I. THEORIES ON FORMATION OF A CORPORATION

1. Concession Theory
   - A corporation is an artificial creature without any existence until it has received the imprimatur of the state acting according to law, through the SEC (Tayag vs. Benguet Consolidated, Inc., 26 SCRA 242).
   - Tayag rejects the Genossenschaft Theory which treats a corporation as “the reality of the group as a social and legal entity, independent of state recognition and concession.”

2. Theory of corporate enterprise or economic unit
   - The corporation is not merely an artificial being, but more of an aggregation of persons doing business, or an underlying business unit (Philippine Corporate Law, Cesar Villanueva, 2001 ed.).
   - The theory draws its vitality from the fact that it is not legal fiction alone that creates a corporate entity but also the consent of those who will form the corporation to engage in a common venture or business for profit.

II. ATTRIBUTES OF A CORPORATION

1. It is an artificial being with separate and distinct personality
2. It is created by operation of law.
3. It enjoys the right of succession.
4. It has the powers, attributes and properties expressly authorized by law or incident to its existence.

ARTIFICIAL BEING WITH SEPARATE PERSONALITY

DOCTRINE OF SEPARATE PERSONALITY A corporation is a legal or juridical person with a personality separate and apart from its individual stockholders or members and from any other legal entity to which it may be connected (Philippine Corporate Law, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.).

Consequences:
1. Liability for acts or contracts
   - The general rule is that obligations incurred by a corporation, acting through its authorized agents are its sole liabilities. Similarly, a corporation may not be made to answer for acts or liabilities of its stockholders or members or those of the legal entities to which it may be connected and vice versa (Creese vs. CA, 93 SCRA 483).
2. Right to bring actions
   - It may bring civil and criminal actions in its own name in the same manner as natural persons (Art. 46, NCC).
3. Right to acquire and possess property
   - Property conveyed to or acquired by the corporation is in law the property of the corporation itself as a distinct legal entity and not that of the stockholders or members (Art. 44(3), NCC).
4. Acquisition of court of jurisdiction
   - Service of summons may be made on the president, general manager, corporate secretary, treasurer or in-house counsel (Sec. 11, Rule 14, Rules of Court).
5. Changes in individual membership
   - Corporation remains unchanged and unaffected in its identity by changes in its individual membership (The Corporation Code of the Philippines Annotated, Hector De Leon, 2002 ed.).
6. Entitlement to constitutional guaranties
   - Corporations are entitled to certain constitutional rights.

a. Due process (Albert v. University Publishing, Inc. 13 SCRA 84 [1965])
 b. Equal Protection of the law (Smith, Bell & Co. v. Natividad, 40 Phil. 136 [1919])
 c. Protection against unreasonable searches and seizures (Stonehill v. Diokno, 20 SCRA 383 [1967])

However, it is not entitled to certain constitutional rights such as political rights or purely personal rights not only because it is an artificial being but also because it is a mere creature of law (Reviezer in Commercial Law, Jose R. Sundiang & Timoteo Aquino, 2005 ed.).

a. Right against self-incrimination (Bataan Shipyard v. PCGG, 150 SCRA [1987]).

7. Moral Damages
   - A corporation is not entitled to moral damages because it has no feelings, no emotions, no senses (ABS-CBN vs. Court of Appeals, G.R. No. 128690, Jan. 21, 1999).
   - In Filipinas Broadcasting vs. Aga Med., however, it was held that a juridical person such as a corporation can validly complain for libel or any other form of defamation and claim for moral damages. The SC had rationated that Art. 2219 (7) does not qualify whether the plaintiff is a natural or a juridical person (Filipinas Broadcasting vs. Aga Medical Center-Bicol, et. al., 448 SCRA 413).

8. Liability for torts
   - A corporation is liable whenever a tortuous act is committed by an officer or agent under the express direction or authority of the stockholders or members acting as a body, or, generally, from the directors as the governing body (PNB vs. CA, 83 SCRA 237 [1978]).

9. Liability for Crimes
   - Since a corporation is a mere legal fiction, it cannot be held liable for a crime committed by its officers since it does not have the essential element of malice, except if by express provision of law, the corporation is held criminally liable; In such case the responsible officers would be criminally liable (People vs. Tan Boon Kong, 54 Phil. 607 [1930]).

TESTS TO DETERMINE NATIONALITY OF CORPORATIONS

1. Incorporation Test – determined by the state of incorporation, regardless of the nationality of its stockholders.
2. Domicile Test – determined by the state where it is domiciled.
   - The domicile of a corporation is the place fixed by the law creating or recognizing it; in the absence thereof, it shall be understood to be the place where its legal representation is established or where it exercises its principal functions (Art. 51, NCC).
3. Control Test – determined by the nationality of the controlling stockholders or members. This test is applied in times of war. Also known as the WARTIME TEST.

“Philippine National” under the Foreign Investment Act of 1991 (R.A. No. 7042):

a. a corporation organized under Philippine laws of which 60% of the capital stock outstanding and entitled to vote is owned and held by Filipino citizens;
 b. a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which 100% of the capital stocks entitled to vote belong to Filipinos.

However, it provides that where a corporation and its non-Filipino stockholders own stocks in a SEC-registered enterprise, at least 60% of the capital stock outstanding and entitled to vote of both corporations and at least 60% of the members of the board of directors of both corporations must be Filipino citizens (double 60% rule).
DOCTRINE OF PIERCING THE VEIL OF CORPORATE ENTITY

- The doctrine that a corporation is a legal entity distinct from the persons composing it is a theory introduced for purposes of convenience and to serve the ends of justice. But when the veil of corporate fiction is used as a shield to defeat public convenience, justify wrong, protect fraud, or defend a crime, this fiction shall be disregarded and the individuals composing it will be treated identically (Cruz vs. Dalisay, 152 SCRA 487 [1987]).

- The doctrine requires the court to see through the protective shroud which exempts its stockholders from liabilities that they ordinarily would be subject to, or distinguishes a corporation from a seemingly separate one, were it not for the existing corporate fiction (Lim vs. CA, 323 SCRA 102).

In any cases where the separate corporate identity is disregarded, the corporation will be treated merely as an association of persons and the stockholders or members will be considered as the corporation, that is, liability will attach personally or directly to the officers and stockholders (Umali vs. Court of Appeals, 189 SCRA 529 [1990]).

- However, 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 (Umali vs. Court of Appeals, 189 SCRA 529 [1990]).

- The doctrine aims to protect the interest of innocent third person dealing with the corporation.

Classification of facts on which corporate entity may be disregarded:

1. Avoidance of redress of fraud;
2. Prevention of evasion of statute or law;
3. Prevention of evasion of contract;
4. Internal corporate dealings disregarding corporate entity where third persons are not involved;
5. Corporation agencies or instrumentalities of undisclosed principals

- These enumerations are not exclusive and sometimes two or more of these elements concur.

Nature and Consequences of Piercing Doctrine (Philippine Corporate Law, Cesar Villanueva, 2001 ed.):

1. has only res judicata effect;
2. to prevent fraud or wrong and not available for other purposes;
3. Prevention of evasion of contract;
4. Internal corporate dealings disregarding corporate entity where third persons are not involved;
5. Corporation agencies or instrumentalities of undisclosed principals

- These enumerations are not exclusive and sometimes two or more of these elements concur.

Elements:

a. There must have been fraud or evil motive in the affected transaction and the mere proof of control of the corporation by itself would not authorize piercing.

b. The main action should seek for the enforcement of pecuniary claims pertaining to the corporation against corporate officers or stockholders, or vice-versa; and

- The corporate entity has been used in the perpetration of the fraud or in justification of wrong, or to escape personal liability.

Classification:

1. Fraud Cases

When the corporate identity is used to justify wrong, to commit fraud, or to defend a crime.

- There is always an element of malice or evil motive in fraud cases.

2. Alter Ego Cases (or Conduit Cases)

- Fraud is not an element in these cases but that the stockholders or those who compose the corporation did not treat the corporation as a separate entity but only as part of the property or business of an individual or group of individuals or another corporation.

Probative factors

a. Stock ownership by one or common ownership of both corporations;

b. Identity of directors and officers;

c. The manner of keeping corporate books and records;

d. Methods of conducting the business (Concept Builders, Inc. vs. NLRC, 257 SCRA 149 [1996]).

Four Policy Bases in Piercing:

a. Even when the controlling stockholder or managing officer intends consciously to do no evil, the use of the corporation as an alter ego is in direct violation of a central corporate law principle of treating the corporation as a separate juridical entity from its members and stockholders;

b. If the stockholders do not respect the separate entity, others cannot also be expected to be bound by the separate juridical entity;

c. Applies even when there are no monetary claims sought to be enforced against the stockholders or officers of the corporation;

d. When the underlying business enterprise does not really change and only the medium by which that business enterprise is changed.

Instrumentality or Alter Ego Rule

When one corporation is so organized and controlled and its affairs are conducted so that it is in fact a mere instrumentality or adjunct of the other, the fiction of the corporate entity to the instrumentality may be disregarded (Concept Builders Inc. vs. NLRC, 257 SCRA 149 [1996]).

Test:

1. Control, not mere majority or complete stock control, but complete dominion, not only of finances but of policy and business in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will, or existence of its own;

2. Such control must have been used by the defendant to commit fraud or wrong in
contravention of plaintiff's legal rights; and

3. The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of (Concept Builders Inc. vs. NLRC, 257 SCRA 149 [1996]).

3. Equity cases

➢ When piercing the corporate fiction is necessary to achieve justice or equity.
➢ The "dumping ground" where no fraud or alter ego circumstances can be culled to warrant piercing.

CREATED BY OPERATION OF LAW

DOCTRINE OF CORPORATE ENTITY

➢ A corporation comes into existence upon the issuance of the certificate of incorporation (Sec. 19). Then and only then will it acquire a juridical personality to sue and be sued, enter into contracts, hold or convey property or perform any legal act, in its own name (Corporation Code of the Philippines, Ruben C. Ladia, 2001 Ed.).
➢ Corporations cannot come into existence by mere agreement of the parties as in the case of business partnerships. They require special authority or grant from the State. This power is exercised by the State through the legislature, either by a special incorporation law or charter which directly creates the corporation or by means of a general corporation law under which individuals desiring to be and act as a corporation may incorporate (The Corporation Code of the Philippines, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.).

FRANCHISES OF CORPORATION

1. Primary or corporate franchise/General franchise

➢ The right or privilege granted by the State to individuals to exist and act as a corporation after its incorporation.

2. Secondary or special franchise

➢ The special right or privilege conferred upon an existing corporation to the business for which it was created. e.g. use of the streets of a municipality to lay pipes or tracks, or operation of a public utility or a messenger and express delivery service.

POWERS, ATTRIBUTES AND PROPERTIES

THEORY OF SPECIAL CAPACITIES/LIMITED CAPACITY DOCTRINE

➢ No corporation under the Code, shall possess or exercise any corporate power, except those conferred by law, its Articles of Incorporation, those implied from express powers and those as are necessary or incidental to the exercise of the powers so conferred. The corporation's capacity is limited to such express, implied and incidental powers (Reviewer in Commercial Law, Jose R. Sundiang & Timoteo Aquino, 2005 ed.).
➢ If the act of the corporation is not one of those express, implied or incidental powers, the act is ultra vires. (Reviewer in Commercial Law, Jose R. Sundiang & Timoteo Aquino, 2005 ed.).

III. CLASSIFICATIONS OF CORPORATIONS

1. As to organizers:
   a. public – by State only; or
   b. private – by private persons alone or with the State.

2. As to functions:
   a. public - government of a portion of the State; or
   b. private – usually for profit-making functions.

3. As to governing law:
   a. public – Special Laws and Local Government Code; or
   b. private – Law on Private Corporations.

4. As to legal status:
   a. de jure corporation – corporation created in strict or substantial conformity with the mandatory statutory requirements for incorporation and the right of which to exist as a corporation cannot be successfully attacked or questioned by any party even in a direct proceeding for that purpose by the State; or
   b. de facto corporation – organized with a colorable compliance with the requirements of a valid law and its existence cannot be inquired collaterally but such inquiry may be made by the Solicitor General in a quo warranto proceeding (Sec. 20).

➢ The only difference between a de facto corporation and a de jure corporation is that a de jure corporation can successfully resist a suit brought by the State challenging its existence; a de facto corporation cannot sustain its right to exist as against the State.

   c. corporation by estoppel – group of persons that assumes to act as a corporation knowing it to be without authority to do so, and enters into a transaction with a third person on the strength of such appearance. It cannot be permitted to deny its existence in an action under said transaction (Sec. 21).
   d. corporation by prescription – one which has exercised corporate powers for an indefinite period without interference on the part of the sovereign power, e.g. Roman Catholic Church.

5. As to existence of stocks:
   a. stock corporation – a corporation which has capital stock divided into shares and is authorized to distribute to holders of such shares, dividends or allotments of the surplus profits on the basis of the shares held (Sec. 3); or
   b. For a stock corporation to exist, the above requisites must be complied with for even if there is
6. As to laws of incorporation:
   a. **domestic corporation** – corporation formed, organized or existing under Philippine laws; or
   b. **foreign corporation** – a corporation formed, organized or existing under any laws other than those of the Philippines and whose laws allow Filipino citizens and corporation to do business in its own country or state.

7. As to whether they are open to the public or not:
   a. open – one which is open to any person who may wish to become a stockholder or member thereto; or
   b. close - those whose shares of stock are held by limited number of persons like the family or other closely-knit group (The Corporation Code of the Philippines, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.)

8. As to relationship of management and control:
   a. **holding corporation** - it is one which controls another as a subsidiary by the power to elect management. It is one that holds stocks in other companies for purposes of control rather than for mere investment.
   b. **subsidiary corporation** – one which is so related to another corporation that the majority of its directors can be elected either directly or indirectly by such other corporation. It is always controlled; or
   c. **affiliate** – one related to another by owning or being owned by common management or by a long-term lease of its properties or other control device. It may be the controlled or controlling corporation, or under common control; or
   d. **parent and subsidiary corporation** – When a corporation has a controlling financial interest in one or more corporations, the one having control is the parent corporation, and the others are the subsidiary corporations (Philippine Corporate Law, Cesar Villanueva, 2001 ed.).

9. As to number of persons who compose them:
   a. **aggregate corporation** – a corporation consisting of more than one person or member; or
   b. **corporation sole** – a corporation consisting of only one person or member; a special form of corporation usually associated with the clergy.

10. As to whether they are for religious purposes or not:
    a. **ecclesiastical corporation** – one organized for religious purposes; or
    b. **lay corporation** – one organized for a purpose other than for religion.

11. As to whether they are for charitable purposes or not:
    a. **eleemosnary corporation** – one established for or devoted to charitable purposes or those supported by charity; or
    b. **civil corporation** – one established for business or profit.

CONCEPT OF GOING PUBLIC AND GOING PRIVATE
A corporation is deemed to be “going public” when it decides to list its shares in the stock exchange. These include corporations that will make initial public offering of its shares. A corporation is said to be “going private” when it would restrict the shareholders to a certain group. In a sense, these also include closed and closely held corporation. (Philippine Corporate Law Compendium, Timoteo Aquino, 2006 ed.)

ONE-MAN CORPORATION
A corporation wherein all or substantially all of the stocks is held directly or indirectly by one person. However, it should still follow the formal requirements of a corporation (e.g. number of incorporators, board of directors composed of stockholders owning shares in a nominal capacity) in order to validly enjoy the attributes of the corporation, so as to avoid the application of the doctrine of piercing the veil of corporate entity.

### IV. CORPORATION DISTINGUISHED FROM PARTNERSHIP

<table>
<thead>
<tr>
<th>PARTNERSHIP</th>
<th>CORPORATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Creation</td>
<td>Created by mere agreement of the parties</td>
</tr>
<tr>
<td></td>
<td>Created by law or by operation of law</td>
</tr>
<tr>
<td>2. Number of incorporators</td>
<td>May be organized by at least two persons</td>
</tr>
<tr>
<td></td>
<td>Requires at least five incorporators (except a corporation sole)</td>
</tr>
<tr>
<td>3. Commencement of juridical personality</td>
<td>Acquires juridical personality from the moment of execution of the contract of partnership</td>
</tr>
<tr>
<td></td>
<td>Acquires juridical personality from the date of issuance of the certificate of incorporation by the Securities and Exchange Commission</td>
</tr>
<tr>
<td>4. Powers</td>
<td>Partnership may exercise any power authorized by the partners (provided it is not contrary to law, morals, good customs, public order, public policy)</td>
</tr>
<tr>
<td></td>
<td>Corporation can exercise only the powers expressly granted by law or implied from those granted or incident to its existence</td>
</tr>
<tr>
<td>5. Management</td>
<td>The power to do business and manage its affairs is vested in the board of directors or trustees</td>
</tr>
<tr>
<td>6. Effect of mismanagement</td>
<td>The suit against a member of the board of directors or trustees who mismanages must be in the name of the corporation</td>
</tr>
<tr>
<td>7. Right of succession</td>
<td>Partnership has no right of succession</td>
</tr>
<tr>
<td></td>
<td>Corporation has right of succession</td>
</tr>
<tr>
<td>8. Extent of liability to third persons</td>
<td>Partners are liable personally and subsidiarily</td>
</tr>
<tr>
<td></td>
<td>Stockholders are liable only to the extent of the shares</td>
</tr>
</tbody>
</table>
V. ADVANTAGES AND DISADVANTAGES OF A BUSINESS CORPORATION (The Corporation Code of the Philippines Annotated, Hector de Leon, 2002 ed.)

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. has a legal capacity to act and contract as a distinct unit in its own name</td>
<td>1. complicated in formation and management</td>
</tr>
<tr>
<td>2. continuity of existence</td>
<td>2. high cost of formation and operations</td>
</tr>
<tr>
<td>3. its credit is strengthened by its continuity of existence</td>
<td>3. its credit is weakened by the limited liability feature</td>
</tr>
<tr>
<td>4. centralized management in the board of directors.</td>
<td>4. lack of personal element.</td>
</tr>
<tr>
<td>5. its creation, management, organization and dissolution are standardized as they are governed under one general incorporation law.</td>
<td>5. greater degree of governmental supervision</td>
</tr>
<tr>
<td>6. limited liability</td>
<td>6. management and control are separated from ownership</td>
</tr>
<tr>
<td>7. shareholders are not the general agents of the business</td>
<td>7. Stockholders have little voice in the conduct of the business.</td>
</tr>
<tr>
<td>8. transferability of shares</td>
<td></td>
</tr>
</tbody>
</table>

9. Transferability of interest

Partner cannot transfer his interest in the partnership so as to make the transferee a partner without the unanimous consent of all the existing partners because the partnership is based on the principle of _delectus personarum_.

Stockholder has generally the right to transfer his shares without prior consent of the other stockholders because corporation is not based on this principle.

10. Term of existence

Partnership may be established for any period of time stipulated by the partners.

Corporation may not be formed for a term in excess of 50 years extendible to not more than 50 years in any one instance.

11. Firm name

Limited partnership is required by law, to add the word "Ltd." to its name.

Corporation may adopt any name provided it is not the same as or similar to any registered firm name.

12. Dissolution

May be dissolved at any time by any or all of the partners.

Can only be dissolved with the consent of the State.

13. Governing Law

Governed by the NCC

Governed by the Corporation Code

VI. COMPONENTS OF A CORPORATION

1. Corporators – those who compose a corporation, whether as stockholders or members.

2. Incorporators - those mentioned in the Articles of Incorporation as originally forming and composing the corporation, having signed the Articles and acknowledged the same before a notary public. They have no powers beyond those vested in them by the statute.

   - There is only one set of incorporators, hence, they will remain to be such incorporators up to the termination of the life of the corporation.

   Qualifications:
   a. natural person;
   b. not less than 5 but not more than 15;
   c. of legal age;
   d. majority must be residents of the Philippines; and
   e. each must own or subscribe to at least one share (Sec. 10).

   GENERAL RULE: Only natural persons can be incorporators.

   EXCEPTION: When otherwise allowed by law, e.g., Rural Banks Act of 1992, where incorporated cooperatives are allowed to be incorporators of rural banks.

   Note: However, it is undeniable that corporations can be corporators.

3. Stockholders – owners of shares of stock in a stock corporation

4. Members – corporators of a corporation which has no capital stock

<table>
<thead>
<tr>
<th>INCORPORATORS</th>
<th>CORPORATORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>stockholder (stock corporation)</td>
<td>member (non-stock corporation)</td>
</tr>
<tr>
<td>(the Articles of Incorporation cannot be amended to replace them)</td>
<td>they may cease to be such if they subsequently lose their shareholdings</td>
</tr>
<tr>
<td>number is limited to 5-15</td>
<td>no restriction as to number</td>
</tr>
<tr>
<td>must have contractual capacity</td>
<td>may be such through a guardian</td>
</tr>
</tbody>
</table>

OTHER COMPONENTS

1. Promoter - A person who, taking initiative in founding and organizing the business or enterprise of the issuer and receives consideration therefor (Sec. 3, R.A. 8799).

   - He is an agent of the incorporators but not of the corporation.

   - Contracts by the promoter for and in behalf of a proposed corporation generally bind only him, subject to and to the extent of his representations, and not the corporation, unless and until after these contracts are ratified, expressly or impliedly, by its Board of Directors/Trustees (Cagayan Fishing Development Co., Inc. v. Sandiko, 65 Phil. 223).

2. Subscriber - A person who has agreed to take and pay for original and unissued shares of a corporation formed or to be formed.

3. Underwriter – A person who guarantees on a firm commitment and/or declared best effort basis the distribution and sale of securities of any kind by another company (Sec. 3, R.A. 8799).

VII. CLASSIFICATION OF SHARES

1. Common shares
The basic class of stock ordinarily and usually issued without extraordinary rights and privileges, and the owners thereof are entitled to a pro rata share in the profits of the corporation and in its assets upon dissolution and, likewise, in the management of its affairs without preference or advantage whatsoever.

Common shares or stocks represent the residual ownership interest in the corporation.

Common shares have complete voting rights. They cannot be deprived of said rights except as provided by law.

2. Preferred shares

Shares with a stated par value which entitle the holder thereof to certain preferences over the holders of common stock. The preference may be (a) as to asset; or (b) as to dividends; or (c) as may be determined by the board of directors when so authorized to do so (The Corporation Code of the Philippines, H. De Leon, 2002 ed.).

Purpose: To induce more persons to subscribe for shares of a corporation.

Preferred shareholders are not creditors of the corporation. Yet all preferred stock contracts are, fundamentally attempts to endow certain owners with rights analogous to creditor rights and statutes and court decisions on this matter have been concerned, primarily, with the length to which the preferred stock contract can go in extending creditor rights to stockholder. The reason why there is an effort to extend such right is to make preferred shares attractive to investors for they can remain as such and at the same time enjoy certain advantages that are available to creditors (Philippine Corporate Law Compendium, Timoteo Aquino, 2006 ed.).

Limitations:

a. If deprived of voting rights, it shall still be entitled to vote on matters enumerated in Section 6, par. 6.

b. Preference must not be violative of the Code.

c. May be issued only with a stated par value.

d. The board of directors may fix the terms and conditions only when so authorized by the articles of incorporation and such terms and conditions shall be effective upon filing a certificate thereof with the SEC.

Kinds:

a. Cumulative – one which entitles the holder thereof to payment not only of current dividends but also back dividends not previously paid whether or not during the past years dividends were declared or paid.

b. Non-cumulative – one which grants the holders of such shares only to the payment of current dividends but not back dividends when and if dividends are paid to the extent agreed upon before any other stockholders are paid the same.

c. Participating - one which entitles the shareholder to participate with the common shares in excess distribution at some predetermined or at a fixed ratio as may be determined.

d. Non-participating - one which entitles the shareholder thereof to receive the stipulated preferred dividends and no more.

e. Cumulative participating - share which is a combination of the cumulative share and participating share.

3. Redeemable shares

Shares of stocks issued by the corporation which said corporation can purchase or take up from their holders as expressly provided for in the articles of incorporation and certificate of stock representing said shares at a fixed date or at the option of the issuing corporation or the stockholder or both at a certain redemption price.

Limitations:

a. Redeemable shares may be issued only when expressly provided for in the articles of incorporation;

b. The terms and conditions affecting said shares must be stated both in the articles of incorporation and in the certificates of stock representing such shares;

c. Redeemable shares may be redeemed of voting rights in the articles of incorporation, unless otherwise provided in the Code.

Redeemable shares may be redeemed, regardless of the existence of unrestricted retained earnings (Sec. 8), provided that the corporation has, after such redemption, sufficient assets in its books to cover debts and liabilities inclusive of capital stock.

Redemption may not be made where the corporation is insolvent or if such redemption would cause insolvency or inability of the corporation to meet its debts as they mature. Such limitation is based on the principle that corporate assets are a trust fund for creditors.

When redeemable shares are reacquired, the same shall be considered retired and no longer issuable unless otherwise provided for in the Articles of Incorporation.

Note: For tax purposes, there are cases when redemption of shares is considered a scheme to circumvent the tax consequences of cash dividends. Hence, the amounts received by the shareholders shall be treated as cash dividends because proceeds of redemption in such a case is additional wealth and not merely a return of the capital (Philippine Corporate Law Compendium, Timoteo Aquino, 2006 ed.).

4. Treasury shares

Shares of stock which have been issued and fully paid for, but subsequently reacquired by the issuing corporation by purchase, redemption, donation or through some other lawful means (Sec. 9).

Treasury shares are not retired shares. They do not form revert to the unissued shares of the corporation but are regarded as property acquired by the corporation which may be reissued or resold at a price to be fixed by the Board of Directors (SEC Rules Governing Redeemable and Treasury Shares, CCP No. 1-1982).

If purchased from stockholders: The transaction in effect is a return to the stockholders of the value of their investment in the company and a reversion of the shares to the corporation. The corporation must have surplus profits with which to buy the shares so that the transaction will not cause an impairment of the capital.

If acquired by donation from the stockholders: The act would amount to a surrender of their stock without getting back their investments that are instead, voluntarily given to the corporation.

Treasury shares need not be sold at par or issued value but may be sold at the best price obtainable, provided it is reasonable. When treasury shares are sold below its par or issued value, there can be no watering of stock because such watering contemplates an original issuance of shares.

Treasury shares have no voting rights as long as they remain in treasury (uncalled and subject to reissue) (Sec. 57).

Reason: A corporation cannot in any proper sense be a stockholder in itself and equal distribution of voting rights will be effectively lost.

Neither are treasury shares entitled to dividends or assets because dividends cannot be declared by a corporation to itself.

Treasury shares may be declared as property dividend to be issued out of the retained earnings previously used to support their acquisition provided that the amount of the retained earnings has not been subsequently impaired by losses.
5. Founders’ shares
Shares classified as such in the articles of incorporation and issued to organizers and promoters of a corporation in consideration of some supposed right or property such as special preference in voting rights and dividend payments. But if an exclusive right to vote and be voted for as director is granted, this privilege is subject to approval by the SEC, and cannot exceed 5 years from the date of approval (Sec. 7).

6. Voting shares
- Shares with a right to vote.
- Under the code, whenever a vote is necessary to approve a particular corporate act, such vote refers only to stocks with voting rights except in certain cases when even non-voting shares may also vote (Sec. 6, par. 6 and last par.).

7. Non-voting shares
- Shares without right to vote.
- The law only authorizes the denial of voting rights in the case of redeemable shares and preferred shares, provided that there shall always be a class or series of shares which have complete voting rights.
- These redeemable and preferred shares, when such voting rights are denied, shall nevertheless be entitled to vote on the following fundamental matters: Key: (A² SF MID)
  a. amendment of Articles of Incorporation
  b. adoption and amendment of by-laws;
  c. sale or disposition of all or substantially all of corporate property;
  d. incurring, creating or increasing bonded indebtedness;
  e. increase or decrease of capital stock
  f. merger or consolidation of capital stock
  g. investments of corporate funds in another corporation or another business purpose; and
  h. corporate dissolution

8. Share in escrow
- Share subject to an agreement by virtue of which the share is deposited by the grantor or his agent with a third person to be kept by the escrow agent until the performance of a certain condition or he happening of a certain event contained in the agreement (Cannon v. Handley, 12 Phil. 315).
- The escrow deposit makes the depository a trustee under an express trust (Articles 1440 and 1441 of the New Civil Code).

9. Over-issued stock
Stock issued in excess of the authorized capital stock. It is also known as spurious stock. Its issuance is considered null and void.

10. Watered stock
- A stock issued not in exchange for its equivalent value either in cash, property, share, stock dividends, or services.
- “Water” in the stock represents the difference between the fair market value at the time of the issuance of the stock and the par or issued value of said stock. Both par and no par stocks can thus be watered stocks.
- It includes stocks:
  a. Issued without consideration (bonus share).
  b. Issued as fully paid when the corporation has received a lesser sum of money than its par or issued value (discount share).
  c. Issued for a consideration other than actual cash such as property or services, the fair valuation of which is less than its par or issued value.
  d. Issued as stock dividend when there are no sufficient retained earnings to justify it.

11. Par value shares
Shares with a value fixed in the articles of incorporation and the certificates of stock.

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Easily sold as the public is more attracted</td>
<td>Subscribers are liable to the corporate creditors for their unpaid subscription</td>
</tr>
<tr>
<td>issued than its par or issued value.</td>
<td></td>
</tr>
<tr>
<td>Greater protection to creditors</td>
<td>The stated value of the share is not an accurate criterion of its true value</td>
</tr>
<tr>
<td>Unlikelihood of sale of subsequently issued shares at a lower price</td>
<td></td>
</tr>
<tr>
<td>Unlikelihood of distribution of dividends that are only ostensible profits</td>
<td></td>
</tr>
</tbody>
</table>

12. No par value shares
Shares having no par value but have issued value stated in the certificate or articles of incorporation.

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued as fully paid and non-assessable.</td>
<td>Legalizes issuance of large stock for property</td>
</tr>
<tr>
<td>Price is flexible</td>
<td>Conceal money or property represented by the shares</td>
</tr>
<tr>
<td>Enjoy wider distribution because of it being</td>
<td>Promote the issuance of watered stock</td>
</tr>
<tr>
<td>low-priced</td>
<td></td>
</tr>
<tr>
<td>Tell no untruth concerning the value of the</td>
<td>Lesser protection to creditors</td>
</tr>
<tr>
<td>stockholder’s contribution</td>
<td></td>
</tr>
<tr>
<td>More easily issued, thereby simplifying</td>
<td></td>
</tr>
<tr>
<td>accounting procedures</td>
<td></td>
</tr>
</tbody>
</table>

Limitations:
- No par value shares cannot have an issued price of less than P5.00;
- The entire consideration for its issuance constitutes capital so that no part of it should be distributed as dividends;
- They cannot be issued as preferred stocks;
- They cannot be issued by banks, trust companies, insurance companies, public utilities and building and loan association (BPI-TB);
- The articles of incorporation must state the fact that it issued no par value shares as well as the number of said shares;
- Once issued, they are deemed fully paid and non-assessable (Sec. 6).

12. Street certificate
A stock certificate endorsed by the registered holder in blank and the transferee can command its transfer to his name from the issuing corporation.

13. Convertible share
A share that is changeable by the stockholder from one class to another at a certain price and within a certain period.
14. Fractional share
A share with a value of less than one full share.

WHEN CLASSIFICATION OF SHARES MAY BE MADE
(The Corporation Code of the Philippines, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.):

1. By the incorporators – The classes and number of shares which a corporation shall issue are first determined by the incorporators as stated in the articles of incorporation filed with the SEC.

2. By the Board of Directors and the Stockholders – After the corporations comes into existence, they may be altered by the board of directors and the stockholders by amending the articles of incorporation pursuant to Sec. 16.

A corporation may issue such classes or series of shares as the prospects and needs of its business may require. Furthermore, it may classify its shares for the purpose of insuring compliance with constitutional or legal requirements (Sec. 6, par. 4).

Shares may also be issued in different classes to create preferences or to deny or grant certain rights e.g. voting or non-voting shares.

DOCTRINE OF EQUALITY OF SHARES -Where the articles of incorporation do not provide for any distinction of the shares of stock, all shares issued by the corporation are presumed to be equal and enjoy the same rights and privileges and are also subject to the same liabilities (Sec. 6, par. 5).

DEFINITION OF TERMSENF 0
1. Capital Stock or Legal Stock or Stated Capital - The amount fixed in the corporate charter to be subscribed and paid in cash, kind or property at the organization of the corporation or afterwards and upon which the corporation is to conduct its operation.

2. Capital – The value of the actual property or estate of the corporation whether in money or property, its net worth (or stockholder’s equity) is its assets less its liabilities.

3. Authorized Capital Stock - The capital stock divided into shares.

4. Subscribed Capital Stock- The total amount of the capital stock subscribed whether fully paid or not.

5. Outstanding Capital Stock - The portion of the capital stock issued to subscribers, whether fully paid or partially paid (as long as there is a binding subscription contract) except treasury stocks (Sec. 137).

6. Unissued Capital Stock – The portion of the capital stock that is not issued or subscribed. It does not vote and does not carry dividends.

7. Legal Capital - The amount equal to the aggregate par value and/or issued value of the outstanding capital stock.

8. Stated Capital – The capital stock divided into no par value shares.

9. Paid-up Capital – The amount paid by the stockholders on subscriptions from unissued shares of the corporation.

VIII. FORMATION AND ORGANIZATION OF PRIVATE CORPORATION

STEPs IN THE CREATION OF A CORPORATION

1. Promotion – A 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, SRC).

2. Incorporation
Steps:
   a. Drafting and execution of Articles of Incorporation by the incorporators and other documents required for registration of the corporation
   b. Filing with the SEC of the articles of incorporation

3. Formal Organization and Commencement of the Transaction of Business
These are conditions subsequent, which may be satisfied by substantial compliance in order that a corporation may legally continue as such.

Formal organization:
   a. Adoption of By-Laws and filing of the same with the SEC;
   b. Election of board of directors/trustees, and officers;
   c. Establishment of principal office;
   d. Providing for subscription and payment of capital stock.

ARTICLES OF INCORPORATION (AI)

The document prepared by the persons establishing a corporation and filed with the SEC containing the matters required by the Code.

The Articles of Incorporation have been described as one that defines the charter of the corporation, and the contractual relationships between the State and the corporation, the stockholder and the State, and between the corporation and its stockholders (Lanuza v. CA GR No.131394, March 28, 2005).

Significance:
1. The issuance of a certificate of incorporation signals the birth of the corporation’s juridical personality;
2. It is an essential requirement for the existence of a corporation, even a de facto one.

Contents (Sec. 14):

1. Corporate Name (Sec. 18)

The corporation acquires juridical personality under the name stated in the certificate of incorporation. It is the name of the corporation which identifies and distinguishes it from other corporations, firms or entities.

A corporation’s right to use its corporate and trade name is a property right, a right in rem which it may assert or protect against the whole world in the same manner as it may protect its tangible property against trespass or conversion (Philips Export B.V. vs. CA, 206 SCRA 457).

Statutory limitation:
The proposed name must not be:
   a. identical; or
   b. deceptively or confusingly similar to that of any existing corporation or to any other name already protected by law; or
   c. patently deceptive, confusing or contrary to law.

Remedies of corporation whose name has been adopted by another:
   1. Injunction
   2. De-registration

A corporation can change the name originally selected by it after complying with the formalities prescribed by law, to wit: amendment of the articles of incorporation and filing of the amendment with the SEC (Sec. 16).

An authorized change in the name of the corporation, whether effected by a special act or under a general law, has no more effect upon its identity as a corporation than a change of name of natural person upon his identity. It does not affect the property, rights, or liabilities of the corporation, nor lessen or add to its obligations. It is in no sense a new corporation, nor the successor of the original corporation. It is the same corporation with a different name and its character is in
2. Purpose Clause
Significance:
   a. A person who intends to invest his money in the business corporation will know where and in what kind of business or activity his money will be invested;
   b. The directors and the officers of the corporation will know within what scope of business they are authorized to act; and
   c. A third person who has dealings with the corporation may know by perusal of the articles whether the transaction or dealing he has with the corporation is within the authority of the corporation or not.

Limitations:
   a. Purpose or purposes must be lawful;
   b. Purpose or purposes must be stated with sufficient clarity;
   c. If there is more than one purpose, the primary as well as the secondary purpose must be specified; and
   d. Purposes must be capable of being lawfully combined.

3. Principal Office
   - The articles of incorporation must state the place where the principal office of the corporation is to be established or located, which place must be within the Philippines (Sec. 14 [3]).

Purpose:
   - To fix the residence of the corporation in a definite place, instead of allowing it to be ambulatory (Young Auto Supply Co. vs. CA, 223 SCRA 670).

It is now required by the SEC that all corporations and partnerships applying for registration should state in their Articles of Incorporation the specific address of their principal office, which shall include, if feasible, the strict number; street name; barangay; city or municipality; and specific residence address of each incorporator, stockholder, director or trustee in line with the full disclosure requirement of existing laws (SEC Circ. No. 3, Series of 2006).

4. Term of Existence (Sec. 11)
   - The corporation shall exist for the term specified in the articles of incorporation not exceeding 50 years, unless sooner legally dissolved or unless its registration is revoked upon any of the grounds provided by law.

   - The corporate life may be reduced or extended by amendment of the articles of incorporation by complying with the procedural requirements laid down in Sec. 37.

   - The extension of corporate term is subject to the following limitations:
     a. The term shall not exceed 50 years in any one instance;
     b. The amendment is effected before the expiration of the corporate term of existence, for after dissolution by expiration of the corporate term, there is no more corporate life to extend (Alhambra Cigar vs. SEC, 24 SCRA 269).
     c. The extension cannot be made earlier than 5 years prior to the expiration date unless there are justifiable reasons therefore as may be determined by the SEC.

   - The mere extension of the corporate term of existence made before the expiration of the original term constitutes a continuation of the old, and not the creation of a new corporation. (The Corporation Code of the Philippines, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.)

   - The expiration of the term for which the corporation was created does not, however, produce its immediate dissolution for all purposes (Sec. 122).

DOCTRINE OF RELATION OR RELATING BACK
   - The filing and recording of a certificate of extension after the term cannot relate back to the date of the passage of the resolution of the stockholders to extend the life of the corporation. However, the doctrine of relations applies if the failure to file the application for extension within the term of the corporation is due to the neglect of the officer with whom the certificate is required to be filed or to a wrongful refusal on his part to receive it (Philippine Corporate Law Compendium, Timoteo Aquino, 2006 ed.)

5. Incorporators (See VI. Components of a Corporation)

6. Directors and Trustees
   - The Board of Directors is the governing body in a stock corporation while Board of Trustees is the governing body in a non-stock corporation. They exercise the powers of the corporation (Reviewer in Commercial Law, Jose R. Sundiang & Timoteo Aquino, 2005 ed.).

Matters required to be stated in the AI:
   a. a statement of the names, nationalities and residences of the incorporating directors or the persons who shall act as such until the first regular directors or trustees are duly elected and qualified in accordance with the law
   b. the number of directors or trustees, which shall not be less than 5 but not more than 15.

Exceptions:
   1. educational corporations registered as non-stock corporation whose number of trustees though not less than five and not more than fifteen should be divisible by five; and
   2. in close corporation where all the stockholders are considered as members of the board of directors thereby effectively allowing twenty members in the board (Corporation Code of the Philippines, Ruben C. Ladis, 2001 ed.).

7. Capitalization
   Matters required to be stated in the AI:
   a. the amount of its authorized capital stock in lawful money of the Philippines;
   b. the number of shares and kind of shares into which it is divided;
   c. in case the shares are par value shares, the par value of each;
   d. the names, nationalities and residences of the original subscribers;
   e. the amount subscribed and paid by each on his subscription;
   f. sworn statement of the treasurer elected by the subscribers showing that at least 25% of the authorized capital stock of the corporation has been subscribed;
   g. sworn statement of the treasurer elected by the subscribers showing that at least 25% of the total subscription has been fully paid to him in actual cash and/or in property the fair valuation of which is equal to at least 25% of the said subscription; and
   h. sworn statement of the treasurer elected by the subscribers showing that such paid-up capital being not less that five thousand pesos.

9
CAPITAL STOCK REQUIREMENT

GENERAL RULE: No minimum authorized capital stock as long as the paid-up capital is not less than P5,000.00

EXCEPTIONS:
1. as provided for by special law
   a. Private Development Banks
      - P4M for class A
      - P2M for class B
      - P1M for class C
   b. Investment Companies – paid up at least P50,000,000
   c. Savings and Loan Corporation – to be fixed by the Monetary Board, but not less than P100T
   d. Financing Companies
      Paid up: - P10M for Metro Manila
      and other 1st class city
      - P5M for other classes
      of cities
   e. Insurance companies
      1. Insurance Broker – P250,000.00
      2. General Agent – P 250,000.00
      3. Reinsurance Broker – P 0.5 M
   2. provided that at least 25% of the authorized capital stock has been subscribed and at least 25% of the total subscription must be paid-up.

FILIPINO PERCENTAGE OWNERSHIP REQUIREMENT

No Foreign Equity
1. Mass Media except recording (Art. XVI, Sec. 11 of the Constitution; Presidential Memorandum dated 04 May 1994)
2. Practice of all professions
3. Retail trade enterprises with paid-up capital of less than US$2,500,000/(Sec. 5 of RA 8762)
4. Cooperatives (Ch. III, Art. 26 of RA 6938)
5. Private Security Agencies (Sec. 4 of RA 5487)
6. Small-scale Mining (Sec. 3 of RA 7076)
7. Utilization of Marine Resources in archipelagic waters, territorial sea, and exclusive economic zone as well as small-scale utilization of natural resources in rivers, lakes, bays, and lagoons (Art. XII, Sec. 2 of the Constitution)
8. Ownership, operation and management of cockpits (Sec. 5 of PD 449)
9. Manufacture, repair, stockpiling and/or distribution of nuclear weapons (Art. II, Sec. 8 of the Constitution)
10. Manufacture, repair, stockpiling and/or distribution of biological, chemical and radiological weapons and anti-personnel mines (Various treaties to which the Philippines is a signatory and conventions supported by the Philippines)
11. Manufacture of firecrackers and other pyrotechnic devices (Sec. 5 of RA 7183)

Up to Twenty Percent (20%) Foreign Equity
1. Private radio communications network (RA 3846)

Up to Twenty-Five Percent (25%) Foreign Equity
1. Private recruitment, whether for local or overseas employment (Art. 27 of PD 442)
2. Contracts for the construction and repair of locally-funded public works (Sec. 1 of CA 541, LOI 630) except:
   a. infrastructure/development projects covered in RA 7718; and
   b. projects which are foreign funded or assisted and required to undergo international competitive bidding (Sec. 2a of RA 7718)
3. Contracts for the construction of defense-related structures (Sec. 1 of CA 541)

Up to Thirty Percent (30%) Foreign Equity
1. Advertising (Art. XVI, Sec. 11 of the Constitution)

Up to Forty Percent (40%) Foreign Equity
1. Exploration, development and utilization of natural resources (Art. XII, Sec. 2 of the Constitution)
2. Ownership of private lands (Art. XII, Sec. 7 of the Constitution; Ch. 5, Sec. 22 of CA 141; Sec. 4 of RA 9182)
3. Operation and management of public utilities (Art. XII, Sec. 11 of the Constitution; Sec. 16 of CA 146)
4. Ownership/establishment and administration of educational institutions (Art. XIV, Sec. 4 of the Constitution)
5. Culture, production, milling, processing, trading excepting retailing, of rice and corn and acquiring, by barter, purchase or otherwise, rice and corn and the by-products thereof (Sec. 5 of PD 194;Sec. 15 of RA 8762
6. Contracts for the supply of materials, goods and commodities to government-owned or controlled corporation, company, agency or municipal corporation (Sec. 1 of RA 5183)
7. Project Proponent and Facility Operator of a BOT project requiring a public utilities franchise (Art. XII, Sec. 11 of the Constitution; Sec. 2a of RA 7718)
8. Operation of deep sea commercial fishing vessels (Sec. 27 of RA 8550)
9. Adjustment Companies (Sec. 323 of PD 612 as amended by PD 1814)
10. Ownership of condominium units where the common areas in the condominium project are co-owned by the owners of the separate units or owned by a corporation (Sec. 5 of RA 4726)

Up to Sixty Percent (60%) Foreign Equity
1. Financing companies regulated by the Securities and Exchange Commission (Sec. 6 of RA 5980 as amended by RA 8556)
2. Investment houses regulated by the SEC (Sec. 5 of PD 129 as amended by RA 8366)

8. Shares of Stock (See XIII. Stocks and Stockholders)

COMMENCEMENT OF CORPORATE EXISTENCE

A corporation commences to have juridical personality and legal existence only from the moment the SEC issues to the incorporators a certificate of incorporation and affixes its official seal.

It is the certificate of incorporation that gives juridical personality to a corporation and placed it under the jurisdiction of the commission.

In the case of religious corporations, the Code does not require the SEC to issue a certificate of incorporation. In fact, Sec. 112 clearly states that from and after the filing with the Commission of the articles of incorporation, the chief archbishop shall become a corporation sole.

The issuance of the articles calls the corporation into being but it is not really ready to do business until it is organized. The corporation must formally organized and commence the transaction of its business or the construction of its works within two years from the date of its incorporation or, otherwise, its corporate powers shall cease and it shall be deemed dissolved (Sec. 22.)

AMENDMENT OF ARTICLES OF INCORPORATION

Procedure:
1. Resolution by at least a majority of the board of directors or trustees;
2. Vote or written assent of the stockholders representing at least 2/3 of the outstanding capital stock s or 2/3 of the members in case of non-stock corporations.
3. Submission and filing with the SEC of:
   a. the original and amended articles together
containing all the provisions required by law to be set out in the articles of incorporation. Such articles, as amended, shall be indicated by underscored the change or changes made;

b. a copy thereof, duly certified under oath by the corporate secretary and a majority of the directors or trustees stating the fact that such amendments have been duly approved by the required vote of the stockholders or members; and

c. a favorable recommendation of the appropriate government agency concerned if required by law.

Limitations:
1. The amendment of any provision or matters stated in the articles of incorporation is not allowed when it will be contrary to the provisions or requirement prescribed by the Code or by special law or changes any provision in the articles of incorporation stating an accomplished fact;

2. It must be for legitimate purposes;

3. It must be approved by the required vote of the board of directors or trustees and the stockholders or members;

4. The original articles and amended articles together must contain all provisions required by law to be set out in the articles of incorporation;

5. Such articles, as amended, must be indicated by underscored the changes made, and a copy thereof duly certified under oath by the corporate secretary and a majority of the directors or trustees stating that the amendments have been duly approved by the required vote of the stockholders or members must be submitted to the SEC;

6. The amendments shall take effect only upon their approval by the SEC;

However, express approval is not indispensable. This is because the amendment shall also take effect from the date of filing with the said Commission if it is not acted upon by the Commission within 6 months from the date of filing for a cause not attributable to the corporation.

7. If the corporation is governed by special law, the amendments must be accompanied by a favorable recommendation of the appropriate government agency;

8. No right or remedy in favor of or against any corporation, its stockholders, members, directors, trustees, or officers, nor any liability incurred by any such corporation, stockholders, members, directors, trustees, or officers, shall be removed or impaired either by the subsequent dissolution of said corporation or by any subsequent amendment or repeal of this Code or of any part thereof (Section 146 of the Corporation Code).

Facts not subject to amendments:
1. Names of incorporators;
2. Names of original subscribers to the capital stock of the corporation and their subscribed and paid up capital;
3. Treasurer elected by the original subscribers;
4. Members who contributed to the initial capital of a non-stock corporation;
5. Date and place of execution of the articles of incorporation;
6. Witnesses to the signing and acknowledgment of the articles

Grounds for Rejection of the Articles of Incorporation or Amendment thereto (Sec. 17)
1. That the articles of incorporation or any amendment thereto is not substantially in accordance with the form prescribed therein;
2. That the purpose or purposes of the corporation are patently unconstitutional, illegal, immoral, or contrary to government rules and regulations;
3. That the Treasurer’s Affidavit concerning the amount of capital stock subscribed and/or paid is false;
4. That the required percentage of ownership of the capital stock to be owned by citizens of the Philippines has not been complied with as required by existing laws or the constitution.

These grounds are not exclusive.

Before rejecting the Articles of Incorporation or any amendments, the SEC should give the incorporators reasonable time within which to correct or modify the objectionable portions of the articles or amendments.

Any decision of the Commission rejecting the articles of incorporation or disapproving any amendment thereto is appealable by petition for review to the Court of Appeals in accordance with the pertinent provisions of the Rules of Court.

All the grounds enumerated in Section 17 can be determined on the basis of the Articles of incorporation itself and the other required documents. Generally, if the Articles of Incorporation and its supporting documents are in order, the SEC has no recourse but to issue the Certificate of Incorporation (Philippine Corporate Law Compendium, Timoteo Aquino, 2006 ed.).

Grounds for Suspension or Revocation of Certificate of Registration (Pres. Decree No. 902-A)
1. Fraud in procuring its certificate of incorporation
2. Serious misrepresentation as to what the corporation can do or is doing to the great prejudice of, or damage to, the general public
3. Refusal to comply with or defiance of a lawful order of the SEC restraining the commission of acts which would amount to a grave violation of its franchise
4. Continuous inoperation for a period of at least 5 years
5. Failure to file the by-laws within the required period
6. Failure to file required reports

EFFECTS OF NON-USE OF CORPORATE CHARTER (Sec. 22)

If a corporation does not formally organize and commence the transaction of its business or the construction of its works within 2 years from the date of incorporation, the corporation shall be deemed dissolved.

If a corporation has commenced transaction of its business but subsequently becomes continuously inoperative for a period of at least 5 years, the same shall be a ground for the suspension or revocation of its corporate franchise or certificate of incorporation.

If the non-use of corporate charter or continuous inoperation of a corporation is due to causes beyond its control as found by the Commission, the effects mentioned shall not take place.

DE FACTO CORPORATION
A corporation which actually exists for all practical purposes as a corporation but which has no legal right to corporate existence as against the State. It is one which has not complied with all the requirements necessary to be a de jure corporation but has complied sufficiently to be accorded corporate status as against third parties although not against the state.

Requisites:
1. The existence of a valid law under which it may be incorporated;
2. A bona fide attempt in good faith to incorporate under such law;
3. Actual use or exercise in good faith of corporate powers; and
4. Issuance of a certificate of incorporation by the SEC as a minimum requirement of continued good faith.

In the case of a de facto corporation, the only way in which its corporate existence can be questioned is in a direct proceeding by the State, brought for that
purpose. Private individuals cannot raise the objection in such a case, either directly or indirectly, and nobody can raise the objection collaterally (The Corporation Code of the Philippines, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.).

- Such a corporation is practically as good as a de jure corporation. It is deemed to have a substantial legal existence and ordinarily, in its relation with all persons except the State, has the same powers and is subject to the same liabilities, duties and responsibilities, as a corporation de jure, and is bound by all such acts as it might rightfully perform if it were a corporation de jure (The Corporation Code of the Philippines, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.).

- The officers and directors of a de facto corporation are subject to all the liabilities and penalties attending to officers and directors duly chosen by a corporation de jure, including the liability under the criminal law, and their acts are binding when such acts would be within the power of such officers if the corporation were one de jure (The Corporation Code of the Philippines, Hector S. De Leon & Hector M. De Leon, Jr., 2006 ed.).

CORPORATION BY ESTOPPEL

- An unincorporated association which represented itself to be a corporation will be estopped from denying its corporate capacity in a suit against it by a third person who relied in good faith on such representation, liabilities and damages incurred or arising as a result thereof.

- A corporation by estoppel has no real existence in law. It is neither a de jure nor a de facto corporation, but is a mere fiction existing for the particular case, and vanishing where the element of estoppel is absent. It exists only between the persons who misrepresented their status and the parties who relied on the misrepresentation. Its existence may be attacked by any third party except where the attacking party is estopped to treat the entity other than as a corporation.

- All persons not stockholders or members who assume to act as a corporation knowing it to be without authority to do so shall be liable as general partners for all debts, liabilities, and damages incurred or arising as a result thereof (Sec. 21).

- When any such ostensible corporation is sued on any transaction entered by it as a corporation or on any tort committed by it as such, it shall not be allowed to use as a defense its lack of corporate personality (Sec. 21).

- A third party who, knowing an association to be unincorporated, nonetheless treated it as a corporation and received benefits from it, may be barred from denying its corporate existence in a suit brought against the alleged corporation (Lim Tong Lim vs. Phil. Fishing Gear Industries, Inc. 317 SCRA 728).

IX. BOARD OF DIRECTORS AND TRUSTEES

Qualifications:
1. For a stock corporation, ownership of at least 1 share capital stock of the corporation in his own name, and if he ceases to own at least one share in his own name, he automatically ceases to be a director (Sec. 29). For a non-stock corporation, only members of the corporation can be elected to the Board of Trustees.

- In order to be eligible as a director, what is material is the legal title to, not beneficial ownership of the stocks appearing on the books of the corporation.

- A person who does not own a stock at time of his election or appointment does not disqualify him as a director if he becomes a shareholder before assuming the duties of his office.

- A person who is not a stockholder cannot be a director, but he can be an ex officio member without voting rights in the board (Grace Christian High School v. CA 281 SCRA 133 October 23, 1997).

2. A majority of the directors/trustees must be residents of the Philippines (Sec. 23).

3. He must not have been convicted by final judgment of an offense punishable by imprisonment for a period exceeding 6 years or a violation of the Corporation Code, committed within five years from the date of his election (Sec. 27).

4. Only natural persons can be elected directors/trustees.

- In case of corporate stockholders or members, their representation in the board can be achieved by making their individual representatives trustees of the shares or membership to make them stockholders/members of record.

5. Other qualifications as may be prescribed in the by-laws of the corporation.

6. Must be of legal age

Election of Board Members (Secs. 24-25)

<table>
<thead>
<tr>
<th>STOCK CORPORATION</th>
<th>NON-STOCK CORPORATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owners of a majority of the outstanding capital stock, in person or by their authorized representative, as such by written proxy, must be present at the election of the directors. Cumulative voting is mandatory; a matter of right granted by law to each stockholder with voting rights.</td>
<td>A majority of the members entitled to vote, in person or by proxy, if allowed in its articles of incorporation or by-laws, must be present in the election. Cumulative voting is generally not available unless allowed by the articles of incorporation or by-laws, since each member is entitled only to one vote.</td>
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Methods of Voting (Sec. 24)

1. Straight Voting – every stockholder may vote such number of shares for as many persons as there are directors to be elected.

2. Cumulative Voting for One Candidate – a stockholder is allowed to concentrate his votes and give one candidate as many votes as the number of directors to be elected multiplied by the number of his shares shall equal.

3. Cumulative Voting by Distribution – by this method, a stockholder may cumulate his shares by multiplying also the number of his shares by the number of directors to be elected and distribute the same among as many candidates as he shall see fit.

- Cumulative voting being a statutory right, a corporation is without power to deprive the stockholders of its use or even restrict the right to vote to only one way or method. A stockholder may or may not exercise the right as he shall see fit (SEC Opinion, Oct. 20, 1964).

- In electing directors by cumulative voting, the total number of votes cast by a stockholder shall not exceed the number of shares owned by him as shown in the books of the corporation multiplied by the whole number of directors to be elected.

- Members of non-stock corporations may cast as many votes as there are trustees to be elected but may cast not more than one vote for one candidate. This is the manner of voting in non-stock corporations unless otherwise provided in the articles of incorporation.
Limitations on the Election of Directors/Trustees
1. At any meeting of holder or members called for the election of directors or trustees, there must be present either in person or by representative, authorized to act by written proxy, the owners of the majority of the outstanding capital stock or majority of the members entitled to vote.
2. The election must be by ballot if requested by any voting member or stockholder.
3. A stockholder cannot be deprived of the articles of incorporation or in the by-laws of his statutory right to vote, any of the methods of voting in the election of directors.
4. No delinquent stock shall be voted.
5. The candidates receiving the highest number of votes shall be declared elected. A majority vote is not necessary. However, it is necessary that there is a quorum. And in the absence thereof, election shall be considered invalid (SEC Opinion).

Limitations on the Stockholder’s Right to Vote
1. Where the articles of incorporation provides for classification of shares pursuant to Sec. 6, non-voting shares are not entitled to vote except as provided for in the last paragraph of Sec. 6.
2. Preferred or redeemable shares may be deprived of the right to vote unless otherwise provided in the Code.
3. Fractional shares of stock cannot be voted.
4. Treasury shares have no voting rights as long as they remain in the treasury.
5. Holders of stock declared delinquent by the board of directors for unpaid subscription are not entitled to vote or representation by any stockholder’s meeting.
6. A transferee of stock cannot vote if his transfer is not registered in the stock and transfer book of the corporation.

Term of Office (Sec. 23)
The directors or trustees shall serve for a term of one year and until their successors are elected and qualified. If no election is conducted or no qualified candidate is elected, they shall continue to act as such in a hold-over capacity until an election is held and a qualified candidate is so elected (HOLD-OVER PRINCIPLE) (Corporation Code of the Philippines, Ruben C. Ladia, 2001 ed.).

Quorum Requirement in Board Meetings (Sec. 25)
Unless the articles of incorporation or the by-laws provide for a greater majority, a majority of the number of directors or trustees as fixed in the articles of incorporation shall constitute a quorum for the transaction of corporate business, and every decision of at least a majority of the directors or trustees present at a meeting at which there is a quorum shall be valid as a corporate act, except for the election of officers which shall require the vote of a majority of all the members of the board.

Removal of Directors or Trustees (Sec. 28)
The law does not specify cases for removal of a director or trustee nor even require that removal should be for sufficient cause or reason. However, the incumbent directors or trustees cannot be removed merely by replacing a new set of directors or trustees.

Requisites:
1. The removal should take place at a regular or special meeting duly called for the purpose;
2. The director or trustee can only be removed by at least 2/3 of the outstanding capital stock or of the members entitled to vote;
3. There must be a previous notice to stockholders or members of the corporation the intention to propose such removal at the meeting.
4. The removal without cause may not be used to deprive minority stockholders or members of the right to representation to which they may be entitled under Sec. 24 of the Code.
5. There is no need to follow the procedure under Section 28 if the director is disqualified. By operation of law, such director is disqualified to act as director thereby creating vacancies in the Board. Mere declaration of the disqualification as the cause of the vacancy is sufficient (SEC Opinion, February 3, 1992).
6. The meeting must be called by the secretaries on order of the president or on the written demand of the stockholders representing a majority of the outstanding capital stock or majority members entitled to vote.
7. The law also provides that should the secretary fail or refuse to call the special meeting upon such demand or fail or refuse to give the notice, or if there is no secretary, the call for the meeting may be addressed directly to the stockholders or members by any stockholder or member of the corporation signing the demand.

Vacancies in the Board (Sec. 29)
A vacancy in the office of director or trustee other than by removal or by expiration of term may be filled as follows:
1. By the stockholders or members:
   a. If the vacancy results from the removal by the shareholders or members or the expiration of term;
   b. If the vacancy occurs other than by removal or by expiration of term, such as death, resignation, or disqualification, if the remaining directors or trustees do not constitute a quorum for the purpose of filling the vacancy;
   c. If the vacancy may be filled by the remaining directors or trustees but the board refers the matter to stockholders or members;
   d. If the vacancy is created by reason of an increase in the number of directors or trustees.
2. By the members of the Board – if still constituting a quorum, at least a majority of them are empowered to fill any vacancy occurring in the board other than by removal by the stockholders or members or by expiration of term.

Compensation of Board Members (Sec. 30)
GENERAL RULE: Directors are not entitled to receive any compensation except for reasonable per diems.

EXCEPTIONS:
1. When their compensation is fixed in the by-laws
2. When granted by the vote of stockholders representing at least a majority of the outstanding capital stock at a regular or special meeting
3. When they are also officers of the corporation
   a. The only limitation in the granting of compensation is that the amount to be given shall not exceed 10% of the net income before income tax of the corporation during the preceding year.

CORPORATE OFFICERS
1. President – must be a director and he may not be concurrently the treasurer or secretary
2. Treasurer – may or may not be a director; as a matter of sound corporate practice, must be a resident
3. Secretary – need not be a director unless required by the by-laws; must be a resident and citizen of the Philippines; and
4. Such other officers as may be provided in the by-laws.

<table>
<thead>
<tr>
<th>CORPORATE OFFICER</th>
<th>CORPORATE EMPLOYEE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Position is provided for in the by-laws or under the Corporation Code</td>
<td>Employed by the action of the managing officer of the corporation</td>
</tr>
<tr>
<td>RTC has jurisdiction in case of labor dispute</td>
<td>NLRC has jurisdiction in case of labor disputes</td>
</tr>
</tbody>
</table>

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Authority of Officers is generally derived from:

1. Law
2. By-laws
3. Authorization from the Board, either expressly or impliedly by habit, custom or acquiescence in the general course of business (Inter-Asia Investment Industries v. CA GR no. 125778, June 10, 2003).

Extent of Powers or Authority of Corporate Officers

1. The authority which he has by virtue of his office;
2. The authority which is expressly conferred upon him or is incidental to the effectualness of such express authority;
3. As to third persons dealing with him without notice of any restriction thereof, the authority which the corporation holds the officer out as possessing or is estopped to deny.
4. The nature of the corporate business must also be taken into consideration; and
5. The nature act of an officer though originally unauthorized may become binding upon the corporation by a subsequent ratification (The Corporation Code of the Philippines Annotated, Hector de Leon, 2002 ed.).

DOCTRINE OF APPARENT AUTHORITY

- It is a familiar doctrine that if a corporation knowingly permits one of its officers, or any other agent, to act within the scope of an apparent authority, it holds him out to the public as possessing the power to do those acts; and thus, 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.
- Apparent authority is derived not merely from practice. Its existence may be ascertained through:
  1. the general manager in which the corporation holds an officer or agent as having the power to act or, in other words the apparent authority to act in general, with which it clothes him; 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, Inc. vs. CA, G.R. No. 126006, January 29, 2004).

LIMITATIONS ON POWERS OF BOARD OF DIRECTORS/TRUSTEES:

1. Limitations imposed by the Constitution, statutes, articles of incorporation or by-laws.
2. It cannot perform constituent or those acts which involve fundamental changes in the corporation which require the approval of its stockholders or members.
3. It cannot exercise powers not possessed by the corporation (The Corporation Code of the Philippines Annotated, Hector de Leon, 2002 ed.).
- The corporation powers conferred upon the board of directors usually refer only to the ordinary business transactions of the corporation and does not extend beyond the management of ordinary corporate affairs nor beyond the limits of its authority (SEC Opinion, May 2, 1994).

Nature of powers of board of directors or trustees (The Corporation Code of the Philippines Annotated, Hector de Leon, 2002 ed.)

1. Under the Theory of Original Power, the powers of the board of directors or trustees are ORIGINAL and UNDELEGATED. The stockholders or members do not confer, nor can they revoke those powers.
2. They are DERIVATIVE only in the sense of being received from the State in the act of incorporation.

BUSINESS JUDGMENT RULE

Courts cannot undertake to control the discretion of the board of directors about administrative matters as to which they have the legitimate power of action, and contracts intra vires entered into by the board of directors are binding upon the corporation and courts will not interfere unless such contracts are so unconscionable and oppressive as to amount to a wanton destruction of the rights of the minority (Gamboa vs. Victoriano, 90 SCRA 40).

Consequences:

1. Resolutions and transactions entered into by the Board within the powers of the corporation cannot be reversed by the courts not even on the behest of the stockholders.
2. Directors and officers acting within such business judgment cannot be held personally liable for such acts (Philippine Corporate Law, Cesar Villanueva, 2001 ed.).
Basis: The directors or trustees and officers to be elected shall perform the duties enjoined on them by law and the by-laws (Sec. 25).

2. Duty of Diligence

Directors and officers are required to exercise due care in the performance of their functions.

Basis: Directors or trustees who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons (Sec. 31).

3. Duty of Loyalty

- The director or officer owes loyalty and allegiance to the corporation—a loyalty that is undivided and an allegiance that is influenced by no consideration other than the welfare of the corporation.

**Basis:** Directors or trustees who acquire any pecuniary or personal interest in conflict with their duty as such directors or trustees shall be liable jointly and severally for all damages resulting therefrom (Sec. 31).

- When a director or trustee attempts to acquire or acquires in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed in him in confidence as to which equity imposes a liability upon him to deal in his own behalf, he shall be liable as trustee for the corporation and must account for all the profits which otherwise would have accrued to the corporation (Sec. 31, par. 2)

- Where a director, by virtue of his office, acquires for himself a business opportunity which should belong to the corporation, thereby obtaining profits which should belong to the corporation, he must account to the latter for all such profits by refunding the same (Sec. 34) (DOCTRINE OF CORPORATE OPPORTUNITY).

- While both the second paragraph of Section 31 and Section 34 covers the same subject matter which is business opportunity, they differ in the following sense:

<table>
<thead>
<tr>
<th>SECTION 31, 2nd paragraph</th>
<th>SECTION 34</th>
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<tbody>
<tr>
<td>Applicable to directors, trustees and officers</td>
<td>Only applicable to directors</td>
</tr>
<tr>
<td>Does not allow ratification of a transaction by a self-dealing directors, trustees or officers</td>
<td>Allows the ratification of a transaction by a dealing directors, i.e. by the votes of stockholders representing 2/3 of the outstanding capital stock</td>
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**Personal Liability of Directors**

**GENERAL RULE:** Directors and officers are not solidarily liable with the corporation.

**EXCEPTIONS:** In the following cases, personal liability may be incurred by directors and trustees, or in appropriate cases, the officers of the corporation, when they—

1. Willfully and knowingly vote for and assent to patently unlawful acts of the corporation; (Sec. 31)

2. Are guilty of gross negligence or bad faith in directing the affairs of the corporation; (Sec. 31)

3. Acquire any personal or pecuniary interest in conflict of their duty; (Sec. 31)

4. Consent to the issuance of watered stocks, or, having knowledge thereof, fails to file objections with the secretary; (Sec. 65)

5. Agree or stipulate in a contract to hold himself personally liable with the corporation; or

6. By virtue of a specific provision of law

- A director is not liable for misconduct of co-directors or other officers unless (1) he connives or participates in it; or (2) he is negligent in not discovering or acting to prevent it (Corporation Code of the Philippines, Ruben C. Ladia, 2001 Ed.).

**Par. 1 of Sec. 31** applies to directors or trustees. The erring director/trustee shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons.

**Par. 2 of Sec. 31** applies to directors, trustees, or officers who attempts to acquire or acquires, in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed in him in confidence. He shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation.

**Remedies in case of Mismanagement**

1. Receivership;

2. Injunction, if the act has not yet been done;

3. Dissolution if the abuse amounts to a ground for the institution of a quo warranto proceeding but the Solicitor General refuses to act; and

4. Derivative suit or complaint filed with SEC.

**Special Rules on Contracts entered into by Directors/Trustees or Officers**

1. **Contracts of Self-dealing Directors, Trustees or Officers** (Sec. 32)

- Self-dealing directors, trustees or officers are those who personally contract with the corporation in which they are directors, trustees, or officers.

- Such contracts are VOIDABLE, at the option of the corporation unless:

  a. The presence of such director/trustee in the board meeting approving the contract was not necessary to constitute a quorum for such meeting;

  b. The vote of such director/trustee in the board meeting approving the contract was not necessary for the approval of the contract;

  c. The contract is fair and reasonable under the circumstances;

  d. In the case of an officer, there was previous authorization by the board of directors.

- Although not all conditions are present, the corporation may elect not to attack or question the validity of the contract, without prejudice, however, to the liability of the director/trustee for damages under Sec. 31.

- Where any of the first two conditions is absent, said contract may be ratified by the vote of the stockholders representing at least 2/3 of the outstanding capital stock or 2/3 of the members in a meeting called for the purpose, provided that full disclosure of the adverse interest of the director/trustee involved is made at such meeting and the contract is fair and reasonable.

2. **Contracts of Inter-locking Directors** (Sec. 33)

- Contracts entered into between corporations with interlocking directors (interest of said directors is “substantial”, i.e. exceeding 20% of the outstanding capital stock).

- Interlocking directorship by itself is not prohibited under the Corporation Code. However, the by-laws may contain provisions that disallow interlocking directorship.

- A contract between 2 or more corporations having interlocking directors shall not be invalidated on that ground alone.

- These contracts are valid, provided that:

  a. The contract is not fraudulent; and

  b. The contract is fair and reasonable under the circumstances.

- If the interlocking director’s interest in one corporation or corporations is “nominal” (not exceeding 20% of the outstanding capital stock), then all the conditions prescribed in Sec. 32 on self-dealing directors must be
3. **Doctrine of Corporate Opportunity** (Sec. 34)

- This is consistent with the duty of loyalty of a director — which mandates that he should not give preference to his own amelioration by taking the opportunity of the corporation.

**Applicability:**
- Unless his act is ratified, a director shall refund to the corporation all the profits he realizes on a business opportunity which
  1. the corporation is financially able to undertake;
  2. from its nature, is in line with corporations business and is of practical advantage to it; and
  3. the corporation has an interest or a reasonable expectancy.
- The rule shall be applied notwithstanding the fact that the director risked his own funds in the venture.
- A business opportunity ceases to be corporate opportunity and transforms to personal opportunity where the corporation refuses or is definitely no longer able to avail itself of the opportunity (SEC Opinion, March 4, 1982).

**EXECUTIVE COMMITTEE** (Sec. 35)

A body created by the by-laws and composed of some members of the board which, subject to the statutory limitations, has all the authority of the board to the extent provided in the board resolution or by-laws (The Corporation Code of the Philippines Annotated, Hector de Leon, 2002 ed.).

**Purpose:** The Code allows the creation of such because the Board may not readily face the contingency of confronting urgent matters which requires its attention. Must be provided for in the by laws and composed of not less than 3 members of the board appointed by the board.
- The executive committee has all the authority of the board to the extent provided for in the resolution of the board or in the by laws.
- May act by a majority vote of all of its members.
- Its decisions are not subject to appeal to the board. However, if the resolution of the Executive Committee is invalid i.e. not one of the powers conferred to it), it may be ratified by the board (SEC Opinion).
- If the executive committee is not validly constituted, the members thereof may be considered as de facto officers (SEC Opinion).

**Limitations on the Powers of the Executive Committee**

It cannot act on the following:
1. Matters needing stockholder approval;
2. Filling up of board vacancies;
3. Amendment, repeal or adoption of by-laws;
4. Amendment or repeal of any resolution of the Board which by its express terms is not amendable or repealable; and
5. Cash dividend declaration.

**CODE OF CORPORATE GOVERNANCE**

**Applicability:**

The Code of Corporate Governance shall be applicable to:
1. Corporations whose securities are registered or listed;
2. Corporations which are grantees of permits/licenses and secondary franchise from the Commission; and
3. Public companies.

**Corporate Governance:**

A system whereby shareholders, creditors and other stakeholders of a corporation ensure that management enhances the value of the corporation as it competes in an increasingly global market place.

**Mandatory corporate governance rules are necessary for 2 main reasons:**
1. To overcome the collective action problem resulting from the dispersion among stockholders, and
2. To ensure that the interests of all relevant constituencies are represented.

**X. CORPORATE POWERS**

**Kinds:**
1. **Express** – those expressly authorized by the Corporation Code and other laws, and its Articles of Incorporation or Charter.
2. **Incidental** – those that are incidental to the existence of the corporation.
3. **Implied** – those that can be inferred from or necessary for the exercise of the express powers.

**Classification of Implied Powers**

- a. Acts in the usual course of business
- b. Acts to protect debts owing to the corporation
- c. Acts which involve embarking in a different business usually to collect debts out of profits
- d. Acts to protect or aid employees

**General Powers and Capacity** (Sec. 36)

1. To sue and be sued;
2. Of succession;
3. To adopt and use of corporate seal;
4. To amend its Articles of Incorporation;
5. To adopt its by-laws;
6. For stock corporations: issue and sell stocks to subscribers and treasury stocks; for non-stock corporations: admit members;
7. To purchase, receive, take or grant, hold, convey, sell, lease, pledge, mortgage and deal with real and personal property, securities and bonds
8. To enter into merger or consolidation;
9. To make reasonable donations for public welfare, hospital, charitable, cultural, scientific, civic or similar purposes, provided that no donation is given to any (i) political party, (ii) candidate and (iii) partisan political activity.
10. To establish pension, retirement, and other plans for the benefit of its directors, trustees, officers and employees.
11. To exercise other powers essential or necessary to carry out its purposes.

**Other Powers**

1. **Extension/Shortening of Corporate Term** (Sec. 37)

**Procedure:**
- a. Approval by a majority vote of the board of directors/trustees.
- b. Written notice of the proposed action and the time and place of meeting shall be served to each stockholder or member either by mail or personal service.
- c. Ratification by the stockholders representing at least 2/3 of the outstanding capital stock or 2/3 of the members in case of non-stock corporations.

- May be used as a means to voluntarily dissolve a corporation. Such voluntary dissolution may be effected by amending the articles of incorporation to shorten the corporate term (Sec. 120).
- A dissenting stockholder may exercise his appraisal right.
2. Power to Increase or Decrease Capital Stock (Sec. 38)

Ways of Increasing Authorized Capital Stock:
- By increasing/decreasing the number of shares and retaining the par value;
- By increasing/decreasing the par value of existing shares without increasing/decreasing the number of shares;
- By increasing/decreasing the number of shares and increasing/decreasing the par value.

Reasons for Increasing Capital Stock:
- To generate more working capital.
- To have more shares with which to pay for acquisition of more assets.
- To have extra shares to meet the requirement for deduction of stock dividend (Bar Review Materials in Commercial Law, Jorge Miravite, 2002 ed.).

Requirements:
- Approval by the majority vote of the board of directors;
- Ratification by the stockholders holding or representing at least 2/3 of the outstanding capital stock at a meeting duly called for that purpose;
- Prior written notice of the proposed increase or decrease of the capital stock indicating the time and place of meeting addressed to each stockholder must be made either by mail or personal service;
- A certificate in duplicate signed by a majority of the directors of the corporation, countersigned by the chairman and the secretary of the stockholders meeting;
- In case of increase in capital stock, 25% of such increased capital must be subscribed and that at least 25% of the amount subscribed must be paid either in cash or property;
- In case of decrease in capital stock, the same must not prejudice the right of the creditors;
- Filing of the certificate with the SEC; and
- Approval thereof by the SEC.

3. Power to Incur, Create or Increase Bonded Indebtedness (Sec. 38)

Corporate bond - an obligation to pay a definite sum of money at a future time at fixed rate of interest, whether secured or unsecured, evidenced by a written debt instrument called a bond or debenture.

Requirements:
Same with the power to increase or decrease capital stock.

4. Sell, dispose, lease, encumber all or substantially all of corporate assets (Sec. 40)

Requirements:
- Approval by the majority vote of the board of directors;
- Ratification by the stockholders holding or representing at least 2/3 of the outstanding capital stock at a meeting duly called for that purpose;
- Prior written notice of the proposed increase or decrease of the capital stock indicating the time and place of meeting addressed to each stockholder must be made either by mail or personal service;
- The sale of the assets shall be subject to the provisions of existing laws on illegal combinations and monopolies; and
- Any dissenting stockholder shall have the option to exercise his appraisal right.

5. Power to acquire own shares (Sec. 41)

Instances:
- To eliminate fractional shares out of stock dividends;
- To collect or compromise indebtedness to the corporation, arising out of unpaid subscription, in a delinquency sale and to purchase delinquent shares sold during said sale;
- To pay dissenting or withdrawing stockholders;
- To acquire treasury shares;
- Redeemable shares regardless of existence of retained earnings;
- To effect a decrease of capital stock;
- In close corporations, when there is a deadlock in the management of the business.

Note: In letters a-c, there must be unrestricted retained earnings.

6. Invest corporate funds in another corporation or business engaged in purpose other than primary purpose (Sec. 42)

The other purposes for which the funds may be invested must be among those enumerated as secondary purposes and must further comply with the requirements of Section 42.

Investment of funds includes not only investment of money but also investment of property of the corporation. However, the SEC imposes the following requirements:
- That the property is not presently used by the company and the leasing is not made on a regular basis;
- That by leasing the property, it will make it productive instead of allowing them to remain idle;
- There is no express restrictions in the articles of incorporation or by-laws;
- Leasing is not used as a scheme to prejudice corporate creditors or result in the infringement of the Trust Fund Doctrine; and
e. Compliance with the requirements of Section 42 (Philippine Corporate Law Compendium, Timoteo Aquino, 2006 ed.).

Requirements:

a. Resolution by the majority of the board of directors or trustees;

b. Resolution by the stockholders representing at least 2/3 of the outstanding capital stock or 2/3 of the members in case of non-stock corporation;

c. The ratification must be made at a meeting duly called for the purposes; and

d. Prior written notice of the proposed investment and the time and place of the meeting shall be made, addressed to each stockholder or member by mail or by personal service.

➢ Any dissenting stockholder shall have appraisal right.

➢ A corporation is not allowed to engage in a business distinct from those enumerated in the articles of incorporation without amending the purpose clause of said article.

7. Power to declare dividends out of unrestricted retained earnings (Sec. 43)

➢ RETAINED EARNINGS = ASSETS – LIABILITIES AND LEGAL CAPITAL

➢ UNRESTRICTED – if the retained earnings have not been reserved or set aside by the board of directors for some corporate purpose

➢ DIVIDENDS – Corporate profits set aside, declared, and ordered to be paid by the directors for distribution among shareholders at a fixed time.

Forms:

a. Cash
b. Property
c. Stock

➢ While cash dividends due on delinquent shares can be applied to the payment of the unpaid balance, stock dividends cannot be applied as payment for unpaid subscription. Stock dividends shall be withheld from the delinquent stockholder until his unpaid subscription is fully paid.

➢ The right to dividend is based on duly recorded stockholdings, accordingly, the corporation is prohibited from declaring dividends in favor of non-stockholders.

➢ As a rule, dividends among stockholders of the same class must always be pro rata equal and without discrimination and regardless of the time when the shares were acquired.

➢ Declaration of dividends is discretionary upon the board. Dividends are payable only when there are profits earned by the corporation and as a general rule, even if there are existing profits, the Board of Directors has the discretion to determine whether or not dividends are declared (Republic Planters Bank vs. Agana, 269 SCRA 1), subject to the rule on non-retention of retained earnings in excess of 100% of paid-in-capital.

➢ Dividends cannot be declared out of the capital except in the case of wasting assets corporation or those corporations solely or principally engaged in the exploitation of wasting assets to distribute the net proceeds derived from exploitation of their holdings such as mines, oil wells, patents and leaseholds, without allowance or reduction for depletion (Reviever in Commercial Law, Jose R. Sundiang & Timoteo Aquino, 2005 ed.).

➢ Stockholders at the time of declaration are entitled to dividends. Dividends declared before the transfer of shares belong to the transferor and those declared after the transfer belongs to the transferee (SEC Opinion, July 15, 1994).

➢ Even unpaid subscribers are entitled to dividends, as well as owners of delinquent shares.

Requirements:

a. Resolution by the majority of the quorum of the board of directors or trustees;

b. Approval of stockholders representing at least 2/3 of the outstanding capital stock at a regular or special meeting duly called for the purpose in case of stock dividend.

GENERAL RULE: Stock corporations are prohibited from retaining surplus profits in excess of 100% of their paid-in capital stock.

EXCEPTIONS:

a. When justified by definite corporate expansion projects approved by the board of directors

b. When the corporation is prohibited under any loan agreement with any financial institution or creditor from declaring dividends without its/his consent and such consent has not yet been secured

c. When it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is a need for special reserve for probable contingencies.

Distribution of Dividends:

GENERAL RULE: Dividends can only be declared and paid out of actual and bona fide unrestricted retained earnings.

SPECIAL RULES:

a. Gain from real property

Where a corporation sold its real property, which is not being used for business, at a gain, the income derived therefrom may be availed of for dividend distribution.

b. Revaluation Surplus

Increase in the value of a fixed asset as a result of its revaluation is not retained earning. However, increase in the value of fixed assets as a result of revaluation ("Revaluation surplus") may be declared as cash or stock dividends provided that the company:

i. Has sufficient income from operations from which the depreciation on the appraisal increase was charged

ii. Has no deficit at the time the depreciation on the appraisal increase was charged to operations; and

iii. Such depreciation on appraisal increase previously charged to operations has not been impaired by losses (SEC Opinion, Oct. 2, 1981 and March 19, 1992).

c. Paid-in Surplus

Dividends can be declared out of the amount received in excess of the par value of shares ("paid-in surplus") when:

i. They be declared only as stock dividends and not cash;

ii. No creditors are prejudiced; and

iii. There is no impairment of capital.

Note: Unlike par value shares, when no par value shares are sold at a premium, the entire consideration paid is considered capital; hence the same cannot be declared as dividends.

d. Reduction surplus

There is such where surplus arises from the reduction of the par value of the issued shares of stock. They can be available for dividend declaration provided that the rules on paid-in surplus are complied with.

e.g. Dividends can be declared out of capital only in two instances:

1. liquidating dividends; and

2. dividends from investments in wasting asset corporation.

➢ It permits corporations solely or principally engaged in the exploitation of "wasting assets" to distribute the net proceeds derived from exploitation of their holdings such as mines, oil wells, patents and leaseholds, without
allowance or deduction for depletion.

e. Sale of Treasury Shares
   Profits realized from sale of treasury shares are part of capital and cannot be declared as cash or stock dividend as purchase and sale of such shares are regarded as contractions and expansions of paid-in capital.

f. Indebtedness
   Money cannot be borrowed for the payment of dividends because indebtedness is not a retained earning of the corporation.

g. Corporate earnings which have not yet been received even though they consist in money which is due cannot be included in the profits out of which dividends may be paid.

h. Interim income
   GENERAL RULE: There can be no dividend declaration for profits in a fiscal year that has not yet expired.

   EXCEPTIONS:
   1. the amount of dividend involved would not be impaired by losses during the remaining period of the year.
   2. the projected income for the remaining period shall be submitted to the SEC, and
   3. should the company sustain losses during the remaining period, the dividends should be refunded (SEC Opinion, Oct 22, 1974 and July 24, 1991).

<table>
<thead>
<tr>
<th>CASH DIVIDENDS</th>
<th>STOCK DIVIDENDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Involves a disbursement to the stockholders of accumulated earnings</td>
<td>1. Does not involve any disbursement of funds</td>
</tr>
<tr>
<td>2. When declared and paid becomes the absolute property of the stockholder and cannot be reached by creditors of the corporation in the absence of fraud</td>
<td>2. Since it is still part of corporate property, may be reached by corporate creditors</td>
</tr>
<tr>
<td>3. Declared only by the board of directors at its discretion</td>
<td>3. Declared by the board with the concurrence of the stockholders representing at least 2/3 of the outstanding capital stock at a regular/special meeting</td>
</tr>
<tr>
<td>4. Does not increase the corporate capital</td>
<td>4. Corporate capital is increased</td>
</tr>
<tr>
<td>5. Its declaration creates a debt from the corporation to each of its stockholders</td>
<td>5. No debt is created by its declaration</td>
</tr>
</tbody>
</table>

TRUST FUND DOCTRINE

The subscribed capital stock of the corporation is a trust fund for the payment of debts of the corporation which the creditors have the right to look up to satisfy their credits, and which the corporation may not dissipate. The creditors may sue the stockholders directly for the latter's unpaid subscription.

Application of the TFD:

a. Where the corporation has distributed its capital among the stockholders without providing for the payment of creditors;

b. Where it had released the subscribers to the capital stock from their subscriptions;

c. Where it has transferred the corporate property in fraud of its creditors; and

d. Where the corporation is insolvent.

Coverage of the TFD:

a. If the corporation is solvent, the TFD extends to the capital stock represented by the corporation's legal capital.

b. If the corporation is insolvent, the TFD extends to the capital stock of the corporation as well as all of its property and assets.

Exceptions to the TFD:

The Code allows distribution of corporate capital only in these instances:

a. Amendment of Articles of Incorporation to reduce authorized capital stock;

b. Purchase of Redeemable shares by the corporation regardless of existence of unrestricted retained earnings;

c. Dissolution and eventual liquidation of the corporation;

d. In close corporation, when there should be a deadlock and the SEC orders the payment of the appraised value of the stockholder's share (Sec. 104).

8. Power to enter into management contract (Sec. 44)

Management Contract – any contract whereby a corporation undertakes to manage or operate all or substantially all of the business of another corporation, whether such contracts are called service contracts, operating agreements or otherwise.

Sec. 44 refers only to a management contract with another corporation. Hence, it does not apply to management contracts entered into by a corporation with natural persons.

Requirements:

a. Approval by a majority of the quorum of the board of directors

b. Ratification by the stockholders owning at least majority of the outstanding capital stock or the members of both the managing and the managed corporations, at a meeting duly called for the purpose

c. Approval by the stockholders of the managed corporation owning at least 2/3 of the total outstanding capital stock entitled to vote, or by at least 2/3 of the members in the case of a non-stock corporation:

i. where a stockholder/s representing the same interest of both the managing and the managed corporations own or control more than 1/3 of the total outstanding capital stock entitled to vote of the managing corporation; OR

ii. where a majority of the members of the board of directors of the managing corporation also constitute a majority of the members of the board of directors of the managed corporation.

The period must not be longer than 5 years for any 1 term except those contracts which relate to the exploration, development, exploitation or utilization of natural resources that may be entered into for such periods as may be provided by pertinent laws or regulations.

A management contract cannot delegate entire supervision and control over the officers and business of a corporation to another as this will contravene Sec. 23.
EXECUTIVE COMMITTEE

1. Its creation must be provided for in the by-laws.

2. A governing body which functions as the board itself. *(The Corporation Code of the Philippines Annotated, Hector de Leon, 2002 ed.)*

MANAGEMENT CONTRACT

1. Express power of a corporation

2. Management company must always be subject to the superior power of the board to give specific directions from time to time or to recall the delegation of managerial power. *(The Corporation Code of the Philippines Annotated, Hector de Leon, 2002 ed.)*

9. **Power to deny pre-emptive right** *(Sec. 39; For further discussion, see XIII. Stocks and Stockholders)*

- The corporation can only deny pre-emptive right if the articles of incorporation or amendment thereto denies such right.
- Denial of pre-emptive right extends to shares issued in good faith in exchange for property needed for corporate purposes or in payment of previously contracted debts.

10. **Power to amend Articles of Incorporation** *(See VIII. Formation and Organization of a Private Corporation)*