allegation of fraud or bad faith, without evidence supporting such claims cannot warrant the piercing of the corporate veil. *DBP v. Court of Appeals*, 357 SCRA 626, 358 SCRA 501, 363 SCRA 307 (2001).

(a) Acts by Controlling Shareholder:

The fact that a corporation owns all of the stocks of another corporation, taken alone, is not sufficient to justify their being treated as one entity. If used to perform legitimate functions, a subsidiary's separate existence shall be respected, and the liability of the parent corporation, as well as the subsidiary shall be confined to those arising in their respective business. *Nisce v. Equitable PCI Bank, Inc.*, 516 SCRA 231 (2007).[22]

Where a stockholder, who has absolute control over the business and affairs of the corporation, entered into a contract with another corporation through fraud and false representations, such stockholder shall be liable solidarily with co-defendant corporation even when the contract sued upon was entered into on behalf of the corporation. *Namarco v. Associated Finance Co.*, 19 SCRA 962 (1967).

Where the corporation is used as a means to appropriate a property by fraud which property was later resold to the controlling stockholders, then piercing should be allowed. *Heirs of Ramon Durano, Sr. v. Uy*, 344 SCRA 238 (2000).

(b) Tax Evasion or Fraud:

In a number of cases, the Court has shredded the veil of corporate identity and ruled that where a corporation is merely an adjunct, business conduit or alter ego of another corporation or when they practice fraud on internal revenue laws, the fiction of their separate and distinct corporate identities shall be disregarded, and both entities treated as one taxable person, subject to assessment for the same taxable transaction. *Commissioner of Internal Revenue v. Menguito*, 565 SCRA 461 (2008).

(c) Guiding Principles in Fraud Cases:

✓***Why is there inordinate showing of alter-ego elements?***

- There must have been fraud or an evil motive in the affected transaction, and the mere proof of control of the corporation by itself would not authorize piercing;
- The corporate fiction is used as a means to commit the fraud or avoid the consequences thereof; and
- The main action should seek for the enforcement of pecuniary claims pertaining to the corporation against corporate officers or stockholders.

Respondent corporations may be engaged in the same business or even share the same address, or have interlocking incorporators, directors or officers, in the absence of fraud or other public policy consideration, does not warrant piercing the veil of corporate fiction. *McLeod v. NLRC*, 512 SCRA 222 (2007), *quoting from Indophil Textile Mill Workers Union v. Calica*, 205 SCRA 697 (1992), and *Del Rosario v. NLRC*, 187 SCRA 777 (1990); *Heirs of Fe Tan Uy v. International Exchange Bank*, 690 SCRA 519 (2013).

Mere substantial identity of incorporators of two corporations does not necessarily imply fraud, nor warrant the piercing of the veil of corporate fiction. In the absence of clear and convincing evidence to show that the corporate personalities were used to perpetuate fraud, or circumvent the law, the corporations are to be rightly treated as distinct and separate from each other. To disregard the said separate juridical personality of a corporation, the wrongdoing must be proven clearly and convincingly. *Laguio v. NLRC,* 262 SCRA 715 (1996).[23]

6. <u>ALTER-EGO CASES</u>:

(a) Using Corporation as Conduit or Alter Ego:

Where the capital stock is owned by one person and it functions only for the benefit of such individual owner, the corporation and the individual should be deemed the same. ✓***Arnold v. Willets and Patterson, Ltd.*, 44 Phil. 634 (1923)**.

[22] *Marques v. Far East Bank and Trust Co.*, 639 SCRA 312 (2011).

[23] *Martinez v. Court of Appeals*, 438 SCRA 130 (2004).

A corporation has a personality separate and distinct from the persons composing it, as well as from any other legal entity to which it may be related. Equally well-settled is the principle that the corporate mask may be removed or the corporate veil pierced when the corporation is just an alter ego of a person or of another corporation. *Sarona v. NLRC*, 663 SCRA 394 (2012).

When corporation is merely an adjunct, business conduit or alter ego of another corporation, the fiction of separate and distinct corporation entities should be disregarded. *Tan Boon Bee & Co. v. Jarencio,* 163 SCRA 205 (1988).[24]

The fictive veil of corporate personality holds lesser sway for subsidiary corporations whose shares are wholly if not almost wholly owned by its parent company. The structural and systems overlap inherent in parent and subsidiary relations often render the subsidiary as mere local branch, agency or adjunct of the foreign parent. Thus, when the foreign parent company leased a large parcel of land purposely for the benefit of its subsidiary, which took over possession of the leased premises, the subsidiary was a mere *alter ego* of ESSO Eastern. *Mariano v. Petron Corp.*, 610 SCRA 487 (2010).

The fact that a corporation owns all of the stocks of another corporation, taken alone, is not sufficient to justify their being treated as one entity. If used to perform legitimate functions, a subsidiary's separate existence shall be respected, and the liability of the parent corporation, as well as the subsidiary shall be confined to those arising in their respective business. A corporation has a separate personality distinct from its stockholders and from other corporations to which it may be conducted — a legal fiction created by law for convenience and to prevent injustice. *Nisce v. Equitable PCI Bank, Inc.*, 516 SCRA 231 (2007).

(b) Mixing-up Operations; Disrespect to the Corporate Entity:

Mixing of personal accounts with corporate bank deposit accounts. *Ramirez Telephone Corp. v. Bank of America*, 29 SCRA 191 (1969).

Where two business enterprises are owned, conducted, and controlled by the same parties, both law and equity will, when necessary to protect the rights of third persons, disregard the legal fiction that two corporations are distinct entities and treat them as identical. *Sibagat Timber Corp. v. Garcia*, 216 SCRA 70 (1992).

Employment of same workers; single place of business, etc., may indicate alter ego situation. ***Shoemart v. NLRC,* 225 SCRA 311 (1993**).

The facts that two corporations may be sister companies, and that they may be sharing personnel and resources, without more, is insufficient to prove that their separate corporate personalities are being used to defeat public convenience, justify wrong, protect fraud, or defend crime. ✓***Padilla v. Court of Appeals*, 370 SCRA 208 (2001)**.

(c) Guiding Principles in Alter-Ego Cases:

- Doctrine applies even in the absence of evil intent, because of the direct violation of a central corporate law principle of separating ownership from management;
- Doctrine in such cased is based on estoppel: if stockholders do not respect the separate entity, others cannot also be expected to be bound by the separate juridical entity;
- Piercing in alter ego cases may prevail even when no monetary claims are sought to be enforced against the stockholders or officers of the corporation.

***HOWEVER*:** The mere existence of a parent-subsidiary relationship between two corporation, or that one corporation is affiliated with another company does not by itself allow the application of the alter-ego piercing doctrine. *Koppel (Phil.), Inc. v. Yatco*, 77 Phil. 97 (1946); *PHIVIDEC v. Court of Appeals*, 181 SCRA 669 (1990).

A subsidiary corporation has an independent and separate juridical personality, distinct from that of its parent company, hence, any claim or suit against the latter does not bind the former and vice-versa. *Jardine Davies, Inc. v. JRB Realty, Inc.*, 463 SCRA 555 (2005).[25]

If used to perform legitimate functions, a subsidiary's separate existence shall be respected, and the liability of the parent corporation as well as the subsidiary will be confined to those arising in their respective businesses. Even when the parent corporation agreed to the terms to support a standby credit agreement in favor of the subsidiary, does not mean that its personality has merged with that of the subsidiary. *MR. Holdings, Ltd. V. Bajar*, 380 SCRA 617 (2002).

7. PIERCING DOCTRINE AND THE DUE PROCESS CLAUSE

(a) *Need to Bring a New Case Against the Officer*. *McConnel v. CA*, 1 SCRA 723 (1961).

A suit against individual shareholders is not a suit against the corporation. Failure to implead the corporations as defendants and merely annexing a list of such corporations to the complaints is a violation of due process for it would in effect be disregarding their distinct and separate personality without a hearing. *PCGG v. Sandiganbayan,* 365 SCRA 538 (2001).

Although both lower courts found sufficient basis for the conclusion that PKA and Phoenix Omega were one and the same, and the former is merely a conduit of the other the Supreme Court held void the application of a writ of execution on a judgment held only against PKA, since the RTC obtained no

[24] *General Credit Corp. v. Alsons Dev. and Investment Corp.*, 513 SCRA 225 (2007).

[25] *Fortune v. Quinsayas*, 690 SCRA 336 (2013).

jurisdiction over the person of Phoenix Omega which was never summoned as formal party to the case. The general principle is that no person shall be affected by any proceedings to which he is a stranger, and strangers to a case are not bound by the judgment rendered by the court. ✓***Padilla v. Court of Appeals*, 370 SCRA 208 (2001)**.

(b) ***When corporate officers are sued in their official capacity, the corporation which was not made a party, is not denied due process.*** *Emilio Cano Enterprises v. CIR*, 13 SCRA 291 (1965).

"We suggest as much in *Arcilla v. Court of Appeals,* (215 SCRA 120 [1992]), an appellate proceedings involving petitioner Arcilla's bid to avoid the adverse CA decision on argument that he is not personally liable for the amount adjudged since the same constitutes a corporate liability which nevertheless cannot be enforced against the corporation which has not been impleaded as a party below. *Violago v. BA Finance Corp.,* 559 SCRA 69 (2008).

(c) ***Provided that evidential basis has been adduced during trial to apply the piercing doctrine***. ***Jacinto v. Court of Appeals*, 198 SCRA 211 (1991)**.[26]

VI. CORPORATE CONTRACT LAW

1. Pre-Incorporation Contracts

(a) Who Are Promoters?

"Promoter" is a person who, acting alone or with others, takes initiative in founding and organizing the business or enterprise of the issuer and receives consideration therefor. (Sec. 3.10, Securities Regulation Code [R.A. 8799])

(b) Nature of Pre-incorporation Agreements (Secs. 60 and 61)

(c) Theories on Liabilities for Promoter's Contracts:

✓***Cagayan Fishing Dev. Co., Inc. v. Teodoro Sandiko*, 65 Phil. 223 (1937)**.

✓***Rizal Light & Ice Co., Inc. v. Public Service Comm.*, 25 SCRA 285 (1968)**.

✓***Caram, Jr. v. CA*, 151 SCRA 372 (1987)**.

2. *De Facto* Corporation (Sec. 20)

(a) Elements: *Arnold Hall v. Piccio*, 86 Phil. 634 (1950).

By its failure to submit its by-laws on time, the AIIBP may be considered a *de facto* corporation whose right to exercise corporate powers may not be inquired into collaterally in any private suit to which such corporations may be a party. *Sawadjaan v. Court of Appeals*, 459 SCRA 516 (2005).

3. Corporation by Estoppel Doctrine (Sec. 21; ✓*Salvatierra v. Garlitos*, 103 Phil. 757 [1958]; ✓*Albert v. University Publishing Co.*, 13 SCRA 84 [1965]; ✓*Asia Banking Corp. v. Standard Products*, 46 Phil. 145 [1924]; *Madrigal Shipping Co., v. Ogilvie*, 55 O.G. No. 35, p. 7331)

(a) Nature of Doctrine

Founded on principles of equity and designed to prevent injustice and unfairness, the doctrine applies when persons assume to form a corporation and exercise corporate functions and enter into business relations with third persons. Where no third person is involved in the conflict, there is no corporation by estoppel. A failed consolidation therefore cannot result in a consolidated corporation by estoppel. *Lozano v. De Los Santos*, 274 SCRA 452 (1997)

A party cannot challenge the personality of the plaintiff as a duly organized corporation after having acknowledged same when entering into the contract with the plaintiff as such corporation for the transportation of its merchandise. *Ohta Dev. Co. v. Steamship Pompey,* 49 Phil. 117 (1926).[27]

A person who accepts employment in an unincorporated charitable association is estopped from alleging its lack of juridical personality. *Christian Children's Fund v. NLRC,* 174 SCRA 681 (1989).

One who deals with an unincorporated association which is not duly incorporated is not estopped to deny its corporate existence when his purpose is not to avoid liability, but precisely to enforce the contract against the action for the purported corporation. *Int'l Express Travel v. Court of Appeals,* 343 SCRA 674 (2000).

Under the law on estoppel including that under Sec. 21 of Corporation Code, those acting on behalf of an ostensible corporation *and those benefited by it, knowing it to be without valid existence,* are held liable as general partners. ✓***Lim Tong Lim v. Philippine Fishing Gear Industries, Inc.*, 317 SCRA 728 (1999)**.

(b) Two Levels: (i) With "Fraud;" and (ii) Without "Fraud"

When the incorporators represent themselves to be officers of the corporation which was never duly registered with SEC, and engage in the name of the purported corporation in illegal recruitment, they are estopped from claiming that they are not liable as corporate officers under Sec. 25 of Corporation Code which provides that all persons who assume to act as a corporation knowing it to be without authority to do so shall be liable as general partners for all the debts, liabilities and damages

[26] *Arcilla v. Court of Appeals*, 215 SCRA 120 (1992).

[27] The same principle applied in *Compania Agricole de Ultramar v. Reyes*, 4 Phil. 1 (1911), but that case pertained to a commercial partnership which required registration in the registry under the terms of the Code of Commerce).

incurred or arising as a result thereof. *People v. Garcia*, 271 SCRA 621 (1997); *People v. Pineda*, G.R. No. 117010, 18 April 1997 (unpub).

4. TRUST FUND DOCTRINE

(a) Commercial/Common Law Premise: Equity *versus* Debts; Preference of Creditors over Equity Holders (Art. 2236, Civil Code)

The requirement of unrestricted retained earnings to cover the shares is based on the trust fund doctrine which means that the capital stock, property and other assets of a corporation are regarded as equity in trust for the payment of corporate creditors. The reason is that creditors of a corporation are preferred over the stockholders in the distribution of corporate assets. There can be no distribution of assets among the stockholders without first paying corporate creditors. Hence, any disposition of corporate funds to the prejudice of creditors is null and void. *Boman Environmental Dev. Corp. v. CA*, 167 SCRA 540 (1988).

Under the trust fund doctrine, the capital stock, property and other assets of the corporation are regarded as equity in trust for the payment of the corporate creditors. *Comm. of Internal Revenue v. Court of Appeals,* 301 SCRA 152 (1999).

(b) Nature and Coverage of the Trust Fund Doctrine:

The subscriptions to the capital stock of a corporation constitute a fund to which the creditors have aright to look for satisfaction of their claims and that the assignee in insolvency can maintain an action upon any unpaid stock subscription in order to realize assets for the payment of its debts. *Phil. Trust Co. v. Rivera*, 44 Phil. 469 (1923).

Even when the foreclosure on the corporate assets was wrongful done, stockholders have no standing to recover for themselves moral damages; otherwise, it would amount to the appropriation by, and the distribution to, such stockholders of part of the corporation's assets before the dissolution of the corporation and the liquidation of its debts and liabilities. *APT v. Court of Appeals,* 300 SCRA 579 (1998).

The "*trust fund*" doctrine considers the subscribed capital stock as a trust fund for the payment of the debts of the corporation, to which the creditors may look for satisfaction. Until the liquidation of the corporation, no part of the subscribed capital stock may be turned over or released to the stockholder (except in the redemption of the redeemable shares) without violating this principle. Thus dividends must never impair the subscribed capital stock; subscription commitments cannot be condoned or remitted; nor can the corporation buy its own shares using the subscribed capital as the consideration therefore. *NTC v. Court of Appeals,* 311 SCRA 508 (1999).

We clarify that the *trust fund doctrine* is not limited to reaching the stockholders' unpaid subscriptions. The scope of the doctrine when the corporation is insolvent encompasses not only the capital stock, but also other property and assets generally regarded in equity as a trust fund for the payment of corporate debts. All assets and property belonging to the corporation held in trust for the benefit of creditors that were distributed or in the possession of the stockholders, regardless of full payment of their subscriptions may be reached by the creditors in satisfaction of its claim. ✓***Halley v. Printwell, Inc.*** **649 SCRA 116 (2011),** *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW (2001), p. 558.

(c) To Purchase Own Shares (Secs. 8, 41, 43 and 122, last paragraph)

Under common law, there were originally conflicting views on whether a corporation had the power to purchase its own stocks. Only a few American jurisdictions adopted the strict English rule forbidding a corporation from purchasing its own shares. In some American states where the English rule used to be adopted, statutes granting authority to purchase out of surplus funds were enacted, while in others, shares might be purchased even out of capital provided the rights of creditors were not prejudiced. The reason underlying the limitation of share purchases sprang from the necessity of imposing safeguards against the depletion by a corporation of its assets and against the impairment of its capital needed for the protection of creditors. *Turner v. Lorenzo Shipping Corp.*, 636 SCRA 13 (2010).

(d) Rescission of Subscription Agreement

The violation of terms embodied in a subscription agreement, with are personal commitments, do not constitute legal ground to rescind the subscription agreement since such would violate the Trust Fund Doctrine and the procedures for the valid distribution of assets and property under the Corporation Code. "In the instant case, the rescission of the Pre-Subscription Agreement will effectively result in the unauthorized distribution of the capital assets and property of the corporation, thereby violating the Trust Fund Doctrine and the Corporation Code, since the rescission of a subscription agreement is not one of the instances when distribution of capital assets and property of the corporation is allowed." Distribution of corporate assets among the stockholders cannot even be resorted to achieve "corporate peace." ✓***Ong Yong v. Tiu*****, 401 SCRA 1 (2003)**.

VII. ARTICLES OF INCORPORATION

1. Nature of Charter: The charter is in the nature of a contract between the corporation and the government. *Government of P.I. v. Manila Railroad Co*., 52 Phil. 699 (1929).

The articles of incorporation has been described as one that defines the charter of the corporation and the contractual relationships between the state and the corporation, the stockholders and the State, and between the corporation and its stockholders. *Lanuza v. Court of Appeals*, 454 SCRA 54 (2005).

2. Procedure and Documentary Requirements (**Sec. 14 and 15**)

(a) As to Number and Residency of Incorporators (**Sec. 10**)

It is possible for a business to be wholly owned by one individual, and the validity of its incorporation is not affected when he gives nominal ownership of only one share of stock to each of the other four incorporators. This arrangement is not necessarily illegal, but it valid only between and among the incorporators privy to the agreement. It does not bind the corporation which will consider all stockholders of record as the lawful owners of their registered shares. As between the corporation on the one hand, and its stockholders and third persons on the other, the corporation looks only to its books for the purpose of determining who its shareholders are. *Nautica Canny Corp. v. Yumul*, 473 SCRA 415 (2005).

(b) Corporate Name (**Secs. 18, 14(1) and 42**)

Similarity in corporate names between two corporations would cause confusion to the public especially when the purposes stated in their charter are also the same type of business. *Universal Mills Corp. v. Universal Textile Mills Inc.*, 78 SCRA 62 (1977).

The name of a corporation is essential not only for its existence as a juridical person, but also in manner of dealing with it, and in the exercise of its juridical capacities; it cannot be changed except in the manner provided for by law. *Red Line Trans. v. Rural Transit*, 60 Phil. 549 (1934).

Sec. 18 of Corporation Code expressly prohibits the use of a corporate name which is "*identical or deceptively or confusingly similar to that of any existing corporation or to any other name already protected by law or is patently deceptive, confusing or contrary to existing laws."* The policy behind the foregoing prohibition is to avoid fraud upon the public that will occasion to deal with the entity concerned, the evasion of legal obligations and duties, and the reduction of difficulties of administration and supervision over corporations. *Industrial Refractories Corp. v. Court of Appeals*, 390 SCRA 252 (2002).[28]

Incorporators must choose a name at their peril; and the use of a name similar to one adopted by another corporation, *whether a business or a nonprofit organization*, if misleading or likely to injure the exercise of its corporate functions, regardless of intent, may be prevented by the corporation having a prior right. *Ang Mga Kaanib sa Iglesia ng Dios Kay Kristo Hesus v. Iglesia ng Dios Kay Dristo Jesus*, 372 SCRA 171 (2001).

To fall within the prohibition of the law Revised Guidelines in the Approval of Corporate and Partnership Names, two requisites must be proven, to wit: (a) That the complainant corporation acquired a prior right over the use of such corporate name; and (b) the proposed name is either: (i) identical, or (ii) deceptively or confusingly similar to that of any existing corporation or to any other name already protected by law; or (iii) patently deceptive, confusing or contrary to existing laws. *Philips Export B.V. v. Court of Appeals,* 206 SCRA 457, 463 (1992)

A corporation has no right to intervene in a suit using a name, not even its acronym, other than its registered name, as the law requires and not another name which it had not registered. *Laureano Investment and Dev. Corp. v. Court of Appeals*, 272 SCRA 253 (1997).

There would be no denial of due process when a corporation is sued and judgment is rendered against it under its unregistered trade name: "A corporation may be sued under the name by which it makes itself known to its workers." *Pison-Arceo Agri. Dev. Corp. v. NLRC,* 279 SCRA 312 (1997).

A corporation may change its name by the amendment of its articles of incorporation, but the same is not effective until approved by the SEC. *Phil. First Insurance Co. v. Hartigan*, 34 SCRA 252 (1970).

A change in the corporate name does not make a new corporation, and has no effect on the identity of the corporation, or on its property, rights, or liabilities. *Republic Planters Bank v. Court of Appeals*, 216 SCRA 738 (1992).[29]

(c) Purpose Clauses (**Secs. 14(2) and 42**)

The statement of the primary purpose in the articles of incorporation is means to protect shareholders so they will know the main business of the corporation and file derivative sutis if the corporation deviates from the primary purpose. *Uy Siuliong v. Director of Commerce and Industry*, 40 Phil. 541 (1919).

"The best proof of the purpose of a corporation is its articles of incorporation and by-laws. The articles of incorporation must state the primary and secondary purposes of the corporation, while the by-laws outline the administrative organization of the corporation, which, in turn, is supposed to insure or facilitate the accomplishment of said purpose." Therefore, the Court brushed aside the contention that the corporations were organized to illegally avoid the provisions on land reform and to avoid the payment of estate taxes, as being prohibited collateral attack. *Gala v. Ellice Agro-Industrial Corp.*, 418 SCRA 431 (2003).

(d) Corporate Term (**Sec. 11**)

[28] *Also Lyceum of the Philippines v. Court of Appeals,* 219 SCRA 610, 615 (1993).

[29] *P.C. Javier & Sons, Inc. v. Court of Appeals*, 462 SCRA 36 (2005).

No extension of term can be effected once dissolution stage has been reached, as it constitutes new business. *Alhambra Cigar v. SEC*, 24 SCRA 269 (1968).

Article 605 of Civil Code "clearly limits any usufruct constituted in favor of a corporation or association to 50 years. A usufruct is meant only as a lifetime grant. Unlike a natural person, a corporation or association's lifetime may be extended indefinitely. The usufruct would then be perpetual. This is especially invidious in cases where the usufruct given to a corporation or association covers public land." *NHA v. Court of Appeals*, 456 SCRA 17 (2005).

(e) Principal Place of Business (**Sec. 51**)

Although the Rules of Court do not provide that when the plaintiff is a corporation, the complaint should be filed in the location of its principal office as indicated in its articles of incorporation, jurisprudence has, however, settled that the place where the principal office of a corporation is located, as stated in the articles, indeed establishes its residence. This ruling is important in determining the venue of an action by or against a corporation, as in the present case. *Hyatt Elevators and Escalators Corp. v. Goldstar Elevators, Phils., Inc.*, 473 SCRA 705 (2005), *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW (1998), p. 162.

Place of residence of the corporation is the place of its principal office. *Clavecilla Radio System v. Antillon*, 19 SCRA 379 (1967)

The residence of its president is not the residence of the corporation because a corporation has a personality separate and distinct from that of its officers and stockholders. *Sy v. Tyson Enterprises, Inc.*, 119 SCRA 367 (1982).

(f) Minimum Capitalization (**Sec. 12**): ***Why is maximum capitalization required to be indicated?***

(g) Subscription and Paid-up Requirements (**Sec. 13**)

The entries in the articles of incorporation of the original issuances of shares of stock has a stronger weight that the stock and transfer book in determining the validity and issuance of such shares. *Lanuza v. Court of Appeals*, 454 SCRA 54 (2005).

(h) Steps and Documents Required in SEC

3. Grounds for Disapproval (**Sec. 17**)

When the proposed articles show that the object is to organize a barrio into a separate corporation for the purpose of taking possession and having control of all municipal property within the incorporated barrio and administer it exclusively for the benefit of the residents, the object is unlawful and the articles can be denied registration. *Asuncion v. De Yriarte*, 28 Phil. 67 (1914).

It is well to note that, if a corporation's purpose, as stated in the articles of incorporation, is lawful, then the SEC has no authority to inquire whether the corporation has purposes other than those stated, and mandamus will lie to compel it to issue the certificate of incorporation." *Gala v. Ellice Agro-Industrial Corp.*, 418 SCRA 431 (2003).

4. Amendments to the Articles of Incorporation (**Sec. 16**).

5. Commencement of Corporate Existence (**Sec. 19**).

VIII. BY-LAWS

1. Nature and Functions:

The power to adopt by-laws is an inherent power on the part of those forming a corporation or any other form of association. *Gokongwei v. SEC*, 89 SCRA 337 (1979).

By-laws have traditionally been defined as regulations, ordinances, rules or laws adopted by an association or corporation or the like for its internal governance, including rules for routine matters such as calling meetings and the like. If those key by-law provisions on matters such as quorum requirements, meetings, or on the internal governance of the local/chapter are themselves already provided for in the constitution, then it would be feasible to overlook the requirements for by-laws. Indeed in such an event, to insist on the submission of a separate document denominated as "By-Laws" would be an undue technicality, as well as a redundancy. *San Miguel Corp. v. Mandaue Packing Products Plants Union-FFW*, 467 SCRA 107 (2005)**.**

As the "rules and regulations or private laws enacted by the corporation to regulate, govern and control its own actions, affairs and concerns and its stockholders or members and directors and officers with relation thereto and among themselves in their relation to it," by-laws are indispensable to corporations. These may not be essential to corporate birth but certainly, these are required by law for an orderly governance and management of corporations. *Loyola Grand Villas Homeowners v. CA,* 276 SCRA 681 (1997).

(a) Common Law Limitations on By-Laws

(i) *By-Laws Cannot Be Contrary to Law and Charter*

A by-law provision that empowers the Board of Directors to cancel the shares of any member and return to the owner thereof the value thereof was declared void for being in violation of the provision in the Corporation Law that provided that capital can only be returned after dissolution**.** *Government of P.I. v. El Hogar Filipino*, 50 Phil. 399 (1927)

A by-law provision granting to a stockholder permanent seat in the Board of Directors is contrary to the provision in Corporation Code requiring all members of the Board to be elected by the stockholders. Even when the members of the association may have formally adopted the provision, their action would be of no avail because no provision of the by-laws can be adopted if it is contrary to law. *Grace Christian High School v. Court of Appeals,* 281 SCRA 133 (1997).

By-laws are intended merely for the protection of the corporation, and prescribe regulation, not restrictions; they are always subject to the charter of the corporation. *Rural Bank of Salinas, Inc. v. Court of Appeals*, 210 SCRA 510 (1992).

The by-laws provisions cannot be such or be amended to be able to go around the security of tenure clause of employees nor impair the obligation of existing contracts or rights. . . otherwise, it would enable an employer to remove any employee from his employment by the simple expediency of amending its by-laws and providing that his/her position shall cease to exist upon the occurrence of a specified event." *Salafranca v. Philamlife (Pamplona) Village Homeowners,* 300 SCRA 469 (1998).

(ii) *By-Law Provisions Cannot Be Unreasonable or Be Contrary to the Nature of By-laws.*

Authority granted to a corporation to regulate the transfer of its stock does not empower the corporation to restrict the right of a stockholder to transfer his shares, but merely authorizes the adoption of regulations as to the formalities and procedure to be followed in effecting transfer. *Thomson v. Court of Appeals,* 298 SCRA 280 (1998).

(iii) *By-Law Provisions Cannot Discriminate.*

(b) Binding Effects on By-laws on the Dealing Public:

By-law provisions on the required quorum for special meetings of the Board have the force of law and are binding even on third-parties who deal with the properties of the corporation. ✓***Peña v. Court of Appeals*, 193 SCRA 717 (1991)**.

The nature of by-laws being intramural instruments would mean that they are not binding on third-parties, except those who have actual knowledge of their contents. ✓***China Banking Corp. v. Court of Appeals*, 270 SCRA 503 (1997)**.

"Neither can we concede that such contract would be invalid just because the signatory thereon was not the Chairman of the Board which allegedly violated the corporation's by-laws. Since by-laws operate merely as internal rules among the stockholders, they cannot affect or prejudice third persons who deal with the corporation, unless they have knowledge of the same." *PMI Colleges v. NLRC*, 277 SCRA 462 (1997).

2. Adoption Procedure (**Sec. 46**)

There can be no *automatic dissolution* simply because the incorporators failed to file the required by-laws under Sec. 46 of Corporation Code. There is no outright "demise" of corporate existence. Proper notice and hearing are cardinal components of due process in any democratic institution, agency or society. In other words, the incorporators must be given the chance to explain their neglect or omission and remedy the same." *Loyola Grand Villas Homeowners v. CA,* 276 SCRA 681 (1997).

A corporation which has failed to file its by-laws within the prescribed period does not *ipso facto* lose its powers as such, and may be considered a *de facto* corporation whose right to exercise corporate powers may not be inquired into collaterally in any private suit to which such corporations may be a party. [?] *Sawadjaan v. Court of Appeals*, 459 SCRA 516 (2005).

3. Contents (**Sec. 47**)

4. Amendments and Revisions of By-Laws (**Sec. 48**)

IX. CORPORATE POWERS AND AUTHORITY

1. Corporate Power and Capacity (**Art. 46, Civil Code; Secs. 36 and 45**)

(a) Classification of Corporate Powers: *Express*; *Implied*, and *Incidental*

A corporation has only such powers as are expressly granted to it by law and by its articles of incorporation, those which may be incidental to such conferred powers, those reasonably necessary to accomplish its purposes and those which may be incident to its existence. *Pilipinas Loan Company v. SEC,* 356 SCRA 193 (2001).

(b) Where Corporate Power Lodged

A corporation has no power except those expressly conferred on it by the Corporation Code and those that are implied or incidental to its existence. In turn, a corporation exercises said powers through its board of directors and/or its duly authorized officers and agents. . . In turn, physical acts of the corporation, like the signing of documents, can be performed only by natural persons duly authorized for the purpose by corporate by-laws or by a specific act of the board of directors. *Shipside Inc. v. Court of Appeals*, 352 SCRA 334 (2001).[30]

2. Express Powers

[30] *Salenga v. Court of Appeals*, 664 SCRA 635 (2012); *Ellice Agro-Industrial Corp. v. Young*, 686 SCRA 51 (2012); *Fausto C. Ignacio v. Home Bankers Savings and Trust Co.*, 689 SCRA 173 (2013).

(a) Enumerated Powers (Sec. 36)

(b) Extend or Shorten Corporate Term (**Secs. 37 and 81[1]**)

(c) Increase or Decrease Capital Stock (**Sec. 38**)

Despite the board resolution approving the increase in capital stock and the receipt of payment on the future issues of the shares from the increased capital stock, such funds do not constitute part of the capital stock of the corporation until approval of the increase by SEC. *Central Textile Mills, Inc. v. NWPC*, 260 SCRA368 (1996).

A reduction of capital to justify the mass layoff of employees, especially of union members, amounts to nothing but a premature and plain distribution of corporate assets to obviate a just sharing to labor of the vast profits obtained by its joint efforts with capital through the years, and would constitute unfair labor practice. *Madrigal & Co. v. Zamora*, 151 SCRA 355 (1987).

(d) Incur, Create or Increase Bonded Indebtedness (**Sec. 38**)

(e) Sell or Dispose of Assets (**Sec. 40**)

The property of the corporation is not the property of the stockholders or members, and as such, may not be sold without express authority from the Board of Directors. *Litonjua v. Eternit Corp.*, 490 SCRA 204 (2006).

The Corporation Code defines a sale or disposition of substantially all assets and property of a corporation as one by which the corporation "would be rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated" – any sale or disposition short of this will not need stockholder ratification, and may be pursued by the majority vote of the Board of Directors. ✓***Strategic Alliance Dev. Corp. v. Radstock Securities Ltd.*, 607 SCRA 413 (2009)**.

The disposition of the assets of a corporation shall be deemed to cover substantially all the corporate property and assts, if thereby the corporation would be rendered incapable of continuing the business or accomplishing the purposes for which it was incorporated. Such a sale or disposition must be understood as valid only if it does not prejudice the creditors of the assignor, which necessarily implies that the assignee assumes the debts of the assignor. *Caltex (Phils.), Inc. v. PNOC Shipping and Transport Corp.*, 498 SCRA 400 (2006).

Sale by Board of Trustees of the only corporate property without compliance with Sec. 40 of Corporation Code requiring ratification of members representing at least two-thirds of the membership, would make the sale null and void. *Islamic Directorate v. Court of Appeals*, 272 SCRA 454 (1997); *Peña v. CA*, 193 SCRA 717 (1991).

(f) Invest Corporate Funds for Non-Primary Purpose Endeavor (**Sec. 42**)

Investment by a sugar central in the equity of a corporation that manufactures the jute bags used in packing sugar falls within the implied powers of the sugar central as part of its primary purpose and does not need ratification by the stockholders. ✓***De la Rama v. Ma-ao Sugar Central Co.*, 27 SCRA 247 (1969)**.

(g) Declare Dividends (**Sec. 43**)

Dividends from retained earnings can only be declared to those who are stockholders of the corporation; dividends cannot be declared to creditors as part of the settlement of debts. *Nielson & Co. v. Lepanto Consolidated Mining Co*., 26 SCRA 540 (1968).

Stock dividend is the amount that the corporation transfers from its surplus profit account to its capital account. It is the same amount that can loosely be termed as the "trust fund" of the corporation. *NTC v. CA,* 311 SCRA 508 (1999).

(h) Management Contracts (**Sec. 44**): ***Why the difference in rule between entity and individual?***

A management contract is not the same as an agency contract, and therefore is not revocable at will. *Nielson & Co., Inc. v. Lepanto Consolidated Mining*, 26 SCRA 540 (1968); *Ricafort v. Moya*, 195 SCRA 247 (1991).

3. Implied Powers

When the articles expressly provide that the purpose of the corporation was to "engage in the transportation of person *by water*," such corporation cannot engage in the business of *land transportation*, which is an entirely different line of business, and, for which reason, may not acquire any certificate of public convenience to operate a taxicab service. *Luneta Motor Co. v. A.D. Santos, Inc*., 5 SCRA 809 (1962).

A corporation whose primary purpose is to generate electric power has no authority to undertake stevedoring services to unload coal into its pier since it is not reasonably necessary for the operation of its power plant. *NPC v. Vera,* 170 SCRA 721 (1989).

A corporation organized to engage as a lending investor cannot engage in pawnbroker. *Philipinas Loan Co. v. SEC*, 356 SCRA 193 (2001).

A mining company has not power to engage in real estate development. *Heirs of Antonio Pael v. Court of Appeals,* 372 SCRA 587 (2001).

An officer who is authorized to purchase the stock of another corporation has implied power to perform all other obligations arising therefrom such as payment of the shares of stock. *Inter-Asia Investments Industries v. Court of Appeals*, 403 SCRA 452 (2003).

4. Incidental Powers

As a creature of the law, the powers and attributes of a corporation are those set out, expressly or implied, in the law. Among the general powers granted by law to a corporation is the power to sue in its own name. This power is granted to a duly-organized corporation, unless *specifically* revoked by another law. *Umale v. ASB Realty Corp.*, 652 SCRA 215 (2011).

The act of issuing checks is within the ambit of a valid corporate act, for it as for securing a loan to finance the activities of the corporation, hence, not an *ultra vires* act. *Atrium Management Corp. v. Court of Appeals*, 353 SCRA 23 (2001).

5. Other Powers (Sec. 36)

(a) Sell Land and Other Properties

When the corporation's primary purpose is to market, distribute, export and import merchandise, the sale of land is not within the actual or apparent authority of the corporation acting through its officers, much less when acting through the treasurer. Articles 1874 and 1878 of Civil Code requires that when land is sold through an agent, the agent's authority must be in writing, otherwise the sale is void. *San Juan Structural v. CA*, 296 SCRA 631 (1998).[31]

(b) Borrow Funds

The power to borrow money is one of those cases where even a special power of attorney is required under Art. 1878 of Civil Code. There is invariably a need of an enabling act of the corporation to be approved by its Board of Directors. The argument that the obtaining of loan was in accordance with the ordinary course of business usages and practices of the corporation is devoid of merit because the prevailing practice in the corporation was to explicitly authorize an officer to contract loans in behalf of the corporation. *China Banking Corp. v. Court of Appeals*, 270 SCRA 503 (1997).

(c) Power to Sue and Be Sued

Under Sec. 36 in relation to Sec. 23 of Corporation Code, where a corporation is an injured party, its power to sue is lodged with its Board of Directors. A minority stockholder who is a member of the Board has no such power or authority to sue on the corporation's behalf. *Tam Wing Tak v. Makasiar*, 350 SCRA 475 (2001).[32]

(i) Power to Bind the Corporation in a Suit

When the power to sue is delegated by the by-laws to a particular officer, such officer may appoint counsel to represent the corporation in a pre-trial hearing without need of a formal board resolution. *Citibank, N.A. v. Chua,* 220 SCRA 75 (1993).

For counsel to sign the certification for the corporation, he must specifically be authorized by the Board of Directors. *BPI Leasing Corp. v. CA*, 416 SCRA 4 (2003); *Mariveles Shipyard Corp. v. CA*, 415 SCRA 573 (2003).

(ii) Certificate of Non-Forum Shopping:

If the petitioner is a corporation, a board resolution authorizing a corporate officer to execute the certification against forum shopping is necessary—a certification not signed by a duly authorized person renders the petition subject to dismissal. *Gonzales v. Climax Mining Ltd.*, 452 SCRA 607 (2005);[33] such as the administrator or project manager, *Esteban, Jr. v. Vda. de Onorio,* 360 SCRA 230 (2001); or the General Manager, *Central Cooperative Exchange Inc. v. Enciso*, 162 SCRA 706 (1988).

Nonetheless, such lack of authority may be cured: even if the counsel executed the verification and certificate of non-forum shopping before the board authorized him, the passing of the board resolution of authorization before the actual filing of the complaint. *Median Container Corp. v. Metropolitan Bank and Trust Co.*, 561 SCRA 622 (2008); the submission in the motion for reconsideration of the authority to sign the verification and certification constitutes substantial compliance with the procedural requirements. *Asean Pacific Planners v. City of Urdaneta*, 566 SCRA 219 (2008).

When a corporate officers has been granted express power by the Board of Directors to institute a suit, the same is considered broad enough to include the power of said corporate officer to execute the verification and certification against forum shopping required in initiatory pleadings under the Rules of Court. *Cunanan v. Jumping Jap Trading Corp.*, 586 SCRA 620 (2009).

A President of a corporation, among other enumerated corporate officers and employees, can sign the verification and certification against non-forum shopping in behalf of the corporation without the benefit of a board resolution. *South Cotabato Communications Corp. v. Sto. Tomas*, 638 SCRA 566 (2011).

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[31] *AF Realty & Dev., Inc. v. Dieselman Freight Services Co.,* 373 SCRA 385 (2002); *Firme v. Bukal Enterprises and Dev. Corp.*, 414 SCRA 190 (2003); *Cosco Philippines Shipping, Inc. v. Kemper Insurance Company*, 670 SCRA 343 (2012).

[32] *Shipside Inc. v. Court of Appeals,* 352 SCRA 334 (2001); *SSS v. COA*, 384 SCRA 548 (2002); *United Paragon Mining Corp. v. Court of Appeals*, 497 SCRA 638 (2006); *Mediserv, Inc. v. Court of Appeals*, 617 SCRA 284 (2010); *Cebu Bionic Builders Supply, Inc. v. DBP*, 635 SCRA 13 (2010); *Ellice Agro-Industrial Corp. v. Young*, 686 SCRA 51 (2012).

[33] *Also DBP v. Court of Appeals*, 440 SCRA 200 (2004); *Public Estates Authority v. Uy*, 372 SCRA 180 (2001); *Philippine Airlines, Inc. v. Flight Attendance and Stewards Association of the Philippines (FASAP)*, 479 SCRA 605 (2006); *Metro Drug Distribution, Inc. v. Narcisco*, 495 SCRA 286 (2006); *Cagayan Valley Drug Corp. v. Commissioner of Internal Revenue*, 545 SCRA 10 (2008) *Mediserv, Inc. v. Court of Appeals*, 617 SCRA 284 (2010); *Cosco Philippines Shipping, Inc. v. Kemper Insurance Company*, 670 SCRA 343 (2012).

(iii) Service of Summons on Corporations

Section 11, Rule 14 of the 1997 Rules of Civil Procedure uses the term "general manager" and unlike the old provision in the Rules of Court, it does not include the term "agent". Consequently, the enumeration of persons to whom summons may be served is "restricted, limited and exclusive" following the rule on statutory construction *expressio unios est exclusion alterius.* Therefore, the earlier cases that uphold service of summons upon a construction project manager;[34] a corporation's assistant manager;[35] ordinary clerk of a corporation;[36] private secretary of corporate executives;[37] retained counsel;[38] officials who had charge or control of the operations of the corporation, like the assistant general manager;[39] or the corporation's Chief Finance and Administrative Officer;[40] no longer apply since they were decided under the old rule that allows service of summons upon an agent[41] of the corporation. *E.B. Villarosa & Partners Co., Ltd. v. Benito*, 312 SCRA 65 (1999).

(d) Power to Hire Employees and Appoint Agents

Except where the authority of employing servants and agents is expressly vested in the board of directors or trustees, an officer or agent who has general control and management of the corporation's business, or a specific part thereof, may bind the corporation by the employment of such agents and employees as are usual and necessary in the conduct of such business. But the contracts of employment must be reasonable. *Yu Chuck v. "Kong Li Po*," 46 Phil. 608 (1924).

(e) Provide Gratuity Pay for Employees (**Sec. 36[10]**)

Providing gratuity pay for employees is an express power of a corporation under the Corporation Code, and cannot be considered to be *ultra vires* to avoid any liability arising from the issuance of resolution granting such gratuity pay. *Lopez Realty v. Fontecha*, 247 SCRA 183, 192 (1995).

(f) Power to Make Donations (**Sec. 36[9]**)

(g) Enter Into a Partnership or Joint Venture: ✓***Tuason & Co. v. Bolanos*, 95 Phil. 106 (1954)**; SEC Opinion, dated 29 February 1980.

6. *ULTRA VIRES* DOCTRINE

(a) Types of *Ultra Vires* Acts (**Sec. 45**)

A corporation has no power except those expressly conferred on it by the Corporation Code, its charter, and those that are implied or incidental to its existence. In turn, a corporation exercises said powers through its Board of Directors and /or its duly authorized officers and agents. *Monfort Hermanos Agricultural Dev. Corp. v. Monfort III*, 434 SCRA 27 (2004).

(i) *First Type Ultra Vires:* An *ultra vires* act is one committed outside the object for which a corporation is created as defined by the law of its organization and therefore beyond the power conferred upon it by law. The term "*ultra vires*" is "distinguished from an illegal act for the former is merely voidable which may be enforced by performance, ratification, or estoppel, while the latter is void and cannot be validated." *Atrium Management Corp. v. CA*, 353 SCRA 23 (2001).

(ii) *Second Type Ultra Vires:* When the President enters into speculative contracts without prior board approval, and without subsequent Board ratification, nor were the transactions included in the reports of the corporation, such contracts do not bind the corporation. It must be pointed out that the Board of Directors, not the President, exercises corporate powers. *Safic Alcan & Cie v. Imperial Vegetable Oil Co., Inc.*, 355 SCRA 559 (2001).

Contracts or acts of a corporation must be made either by the Board of Directors or by a corporate agent duly authorized by the Board—absent such valid delegation/authorization, the rule is that the declaration of an individual directors relating to the affairs of the corporation, but not in the course of, or connected with the performance of authorized duties of such director, are held not binding on the corporation. *Manila Metal Container Corp. v. PNB*, 511 SCRA 444 (2006).

(iii) *Third Type Ultra Vires:*

Although the arrangement between the two mining companies was prohibited under the terms of the old Corporation Law, the Supreme Court did not declare the nullity of the agreements on the ground that only private rights and interests, as distinguished from public interests, were involved in the case.✓***Harden v. Benguet Consolidated Mining Co.*, 58 Phil. 140 (1933)**.

(b) General Judicial Attitude Towards the *Ultra Vires* Doctrine

The plea of "*ultra vires*" will not be allowed to prevail, whether interposed for or against a corporation, when it will not advance justice but, on the contrary, will accomplish a legal wrong to the

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[34] *Kanlaon Construction Enterprises Co., Inc. v. NLRC,* 279 SCRA 337 (1997).

[35] *Gesulgon v. NLRC,* 219 SCRA 561 (1993).

[36] *Golden Country Farms, Inc. v. Sanvar Development Corp.*, 214 SCRA 295 (1992); *G & G Trading Corp. v. Court of Appeals*, 158 SCRA 466 (1988).

[37] *Summit Trading and Dev. Corp. v. Avendaño,* 135 SCRA 397 (1985); *also Vlason Enterprises Corp. v. Court of Appeals,* 310 SCRA 26 (1999).

[38] *Republic v. Ker & Co., Ltd.,* 18 SCRA 207 (1966).

[39] *Villa Rey Transit, Inc. v. Far East Motor Corp.*, 81 SCRA 298 (1978).

[40] *Far Corporation v. Francisco,* 146 SCRA 197 (1986).

[41] *Filoil Marketing Corp. v. Marine Dev. Corp. of the Philippines*, 177 SCRA 86 (1982).

prejudice of another who acted in good faith. *Zomer Dev. Corp. v. Int'l Exchange Bank*, 581 SCRA 115 (2009).

(c) Ratification of *Ultra Vires* Acts:

Acts done by the Board of Directors which are *ultra vires* cannot be set-aside if the acts have been ratified by the stockholders. ✓***Pirovano v. De la Rama Steamship Co., Inc.*, 96 Phil. 335 (1954)**.

Even when a particular corporate act does not fall within the express or implied powers of the corporation, nevertheless it will not be set aside when, not being *malum prohibitum*, the corporation, through its senior officers or its Board of Directors, are estopped from questioning the legality of such act, contract or transaction. *Carlos v. Mindoro Sugar Co.*, 57 Phil. 343 (1932).[42]

Acts done in excess of corporate officers' scope of authority cannot bind the corporation. However, when subsequently a compromise agreement was on behalf of the corporation being represented by its President acting pursuant to a Board of Directors' resolution, such constituted as a confirmatory act signifying ratification of all prior acts of its officers. *NPC v. Alonzo-Legasto*, 443 SCRA 342 (2004).

X. DIRECTORS, TRUSTEES AND OFFICERS

"Board of Directors" is the body which (1) exercises all powers provided for under the Corporation Code; (2) conducts all business of the corporation; and (3) controls and holds all property of the corporation. Its members have been characterized as trustees or directors clothed with a fiduciary character. It is clearly separate and distinct from the corporate entity itself. *Hornilla v. Salunat*, 405 SCRA 220 (2003).

1. DOCTRINE OF CENTRALIZED MANAGEMENT: Powers of Board of Directors (Sec. 23)

Section 23 expressly provides that the corporate powers of all corporations shall be exercised by the Board of Directors. Just as a natural person may authorize another to do certain acts in his behalf, so may the Board of Directors validly delegate some of its functions to individual officers or agents appointed by it. Thus, contracts or acts of a corporation must be made either by the Board of Directors or by a corporate agent duly authorized by the board. Absent such valid delegation/authorization, the rule is that the declarations of an individual director relating to the affairs of the corporation, but not in the course of, or connected with the performance of authorized duties of such director, are held not binding on the corporation. *Manila Metal Container Corp. v. PNB*, 511 SCRA 444 (2006).[43]

(a) *Rationale for "Centralized Management" Doctrine*:

The *raison d'etre* behind the conferment of corporate powers on the Board of Directors is not lost on the Court – indeed, the concentration in the Board of the powers of control of corporate business and appointment of corporate officers and managers is necessary for efficiency in any large organization. Stockholders are too numerous, scattered and unfamiliar with the business of a corporation to conduct its business directly. And so the plan of corporate organization is for the stockholders to choose the directors who shall control and supervise the conduct of corporate business. ✓***Filipinas Port Services v. Go*, 518 SCRA 453 (2007)**.

A corporation is an artificial being and can only exercise its powers and transact its business through the instrumentalities of its Board of Directors, and through its officers and agents, when authorized by resolution or by its by-laws. Consequently, when legal counsel was clothed with authority through formal board resolution, his acts bind the corporation which must be held bound the actuations of its counsel of record. *De Liano v. Court of Appeals*, 370 SCRA 349 (2001).

"The physical acts of the corporation, like the signing of documents, can be performed only by natural persons duly authorized for the purpose by corporate by-laws or by a special act of the board of directors." *Firme v. Bukal Enterprises and Dev. Corp.*, 414 SCRA 190 (2003); *Shipside Inc. v. Court of Appeals*, 352 SCRA 334 (2001).

(b) Theories on Source of Board Power

Delegated Powers Coming from the Stockholders: The Board of Directors is a creation of the stockholders and controls and directs the affairs of the corporation by delegation of the stockholders. By drawing themselves the powers of the corporation, they occupy positions of trusteeship in relation to the stockholders. ✓***Angeles v. Santos*, 64 Phil. 697 (1937)**.

One of the most important rights of a qualified shareholder or member is the right to vote for the directors or trustees who are to manage the corporate affairs. The right to choose the persons who will direct, manage and operate the corporation is significant, because it is the main way in which a stockholder can have a voice in the management of corporate affairs, or in which a member in a nonstock corporation can have a say on how the purposes and goals of the corporation may be achieved. Once the directors or trustees are elected, the stockholders or members relinquish corporate powers to the board in accordance with law. ✓***Tan v. Sycip*, 499 SCRA 216 (2006)**.

(c) Board Must Act As a Body (Sec. 25)

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[42] *Republic v. Acoje Mining Co.*, 3 SCRA 361 (1963); *Crisologo Jose v. Court of Appeals*, 177 SCRA 594 (1989).

[43] *Yu Chuck v. "Kong Li Po*," 46 Phil. 608, 614 (1924); *Gamboa v. Victoriano*, 90 SCRA 40 (1979); *Reyes v. RCPI Employees Credit Union, Inc.*, 499 SCRA 319 (2006); *Yasuma v. Heirs of Cecilio S. De Villa*, 499 SCRA 466 (2006); *Raniel v. Jochico*, 517 SCRA 221 (2007); *Republic v. Coalbrine International*, 617 SCRA 491 (2010).

Exercise of the powers of the Board of Directors may either be express and formal through the adoption of a board resolution in a meeting called for the purpose, or it may be implied where the Board collectively and knowingly allows the President to enter into important contracts in the pursuit of the business of the corporation. ✓***Board of Liquidators v. Heirs of Maximo M. Kalaw*, 20 SCRA 987 (1967)**.

A Director-Treasurer has no power to bind the company even in transactions that are pursuant to the primary purpose its corporation, especially when the by-laws specifically provided that the acts entered into can only be done by the Board of Directors. *Ramirez v. Orientalist Co.*, 38 Phil. 634 (1918).

Between the act of the Board as a body affirming informally the perfection of a contract entered into in behalf of the corporation by a senior officer, and the subsequent formal board resolution rejecting the same contract, the former must prevail under the doctrine of estoppel. *Acuña v. Batac Producers Cooperative Marketing Assn.*, 20 SCRA 526 [1967]).

A corporation, through its Board of Directors, should act in the manner and within the formalities prescribed by its charter or by the general law. Thus, directors must act as a body in a meeting called pursuant, otherwise, any action taken therein may be questioned by any objecting director or shareholder. Be that as it may, jurisprudence tells us that an action of the Board of Directors during a meeting, which was illegal for lack of notice, may be ratified either expressly, by the action of the directors in subsequent legal meeting, or impliedly, by the corporation's subsequent course of conduct. *Lopez Realty v. Fontecha*, 247 SCRA 183 (1995).

(d) Effects of "Bogus" Board: The acts or contracts effected by a bogus board would be void pursuant to Art. 1318 of Civil Code because of the lack of "consent". *Islamic Directorate of the Philippines v. Court of Appeals*, 272 SCRA 454 (1997).

(e) Executive Committee (**Sec. 35**)

It is within the power of the Board of Directors to authorize any person or committee to undertake corporate acts. The board has power to constitute even an executive committee, even when no such committee is provided for in the articles and by-laws of the corporation. *Filipinas Port Services, Inc. v. Go*, 518 SCRA 453 (2007).

2. BUSINESS JUDGMENT RULE: ✓***Montelibano v. Bacolod-Murcia Miling Co., Inc.*, 5 SCRA 36 (1962)**.
✓***PSE v. Court of Appeals,* 281 SCRA 232 (1997)**.

(a) BJR First Branch:

The Board of Directors is the business manager of the corporation, and so long as it acts in good faith, its orders are not reviewable by the courts. *Estacio v. Pampanga I Electric Cooperative, Inc.*, 596 SCRA 542 (2009).

Questions of policy and management are left to the honest decision of the officers and directors of a corporation, and the courts are without authority to substitute their judgment for the judgment of the board of directors. *Cua, Jr. v. Tan*, 607 SCRA 645 (2009).

No court can, as an integral part of resolving the issues between squabbling stockholders, order the corporation to undertake certain corporate acts, since it would be in violation of the business judgment rule. ✓***Ong Yong v. Tiu*, 401 SCRA 1 (2003)**, *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW (1998 ed), p. 288.

(b) BJR Second Branch:

Directors and officers who purport to act for the corporation, keep within the lawful scope of their authority and act in good faith, do not become liable, whether civilly or otherwise, for the consequences of their acts, which are properly attributed to the corporation alone. *Benguet Electric Cooperative, Inc. v. NLRC*, 209 SCRA 55 (1992).

If the cause of the losses is merely error in business judgment, not amounting to bad faith or negligence, directors and/or officers are not liable. For them to be held accountable, the mismanagement and the resulting losses on account thereof are not the only matters to be proven; it is likewise necessary to show that the directors and/or officers acted in bad faith and with malice in doing the assailed acts. Bad faith does not simply connote bad judgment or negligence; it imports a dishonest purpose or some moral obliquity and conscious doing of a wrong, a breach of a known duty through some motive or interest or ill-will partaking of the nature of fraud. *Filipinas Port Services, Inc. v. Go*, 518 SCRA 453 (2007).

3. COUNTER-VEILING DOCTRINES TO PROTECT CORPORATE CONTRACTS

(a) Theory of *Estoppel* or Ratification

The principle of estoppel precludes a corporation and its Board of Directors from denying the validity of the transaction entered into by its officer with a third party who in good faith, relied on the authority of the former as manager to act on behalf of the corporation. ✓***Lipat v. Pacific Banking Corp.,* 402 SCRA 339 (2003).**

In order to ratify the unauthorized act of an agent and make it binding on the corporation, it must be shown that the governing body or officer authorized to ratify had full and complete knowledge of all the material facts connected with the transaction to which it relates. Ratification can never be made on the

part of the corporation by the same person who wrongfully assume the power to make the contract, but the ratification must be by the officer or governing body having authority to make such contract. *Vicente v. Geraldez*, 52 SCRA 210 (1973).

The admission by counsel on behalf of the corporation of the latter's culpability for personal loans obtained by its corporate officers cannot be given legal effect when the admission was "without any enabling act or attendant ratification of corporate act," as would authorize or even ratify such admission. In the absence of such ratification or authority, such admission does not bind the corporation. *Aguenza v. Metropolitan Bank and Trust Co.,* 271 SCRA 1 (1997).

Acts done in excess of corporate officers' scope of authority cannot bind the corporation. However, when subsequently a compromise agreement was on behalf of the corporation being represented by its President acting pursuant to a Board of Directors' resolution, such constituted as a confirmatory act signifying ratification of all prior acts of its officers. *National Power Corp. v. Alonzo-Legasto*, 443 SCRA 342 (2004).

(b) Doctrine of Laches or "*Stale Demands*"

The principle of laches or "stale demands" provides that the failure or neglect, for an unreasonable and unexplained length of time, to do that which by exercising due diligence could or should have been done earlier, or the negligence or omission to assert a right within a reasonable time, warrants a presumption that the party entitled to assert it either has abandoned it or declined to assert it. *Rovels Enterprises, Inc. v. Ocampo*, 391 SCRA 176 (2002).

(c) Doctrine of Apparent Authority: Art. 1883, Civil Code.

If a corporation intentionally or negligently clothes its officers or agents with apparent power to perform acts, it will be estoped to deny such apparent authority is real, as to innocent third persons dealing in good faith with such officers or agents. ✓***Francisco v. GSIS*, 7 SCRA 577 (1963)**.[44]

Under Article 1910 of the New Civil Code, acts done by such officers beyond the scope of their authority cannot bind the corporation unless it has ratified such acts expressly or tacitly, or is estopped from denying them. . . . Thus, contracts entered into by corporate officers beyond the scope of authority are unenforceable against the corporation unless ratified by the Corporation. ✓***Woodchild Holdings, Inc. v. Roxas Electric Constructions Co., Inc.*, 436 SCRA 235 (2004)**.

The general rule remains that, in the absence of authority from the Board of Directors, no person, not even its officers, can validly bind a corporation. If a corporation, however, consciously lets one of its officers, or any other agent, to act within the scope of an apparent authority, it will be estopped from denying such officer's authority. . . Unmistakably, the Court's directive in *Yao Ka Sin Trading* is that a corporation should first prove by clear evidence that its corporate officer is **not** in fact authorized to act on its behalf ***before*** the burden of evidence shifts to the other party to prove, by previous specific acts, that an officer was clothes by the corporation with apparent authority. ✓***Westmont Bank v. Inland Construction and Dev. Corp.*, 582 SCRA 230 (2009)**.

If a corporation knowingly permits one of its officers to act within the scope of an apparent authority, it holds him out to the public as possessing the power to do those acts, the corporation will, as against anyone who has in good faith dealt with it through such agent, be estopped from denying the agent's authority. *Soler v. Court of Appeals*, 358 SCRA 57 (2001); *Rural Bank of Milaor (Camarines Sur) v. Ocfemia*, 325 SCRA 99 (2000)

The authority of a corporate officer dealing with third persons may be actual or apparent . . . the principal is liable for the obligations contracted by the agent. The agent' apparent representation yields to the principal's true representation and the contract is considered as entered into between the principal and the third person. *First Philippine Int'l Bank v. Court of Appeals*, 252 SCRA 259 (1996).

Persons who deal with corporate agents within circumstances showing that the agents are acting in excess of corporate authority, may not hold the corporation liable. *Traders Royal Bank v. Court of Appeals*, 269 SCRA 601 (1997).

Apparent authority may be ascertained through (1) the general manner in which the corporation holds out an officer or agent as having the power to act, or, in other words the apparent authority to act in general with which is clothes them; or (2) the acquiescence in his acts of a particular nature, with actual or constructive knowledge thereof, within or beyond the scope of his ordinary powers. *Inter-Asia Investment Industries v. Court of Appeals,* 403 SCRA 452 (2003).

When an officer in a banking corporation arrange a credit line agreement and forwards the same to the legal department at its head officer, and the bank did no disaffirm the contract, then it is bound by it. *Premier Dev. Bank v. Court of Appeals*, 427 SCRA 686 (2004.

A corporation cannot disown its President's act of applying to the bank for credit accommodation, simply on the ground that it never authorized the President by the lack of any formal board resolution. The following placed the corporation and its Board of Directors in estoppel *in pais*: Firstly, the by-laws provides for the powers of the President, which includes, executing contracts and agreements, borrowing money, signing, indorsing and delivering checks; secondly, there were already previous transaction of discounting the checks involving the same personalities wherein any enabling resolution from the Board was dispensed with and yet the bank was able to collect from the corporation. *Nyco Sales Corp. v. BA Finance Corp.,* 200 SCRA 637 (1991).

[44] *United Coconut Planters Bank v. Planters Products, Inc.*, 672 SCRA 285 (2012).

Per its Secretary's Certificate, the foundation had given its President ostensible and apparent authority to *inter alia* deal with the respondent Bank, and therefore the foundation is estopped from questioning the President's authority to obtain the subject loans from the respondent Bank. *Lapulapu Foundation, Inc., v. Court of Appeals*, 421 SCRA 328 (2004).

A verbal promise given by the Chairman and President of the company to the general manager and chief operating officer to give the latter unlimited sick leave and vacation leave benefits and its cash conversion upon his retirement or resignation, when not an integral part of the company's rules and policies, is not binding on the company when it is without the approval of the Board of Directors. *Kwok v. Philippine Carpet Manufacturing Corp.*, 457 SCRA 465 (2005).

The acceptance of the offer to purchase by the clerk of the branch of the bank, and the representation that the manager had already approved the sale (which in fact was not true), cannot bind the bank to the contract of sale, it being obvious that such a clerk is not among the bank officers upon whom putative authority may be reposed by a third party. There is, thus, no legal basis to bind the bank into any valid contract of sale with the buyers, given the absolute absence of any approval or consent by any responsible officer of the bank. *DBP v. Ong*, 460 SCRA 170 (2005).

Rationale for the Doctrine of Apparent Authority: "Naturally, the third person has little or no information as to what occurs in corporate meeting; and he must necessarily rely upon the external manifestations of corporate consent. The integrity of commercial transactions can only be maintained by holding the corporation strictly to the liability fixed upon it by its agents in accordance with law. What transpires in the corporate board room is entirely an internal matter. Hence, petitioner may not impute negligence on the part of the respondents in failing to find out the scope of Atty. Soluta's authority. Indeed, the public has the right to rely on the trustworthiness of bank officers and their acts." ✓***Associated Bank v. Pronstroller*, 558 SCRA 113 (2008)**.

4. Qualifications of Directors/Trustees (**Secs. 23 and 27**)

The qualifications provided for in the law are only minimum qualifications; additional qualifications and disqualifications can be provided for but only by proper provisions in the by-laws of the corporation. ***Gokongwei, Jr. v. SEC*, 89 SCRA 336 (1979)**.

A director must own at least one share of stock. *Peña v. CA*, 193 SCRA 717 (1991).[45]

The law does not require that a Vice-President be a stockholder. *Baguio v. Court of Appeals*, 226 SCRA 366 (1993).

Beneficial ownership under VTA no longer qualifies. ✓***Lee v. CA*, 205 SCRA 752 (1992)**.

5. Election of Directors and Trustees

(a) Directors (Secs. 24 and 26)

Since under Sec. 26 of the Corporation Code all corporations are mandated to submit a formal report to the SEC on the changes in their directors and officers, then only those directors and officers appearing in such report (General Information Sheet) to the SEC are deemed legally constituted to bind the corporation, especially in the bringing of suits in behalf of the corporation. ✓***Premium Marble Resources v. CA,* 264 SCRA 11 (1996)**.

The underlying policy of the Corporation Code is that the business and affairs of a corporation must be governed by a board of directors whose members have stood for election, and who have actually been elected by the stockholders, on an annual basis. Only in that way can the directors' continued accountability to the shareholders, and the legitimacy of their decisions that bind the corporation's stockholders, be assured. The shareholder vote is critical to the theory that legitimizes the exercise of power by the directors or officers over properties that they do not own. ✓***Valle Verde Country Club, Inc. v. Africa*, 598 SCRA 202 (2009)**.

Corporations are required under Section 26 of the Corporation Code to submit to the SEC within thirty (30) days after the election the names, nationalities, and residences of the directors, trustees and officers of the Corporation. In order to keep stockholders and the public transacting business with domestic corporation properly informed of their organization operational status, the SEC has issued the rule requiring the filing of the General Information Sheet. *Monfort Hermanos Agricultural Dev. Corp. v. Monfort III*, 434 SCRA 27 (2004).

When the names of some of the directors who signed the board resolution does not appear in the General Information Sheet filed with the SEC, then there is doubt whether they were indeed duly elected members of the Board legally constituted to bring suit in behalf of the Corporation. *Monfort Hermanos Agricultural Dev. Corp. v. Monfort III*, 434 SCRA 27 (2004).

(b) CUMULATIVE VOTING (**Sec. 24**; ✓***Cumulative Voting in Corporate Elections: Introducing Strategy in the Equation,* 35 SOUTH CAROLINA L. REV. 295**)

(c) Trustee (**Secs. 92 and 138**)

6. Vacancy in Board (**Sec. 29**)

A by-law provision or company practice of giving a stockholder a permanent seat in the Board would be against the provision of Secs. 28 and 29 of Corporation Code which requires member of the board of corporations to be elected. *Grace Christian High School v. Court of Appeals,* 281 SCRA 133 (1997).

[45] *Also Detective & Protective Bureau, Inc. v. Cloribel*, 26 SCRA 255 (1969).

The theory of delegated power of the board of directors similarly explains why, under Section 29 of the Corporation Code, in cases where the vacancy in the corporation's board of directors is caused not only by the expiration of a member's term, the successor "so elected to fill in a vacancy shall be elected *only for the unexpired term* of his predecessors in office. The law has authorized the remaining members of the board to fill in a vacancy only in specified instances, so as not to retard or impair the corporation's operations; yet, in recognition of the stockholders' right to elect the members of the board, it limited the period during which the successor shall serve only to the "*unexpired term* of his predecessor in office." ✓***Valle Verde Country Club, Inc. v. Africa*, 598 SCRA 202 (2009).**

7. Term of Office, Hold-over Principle

Directors may lawfully fill vacancies occurring in the board, and such officials, as well as the original directors, hold-over until qualification of their successors. *Government v. El Hogar Filipino*, 50 Phil. 399 (1927).

The remedy is *quo warranto* to question the legality and proper qualification of persons elected to the board. *Ponce v. Encarnacion*, 94 Phil. 81 (1953).

The remaining members of a corporation's board of directors cannot elect another director to fill in a vacancy caused by the resignation of a hold-over director. The holdover period is not part of the term of office of a member of the board of directors. Consequently, when during the holdover period, a director resigns from the board, the vacancy can only be filled-up by the stockholders, since there is no term left to fill-up pursuant to the provisions of Section 29 of the Corporation which mandates that a vacancy occurring in the board of directors caused by the expiration of a member's term shall be filled by the corporation's stockholders. That a director continues to serve after one year from his election (i.e., on a holdover capacity), cannot be considered as extending his term. This holdover period, however, is not to be considered as part of his term, which, as declared, had already expired. ✓***Valle Verde Country Club, Inc. v. Africa*, 598 SCRA 202 (2009)**.

8. Removal of Directors or Trustees (**Sec. 28**)

A stockholders' meeting called for th removal of a director is valid only when called by at least two-thirds of the outstanding capital stock. *Roxas v. De la Rosa*, 49 Phil. 609 (1926).

Only stockholders or members have the power to remove the directors or trustees elected by them, as laid down in Sec. 28 of Corporation Code. *Raniel v. Jochico*, 517 SCRA 221, 230 (2007).

9. Directors' or Trustees' Meetings (**Secs. 49, 53, 54 and 92**)

(a) Quorum

For stock corporations, the "quorum" referred to in Section 52 of the Corporation Code is based on the number of *outstanding voting* stocks. For nonstok corporations, only those who are *actual, living* members with *voting rights* shall be counted in determining the existence of a quorum during members' meetings. Dead members shall not be counted. *Tan v. Sycip*, 499 SCRA 216 (2006).

In stock corporations, the presence of a quorum is ascertained and counted on the basis of the *outstanding capital stock*, as defined by Section 137 of the Corporation Code. *Tan v. Sycip*, 499 SCRA 216 (2006).

When the principle for determining quorum for stock corporations is applied by analogy to non-stock corporations, only those who are actual members with voting rights should be counted. *Tan v. Sycip*, 499 SCRA 216 (2006).

(b) Abstention: In a board meeting, an abstention is presumed to be counted as an affirmative vote *insofar as it may be construed as an acquiescence in the action of those who voted affirmatively;* but such presumption, being merely *prima facie* would not hold in the face of clear evidence to the contrary. *Lopez v. Ericta*, 45 SCRA 539 (1972).

(c) Minutes of Meetings

The signing of the minutes by all the members of the board is not required—there is no provision in the Corporation Code that requires that the minutes of the meeting should be signed by all the members of the board. The signature of the corporate secretary gives the minutes of the meting probative value and credibility. *People v. Dumlao*, 580 SCRA 409 (2009).

The entries contained in the minutes are *prima facie* evidence of what actually took place during the meeting, pursuant to Section 44, Rule 130 of the Revised Rule on Evidence. *People v. Dumlao*, 580 SCRA 409 (2009).

(i) *Resolution versus Minutes of Meetings:* A resolution is distinct and different from the minutes of the meeting—a board resolution is a formal action by a corporate board of directors or other corporate body authorizing a particular act, transaction, or appointment, while, on the other hand, minutes are a brief statement not only of what transpired at a meeting, usually of stockholders/members or directors/trustees, but also at a meeting of an executive committee. *People v. Dumlao*, 580 SCRA 409 (2009).

10. COMPENSATION OF DIRECTORS (**Sec. 30**)

Directors and trustees are not entitled to salary or other compensation when they perform nothing more than the usual and ordinary duties of their office, founded on the presumption that directors and trustees render service gratuitously, and that the return upon their shares adequately furnishes the

motives for service, without compensation. But they can receive remunerations for executive officer position. ***Western Institute of Technology, Inc. v. Salas,* 278 SCRA 216 (1997)**.[46]

11. FIDUCIARY DUTIES OF DIRECTORS AND OFFICERS

(a) Directors as Fiduciaries

- ***Pre-Corporation Code:* *Palting v. San Jose Petroleum, Inc.*, 18 SCRA 924.**
- ***Nature of Duties of Directors and Officers:* ✓*Prime White Cement Corp. v. IAC*, 220 SCRA 103 (1993)**.

In Philippine jurisdiction, the members of the Board of Directors have a three-fold duty: duty of obedience, duty of diligence, and the duty of loyalty. Accordingly, the members of the board of directors (1) shall direct the affairs of the corporation only in accordance with the purpose for which it was organized; (2) shall not willfully and knowingly vote for or assent to patently unlawful acts of the corporation or act in bad faith or with gross negligence in directing the affairs of the corporation; and (3) shall not acquire any personal or pecuniary interest in conflict with their duty as such directors or trustees. ✓***Strategic Alliance Dev. Corp. v. Radstock Securities Ltd.*, 607 SCRA 413 (2009),** *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW, 2001, p. 318.

(b) Duty of Obedience

A corporation, through its Board of Directors, should act in the manner and within the formalities, if any, prescribed by its charter or by the general law. *Lopez Realty, Inc. v. Fontecha*, 247 SCRA 183 (1995)

(c) Duty of Diligence (Sec. 31)

The directors of the corporation shall be personally liable to reimburse the corporation for the amounts of dividends wrongfully declared and paid to stockholders, when they failed to consider that therecoreded retained earnings in the books of the corporation was illusory considering the various accounts receivables that had to be written off as uncollectible. ✓***Steinberg v. Velasco*, 52 Phil. 953 (1929)**.

The President being closer to the operations of the bank on a day to day basis is more liable for breach of diligence when compared to directors who must act on the basis of reports and representations to them during board meetings. ✓***Bates v. Dresser*, 251 U.S. 524, 64 L. Ed. 388, 40 S. Ct. 247 [1919)**.

Although directors have the protection of the business judgment rule against personal liability for decisions that cause damage to the corporation, such protection is available only when they act or decide based on an ***informed judgment*** and not merely accept the representations and reports of the CEO. ✓***Smith v. Van Gorkam*, 488 A.2d 858, Supreme Court of Delaware, 1985**).

For wrongdoing to make a director personally liable for debts of the corporation, the wrongdoing approved or assented to by the director must be a **patently unlawful act**. Mere failure to comply with the notice requirement of labor laws on company closure or dismissal of employees does not amount to a patently unlawful act. Patently unlawful acts are those **declared unlawful by law** which imposes penalties for commission of such unlawful acts. There must be a law declaring the act unlawful and penalizing the act. *Carag v. NLRC*, 520 SCRA 28 (2007); *Dy-Dumalasa v. Fernandez*, 593 SCRA 656 (2009).

Holding a corporate officer personally liable for directing the corporate affairs with gross negligence or in bad faith does not amount to an application of the doctrine of piercing the veil of corporate fiction, for such personal liability is imposed directly under Section 31 to directors and officers of corporation who are guilty of violating their duty of diligence. *Sanchez v. Republic*, 603 SCRA 229 (2009).

(d) Duty of Loyalty (Secs. 31 to 34)

(i) *Doctrine of Corporate Opportunity*.

(ii) Using Inside Information

It is well established that corporate officers are not permitted to use their position of trust and confidence to further their private interests. The doctrine of “corporate opportunity” s precisely a recognition by the courts that the fiduciary standards could not be upheld where the fiduciary was acting for two entities with competiting interest. The doctrine rest fundamentally on the unfairness, in particular circumstances, of an officer or director taking advantage of an opportunity for his personal profi when the interest of the corporation justly calls for protection. ✓***Gokongwei v. SEC*, 89 SCRA 336 (1979)**.

When a director-majority stockholder, who is the administrator of corporate affairs directly negotiating the sale of corporate landholdings to the Government at great prices, purchases the stocks of a shareholder without informing the latter of the on-going negotiations, such director is deemed to have fraudulently acquired the shareholdings by way of deceit practiced by means of concealing his knowledge of important corporate affairs. *Strong v. Repide*, 41 Phil. 947 (1909).

Doctrine of corporate opportunity applies to confidential employees of the corporation. *cf. Sing Juco v. Llorente*, 43 Phil. 589 (1922).

[46] *Singson v. Commission on Audit*, 627 SCRA 36 (2010).

(e) Duty to Creditors and Outsiders

Under the trust fund doctrine, it would be a violation of the right of creditors to allow the retur to the stokholders of any portion of their capital or declare dividends outside of the unrestricted retained earnings. Also upon insolvency of the corporation, the Board of Directors are duty bound to hold th assets of the corporation primarily for the payment of the creditors. ✓***Mead v. McCullough*, 21 Phil. 95 (1911).**

(f) Corporate Dealings with Directors and Officers (**Sec. 32**)

The provisions of Section 32 of the Corporation Code on self-dealings by directors/trustees and officers merely incorporate well-established principles in Corporate Law. A director who enters into a distributorship agreement with the corporation would make the contract voidable at the option of the corporation especially when the terms are disadvantageous to the corporation. The director cannot claim the same doctrine as an outsider dealing in good faith with the corporation. *Prime White Cement Corp. v. IAC*, 220 SCRA 103 (1993).

(g) Contracts Between Corporations with Interlocking Directors (**Sec. 33**)

The rule under Sec. 33 of Corporation Code allowing annulment of contracts between corporations with interlocking directors resulting in the prejudice to one of the corporation, has no application to cases where fraud is alleged to have been committed to third parties. *DBP v. Court of Appeals,* 363 SCRA 307 (2001).

(h) SEC Revised Code of Corporate Governance (**SEC Memorandum. Circular No. 6, s. 2009**)

12. CORPORATE OFFICERS

The general principles of agency govern the relation between the corporation and its officers or agents, subject to the articles of incorporation, by-laws, or relevant provisions of law—when authorized, their acts bind the corporation, otherwise, their acts cannot bind it. *Yasuma v. Heirs of Cecilio S. De Villa*, 499 SCRA 466 (2006); *Litonjua v. Eternit Corp.*, 490 SCRA 204 (2006).

(a) Powers of Corporate Officers:

Just as a natural person may authorize another to do certain acts for and on his behalf, the Board of Directors may validly delegate some of its functions and powers to officers, committees or agents—the authority of such individuals to bind the corporation is generally derived from law, corporate by-laws or authorization from the board, either expressly or impliedly by habit, custom or acquiescence in the general course of business. *Cebu Mactan Members Center Inc. v. Tsukahara*, 593 SCRA 172 (2009).While it is a general rule that, in the absence of authority from the board of directors, no person, not even its officers, can validly bind a corporation, the Board may validly delegate some of its functions and powers to its officers, committee and agents. ✓***Associated Bank v. Pronstroller*, 558 SCRA 113 (2008)**.[47]

While the Court agrees that those who belong to the upper corporate echelons would have more privileges, it cannot be presume the existence of such privileges or benefits—he who claims the same is burdened to prove not only the existence of such benefits but also that he is entitled to the same. *Kwok v. Philippine Carpet Manufacturing Corp.*, 457 SCRA 465 (2005).

Even though a judgment, decree or order is addressed to the corporation only, the officers as well as the corporation itself, may be punished for contempt for disobedience to its terms, at least if they knowingly disobey the court's mandate, since a lawful judicial command to a corporation is in effect a command to the officers. *Heirs of Trinidad de Leon Vda. De Roxas v. Court of Appeals*, 422 SCRA 101 (2004).

(i) *Rule on Corporate Officer's Power to Bind Corporation*

An officer's power as an agent of the corporation must be sought from the statute, charter, the by-laws or in a delegation of authority to such officer, from the acts of the board of directors formally expressed or implied from a habit or custom of doing business. *Vicente v. Geraldez*, 52 SCRA 210 (1973); *Boyer-Roxas v. Court of Appeals*, 211 SCRA 470 (1992).

As a general rule, the acts of corporate officers within the scope of their authority are binding on the corporation, but when these officers exceeded their authority, their actions cannot bind the corporation, unless it has ratified such acts or is estopped from disclaiming them. *Reyes v. RCPI Employees Credit Union, Inc.*, 499 SCRA 319 (2006).

Doctrine of Apparent Authority: Corporate policies need not be in writing. Contracts entered into by a corporate officer or obligations or prestations assumed by such officer for and in behalf of such corporation are binding on the said corporation only if such officer acted within the scope of his authority or if such officer exceeded the limits of his authority, the corporation has ratified such contracts or obligations. *Kwok v. Philippine Carpet Manufacturing Corp.*, 457 SCRA 465 (2005).

(ii) *President.* ✓*People's Aircargo v. Court of Appeals*, 297 SCRA 170 (1998).

It is the Board of Directors, not the President, that exercises corporate powers. It must be emphasized that the basis for agency is representation and a person dealing with an agent is put upon inquiry and must discover upon his peril the authority of the agent. *Safic Alcan & Cie v. Imperial Vegetable Oil Co., Inc.,* 355 SCRA 559 (2001).

[47] *Yu Chuck v. "Kong Li Po*," 46 Phil. 608, 614 (1924); *Cebu Mactan Members Center Inc. v. Tsukahara*, 593 SCRA 172 (2009).

A corporation may not distance itself from the acts of a senior officer: "the dual roles of Romulo F. Sugay should not be allowed to confuse the facts." *R.F. Sugay v. Reyes*, 12 SCRA 700 (1961).

The President is considered as the corporation's agent, and as such, his knowledge of the repeal of a resolution in another juridical person in which his corporation has an interest, is ascribed to his principal under the theory of imputed knowledge. *Rovels Enterprises, Inc. v. Ocampo*, 392 SCRA 176 (2002).

The President of the corporation which becomes liable for the accident caused by its truck driver cannot be held solidarily liable for the judgment obligation arising from quasi-delict, since the fact alone of being President is not sufficient to hold him solidarily liable for the liabilities adjudged against the corporation and its employee. *Secosa v. Heirs of Erwin Suarez Fancisco*, 433 SCRA 273 (2004).

(iii) *Corporate Secretary*

In the absence of provisions to the contrary, the corporate secretary is the custodian of corporate records—he keeps the stock and transfer book and makes proper and necessary entries therein. It is his duty and obligation to register valid transfers of stock in the books of the corporation; and in the event he refuses to comply with such duty, the transferor-stockholder may rightfully bring suit to compel performance. *Torres, Jr. v. Court of Appeals,* 278 SCRA 793 (1997).

Although the corporate secretary's duty to record transfers of stock is ministerial, he cannot be compelled to do so when the transferee's title to said shares has no *prima facie* validity or is uncertain. More specifically, a pledgor, prior to foreclosure and sale, does not acquire ownership rights over the pledged shares and thus cannot compel the corporate secretary to record his alleged ownership of such shares on the basis merely of the contract of pledge. Mandamus will not issue to establish a right, but only to enforce one that is already established. *Lim Tay v. Court of Appeals,* 293 SCRA 634 (1998); *TCL Sales Corp. v. Court of Appeals,* 349 SCRA 35 (2001).

A sale that fails to comply with Sec. 40 of Corporation Code, cannot be invalidated when the buyer relies upon a Secretary's Certificate confirming authority. A secretary's certificate which is regular on its face can be relied upon by a third party who does not have to investigate the truths of the facts contained in such certification; otherwise business transactions of corporations would become tortuously slow and unnecessarily hampered. *Esguerra v. Court of Appeals,* 267 SCRA 380 (1997).

(iv) *Corporate Treasurer*

A corporate treasurer's function have generally been described as "to receive and keeps funds of the corporation, and to disburse them in accordance with the authority given him by the board or the properly authorized officers." Unless duly authorized, a treasurer, whose power are limited, cannot bind the corporation in a sale of its assets, which obviously is foreign to a corporate treasurer's function. *San Juan Structural v. Court of Appeals*, 296 SCRA 631, 645 (1998).

A corporate treasurer whose negligence in signing a confirmation letter for rediscounting of crossed checks, knowing fully well that the checks were strictly endorsed for deposit only to the payee's account and not to be further negotiated, may be personally liable for the damaged caused the corporation. *Atrium Management Corp. v. Court of Appeals*, 353 SCRA 23 (2001).

(v) *Manager*

Although a branch manager of a bank, within his field and as to third persons, is the general agent and is in general charge of the corporation, with apparent authority commensurate with the ordinary business entrusted him and the usual course and conduct thereof, yet the power to modify contracts of the bank remains generally with the board of directors. Being a branch manager *alone* is insufficient to support the conclusion that he has been clothed with "apparent authority" to verbally alter terms of the bank's written contract, such a the mortgage contract. *Banate v. Philippine Countryside Rural Bank (Liloan, Cebu), Inc.*, 625 SCRA 21 (2010).

(b) POWER OF THE BOARD TO APPOINT AND TERMINATE CORPORATE OFFICERS

(i) *Who Is a "Corporate Officer"?* (Sec. 25)

"*Corporate officers*" in the context of P.D. No. 902-A are those officers of the corporation who are given that character by the Corporation Code or by the corporation's by-laws. ✓***Gurrea v. Lezama*, 103 Phil. 553 (1958)**.[1]

The position of Executive Secretary, which is provided for in the Society's by-laws, is an "officer" position. Since the appointment of the incumbent did not contain a fixed term, the implication was that the appointee held the appointent at the pleasure of the Board of Directors, such that when the Board opted to replace the incumbent, technically there was no removal but only an expiration of the term and there was no need of prior notice, due hearing or sufficient grounds before the incumbent could be separated from office. ✓***Mita Pardo de Tavera v. Tuberculosis Society*, 112 SCRA 243 (1982)**.[2]

Ordinary company employees are generally employed not by action of the directors and stockholders but by that of the Management of the corporation who also determines the compensation to be paid such employees. Corporate officers, on the other hand, are elected or appointed by the directors or stockholders, and are those who are given that character either by the Corporation Code

[1] *Garcia v. Eastern Telecommunications Philippines,* 585 SCRA 450 (2009); *WQPP Marketing Communications, Inc. v. Galera*, 616 SCRA 422 (2010).

[2] *PSBA v. Leaño*, 127 SCRA 778 (1984); *Dy v. NLRC*, 145 SCRA 211 (1986); *Visayan v. NLRC*, 196 SCRA 410 (1991); *Easycall Communications Phils., Inc. v. King*, 478 SCRA 102 (2005); *Marc II Marketing, Inc. v. Joson*, 662 SCRA 35 (2011); *Barba v. Liceo de Cagayan University,* 686 SCRA 648 (2012).

or by the corporation's by-laws. *Gomez v. PNOC Dev. and Management Corp.*, 606 SCRA 187 (2009).[3]

A mere manager not so named in the by-laws does is not an officer of the corporation. *Pamplona Plantation Company v. Acosta*, 510 SCRA 249 (2006).

When the by-laws provide for the position of "Superintendent/ Administrator," it is clearly a corporate officer position and issues of reinstatement would be within the jurisdiction of the SEC and not the NLRC. *Ongkingco v. NLRC*, 270 SCRA 613 (1997).

Although the by-laws provide expressly that the Board of Directors "shall have full power to create new offices and to appoint the officers thereto," any office created, and any officer appointed pursuant to such clause does not become a "corporate officer", but is an employee and the determination of the rights and liabilities relating to his removal are within the jurisdiction of the NLRC; they do not constitute intra-corporate controversies. "A different interpretation can easily leave the way open for the Board of Directors to circumvent the constitutionally guaranteed security of tenure of the employee by the expedient inclusion in the By-Laws of an enabling clause on the creation of just any corporate officer position." (at p. 27). The rulings in *Tabang v. NLRC,* 266 SCRA 462 (1997), and *Nacpil v. International Broadcasting Corp.*, 379 SCRA 653 (2002), "should no longer be controlling." ✓***Matling Industrial and Commercial Corp. v. Coros*, 633 SCRA 12 (2010)**.[4]

(ii) *Nature of Exercise of Power to Terminate Officers*

An officer's removal is a corporate act, and if such removal occasions an intra-corporate controversy, its nature is not altered by the reason or wisdom, or lack thereof, with which the Board of Directors might have in taking such action. Perforce, the matter would come within the area of corporate affairs and management, and such a corporate controversy would call for SEC adjudicative expertise [now RTC Special Commercial Courts], not that of NLRC. ✓***De Rossi v. NLRC*, 314 SCRA 245 (1999)**; *Okol v. Slimmers World International*, 608 SCRA 97 (2009).

One who is included in the by-laws of a corporation in its roster of corporate officers is an officer of said corporation and not a mere employee—being a corporate officer, his removal is deemed to be an intra-corporate dispute cognizable by the SEC and not by the Labor Arbiter. *Garcia v. Eastern Telecommunications Philippines,* 585 SCRA 450 (2009).

13. LIABILITIES OF CORPORATE OFFICERS (Sec. 31)

Mere ownership by an officer (President) of majority of the equity of the corporation do not warrant a piercing of the veil of corporate fiction to make such officer personally liable for the debts of the corporation. ✓***Palay, Inc. v. Clave*, 124 SCRA 638 (1093)**.[5]

(a) GENERAL RULE: Corporate Officers Not Liable for Corporate Debts

Unless they have exceeded their authority, corporate officers are, as a general rule, not personally liable for their official acts, because a corporation, by legal fiction, has a personality separate and distinct from its officers, stockholders and members. *Price v. Innodata Phils., Inc.*, 567 SCRA 269 (2008).[6]

Corporate officers who entered into and signed contracts on behalf of the corporation in their official capacities cannot be made personally liable thereunder in the absence of stipulation to that effect, due to the personality of the corporation being separate and distinct from the persons composing it. *Western Agro Industrial Corp. v. Court of Appeals*, 188 SCRA 709 (1990).[7]

Officers of a corporation may become liable for its loans when they have breached their duty of diligence under Section 31 of the Corporation Code. *Aratea v. Suico*, 518 SCRA 501 (2007);[8] or when they have contractually made themselves personally liable for a corporate loan. *Prisma Construction & Dev. Corp. v. Menchavez*, 614 SCRA 590 (2010).

A corporation has a personality separate and distinct from the persons composing or representing it; hence, personal liability attaches only in exceptional cases, such as when the director, trustee, or officer is guilty of bad faith or gross negligence in directing the affairs of the corporation. *Continental Cement Corp. v. Asea Brown Boveri, Inc.*, 659 SCRA 137 (2011).[9]

Where the Chairman & President has made himself accountable in the promissory note "*in his personal capacity and as authorized by the Board* Resolution," and in the absence of any representation on the part of corporation that the obligation is all its own because of its separate corporate identity, we see no occasion to consider piercing the corporate veil as material to the case." *Prisma Construction & Dev. Corp. v. Menchavez*, 614 SCRA 590 (2010).

To hold a director personally liable for debts of the corporation, and thus pierce the veil of corporate fiction, the bad faith or wrongdoing of the director must be established clearly and convincingly. Bad

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[3] *Okol v. Slimmers World Int'l*, 608 SCRA 97 (2009).

[4] *Reiterated in Marc II Marketing, Inc. v. Joson*, 662 SCRA 35 (2011); *Barba v. Liceo de Cagayan University,* 686 SCRA 648 (2012).

[5] *Pabalan v. NLRC,* 184 SCRA 495 (1990); *Sulo ng Bayan, Inc. v. Araneta, Inc. Inc.*, 72 SCRA 347 (1976); *Mindanao Motors Lines, Inc. v. CIR*, 6 SCRA 710 (1962).

[6] *Republic Planters Bank v. Court of Appeals*, 216 SCRA 738 (1992); *Lowe, Inc. v. Court of Appeals*, 596 SCRA 140 (2009); *Marc II Marketing, Inc. v. Joson*, 662 SCRA 35 (2011); *St. Tomas v. Salac*, 685 SCRA 245 (2012).

[7] *Rustan Pulp & Paper Mills, Inc. v. IAC*, 214 SCRA 665 (1992); *Banque Generale Belge v. Walter Bull and Co.*, 84 Phil. 164 (1949).

[8] *Singian, Jr. v. Sandiganbayan*, 478 SCRA 348 (2005)

[9] *Prisma Construction & Dev. Corp. v. Menchavez*, 614 SCRA 590 (2010); *Urban Ban, Inc. v. Pena*, 659 SCRA 418 (2011).

faith is never presumed. Bad faith does not connote bad judgment or negligence. Bad faith imports a dishonest purpose. Bad faith means [a] breach of a known duty through some ill motive or interest. Bad faith partakes of the nature of fraud. *Carag v. NLRC*, 520 SCRA 28 (2007).[10]

The finding of solidary liability among the corporation, its officers and directors would patently be baseless when the decision contains no allegation, finding or conclusion regarding particular acts committed by said officers and director that show them to have been individually guilty of unmistakable malice, bad faith, or ill-motive in their personal dealings with third parties. When corporate officers and directors are sued merely as nominal parties in their official capacities as such, they cannot be held liable personal for the judgment rendered against the corporation. *NPC. v. Court of Appeals*, 273 SCRA 419 (1997).[11]

An officer-stockholder who signs in behalf of the corporation to a fraudulent contract cannot claim the benefit of separate juridical entity: "Thus, being a party to a simulated contract of management, petitioner Uy cannot be permitted to escape liability under the said contract by using the corporate entity theory. This is one instance when the veil of corporate entity has to be pierced to avoid injustice and inequity." *Paradise Sauna Massage Corporation v. Ng*, 181 SCRA 719 (1990).

(b) *Rundown on Officer's Liabilities: ✓Tramat Mercantile, Inc. v. Court of Appeals*, 238 SCRA 14 (1994).[12]

While the limited liability doctrine is intended to protect the stockholder by immunizing him from personal liability for the corporate debts, a corporate officer may nevertheless divest himself of this protection by voluntarily binding himself to the payment of the corporate debts. *Toh v. Solid Bank Corp.*, 408 SCRA 544 (2003).

The corporate representatives signing as a solidary guarantee as corporate representative did not undertake to guarantee personally the payment of the corporation's debt embodied in the trust receipts. Debts incurred by directors, officers and employees acting as such corporate agents are not theirs but the direct liability of the corporation they represent. As an exception, directors or officers are personally liable for the corporation's debt if they so contractually agree or stipulate. *Tupaz IV v. Court of Appeals*, 476 SCRA 398 (2005).

"*Bad faith*" does not arise just because a corporation fails to pay its obligation, because the inability to pay one's obligation is not synonymous with fraudulent intent not to honor the obligations. In order to piece the veil of corporate fiction, for reasons of negligence by the director, trustee or officer in the conduct of the transactions of the corporation, such negligence must be "gross". *Magaling v. Ong*, 562 SCRA 152 (2008).

Directors or trustees who willfully or knowingly vote for or assent to patently unlawful acts of the corporation or acquire any 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. *EDSA Shangri-La Hotel and Resorts, Inc. v. BF Corp.*, 556 SCRA 25 (2008).

***x*(c) <u>SPECIAL PROVISIONS IN LABOR LAWS</u>:**

Since a corporate employer is an artificial person, it must have an *officer* who can be presumed to be the *employer*, being the "person acting in the interest of (the) employer" as defined in Art. 283 of the Labor Code. **✓*A.C. Ransom Labor Union-CCLU v. NLRC*, 142 SCRA 269 (1986).**

(i) *Overturning the A.C. Ransom Ruling:*

Article 212(e) of the Labor Code, by itself, does not make a corporate officer personally liable for the debts of the corporation because Section 31 of the Corporation Code is still the governing law on personal liability of officers for the debts of the corporation. *David v. National Federation of Labor Unions,* 586 SCRA 100 (2009).

Corporate officers cannot be held personally liable for damages on account of the employees dismissal because the employer corporation has a personality separate and distinct from its officers who merely acted as its agents. *Malayang Samahan ng mga Mangagagawa sa M. Greenfields v. Ramos,* 357 SCRA 77 (2001).[13]

Corporate officers are not personally liable for money claims of discharged employees unless they acted with evident malice and bad faith in terminating their employment. *AHS/Philippines v. Court of Appeals,* 257 SCRA 319 (1996).[14]

Only the responsible officer of a corporation who had a hand in illegally dismissing an employee should be held personally liable for the corporate obligations arising from such act. *Maglutac v. NLRC*,

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[10] *EPG Constructions Co. v. CA*, 210 SCRA 230 (1992).

[11] *Emilio Cano Enterprises, Inc. v. CIR*, 13 SCRA 291 (1965); *Arcilla v. Court of Appeals*, 215 SCRA 120 (1992).

[12] *MAM Realty v. NLRC,* 244 SCRA 797 (1995); *NFA v. Court of Appeals,* 311 SCRA 700 (1999); *Atrium Management Corp. v. Court of Appeals,* 353 SCRA 23 (2001); *Malayang Samahan ng mga Manggawgawa sa M. Greenfield v. Ramos*, 357 SCRA 77 (2001); *Powton Conglomerate, Inc. v. Agcolicol*, 400 SCRA 523 (2003); *H.L. Carlos Construction, Inc. v. Marina Properties Corp.*, 421 SCRA 428 (2004); *McLeod v. NLRC*, 512 SCRA 222 (2007).

[13] *AMA Computer College-East Rizal v. Ignacio*, 590 SCRA 633, 659-660 (2009).

[14] *Reiterated in Nicario v. NLRC,* 295 SCRA 619 (1998); *Flight Attendants and Stewards Association of the Philippines v. Philippine Airlines,* 559 SCRA 252 (2008); *M+W Zander Philippines, Inc. v. Enriquez*, 588 SCRA 590 (2009); *AMA Computer College-East Rizal v. Ignacio*, 590 SCRA 633, 659-660 (2009); *Lowe, Inc. v. Court of Appeals*, 596 SCRA 140, 155 (2009); *Peñaflor v. Outdoor Clothing Manufacturing Corp.*, 618 SCRA 208 (2010).

189 SCRA 767 (1990);[15] and for the separate juridical personality of a corporation to be disregarded as to make the highest corporate officer personally liable on labor claims, the wrongdoing must be clearly and convincingly established. *Del Rosario v. NLRC*, 187 SCRA 777 (1990).

A corporation, being a juridical entity, may act only through its directors, officers and employees and obligations incurred by them, acting as corporate agents, are not theirs but the direct accountabilities of the corporation they represent. In labor cases, corporate directors and officers are solidarily liable with the corporation for the termination of employment of employees done with malice or bad faith. *Brent Hospital, Inc. v. NLRC,* 292 SCRA 304 (1998).[16]

In labor cases, corporate directors and officers are solidarily liable with the corporation for the termination of employment of corporate employees done with malice or in bad faith. In this case, it is undisputed that the corporate officers have a direct hand in the illegal dismissal of the employees. They were the one, who as high-ranking officers and directors of the corporation, signed the Board Resolution retrenching the employees on the feigned ground of serious business losses that had no basis apart from an unsigned and unaudited Profit and Loss Statement which, to repeat, had no evidentiary value whatsoever. *Uichico v. NLRC*, 273 SCRA 35 (1997).

(ii) *Limiting the A.C. Ransom Ruling to Insolvent Corporation*

A.C. Ransom is not in point because there the corporation actually ceased operations after the decision of the Court was promulgated against it, making it necessary to enforce it against its former president. When the corporation is still existing and able to satisfy the judgment in favor of the private respondent, the corporate officers cannot be held personally liable. *Lim v. NLRC*, 171 SCRA 328 (1989).

A.C. Ransom will apply only where the persons who are made personally liable for the employees' claims are stockholders-officers of employer-corporation. In the case at bar, a mere general manager while admittedly the highest ranking local representative of the corporation, is nevertheless not a stockholder and much less a member of the Board of Directors nor an officer thereof. *De Guzman v. NLRC*, 211 SCRA 723 (1992).

(iii) *Upholding the A.C. Ransom Ruling:*

Under the Labor Code, in the case of corporations, it is the president who responds personally for violation of the labor pay laws. *Villanueva v. Adre*, 172 SCRA 876 (1989).

A.C. Ransom doctrine has been reiterated subsequently in *Restuarante Las Conchas v. Llego*, 314 SCRA 24 (1999).[17]

Since a corporation is an artificial person, it must have an officer who can be presumed to be the employer, being the "person acting in the interest of the employer"—the corporation, in the technical sense only, is the employer. The manager of the corporation falls within the meaning of an "employer" as contemplated by the Labor code, who may be held jointly and severally liable for the obligation of the corporation to its dismissed employees. *NYK International Knitwear Corp. Phil. v. NLRC*, 397 SCRA 607 (2003).

(iv) *Definitive Overturning of A.C. Ransom Ruling:*

It is settled that in the absence of malice, bad faith, or specific provisions of law, a stockholder or an officer of a corporation cannot be made personally liable for corporate liabilities. *McLeod v. NLRC*, 512 SCRA 222 (2007).[18]

Clearly, in *A.C. Ransom,* RANSOM, through its President, organized ROSARIO to evade payment of backwages to the 22 strikers. This situation, or anything similar showing malice or bad faith on the part of Patricio, does not obtain in the present case. [What applies therefore is the ruling [i]n *Santos v. NLRC*, [254 SCRA 673 (1996)]. *McLeod v. NLRC*, 512 SCRA 222 (2007).[19]

It was clarified in *Carag v. NLRC*, 520 SCRA 28 (2007), and *McLeod v. NLRC*, 512 SCRA 22 (2007), that Article 212(e) of the Labor Code, by itself, does not make a corporate officer personally liable for the debts of the corporation—the governing law on personal liability of directors or officers for debts of the corporation is still Section 31 of the Corporation Code. *Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009).[20]

(c) Personal Liability of Trustees and Officers of Non-Stock Corporation

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[15] *Reiterated in Gudez v. NLRC*, 183 SCRA 644 (1990); *Chua v. NLRC*, 182 SCRA 353 (1990); *Reahs Corp. v. NLRC,* 271 SCRA 247 (1997)

[16] *Culili v. Eastern Telecommunications Philippines, Inc.*, 642 SCRA 338 (2011); *Grandteq Industrial Steel Products, Inc. v. Estrella*, 646 SCRA 391 (2011); *Alert Security and Investigation Agency, Inc. v. Pasawilan*, 657 SCRA 655 (2011); *Lynvil Fishing Enterprises, Inc. v. Ariola*, 664 SCRA 679 (2012); *Blue Sky Trading Co., Inc. v. Blas*, 667 SCRA 727 (2012).

[17] *Reiterated in Carmelcraft Corp. v. NLRC,* 186 SCRA 393 (1990); *Valderrama v. NLRC*, 256 SCRA 466 (1996).

[18] *Citing Land Bank of the Philippines v. Court of Appeals*, 364 SCRA 375 (2001); *Bogo-Medellin Sugarcane Planters Asso., Inc. v. NLRC*, 296 SCRA 108 (1998); *Complex Electronics Employees Assn. v. NLRC*, 310 SCRA 403 (1999); *Acesite Corp. v. NLRC*, 449 SCRA 360 (2005); *Coca-Cola Bottlers Phils., Inc. v. Daniel*, 460 SCRA 494 (2005); *Suldao v. Cimech System Construction, Inc.*, 506 SCRA 256 (2006); *Supreme Steel Pipe Corp. v. Bardaje*, 522 SCRA 155 (2007); *Culili v. Eastern Telecommunications Philippines, Inc.*, 642 SCRA 338 (2011). *Grandteq Industrial Steel Products, Inc. v. Estrella*, 646 SCRA 391 (2011).

[19] *Reiterated in H.R. Carlos Construction, Inc. v. Marina Properties Corp.*, 421 SCRA 428 (2004); *Pamplona Plantation Company v. Acosta*, 510 SCRA 249 (2006); *Elcee Farms, Inc. v. NLRC*, 512 SCRA 602 (2007); *Uy v. Villanueva*, 526 SCRA 73 (2007).

[20] *Reiterated in David v. National Federation of Labor Unions,* 586 SCRA 100 (2009).

The non-stock corporation acted in clear bad faith when it sent the final notice to a member under the pretense they believed him to be still alive, when in fact it had very well known that he had already died. *Valley Golf and Country Club, Inc. v. Vda. De Caram,* 585 SCRA 218 (2009).

Non-stock corporations and their officers are not exempt from the obligation imposed by Articles 19, 20 and 21 under the Chapter on Human Relations of the Civil Code, which provisions enunciate a general obligation under law for every person to act fairly and in good faith towards one another. *Valley Golf and Country Club, Inc. v. Vda. De Caram,* 585 SCRA 218 (2009).

XI. RIGHT OF STOCKHOLDERS AND MEMBERS

1. What Does "Share" Represent?

While shares of stock constitute personal property, they do not represent property of the corporation [*i.e.,* they are properties of the stockholders who own them]. A share of stock only typifies an aliquot part of the corporation's property, or the right to share in its proceeds to that extent *when distributed according to law and equity,* but the holder is not the owner of any part of the capital [properties] of the corporation, nor is he entitled to the possession of any definite portion of its assets. The stockholder is not a co-owner of corporate property. *Stockholders of F. Guanson and Sons, Inc. v. Register of Deeds of Manila*, 6 SCRA 373 (1962).

The registration of shares in a stockholder's name, the issuance of stock certificates, and the right to receive dividends which pertain to the shares are all rights that flow from ownership. *Lim Tay v. Court of Appeals,* 293 SCRA 634 (1998); *TCL Sales Corp. v. Court of Appeals*, 349 SCRA 35 (2001).

"As early as the case of *Fisher v. Trinidad*, the Court already declared that "[t]he distinction between the title of a corporation, and the interest of its members or stockholders in the property of the corporation, is familiar and well-settled. The ownership of that property is in the corporation, and not in the holders of shares of its stock. The interest of each stockholder consists in the right to a proportionate part of the profits whenever dividends are declared by the corporation, during its existence, under its charter, and to a like proportion of the property remaining, upon the termination or dissolution of the corporation, after payment of its debts." *Mobilia Products, Inc. v. Umezawa*, 452 SCRA 736 (2005).

2. Preemptive Rights (Sec. 39)

Pre-emptive right under Section 39 of the Corporation Code refers to the right of a stockholder of a stock corporation to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings. Although it can validly be withdrawn, it cannot be done in breach of fiduciary duties such as to perpetuate control over the corporation. ✓***Majority Stockholders of Ruby Industrial Corp. v. Lim*, 650 SCRA 461 (2011)**.

The early pronouncement in *Datu Tagoranao Benito v. SEC*, 123 SCRA 722 (1983) that pre-emptive right only covers increases in authorized capital stock, the new wordings under Section 39 as to cover all issuances of shares has been corrected in *Dee v. SEC*, 199 SCRA 238 (1991).

3. Right to Transfer or Dispose of Shareholdings (Sec. 63)

Shares of stock of a corporation are not owned or are the assets of the corporation—they are owned by the stockholders of record. The corporation whose shares of stock are the subject of transfer transaction (through sale, assignment, donation, or any other mode of conveyance) need not be a part to transaction to be valid; however, to bind the corporation as well as third parties, it is necessary that the transfer is recorded in the books of the corporation. *Forest Hills Golf & Country Club v. Vertex Sales and Trading, Inc.*, 692 SCRA 706 (2013).

(a) Restriction on Transfers:

A contractual undertaking on restriction of transfer of shares that has a reasonable business purpose and limited in coverage is valid and binding. ✓***Lambert v. Fox*, 26 Phil. 588 (1914).**

(i) *RIGHT OF REFUSAL*:

The indication on th face of the stock certificate that it is "Nontranferable" alone odes no compel the corporation to buy back the shares from the stockholder, and held that "in the absence of a similar contractual obligation and of a legal provision applicable thereto, it is logical to conclude that it would be unjust and unreasonable to compel the corporation to comply with a non-exisent or imarignary obligation." ✓***Padgett v. Babcock & Templeton, Inc.*, 59 Phil. 232 (1933)**.

Section 63 contemplates no restriction as to whom the stocks may be transferred. It does not suggest that any discrimination may be created by the corporation in favor of, or against a certain purchaser. The owner of shares, as owner of personal property, is at liberty, under said section to dispose them in favor of whomever he pleases, without limitation in this respect, than the general provisions of law. ✓***Fleishcher v. Botica Nolasco*, 47 Phil. 583 (1925)**.

The only limitation imposed by Sec. 63 is when the corporation holds any unpaid claim against the shares intended to be transferred. A corporation, either by its board, its by-laws, or the act of its officers, cannot create restrictions in stock transfers, because "Restrictions in the traffic of stock must have their source in legislative enactment, as the corporation itself cannot create such impediment. By-laws are intended merely for the protection of the corporation, and prescribe relation, not

restriction; they are always subject to the charter of the corporation." *Rural Bank of Salinas v. CA*, 210 SCRA 510 (1992).

The "right of first refusal" is primarily an attribute of ownership. Conversely, a waiver thereof is an act of ownership. To allow the PCGG to vote the sequestered shares for this purpose would be sanctioning its exercise of an act of strict ownership. *PCGG v. SEC*, G.R. No. 82188, 30 June 1988 (unrep.)

The agreement of co-shareholders to mutually grant the right of first refusal to each other, by itself, does not constitute a violation of the provisions of the Constitution limiting land ownership to Filipinos and Filipino corporations; if the foreign shareholdings of a landholding corporation exceed 40%, it is not the foreign stockholders' ownership of the shares which is adversely affected by the capacity of the corporation to own land—that is, the corporation becomes disqualified to own land. This finds support under the basic corporate law principle that the corporation and its stockholders are separate juridical entities. In this vein, the right of first refusal over shares pertains to the shareholders whereas the capacity to own land pertains to the corporation. *J.G. Summit Holdings, Inc. v. Court of Appeals*, 450 SCRA 169 (2005).

In a landholding corporation which by constitutional mandate is limited to 40% foreign equity, and where there exists a right of first refusal agreement between the co-shareholders, the fact that the corporations owns land cannot deprive stockholders of their right of first refusal. No law disqualifies a person from purchasing shares in a landholding corporation even if the latter will exceed the allowed foreign equity, what the law disqualifies is the corporation from owning land. *J.G. Summit Holdings, Inc. v. Court of Appeals*, 450 SCRA 169 (2005).

(ii) ***Restraint of Trade:*** An agreement by which a person obliges himself not to engage in competitive trade for five years is valid and reasonable and not an undue or unreasonable restraint of trade and is obligatory on the parties who voluntarily enter into such agreement. x *Ollendorf v. Abrahamson,* 38 Phil. 585 (1918).

(b) Remedy If Registration Refused:

Mandamus will not lie to compel the corporate secretary to register the transfer of shares in the corporate books when the petitioner is not the registered stockholder nor does he hold a power of attorney from the latter. This is under the general rule that as between the corporation one the one hand and its shareholders on other, the corporation looks only to its books for the purpose of determining who its shareholders are, so that a mere indorsee of a certificate of stock, claiming to be the owner, will not necessarily be recognized as such by the corporation and its officers, in absence of express instructions of the registered owner to make such transfer to the indorsee, or a power of attorney authorizing such transfer. ✓***Hager v. Bryan*, 19 Phil. 138 (1911)**.[21]

Period to Enforce. – Considering that the law does not prescribe a period within which the registration of purchase of shares should be effected, the action to enforce the right does not accrue until there has been a demand and a refusal concerning the transfer." *Ponce v. Alsons Cement Corp.*, 393 SCRA 602 (2002).

A stipulation on the stock certificate that any assignment would not be binding on the corporation unless registered in the corporate books as required under the by-laws and without providing when registration should be made, would mean that the cause of action and the determination of prescription period would begin only when demand for registration is made and not at the time of the assignment of the certificate. *Won v. Wack Wack Golf & Country Club*, 104 Phil. 466 (1958).

The claim for damages of what the shares could have sold had the demand for their registration in the name of the buyer been complied with is deemed to be speculative damage and non-recoverable *Batong Buhay Gold Mines v. CA*, 147 SCRA 4 (1987).

4. Rights to Dividends (**Sec. 43**)

The term "dividend" in its technical sense and ordinary acceptation is that part of portion of the profits of the enterprise which the corporation, by its governing agents, sets apart for ratable division among the holders of it capital stock—it is a payment, and the right thereto is an incident of ownership of stock. *Cojuangco v. Sandiganbayn*, 586 SCRA 790 (2009).

Although stock certificates grant the stockholder the right to receive quarterly dividends of 1%, cumulative and participating, the stockholders do not become entitled to the payment thereof as a matter of right without necessity of a prior declaration of dividends. Sec. 43 of Corporation Code prohibits the issuance of any stock dividend without the approval of stockholders, representing not less than two-thirds (2/3) of the outstanding capital stock, which underscores the fact that payment of dividends to a stockholder is not a matter of right but a matter of consensus. Furthermore, "interest bearing stocks", on which the corporation agrees absolutely to pay interest before dividends are paid to the common stockholders, is legal only when construed as requiring payment of interest as dividends from net earnings or surplus only. *Republic Planters Bank v. Agana*, 269 SCRA 1 (1997).

When the Court directed that a total of 111,415 shares of PLDT be reconveyed to the Republic by way of declaring the Republic to be the rightful owner of said shares, that necessarily included the

[21] *Rivera v. Florendo,* 144 SCRA 643 (1986); *Ponce v. Alsons Cement Corp.*, 393 SCRA 602 (2002).

reconveyance to the Republic of the dividends and interest accruing thereto. *Cojuangco v. Sandiganbayn*, 586 SCRA 790 (2009).

5. Right to Vote and to Attend Meetings (**Secs. 6 and 89**)

The right to vote is inherent in and incidental to the ownership of corporate stocks. It is settled that unissued stocks may not be voted or considered in determining whether a quorum is present in a stockholders' meeting, or whether a requisite proportion of the stock of the corporation is voted to adopt a certain measure or act. Only stock *actually* issued and outstanding may be voted. Under Section 6 of the Corporation Code, each share of stock is entitled to vote, unless otherwise provided in the articles of incorporation or declared delinquent under Section 67 of the Code. Neither the stockholders nor the corporation can vote or represent shares that have never passed to the ownership of stockholders, or, having so passed, have again been purchased by the corporation. These shares are not to be taken into consideration in determining majorities. When the law speaks of a given proportion of the stock, it must be construed to mean *shares that have passed* from the corporation, and that may be voted. *Tan v. Sycip*, 499 SCRA 216 (2006).

One of the rights of a stockholder is the right to participate in the control and management of the corporation that is exercised through his vote. The right to vote is a right inherent in and incidental to the ownership of corporate stock, and as such is a property right. *Castillo v. Balinghasay*, 440 SCRA 442 (2004).

Until challenged successfully in proper proceedings, a registered stockholder has a right to participate in any meeting, and in the absence of fraud the action of the stockholders' meeting cannot be collaterally attacked on account of such participation, even if it be shown later on that the shares had been previously sold (but not recorded). *Price and Sulu Dev. Co. v. Martin*, 58 Phil. 707 (1933).

The sequestration of shares does not entitle the government to exercise acts of ownership over the shares; even sequestered shares may be voted upon by the registered stockholder. *Cojuangco Jr. v. Roxas*, 195 SCRA 797 (1991).

The right to vote sequestered shares of stock registered in the names of private individuals or entities *and* alleged to have been acquired with ill-gotten wealth shall, as a rule, be exercised by the registered owner. The PCGG may, however, be granted such voting right provided it can (1) show *prima facie* evidence that the wealth and/or the shares are indeed ill-gotten; and (2) demonstrate imminent danger of dissipation of the assets, thus necessitating their continued sequestration and voting by the government until a decision, ruling with finality on their ownership, is promulgated by the proper court. Nevertheless, the foregoing "two-tiered" test does not apply when the funds that are *prima facie* public in character or, at least, are affected with public interest. Inasmuch as the subject UCPB shares in the present case were undisputably acquired with coco levy funds which are public in character, then the right to vote them shall be exercised by the PCGG. In sum, the "public character" test, not the "two-tiered" one, applies. *Republic v. COCOFED,* 372 SCRA 462 (2001); *Trans Middle East (Phils) v. Sandiganbayan*, 490 SCRA 455 (2006).

(a) Instances When Stockholders Entitled to Vote:

- Amendment of articles of incorporation (Sec. 16)
- Election of directors and trustees (Sec. 24)
- Investment in another business or corporation (Secs. 36 and 42)
- Increase and Decrease of capital stock (Sec. 38)
- Incurring, or increasing bonded indebtedness (Sec. 38)
- Sale, disposition or encumbrance of all or substantially all of the corporate assets (Sec. 40)
- Declaration of stock dividends (Sec. 43).
- Management contracts (Sec. 44)
- Adoption, amendment and repeal of by-laws (Sec. 48).
- Fixing of consideration of no par value shares (Sec. 62)
- Merger and consolidation (Sec. 72)

(b) Joint Ownership (**Sec. 56**)

(c) Pledgor, Mortgagors and Administrators (**Sec. 55**)

When shares are pledged by means of endorsement in blank and delivery of the covering certificates to a loan, the pledgee does not become the owner thereof simply by the failure of the registered stockholder to pay his loan. Consequently, without proper foreclosure, the lender cannot demand that the shares be registered in his name. *Lim Tay v. Court of Appeals,* 293 SCRA 634 (1998).

Although the Rules of Court, while permitting an executor or administrator to represent or to bring suits on behalf of the deceased, do no prohibit the heirs from representing the deceased. When no administrator has been appointed, there is all the more reason to recognize the heirs as the proper representatives of the deceased. *Gochan v. Young,* 354 SCRA 207 (2001).

(d) Treasury Share No Voting Rights (**Sec. 57**)

Treasury shares cannot be voted upon. *Tan v. Sycip*, 499 SCRA 216 (2006).

(e) Voting Rights of Members

In stock corporation, shareholders may generally transfer their shares. Thus, on the death of a shareholder, the executor or administrator duly appointed by the Court is vested with the legal title to

the stock and entitled to vote it. Until a settlement and division of the estate is effected, the stocks of the decedent are held by the administrator or executor. On the other hand, membership in and all rights arising from a nonstock corporation are personal and non-transferable, unless the articles of incorporation or the bylaws of the corporation provide otherwise. In other words, the determination of whether or not "dead members" are entitled to exercise their voting rights (through their executor or administrator), depends on those articles of incorporation or bylaws. *Tan v. Sycip*, 499 SCRA 216 (2006).

Under the By-Laws of GCHS, membership in the corporation shall, among others, be terminated by the death of the member. Section 91 of the Corporation Code further provides that termination extinguishes all the rights of a member of the corporation, unless otherwise provided in the articles of the incorporation or the bylaws. Applying Section 91 to the present case, we hold that dead members who are dropped from the membership roster in the manner for the cause provided for in the By-Law of GCHS are not to be counted in determining the requisite vote in corporate matters or the requisite quorum for the annual members' meeting. With 11 remaining members, the quorum in the present case should be 6. therefore, there being a quorum, the annual members' meeting, conducted with six members present, was valid. *Tan v. Sycip*, 499 SCRA 216 (2006).

(f) Conduct of Stockholders' Meetings:

- ***Kinds and Requirements of Meetings*** (**Secs. 49 and 50**);
- ***Place and Time of Meeting*** (**Secs. 51 and 93**);
- ***Quorum*** (**Sec. 52**)

Quorum is based on the totality of the shares which have been subscribed and issued whether it be founders' shares or common shares. To base the computation of quorum solely on the obviously deficient, if not inaccurate stock and transfer book, and completely disregarding the issued and outstanding shares indicated in the articles of incorporation would work injustice to the owners and/or successors in interest of the said shares. The stock and transfer book cannot be used as the sole basis for determining the quorum as it does not reflect the totality of shares which have been subscribed, more so when the articles of incorporation show a significantly larger amount of shares issued and outstanding as compared to that listed in the stock and transfer book. *Lanuza v. Court of Appeals*, 454 SCRA 54 (2005).

6. Contracts and Agreement Affecting Shareholdings

(a) Proxy (**Sec. 58**)

Proxy solicitation involves the securing and submission of proxies, while proxy validation concerns the validation of such secured and submitted proxies. It is possible that an intra-corporate controversy may animate a disgruntled shareholder to complain to the Securities and Exchange Commission (SEC) a corporation's violations of SEC rules and regulations, but that motive alone should not be sufficient to deprive the SEC of its investigatory and regulatory powers, especially so since such powers are exercisable on a *motu proprio* basis. *GSIS v. Court of Appeals,* 585 SCRA 679 (2009).

The SEC's power to pass upon the validity of proxies in relation to election controversies has effectively been withdrawn, tied as it is to its abrogated jurisdictional powers. The fact that the jurisdiction of the regular courts under Section 5(c) is confined to the voting on election of officers, and not on all matters which may be voted upon by stockholders, elucidates that the power of the Securities and Exchange Commission (SEC) to regulate proxies remains extant and could very well be exercised when stockholders vote on matters other than the election of directors. *GSIS v. Court of Appeals,* 585 SCRA 679 (2009).

(b) Voting Trust Agreements (**Sec. 59**)

A VTA separates the voting rights and other rights covered of the stock from other attributes of ownership, intended to be irrevocable for a definite period of time and the purpose of which is to give to the trustee to acquire voting control of the corporation. ✓***Lee v. CA*, 205 SCRA 752 [1992]).**

The trustor has a right to terminate the VTA for breach thereof. *Everett v. Asia Banking Corporation*, 49 Phil. 512 (1926).

Voting trust agreement as part of a loan arrangement. *NIDC v. Aquino*, 163 SCRA 153 (1988).

(c) Pooling Agreements or Shareholders' Agreements (**Sec. 100**)

7. Rights to Inspect and Copy Corporate Records

(a) Basis of Right

The stockholder's right of inspection of corporate books and records is based on his ownership of the assets and property of the corporation. It is therefore an incident of ownership of the corporate property, whether this ownership or interest be termed an equitable ownership, a beneficial ownership or a quasi-ownership. The right of inspection is predicated upon the necessity of self-protection on the part of the stockholder. ✓***Gokongwei, Jr. v. SEC*, 89 SCRA 336 (1979)**.

The stockholder's right of inspection of the corporation's books and records is based upon his ownership of shares in the corporation and the necessity for self-protection. *Puno v. Puno Enterprises*, 599 SCRA 585 (2009).

(b) Limitations on Right

The only express limitations on the right of inspection under Sec. 74 of Corporation Code are: (a) it should be exercised at reasonable hours on business days; (b) the person demanding the right to examine and copy excerpts from the corporate records and minutes has not improperly used any information secured through any previous examination of records; and (c) the demand is made in good faith or for a legitimate purpose. *Africa v. PCGG*, 205 SCRA 39 (1992).

Summary of Rulings: The right to inspect corporate books and records:

- Is exercisable through agents and representatives, otherwise it would often be useless to the stockholder who does not know corporate intricacies. *W.G. Philpotts v. Philippine Manufacturing Co.*, 40 Phil. 471 (1919).
- Cannot be denied on the ground that the director is on unfriendly terms with the officers of the corporation whose records are sought to be inspected. *Veraguth v. Isabela Sugar Co.*, 57 Phil. 266 (1932).
- Although it includes the right to make copies, does not authorize bringing the books or records outside of corporate premises. *Veraguth v. Isabela Sugar Co.*, 57 Phil. 266 (1932).
- Does not include the right of access to minutes until such minutes have been written up and approved by the directors. *Veraguth v. Isabela Sugar Co.*, 57 Phil. 266 (1932).
- Cannot be limited to a period of ten days shortly prior to the annual stockholders' meeting, as such would be an unreasonable restriction and violates the legal provision granting the exercise of such right "at reasonable hours." *Pardo v. Hercules Lumber Co.*, 47 Phil. 964 (1924).

(c) Specified Records (**Secs. 74, 75 and 141**)

(d) Remedies If Denied: Mandamus

In contrasting the language of the present Corporation Code from the old Corporation Law, the law now provides for express limitation on the right to inspect and now requires as a condition for such examination that one requesting it must not have been guilty of using improperly any information secured through a prior examination, an that the person asking for such examination must be acting in good faith and for a legitimate purpose in making his demand. The stockholder seeking to exercise the right of inspection must set forth the reasons and the purposes for which he desires such inspection. ✓***Gonzales v. PNB*, 122 SCRA 489 (1983)**.

Burden of proof to show that examination is for improper purpose is on the part of the corporation. *Republic v. Sandiganbayan,* 199 SCRA 39 (1999).

(e) Criminal Sanction under Section 144

In the recent case of ✓***Ang-Abaya v. Ang*, 573 SCRA 129 (2008)**, the Court had the occasion to enumerate the requisites before the penal provision under Section 144 of the Corporation Code may be applied in a case of violation of a stockholder or member's right to inspect the corporate books/records as provided for under Section 74 of the Corporation Code. *Sy Tiong Shiou v. Sy Chim*, 582 SCRA 517 (2009).

In a criminal complaint for violation of Section 74 of the Corporation Code, the defense of improper use or motive is in the nature of a justifying circumstance that would exonerate those who raise and are able to prove the same—where the corporation denies inspection on the ground of improper motive or purpose, the burden of proof is taken from the shareholder and placed on the corporation. *Sy Tiong Shiou v. Sy Chim*, 582 SCRA 517 (2009).

(f) Confidential Nature of SEC Examinations (**Sec. 142**)

8. Appraisal Right (**Secs. 81 to 86 and 105**)

A stockholder who dissents from certain corporate actions has the right to demand payment of the fair value of his or her shares. This right, known as the right of appraisal, is expressly recognized in Section 81 of the Corporation Code. Clearly, the right of appraisal may be exercised when there is a fundamental change in the charter or articles of incorporation substantially prejudicing the rights of the stockholders. It does not vest unless objectionable corporate action is taken. It serves the purpose of enabling the dissenting stockholder to have his interest purchased and to retire from the corporation. *Turner v. Lorenzo Shipping Corp.*, 636 SCRA 13 (2010).

9. <u>DERIVATIVE SUITS</u> (Interim Rules of Procedure Governing Intra-Corporate Controversies)

Derivative suits are governed by a special set of procedural rules known as the "Interim Rules of Procedure Governing Intra-Corporate Controversies under Republic Act No. 8799" (A.M. No. 01-2-04-SC; effective 01 April 2001). Section 1, Rule 1 thereof expressly lists derivative suits among the cases covered by it. *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548, 556 (2009).

(a) Derivative Suit Must Be Effected When Board Cannot Properly Exercise Business Judgment

***<u>General Rule</u>*:** In the absence of a special authority from the Board of Directors to institute a derivative suit for and in behalf of the corporation, the president or managing director is disqualified by law to sue in her own name. The power to sue and be sued in any court by a corporation is lodged in

the Board that exercises its corporate powers and not in the president or officer thereof. *Bitong v. Court of Appeals,* 292 SCRA 503 (1998).

While questions of policy and management are left to the honest decision of the officers and directors of a corporation, and the courts are without authority to substitute their judgment for the judgment of the Board of Directors; yet where the corporate directors are guilty of breach of trust—not of mere error of judgment or abuse of discretion—and intracorporate remedy is futile or useless, a stockholder may institute a suit in behalf of himself and other stockholders and for the benefit of the corporation. However, the corporation is the real party in interest in a derivative suit and the suing stockholder is only a nominal party. *Cua, Jr. v. Tan*, 607 SCRA 645 (2009).

Under Sec. 36 of the Corporation Code, in relation to Sec. 23, where a corporation is an injured party, its power to sue is lodged with its board of directors or trustees. An individual stockholder is permitted to institute a derivative suit on behalf of the corporation wherein he holds stocks in order to protect or vindicate corporate rights, whenever the officials of the corporation refuse to sue, or are the ones to be sued, or hold the control of the corporation. In such actions, the suing stockholder is regarded as a nominal party, with the corporation as the real party in interest. ✓***Chua v. Court of Appeals*, 443 SCRA 259 (2004)**.[22]

(b) Nature of the Power to File Derivative Suit

A stockholder's right to institute a derivative suit ***is not based*** on any express provision of the Corporation Code, or even the Securities Regulation Code, but is impliedly recognized when the said laws make corporate directors or officers liable for damages suffered by the corporation and its stockholders for violation of their fiduciary duties. *Yu v. Yukayguan*, 589 SCRA 588 (2009).

A derivative suit is an action brought by minority shareholders in the name of the corporation to redress wrongs committed against the corporation, for which the directors refuse to sue. It is a remedy designed by equity and has been the principal defense of the minority shareholders against abuses by the majority. *Western Institute of Technology, Inc. v. Salas,* 278 SCRA 216 (1997).

The whole purpose of the law authorizing a derivative suit is to allow the stockholders/member to enforce rights which are derivative (secondary) in nature, i.e., to enforce a corporate cause of action. *R.N. Symaco Trading Corp v. Santos*, 467 SCRA 312 (2005).[23]

An individual stockholder is permitted to institute a derivative suit on behalf of the corporation wherein he holds stocks in order to protect or vindicate corporate rights, whenever officials of the corporation refuse to sue or are the ones to be sued or hold the control of the corporation-in such actions, the suing stockholder is regarded as the nominal party, with the corporation as the party in interest. *Majority Stockholders of Ruby Industrial Corp. v. Lim*, 650 SCRA 461 (2011).

(c) Requisites of Derivative Suit

In the case of, we enumerated the foregoing requisites before a stockholder can file a derivative suit: (a) the party bringing suit should be a shareholder during the time of the act or transaction complained of, the number of shares not being material; (b) the party has tried to exhaust intra-corporate remedies, relief, but the latter has failed or refused to heed his plea; and (c) the cause of action actually devolves on the corporation; the wrongdoing or harm having been or being caused to the corporation and not to the particular stockholder bringing the suit. ✓***San Miguel Corp. v. Kahn*, 176 SCRA 447 (1989)**.[24]

Section 1, Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies lays down the following requirements which a stockholder must comply with in filing a derivative suit: A stockholder or member may bring an action in the name of a corporation or association, as the case may be, provided, that: (1) He was a stockholder or member at the time the acts or transactions subject of the action occurred and at the time the action was filed; (2) He exerted all reasonable efforts, and alleges the same with particularity in the complaint, to exhaust all remedies available under the articles of incorporation, by-laws, laws or rules governing the corporation or partnership to obtain the relief he desires; (3) No appraisal rights are available for the act or acts complained of; and (4) The suit is not a nuisance or harassment suit. *Yu v. Yukayguan*, 589 SCRA 588 (2009).[25]

The fact that it is a family corporation does not in any way exempt a stockholder from complying with the clear requirements and formalities of the rules for filing derivative suit—there is nothing in the pertinent laws or rules supporting the distinction between, and the difference in the requirements for, family corporations *vis-a-vis* other types of corporations, in the institution by a stockholder of a derivative suit. *Yu v. Yukayguan*, 589 SCRA 588 (2009).

(d) Who May Bring the Suit

The relators must be stockholders both at time of occurrence of the events constituting the cause of action and at the time of the filing of the derivative suit. ✓***Pascual v. Orozco*, 19 Phil. 83 (1911)**; *Gochan v. Young*, 354 SCRA 207 (2001).

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[22] *Filipinas Port Services, Inc. v. Go*, 518 SCRA 453 (2007); *Yu v. Yukayguan*, 589 SCRA 588 (2009); *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548 (2009).

[23] *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548, 556 (2009); *Strategic Alliance Dev. Corp. v. Radstock Securities Ltd*., 607 SCRA 413 (2009).

[24] *Filipinas Port Services, Inc. v. Go*, 518 SCRA 453 (2007)*Reyes v. Regional Trial Court of Makati, Br. 142,* 561 SCRA 593 (2008); *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548 (2009).

[25] *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548, 556 (2009); *Strategic Alliance Dev. Corp. v. Radstock Securities Ltd*., 607 SCRA 413 (2009); *Cua, Jr. v. Tan*, 607 SCRA 645 (2009).

A derivative action is a suit by a shareholder to enforce a corporate cause of action. The corporation is a necessary party to the suit. And the relief which is granted is a judgment against a third person in favor of the corporation. Similarly, if a corporation has a defense to an action against it and is not asserting it, a stockholder may intervene and defend on behalf of the corporation. ✓***Chua v. Court of Appeals*, 443 SCRA 259 (2004)**.[26]

Since the ones to be sued are the directors/officers of the corporation itself, a stockholder, like petitioner Cruz, may validly institute a derivative suit to vindicate the alleged corporate injury, in which case Cruz is only a nominal party while Filport is the real party-in-interest. *Filipinas Port Services, Inc. v. Go*, 518 SCRA 453 (2007).

A minority stockholder and member of the board has no power or authority to sue on the corporation's behalf. Nor can we uphold this as a derivative suit, since it is required that the minority stockholder suing for and on behalf of the corporation must allege in his complaint that he is suing on a derivative cause of action on behalf of the corporation *and all other stockholders similarly situated who may wish to join him in the suit*. There is now showing that petitioner has complied with the foregoing requisites. *Tam Wing Tak v. Makasiar,* 350 SCRA 475 (2001); *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548, 556 (2009).

A minority stockholder can file a derivative suit against the president for diverting corporate income to his personal accounts. *Commart (Phils.) Inc. v. SEC*, 198 SCRA 73 (1991).

The status of heirs as co-owners of shares of stocks prior to the partition of the decedent's estate does not immediately and necessarily make them stockholders of the corporation–-unless and until there is compliance with the Section 63 of the Corporation Code on the manner of transferring shares, the heirs do not become registered stockholders of the corporation. *Reyes v. Regional Trial Court of Makati, Br. 142,* 561 SCRA 593 (2008); *Puno and Puno Enterprises, Inc.*, 599 SCRA 585 (2009).

A lawyer engaged as counsel for a corporation cannot represent members of the same corporation's board of directors in a derivative suit brought against them. To do so would be tantamount to representing conflicting interests, which is prohibited by the Code of Professional Responsibility." *Hornilla v. Salunat*, 405 SCRA 220 (2003).

(e) Exhaustion of Intra-Corporate Remedies:

A condition precedent to the filing of a derivative suit is that the party has tried to exhaust inta-corporate remedies, i.e., has made a demand on the Board of Directors for the appropriate relief, but the latter has failed to or refused to heed his plea. *Everett v. Asia Banking Corp.,* 49 Phil. 512 (1927); *Angeles v. Santos,* 64 Phil. 697 (1937).

A derivative suit to question the validity of the foreclosure of the mortgage on corporate assets can be filed without prior demand upon the Board of Directors where the legality of the constitution of the Board lies at the center of the issues. *DBP v. Pundogar,* 218 SCRA 118 (1993).

Further, while it is true that the complaining stockholder must satisfactorily show that he has exhausted all means to redress his grievances within the corporation, except when such remedy is complete control of the person against whom the suit is being filed. The reason is obvious: a demand upon the board to institute an action and prosecute the same effectively would have been useless and an exercise in futility. *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548, 557 (2009).

The obvious intent behind the rule requiring the stockholder filing a derivative suit to first exert all reasonable efforts to exhaust all remedies available under the articles of incorporation, by laws, laws or rules governing the corporation or partnership to obtain relief he desires is to make the derivative suit the final recourse of the stockholders, after all other remedies to obtain the relief sought had failed. *Yu v. Yukayguan*, 589 SCRA 588 (2009).

(f) Nature of Relief or Remedies Prayed For:

The complaint cannot demand for the defendants to pay the suing stockholders the value of their respective participation in the assets that have been damaged, for a derivative suit must have cause of action for the benefit of the corporation. *Evangelista v. Santos*, 86 Phil. 387 [1950]; *Republic Bank v. Cuaderno*, 19 SCRA 671 (1967); *Reyes v. Tan*, 3 SCRA 198 (1961).

Since it is the corporation that is the real party-in-interest in a derivative suit, then the reliefs prayed for must be for the benefit or interest of the corporation. When the relief prayed for do not pertain to the corporation, then it is an improper derivative suit. *Legaspi Towers 300, Inc. v. Muer*, 673 SCRA 453 (2012),[27] *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW, 1998 ed., p. 375.

The allegations of injury to the relators can co-exist with those pertaining to the corporation, and does not disqualify them from filing a derivative suit on behalf of the corporation. It merely gives rise to an additional cause of action for damages against the erring directors. *Gochan v. Young*, 354 SCRA 207 (2001).

In a derivative action, the real party in interest is the corporation itself, not the shareholders who actually instituted it. A suit to enforce preemptive rights in a corporation is not a derivative suit, and therefore a temporary restraining order enjoining a person from representing the corporation will not bar such action, because it is instituted on behalf and for the benefit of the shareholder, not the corporation. *Lim v. Lim-Yu,* 352 SCRA 216 (2001).

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[26] *Go v. Distinction Properties Dev. and Construction, Inc.*, 671 SCRA 461 (2012).

[27] *Also R.N. Symaco Trading Corp. v. Santos*, 467 SCRA 312 (2005).

Appointment of receiver can be an ancillary remedy in a derivative suit. *Chase v. CFI of Manila*, 18 SCRA 602 (1966).

Where corporate directors have committed a breach of trust either by their frauds, *ultra vires* acts, or negligence, and the corporation is unable or unwilling to institute suit to remedy the wrong, a stockholder may sue on behalf of himself and other stockholders and for the benefit of the corporation, to bring about a redress of the wrong done directly to the corporation and indirectly to the stockholders. This is what is known as a derivative suit, and settled is the doctrine that in a derivative suit, the corporation is the real party in interest while the stockholder filing suit for the corporation's behalf is only nominal party. The corporation should be included as a party in the suit. *Hornilla v. Salunat*, 405 SCRA 220 (2003).

(g) Venue for Derivative Suit

Under Section 5, Rule 1 of the Interim Rules, the proper venue for derivative suit would be in the RTC which has jurisdiction over the principal office of the corporation. *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548 (2009).

10. Right to Proportionate Share of Remaining Assets Upon Dissolution (**Sec. 122**)

In the liquidation of a corporation, after the payment of all corporate debts and liabilities, the remaining assets, if any, must be distributed to the stockholders in proportion to their interests in the corporation. The share of each stockholder in the assets upon liquidation is what is known as *liquidating dividend. President of PDIC v. Reyes*, 460 SCRA 473 (2005).

XII. CAPITAL STOCK & SHARES OF STOCK

1. Power of the Corporation to Issue Shares of Stock

The power to issue shares of stock in a corporation is lodged in the board of directors and no stockholders' meting is required to consider it because additional issuances of shares of stock does not need approval of the stockholders—what is only required is the board resolution approving the additional issuance of shares. *Majority Stockholders of Ruby Industrial Corp. v. Lim*, 650 SCRA 461 (2011).

2. Concept of "Capital Stock" (**Sec. 137**)

The outstanding capital stock is defined under Sec. 137 of the Corporation Code as "the total shares of stock issued to subscribers or stockholders whether or not fully or partially paid (as long as there is binding subscription agreement) except treasury shares." Thus, quorum is based on the totality of the shares which have been subscribed and issued, whether it be founders' shares or common shares. *Lanuza v. Court of Appeals*, 454 SCRA 54 (2005).

By express provision of Sec. 13 of Corporation Code, paid-up capital is that portion of the authorized capital stock which has been both subscribed and paid. . . Not all funds or assets received by the corporation can be considered paid-up capital, for this term has a technical signification in Corporation Law. Such must form part of the authorized capital stock of the corporation, subscribed and then actually paid up. *MSCI-NACUSIP v. National Wages and Productivity Comm.,* 269 SCRA 173 (1997).

The term "*capital*" and other terms used to describe the capital structure of a corporation are of universal acceptance, and their usages have long been established in jurisprudence. Briefly, capital refers to the value of the property or assets of a corporation. The capital subscribed is the total amount of the capital that persons (subscribers or shareholders) have agreed to take and pay for, which need not necessarily be, and can be more than, the par value of the shares. In fine, it is the amount that the corporation receives, inclusive of the premium if any, in consideration of the original issuance of the shares. *NTC v. Court of Appeals*, 311 SCRA 508 (1999).

An "investment", being in the nature of equity, is an expenditure to acquire property or other assets in order to produce revenue. It is the placing of capital or laying out of money in a way intended to secure income or profit from its employment. Unlike a deposit of money or a loan that earns interest, cannot be assured of a dividend or an interest on the amount invested, for dividends on investments are granted only after profits or gains are generated. *President of PDIC v. Reyes*, 460 SCRA 473 (2005).

"*Advances for Future Subscription*" is a receivable account and does not form part of the capital stock of the corporation since it does not correspond to any particular issuance of shares of stock. *Central Textile Mills v. National Wage and Productivity Comm.,* 260 SCRA 368 (1996). Consequently there is no liability for the payment of the documentary stamp tax on such deposit for future subscription for the reason that there is yet no subscription that creates rights and obligations between the subscriber and the corporation. *Commissioner of Internal Revenue v. First Express Pawnshop Co., Inc.*, 589 SCRA 253 (2009).

3. Classification of Shares (**Sec. 6**)

It is not correct to say that holders of the preferred shares lose all their voting rights, since Section 6 of the Corporation Code provides for the situations where non-voting shares like preferred shares are granted voting rights. *Philippine Coconut Producers Federation. v. Republic*, 600 SCRA 102 (2009).

(a) Common Shares

"A common stock represents the residual ownership interest in the corporation. It is a basic class of stock ordinarily and usually issued without extraordinary rights or privileges and entitles the shareholder to a *pro rata* division of profits." *Commissioner of Internal Revenue v. Court of Appeals*, 301 SCRA 152 (1999).

(b) Preferred Shares: ✓*Republic Planters Bank v. Agana*, 269 SCRA 1 (1997):

- ***Participating and Non-participating***
- ***Cumulative and Non-cumulative***
- ***Par Value and No Par Value***

"Preferred stocks are those which entitle the shareholder to some priority on dividends and asset distribution." *CIR v. Court of Appeals,* 301 SCRA 152 (1999).

In the absence of provisions in the articles of incorporation denying voting rights to preferred shares, preferred shares have the same voting rights as common shares. However, preferred shareholders are often excluded from any control, that is, deprived of the right to vote in the election of directors and on other matters, on the theory that the preferred shareholders are merely investors in the corporation for income in the same manner as bondholders. In fact, under the Corporation Code only preferred or redeemable shares can be deprived of the right to vote. Common shares cannot be deprived of the right to vote in any corporate meeting, and any provision in the articles of incorporation restricting the right of common shareholders to vote is invalid. ✓***Gamboa v. Teves*, 652 SCRA 690 (2011)**; *affirmed in* ✓***Heirs of Gamboa v. Teves*, 682 SCRA 397 (2012)**.

(b) Redeemable Shares (**Sec. 8**; ✓***Republic Planters Bank v. Agana*, 269 SCRA 1 [1997]**)

"Redemption is repurchase, a reacquisition of stock by a corporation which issued the stock in exchange for property, whether or not the acquired stock is cancelled, retired or held in the treasury. Essentially, the corporation gets back some of its stock, distributes cash or property to the shareholder in payment for the stock, and continues in business as before. The redemption of stock dividends previously issued is used as a veil for the constructive distribution of cash dividends. *Commissioner of Internal Revenue v. Court of Appeals,* 301 SCRA 152 (1999).

(c) Founder Shares (**Sec. 7**)[28]

(d) Treasury Shares (**Sec. 9**; *Commissioner v. Manning*, 66 SCRA 14 [1975]).

A treasury share, which may be common or preferred, may be used for a variety of corporate purposes, such as for a stock bonus plan for management and employees, or for acquiring another company. It may be held indefinitely, resold or retired. While held in the company's treasury, the stock earns no dividends and has no vote in company affairs. *Philippine Coconut Producers Federation, Inc. v. Republic*, 600 SCRA 102 (2009).

(e) Stock Warrants

(f) Stock Options

(g) Re-Classification of Shares

"Reclassification of shares does not always bring any substantial alteration in the subscriber's proportional interest. But the exchange is different—there would be a shifting of the balance of stock features like priority in dividend declarations or absence of voting rights. Yet neither the reclassification nor exchange *per se* yields income for tax purposes. . . In this case, the exchange of shares, without more, produces no realized income to the subscriber. There is only a modification of the subscriber's rights and privileges—which is not a flow of wealth for tax purposes. The issue of taxable dividend may arise only once a subscriber disposes of his entire interests and not when there is still maintenance of proprietary interest." *CIR v. Court of Appeals,* 301 SCRA 152 (1999).

The conversion of common shares into preferred shares, pursued to the amendment of the SMC articles of incorporation, is a legitimate exercise of corporate powers under the Corporation Code. The conversion does not amount to SMC using its funds to effect conversion, but would amount merely to a reconfiguration of said (common) shares into preferred shares. *Philippine Coconut Producers Federation, Inc. v. Republic*, 600 SCRA 102 (2009).

4. Hybrid Securities: ✓*Government v. Phil. Sugar Estates*, 38 Phil. 15 (1918).

5. Quasi-Reorganization

(a) Reduction of Capital Stock (**Sec. 38**)

Reduction of capital stock cannot be employed to avoid the corporation's obligations under the Labor Code. *xMadrigal & Co. v. Zamora*, 151 SCRA 355 (1987).

(b) Stock Splits

(c) Stock Consolidations

6. Shareholders Not Corporate Creditors. *Garcia v. Lim Chu Sing*, 59 Phil. 562 (1934).

[28] In *Castillo v. Balinghasay*, 440 SCRA 442 (2004), the position that when the articles of incorporation provide expressly a class of shares to have the exclusive right to vote and be voted for into the Board of Directors, that such shares would essentially be founder's share was raised but not resolved by the Court.

7. Subscription Contract (**Secs. 60 and 72**; *overturned Trillana v. Quezon Colegialla*, 93 Phil. 383 [1953]).

(a) "***Purchase Agreement*": ✓*Bayla v. Silang Traffic Co., Inc.*, 73 Phil. 557 (1942**).

(b) Pre-Incorporation Subscription (Sec. 61)

When properties were assigned pursuant to a pre-incorporation subscription agreement, but the corporation fails to issue the covered shares, the return of such properties to the subscriber is a direct consequence of rescission and does not amount to corporate distribution of assets prior to dissolution. ✓***On Yong v. Tiu*, 375 SCRA 614 (2002)**.

(c) Release from Subscription Obligation: ***Tan v. Sycip*, 499 SCRA 216 (2006**).[29]

(d) Condition of Payment Provided in By-laws. *De Silva v. Aboitiz & Co.*, 44 Phil. 755 (1923).

8. CONSIDERATION (**Sec. 62**): **(a) Cash** **(c) Service** **(d) Shares**
(b) Property **(d) Retained Earnings**

Stock dividends are in the nature of shares of stock, the consideration for which is the amount of unrestricted retained earnings converted into equity in the corporation's books. *Lincoln Phil. Life v. Court of Appeals*, 293 SCRA 92 (1998).[30]

(a) Watered Stocks (**Sec. 65**)

(b) Payment of Balance of Subscription (**Secs. 66 and 67**): ✓***Lingayen Gulf Electric Power Co. v. Baltazar*, 93 Phil. 404 (1953)**.

A stockholder who is employed with the company, cannot offset his unpaid subscription against his awarded claims for wages, where there has been no call for the payment of such subscription. *Apodaca v. NLRC,* 172 SCRA 442 (1989).

(c) Delinquency on Subscription (**Secs. 68, 69, 70 and 71**; *Philippine Trust Co. v. Rivera*, 44 Phil. 469 [1923]; *Miranda v. Tarlac Rice Mill Co.*, 57 Phil. 619 [1932])

The prescriptive period to recover on unpaid subscription does not commence from the time of subscription but from the time of demand by Board of Directors to pay the balance of subscription. *Garcia v. Suarez*, 67 Phil. 441 (1939).

Who May Question a Delinquency Sale? (**Sec. 68 and 69**).

9. CERTIFICATE OF STOCK (**Sec. 63**)

(a) Nature of Certificate:

A stock certificate is not necessary to render one a stockholder in a corporation; nevertheless, it is the paper representative or tangible evidence of the stock itself and the various interests therein. The stock certificate expresses the contract between the corporation and the stockholder, but it is not essential to the existence of a share in stock or the creation of the relation of shareholder to the corporation. ✓***Tan v. SEC*, 206 SCRA 740 (1992)**.[31]

A certificate of stock is the evidence of a holder's interest and status in a corporation—it is *prima facie* evidence that the holder is a shareholder of a corporation; it is not the share itself. *Lincoln Phil. Life v. Court of Appeals*, 293 SCRA 92 (1998); *Lao v. Lao*, 567 SCRA 558 (2008).

Even without the covering certificate of stock having been issued, yet, the registered subscriber to the shares may validly and legally transact with the shares, and sell and dispose of them to ay interest buyer thereof provided he complies with the right of first refusal provided for in the by-laws (?) of the corporation. ✓***Makati Sports Club, Inc. v. Cheng*, 621 SCRA 103 (2010)**.

The fact that the stock certificates registered in the name of one person are found in the possession of another stockholder does not prove that the possessor is the owner of the covered shares. A stock certificate is merely a tangible evidence of ownership of shares of stock. Its presence or absence does not affect the right of the registered owner to dispose of the shares covered by the stock certificate. *Republic v. Estate of Hans Menzi*, 475 SCRA 20 (2005).

A certificate of stock could not be considered issued in contemplation of law unless signed by the president or vice-president and countersigned by the secretary or assistance secretary. *Bitong v. Court of Appeals,* 292 SCRA 503 (1998).

(b) *Quasi*-Negotiable Character of Certificate of Stock

A certificate of stock is merely a *quasi*-negotiable instrument in the sense that it may be transferred by endorsement, coupled with delivery; but it is not negotiable because the holder thereof takes it without prejudice to such rights or defenses as the registered owners or transferor's creditors may

[29] *Velasco v. Poizat*, 37 Phil. 802 (1918); *PNB v. Bituloc Sawmill, Inc.*, 23 SCRA 1366 (1968); *National Exchange Co. v. Dexter*, 51 Phil. 601 (1928).

[30] The basis for determining the documentary stamps due on stock dividends declared would be their book value as indicated in the latest audited financial statements of the corporation, and not the par value thereof. *Commissioner of Internal Revenue v. Lincoln Phil. Life Insurance Co.*, 379 SCRA 423 (2002).

[31] *C.N. Hodges v. Lezama*, 14 SCRA 1030 (1965); *Ponce v. Alsons Cement Corp.*, 393 SCRA 602 (2002); *Nautica Canning Corp. v. Yumul*, 473 SCRA 415 (2005).

have under the law, *except only insofar as such rights or defenses are subject to the limitations imposed by the principles governing estoppel.* ✓***De los Santos v. Republic,*** **96 Phil. 577 (1955)**.

In order for a transfer of stock certificate to be effective, it must be properly indorsed and that title to such certificate of stock is vested in the transferee by the delivery of the duly indorsed certificate of stock. Indorsement of the certificate of stock is a mandatory requirement of law for an effective transfer of a certificate of stock. *Razon v. IAC*, 207 SCRA 234 (1992).

The rule is that the endorsement of the certificate of stock by the owner or his attorney-in-fact or any other person legally authorized to make the transfer shall be sufficient to effect the transfer of shares only if the same is coupled with delivery. The delivery of the stock certificate duly endorsed by the owner is the operative act of transfer of shares from the lawful owner to the new transferee. But to be valid against third parties, the transfer must be recorded in the books of the corporation. ✓***Bitong v. Court of Appeals,*** **292 SCRA 503 (1998)**; *Raquel-Santos v. Court of Appeals*, 592 SCRA 169 (2009).

Even when a formal Deed of Assignment covering the shares was duly executed, without the endorsement and delivery of the covering certificates of stocks, the covered shares cannot be deemed to transferred and registered in the names of the assignees. ✓***Rural Bank of Lipa City v. Court of Appeals*****, 366 SCRA 188 (2001)**; *Rivera V. Florendo*, 144 SCRA 643 (1986).

(c) Right to Certificate of Stock for Fully Paid Shares (**Sec. 64**)

The Board resolution which prohibited from voting shares of stocks which were not fully paid, although certificates have been issued for them. Not fully paid shares which are not delinquent may not be denied their voting rights. It also held that (under the old Corporation Law) unless prohibited by the b-laws, certificates of stock may be issued for less than the number of the shares subscribed for provided the par value of ach of the stocks represented by each of the certificates has been paid. ✓***Baltazar v. Lingayen Gulf Elect. Power Co., Inc.*****, 14 SCRA 522 [1965])**.

(d) Lost or Destroyed Certificates (**Sec. 63 and 73**)

While Sec. 73 of Corporation Code appears to be mandatory, the same admits exceptions, such that a corporation may voluntarily issue a new certificate in lieu of the original certificate of stock which has been lost without complying with the requirements under said section. It would be an internal matter for the corporation to find measures in ascertaining who are the real owners of stock for purposes of liquidation. It is well-settled that unless proven otherwise, the "*stock and transfer book"* is the best evidence to establish stock ownership. (SEC Opinion, dated 28 January 1999, addressed to Ms. Ma. Cecilia Salazar-Santos).

(e) Forged and Unauthorized Transfers.

Since certificates of stock are only *quasi*-negotiable instruments, a transferee in good faith under a forged assignment acquires no title which can be asserted against the true owner, *unless the true owner's own negligence has been such as to create an estoppel against him.* ✓***Delos Santos v. Republic*****, 96 Phil. 577 (1955).**

A *bona fide* pledgee or transferee of a stock from the apparent owner is not chargeable with knowledge of the limitations laced on said certificates by the real owner, or of any secret agreement relating to the use which might be made of the stock by the holder. When a stock certificate has been endorsed in blank by the owner thereof, it becomes a "street certificate" so that upon its face the holder is entitled to demand its transfer into his name from the issuing corporation. As such the certificate if quasi-negotiable and the transferee thereof is justified in believing that it belongs to the older and transferor. ✓***J. Santamaria v. HongKong and Shanghai Banking Corp.*****, 89 Phil. 780 (1951)**.

When the stock certificates have been endorsed in blank for purposes of showing the nominee relations, the eventual delivery and registration of th shares in violation of th trust relationship and after their having been stolen, would be void, even when such transfers have been registered in the stock and transfer book. ✓***Neugene Marketing, Inc. v. Court of Appeals*****, 303 SCRA 295 (1999)**.

10. STOCK AND TRANSFER BOOK (Secs. 63, 72 and 74):

Sales and other dispositions of shares of stock must under Section 63 be registered in the stock and transfer book: (a) to enable the corporation to know at all times who are the actual stockholders; (b) to afford the corporation an opportunity to object or refuse its consent to such transfer when it has claims against such shares; and (c) to avoid fictitious or fraudulent transfers. ✓***Escaño v. Filipinas Mining Corporation*****, 74 Phil. 71 (1944)**.

Shares for which no certificate of stock has been issued may validly be mortgaged in whole (an not just with respect to the portion paid-up) and the corporation receiving notice thereof is bound to respect the security arrangement. ✓***Fua Cun v. Summers*****, 44 Phil. 704 (1923)**.

When the shares are covered by a stock certificate issued in the name of the usufructuary by the original owner with the agreement between them that they should not be disposed or sold, but the registerd owner had pledged the shares by endorsement and delivery of the certificate to one who took them in good faith and for value, the latter shall be preferred since registration of a security arrangement

covering shares of stock does not require, for its validity and binding effect on the world, to be registered in the stock and transfer book. ✓***Monserrat v. Ceran*, 58 Phil. 469 (1933)**.

In order for the chattel mortgage on shares of stock be valid and binding on third parties, registration thereof in the stock and transfer book is not required and not legally effective. What is necessary is that the chattel mortgage over the shares be registered in the Registry of Deeds of the principal place of business of the corporation, as well as in the Registry of Deeds of the stockholders' domicile. ✓***Chua Guan v. Samahang Magsasaka, Inc*., 62 Phil. 472 (1935)**.

The failure to register a sale or disposition of shares of stock in the books of the corporation would render the same invalid to all persons, including the attaching creditors of the seller. ✓***Uson v. Diosomito*, 61 Phil. 535 (1935)**.

The pledge of shares of stock covered by a certificate is valid and binding on third parties, when the certificate of stock has been endorsed and delivered to the creditor, notwithstanding the fact that the contract does not appear in a public instrument (chattel mortgage). "Certificates of stock . . . are *quasi*-negotiable instruments in the sense that they may be given in pledge or mortgage to secure an obligation." ✓***Bachrach Motor Co. v. Lacson Ledesma*, 64 Phil. 681 (1937)**.

Only fully paid shares for which certificates of stock have been issued are subject to the registration requirement in the stock and transfer book in cases dealing with their sales and absolute disposition. ✓***Nava v. Peers Marketing Corp.*, 74 SCRA 65 (1976)**.

BUT: The stock and transfer book records the names and addresses of all stockholders arranged alphabetically, the installments paid and unpaid on all stock for which subscription has been made, and the date of payment thereof, a statement of every alienation, sale or transfer of stock made the date thereof and by and to whom made, and such other entries as may be prescribed by law. A stock and transfer book, like other corporate books and records, is not in any sense a public record, and thus is not exclusive evidence of the matters and things which ordinarily are or should be written therein. *Lanuza v. Court of Appeals*, 454 SCRA 54 (2005).

(a) Validity of Transfers:

Under Sec. 63 of Corporation Code, the sale of stocks shall not be recognized as valid unless registered in the books of the corporation insofar as third persons, including the corporation, are concerned—as between the parties to the sale, the transfer shall be valid even if not recorded in the books of the corporation. ✓***Batangas Laguna Tayabas Bus Co. v. Bitanga,* 362 SCRA 635 (2001)**.

As between the General Information Sheet and the corporate books, it is the latter that is controlling. *Lao v. Lao*, 567 SCRA 558 (2008).

A transfer of shares which is not recorded in the books of the corporation is valid only as between the parties, hence, the transferor has the right to dividends as against the corporation without notice of transfer but it serves as trustee of the real owner of the dividends, subject to the contract between the transferor and transferee as to who is entitled to receive the dividends. *Cojuangco v. Sandiganbayn*, 586 SCRA 790 (2009).

The view that under Section 63 of the Corporation Code, the sale of the stocks shall not be recognized as valid unless registered in the books of the corporation is valid only insofar as third persons, including the corporation, are concerned—as between the parties to the sale, the transfer shall be valid even if not recorded in the books of the corporation. *Batangas Laguna Tayabas Bus Co. v. Bitanga,* 362 SCRA 635 (2001).

A transferee has no right to intervene as a stockholder in corporate issue on the strength of the transfer of shares allegedly executed by a registered stockholder. It is explicit under Sec. 63 that the transfer must be registered to affect the corporation and third persons. *Magsaysay-Labrador v. CA*, 180 SCRA 266 (1989).

The purpose of registration is two-fold: to enable the transferee to exercise all the rights of a stockholder, including the right to vote and to be voted for, and to inform the corporation of any change in share ownership so that it can ascertain the persons entitled to the rights and subject to the liabilities of a stockholder. Until challenged in a proper proceeding, a stockholder of record has a right to participate in any meeting; his vote can be properly counted to determine whether a stockholders' resolution was approved, despite the claim of the alleged transferee. On the other hand, a person who has purchased stock, and who desires to be recognized as a stockholder for the purpose of voting, must secure such a standing by having the transfer recorded on the corporate books. Until the transfer is registered, the transferee is not a stockholder but an outsider. ✓***Batangas Laguna Tayabas Bus Company, Inc. v. Bitanga*, 362 SCRA 635 (2001). [CLV- I agree with the dissenting opinion of Justice Puno: "The rule [Section 63] is intended to protect the interest of the corporation and third persons who may be prejudiced by the transfer of the shares of stocks. *It follows, therefore, that as between the parties to the sale, the transfer shall be valid even if not recorded in the books of the corporation."*]**

A *bona fide* transfer of shares, not registered in the corporate books, is not valid as against a subsequent lawful attachment of said shares, regardless of whether the attaching creditor had actual notice of said transfer or not. All transfers not so entered on the books of the corporation are absolutely void; not because they are without notice or fraudulent in law or fact, but because they are made so void by statute. ✓***Garcia v. Jomouad*, 323 SCRA 424 (2000).**

Pursuant to Sec. 63, a transfer of shares of stock not recorded in the stock and transfer book is non-existent as far as the corporation is concerned. As between the corporation on the one hand, and

its shareholders and third persons on the other, the corporation looks only into its books for the purpose of determining who its shareholders are. *Ponce v. Alsons Cement Corp.*, 393 SCRA 602 (2002).

The absence of a deed of sale evidencing the sale of shares of stock does not necessarily show irregularity since Section 63 of the Corporation Code itself does not require any deed for the validity of the transfer of shares stock, it being sufficient that such transfer be effected by delivery of the stock certificates duly endorsed. "The Corporation Code acknowledges that the delivery of a duly indorsed stock certificate is sufficient to transfer ownership of shares of stock in stock corporations. Such mode of transfer is valid between the parties. In order to bind third persons, however, the transfer must be recorded in the books of the corporation. Clearly then, the absence of a deed of assignment is not a fatal flaw which renders the transfer invalid as the Republic posits. In fact, as has been held in *Rural Bank of Lipa City, Inc. v. Court of Appeals*, [366 SCRA 188 (2001)] the execution not a deed of sale does not necessarily make the transfer effective." *Republic v. Estate of Hans Menzi*, 475 SCRA 20, 38 (2005).

(b) Who May Make Entries: Entries made on the stock and transfer book by any person other than the corporate secretary, such as those made by the President and Chairman, cannot be given any valid effect. *Torres, Jr. v. Court of Appeals,* 278 SCRA 793 (1997)

(c) Attachments: Attachments of shares of stock are not included in the term "transfer" as provided in Sec. 63 of Corporation Code. Both the Revised Rules of Court and the Corporation Code do not require annotation in the corporation's stock and transfer books for the attachment of shares to be valid and binding on the corporation and third parties. *Chemphil Export & Import Corp. v. CA*, 251 SCRA 257 (1995).

(d) Meaning of "*Unpaid Claims*": "Unpaid claims" under Sec. 63 refers to any unpaid subscription, and not to any indebtedness which a stockholder may owe the corporation arising from any other transactions, like unpaid monthly dues. *Fua Cun v. Summers*, 44 Phil. 704 (1923); *China Banking Corp. v. CA*, 270 SCRA 503 (1997).

(e) Equitable Mortgage Assignment: It seems that the assignment of voting shares as security for a loan operates to give the assignee not only the right to vote on the shares, but would also treat the assignee as the owner of the shares (not just an equitable mortgage): "It is true that the assignment was predicated on the intention that it would serve as security *vis-à-vis* DBP's financial accommodation extended to PJI, but it was a valid and duly executed assignment, subject to a resolutory condition, which was the settlement of PJI's loan obligation with DBP." *APT v. Sandiganbayan,* 341 SCRA 551, 560 (2000).

11. Situs of Shares of Stocks (**Sec. 55**)

Situs of shares of stock is the domicile of the corporation to which they pertain to. *Wells Fargo Bank and Union v. Collector*, 70 Phil. 325 (1940).[32]

XIII. ACQUISITIONS, MERGERS AND CONSOLIDATIONS

A. ACQUISITIONS AND TRANSFERS

1. Concept of "Business Enterprise", "Economic Unit" or "Going Concern" (**Sec. 40**)

Business enterprise constitutes the goodwill, the customer lists and all factors that make a business profitable. ✓***Villa Rey Transit, Inc. v. Ferrer*, 25 SCRA 845 (1968)**.

2. Types of Acquisitions\Transfers

As a rule, a corporation that purchases the assets of another will not be liable for the debts of the selling corporation, provided the former acted in good faith and paid adequate consideration for such assets, except when any of the following circumstances is present: (1) where the purchasers expressly or impliedly agrees to assume the debts; (2) where the selling corporation fraudulently enters into the transactions to escape liability for those debts (3) where the purchasing corporation is merely a continuation of the selling corporation, and (4) where the transaction amounts to a consolidation or merger of the corporations. ✓***Edward J. Nell Co. v. Pacific*, 15 SCRA 415 (1965)**.[33]

Even under the provisions of the Civil Code, a creditor has a real interest to go after any person to whom the debtor fraudulently transferred its assets. ✓***Caltex (Phils.), Inc. v. PNOC Shipping and Transport Corp.*, 498 SCRA 400 (2006)**.

PSALM took ownership over most of NPC's assets by operation of law—these properties may be used to satisfy the Court's judgment, and such being the case, the employees may go after such properties. *NPC Drivers and Mechanics Association (NPC DAMA) v. NPC*, 606 SCRA 409 (2009).

3. Business Enterprise Transfers: ✓***A.D. Santos v. Vasquez*, 22 SCRA 1156 (1968);***Laguna Trans. Co., Inc. v. SSS*, 107 Phil. 833 (1960)**.

[32] *Tayag v. Benguet Consolidated, Inc.*, 26 SCRA 242 (1968); *cf. Perkins v. Dizon*, 69 Phil. 186 (1939).

[33] *Philippines National Bank v. Andrada Electric & Engineering Co.*, 381 SCRA 244 (2002); *McLeod v. NLRC*, 512 SCRA 222 (2007); *Jiao v. NLRC*, 670 SCRA 184 (2012).

A business enterprise operated under a partnership and later incorporated, or where a corporation assumed all the assets and liabilities of the partnership, then the corporation cannot be regarded, for purposes of the SSS Law, as having come into being only on the date of its incorporation but from the date the partnership started the business. *Oromeca Lumber Co. v. SSS,* 4 SCRA 1188 (1962); *San Teodoro Dev. v. SSS*, 8 SCRA 96 (1963).

When a corporation transferred all its assets to another corporation "to settle its obligations" that would not amount to a fraudulent transfer. ✓***McLeod v. NLRC*, 512 SCRA 222 (2007)**.

When the bus operations belonging to the estate of the deceased spouses is duly incorporated by the administratrix with the intention to make the corporation liable for past and pending obligations of the estate as the transportation business itself, then that liability on the part of the corporation, vis-à-vis the estate, should continue to remain with it even after the percentage of the estate's shares of stock in the corporation should have been diluted. *Buan v. Alcantara,* 127 SCRA 845 (1984).

Settled now is the rule that where one corporation sells or otherwise transfers all its assets to another corporation for value, the latter is not, by that fact alone, liable for the debts and liabilities of the transferor. ✓***Pantranco Employees Association (PEA-PTGWO) v. NLRC*, 581 SCRA 598 (2009).**

4. Equity Transfers

The transfer by the controlling shareholder of all of its equity in the corporation warrants the application of the alter ego piercing doctrine since it shows that the transferor had complete control of the corporation. (?)✓***Phividec v. Court of Appeals*, 181 SCRA 669 (1990)**.

Proper Doctrine: The mere fact that a stockholder sells his shares of stock in the corporation during the pendency of a collection case against the corporation, does not make such stockholder personally liable for the corporate debt, since the disposing stockholder has no personal obligation to the creditor, and it is the inherent right of the stockholder to dispose of his shares of stock anytime he so desires. *Remo, Jr. v. IAC*, 172 SCRA 405 (1989).[34]

B. MERGER AND CONSOLIDATIONS

1. Concepts (✓*McLeod v. NLRC*, 512 SCRA 222 [2007]).

A consolidation is the union of two or more existing entities to form a new entity called the consolidated corporation. A merger, on the other hand, is a union whereby one or more existing corporations are absorbed by another corporation that survives and continues the combined business. Since a merger or consolidation involves fundamental changes in the corporation, as well as in the rights of stockholders and creditors, there must be an express provision of law authorizing them. *PNB v. Andrada Electric & Engineering Co.,* 381 SCRA 244 (2002).

2. Procedure:

(a) Plan of Merger or Consolidation (**Sec. 76**)

(b) Stockholders' or Members' Approvals (**Sec. 77**)

(c) Articles of Merger or Consolidation (**Sec. 78**)

(d) ***Submission of Financial Statements Requirements:*** For applications of merger, the audited financial statements of the constituent corporations (surviving and absorbed) as of the date not earlier than 120 days prior to the date of filing of the application and the long-form audit report for absorbed corporation(s) are always required. Long form audit report for the surviving corporation is required if it is insolvent. (SEC Opinion 14, s. of 2002, 15 November 2002).

(e) Approval by SEC (**Sec. 79**)

The issuance by the SEC of the certificate of merger is crucial because not only does it bear out SEC's approval but also marks the moment whereupon the consequences of a merger take place. By operation of law, upon the effectivity of the merger, the absorbed corporation ceases to exist but its rights, and properties as well as liabilities shall be taken and deemed transferred to and vested in the surviving corporation. *Poliand Industrial Ltd. V. NDC*, 467 SCRA 500 (2005).[35]

When the procedure for merger/consolidation prescribed under the Corporation Code are not followed, there can be no merger or consolidation, and corporate separateness between the constituent corporations remains, and the liabilities of one entity cannot be enforced against another entity. *PNB v. Andrada Electric & Engineering Co.,* 381 SCRA 244 (2002).

3. Effects of Merger or Consolidation (**Sec. 80**)**:** ✓***Associated Bank v. CA,* 291 SCRA 511 (1998)**.

Global is bound by the terms of the contract entered into by its predecessor-in-interest, Asian Bank. Due to Global's merger with Asian Bank and because it is the surviving corporation, it is as if it was the one which entered into contract with Surecomp. In the merger of two existing corporation, one of the corporations survives and continues the business, while the other is dissolved, and all its rights, properties, and liabilities are acquired by the surviving corporation. In the same way, Global also has the right to exercise all defenses, rights, privileges, and counter-claims of every kind and nature which Asian Bank may have or invoke under the law. *Global Business Holdings Inc. v. Surecompsoftware, B.V.*, 633 SCRA 94 (2010)

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[34] *PNB v. Ritratto Group, Inc.*, 362 SCRA 216 (2001).

[35] *Mindanao Savings and Loan Asso. V. Willkom*, 634 SCRA 291 (2010).

It is settled that in the merger of two existing corporations, one of the corporations survives and continues the business, while the other is dissolved and all its rights, properties and liabilities are acquired by the surviving corporation. The surviving corporation therefore has a right to institute a collection suit on accounts of one of one of the constituent corporations. *Babst v. CA*, 350 SCRA 341 (2001).

C. EFFECTS ON EMPLOYEES OF CORPORATION

1. Assets Only Transfers: ✓*Sundowner Dev. Corp. v. Drilon,* 180 SCRA 14 (1989).

"There is no law requiring that the purchaser of MDII's assets should absorb its employees . . . the most that the NLRC could do, for reasons of public policy and social justice, was to direct [the buyer] to give preference to the qualified separated employees of MDII in the filling up of vacancies in the facilities. *MDII Supervisors & Confidential Employees Asso. v. Pres. Assistance on Legal Affairs*, 79 SCRA 40.

2. Business-Enterprise Transfers: ✓*Central Azucarera del Danao v. CA*, 137 SCRA 295 (1985); ✓*Complex Electronics Employees Assn. v. NLRC,* 310 SCRA 403 (1999).[36]

Furthermore, under the principle of absorption, a *bona fide* buyer or transferee of all, or substantially all, the properties of the seller or transferor is not obliged to absorb the latter's employees. The most that the purchasing company may do, for reasons of public policy and social justice, is to give preference of reemployment to the selling company's qualified separated employees, who in its judgment are necessary to the continued operation of the business establishment. *Barayoga v. Asset Privation Trust*, 473 SCRA 690 (2005).

Although a corporation may have ceased business operations and an entirely new company has been organized to take over the same type of operations, it does not necessarily follow that no one may now be held liable for illegal acts committed by the earlier firm. **✓*Pepsi-Cola Bottling Co., v. NLRC*, 210 SCRA 277 (1992)**.

Where a corporation is closed for alleged losses and its equipment are transferred to another company which engaged in the same operations, the separate juridical personality of the latter can be pierced to make it liable for the labor claims of the employees of the closed company. *National Federation of Labor Union v. Ople*, 143 SCRA 124 (1986).

In the case of a transfer of all or substantially all of the assets of a corporation (i.e., business enterprise transfers), the liabilities of the previous owners to its employees are not enforceable against the buyer or transferee, unless (a) the latter unequivocally assumes them; or (b) the sale or transfer was made in bad faith. *Barayoga v. Asset Privatization Trust*, 473 SCRA 690 (2005).

Where the change of ownership is done in bad faith, or is used to defeat the rights of labor, the successor-employer is deemed to have absorbed the employees and is held liable for the transgressions of his or her precedessor. *Peñafrancia Tours and Travel Transport v. Sarmiento*, 634 SCRA 279 (2010).

3. Equity Transfers: ✓*Pepsi Cola Distributors v. NLRC*, 247 SCRA 386 (1995); ✓*Manlimos v. NLRC*, 242 SCRA 145 (1995).[37]

4. Mergers and Consolidations: ✓*Filipinas Port Services v. NLRC,* 177 SCRA 203 (1989).[38]

It is more in keeping with the dictates of social justice and the State policy of according full protection to labor to deem employment contracts as automatically assumed by the surviving corporation in a merger, even in the absence of an express stipulation in the articles of merger or the merger plan. By upholding the automatic assumption of the nonsurviving corporation's existing employment contracts by the surviving corporation in a merger, the Court strengthens judicial protection of the right to security of tenure of employees affected by a merger and avoids confusion regarding the status of their various benefits. *Bank of P.I. v. BPI Employees Union-Davao Chapter, etc.*, 658 SCRA 828 (2011).

5. Spin-Offs: ✓*SMC Employees Union-PTGWO v. Confessor*, 262 SCRA 81 (1996).

XIV. *x*REHABILITATION AND INSOLVENCY

XV. CORPORATE DISSOLUTION AND LIQUIDATION

1. No Vested Rights to Corporate Fiction: No person who has a claim against a juridical entity can claim any constitutional right to the perpetual existence of such entity. *Gonzales v. SRA,* 174 SCRA 377 (1989).

2. Voluntary Dissolution (**Sec. 117**)

(a) No Creditors Affected (**Sec. 118**)

(b) There Are Creditors Affected (**Secs. 119 and 122**).

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[36] *Yu v. NLRC,* 245 SCRA 134 (1995); *Sunio v. NLRC*, 127 SCRA 390 (1984); *San Felipe Neri School of Mandaluyong, Inc. v. NLRC*, 201 SCRA 478 (1991).

[37] *Robledo v. NLRC*, 238 SCRA 52 (1994); *Pepsi-Cola Bottling Co. v. NLRC*, 210 SCRA 277 (1992); *DBP v. NLRC*, 186 SCRA 841 (1990); *Coral v. NLRC*, 258 SCRA 704 (1996); *Avon Dale Garments, Inc. v. NLRC*, 246 SCRA 733 (1995).

[38] *Reiterated in Filipinas Port Services v. NLRC,* 200 SCRA 773 (1991); *National Union Bank Employees v. Lazaro*, 156 SCRA 123 (1988); *First Gen. Marketing Corp. v. NLRC*, 223 SCRA 337 (1993).

When a corporation is contemplating dissolution, it must submit tax return on the income earned by it from the beginning of the year up to the date of its dissolution and pay the corresponding tax due. *BPI v. Court of Appeals*, 363 SCRA 840 (2001).

(c) Shortening of Corporate Term (**Sec. 120**)

Where a corporation is contemplating dissolving itself, it is required to submit tax return on the income earned by it from the beginning of the year up to the date of its dissolution and pay the corresponding tax due. *Bank of P.I. v. Court of Appeals*, 363 SCRA 840 (2001).

3. Involuntary Dissolution (**Sec. 121; Sec. 6(l), P.D. 902-A; Sec. 2, Rule 66, Rules of Court**)

(a) *Quo Warranto*

Dissolution is a serious remedy granted by the courts only in extreme cases and only to ensure that there is an avoidance of prejudice to the public. Even when the prejudice were public in nature, the remedy is to enjoin or correct the mistake; and only when it cannot be remedied anymore that dissolution should be imposed. *Republic v. Bisaya Land Transportation Co.*, 81 SCRA 9 (1978). *Government v. El Hogar Filipino*, 50 Phil. 399 (1927).

Thus, in *Republic v. Security Credit & Acceptance Corp.*, 19 SCRA 58 (1967), dissolution was imposed on a corporation that was engaging in banking activities without a license from the Central Bank, and risking the savings of the public.

(b) Non-user of Charter and Continuous In-Operation (Sec. 22)

"Organize" involves the election of officers, providing for the subscription and payment of the capital stock, the adoption of by-laws, and such other steps as are necessary to endow the legal entity with the capacity to transact the legitimate business for which the corporation was created. "Organization" relates merely to the systematization and orderly arrangement of the internal and managerial affairs and organs of the corporation. *Benguet Consolidated Mining Co. v. Pineda,* 98 Phil. 711.

The failure to file the by-laws does not automatically operate to dissolve a corporation but is now considered only a ground for such dissolution. *Chung Ka Bio v. IAC,* 163 SCRA 534 (1988).

(c) Expiration of Term

Where the corporate life of a corporation as stated in its articles of incorporation expired, without a valid extension having been effected, it was deemed dissolved by such expiration without need of further action on the part of the corporation. *Majority Stockholders of Ruby Industrial Corp. v. Lim*, 650 SCRA 461 (2011), *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW (2010 ed.), p. 841.

(d) Demand of Minority Stockholders for Dissolution.

When it comes to close or family corporations, there was recognition under the Corporation Law of a equitable right to demand dissolution of the corporation. *Financing Corp. of the Phil. v. Teodoro*, 93 Phil. 404 (1953).

Corporate dissolution due to mismanagement of majority stockholder is too drastic a remedy, especially when the situation can be remedied such as giving minority stockholders a veto power to any decision. *Chase v. Buencamino,* 136 SCRA 365 (1985).

4. Legal Effects of Dissolution

A corporation's board of directors is not rendered *funtus officio* by its dissolution, since Section 122 of the Corporation Code prohibits a dissolved corporation from continuing its business, but allows it to continue with a limited personality in order to settle and close it affairs, including its complete liquidation. Necessarily there must be a board that will continue acting for and on behalf of the dissolved corporation for that purpose. *Aguirre II v. FQB+7, Inc.*, 688 SCRA 242 (2013).

The dissolution of a juridical entity does not by itself cause the extinction or diminution of the rights and liability of such entity, since it is allowed to continue as a juridical entity for 3 years for the purpose of prosecuting and defending suits by or against it and enabling it to settle and close its affairs, to dispose of and convey its property, and to distribute its assets. *Republic v. Tancinco*, 394 SCRA 386 (2002).

A board resolution to dissolve the corporation does not operate to so dissolve the juridical entity. For dissolution to be effective "[t]he requirements mandated by the Corporation Code should have been strictly complied with." *Vesagas v. Court of Appeals,* 371 SCRA 509 (2002).

A corporation cannot extend its life by amendment of its articles of incorporation effected during the three-year statutory period for liquidation when its original term of existence had already expired, as the same would constitute new business. *Alhambra Cigar & Cigarette Manufacturing Company, Inc. v. SEC*, 24 SCRA 269 (1968).

When the period of corporate life expires, the corporation ceases to be a body corporate for the purpose of continuing the business for which it was organized. *PNB v. Court of First Instance of Rizal, Pasig, Br. XXI*, 209 SCRA 294 (1992).

A corporation that has reached the stage of dissolution is no longer qualified to receive a secondary franchise. *Buenaflor v. Camarines Industry*, 108 Phil. 472 (1960).

5. Meaning of "*Liquidation*"

Following the dissolution of a corporation, liquidation or the settlement of its affairs consists of adjusting the debts and claims, *i.e.,* collecting all that is due to the corporation, the settlement and

adjustment of claims against it and the payment of its just debts. *Yu v. Yukayguan*, 589 SCRA 588 (2009).[1]

Liquidation, in corporation law, connotes a winding up or settling with creditors and debtors. It is the winding up of a corporation so that assets are distributed to those entitled to receive them. It is the process of reducing assets to cash, discharging liabilities and dividing surplus or loss. *PVB Employees Union-N.U.B.E. v. Vega,* 360 SCRA 33 (2001).

A derivative suit is fundamentally distinct and independent from liquidation proceedings—they are neither part of each other nor the necessary consequence of the other. There is therefore no basis from one action to result in the other. *Yu v. Yukayguan*, 589 SCRA 588 (2009).

6. Methods of Liquidation (**Sec. 122)**

(a) The Board of Trustees Pursuing Liquidation; Subject to the 3-year Period

There is nothing in the Corporation Law which bars an action for the recovery of the debts of the corporation against the liquidator thereof, after the lapse of the said three-year period. "It immaterial that the present action was filed after the expiration of the three years . . . for at the very least, and assuming that judicial enforcement of taxes may not be initiated after said three years despite the fact that actual liquidation has not terminated and the one in charge thereof is still holding the assets of the corporation, obviously for the benefit of all the creditors thereof, the assessment aforementioned, made within the three years, definitely established the Government as a creditor of the corporation for whom the liquidator is supposed to hold assets of the corporation." *Republic v. Marsman Dev. Co.,* 44 SCRA 418 (1972). *Reiterated under the Corporation Code in Paramount Insurance Corp. v. A.C. Ordonez Corp.*, 561 SCRA 327 (2008).

Old Rule: Since the old Corporation Law did not contain any provision that allowed any action after the 3-year period for liquidation, then all actions for or against the corporation as abated after the expiration thereof. *National Abaca Corp. v. Pore*, 2 SCRA 989 (1961).

Now: Even after the expiration of the 3-year period, corporate creditors can still pursue their claims against corporate assets against the officers or stockholders who have taken over the properties of the corporation. *Tan Tiong Bio v. Commissioner*, 100 Phil. 86 (1956).[2]

Although a corporate officer is not liable for corporate obligations, such as claims for wages, however, when such corporate officer ceases corporate property to apply to his own claims against the corporation, he shall be liable to the extent thereof to corporate liabilities, since knowing fully well that certain creditors had similarly valid claims, he took advantage of his position as general manager and applied the corporation's assets in payment exclusively to his own claims. *De Guzman v. NLRC*, 211 SCRA 723 (1992).

(b) Liquidation Pursued Thru a Court-Appointed Receiver

When the liquidation of a dissolved corporation has been placed in the hands of a receiver or assignee, the 3-year period prescribed by law for liquidation cannot be made to apply, and that the receiver or trustee may institute all actions leading to the liquidation of the assets of the corporation even after the expiration of said period. *Sumera v. Valencia*, 67 Phil. 721 (1939).

There can be no doubt that under the Corporation Law, the Legislature intended to let the shareholders have the control of the assets of the corporation upon dissolution in winding up its affairs, by having the directors and executive officers to have charge of the winding up operations, though there is the alternative method of assigning the property of the corporation to the trustees for the benefit of its creditors and shareholders. "While the appointment of a receiver rests within the sound judicial discretion of the court, such discretion must, however, always be exercised with caution and governed by legal and equitable principles, the violation of which will amount to its abuse, and in making such appointment the court should take into consideration all the facts and weigh the relative advantages and disadvantages of appointing a receiver to wind up the corporate business." *China Banking Corp. v. M. Michelin & Cie*, 58 Phil. 261 (1933).

(c) Liquidation Pursued Through a Trustee

When upon dissolution the affairs of the corporation were placed in a Board of Liquidators, they were duly constituted as trustees for the liquidation of the corporate affairs, and there being no term placed on the Board, their power to pursue liquidation did not terminate upon the expiration of the 3-year period. *Board of Liquidators v. Kalaw*, 20 SCRA 987 (1967)

For purposes of dissolution and liquidation of a corporation, the term "trustee" should include counsel of record who may be deem to have authority to pursue pending litigation after the expiration of the 3-year liquidation period. ✓***Gelano v. Court of Appeals*, 103 SCRA 90 (1981)**.

If the 3-year extended life has expired without a trustee or receiver having been designated, the Board of Directors itself, following the rationale of the decision in *Gelano*, may be permitted to so continue as "trustees" to complete liquidation; and in the absence of a Board, those having pecuniary interest in the assets, including the shareholders and the creditors of the corporation, acting for and in its behalf, might make proper representations with the appropriate body for working out a final settlement of the corporate concerns. *Clemente v. Court of Appeals*, 242 SCRA 717 (1995).[3]

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[1] *Majority Stockholders of Ruby Industrial Corp. v. Lim*, 650 SCRA 461 (2011).

[2] *Reiterated in Republic v. Marsman Dev. Co.,* 44 SCRA 418 (1972).

Under Section 122 of the Corporation Code, a corporation whose corporate existence is terminated in any manner continues to be a body corporate for three (3) years after its dissolution for purposes of prosecuting and defending suits by and against it and to enable it to settle and close its affairs, culminating in the disposition and distribution of its remaining assets. If the three-year extended life has expired without a trustee or receiver having been expressly designated by the corporation within that period, the board of directors (or trustee) itself, may be permitted to continue as "trustees" by legal implication to complete the corporation liquidation.

A trustee appointed for purposes of liquidation does not become personally liable for the outstanding obligations of the corporation. *Republic v. Tancinco*, 394 SCRA 386 (2003).

7. Reincorporation: By following the procedures on the sale of all or substantially all of the assets of the corporation, the stockholders may transfer the assets and business enterprise of the dissolved corporation to a newly registered entity bearing the same corporate name. ✓***Chung Ka Bio v. IAC*, 163 SCRA 534 (1988)**.

XVI. CLOSE CORPORATIONS

1. Definition (**Sec. 96**)

The concept of a close corporation organized for the purpose of running a family business or managing family property has formed the backbone of Philippine commerce and industry. Through this device, Filipino families have been able to turn their humble, hard-earned life savings into going concerns capable of providing them and their families with a modicum of material comfort and financial security as a reward for years of hard work. A family corporation should serve as a reward for years of hard work—as a rallying point for family unity and prosperity, not as a flashpoint for familial strife. It is hoped that people reacquaint themselves with the concepts of mutual aid and security that are the original driving forces behind the formation of family corporations and use these tenets in order to facilitate more civil, if not more amicable, settlements of family corporate disputes. *Gala v. Ellice Agro-Industrial Corp.*, 418 SCRA 431 (2003).

(a) *De Jure* Close Corporations: Articles of Incorporation Requirements (**Sec. 97**)

(i) Restriction on Transfer of Shares (**Secs. 98 and 99**)

(ii) Pre-Emptive Rights (**Sec. 102**)

(iii) Amendment (**Sec. 103**)

(b) *De Facto Close Corporation:*

✓***Manuel R. Dulay Enterprises v. Court of Appeals*, 225 SCRA 678 (1993)**.

✓***Sergio F. Naguiat v. NLRC,* 269 SCRA 564 [1997]**

***BUT SEE*: ✓*San Juan Structural v. Court of Appeals*, 296 SCRA 631 (1998)**.

2. Binding Agreements by Stockholders (**Sec. 100**)

3. No Necessity of Board (**Sec. 101**;).

4. Deadlocks (**Sec. 104**): ✓***Ong Yong v. Tiu*, 401 SCRA 1 (2003)**.

5. Withdrawal and Dissolution (**Sec. 105**)

Even prior to the passage of Corporation Code which recognized close corporations, the Supreme Court had on limited instances recognized the common law rights of minority stockholders to seek dissolution of the corporation. *Financing Corp. of the Phil. v. Teodoro*, 93 Phil. 404 (1953).

XVII. NON-STOCK CORPORATIONS AND FOUNDATIONS

1. Theory on Non-Stock Corporation (**Secs. 14(2), 43, 87, 88 and 94[5])**

It is not inconsistent with the nature of a non-stock corporation for it to *incidentally earn profits* in pursuing its eleemosynary purpose. What is prohibited is to operate the company for profit and/or distribute any profits so earned to its officers and members. *Collector of Internal Revenue v. Club Filipino Inc. de Cebu*, 5 SCRA 321 (1962); *Collector of Internal Revenue v. University of Visayas*, 1 SCRA 669 (1961).

A non-stock corporation may only be formed or organized for charitable, religious, educational, professional, cultural, fraternal, literary, scientific, social, civic or other similar purposes. It may not engage in undertakings such as the investment business where profit is the main or underlying purpose. Although the non-stock corporation may obtain profits as an incident to its operation such profits are not to be distributed among its members but must be used for the furtherance of its purposes. *People v. Menil*, G.R. 115054-66, 12 September 1999 [unrep.])

The incurring of profit or losses does not determine whether an activity is for profit or non-profit, and the courts will consider whether dividends have been declared or its members or that is property, effects

[3] *Reiterated in Reburiano v. Court of Appeals,* 301 SCRA 342 (1999); *Knecht v. United Cigarette Corp.*, 384 SCRA 48 (2002); *Pepsi-Cola Products Phils., Inc. v. Court of Appeals*, 443 SCRA 571 (2004).

or profit was ever used for personal or individual gain, and not for the purpose of carrying out the objectives of the enterprise. *Manila Sanitarium and Hospital v. Gabuco*, 7 SCRA 14 (1963).

In a mutual life insurance company organized as a non-stock nonprofit corporation, the so-called "dividend" that is received by members-policyholders is not a portion of profits set aside for distribution to the stockholders in proportion to their subscription to the capital stock of a corporation. *One,* a mutual company has no capital stock to which subscription is necessary; there are no stockholders to speak of, but only members. *Two*, the amount they receive does not partake of the nature of a profit or income. The *quasi*-appearance of profit will not change its character; it remains an overpayment, a benefit to which the member-policyholder is equitably entitled. *Republic v. Sunlife Assurance Company of Canada*, 473 SCRA 129 (2005).

2. Non-Applicability of the Nationalization Laws

A foreigner may a member or an officer of a non-stock corporation. Save for the position of the Secretary, who must be a Filipino citizen and a resident of the Philippines, the prohibition of foreign citizens becoming officers in corporations engaged in business does not apply to the activities of a non-stock corporation which do not fall within the coverage of a nationalized industry or area of business reserved by law exclusively to Filipino citizens. (SEC Opinion No. 12, series of 2002, 21 November 2002).

3. Delinquency of Membership Dues

Sec. 69 of the Corporation Code refers specifically to unpaid subscriptions to capital stock, the sale of which is governed by Sec. 68. Indeed, there are fundamental differences that defy equivalence or even an analogy between sale of delinquent stock under Section 68 and sale that occurred in this case. *Calatagan Golf Club, Inc. v. Clemente, Jr.,* 585 SCRA 300 (2009).

Neither Article 1146 or Article 1149 is applicable but Article 1140 of the Civil Code which provides that an action to recover movables shall prescribe in eight (8) years. *Calatagan Golf Club, Inc. v. Clemente, Jr.,* 585 SCRA 300 (2009).

The utter bad faith exhibited by Calatagan brings into operation Articles 19, 20 and 21 of the Civil Code under the Chapter on Human Relations; The obligation of a corporation to treat every person honestly and in good faith extends even to its shareholders or members, even if the latter find themselves contractually bound to perform certain obligations to the corporation. *Calatagan Golf Club, Inc. v. Clemente, Jr.,* 585 SCRA 300 (2009).

A non-stock corporation may seize and dispose of the membership share of a fully-paid member on account of its unpaid debts to the corporation (*i.e.*, unpaid monthly dues) when it is authorized to do so under the corporate by-laws (not by the articles of incorporation), and in spite of the fact that Sec. 67 of Corporation Code on delinquency sale pertains to payment of shares subscription. The right of a non-stock corporation to expel a member through the forfeiture of such member's share may be established in the by-laws alone, and need not be embodied in the articles of incorporation. This is authorized under Sec. 91 of Corporation Code providing that membership shall be terminated in the manner and for causes provided in the articles of incorporation or the by-laws of a non-stock corporation. ✓***Valley Golf & Country Club v. Vda. De Caram*, 585 SCRA 218 (2009).**

4. Board of Trustees and Corporate Officers

The second paragraph of Section 108 of the Corporation Code, although setting the term of the members of the Board of Trustees at five years, contains a proviso expressly subjecting the duration to what is otherwise provided in the articles of incorporation or by-laws of the educational corporation—that contrary provision control on the term of office. *Barayuga v. Advestist University of the Philippines*, 655 SCRA 640 (2011).

A trustee occupying his office in a hold-over capacity could be removed at any time, without cause, upon the election or appointment of his successor. *Barayuga v. Advestist University of the Philippines*, 655 SCRA 640 (2011).

5. Conversion of Non-Stock Corporation to Stock Corporation

The conversion of a non-stock educational institution into a stock corporation is not legally feasible, as it violates Sec. 87 of Corporation Code that no part of the income of a non-stock corporation may be distributable as dividends to its members, trustees or officers. "Thus, the Commission has previously ruled that a non-stock corporation cannot be converted into a stock corporation by a mere amendment of the Articles of Incorporation. For purposes of transformation, it is fundamental that the non-stock corporation be dissolved first under any of the methods specified Title XIV of the Corporation Code. Thereafter, the members may organize as a stock corporation directed to bring profits or pecuniary gains to themselves. (SEC Opinion dated 24 February 2003; SEC Opinion dated 10 December 1992).

5. What Is a Foundation? (Secs. 30 and 34(H), NIRC of 1997; Sec. 24, Rev. Reg. No. 2; BIR-NEDA Regulations No. 1-81, as amended)

Formal requirements of Rev. Reg. No. 2 are not mandatory and an entity may, in the absence of compliance with such requirements, still show that it falls under the provisions of Sec. of NIRC. *Collector v. V.G. Sinco Educational Corp.*, 100 Phil. 127 (1956).

6. Dissolution: Right of Members to Proportionate Share of Remaining Assets (Secs. 94 and 95; Sec. 34(H)(2)(c), 1997 NIRC).

As provided for under Secs. 94 and 95 of Corporation Code, in the event of dissolution of a non-stock corporation, its assets shall be distributed in accordance with the rules. Unless, it is so provided in the

Articles of Incorporation or By-Laws, the members are not entitled to any beneficial or vested interest over the assets of the non-stock corporation. In other words, non-stock, non-profit corporations hold their funds in trust for the carrying out of the objectives and purposes expressed in its charter. (SEC Opinion dated 24 February 2003; SEC Opinion dated 13 May 1992).

XVIII. FOREIGN CORPORATIONS

1. Definition (**Sec. 123**)

A foreign corporation is one which owes its existence to the laws of another state, and generally, has no legal existence within the State in which it is foreign. *Avon Insurance PLC v. Court of Appeals,* 278 SCRA 312 (1997)

2. License to Do Business in the Philippines

(a) Application for License (**Secs. 124 and 125; Art. 48, Omnibus Investment Code**)

(b) ***Rationale for Requiring License:***

Sec. 69 of old Corporation Law was intended to subject the foreign corporation doing business in the Philippines to the jurisdiction of our courts and not to prevent the foreign corporation from performing single acts, but to prevent it from acquiring domicile for the purpose of business without taking the necessary steps to render it amenable to suit in the local courts. ✓***Marshall-Wells v. Elser*, 46 Phil. 71 (1924)**.

Otherwise, a foreign corporation illegally doing business here because of its refusal or neglect to obtain the required license to do business may successfully though unfairly plead such neglect or illegal act so as to avoid service and thereby impugn the jurisdiction of the local courts. *Avon Insurance PLC v. CA,* 278 SCRA 312 (1997).

The same danger does not exist among foreign corporations that are indubitably not doing business in the Philippines: there would be no reason for it to be subject to the State's regulation; for in so far as the State is concerned, such foreign corporation has no legal existence. Therefore, to subject such foreign corporation to the local courts' jurisdiction would violate the essence of sovereignty of the creating state. *Avon Insurance PLC v. CA,* 278 SCRA 312 (1997).

(c) Appointment of a Resident Agent (**Sec. 127 and 128**)

Being a resident agent of a foreign corporation does not mean that he is authorized to execute the requisite certification against forum shopping—while a resident agent may be aware of actions filed against his principal (a foreign corporation doing business in the Philippines), he may not be aware of actions initiated by its principal, whether in the Philippines or abroad. *Expertravel & Tours, Inc. v. Court of Appeals*, 459 SCRA 147 (2005).

A complaint filed by a foreign corporation is fatally defective for failing to allege its duly authorized representative or resident agent in Philippine jurisdiction. *New York Marine Managers, Inv. c. Court of Appeals,* 249 SCRA 416 (1995).

When a corporation has designated a person to receive service of summon pursuant to the Corporation Code, the designation is exclusive and service of summons on any other person is inefficacious. *H.B. Zachry Company Int'l v. CA*, 232 SCRA 329 (1994)

(d) Issuance of License (**Sec. 126; Art. 49, Omnibus Investment Code**)

A foreign corporation licensed to do business should be subjected to no harsher rules that is required of domestic corporation and should not generally be subject to attachment on the pretense that such foreign corporation is not residing in the Philippines. *Claude Neon Lights v. Phil. Advertising Corp.*, 57 Phil. 607 (1932).

(e) Amendment of License (**Sec. 131**)

(f) Effects of Failure to Obtain License:

(i) On the Contract Entered Into: ✓*Home Insurance Co. v. Eastern Shipping Lines*, 123 SCRA 424 (1983).

(ii) Standing to Sue (**Sec. 133**)

(iii) Criminal Liability under Sec. 144: ✓*Home Insurance Co. v. Eastern Shipping Lines*, 123 SCRA 424 (1983).

***Summary of Rulings on Doing Business*:** The principles regarding the right of a foreign corporation to bring suit in Philippine courts may thus be condensed in four statements: (1) if a foreign corporation does business in the Philippines without a license, it cannot sue before Philippine courts; (2) if a foreign corporation is not doing business in the Philippines, it needs no license to sue before Philippine courts on an isolated transaction or on a cause of action entirely independent of any business transaction; (3) if a foreign corporation does business in the Philippines without a license, a Philippine citizen or entity which has contracted with said corporation may be estopped from challenging the foreign corporation's corporate personality in a suit brought before the Philippine

courts; and (4) if a foreign corporation does business in the Philippines with the required license, it can sue before Philippine courts on any transaction. *MR. Holdings, Ltd. V. Bajar,* 380 SCRA 617 (2002).[1]

3. Concepts of "*Doing Business in the Philippines*"; Effects of Not Obtaining the Licesnse

(a) Statutory Concept of Doing Business (R.A. No. 7042, Foreign Investment Act of 1991).

Under Sec. 123 of Corporation Code, a foreign corporation must first obtain a license and a certificate from the appropriate government agency before it can transact business in the Philippines. Where a foreign corporation does business in the Philippines without the proper license, it cannot maintain any action or proceeding before Philippine courts as provided in Section 133 of the Corporation Code. *Cargill, Inc. v. Intra Strata Assurance Corp.*, 615 SCRA 304 (2010).

The Foreign Investments Act of 1991, repealed Articles 44-56 of Book II of the Omnibus Investments Code of 1987, enumerated in Sec. 3(d) not only the acts or activities which constitute "doing business" but also those activities which are not deemed "doing business". *Cargill, Inc. v. Intra Strata Assurance Corp.*, 615 SCRA 304 (2010).

Under Section 3(d) of the Foreign Investments Act of 1991, as supplemented by Rule I, Section 1(f) of its Implementing Rules and Regulations, the appointment of a distributor in the Philippines is not sufficient to constitute "doing business" unless it is under the full control of the foreign corporation. In the same manner, if the distributor is an independent entity which buys and distributes products, other than those of the foreign corporation, for its own name and its own account, the latter cannot be considered to be doing business in the Philippines. *Steelcase, Inc. v. Design International Selections, Inc.*, 670 SCRA 64 (2012).

(b) Jurisprudential Concepts of "*Doing Business*": It implies a continuity of commercial dealings and arrangements and the performance of acts or works or the exercise of some of the functions normally incident to the purpose or object of a foreign corporation's organization. ✓***Mentholatum v. Mangaliman*, 72 Phil. 525 (1941)**.

(i) *Single Transaction* – Where a single act or transaction, however, is not merely incidental or casual but indicates the foreign corporation's intention to do other business in the Philippines, said single act or transaction constitutes doing business. *Far East Int'l. v. Nankai Kogyo*, 6 SCRA 725 (1962).

It is not really the fact that there is only a single act done that is material for determining whether a corporation is engaged in business in the Philippines, since other circumstances must be considered. Where a single act or transaction of a foreign corporation is not merely incidental or casual but is of such character as distinctly to indicate a purpose on the part of the foreign corporation to do other business in the state, such act will be considered as constituting business. *Litton Mills, Inc. v. Court of Appeals*, 256 SCRA 696 (1996).

Participating in a bidding process constitutes "doing business" because it shows the foreign corporation's intention to engage in business in the Philippines. In this regard, it is the performance by a foreign corporation of the acts for which it was created, regardless of volume of business, that determines whether a foreign corporation needs a license or not." *European Resources and Technologies, Inc. v. Ingenieuburo Birkhanh + Nolte*, 435 SCRA 246 (2004).

(ii) "***Territoriality Rule***" –

To be doing business in the Philippines requires that the contract must be perfected or consummated in Phlippine soil. A CIF, West Coast arrangement makes delivery outside of the Philippines. ✓***Pacific Vegetable Oil Corp. v. Singson*, Advanced Decision Supreme Court, April 1955 Vol., p. 100-A;** ***Aetna Casualty & Surety Co. v. Pacific Star Line*, 80 SCRA 635 (1977)**.[2]

To be "transaction business in the Philippines" for purposes of Section 133 of the Corporation Code, the foreign corporation must actually transact business in the Philippines, that is, perform specific business transactions within the Philippine territory on a continuing basis in its own name and for its own account. *B. Van Zuiden Bros., Ltd v. GTVL Manufacturing Industries, Inc.*, 523 SCRA 233 (2007), *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW 813 (2001).

Exception:

- ***Acts of Solicitations*** – Solicitation of business contracts constitutes doing business in the Philippines. *Marubeni Nederland B.V. v. Tensuan*, 190 SCRA 105.

(iii) ***"Transactions Seeking Profit"*** – Although each case must be judged in light of its attendant circumstances, jurisprudence has evolved several guiding principles for the application of these tests. "By and large, to constitute 'doing business,' the activity to be undertaken in the Philippines is one that is for profit-making." ✓***Agilent Technolgies Singapore (PTE) Ltd. v. Integrated Silicon Technology Phil. Corp.*, 427 SCRA 593 (2004)**, *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW 596 et seq. (1998 ed.); *Cargill, Inc. v. Intra Strata Assurance Corp.*, 615 SCRA 304 (2010), *citing* VILLANUEVA, PHILIPPINE CORPORATE LAW 801-802 (2001).

Examples:

[1] *Agilent Technologies Singapore (PTE) Ltd. v. Integrated Silicon Technology Phil. Corp.*, 427 SCRA 593 (2004).

[2] *Universal Shipping Lines, Inc. v. IAC*, 188 SCRA 170 (1990).

- ***Insurance Business*** – A foreign corporation with a settling agent in the Philippines which issues twelve marine policies covering different shipments to the Philippines is doing business in the Philippines. *General Corp. of the Phil. v. Union Insurance Society of Canton, Ltd.,* 87 Phil. 313 (1950).

  A foreign corporation which had been collecting premiums on outstanding policies is doing business in the Philippines. *Manufacturing Life Ins. v. Meer*, 89 Phil. 351 (1951).

- ***Air Carriers*** – Off-line air carriers having general sales agents in the Philippines are engaged in business in the Philippines and that their income from sales of passage here (*i.e.*, uplifts of passengers and cargo occur to or from the Philippines) is income from within the Philippines. *South African Airways v. Commissioner of Internal Revenue*, 612 SCRA 665 (2010).

Exception:

- *Transactions with Agents and Brokers* **– ✓*Granger Associates v. Microwave Systems, Inc.*, 189 SCRA 631 (1990)**.[3]

(c) The Special Cases on Infringement of Business Names and Trademarks: ✓*Western Equipment & Supply Co. v. Reyes*, 51 Phil. 115 (1927).

Infringement of trade name. *General Garments Corp. v. Director of Patens*, 41 SCRA 50 (1971); *Universal Rubber Products, Inc. v. Court of Appeals*, 130 SCRA 104 (1988).

(d) Doctrine on Unrelated or Isolated Transactions: ✓*Antam Consolidated v. CA*, 143 SCRA 288 (1986).[4]

A foreign corporation needs no license to sue before Philippine courts on an isolated transaction. *Lorenzo Shipping v. Chubb and Sons, Inc.*, 431 SCRA 266 (2004).

Single or isolated acts, contracts, or transactions of foreign corporations are not regarded as a carrying on of business. Typical examples of these are the making of a single contract, sale with the taking of a note and mortgage in the state to secure payment thereof, purchase, or note, or the mere commission of a tort. In these instances, there is no purpose to do any other business within the country. *MR. Holdings, Ltd. V. Bajar*, 380 SCRA 617 (2002).

Even a series of transactions which are occasional, incidental and casual—not of a character to indicate a purpose to engage in business—do not constitute the doing or engaging in business as contemplated by law. *Lorenzo Shipping v. Chubb and Sons, Inc.*, 431 SCRA 266 (2004).

Case-Law Examples of Isolated Transactions:

- Recovery on the collision of two vessels at the Manila Harbor. *Dampfschieffs Rhederei Union v. La Campañia Transatlantica*, 8 Phil. 766 (1907).
- Loss of goods bound for Hongkong but erroneously discharged in Manila. *The Swedish East Asia Co., Ltd. v. Manila Port Service*, 25 SCRA 633 (1968).
- Recovery of damages sustained by cargo shipped to the Philippines. *Bulakhidas v. Navarro*, 142 SCRA 1 (1986).
- Sale of construction equipment to the Government with no intent of continuity of transaction. *Gonzales v. Raquiza*, 180 SCRA 254 (1989).
- Recovery on a Hongkong judgment against a Manila resident. *Hang Lung Bak v. Saulog*, 201 SCRA 137 (1991).
- Appointment of local lawyer by foreign movie companies who have registered intellectual property rights over their movies in the Philippines, to protect such rights for piracy: "We fail to see how exercising one's legal and property rights and taking steps for the vigilant protection of said rights, particularly the appointment of an attorney-in-fact, can be deemed by and of themselves to be doing business here." *Columbia Pictures Inc. v. Court of Appeals,* 261 SCRA 144 (1996).

4. Suits Brought by Foreign Corporations

(a) ***Need to Allege Capacity to Sue:*** The fact that a foreign corporation is not doing business in the Philippines must be alleged if a foreign corporation desires to sue in Philippines courts under the "isolated transactions rule." **✓*Atlantic Mutual Inc. Co. v. Cebu Stevedoring Co.*, 17 SCRA 1037 (1966)**.[5]

(b) ***Estoppel Doctrine*:** Under the principle of estoppel, a foreign corporation doing business in the Philippines may sue in Philippine courts even without license to do business against a Philippine citizen who had contracted with and been benefited by said corporation and knew it to be without the necessary license to do business. **✓*Merrill Lynch Futures, Inc. v. CA*, 211 SCRA 824 (1992)**.[6]

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[3] *La Chemise Lacoste, S.A. v. Fernandez*, 129 SCRA 373 (1984); *Schmid & Oberly v. RJL*, 166 SCRA 493 (1988); *Wang Laboratories, Inc. v. Mendoza*, 156 SCRA 44 (1974).

[4] *Eastboard Navigation, Ltd. v. Juan Ysmael and Co., Inc.*, 102 Phil. 1 (1957).

[5] This overturned the previous doctrine in *Marshall-Wells* (as well as in *In re Liquidation of the Mercantile Bank of China, etc.*, 65 Phil. 385 (1938), that the lack of authority of foreign corporation to sue in Philippine courts for failure to obtain the license is a matter of affirmative defense. Also *Commissioner of Customs v. K.M.K. Gani*, 182 SCRA 591 (1990).

[6] *Georg Grotjahn GMBH & C. v. Isnani*, 235 SCRA 216 (1994); *Communications Material and Design, Inc. v. Court of Appeals*, 260 SCRA 673 (1996); *Agilent Technologies Singapore (PTE) Ltd. v. Integrated Silicon Technology Phil. Corp.*, 427 SCRA 593 (2004); *Global Business Holdings, Inc. v. Surecomp Software, B.V.*, 633 SCRA 470 (2010); *Steelcase, Inc. v. Design International Selections,*

***Proper Doctrine*: ✓*Eriks Ltd. v. Court of Appeals,* 267 SCRA 567 (1997)**.

(c) ***On Isolated Transactions:*** A foreign corporation not licensed to do business in the Philippines is not absolutely incapacitated from filing a suit in local court. *Aboitiz Shipping Corp. v. Insurance Company of North America,* 561 SCRA 262 (2008).

5. Suits Against Foreign Corporations:

A fundamental rule of international law on state jurisdiction is that no state can by its laws, and no court which is only a creature of the state, can by its judgments and decrees, directly bind or affect property or persons beyond the limits of that state. *Times, Inc. v. Reyes*, 39 SCRA 303 (1971).

(a) Jurisdiction Over Foreign Corporations (**Sec. 14, Rule 14, Rules of Court**; ✓***General Corp. of the Phil. v. Union Insurance Society of Canton, Ltd.*, 87 Phil. 313 (1950)**.[7]

For purpose serving summons a foreign corporation in accordance with Rule 14, Section 14, it is sufficient that it be alleged in the complaint that it is doing business in the Philippines. *Hahn v. Court of Appeals,* 266 SCRA 537 (1997).

When it is shown that a foreign corporation is doing business in the Philippines, summons may be served on (a) its resident agent designated in accordance with law; (b) if there is no resident agent, the government official designated by law to that effect; or (c) any of its officers or agent within the Philippines. The mere allegation in the complaint that a local company is the agent of the foreign corporation is not sufficient to allow proper service to such alleged agent; it is necessary that there must be specific allegations that establishes the connection between the principal foreign corporation and its alleged agent with respect to the transaction in question. *French Oil Mills Machinery Co.v. CA,* 295 SCRA 462 (1998).

For purposes of venue involving a foreign corporation, its "residence" includes the country where it exercises corporate functions or the place where its business is done. *State Investment House v. Citibank*, 203 SCRA 9 (1991); *Northwest Orient Airlines v. Court of Apppeals,* 241 SCRA 192 (1995).

(b) ***Objection to Jurisdiction*:** Appearance of a foreign corporation to a suit precisely to question the tribunal's jurisdiction over its person is not equivalent to service of summons, nor does it constitute an acquiescence to the court's jurisdiction. *Avon Insurance PLC v. Court of Appeals,* 278 SCRA 312 (1997).

(c) ***Discredited Pari Delicto* Doctrine:** The local party to a contract with a foreign corporation that does business in the Philippines without license cannot maintain suit against the foreign corporation just as the foreign corporation cannot maintain suit, under the principle of *pari delicto*. ✓***Top-Weld Mfg. v. ECED*, 119 SCRA 118 (1985).**

***BUT SEE:* ✓*Communication Materials v. Court of Appeals,* 260 SCRA 673 (1996**).

(d) ***Odd But Prevailing Doctrine*:**

"Indeed, if a foreign corporation, not engaged in business in the Philippines, is not barred from seeking redress from the courts in the Philippines, *a fortiori,* that same corporation cannot claim exemption from being sued in Philippine courts for acts done against a person or persons in the Philippines." ✓***Facilities Management Corp. v. De la Osa*, 89 SCRA 131 (1979)**.[8]

CONTRA*:** The *sine qua non* requirement for service of summons and other legal processes or any such agent or representative is that the foreign corporation is doing business in the Philippines. *Hyopsung Maritime Co., Ltd. v. CA*, 165 SCRA 258 1988); ✓Signetics Corp. v. CA*, 225 SCRA 737 (1993)**.

***BUT NOW SEE:* ✓*Avon Insurance PLC v. Court of Appeals,* 278 SCRA 312 (1997)**.

(e) ***Stipulation on Venue*:** When the contract sued upon has a venue clause within the Philippines, it is deemed a confirmation by the foreign corporation, even though not doing business in the Philippines, to be sued in local courts. *Linger & Fisher GMBH v. IAC*, 125 SCRA 522 (1983).

6. Laws Applicable to Foreign Corps. (**Sec. 129**)

The provision in the New York law which allowed only stockholders with a minimum number of shareholdings (3%) to be entitled to exercise the right of inspection is valid in the case of a foreign corporation licensed to do business in the Philippines which in its internal relationship was bound by th New York law. *Grey v. Insular Lumber Co.*, 67 Phil. 139 (1938)

7. Amendment of Articles of Incorporation (**Sec. 130**)

8. Merger and Consolidation (**Sec. 132; Art. 51, Omnibus Code**)

9. Revocation of License (**Secs. 134 and 135**; **Art. 50, Omnibus Investment Code**)

10. Withdrawal of Foreign Corporation (**Sec. 136**)

Inc., 670 SCRA 64 (2012).

[7] *Johnlo Trading Co., v Flores,* 88 Phil. 741 (1951); *Johnlo Trading Co. v. Zulueta*, 88 Phil. 750 (1951); *Pacific Micronisian Line, Inc. v. Del rosario*, 96 Phil. 23 (1954); *Far East Int'l Import and Export Corp. v. Nankai Kogyo Co., Ltd.*, 6 SCRA 725 (1962).

[8] *FBA Aircraft v. Zosa*, 110 SCRA 1 (1981); *Royal Crown Int'l v. NLRC*, 178 SCRA 569 (1989); *Wang Laboratories, Inc. v. Mendoza*, 156 SCRA 44 (1987).

XIX. PENALTY PROVISIONS OF THE CODE

1. **Penalty Clause for Violations of the Provisions of the Code** (Sec. 144)
2. **Cross-reference** (**Sec. 27**).
3. **Specific application** (**Sec. 74**).
4. **Strict Principles in Criminal Law; the issue of malice.**
5. **Historical Background of Sec. 144 (Sec. 190 1/7 of the Corporation Law)**

   Sec. 190 was not intended to make every casual violation of one of the Corporation Law provisions ground for involuntary dissolution of the corporation and that the court was entitled to exercise discretion in such matters. *Government of P.I. v. El Hogar Filipino*, 50 Phil. 399 (1927).

   Penalties imposed in Sec. 190(A) for the violation of the prohibition in question are of such nature that they can be enforced only by a criminal prosecution or by an action of *quo warranto*. *But these proceedings can be maintained only by the Attorney-General in representation of the Government. Harden v. Benguet Consolidated Mining Co.,* 58 Phil. 141 (1933).

6. **Violation of Sec. 133 by Foreign Corporations**

   Sec. 133, which unlike its counterpart Sec. 69 of Corporation Law provided specifically for penal sanctions for foreign corporations engaging in business in the Philippines without obtaining the requisite license, should be deemed to have a penal sanction by virtue of Section 144 of the Corporation Code. *Home Insurance Co. v. Eastern Shipping Lines*, 123 SCRA 424 (1983).

XX. MISCELLANEOUS

1. **SEC Power and Supervision** (**Secs. 108 and 143; PD 902-A**)
2. **Special Corporations** (**Sec. 4**)
3. **New Requirements on Existing Corporations** (**Sec. 148**).
4. **Applicability of Other Provision of old Corporation Law** (**Secs. 145 and 146**).

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