ATTENTION: Atty. Angelo M. Cabrera

Gentlemen:

This refers to your letter dated 07 May 2009 requesting our opinion on the following matters:

I. Whether or not the articles of incorporation of your client’s planned close corporation may validly contain the following provisions:

1) A provision providing for a greater quorum and voting requirement of 6/7 in the meetings of stockholders or directors instead of the usual 2/3 provided by the Corporation Code of the Philippines.

2) A provision prohibiting the transfer, conveyance, sale or assignment of shares to non-blood relatives, and with right
of first refusal granted to the holding corporation in cases of valid transfers.

3) A provision limiting the shareholdings of each of the children to a maximum of 20% either in personal capacity or in trust.

4) A provision providing for a discounted purchase price of shares in case any of the children decided to leave the family business and sells his shares back to the holding corporation.

5) A provision classifying stocks into COMMON shares and FOUNDER'S shares. The latter be issued only to the Client and his spouse in recognition of the efforts they made in bringing the family business to where it is now. The COMMON shares, on the other hand, shall be available to every member of the family.

The FOUNDER'S shares shall only comprise 10% of the outstanding capital stock of the holding corporation and the rest (90%) shall be COMMON shares.

In terms of voting rights, FOUNDER'S shares shall have a 1:10 ratio as opposed to 1:1 ratio for the COMMON shares. In the other words, one FOUNDER'S share be equivalent to ten votes. All shares regardless of whether it is FOUNDER'S or COMMON, shall be allowed to vote on all matters of the holding corporation, including the right to vote and be voted for in the election of directors.

Other than the one provided in the preceding paragraph, there shall be no other restrictions or privileges to be granted to the FOUNDER'S shares, nor there shall be any restriction imposed on the COMMON shares in terms of voting rights.

The FOUNDER'S shares cease to be as such, and shall be converted to COMMON shares once its ownership is transferred to the children or is sold back to the holding corporation thereby effectively cancelling the 1:10 voting right.
II. Whether or not the proposed 1:10 voting rights ratio for founder's shares is subject to a limited period not to exceed five (5) years provided under Section 7 of the Corporation Code.¹

We opine as follows:

To be considered a close corporation under the Corporation Code, your planned corporation's articles of incorporation must provide that (1) the number of stockholders shall not exceed 20, (2) a preemption of shares is restricted in favor of any stockholder or of the corporation, and (3) the listing of its stocks in any stock exchange or making a public offering of such stocks is prohibited.²

Under the Corporation Code, the articles of incorporation of a close corporation may provide for a greater quorum or voting requirements in meetings of stockholders or directors instead of those provided in the Corporation Code.³ Thus your planned close corporation's articles of

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¹ BATAS PAMBANSA bilang. 68 (May 1, 1980).
² CORPORATION CODE, Title XII, Section 96, provides:

“Definition and applicability of Title. - A close corporation, within the meaning of this Code, is one whose articles of incorporation provide that: (1) All the corporation's issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than a specified number of persons, not exceeding twenty (20); (2) all the issued stock of all classes shall be subject to one or more specified restrictions on transfer permitted by this Title; and (3) The corporation shall not list in any stock exchange or make any public offering of any of its stock of any class. Notwithstanding the foregoing, a corporation shall not be deemed a close corporation when at least two-thirds (2/3) of its voting stock or voting rights is owned or controlled by another corporation which is not a close corporation within the meaning of this Code.

Any corporation may be incorporated as a close corporation, except mining or oil companies, stock exchanges, banks, insurance companies, public utilities, educational institutions and corporations declared to be vested with public interest in accordance with the provisions of this Code.

The provisions of this Title shall primarily govern close corporations: Provided, that the provisions of other Titles of this Code shall apply suppletorily except insofar as this Title otherwise provides.”

³ CORPORATION CODE, Title XII, Section 97 (3), provides:

“Section 97. Articles of incorporation. - The articles of incorporation of a close corporation may provide:

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3. For a greater quorum or voting requirements in meetings of stockholders or directors than those provided in this Code.”
incorporation may validly provide for a greater quorum and voting requirement of six-sevenths (6/7) in the meetings of stockholders or directors instead of the usual two-thirds (2/3).

Further, a close corporation's articles of incorporation may provide restrictions on the transfers of shares,⁴ as long as the said restrictions are not more onerous than granting the existing stockholders or the corporation the option to purchase the shares of the transferring stockholder with such reasonable terms, conditions or period.⁵ If the existing stockholders or the corporation fails to exercise the option to purchase, the Corporation Code expressly provides that the transferring stockholder may sell his shares to any third person.⁶ Thus, your desired provision prohibiting the transfer, conveyance, sale or assignment of shares to non-blood relatives is not allowed, and the validity of the provision for a discounted purchase price in cases the corporation exercises its option to buy its own shares depends on the reasonableness of the discount.

Lastly, a close corporation's articles of incorporation may provide for the classification of shares or rights.⁷ Hence, the desired articles of incorporation provision classifying stocks into Common shares and Founder's shares, and providing that in terms of voting rights, Founder shares shall have a 1:10 ratio as opposed to 1:1 ratio for Common shares is allowed. Further, this 1:10 voting rights ratio for Founder's shares is not subject to the limited period not to exceed five (5) years provided under Section 7 of the Corporation Code since this

⁴ CORPORATION CODE, Title XII, Section 97 (1), provides:

"Section 97. Articles of incorporation. - The articles of incorporation of a close corporation may provide:

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1. For a classification of shares or rights and the qualifications for owning or holding the same and restrictions on their transfers as may be stated therein, subject to the provisions of the following section;"

⁵ CORPORATION CODE, Title XII, Section 98, provides:

"Sec. 98. Validity of restrictions on transfer of shares. - Restrictions on the right to transfer shares must appear in the articles of incorporation and in the by-laws as well as in the certificate of stock; otherwise, the same shall not be binding on any purchaser thereof in good faith. Said restrictions shall not be more onerous than granting the existing stockholders or the corporation the option to purchase the shares of the transferring stockholder with such reasonable terms, conditions or period stated therein. If upon the expiration of said period, the existing stockholders or the corporation fails to exercise the option to purchase, the transferring stockholder may sell his shares to any third person."

⁶ id.
⁷ Supra note 4.
provision only applies to the exclusive right to vote and be voted for in the election of directors.\(^8\)

This *Opinion* is rendered based solely on the facts and circumstances disclosed and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether of similar or dissimilar circumstances. If, upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Please be guided accordingly.

VERNETTE G. UMALI-PACO  
General Counsel*

\(^8\) CORPORATION CODE, Section 7 provides:

"Section 7. Founders' shares. - Founders' shares classified as such in the articles of incorporation may be given certain rights and privileges not enjoyed by the owners of other stocks, provided that where the exclusive right to vote and be voted for in the election of directors is granted, it must be for a limited period not to exceed five (5) years subject to the approval of the Securities and Exchange Commission. The five-year period shall commence from the date of the aforesaid approval by the Securities and Exchange Commission."