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**Directors, Officers and Managers Liability  
The Legal Position in the Philippines**

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# LIABILITY OF DIRECTORS, OFFICERS, AND MANAGERS IN THE PHILIPPINES<sup>1</sup>

## Structure of Corporate Entities<sup>2</sup>

Corporations in the Philippines may either be incorporated as stock or non-stock corporations. Corporations which have their capital stock divided into shares and are authorized to distribute to the holders of such shares dividends or allotment of the surplus profits are stock corporations. All other corporations are non-stock corporations. Basically, a stock corporation is an entity primarily engaged in business for some pecuniary purpose. A non-stock corporation, on the other hand, is organized not primarily for profit but for other purposes, which may be charitable, religious, educational, professional, cultural, fraternal, literary, scientific, social, or civic service.

## Directors, Officers, and Managers

Whether stock or non-stock, corporations are controlled by the Board of directors or trustees elected by the stockholders or members of the corporation. It is through the Board that the corporation exercises its powers and conducts its business. It is the Board's responsibility to foster the long-term success of the corporation and secure its sustained competitiveness in a manner consistent with its fiduciary responsibility, which it should exercise in the best interest of the corporation and its shareholders.<sup>3</sup>

The law mandates that after a Board has been constituted, the corporation must formally organize by electing officers that will run its affairs. If the corporation fails to formally organize within two years from the date of its incorporation, it shall be deemed dissolved. The statutory officers, or those provided for in the Corporation Code, are the president, secretary and treasurer. A corporation may, nonetheless, create other positions like chairman of the Board, chief executive officer, chief operating officer, chief financial officer, one or two vice presidents,

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<sup>2</sup>If not specifically provided otherwise, source of material in this article is the Corporation Code of the Philippines.

<sup>3</sup> II(6), Code of Corporate Governance. The Code of Corporate Governance was recently adopted by the Philippine Securities and Exchange Commission on 5 April 2002 and is applicable to corporations whose securities are registered or listed, corporations which are grantees of permits/licenses and secondary franchise from the SEC, public companies and branches and subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed.

managers, and other similar positions by either providing for their creation in the by-laws or passing a Board resolution for the purpose.

Managers, though, may either be categorized as a corporate officer or a mere employee of the company. If the position of manager is created under the by-laws or the by-laws authorize the Board to create the office, then the office is considered a corporate position and falls within the scope of the Corporation Code and other relevant laws. However, if the position creates an employer-employee relationship between the corporation and the manager and the selection of the manager lies within the sole discretion of one officer and not of the Board, the relationship created will be governed by pertinent Philippine labor laws.

The above doctrine was enunciated by the Philippine Supreme Court in the following recent case:<sup>4</sup>

The Court has held that in most cases the "by-laws may and usually do provide for such other officers," and that where a corporate office is not specifically indicated in the roster of corporate offices in the by-laws of a corporation, the board of directors may also be empowered under the by-laws to create additional officers as may be necessary.

An "office" has been defined as a creation of the charter of a corporation, while an "officer" as a person elected by the directors or stockholders. On the other hand, an "employee" occupies no office and is generally employed not by action of the directors and stockholders but by the managing officer of the corporation who also determines the compensation to be paid to such employee.

### **Legal Basis of Directors, Officers, and Managers Liability**

To become a director, officer or manager (under the category of executive or corporate officers) of a corporation, being a privilege rather than a right<sup>5</sup>, one has to comply with the minimum prerequisites as provided under relevant laws:

1. Every director must hold in his own name at least one share of the capital stock of the corporation. The moment he ceases to hold a share in the corporation, he automatically ceases to be a director.

2. A majority of the directors/ trustees must be residents of the Philippines.

3. No person convicted by final judgment of an offense punishable by imprisonment for a period exceeding six years, or a violation of the Corporation Code committed within five years prior to the date of his election or appointment, shall qualify as a director, trustee or officer of any corporation.

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<sup>4</sup>*Nacpil vs. International Broadcasting Corp.*, G.R. No. 144767, March 21, 2002.

<sup>5</sup>*Gokongwei vs. Securities and Exchange Commission*, 97 SCRA 78 (1979)

4. Under the Code of Corporate Governance, the following are grounds for the disqualification of a director:

a. Any person who has been finally convicted by a competent judicial or administrative body of the following: (i) any crime involving the purchase or sale of securities, e.g. proprietary or non-proprietary membership certificate, commodity futures contract, or interest in a common trust fund, pre-need plan, pension plan or life plan; (ii) any crime arising out of the person's conduct as an underwriter, broker, dealer, investment company, investment adviser, principal distributor, mutual fund dealer, futures commission merchant, commodity trading advisor, floor broker; and (iii) any crime arising out of his relationship with a bank, quasi-bank, trust company, investment house or as an affiliated person of any them.

b. Any person who, by reason of any misconduct, after hearing or trial, is permanently or temporarily enjoined by order, judgment or decree of the Commission or any court or other administrative body of competent jurisdiction from (i) acting as an underwriter, broker, dealer, investment adviser, principal distributor, mutual fund dealer, futures commission merchant, commodity trading advisor, or a floor broker; (ii) acting as a director or officer of a bank, quasi-bank, trust company, investment house, investment company or an affiliated person of any of them; (iii) engaging in or continuing any conduct or practice in connection with any such activity or willfully violating laws governing securities, and banking activities. Such disqualification shall also apply when such person is currently subject to an effective order of the Commission or any court or other administrative body refusing, revoking or suspending any registration, license or permit issued under the Corporation Code, Securities Regulation Code, or any other law administered by the Commission or Bangko Sentral ng Pilipinas, or under any rule or regulation promulgated by the Commission or Bangko Sentral ng Pilipinas, or otherwise restrained to engage in any activity involving securities and banking. Such person is also disqualified when he is currently subject to an effective order of a Self-regulatory organization suspending or expelling him from membership or participation or from associating with a member or participant of the organization.

c. Any person finally convicted judicially or administratively of an offense involving moral turpitude, fraud, embezzlement, theft, estafa, counterfeiting, misappropriation, forgery, bribery, false oath, perjury or other fraudulent act or transgressions.

d. Any person finally found by the Commission or a court or other administrative body to have willfully violated, or willfully aided, abetted, counseled, induced or procured the violation of any provision of the Securities Regulation Code, the Corporation Code, or any other law administered by the Commission or Bangko Sentral ng Pilipinas, or who has filed a materially false or misleading application, report or registration statement required by the Commission, or any rule, regulation or order of the Commission.

e. Any person judicially declared to be insolvent.

f. Any person finally found guilty by a foreign court or equivalent financial regulatory authority of acts, violations or misconduct similar to any of the acts, violations or misconduct listed in paragraph (a) to (e) hereof.

g. Any affiliated person who is ineligible, by reason of paragraphs (a) to (e) hereof to serve or act in the capacities listed in those paragraphs.

h. Conviction by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years, or a violation of the Corporation Code, committed within five (5) years prior to the date of his election or appointment.

5. A director must not have substantial interest in a competing corporation.<sup>6</sup>

6. The president shall be a director of the Corporation.

7. The treasurer must, as a matter of Securities and Exchange Commission policy, be a resident of the Philippines. (*SEC Opinions dated 13 April 1989 and 30 January 1990*)

8. The secretary shall be a resident and citizen of the Philippines.

#### Duties of Directors, Officers, and Managers

Inasmuch as directors, officers, and managers occupy positions of trust and confidence, they have corresponding duties and obligations towards the corporation and its shareholders. First and foremost, the directors or trustees and officers elected shall perform the duties enjoined on them by law and the by-laws of the corporation. It is a settled principle that a director owes a three-fold duty to the corporation: to be diligent, to be loyal, and to be obedient<sup>7</sup>, a principle that has been adopted and broadened under the Philippine Code of Corporate Governance. The general as well as specific duties and functions of the Board of directors are spelled out in the said code as follows:

##### a. General Responsibility

A director's office is one of trust and confidence. He should act in the best interest of the corporation in a manner characterized by transparency, accountability and fairness. He should exercise leadership, prudence and integrity in directing the corporation towards sustained progress over the long term. A director assumes certain responsibilities to different constituencies or stakeholders, who have the right to expect that the institution is being run in a prudent and sound manner.

To ensure good governance of the corporation, the Board should establish the corporation's vision and mission, strategic objectives, policies and procedures that may guide and direct the activities of the company and the means to attain the same as well as the mechanism for monitoring management's performance. While the management of the day-to-day affairs of the institution is the responsibility of

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<sup>6</sup>*Gokongwei vs. Securities and Exchange Commission*, 97 SCRA 78 (1979)

<sup>7</sup>Campos, Jose and Campos, Maria Clara, *The Corporation Code of the Philippines: Comments, Notes and Selected Cases*, 1990, Vol. 2, page 641 citing Ballantine, *op cit*, p. 156

the management team, the Board is, however, responsible for monitoring and overseeing management action.

b. Duties and Functions

To insure a high standard of best practice for the company and its stakeholders, the Board should conduct itself with utmost honesty and integrity in the discharge of its duties, functions and responsibilities which include, among others, the following:

- i. Install a process of selection to ensure a mix of competent directors, each of whom can add value and contribute independent judgment to the formulation of sound corporate strategies and policies. Select and appoint the CEO and other senior officers, who must have the motivation, integrity, competence and professionalism at a very high level. Adopt a professional development program for employees and officers, and succession planning for senior management.
- ii. Determine the corporation's purpose and value as well as strategies and general policies to ensure that it survives and thrives despite financial crises and its assets and reputation are adequately protected. Provide sound written policies and strategic guidelines to the corporation that will help decide on major capital expenditures. Determine important policies that bear on the character of the corporation with a view towards ensuring its long-term viability and strength. It must periodically evaluate and monitor implementation of such strategies and policies, business plans and operating budgets as well as management's over-all performance to ensure optimum results.
- iii. Ensure that the corporation complies with all relevant laws, regulations and codes of best business practices.
- iv. Identify the corporation's major and other stakeholders and formulate a clear policy on communicating or relating with them accurately, effectively and sufficiently. There must be an accounting rendered to them regularly in order to serve their legitimate interests.  
  
Likewise, an investor relations program that reaches out to all shareholders and fully informs them of corporate activities should be developed. As a best practice, the chief financial officer or CEO should have oversight of this program and should actively participate in public activities.
- v. Adopt a system of internal checks and balances, which may be applied in the first instance to the Board. A regular review of the effectiveness of such system must be conducted so that the decision-making capability and the integrity of corporate operations and reporting systems are maintained at a high level at all times.
- vi. Endeavor to provide appropriate technology and systems rating to account for available resources to ensure a position of a strong and meaningful competitor. Identify key risk areas and key performance indicators and monitor these factors with due diligence.
- vii. Constitute an Audit and Compliance Committee.

- viii. Properly discharge Board functions by meeting regularly. Independent views during Board meetings should be given due consideration and all such meetings should be duly minuted.
- ix. Keep Board authority within the powers of the institution as prescribed in the articles of incorporation, by-laws and in existing institution within the scope of its authority as prescribed in its charter and in existing laws, rules and regulations.
- c. Specific Duties and Responsibilities of a Director
  - i. **To conduct fair business transactions with the corporation and to ensure that personal interest does not bias Board decisions.** The basic principle to be observed is that a director should not use his position to make profit or to acquire a benefit or advantage for himself and/or his related interests. He should avoid situations that may compromise his impartiality. If an actual or potential conflict of interest arises on the part of directors or senior executives, it should be fully disclosed and the concerned director should not participate in the decision making. A director who has a continuing conflict of interest of a material nature should consider resigning.
  - ii. **To devote time and attention necessary to properly discharge his duties and responsibilities.** A director should devote sufficient time to familiarize himself with the institution's business. He should be constantly aware of the institution's condition and be knowledgeable enough to contribute meaningfully to the Board's work. He should attend and actively participate in Board and committee meetings, request and review meeting materials, ask questions, and request explanations.
  - iii. **To act judiciously.** Before deciding on any matter brought before the Board, every director should thoroughly evaluate the issues, ask questions, and seek clarifications when necessary.
  - iv. **To exercise independent judgment.** A director should view each problem/situation objectively. When a disagreement with other directors occurs, he should carefully evaluate the situation and state his position. He should not be afraid to take a position even though it might be unpopular. Corollarily, he should support plans and ideas that he thinks are beneficial to the corporation.
  - v. **To have a working knowledge of the statutory and regulatory requirements affecting the corporation, including the contents of its articles of incorporation and by-laws, the requirements of the Commission, and where applicable the requirements of other regulatory agencies.** A director should also keep himself informed of industry developments and business trends in order to safeguard the corporation's competitiveness.
  - vi. **To observe confidentiality.** A director should observe the confidentiality of non-public information acquired by reason of his position as director. He should not disclose any information to any other person without the authority of the Board.
  - vii. **To ensure the continuing soundness, effectiveness and adequacy of the company's control environment.**

## Duties of Directors, Officers, and Managers to Minority Shareholders

The duties of directors, officers and managers towards majority and minority shareholders are not clearly delineated under the Corporation Code. However, scattered in the Corporation Code are various provisions intended to protect shareholders in general and which were adopted in the Code of Corporate Governance. These are:

### **V. Stockholders= Rights and Protection of Minority Stockholders= Interests**

The Board shall be committed to respect the following rights of the stockholders:

#### 1. Voting Right

Shareholders have the right to elect, remove and replace directors and vote on certain corporate acts in accordance with the Corporation Code.

The Code mandates the use of cumulative voting in the election of directors. Although directors may be removed with or without cause, the Code prohibits removal without cause if it will deny minority shareholders representation in the Board. Removal of directors requires an affirmative vote of two-thirds of the outstanding capital.

#### 2. Pre-emptive Right

All shareholders have pre-emptive rights, unless there is a specific denial of this right in the articles of incorporation or an amendment thereto. They shall have the right to subscribe to the capital stock of the corporation. The articles of incorporation may lay down the specific rights and powers of shareholders with respect to the particular shares they hold, all of which are protected by law so long as they are not in conflict with the Corporation Code.

#### 3. Power of Inspection

The Corporation Code mandates corporations to allow shareholders to inspect corporate books and records including minutes of Board meetings and stock registries in accordance with the Corporation Code, and to provide them an annual report, including financial statements, without cost or restrictions.

#### 4. Right to Information

The shareholders shall be provided, upon request, with periodic reports which disclose personal and professional information about the directors and officers and certain other matters such as their holdings of the company=s shares, dealings with the company, relationships among directors and key officers, and the aggregate compensation of directors and officers. The Information Statement/Proxy Statement where these are found must be distributed to the shareholders before annual general meetings and in the Registration Statement and Prospectus in case of registration of shares for public offering with the Commission.

The minority shareholders should be granted the right to propose the holding of a meeting, and the right to propose items in the agenda of the meeting, provided the items are for legitimate business purposes.

The minority shareholders should have access to any and all information relating to matters for which the management is accountable and to those relating to matters for which the management should include such information and, if not included, then the minority shareholders can propose to include such information and, if not included, then the minority shareholders can propose to include such matters in the agenda of stockholders= meeting, being within the definition of A legitimate purposes=.

#### 5. Right to Dividends

Shareholders have the right to receive dividends subject to the discretion of the Board. However, the Commission may direct the corporation to declare dividends when its retained earnings are in excess of 100% of its paid-in capital stock, except: a) when justified by definite corporate expansion projects or programs approved by the Board or b) when the corporation is prohibited under any local or foreign creditor from declaring dividends without its consent, and such consent has not been secured; or 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.

#### 6. Appraisal Right

The Corporation Code allows the exercise of the shareholders= appraisal rights under the following circumstances:

- a) In case any amendment to the articles of incorporation has the effect of changing or restricting the rights of any stockholders or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, or of extending or shortening the term of corporate existence;
- b) In case of sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets as provided in the Corporation Code; and
- c) In case of merger or consolidation.

It is the duty of the directors to promote shareholder rights, remove impediments to the exercise of shareholders rights, and allow possibilities to seek redress for violation of their rights. They shall encourage the exercise of shareholders= voting rights and the solution of collective action problems through appropriate mechanisms. They shall be instrumental in removing excessive costs and other administrative or practical impediments to shareholders participating in meetings and/or voting in person. The directors shall pave the way for the electronic filing and distribution of shareholder information necessary to make informed decisions subject to legal constrains.

### *Duties of Directors, Officers, and Managers in Case of Insolvency*

When a corporation voluntarily initiates insolvency proceedings, the role of the Board or any of its officers extends so far as filing the petition for

insolvency.<sup>8</sup> The Insolvency Law, however, provides that provisions on both voluntary and involuntary insolvency which apply to the individual debtor, or set forth his duties, examination, and liabilities, or prescribe penalties, or relate to fraudulent conveyances, payments, and assignments, apply to each and every officer of any corporation or *sociedad anonima* in relation to the same matters concerning the corporation. We summarize these duties as follows:

1. In voluntary insolvency, the corporation through its Board of directors or officers must submit a schedule of all its debts and liabilities.
2. In involuntary insolvency, the corporation must likewise submit an inventory of all its assets, including real and personal property.
3. In either voluntary or involuntary insolvency, upon issuance of the order declaring a corporation insolvent, the order shall forbid payment to the corporation, through its officers, of any debts due to it and the delivery to the corporation, or to any person for it, and the transfer of any property by it.
4. The corporation shall abide by the assignee elected by the creditors and the transfer of all assets and property of the corporation to the assignee.

#### Business Judgment Rule

While directors are expected to observe diligence, care, and prudence in the performance of their duties, they are nonetheless protected from mistakes or errors committed in the exercise of their business judgment provided they acted in good faith and with due care and prudence under the "business judgment rule" which has been accordingly adopted in the Philippines. The Philippine Supreme Court has consistently applied the foregoing principle in several cases<sup>9</sup>, as it held:

The general rule is that in corporate affairs the will of the majority controls, and that contracts *intra vires* entered into by the board of directors are binding upon the corporation and that the 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.<sup>10</sup>

#### Liability of Directors, Officers, and Managers

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<sup>8</sup>Sec. 52, The Insolvency Law, Act No. 1956

<sup>9</sup>*Philippine Stock Exchange vs. Court of Appeals*, 281 SCRA 232 (1997), *Midas Touch Food Corporation vs. NLRC*, 259 SCRA 652 (1996), *Benguet Electric Cooperative vs. NLRC*, 209 SCRA 55 (1992), *Sales vs. Securities and Exchange Commission*, 169 SCRA 109, *Board of Liquidators vs. Kalaw*, 20 SCRA 987 (1967), *Montelibano vs. Bacolod-Murcia Milling Co., Inc.*, 5 SCRA 36 (1962)

<sup>10</sup>*Ingersoll vs. Malabon Sugar Co.*, 53 Phil. 745 (1927).

Notwithstanding the "business judgment rule", however, a director, officer, or manager cannot seek refuge under the said principle to escape liability for the following acts provided under the Corporation Code:

Section 31. *Liability of directors, trustee or officers.* - 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 or acquire any personal or pecuniary interest in conflict with their duty as such directors or trustee shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons.

When a director, trustee, or officer 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 disability upon him to deal in his own behalf, he shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation.

Section 34. *Disloyalty of a director.* - Where a director, by virtue of his office, acquires for himself a business opportunity which should belong to the corporation, thereby obtaining profits to the prejudice of such corporation, he must account to the latter for all such profits by refunding the same, unless his act has been ratified by a vote of the stockholder owning or representing at least two-thirds (2/3) of the outstanding capital stock. This provision shall be applicable, notwithstanding the fact that the director risked his own funds in the venture.

The above provisions embody basically the scope of liability of a director, officer, or manager in the Philippines. The rule presupposes bad faith which is the missing element under the "business judgment rule". Moreover, the said provisions name the exception to the general rule that corporate officers and stockholders cannot ordinarily be held personally liable for the debts of the corporation<sup>11</sup>. The Philippine Supreme Court has applied the following doctrine:

Personal liability of a corporate director, trustee or officer along (although not necessarily) with the corporation may so validly attach, as a rule, only when

1. He assents (a) to a patently unlawful act of the corporation, or (b) for bad faith, or (c) for conflict of interest, resulting in damages to the corporation, its stockholders or other persons;
2. He consents to the issuance of watered stocks or who, having knowledge thereof, does not forthwith file with the corporate secretary his written objection thereto;
3. He agrees to hold himself personally and solidarily liable with the corporation; or
4. He is made, by a specific provision of law, to personally answer for his corporate action.<sup>12</sup>

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<sup>11</sup>*Consolidated Bank and Trust Corporation v. Court of Appeals*, 197 SCRA 663 (1991).

<sup>12</sup>*Tramat Mercantile, Inc. vs. Court of Appeals*, 238 SCRA 14 (1994).

As discussed in the aforesaid case, a director may also be held personally liable with the stockholder concerned to the corporation and its creditors for the difference between the fair value received at the time of the issuance of the watered stock and the par or issued value when he consented to the issuance of watered stocks. Another instance when an officer of the corporation becomes liable for damages is when he refuses to allow any director, trustee or stockholder to examine the books and records of the corporation.

Another settled principle which disregards the corporate fiction and holds the stockholders, directors or officers personally liable for the acts and contracts of the corporation is when resort to the fiction will defeat public convenience, justify wrong, protect fraud, or defend crime, or is used as a device to defeat the labor laws. Thus, the Philippine Supreme Court ruled:

With specific regard to corporate officers, the general rule is that the officer cannot be held personally liable with the corporation, whether civilly or otherwise, for the consequences of his acts, if he acted for and in behalf of the corporation, within the scope of his authority and in good faith. In such cases, the officer's acts are properly attributed to the corporation. However, if it is proven that the officer has used the corporate fiction to defraud a third party, or that he has acted negligently, maliciously or in bad faith, then the corporate veil shall be lifted and he shall be held personally liable for the particular corporate obligation involved.<sup>13</sup>

There are likewise other statutes which specifically provide for the liability of a director or officer under the following special laws:

1. General Banking Act of 2000 (Rep. Act No. 8791)

SECTION 66. Penalty for Violation of this Act. X Unless otherwise herein provided, the violation of any of the provisions of this Act shall be subject to Sections 34, 35, 36 and 37 of the New Central Bank Act. If the offender is a director or officer of a bank, quasi-bank or trust entity, the Monetary Board may also suspend or remove such director or officer. If the violation is committed by a corporation, such corporation may be dissolved by *quo warranto* proceedings instituted by the Solicitor General.

SECTION 70. Penalty for Transactions After a Bank Becomes Insolvent. X Any director or officer of any bank declared insolvent or placed under receivership by the Monetary Board who refuses to turn over the bank's records and assets to the designated receivers, or who tampers with banks records, or who appropriates for himself or another party or destroys or causes the misappropriation and destruction of the bank's assets, or who receives or permits or causes to be received in said bank any deposit, collection of loans and/or receivables, or who pays out or permits or causes to be paid out any funds of said bank, or who transfers or permits or causes to be transferred any

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<sup>13</sup>*Francisco vs. Merryland Development Corporation*, G.R. No. 141617, 14 August 2001.

securities or property of said bank shall be subject to the penal provisions of the New Central Bank Act.

## 2. Securities Regulation Code of 2000 (Rep. Act No. 8799)

SECTION 51.3. It shall be unlawful for any director or officer of, or any owner of any securities issued by, any issuer required to file any document, report or other information under this Code or any rule or regulation of the Commission thereunder, without just cause, to hinder, delay or obstruct the making or filing of any such document, report, or information.

SECTION 73. Penalties. X Any person who violates any of the provisions of this Code, or the rules and regulations promulgated by the Commission under authority thereof, or any person who, in a registration statement filed under this Code, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall, upon conviction, suffer a fine of not less than Fifty thousand pesos (P50,000.00) nor more than Five million pesos (P5,000,000.00) or imprisonment of not less than seven (7) years nor more than twenty-one (21) years, or both in the discretion of the court. If the offender is a corporation, partnership or association or other juridical entity, the penalty may in the discretion of the court be imposed upon such juridical entity and upon the officer or officers of the corporation, partnership, association or entity responsible for the violation, and if such officer is an alien, he shall in addition to the penalties prescribed, be deported without further proceedings after service of sentence.

## 3. Trust Receipts Law (Pres. Decree No. 115)

SECTION 13. Penalty clause. X The failure of an entrustee to turn over the proceeds of the sale of the goods, documents or instruments covered by a trust receipt to the extent of the amount owing to the entruster or as appears in the trust receipt or to return said goods, documents or instruments if they were not sold or disposed of in accordance with the terms of the trust receipt shall constitute the crime of estafa, punishable under the provisions of Article Three hundred and fifteen, paragraph one (b) of Act Numbered Three thousand eight hundred and fifteen, as amended, otherwise known as the Revised Penal Code. If the violation or offense is committed by a corporation, partnership, association or other juridical entities, the penalty provided for in this Decree shall be imposed upon the directors, officers, employees or other officials or persons therein responsible for the offense, without prejudice to the civil liabilities arising from the criminal offense.

Directors, officers, and managers become also personally bound with the corporation if they agreed to be so bound under contract. The Philippine Supreme Court recognized such an undertaking and upheld the liability of a director who jointly and severally warranted payment of all valid and legitimate corporate liabilities of the corporation.<sup>14</sup>

Liability of directors and officers can likewise cover criminal liability. Section 144 of the Corporation Code categorically provides so:

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<sup>14</sup> *Francisco De Asis, Co., Inc. vs. Court of Appeals*, 136 SCRA 599 (1985)

Violations of any of the provisions of this Code or its amendments not otherwise specifically penalized therein shall be punished by a fine of not less than one thousand (Php 1,000.00) pesos but not more than ten thousand (Php 10,000.00) pesos or by imprisonment for not less than thirty (30) days but not more than five (5) years, or both, in the discretion of the court. xxx

There are also other special laws which subject guilty directors and officers to penal provisions, including the General Banking Act of 2000, Securities Regulation Code, and the Trusts Receipts Law.

As a summary, the general rule is that directors and officers of a corporation are not liable for acts of the corporation provided they acted in good faith following the "business judgment rule", whether such refer to liabilities arising from contractual obligations, intra-corporate issues, tax matters, labor, or environmental regulations. However, if it has been found that they have been guilty of gross negligence or bad faith in their dealings affecting the corporation, its stockholders, and the public in general, they may be held personally liable for damages and may further be criminally bound. The Supreme Court of the Philippines has not hesitated to hold directors and officers principally and personally bound provided a finding of bad faith, wrongdoing, fraud, or gross negligence has been clearly established.

### **Corporate Suits**

Suits by stockholders or members of a corporation based on wrongful or fraudulent acts of directors or other persons may be classified into individual suits, class suits and derivative suits.<sup>15</sup> Derivative suits are those brought on behalf of the corporation and may be instituted by shareholders. This kind of suit has no statutory basis under Philippine law; the principles governing them can be found only in Philippine jurisprudence.

The requisites for a derivative suit are as follows:

- a) the party bringing suit should be a shareholder as of the time of the act or transaction complained of, the number of his shares not being material;
- b) he has tried to exhaust intra-corporate remedies, i.e., has made a demand on the Board for the appropriate relief but the latter has failed or refused to heed his plea; and
- c) the cause of action actually devolves on the corporation, the wrongdoing or harm having been or being caused to the corporation and not to the particular stockholder bringing the suit.

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<sup>15</sup>Campos, Jose and Campos, Maria Clara, *The Corporation Code of the Philippines: Comments, Notes and Selected Cases*, 1990, Vol. 1, page 891

The *bona fide* ownership by a stockholder of stock in his own right suffices to invest him with standing to bring a derivative action for the benefit of the corporation. The number of his shares is immaterial since he is not suing in his own behalf, or for the protection or vindication of his own particular right, or the redress of a wrong committed against him, individually, but in behalf and for the benefit of the corporation.<sup>16</sup>

It has been recognized in the Philippines that the function of a derivative suit is primarily to protect minority stockholders against abuses by the majority. It has been viewed as a remedy designed by equity for those situations in which the management, through fraud, neglect of duty, or other cause, declines to take the proper and necessary steps to assert the corporation's rights.<sup>17</sup>

Aside from derivative suits, shareholders can likewise bring an individual suit against the corporation. An instance when this is applicable under Philippine law is when a shareholder is denied his right to inspect the books and records of the corporation. Where a stockholder is denied the right of inspection, his suit would be individual because the wrong is done to him personally and not to the other stockholders or the corporation.<sup>18</sup>

Shareholders can also file a class action against the corporation. They can do this when the subject matter of the controversy is one of common or general interest to many persons so numerous that it is impracticable to join all as parties, and they are sufficiently numerous and representative as to be found by the court to fully protect the interests of all concerned.<sup>19</sup> Said the Supreme Court in one case:<sup>20</sup>

What is contemplated, as will be noted, is that (a) the subject matter in controversy is of common or general interest to many persons, and (b) those persons are so numerous as to make it impracticable to bring them all before the court . . . . What makes the situation a proper case for a class suit is the circumstance that there is only one right or cause of action pertaining or belonging in common to many persons xxx not separately or severally to distinct individuals . . . . The object of the suit is to obtain relief for or against

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<sup>16</sup>*San Miguel Corporation vs. Khan*, 176 SCRA 447 (1989)

<sup>17</sup>*Commart (Phils.), Inc. vs. Securities and Exchange Commission*, 198 SCRA 73 (1991).

<sup>18</sup>Campos, Jose and Campos, Maria Clara, *The Corporation Code of the Philippines: Comments, Notes and Selected Cases*, 1990, Vol. 1, page 819

<sup>19</sup>Sec. 12, 1997 Rules of Civil Procedure

<sup>20</sup>*Liana=s Supermarket v. National Labor Relations Commission*, 257 SCRA 186 (1996).

numerous persons as a group or as an integral entity, and not as separate, distinct individuals whose rights or liabilities are separate from and independent of those affecting the others . . . . The other factor that serves to distinguish the rule on class suits . . . is . . . the numerousness of parties involved . . . . The rule is that for a class suit to be allowed, it is needful inter alia that the parties be so numerous that it would be impracticable to bring them all before the court.

Not only shareholders can bring an action against the corporation or its directors and officers. Employees, creditors, or insolvency assignees or third parties may also file an action against the corporation or any of its directors and officers. Although derivative suits have been recognized as an effective remedy to redress grievances of shareholders, what continue to flourish in Philippine trial practice are suits instituted by creditors and employees against the corporation and/or its directors and officers for money claims and wrongful termination, respectively.

Suits instituted by employees against Philippine corporations range from illegal dismissal to non-payment of wages to sexual harassment cases. An employee can sue an employer under Rep. Act No. 7877 or the Anti-Sexual Harassment Act of 1995, when the latter demands, requests, or otherwise requires any sexual favor from the other, regardless of whether the demand, request or requirement for submission is accepted. Sexual harassment is also committed when:

- (1) The sexual favor is made as a condition in the hiring or in the employment, re-employment or continued employment of said individual, or in granting said individual favorable compensation, terms, conditions, promotions, or privileges; or the refusal to grant the sexual favor results in limiting, segregating or classifying the employee which in any way would discriminate, deprive or diminish employment opportunities or otherwise adversely affect said employee;
- (2) The above acts would impair the employee's rights or privileges under existing labor laws; or
- (3) The above acts would result in an intimidating, hostile, or offensive environment for the employee.<sup>21</sup>

Venue of suits brought by shareholders against the corporation, whether by way of derivative, class, or individual suits, as well as actions brought by creditors, third parties, insolvency assignees, and employees suing under the Anti-Sexual Harassment Act, are with the regular courts. Prior to the enactment of the Securities Regulation Code, jurisdiction over cases involving intra-corporate disputes, including derivative suits, was lodged with the Securities and Exchange Commission.<sup>22</sup> However, the Securities and Exchange Commission remains the Philippine capital market regulator and has control and supervision over all corporations, partnerships, associations who are grantees of primary franchises and/or license or permit issued by the government. Actions brought by employees against the corporation for illegal

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<sup>21</sup>Section 3, Rep. Act No. 7877.

<sup>22</sup>Sec. 5.2, Securities Regulation Code.

dismissal and non-payment of wages, on the other hand, are within the jurisdiction of the National Labor Relations Commission.<sup>23</sup>

### **Statute of Limitations for Suits**

The statute of limitations for the foregoing actions varies depending on its enabling law or the Civil Code of the Philippines:

1. Shareholders= actions: Neither Pres. Decree No. 902-A nor the Corporation Code provides for a prescriptive period for such actions. However, Article 1149 of the Civil Code of the Philippines provides that all other actions whose period are not fixed in other laws must be brought within five years from the time the right of action accrues. The Securities Regulation Code, however, provides that no action shall be maintained to enforce any liability created under Section 56 or 57 (in relation to false registration statements, prospectus, communications and reports) of the Code unless brought within two years after the discovery of the untrue statement or the omission, or, if the action is to enforce a liability created under Subsection 57.1 (a) (offer to sell securities in violation of registration requirements under the Code), unless brought within two years after the violation upon which it is based. No action can be brought to enforce a liability created under Section 56 or Subsection 57.1 (a) more than five years after the security was *bona fide* offered to the public, or under Subsection 57.1 (b) more than five years after the sale.<sup>24</sup>

The Securities Regulation Code further provides that no action shall be maintained to enforce any liability created under any other provision of the Code unless brought within two years after the discovery of the facts constituting the cause of action and within five years after such cause of action accrued.<sup>25</sup>

2. Contractual disputes: Ten years from the time the right of action accrues.<sup>26</sup>
3. Discrimination actions: The Philippines has no specific law on discrimination suits. However, this may fall under termination disputes which have a prescription of three years and one year for unfair labor practice.<sup>27</sup>

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<sup>23</sup>Art. 217, The Labor Code of the Philippines.

<sup>24</sup>Sec. 62, Securities Regulation Code.

<sup>25</sup>Sec. 62.2, Securities Regulation Code.

<sup>26</sup>Art. 1144 (1), Civil Code of the Philippines.

<sup>27</sup>Art. 290, Art. 291, The Labor Code Of the Philippines.

4. Sexual harassment actions: Three years.<sup>28</sup>
5. Wrongful termination actions, including money claims arising from employer-employee relations: Three years. Unfair labor practice: One year.<sup>29</sup>
6. Fraud: If the action involves immovable property, 30 years; if the action is for the recovery of movables, eight years from the time possession is lost; if the action is based upon a written contract, or an obligation created by law or a court judgment, 10 years; if the action is based upon an oral or quasi-contract, six years; if it is based upon an injury to the rights of the plaintiff or upon a quasi-delict, four years.<sup>30</sup>
7. Tax: Internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return. If a return is filed beyond the period prescribed by law, the three-year period is counted from the day the return was filed.<sup>31</sup>

In case of a false or fraudulent return with intent to evade tax or failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within 10 years after the discovery of the falsity, fraud, or omission.<sup>32</sup>

## Foreign Judgments

To enforce a foreign judgment in the Philippines requires the filing of a claim with the regular courts.<sup>33</sup> The Supreme Court recognizes the enforceability of foreign judgments as it held in the following case that:

In this jurisdiction, a valid judgment rendered by a foreign tribunal may be recognized insofar as the immediate parties and the underlying cause of action are concerned so long as it is convincingly shown that there has been an opportunity for a full and fair hearing before a court of competent jurisdiction; that trial upon regular proceedings has been conducted, following due citation or voluntary appearance of the defendant and under a system of jurisprudence likely to secure an impartial administration of justice; and that there is nothing to indicate either a prejudice in court and in the system of laws under which it is sitting or fraud in procuring the judgment. A foreign judgment is presumed to be valid and binding in the country from which it comes, until a contrary showing, on the basis of a presumption of regularity of proceedings and the giving of due notice in the

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<sup>28</sup>Sec. 7, Rep. Act No. 7877.

<sup>29</sup>Art. 290 & 291, The Labor Code Of the Philippines.

<sup>30</sup>Arts. 1140, 1141, 1144, 1145, 1146, 1147, Civil Code of the Philippines.

<sup>31</sup>Sec. 203, The National Internal Revenue Code of 1997.

<sup>32</sup>Sec. 222, The National Internal Revenue Code of 1997.

<sup>33</sup>*Pacific Asia Overseas Shipping Corporation vs. NLRC*, 161 SCRA 122 (1988).

foreign forum. Rule 39, section 48 of the Rules of Court of the Philippines provides (now Section 48, Rule 39 of the 1997 Rules of Civil Procedure:

>Sec. 48. Effect of foreign judgments or final orders X The effect of a judgment or final order of a tribunal of a foreign country, having jurisdiction to render the judgment or final order is as follows: xxx

(b) In case of a judgment or final order against a person, the judgment or final order is presumptive evidence of a right as between the parties and their successors-in-interest by a subsequent title.

In either case, the judgment or final order may be repelled by evidence of a want of jurisdiction, want of notice to the party, collusion, fraud, or clear mistake of law or fact.=

In *Soorajmull Nagarmull vs. Binalbagan-Isabela Sugar Co. Inc.*, one of the early Philippine cases on the enforcement of foreign judgments, this Court has ruled that a judgment for a sum of money rendered in a foreign court is presumptive evidence of a right between the parties and their successors in-interest by subsequent title, but when suit for its enforcement is brought in a Philippine court, such judgment may be repelled by evidence of want of jurisdiction, want of notice to the party, collusion, fraud or clear mistake of law or fact. In *Northwest Orient Airlines, Inc., vs. Court of Appeals*, the Court has said that a party attacking a foreign judgment is tasked with the burden of overcoming its presumptive validity.<sup>34</sup>

## **Liability for Punitive Damages**

As previously discussed, directors and officers in the Philippines can be made liable for punitive damages. To protect directors and officers from such liability, there are corporations in the Philippines that provide for indemnification by either stipulating an indemnification clause in the by-laws or creating a separate agreement. These undertakings are in the nature of contractual obligations and are valid provided the stipulations, clauses, terms and conditions established by the parties are not contrary to law, morals, good customs, public order, or public policy.<sup>35</sup>

## **Indemnification of Directors, Officers, and Managers**

In the same way that a corporation may undertake to indemnify its directors and officers from liability arising from performing their duties as such, a corporation may likewise procure directors and officers liability insurance for its directors. The damages that may be incurred by such directors or officers may be insurable under Philippine law. Pres. Decree No. 1460, otherwise known as the Insurance Code of the Philippines, states that a "contract of insurance" is an agreement whereby one undertakes for a consideration to indemnify another against loss, damage or liability arising from an unknown or contingent event".<sup>36</sup> It further provides that any contingent or unknown event, whether past or future, which may damnify a person

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<sup>34</sup>*Philippine Aluminum Wheels vs. Fasgi Enterprises*, 342 SCRA 722 (2000).

<sup>35</sup>Art. 1306, Civil Code of the Philippines.

<sup>36</sup>Sec. 2(1), Insurance Code of the Philippines.

having an insurable interest, or create a liability against him, may be insured against.<sup>37</sup> The Insurance Commission has approved and allowed the issuance of such kind of non-life insurance as one which falls under casualty insurance. The Insurance Code defines casualty insurance as follows:

SECTION 174. Casualty insurance is insurance covering loss or liability arising from accident or mishap, excluding certain types of loss which by law or custom are considered as falling exclusively within the scope of other types of insurance such as fire or marine. It includes, but is not limited to, employer's liability insurance, workmen's compensation insurance, public liability insurance, motor vehicle liability insurance, plate glass insurance, burglary and theft insurance, personal accident and health insurance as written by non-life insurance companies, and other substantially similar kinds of insurance.

The directors and officers liability insurance are currently being offered by non-life insurance companies in the Philippines. These companies can only transact insurance business and offer their products in the Philippines after they shall have obtained a certificate of authority<sup>38</sup> from the Insurance Commissioner to conduct such business, and approval<sup>39</sup> to issue or deliver any policy, certificate or contract of insurance. Thus, any liability insurance which a corporation intends to procure for its directors in the Philippines must be taken from an insurance company duly authorized to do business in the Philippines. Generally, the premium on such insurance is paid by the corporation.

This directors and officers liability insurance, although currently marketed in the Philippines, has not gained wide recognition. For this reason, no controversial issues have arisen in the Supreme Court and/or settled rules established on the matter. It remains common practice in the Philippines for corporations to undertake to indemnify its directors and officers under contract for any liability that the latter might incur in the performance of their duties. However, this may not prove advantageous in the long run for the directors and officers since the corporation may later be unable to fund the liability or intentionally exclude certain liabilities that may have been incurred by such directors. With the increasing claims and suits against directors and officers, it would be beneficial not only to the directors and officers but to the corporation as well to secure liability insurance for its directors and officers.

**This article is intended to provide a general framework of the liability of corporate directors, officers, and managers under Philippine law. It contains a discussion of applicable Philippine laws, regulations, and jurisprudence in force as of the date of its writing. It is not intended to be a comprehensive or exhaustive discussion of the issue, nor is it meant to constitute legal advice on a particular problem. All rights to this article are reserved.**

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<sup>37</sup>Sec. 3, Insurance Code of the Philippines.

<sup>38</sup>Sec. 187, Insurance Code of the Philippines

<sup>39</sup>Sec. 226, Insurance Code of the Philippines

