Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

SEC-OGC Opinion No. 07-11
Independent Directors

24 May 2007

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Attention: Atty. Rafael Arsenio S. Dizon

Gentlemen:

This refers to your letter dated 13 July 2005 requesting clarification on certain provisions of R.A. No. 8799 also known as the "Securities Regulation Code" (SRC). In particular, you raised the question of who has the burden of electing the independent directors, the majority or the minority block?

Pertinent to your query is the provision of Section 38 of the SRC. Said section defines an "independent director" as follows:

> "Sec. 38. xxx 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."

In the amended Implementing Rules and Regulations ("IRR") of the SRC, an independent director is "a person who, apart from his fees and shareholdings, is independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director in any covered company.[1]

[1] Rule 38 (2) of the IRR of the SRC enumerates the following as independent directors:

> "A. Is not a director or officer of the covered company or of its related companies or any of its substantial shareholders except when the same shall be an independent director of any of the foregoing;

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The policy behind the appointment of an independent director is that a non-executive director must not have a relationship with the corporation that would "materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director in any covered company." Moreover, any relationship the independent director may have with the covered company must not compromise said director's objectivity and loyalty to the shareholders. In the language of the *Code of Corporate Governance* (CCG),[2] independent directors serve as an independent check on management, *viz*:

> "CCG, II.- The Board of Directors is primarily responsible for the governance of the corporation. It needs to be structured so that it provides an independent check on management. As such, it is vitally important that a number of board members be independent from management."

The SRC mandates that it is the entire membership which shall elect the independent directors. The IRR explicitly provides for the manner of nominating and electing the independent directors. This Commission likewise adopted the *Guidelines on the Nomination and Election of Independent Directors* (Guidelines)[3] to facilitate the nominations and elections of independent directors. Under the Guidelines, the nomination of independent directors shall be conducted by the Nomination Committee (Committee) prior to a stockholders' meeting. After the nomination, the Committee shall prepare a Final List of Candidates which shall contain all the information about all the nominees for independent directors.[4] The conduct of the election of independent directors shall be made in accordance with the standard election

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B. Does not own more than two percent (2%) of the shares of the covered company and/or its related companies or any of its substantial shareholders;

C. Is not related to any director, officer or substantial shareholder of the covered company, any of its related companies or any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister;

D. Is not acting as a nominee or representative of any director or substantial shareholder of the covered company, and/or any of its related companies and/or any of its substantial shareholders, pursuant to a Deed of Trust or under any contract or arrangement;

E. Has not been employed in any executive capacity by the covered company, any of its related companies and/or by any of its substantial shareholders within the last two (2) years;

F. Is not retained, either personally or through his firm or any similar entity, as professional adviser, by that covered company, any of its related companies and/or any of its substantial shareholders, within the last two (2) years; or

G. Has not engaged and does not engage in any transaction with the covered company and/or with any of its related companies and/or with any of its substantial shareholders, whether by himself and/or with other persons and/or through a firm of which he is a partner and/or a company of which he is a director or substantial shareholder, other than transactions which are conducted at arms length and are immaterial."

[2] SEC Memorandum Circular No. 2, Series of 2002.
[3] SEC Memorandum Circular No. 16, Series of 2002.
[4] *Ibid,* IV.D.

procedures of the company or its by-laws.[5] It is during annual stockholders'/memberships' meeting that the independent directors are elected. The seats allocated for the independent directors are excluded from the total number of board seats allocated to the majority and minority blocks.[6]

Based on the above premises, it is not correct to say that it is either the majority block or the minority one which has the burden to elect the independent directors since to do so would be anathema to the policy behind the appointment of independent directors. Rather, it is the stockholders themselves who will elect the independent directors during the annual stockholders' meeting.

It shall be understood that the foregoing shall not be used in the nature of a standing rule binding upon the Commission in other cases.[7]

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel

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5 *Ibid,* IV.F.i.
6 Memorandum from the Corporate Finance Department dated 09 August 2005.
7 Paragraph 7 of SEC Memorandum Circular No. 15, Series of 2003.