Republic of the Philippines
SECURITIES AND EXCHANGE COMMISSION
SEC Bldg. EDSA, Greenhills, Mandaluyong City

ARTEMIO V. PANGANIBAN,
Appellant,

\- versus -

SEC En Banc Case No. 08-11-242

CORPORATION FINANCE DEPARTMENT OF THE SECURITIES AND EXCHANGE COMMISSION,
Appellee.

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DECISION

For consideration of the Commission *En Banc* is the Appeal filed by Artemio V. Panganiban (hereinafter referred to as "appellant") seeking the reversal of the letter-ruling of the Corporation Finance Department (hereinafter referred to as "CFD") which disallowed the grant of stock options to appellant by Metro Pacific Investments Corporation (hereinafter referred to as "MPIC") as independent director and praying that the Commission *En Banc* revisit and reverse the "no stock option" policy and permit the grant of stock options to independent directors.

FACTS OF THE CASE

Appellant serves as an independent director of several publicly-listed corporations including MPIC. In 2008 and 2009, MPIC granted, pursuant to its Executive Stock Option Plan (ESOP), stock options for common shares of MPIC to its corporate officers and employees as well as members of its Board of Directors including its three (3) independent directors, one of whom is herein appellant.

CFD, in the course of evaluating MPIC's application for exemption from registration under the Securities Regulation Code (SRC)[1] for the grant of said stock options, directed MPIC to refrain from awarding stock options to the three (3) independent directors. Subsequently, CFD resolved to deny MPIC's request to

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[1] Republic Act No. 8799 (2000).

reconsider its position of barring independent directors from receiving or accepting stock options under the ESOP, prompting MPIC to cancel the stock option offers.

Aggrieved, appellant, through a letter-request, sought redress with the CFD alleging and arguing that (1) CFD's denial of the grant of stock options to independent directors deprived appellant of the opportunity to acquire 2,500,000 shares of stock of MPIC; (2) CFD exceeded its authority because there is no statutory or regulatory prohibition against the grant of stock options to independent directors and independent directors are allowed to acquire and own shares in the covered corporations up to 2% of its outstanding capital stock; and (3) prohibiting stock option plans to independent directors is discriminatory as there is no real and tangible difference between an independent director and a non-independent director.

The CFD, however, denied appellant's letter-request to reverse the disallowance of the grant of stock options to independent directors of MPIC. It maintained its position that the grant of stock options to independent directors would impair the independence of said directors as it would negate the purpose of the law for requiring their inclusion in the Board. Citing Sections 5.1 and 72.1 of the SRC, the CFD invoked the Commission's power to issue rules or set up policies regarding the said matter and to classify persons within its jurisdiction and prescribe different requirements for different classes of persons. It further emphasized that the prohibition to grant stock options to independent directors is not discriminatory because of the vital role that independent directors play in guaranteeing the integrity and accountability of public and covered companies. Hence, the instant appeal.

On appeal, appellant asserts that the CFD erred in maintaining its policy of disallowing the grant of stock options to independent directors. Appellant's arguments can be summarized as follows:

> (1) The Corporation Code,[2] the SRC and its Amended Implementing Rules and Regulations (IRR), SEC Memorandum Circular No. 16-02,[3] the Memorandum Circular No. 02-02[4] and Memorandum Circular No. 06-09[5] are bereft of any proscription against offering stock options to independent directors;
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> (2) While the Commission can promulgate rules and regulations to supplement laws, and such rules and regulations have the force and effect of law, it cannot exceed or modify the statute it is implementing, thus, it cannot substitute its own judgment for that of the Legislature;

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[2] Batas Pambansa Bilang 68 (1980).
[3] Guidelines on Nomination and Election of Independent Directors.
[4] Code of Corporate Governance.
[5] Revised Code of Corporate Governance.

(3) SEC Memorandum Circular No. 06-09, Article 3(D)(2)(iv) of SEC Memorandum Circular No. 16-02 and Rule 38.1 (2)(B) of the Amended IRR allow independent directors to acquire, own and hold shares to as much as 2% of the subscribed capital stock of the covered corporations, which, in listed or public corporations, could constitute a substantial portion in absolute peso terms of their total equity. Compared to the miniscule stock options granted to independent directors, as of 22 August 2011, 2% of PLDT would have a market value of P8.732 billion; 2% of Meralco would be P5.636 billion and 2% of MPIC would be P1.623 billion.

(4) There is no real and tangible difference between an independent director and a non-independent one that will warrant their exclusion from stock option plans;

(5) Stock option grants can hardly be deemed effective tools for swaying the judgment of independent directors because (a) the stock options being referred to are granted to all directors and senior officers of the corporation; (b) said options are part of the compensation of all the directors accruing to them as such and are not given as a result of other work performed by non-independent directors; (c) said option plans will have to be approved by the stockholders and by the Commission; (d) stock option grantees would be required to pay for the shares they will acquire;

(6) The "no stock options" policy is too oppressive and discriminative against independent directors and will ultimately be a disincentive against serving as independent directors;

(7) The grant to or acceptance by independent directors of stock options is not prohibited in other jurisdictions i.e. New York, Singapore and Hongkong.

The CFD filed its Reply Memorandum[6] on 15 September 2011. The CFD's arguments, on the other hand, can be summarized as follows:

(1) In 2007, the Commission, through SEC Res. No. 452, enunciated the policy that independent directors should not be qualified to participate in stock option plans to ensure that their independence would not be compromised;

(2) Being the administrative agency entrusted with the enforcement of the SRC, the Commission is left with the task of

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[6] Records, page 58.

determining the circumstances or relationship which are likely to affect, or could appear to affect, the independent director's judgment;

(3) Disallowance of stock option grants to independent directors should be regarded as a further limitation to the general right granted to them for share ownership;

(4) The purpose of prohibiting the grant of stock options to independent directors is consistent with the declared policy of the SRC i.e. the protection of investors and the minimization, if not total elimination, of fraudulent and manipulative practices;

(5) There is substantial distinction between the independent director and the regular director, viz: (a) independent directors are supposed to be watchdogs of stockholders and of the larger public by bringing an objective and detached view to the board room and providing an independent check on management; (b) their primary focus is on good governance and not on having pecuniary/ownership interest in the corporation; and (c) they must be independent from management in fact and perception by the public;

(6) The independence and objectivity of an independent director may be compromised by expectation of economic reward/benefit because it is the Board that initially determines the award of stock option plans and as a result, the independent director would have an attachment or feel beholden to the management of the corporation if he was granted stock options;

(7) Other countries like Netherlands, France, Brazil and the EEU do not grant stock options to independent directors.

ISSUE

The main issue in this case is whether or not (1) the prohibition against the participation of independent directors to stock option or stock ownership plans is proper, and (2) the CFD has sufficient basis in disallowing the grant of stock options to independent directors. In other words, the Commission *En Banc* is now being asked to review and reconsider a standing policy.

RULING

The appeal is meritorious.

Section 38 of the SRC mandates the inclusion of independent directors in the Board of covered corporations, viz –

> Section 38. Independent Directors. – Any corporation with a class of equity securities listed for trading on an Exchange or with assets in excess of Fifty million pesos (P50,000,000.00) and having two hundred (200) or more holders, at least two hundred (200) of which are holding at least one hundred (100) shares of a class of its equity securities or which has sold a class of equity securities to the public pursuant to an effective registration statement in compliance with Section 12 hereof shall have at least two (2) independent directors or such independent directors shall constitute at least twenty percent (20%) of the members of such board, whichever is the lesser. For this purpose, an "independent director" shall mean a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

Such inclusion is a legislative measure aimed to promote and strengthen corporate governance, protect and safeguard the rights and interest of all investors and consequently raise investor confidence, develop the capital market and help sustain high levels of growth in the corporate sector and the economy.

The Commission recognizes that the amended IRR of the SRC and the Revised Code of Corporate Governance provide limitations on actual and beneficial equity ownership of shares of an independent director but do not clarify under what modes such shares may be lawfully acquired. Specifically, SRC Rule 38(2)(B) allows an independent director to own at most 2% of the shares of the covered corporation and/or its related companies or any of its substantial shareholders, but has no express prohibition on the acquisition of shares through stock options by independent directors.

Furthermore, the "no stock option" policy of other countries like Netherlands and France are expressly provided for in their laws, rules and regulations. Also worth considering are the Final Corporate Governance Rules of the New York Stock Exchange approved by the United States Securities and Exchange Commission and the Hong Kong Stock Exchange Main Board Listing Rules, which do not expressly prohibit the grant of stock options to independent directors. In fact, both rules based the assessment of independence from management of an independent director on relevant facts and circumstances and not solely on their ownership of shares. The Hong Kong Stock Exchange Main Board Listing Rules even provide a similar limitation on ownership of shares of an independent director. Thus, by analogy, it would be erroneous to maintain a "no stock option" policy absent any express prohibition in the SRC and in the IRR, or in any Memorandum Circular/Order issued thereunder prohibiting independent directors from participating in stock option plans of covered corporations.

However, the Commission is not precluded from issuing any rules, regulations or orders to put into effect the intentions of the SRC in requiring the inclusion of independent directors in the Board of covered corporations as there is a substantial distinction between a regular and an independent director.

The SRC and its Amended IRR clearly sets apart an independent director as one who does not hold any position in the management of the covered corporation or of its related companies or substantial shareholders and one who is free from any business or other relationship or transaction that could, or could reasonably be perceived to, materially interfere with the exercise of independent judgment. Thus, an independent director is expected to check the management and controlling stockholders, and to provide a neutral and non-partisan view in overseeing corporate affairs, and in effect, safeguard the interests of all its stockholders by reducing insider control, large shareholder manipulation and managerial opportunism in the form of excessive compensation.

The impartiality and objectivity expected from an independent director could, or may reasonably be perceived to be materially compromised by the very expectation of economic reward and benefit from the grant of stock options and by the opportunity to determine the date on which th e stock option plan will be given to independent directors. When the Board of Directors approves the stock option plans from which all of them will receive and benefit from, there appears to be no incentive on the part of the independent directors to constrain the Board from taking advantage of such reward as well as such opportunity in choosing a date when the stock price is low. Thus, it is but only necessary to provide restrictions over such grant to ensure the intent of the SRC in requiring the inclusion of such independent directors be realized.

As pointed out by appellant, the Amended IRR of the SRC and the Revised Code of Corporate Governance confined the actual and beneficial equity ownership of shares of an independent director in the covered company or any of its related companies or substantial shareholders to two percent (2%) of the outstanding capital stock. This limitation was intended to safeguard their independence from management and controlling stockholders. Accordingly, the grant of stock options to independent directors should likewise be subject to said ownership limitation such that any award of stock options to the independent director shall not cause his actual and beneficial ownership of shares to exceed 2% of the outstanding capital stock.

At any rate, the Commission En Banc, in SEC Resolution No. 296, series of 2012, allowed the participation of independent directors in an employee stock option plan, provided that the two percent (2%) ownership limitation under SRC Rule 38(2)(B) is strictly observed.

WHEREFORE, premises considered, the appeal is **GRANTED**. SEC Resolution No. 452, series of 2007, insofar as it prohibits independent directors from participating in employee or executive stock option plans of covered or related companies, is hereby abandoned. Let the standing policy be that embodied in SEC Resolution No. 296, series of 2012, allowing the participation of independent directors in the executive or employee stock option or stock ownership plans, subject to the limitations imposed by law and regulations.

SO ORDERED.

City of Mandaluyong, 05 July 2012.

TERESITA J. HERBOSA
Chairperson

TOOK NO PART
MA. JUANITA E. CUETO
Commissioner

I DISSENT
RAUL J. PALABRICA
Commissioner

MANUEL HUBERTO B. GAITE
Commissioner

ELADIO M. JALA
Commissioner