DERIVATIVE LITIGATIONS IN ENGLAND AND THE PHILIPPINES: A COMPARATIVE STUDY

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ABSTRACT

This thesis compares the current status of the English statutory derivative claim mechanism and the Philippine common law derivative suit mechanism, and evaluates which fulfills its function better. After the comparative analysis of the derivative litigations in England and the Philippines based on eight factors of comparison, it is the conclusion of this thesis that the approach of the Philippine jurisdiction is better in terms of fulfilling the function of derivative litigation, which is to give a member or shareholder the right to bring action for and on behalf of the company or corporation when it fails to take action to redress an injury or wrong that it suffered.

Derivative claims remain rare in England and not as utilized as derivative suits in the Philippines due to, among other factors, the restrictiveness of the English mechanism and the presence of an alternative remedy. Notwithstanding the foregoing, England's effort to statutorily recognize the right to bring derivative claims is commendable and can be learned from. While the beauty of the Philippine common law derivative suit mechanism is that it is flexible and accessible, the downside is that it is like a maze that is difficult to navigate. It is true that if something is not broke, it does not have to be fixed. However, there is always room for improvement. Thus, this thesis recommends that it would be best practice for the Philippines to statutorily recognize the substantive law on derivative suits, following the English example, albeit with less restrictive provisions, in order to achieve a mechanism that is coherent, predictable and easier to navigate than the existing common law mechanism.

TABLE OF CONTENTS

CHAPTER 1 - INTRODUCTION

1.1 Background

The English landmark case *Foss v. Harbottle*[1] for derivative claims in England was decided in 1843. This case and its jurisprudential developments shaped the common law rule on derivative claims for more than one and a half centuries. The right to file derivative claims in England only became statutorily provided in Part 11 of the Companies Act 2006, which became effective on 1 October 2007.[2] The common law rule in *Foss v. Harbottle* theoretically no longer binds the court, yet the court must still consider certain relevant matters to the Foss Rule when rendering decisions.[3]

In contrast with the English jurisdiction, the right to file derivative suits in the Philippines, although consistently recognized in jurisprudence since 1911 through the landmark case *Pascual v. Orozco,*[4] still remains based on case law.[5] There is no provision in the Philippine Corporation Code on the right to file derivative suits.[6]

In 2001, the Supreme Court recapitulated the jurisprudential requisites for bringing derivative suits under Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies under Republic Act No. 8799 or the Securities Regulation Code ("Interim Rules").[7] However, the substantive rules on bringing derivative suits still remain uncodified and based purely on jurisprudence that stretch for more than a century from 1911 until present.

[1] Foss v. Harbottle, No. 67 ER 189, 2 Hare 461 (1843).
[2] Frank Wooldridge & Liam Davies, *Derivative Claims under UK Company Law and Some Related Provisions of German Law*, 2012 AMIC. CURIAE 5, 5 (2012).
[3] *Id.* at 6.
[4] Candido Pascual v. Eugenio Del Saz Orozco, G.R. No. L-5174 (Supreme Court of the Philippines Mar. 17, 1911).
[5] VILLANUEVA, CESAR, PHILIPPINE CORPORATE LAW 472 (Rex Book Store 2013).
[6] Yu v. Yukayguan, No. 589 SCRA 588 (Supreme Court of the Philippines 2009).
[7] Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799, AM NO 01-2-04-SC (2001).

Notwithstanding the foregoing, derivative litigation is utilized more in the Philippine jurisdiction[8] than in the English jurisdiction. Derivative claims remain particularly rare in England, as it always has.[9] This is ironic, considering the abovementioned English reforms that led to the statutory recognition of derivative claims. In view thereof, it is thus the aim of this thesis to compare the two jurisdictions' contrasting approaches to derivative litigation and determine which between the English statutory derivative claim mechanism and Philippine common law derivative suit mechanism fulfills its function. In so doing, this thesis also aims to confirm, secondarily, whether codification—similar to that of the English jurisdiction—can improve the Philippine derivative suit mechanism, or whether it is better left alone in keeping with the maxim: "If it ain't broke, don't fix it."

1.2 Justification for the Comparative Study

The English jurisdiction is chosen as a starting point of comparison not because it is regarded as a model law fit to be a benchmark for derivative litigation, but rather because the English jurisdiction birthed *Foss v. Harbottle*, which is considered the "seminal case" [10] on derivative litigation. As explained by a corporate law scholar, David Skeel, Jr., *Foss v. Harbottle* is the suitable starting point because throughout the nineteenth century, both English and American courts have treated this case as a turning point in the history of shareholder remedies.[11] It has gained a reputation of being "the wellspring of derivative litigation"[12] which, as Skeel points

[8] Jewelynn Gay B. Zareno & Earla Kahlila Mikhaila C. Langit, *Upholding Equity: An Analysis of the Requisites for the Institution of Derivative Actions*, 86 PHILIPP. LAW J. 749 (2012): Authors comment that procedural limitations were specified under the Interim Rules of Procedure Governing Intra-Corporate Controversies under Republic Act No. 8799 in order to discourage or eliminate the common practice of filing nuisance suits.
[9] David A. Skeel, *The Accidental Elegance of Aronson v. Lewis*, LEWIS OCT. 2007 U PENN INST LAW ECON RES. PAP. 4 (2007) citing John Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, SSRN Scholarly Paper ID 1133542 (Social Science Research Network), Apr. 1, 2008.
[10] Ann M. Scarlett, *Shareholder Derivative Litigation's Historical and Normative Foundations*, 61 BUFF REV 837, 856 (2013).
[11] Skeel, *supra* note 9, at 4.
[12] *Id.*

out, is ironic because *Foss v. Harbottle* speaks about restrictions on derivative litigation rather than affirmation of its legitimacy as a shareholder remedy.[13]

Some principles of derivative litigation were imported into the American Corporate Law from the English Company Law[14] particularly the necessary parties rule and exceptions to that rule.[15] As an English colony, American corporate law and shareholder litigation followed English precedents prior to the American Revolution.[16] After gaining independence from England, however, American corporate law took a divergent doctrinal development.[17]

As the English wielded power through common law when it colonized America, so did the Americans when it colonized the Philippines.[18] During the American colonial rule, the Americans diluted the previous Spanish colonizer's civil law influence in the Philippines with common law concepts[19] and introduced English as the language of the law and medium of legal instruction.[20] As a result, the Philippine legislative body extensively borrowed American laws in the area of commercial law, including corporation law.[21] Thus, the Corporation Law (Act No. 1459), which was enacted in 1906, was patterned after the American corporation law.[22] In 1911, when the Philippine Supreme Court decided *Pascual v. Orozco,*[23] the landmark case on Philippine derivative suits, it realized that neither the Corporation Law nor

[13] *Id.*
[14] Nicholas Calcina Howson, *When'Good'Corporate Governance Makes' Bad'(Financial) Firms: The Global Crisis and the Limits of Private Law*, 108 MICH. LAW REV. FIRST IMPR. 44, 47 (2009).
[15] Scarlett, *supra* note 10, at 842.
[16] *Id.* citing *Bank of the U.S. v. Deveaux*, 9 U.S. (5 Cranch) 61, 88 (1809): "[O]ur ideas of a corporation, its privileges and its disabilities, are derived entirely from the English books, we resort to them for aid, in ascetaining its character." .
[17] *Id.*; Skeel, *supra* note 9, at 4.
[18] Pacifico Agabin, *Philippines: "The Twentieth Century as the Common Law"s Century', in* STUDY MIX. LEG. SYST. ENDANGER. ENTREN. BLENDED 61 (Susan Farran et al. eds., 2014).
[19] *Id.* at 76.
[20] *Id.* at 71.
[21] *Id.* at 82.
[22] *Id.*
[23] Candido Pascual v. Eugenio Del Saz Orozco, No. G.R. No. L-5174 (Supreme Court of the Philippines Mar. 17, 1911).

the Code of Civil Procedure then in force provided the right to file derivative suit.[24] Nevertheless, the Court took cognizance of the suit on the ground of equity, relying on American jurisprudence in affirming the validity of derivative suits.[25] Even after the American colonial rule, American jurisprudence remained a persuasive authority in the area of derivative litigation.[26]

In view of the foregoing, the English jurisdiction was chosen as the point of comparison because: First, it is historically and doctrinally the most suitable starting point as it produced the seminal case on derivative litigation; Second, the derivative litigation in both English and Philippine jurisdictions endured a lifespan of more than a century being purely based on common law, but developed differently and grew in the opposite direction, with the English mechanism becoming codified yet remaining rarely resorted to, while the Philippine mechanism still remains uncodified yet more utilized. The stark contrast between the two opposites makes it ideal to study them.

This study therefore contributes to existing literature on company law by comparing the derivative litigation mechanisms of the two jurisdictions—England and the Philippines. By juxtaposing the two derivative litigation mechanisms against each other, the gaps as well as the strengths will be brought to the surface, and it can be determined which fulfills its function better. In doing so, it can likewise be ascertained whether the Philippines should follow the English codification example, or whether the Philippine common law derivative suit mechanism is better left alone.

[24] *Id.*
[25] Jewelynn Gay B. Zareno & Earla Kahlila Mikhaila C. Langit, *supra* note 8, at 729.
[26] *Id.* at 730.

1.3 Terminology

Derivative litigation refers to a suit brought by a shareholder on behalf of the corporation against a corporate officer or a third party when the corporation failed to take such action.[27] The English jurisdiction has termed the same "derivative claim"[28], while the Philippine jurisdiction has termed it "derivative suit"[29]. For purposes of consistency with the terminology used by the respective legal jurisdictions, the term "derivative claim" shall be used when referring solely to English jurisdiction, and the term "derivative suit" shall be used when referring exclusively to Philippine jurisdiction. Otherwise, the term "derivative litigation" shall be used when referring to both jurisdictions in general without making any distinction.

The English jurisdiction uses the term "company" which the Companies Act 2006 defines as a juridical entity validly formed and registered[30] covering both limited[31] and unlimited[32] companies as well as private[33] and public[34] companies. The Philippine jurisdiction, however, uses the term "corporation" which the Corporation Code of the Philippines defines as an artificial being formed or organized under the Corporation Code of the Philippines, "having the right of succession and powers, attributes and properties expressly authorized by law or

[27] Black's Law Dictionary (9th ed. 2009).
[28] Companies Act 2006, § 260.
[29] DE LEON, HECTOR S. & DE LEON, JR., HECTOR M., THE CORPORATION CODE OF THE PHILIPPINES ANNOTATED 577 (Rex Book Store 2006).
[30] Companies Act 2006, § 1 (1).
[31] *Id.* § 3 (1) categorizes a company as limited company when "the liability of its members is limited by its constitution. It may be limited by shares or limited by guarantee."
[32] *Id.* § 3 (4) categorizes a company as unlimited company when "there is no limit on the liability of its members."
[33] *Id.* § 4 (1) categorizes a company as private company when it does not satisfy the requirements of a public company under Section 4 (2) of the same.
[34] *Id.* § 4 (2) categorizes a company as public company when it is a company limited by shares or limited by guarantee, and having a share capital, and whose certificate of incorporation states that it is a public company, and validly registered or re-registered as a public company under the Companies Act.

incident to its existence"[35] which may be stock[36] or non-stock [37]corporations.[38] For purposes of consistency with the terminology used by the respective legal jurisdictions, the term "company" shall be used when referring solely to English jurisdiction, and the term "corporation" shall be used when referring exclusively to Philippine jurisdiction. Otherwise, the phrase "company or corporation" shall be used when referring to legal entities of both jurisdictions in general.

1.4 Scope and Limitation

There are three modes in which litigation can be brought against a company director for breach of duty: (1) when the board of directors directly commences proceedings; (2) when the liquidator or administrator commences proceedings pursuant to a formal insolvency procedure, or when creditors pursue derivative litigation in order to protect their residual claims; and (3) when one or more members or stockholders bring derivative litigation on behalf of the company.[39] The third mode—derivative litigation—shall be the scope of this thesis. The two jurisdictions that will be compared are England and the Philippines.

It is not the objective of this thesis to analyze the complex Foss Rule of the English jurisdiction. References to the Foss Rule and its developments are only made for purposes of understanding the proper interpretation and limitations of the current provisions of the Companies Act 2006 on derivative claims.

[35] Corporation Code of the Philippines, BATAS PAMBANSA BLG 68 § 2 (1980).
[36] *Id.* § 3 defines stock corporations as corporations which have capital stock divided into shares and are authorized to distribute to the holders of such shares dividends or allotments of the surplus profits on the basis of shares held.
[37] *Id.* defines nonstock corporations as corporations which do not comply with the statutory requirements of stock corporation.
[38] DE LEON, HECTOR S. & DE LEON, JR., HECTOR M., *supra* note 29, at 577.
[39] Department of Trade and Industry, Companies Act 2006 - Explanatory Notes 73 (2006).

The comparative analysis of this thesis concentrates on the current status of derivative litigation in England and the Philippines. It is not the aim of this thesis to survey all existing jurisprudence on the matter. Reference to antecedent jurisprudence from both jurisdictions will be limited to the decisions that made a considerable impact on the current status of derivative litigations.

1.5 Methodology

The methodology employed in this thesis is the functional comparative law method, which has a factual approach that focuses on the effects of the law.[40] Thus, its objects are judicial decisions made in response to actual legal dilemmas.[41] This thesis involves the study of a number of relevant English and Philippine judicial decisions to which this method is thus appropriate to be employed. As the advocates of the functional comparative law method Konrad Zweigert and Hein Kötz maintain, "The basic methodological principle of all comparative law is that of *functionality.*"[42] Ralf Michaels, a comparative law scholar, expounds on the concept of functionality and explains that it can serve as an evaluative criterion in 'better-law comparison'—where the better law would be that which fulfills its function better than the others.[43]

Therefore, the functional comparative method suits the purpose of this thesis, which is ultimately to answer the central question: Which fulfills its function better—the English statutory derivative claim mechanism or the Philippine common law derivative suit mechanism? It is likewise the aim of this thesis to answer the secondary question: Should the Philippines follow the English example and codify the substantive law on derivative suits, or is the common law derivative suit mechanism better left alone?

[40] Ralf Michaels, *The Functional Method of Comparative Law* 5 (2005).
[41] *Id.*
[42] *Id.* at 4.
[43] *Id.*

1.6 Thesis Structure

The first chapter discusses the background, justification for the comparative study, terminology, scope and limitations, and methodology. The second chapter discusses the origins and development of derivative litigation in the English and Philippine jurisdictions to lay the foundational support for a substantial comparative analysis. The third chapter then deals with the comparative analysis of the current status of derivative litigations in England and the Philippines based on eight factors of comparison: (1) proper party and the application procedure; (2) ownership of shares by members and shareholders; (3) wrongful acts that warrant the filing of derivative claims; (4) procedural requisites for derivative litigation; (5) derivative claims versus direct shareholder claims; (6) alternative remedy to derivative litigation; (7) judicial non-interference or business judgment rule; and (8) costs to bringing derivative litigation. The fourth chapter presents the conclusion of the comparative study as to which between the English statutory derivative claim mechanism and Philippine common law derivative suit mechanism fulfills the function of derivative litigation better. The fourth chapter likewise presents the recommendations as to whether the Philippines should follow the English codification example and should statutorily recognize the substantive law on derivative suits, or whether the Philippine common law derivative suit mechanism is better left alone.

CHAPTER 2 - DERIVATIVE LITIGATION: ORIGINS AND DEVELOPMENTS

2.1 The English Derivative Claim

2.1.1 Origins: Foss v. Horbottle (1843)

Derivative claims in England have traditionally been regulated by the 1843 landmark case *Foss v. Harbottle*[44] and by the developments in this precedent ("Foss Rule").[45] Although this was not the first case decided by the court on the issue of derivative claims,[46] this case law shaped the rules on derivative claims for more than a century.[47] The court held in this case that a wrong committed by a company's directors gives the company the sole standing to sue.[48] It established two main doctrines that together comprised what is known as the Foss Rule: first, the *proper plaintiff rule*, which states that the company should sue in its own name, or in the name of a lawfully appointed company representative; and second, the *majority rule principle* which provides that the court will not interfere when the alleged wrong committed against the company can be confirmed or ratified by majority of shareholders.[49]

The 1843 decision in *Foss v. Harbottle* relied on early nineteenth-century decisions in the law of partnership.[50] The partnership principles of mutual trust and fiduciary duty were adopted; including the concept that it is not unfair for the will of the minority shareholders to be subordinated to the will of the majority shareholders.[51] Similarly, the court's non-interference

[44] Foss v. Harbottle, No. 67 ER 189, 2 Hare 461 (1843).
[45] XIAONING LI, A COMPARATIVE STUDY OF SHAREHOLDERS' DERIVATIVE ACTIONS: ENGLAND, THE UNITED STATES, GERMANY, AND CHINA (Kluwer 2007).
[46] One of the earliest of these cases are *Carlen v. Drury* (1812) V & B 154; *Walters v. Taylor* (1807) 15 Ves 10; and *Ellison v. Bignold* (1821) 2 Jac & W 503.
[47] LI, *supra* note 45.
[48] *Id.*
[49] *Id.*
[50] A.J. BOYLE, MINORITY SHAREHOLDER'S REMEDIES (Cambridge University Press 2002).
[51] LI, *supra* note 45.

policy with internal corporate affairs also originated from the law of partnership.[52] This policy prevented unjust shareholder intervention and fostered greater risk-taking on the part of the corporate officers.[53] As a consequence, the Foss Rule "transformed the old partnership rule into one of the leading principles of modern company law."[54]

2.1.2 Development: Companies Act 2006

As a result of an intensive review of the existing company law commissioned by the Department of Trade and Industry, the Companies Act 2006, as amended, provided for new statutory provision in Part 11, which permitted shareholders to institute derivative claims against directors on behalf of the company for breach of director's duties.[55] Derivative claim is defined as a "proceeding brought by a member of a company wherein the company seeking relief on behalf of the company in respect of a cause of action vested in the company."[56] The Explanatory Notes prepared by the Department of Trade and Industry—although not endorsed by the Parliament—explains that Part 11 of the Companies Act 2006 on Derivative Claims does not supplant the substantive rule in *Foss v. Harbottle*, but merely embodies the recommendations of the Law Commission on statutorily providing for a "more modern, flexible and accessible criteria"[57] for bringing derivative claim procedure in connection with breach of the directors' duties of reasonable care, skill and diligence. It is not a prerequisite for the directors to have benefited from the breach.[58] Moreover, it is no longer a prerequisite, as it was in the Foss Rule, for the applicant to show that the wrongdoing directors control the majority of company's shares.[59]

[52] *Id.*
[53] *Id.*
[54] *Id.*
[55] Department of Trade and Industry, Companies Act 2006 - Explanatory Notes (2006) at 74.
[56] Companies Act 2006, §260 (Eng.).
[57] LAW COMMISSION, SHAREHOLDER REMEDIES 7 (no. 246, Stationery Office 1997).
[58] Department of Trade and Industry, *supra* note 39, at 74.
[59] *Id.*

Part 11 of the Companies Act 2006 provides three legal requisites to a derivative claim: first, the application for permission to continue derivative claim (or permission application[60]) must be brought by a member of the company; second, the cause of action must belong to the company; and third, the relief must be sought on behalf of the company.[61]

2.2 The Philippine Derivative Suit

2.2.1 Origins: Pascual v. Orozco (1911)

Under the American occupation of the Philippines, it became apparent that there was no entity in the Spanish law[62] that corresponds to the English and American legal concept of "corporation". Thus, the Philippine Commission enacted in 1906 the Corporation Law (Act No. 1459)—a mirror image of the American corporate law—and introduced to the Philippines the American notion of corporation as the standard business entity, with the aim of eventually superseding the Spanish *sociedad anónima.*[63]

In 1911, the Philippine Supreme Court in *Pascual v. Orozco*[64] recognized the right of the stockholders to sue on a derivative action.[65] The Corporation Law and the Code of Civil Procedure then in force were both silent on the right of shareholders to file derivative suits.[66] Nevertheless, the Supreme Court recognized the plaintiff's right to file a derivative suit for and on behalf of the corporation based on his capacity as a stockholder and on the ground of equity, citing American jurisprudence.[67] This right is, however, qualified by the condition that

[60] Practice Direction 19C - Derivative Claims: "application for permission to continue derivative claim" is also termed under the Practice Direction 19C as "permission application."
[61] Department of Trade and Industry, *supra* note 39, at 74.
[62] Prior to the American occupation, the Philippines was under the Spanish colonial rule.
[63] VILLANUEVA, CESAR, PHILIPPINE CORPORATE LAW (Rex Book Store 2013) citing *Harden v. Benguet Consolidated Mining*, G.R. No. L-373331(Supreme Court of the Philippines, March 18, 1933).
[64] Candido Pascual v. Eugenio Del Saz Orozco, G.R. No. L-5174 (Supreme Court of the Philippines Mar. 17, 1911).
[65] *Id.*
[66] *Id.*
[67] *Id.*

a plaintiff must be a stockholder both at the time the suit is brought, and at the time the complained transaction occurred.[68] The exception to this, which is known as the "continuing wrong doctrine",[69] allows the filing of the derivative suit by a plaintiff who was not yet a stockholder at the time the transaction occurred, provided that the act complained of continues until the plaintiff has become a stockholder and that the act injures or affects plaintiff especially or specifically in some way.[70]

2.2.2 Development: Corporation Code of the Philippines

Currently, the right to file derivative suit is not provided for under the Corporation Code.[71] It merely owes its existence to the Philippine jurisprudence, which initially assimilated corporation law principles from the Anglo-American jurisprudence.[72] The Philippine Supreme Court in many decisions repeated its definition of derivative suit as a suit instituted by a stockholder "for and on behalf of the corporation [brought] in order to protect or vindicate corporate rights, whenever the officials of the corporation refuse to sue, or are the ones to be sued, or hold the control of the corporation."[73] The rights enforced by stockholders are merely derivative in nature, with the cause of action belonging to the corporation.[74]

The Supreme Court in 2001 summed up the jurisprudential requisites for bringing derivative suits under Rule 8 of the Interim Rules.[75] However, this merely provides the procedural guidelines; whereas the substantive rules on bringing derivative suits remain scattered

[68] *Id.*
[69] Jewelynn Gay B. Zareno & Earla Kahlila Mikhaila C. Langit, *supra* note 8, at 738.
[70] *Candido Pascual v. Eugenio Del Saz Orozco*.
[71] R.N. Symaco Trading Corp. v. Luisito Santos,G.R. No. 142474 (Supreme Court of the Philippines Aug. 18, 2005).
[72] VILLANUEVA, CESAR, *supra* note 5, at 472.
[73] *Francis Chua v. Court of Appeals*, G.R. No. 150793 (Supreme Court of the Philippines Nov. 19, 2004); *Santiago Cua, Jr. v. Miguel Ocampo Tan*, G.R. No. 181455–56 (Supreme Court of the Philippines Dec. 4, 2009); *Hi-Yield Realty, Inc. v. Court of Appeals*, G.R. No. 168863 (Supreme Court of the Philippines Jun. 23, 2009); *Filipinas Port Services v. Victoriano S. Go*, G.R. No. 161886 (Supreme Court of the Philippines Mar. 16, 2007).
[74] *R.N. Symaco Trading Corp. v. Luisito Santos*.
[75] Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799, AM NO 01-2-04-SC (2001).

throughout a vast number of court decisions that span for more than a century, beginning 1911 until present.

In 2013 and 2014, six bills were filed proposing various amendments to the Corporation Code of the Philippines that were primarily focused on the following areas: introduction of the one-person corporation; lengthening the corporate term from a renewable 50-year term to perpetual, and promotion of corporate good governance by imposing criminal liability of corporation. [76] The bills have been consolidated and substituted on September 8, 2015 under Senate Bill No. 2945[77] as per Committee Report No. 247 prepared by the Senate Committee on Trade, Commerce and Entrepreneurship. [78] The consolidated and substituted bill is currently at the second reading stage in the Senate. The tenor of the proposed provisions and the sponsorship speech of the Chairman of the Senate Committee on Trade, Commerce and Entrepreneurship, reveal that the impetus behind the proposed amendments is primarily economic—for the Philippine business playing field to become globally at par and more attractive to investors.[79]

As it currently stands, the Senate Bill No. 2945 does not mention any provision related to the filing of derivative suits.[80] Arad Reisberg, a company law scholar, explains in his treatise that the reform of the Companies Act 2006, which provided for a statutory derivative claim mechanism, was principally driven by fiscal and macro-economic considerations with the

[76] An Act Amending Batas Pambansa Blg. 68 or the Corporation Code of the Philippines, Senate 2945, Senate (Sixteenth Congress Third Regular Season Sess. 2015).
[77] *Id.*
[78] Committee on Trade, Commerce and Entrepreneurship, *Senate Committee Report No. 247 Re: Senate Bill No. 2945 "An Act Amending Batas Pambansa Blg. 68 Otherwise Known as the Corporation Code of the Philippines,"* Senate Committee Report 247 Sept. 8, 2015.
[79] *Press Release - Aquino: Senate Bill No. 2945 under Committee Report No. 247 An Act Amending Batas Pambansa Blg. 68 otherwise known as the Corporation Code of the Philippines*, SENATE PHILIPP. (Sept. 9, 2015), https://www.senate.gov.ph/press_release/2015/0909_aquino2.asp.
[80] *An Act Amending Batas Pambansa Blg. 68 or the Corporation Code of the Philippines.*

goal of making the United Kingdom (UK) more attractive to business investments.[81] The Philippine jurisdiction, having similar economic objectives as the UK, should have thus taken into consideration the codification of the substantive law on derivative suits in the amendment of the Philippine Corporation Code. Since the procedural guidelines for filing derivative suits have already been provided for under the Interim Rules in 2001, it is high time that the substantive law on derivative suits already be embodied in a statute because substantive law and procedural rules go hand in hand. To illustrate, in the UK, when Part 11 of the Companies Act 2006 came into force on 1 October 2007, it was complemented by amendments to the Civil Procedure Rules that likewise came into force on 1 October 2007.[82]

The beauty of common law derivative suit mechanism is its flexibility and accessibility. It gives shareholders more room for constructive "legal engineering" in terms of crafting the cause of action. However, the downside is that it is like a maze that is difficult to navigate. Although it may still be possible to introduce further amendments to Senate Bill No. 2945 during the legislative process, the silence of the Committee Report No. 247 on the subject matter of derivative suits indicates that the legislators apparently overlooked the subject matter. Neither was derivative suits mentioned during the Senate Committee hearing on December 18, 2014, which discussed the proposed amendments to the Corporation Code.[83] On one hand, the subject matter may have been overlooked because neither the legislators nor their legislative staff are aware of the lacuna in the law regarding derivative suits. On the other hand, it is possible that they may be aware of the lacuna in the law, but they simply do not perceive the need for doing anything about it because they subscribe to the "if it ain't broke, don't fix it" view on the matter.

[81] Arad Reisberg, *Derivative Claims under the Companies Act 2006: Much Ado About Nothing?*, *in* RATION. CO. LAW ESSAYS HONOUR DD PRENTICE (John Armour & Daniel D Prentice eds., Hart Publishing 2009). Available at SSRN: http://ssrn.com/abstract=1092629.
[82] *Id.*
[83] Senate Committee Hearing Transcript - Committee on Trade, Commerce and Entrepreneurship (2014).

CHAPTER 3 - COMPARATIVE STUDY:

THE CURRENT STATUS OF SHAREHOLDERS' DERIVATIVE LITIGATION

3.1 Proper Party and the Application Procedure

3.1.1 English Statutory Law and Foss Rule's Proper Plaintiff Principle

The common law Foss Rule established the proper plaintiff principle,[84] which stems from the company law principle of separate legal personality.[85] The proper plaintiff principle holds that because the wrong was suffered directly by the company—which has a juridical personality that is separate and distinct from its directors and members—then it is exclusively entitled to file a claim in connection with the wrong and it alone can decide whether or not to sue through its board of directors.[86] This principle has been carried over to the Companies Act 2006 wherein a derivative claim may be brought by a member on behalf of a company only in respect of cause of action vested in the company.[87]

The Companies Act 2006 "widened the scope of those with *locus standi* to bring a derivative claim"[88] such that the application for permission to continue derivative claim (or permission application[89]) may be brought not only by official company members on behalf of the company, but may likewise be brought by a person to whom company shares have been transferred by operation of law.[90]

[84] LI, *supra* note 45, at 20; BOYLE, *supra* note 50.
[85] David Kershaw, *The Rule in Foss v Harbottle is Dead: Long Live the Rule in Foss v Harbottle*, J. BUS. LAW 274 (2015).
[86] *Id.*; Department of Trade and Industry, *supra* note 39, at 73.
[87] Companies Act 2006, § 260 (1).
[88] VICTOR JOFFE, MINORITY SHAREHOLDERS: LAW, PRACTICE AND PROCEDURE 38 (Oxford University Press 2011).
[89] Practice Direction 19C - Derivative Claims: "application for permission to continue derivative claim" is also termed under the Practice Direction 19C as "permission application".
[90] Companies Act 2006, § 260 (5) (c) stipulates that references to a "member of a company include a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law."

Rule 19.9 of the Civil Procedure Rules,[91] which provides for the procedural rules in bringing derivative claims, stipulate that the company, on whose behalf the remedy is claimed, must be made a defendant to the claim[92] and not a respondent[93]. The UK Supreme Court in *Roberts v. Gill & Co Solicitors*[94] explained, although by way of *obiter dictum*, that the rule that the company must be made a defendant to the claim is based on the recognized principle that in derivative claims, it is imperative that "the entity on whose behalf the claim is brought is a necessary party to the derivative claim."[95]

The member who brought the permission application must notify the company of the permission application, and must likewise furnish the company of a copy of the evidence filed.[96] Practice Direction 19C,[97] which supplements the Civil Procedure Rules on derivative claims, provides that a permission application made with the High Court will be assigned to the Chancery Division and decided by a High Court judge; while a permission application made with a county court will be decided by a circuit judge.[98]

There are three instances by which a member may bring an application for permission to continue derivative claim: first, *application for permission to continue derivative claim* where a permission application is made by a member;[99] second, *application for permission to continue claim as a derivative claim* where a permission application is made by a member regarding a claim originally brought by the company;[100] and third, *application for permission*

[91] Civil Procedure Rules.
[92] Civil Procedure Rules, rule 19.9 (3).
[93] *Id.* rule 19.9A (3).
[94] Roberts v. Gill & Co Solicitors, No. [2010] UKSC 22 (UK Supreme Court May 19, 2010), para. 59.
[95] *Id.*, para. 59, UKSC merely made this pronouncement as an *obiter dictum* as rule 19.9 (3) does not apply to the type of derivative claims in issue in this case.
[96] *Id.* rule 19.9A (4); *id.* rule 19.9B (3).
[97] Practice Direction 19C - Derivative Claims.
[98] *Id.*, para. 6; *id.*, para. 1 provides that Practice Direction "applies to derivative claims, whether under Chapter 1 of Part 11 of the Companies Act 2006 or otherwise, and for applications for permission to continue or take over such claims; but it does not apply to claims in pursuance of an order under section 996" (i.e., in connection with claim brought in pursuance to court order in an unfair prejudice proceeding).
[99] Companies Act 2006, § 261.
[100] *Id.* § 262.

to continue derivative claim brought by another member, where permission application is made by a member regarding a claim that was originally brought by another member, or that was brought by the company but continued as a derivative claim by another member, or that was already continued as a derivative claim by another member.[101]

Under the above-mentioned first instance of bringing statutory claim, a member must apply to the court for permission to continue derivative claim[102] wherein the applicant must establish a *prima facie* case through satisfactory evidence.[103] If the court does not find a *prima facie* case for giving permission, the court shall dismiss the permission and may, in its discretion, make any consequential order[104] such as civil restraint order against the applicant.[105] However, if the court finds a *prima facie* case, the court may give permission to continue the claim or instruct the company regarding the production of necessary evidence and adjourn the proceedings to allow acquisition of evidence.[106]

Under the aforementioned second instance of bringing statutory claim, where a company has commenced proceedings through its board of directors[107] and the cause of action could be pursued as a derivative claim under the Companies Act 2006,[108] a member of the company may apply for permission to continue claim as a derivative claim under three concurrent conditions: first, when the manner in which the company commenced or continued the claim amount to an abuse of process,[109] for example, when the claim is brought to preempt and hinder a member from bringing a derivative claim;[110] second, the company failed to diligently

[101] *Id.* § 264.
[102] *Id.* § 261 (1).
[103] *Id.* § 261 (2).
[104] *Id.*
[105] Department of Trade and Industry, *supra* note 39, at 75.
[106] Companies Act 2006, § 261 (3); *id.* § 261 (4).
[107] Companies Act 2006, § 262.
[108] *Id.* § 262 (1).
[109] Department of Trade and Industry, *supra* note 39, sec. 262 (2) (a).
[110] *Id.* at 75.

prosecute the claim;[111] and third, when it is appropriate for the member to continue the claim as a derivative claim.[112] The decision in *Iesini & Ors v. Westrip Holdings Ltd & Ors*[113] cited the Law Commission's explanation on the reason behind this provision, which is to provide recourse to shareholders only in cases where the company commences proceedings to forestall a member from instituting a meritorious derivative claim, and not just when the shareholders are unhappy with the progress of the case.[114]

Under the aforementioned third instance of bringing statutory derivative claim, a member of the company may apply for permission to continue a derivative claim brought by another member under the following scenarios: where another member of the company originally brought a derivative claim under the abovementioned first instance, or continued a derivative claim originally brought by the company under the abovementioned second instance, or has continued a derivative claim under the third instance.[115] The permission application may be brought under the same manner and conditions as mentioned above under the second instance for application for permission to continue claim as a derivative claim originally brought by a company.[116]

3.1.2 Philippine Jurisprudence

Locus standi or legal standing has been defined in Philippine jurisprudence as a personal and substantial interest in a case, where the act constituting the cause of action directly causes an injury to the party.[117] The Philippine Supreme Court in *Bitong v. Court of Appeals*[118]

[111] Companies Act 2006, § 262 (2) (b).
[112] *Id.* § 262 (2) (c).
[113] Iesini & Ors v Westrip Holdings Ltd & Ors [2009] EWHC 2526 (Ch), (EWHC (Ch) Oct. 16, 2009).
[114] *Id.*, para. 80.
[115] Companies Act 2006, § 264.
[116] *Id.*
[117] Jelbert B. Galicto v. President Benigno Simeon C. Aquino III, No. G.R. No. 193978 (Supreme Court of the Philippines Feb. 28, 2012) citing Southern Hemisphere Engagement Network, Inc. v. Anti Terrorism Council, 632 SCRA 146, October 5, 2010.
[118] Bitong v. Court of Appeals, No. 292 SCRA 503 (Supreme Court of the Philippines 1998).

summarized the nature and basis of the stockholders' right to bring a derivative suit on behalf of the corporation.[119] The Supreme Court explained that the right to institute a derivative suit is not expressly provided for under the Corporation Code; nevertheless, it is well-established in Philippine jurisprudence that when corporate directors violate their fiduciary duty, which goes beyond mere abuse of discretion or simple error of judgment, and there is no available intra-corporate remedy, a stockholder may file a derivative suit for the benefit of the corporation in order to seek "redress of the wrong inflicted directly upon the corporation and indirectly upon the stockholders."[120]

In *Filipinas Port Services, Inc. v. Go*[121] the Supreme Court explained that notwithstanding the rule that the power to sue is held by the board of directors when the corporation itself is the injured party, an individual stockholder may nevertheless be allowed to bring a derivative suit on behalf of the corporation "in order to vindicate corporate rights whenever the officials of the corporation refuse to sue, or when a demand upon them to file the necessary action would be futile because they are the ones to be sued, or because they hold control of the corporation."[122] The Supreme Court further clarified that in derivative suits, the corporation is the real party-in-interest, whereas the stockholder is only a nominal party acting on behalf of the corporation.[123]As such, it is condition *sine qua non* that the corporation must be joined as party to the derivative suit—either as co-plaintiff or defendant[124]—not only because it is an indispensable party to the suit, but also because it must be served with legal process and

[119] *Id.*
[120] *Id.*
[121] Filipinas Port Services v. Victoriano S. Go, No. G.R. No. 161886 (Supreme Court of the Philippines Mar. 16, 2007).
[122] *Id.*
[123] *Id.*
[124] Jewelynn Gay B. Zareno & Earla Kahlila Mikhaila C. Langit, *supra* note 8, at 733–34: Since misjoinder of parties is not a ground for dismissal of the case, it is immaterial in the Philippine jurisdiction whether corporation is joined either as party-plaintiff or party-defendant.

because the judgment must be made binding against the corporation.[125] This is quite similar to the requirement under the aforementioned English Civil Procedure Rules that the company must be made a defendant[126] and that the company must be notified and furnished with evidence.[127] The difference is that in the Philippine jurisdiction, a corporation must be joined as a party, it does not matter whether defendant or co-plaintiff; but under the English law, a company must specifically be made a defendant.[128]

Unlike in England wherein a permission application may be bought with the High Court or county court, a derivative suit in the Philippines should be brought and tried only in the Regional Trial Court that has jurisdiction over the principal office of a given corporation.[129] This is a jurisdictional requirement that if not complied with may warrant the dismissal of the suit on the ground of improper venue[130] without prejudice, however, to refiling of the same with the proper court.[131]

3.1.3 English Law versus Philippine Jurisprudence

Both jurisdictions adhere to the established separate legal personality principle that makes the company or corporation the proper party in derivative litigation. Hence, in both jurisdictions, the company or corporation is the real party-in-interest on whose behalf a member or stockholder brings the derivative litigation. This is reflected in both jurisdictions' requirement to make the company or corporation a necessary party in the derivative litigation, as well the requirement to serve the company or corporation with legal process.

[125] Francis Chua v. Court of Appeals, G.R. No. 150793 (Supreme Court of the Philippines Nov. 19, 2004); Asset Privatization Trust v. Court of Appeals, G.R. No. 121171 (Supreme Court of the Philippines Dec. 29, 1998).
[126] Civil Procedure Rules, rule 19.9 (3).
[127] *Id.* rule 19.9A (4); *id.* rule 19.9B (3).
[128] *Id.* pt. 19.9A (3) provides that a company must not be made a respondent.
[129] Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799, Rule 1, Sec. 5.
[130] Hi-Yield Realty, Inc. v. Court of Appeals, No. G.R. No. 168863 (Supreme Court of the Philippines Jun. 23, 2009) .
[131] Universal Robina Corporation v. Albert Lim, No. G.R. No. 154338 (Supreme Court of the Philippines Oct. 5, 2007).

The enumerated instances and conditions by which members may bring permission application under the Companies Act 2006 are more defined and easier to follow. However, the requirement to show a *prima facie* case, lest the court would dismiss the case, is a procedural barrier to bringing claims because this implies that the member should produce sufficient evidence to convince the court, which is practically a difficult task without a discovery procedure.[132] The absence in the Philippine jurisdiction of any requirement to show a *prima facie* case, together with its simpler legal standing requirement that any stockholder may bring derivative suit on behalf of the corporation whenever the board of directors refuses to sue, or when a demand upon them would be futile, both make the Philippine derivative suit mechanism relatively more flexible and accessible.

3.2 Ownership of Shares by Members and Shareholders

3.2.1 English Law

Ownership of shares is considered an element of legal standing in bringing derivative claims.[133] There is no minimum number of shares or percentage of shareholding required under the Companies Act 2006 for application for permission to bring derivative claim.[134] Neither is there any requirement on holding period of the shares. The only requirement is that applicant must be a member of a given company at the time he brings the claim, regardless of whether the cause of action arose before he was a member.[135] This is consistent with the separate legal personality principle of company law where the cause of action is vested in the company and not in the member[136] bringing the application.[137] However, during the reform

[132] Arad Reisberg, *supra* note 81.
[133] JOFFE, *supra* note 88, at 38.
[134] Schulte Roth & Zabel LLP, UK Shareholder Activism (Aug. 2014), http://www.srz.com/files/upload/Shareholder_Activism_Resource_Center/SRZ_UK_Shareholder_Activism_Briefing_Pursuing_Derivative_Claims.pdf.
[135] Companies Act 2006, § 260 (4); Department of Trade and Industry, *supra* note 39, at 75.
[136] Companies Act 2006, § 112 provides that a member must have subscribed to the registered memorandum of a company, and whose name must have been entered in the register of members; *id.* at 113 provides that more than

process of the Companies Act 2006, this raised concerns that any third party could acquire shares in a company for the mere purpose of bringing a collusive frivolous claim.[138]

It must be noted that, as mentioned above, that the Companies Act 2006 broadened the definition of membership for the purpose of bringing derivative claims under Part 11 to include a person to whom company shares have been transferred by operation of law,[139] such as in the case of a personal representative of deceased member's estate, or a bankruptcy trustee who acquires interest in a share during the administration of member's estate in insolvency.[140] This implies that for purposes of instituting derivative claim, registered share ownership is not required.

3.2.2 Philippine Jurisprudence and Interim Rules

For a shareholder to have the right to bring derivative suit on behalf of the company, he must be a shareholder both at the time of the complained transaction, as well at the time the action was filed,[141] and must continue to be so during the pendency of the suit.[142] This is the "dual stockholder-status test",[143] which is contrary to the English requirement that a company member may bring derivative claim for a cause of action that arose prior to him becoming a company member.[144] In this sense, the English law is more lenient.

one member may be a joint holder of a company share, although treated as single member for purposes of registration. More than one member may be a joint holder of a company share, although treated as single member for purposes of registration.

[137] Department of Trade and Industry, *supra* note 39, at 73.

[138] Arad Reisberg, *supra* note 81.

[139] Companies Act 2006, § 260 (5) (c) stipulates that references to a "member of a company include a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law."

[140] Department of Trade and Industry, *supra* note 39, at 74.

[141] Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799, AM NO 01-2-04-SC (2001); San Miguel Corp. v. Ernest Kahn, No. G.R. No. 85339 (Supreme Court of the Philippines Aug. 11, 1989).

[142] VILLANUEVA, CESAR, *supra* note 5, at 481; Jewelynn Gay B. Zareno & Earla Kahlila Mikhaila C. Langit, *supra* note 8, at 738.

[143] VILLANUEVA, CESAR, *supra* note 5, at 485.

[144] Companies Act 2006, § 260 (4).

The Philippine Supreme Court established the rule on share ownership in the landmark case of *Pascual v. Orozco*[145] where it sustained the demurrer to the second cause of action because at time when the transaction complained of occurred, the complainant was not a shareholder.[146] In ruling on this issue, the Philippine Supreme Court applied American jurisprudence, particularly *Hawes v. City of Oakland,*[147] and explained that the reason behind the rule that the plaintiff must be a shareholder of the corporation at the time of the transaction complained of was to guard against the fraudulent practice of filing of collusive suits,[148] which, as discussed above in part 3.2.1, was raised as a concern during the reform process of the Companies Act 2006.

There is an exception to the above dual stockholder-status test, known as the "continuing wrong doctrine"[149] that allows a plaintiff who was not yet a shareholder at the time the transaction occurred to bring derivative suit.[150] It is necessary, however, that that the antecedent acts constituting the breach of fiduciary duty continues until the plaintiff has become a shareholder and the acts are injurious to such shareholder or affect him especially or specifically in some other way.[151]

The Supreme Court in *San Miguel v. Kahn,*[152] which reiterated the dual stockholder-status test, held that the *bona fide* ownership of stock by a shareholder, regardless of the number of shares, sufficiently grants shareholder the legal standing to bring a derivative suit for the benefit of the corporation.[153] This is because he is suing on behalf and for the benefit of the

[145] Candido Pascual v. Eugenio Del Saz Orozco, No. G.R. No. L-5174 (Supreme Court of the Philippines Mar. 17, 1911).
[146] *Id.*
[147] Hawes v. City of Oakland, No. 104 US 450 (US Supreme Court 1881).
[148] *Id.*
[149] Jewelynn Gay B. Zareno & Earla Kahlila Mikhaila C. Langit, *supra* note 8, at 738.
[150] *Candido Pascual v. Eugenio Del Saz Orozco*.
[151] *Id.*
[152] San Miguel Corp. v. Ernest Kahn, No. G.R. No. 85339 (Supreme Court of the Philippines Aug. 11, 1989).
[153] *Id.*

corporation, and not for himself.[154] In the case of *Bitong v. Court of Appeals*,[155] the Supreme Court reiterated the ruling in *San Miguel v. Kahn*[156] and affirmed that the most important legal requisite for bringing a derivative suit is "ownership of a stock in his own right at the time of the transaction complained of."[157] *Bona fide* ownership implies actual ownership,[158] and entails that nominal ownership by a trustee of share does not grant legal standing to file a derivative suit. In *Reyes v. Regional Trial Court, Br. 142*,[159] the Supreme Court distinguished a scenario where the transferees held definite and uncontested titles to a specific number of shares of the corporation from a case where the transferees' interest is still inchoate such as in the case of heirs prior to the partition of the decedent's estate, and without any share transfer being recorded yet in the books of the corporation as prescribed by Section 63 of the Corporation Code.[160] This is in stark contrast with the English law, which grants legal standing to a transferee of company share by operation of law.[161]

The Interim Rules, which strictly prohibits nuisance suits, requires the court to consider, among others, the "extent of the shareholding or interest of the initiating stockholder or member" [162] in determining whether a suit is merely frivolous and without merit.[163] This requirement aims to prevent a minority shareholder with very minimal shareholding from interfering with legitimate management decisions of the corporation.[164] Thus, minimal shareholding is not an automatic bar to derivative suits, but a mere factor to be considered by the court in determining whether a suit is frivolous and must be dismissed. In fact,

[154] *Id.*
[155] Bitong v. Court of Appeals, No. 292 SCRA 503 (Supreme Court of the Philippines 1998).
[156] *San Miguel Corp. v. Ernest Kahn*.
[157] *Bitong v. Court of Appeals*.
[158] Corporation Code of the Philippines, BATAS PAMBANSA BLG 68 § 56 (1980) provides that a share may be jointly owned by two or more persons.
[159] Oscar Reyes v. Hon. Regional Trial Court of Makati, Branch 142, No. G.R. No. 165744 (Supreme Court of the Philippines Aug. 11, 2008).
[160] *Id.*
[161] Companies Act 2006, § 260 (5) (c).
[162] Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799, AM NO 01-2-04-SC (2001), Rule 1 Section 1 (b).
[163] *Id.*
[164] Jewelynn Gay B. Zareno & Earla Kahlila Mikhaila C. Langit, *supra* note 8, at 745.

jurisprudence is replete with rulings affirming that ownership of one share is not a bar for derivative suit to proper.[165] There is no similar requirement under the English law requiring the court to consider a member's extent of shareholding in relation with the determination of whether or not a suit is frivolous. However, in determining whether permission to bring derivative claim should be granted, the English court, in relation to the discretionary factors that should be considered in determining whether permission should be given,[166] may look at the extent of a members' shareholding. The court may find it counterintuitive for a member with miniscule shareholding to bring a claim, which in turn may have a bearing on the court's examination of a member's good faith in seeking to continue the claim.

3.2.3 English Law versus Philippine Jurisprudence and Interim Rules

Both jurisdictions merely require ownership of shares, with the number and period of shareholding being immaterial. Compared with other jurisdictions that require minimum number and period of shareholding, the English and Philippine jurisdictions are thus relatively lenient. For example, the one percent shareholding requirement under Chinese law and six-month shareholding period requirement under Japanese law have been criticized for being extremely restrictive.[167]

However, the Philippine dual stockholder-status test, as described above, coupled with the *bona fide* ownership requirement, together make the Philippine jurisdiction restrictive, at least in this respect. The broadening of the definition of a member for purposes of bringing derivative claims under the Companies Act 2006, although not entirely opening the doors of the English derivative claim mechanism, at least unlocks it to more shareholders.

[165] *Id.* at 750.
[166] Companies Act 2006, § 263 (3) sets out the discretionary criteria that the court must take into consideration in determining whether or not to grant permission for the derivative claim to be continued.
[167] Fidy Xiangxing Hong & S.H. Goo, *Derivative Actions in China: Problems and Prospects*, J. BUS. LAW 388 (2009).

3.3 Wrongful Acts that Warrant the Filing of Derivative Claims

3.3.1 English Law

Prior to the Companies Act 2006, the Foss Rule made it extremely challenging, if not almost impossible, to allow derivative claims to prosper.[168] This is because the Foss Rule essentially narrowed down the range of wrongful acts[169] that may warrant the filing of derivative claims to the following: *ultra vires* or non-ratifiable acts (exception to the majority rule principle[170]); and fraud on the minority[171] (where the wrongdoer control[172] is required).[173] Moreover, derivative claims cannot be used then to bring negligence claims against company directors.[174] The narrow scope of acts that could constitute actionable wrong under the Foss Rule deterred the filing derivative claims.[175]

Beginning 1 October 2007, the Companies Act 2006 provision on derivative claims came into force, which allowed a member may bring a derivative claim either under Part 11 of the Companies Act (*Derivative Claims and Proceedings by Members*), or pursuant to a court order in a proceeding under Part 30 of the Companies Act (*Protection of Members against Unfair Prejudice*).[176]

[168] Kershaw, *supra* note 85.
[169] LI, *supra* note 45, at 23: There are four recognized exceptions to the Foss Rule which would allow the filing of derivative claims. However, this thesis subscribes to the explanation by company law Scholar Xiaoning Li that not all of them are true exceptions.
[170] *Id.* at 21 Id.: The majority rule principle holds that when a wrong is ratifiable or curable by a majority vote in a general meeting, a derivative suit cannot be maintained. Since ultra vires acts are non-ratifiable, it operates as an exception to the majority rule principle.
[171] *Id.* at 24: Fraud on the minority is an exception to the Foss Rule where what has been done to the minority amounts to fraud and the wrongdoers themselves are in control of the company.
[172] Kershaw, *supra* note 85, at 278: The wrongdoer control requirement means that the courts will permit a derivative claim filed by a shareholder to proceed only if the company is disabled from bringing such claim—such as in a scenario where there is wrongdoer control of the general meeting.
[173] LI, *supra* note 45, at 23.
[174] Kershaw, *supra* note 85, at 274.
[175] *Id.*
[176] Companies Act 2006, § 260 (2).

Under Part 11 of the Companies Act, the first manner through which derivative claims may be brought, a member can bring a derivative claim against a director or another person or both[177] but "only in respect of a cause of action arising from actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company"[178] which may have arisen prior to the applicant's membership.[179] A director against whom the derivative claim may be brought includes current director, shadow director[180] and former directors.[181]

The inclusion of negligence as a cause of action is that any breach of a director's duty of care and skill can, regardless of whether it is ratifiable, form the basis for a derivative claim.[182] This effectively removes the complex distinction in the fraud on the minority exception[183] under the Foss Rule between negligence *per se*[184] and negligence benefiting the wrongdoer—which is considered as fraud and qualifies as a fraud on the minority exception.[185] David Kershaw, another company law scholar, believes that this increases the exposure of directors to liability for breaches of duty of care.[186]

Pursuant to the abovementioned provision, a member can bring derivative claim on the ground of an alleged breach of any of the general duties owed by directors to the company as codified under Chapter 2 Part 10 of the Companies Act 2006.[187] These duties, which were derived from equitable principles and common law rules, were not codified prior to the

[177] *Id.* § 260 (3).
[178] *Id.*
[179] *Id.* § 260 (4).
[180] *Id.* § 251 defines shadow director as a person who is not a director, yet directors of the company customarily follow his directions or instructions.
[181] *Id.* § 260 (5).
[182] Arad Reisberg, *supra* note 81.
[183] LI, *supra* note 45, at 24: Fraud on the minority is an exception to the Foss Rule where what has been done to the minority amounts to fraud and the wrongdoers themselves are in control of the company.
[184] Negligence per se is not considered fraud, hence, it is not qualified as a Foss Rule fraud on the minority exception.
[185] Arad Reisberg, *supra* note 81; Kershaw, *supra* note 85, at 281.
[186] Kershaw, *supra* note 85, at 281.
[187] Department of Trade and Industry, *supra* note 39, at 75.

enactment of the Companies Act 2006.[188] The Companies Act 2006 provides explicitly that the codified general duties—except the duty to exercise reasonable care, skill and diligence, which is not considered to be a fiduciary duty[189]—should be interpreted in the light of existing body of common law rules and equitable principles.[190] As clarified by Rt. Hon. Lady Justice Arden DBE, this means that the existing duties in general law will be substituted by its counterpart duty in the Companies Act 2006.[191] The Hon. Lady Justice explains further that the task of interpretation would be quite challenging for the courts considering the considerable development in UK common law in the recent years.[192]

The codified general duties are the following: duty to act within powers;[193] duty to promote the success of the company;[194] duty to exercise independent judgment;[195] duty to exercise reasonable care, skill and diligence;[196] duty to avoid conflicts of interest;[197] duty not to accept benefits from third parties;[198] and duty to declare interest in proposed transactions or arrangement.[199] These duties are not exhaustive.[200] Their codification does not remove the other uncodified duties—for example, the duty to act fairly as between different classes of shareholders—from the scope of recognized general duties in the English jurisdiction.[201]

Under the second manner through which derivative claims may be brought, which is in an unfair prejudice proceeding brought by a member of the company on the ground that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to

[188] *Id.* at 45; Companies Act 2006, 170 (3); Arden Dbe, *Regulating the Conduct of Directors*, 10 J. CORP. LAW STUD. 1, 163 (2010).
[189] Department of Trade and Industry, *supra* note 39, at 50.
[190] Companies Act 2006, § 170 (4).
[191] Dbe, *supra* note 188, at 166.
[192] *Id.* at 173.
[193] Companies Act 2006, § 171.
[194] *Id.* § 172.
[195] *Id.* § 173.
[196] *Id.* § 174.
[197] *Id.* § 175.
[198] *Id.* § 176.
[199] *Id.* § 177.
[200] Department of Trade and Industry, *supra* note 39, at 47.
[201] Dbe, *supra* note 188, at 166.

the interest of some or all of the members (himself included),[202] the court may deem it proper to order that a derivative claim instead be brought in the name and on behalf of the company.[203] In which case, it shall be pursued under Part 11 of the Companies Act 2006.[204]

3.3.2 Philippine Jurisprudence

The Philippine Corporation Code does not have a statutory list of what can be considered as sufficient basis or grounds for bringing derivative suits. The Philippine Supreme Court in *Angeles v. Santos*[205] explains what it calls the common law basis of the right of a stockholder to bring a derivative suit by explaining the situation where the controlling directors "wastes or dissipates the funds of the corporation or fraudulently disposes of its properties, or performs *ultra vires* acts,"[206] the courts, exercising its equity jurisdiction, will entertain a suit brought by the minority stockholders provided, under the condition that there was no intra-corporate remedy available.[207] Despite the absence of a statutory provision on the same, the Philippine Supreme Court has been consistent in recognizing injurious acts and omissions to the corporation that are similar to the above-quoted as valid causes of action for filing derivative claims on behalf of the corporation, to wit:

In *Republic Bank v. Cuaderno,*[208] a derivative suit was brought to prevent dissipation or diversion of corporate funds as a result of the board of directors' approval of a resolution granting excess compensation to officers of the corporation. The Supreme Court effectively

[202] Companies Act 2006, § 994 (1).
[203] *Id.* § 996 (2) (c).
[204] *Id.*; *id.* § 260 (2) (b).
[205] Angeles v. Santos, No. 64 Phil. 697 (Supreme Court of the Philippines 1937).
[206] *Id.*
[207] *Id.*
[208] Republic Bank v. Miguel Cuaderno, No. G.R. No. L-22399 (Supreme Court of the Philippines Mar. 30, 1967).

accepted this as a valid cause of action and remanded the case to the court of origin and ordered it to be tried and decided on the merits.[209]

In *Reyes v. Tan,*[210] the directors' act of condoning a fraudulent transaction and acquiescing to the importation of finished textile instead of raw cotton for textile mill, in violation of the Central Bank regulations, coupled with the failure to take action against the erring purchasing managers were considered by the Supreme Court as breach of trust which justified the derivative suit by shareholders on behalf of the corporation.[211]

In *Gochan v. Young,*[212] the Supreme Court considered as valid cause of action the alleged usurpation of business opportunities by the directors in conflict with their fiduciary duties, which resulted in damage to the corporation.[213]

In *Angeles v. Santos,*[214] the Supreme Court found director's act of denying the stockholders' access to books and records of the corporation, in violation of the by-laws of the corporation, and appropriation of the properties, funds and income of the corporation constituted breach of trust that warranted the filing of a derivative suit.[215]

The above-cited cases are just a sampling of the cases often referred to by the courts as benchmarks for valid cause of action for derivative suits in their decisions. Unfortunately, the case law upon which plaintiffs may gauge whether more or less their action could prosper is extensive, making it a daunting task to survey the jurisprudence when confirming the validity of the cause of action. In contrast, the English jurisdiction has a codified list of directors' duties, which if breached constitutes a cause of action to bring derivative claims. Granted that

[209] *Id.*
[210] Catalina Reyes v. Bienvenido Tan, No. G.R. No. L-16982 (Supreme Court of the Philippines Sept. 30, 1961).
[211] *Id.*
[212] Virginia Gochan v. Richard Young, No. G.R. No. 131889 (Supreme Court of the Philippines Mar. 12, 2001).
[213] *Id.*
[214] Angeles v. Santos, No. 64 Phil. 697 (Supreme Court of the Philippines 1937).
[215] *Id.*

the interpretation of the directors' duties must still be supplemented by the existing case law, the codified enumeration embodied in a single legal source still makes it relatively easier for both plaintiffs and courts to check whether there is a valid cause of action.

In the Philippines, there have been inconsistencies in the court decisions on the matter owing to the uncodified nature of the substantive law on derivative suits. For example, in the case of *Bitong v. Court of Appeals,*[216] the Philippine Supreme Court likened the derivative suit to "an action for specific performance of an obligation owed by the corporation to the stockholders to assist its rights of action when the corporation has been put in default by the wrongful refusal of the directors or management to make suitable measures for its protection."[217] The Supreme Court reiterated this pronouncement in the more recent case of *Yu v. Yukayguan.*[218] Specific performance is known as a civil law remedy for breach of contract.[219] Thus, the above-quoted pronouncement of the Supreme Court contradicts the nature of the Philippine corporation law, which is patterned after the American corporation law. As a general rule, neither the Philippine nor American corporation law recognizes the remedy of specific performance.[220] Moreover, this doctrine held in *Bitong* and *Yu* is likewise contrary to previous court pronouncements that recognize only injury to corporation, in view of the concept of separate juridical personality, and does not recognize injury to stockholders.[221]

3.3.3 English Law versus Philippine Jurisprudence

The lack of statutory provision in the Philippine jurisdiction, which either gives a definite criteria or enumerates the acts that warrant the filing of derivative suits, allows for creativity

[216] Bitong v. Court of Appeals, No. 292 SCRA 503 (Supreme Court of the Philippines 1998).
[217] *Id.*
[218] *Yu v. Yukayguan, No. 589 SCRA 588 (Supreme Court of the Philippines 2009).*
[219] Theodore Eisenberg & Geoffrey P. Miller, *Damages versus Specific Performance: Lessons from Commercial Contracts*, 12 J. EMPIR. LEG. STUD. 29, 1 (2015).
[220] *Id.* at 2.
[221] VILLANUEVA, CESAR, *supra* note 5, at 490.

on the part of the plaintiffs in crafting the cause of action and permits flexibility on the part of the court in determining whether there is valid cause of action. This is in line with the notion that derivative suits are remedies based on equity. However, the drawback of having no concrete guidelines is the lack of predictability as to how the courts will determine whether a complained act warrants the filing of derivative suits. As illustrated above, inconsistencies exist in court decisions.

Furthermore, nuances within the extensive Philippine jurisprudence spanning from 1911 until present undoubtedly require legal advice from a corporation law practitioner who has adequate expertise to determine whether a cause of action could prosper. This was identified as one of the motivations behind the codification of the derivative claim mechanism under the Companies Act 2006. The Law Commission acknowledged that the Foss Rule has become so complex that a proper understanding of it necessitated the examination of numerous reported cases decided over a period of 150 years, of which only lawyers specializing in the subject matter are capable.[222] Since derivative suits are costly and time-consuming, it would be best practice for the Philippines to have concrete, easily accessible and codified guidelines akin to the Companies Act 2006, albeit with less restrictive provisions.

3.4 Procedural Requisites for Derivative Litigation

3.4.1 English Law

Bringing a statutory derivative claim under Companies Act 2006 involves a two-stage process wherein the court is given wide latitude of discretion and procedural control. The first stage requires that the applicant establish a *prima facie* case, as discussed above in part 3.1.1 of this thesis. Generally, the decision whether applicant was able to establish a *prima facie* case is

[222] LAW COMMISSION, *supra* note 57, at 40.

made without submissions from or attendance by the company.[223] If the court is not satisfied that there is a *prima facie* case, the case will be dismissed. Otherwise, the second stage begins. It is only at this stage where the company will be involved. The court may give the company directions regarding, among others, the evidence to be produced.[224] During the second stage, the Court may refuse the application for permission based on the mandatory grounds for refusal under section 263 (2) of the Companies Act 2006.[225] Apart from the mandatory grounds, the court must also consider the discretionary considerations set forth under section 263 (3) of the Companies Act 2006,[226] on the basis of which it may decide to grant or refuse permission, or adjourn proceedings and give necessary directions.[227]

As mentioned above, at the second stage, it is mandatory for the court to refuse the application for permission if it is satisfied that any of the following conditions enumerated under section 263 (2) of the Companies Act 2006 exists: (1) from the perspective of a director exercising his duty to promote the success of the company, the claim should not be continued[228] ("hypothetical director test"[229]); (2) where the cause of action arises from an act or omission that has not yet occurred but has been authorized;[230] or (3) where the cause of action arises from an act or omission that has occurred, which was either been authorized prior to its occurrence or subsequently ratified.[231]

As previously mentioned, apart from the foregoing circumstances calling for mandatory refusal, the court—in deciding whether or not it is appropriate to grant permission—must also take into consideration the following discretionary grounds listed under section 263 (3) of the

[223] Practice Direction 19C - Derivative Claims, para. 5.
[224] Companies Act 2006, § 262 (4).
[225] *Id.* § 263 (2).
[226] *Id.* § 263 (3).
[227] *Id.* § 261 (4).
[228] *Id.* § 263 (2) (a).
[229] Kershaw, *supra* note 85, at 288.
[230] Companies Act 2006, § 263 (2) (b).
[231] *Id.* § 263 (2) (c).

Companies Act 2006: (1) good faith of the member in bringing the permission application;[232] (2) if the hypothetical director exercising the duty to promote the success of the company would attach to continuing it;[233] (3) where the act or omission that is perceived to be the cause of action has not yet occurred (proposed breach of duty) and whether there is a likelihood that the same would be authorized by the company before it occurs or ratified thereafter;[234] (4) where the cause of action arises from an act or omission that has already occurred but is likely to be ratified by the company;[235] (5) whether the company has decided not to pursue the claim by means of a board resolution or provision in its constitution;[236] and (6) whether the cause of action could be pursued by the member through a direct action, rather than through a derivative claim.[237]

In case of a proposed breach of duty, what the court must determine is not whether the act or omission is ratifiable *per se*, but whether or not the act or omission is likely to be ratified.[238] Ratification of a conduct by a company director that amounts to negligence, default, breach of duty or breach of trust in relation to the company requires the votes of persons other than the director whose act is complained of and any member connected with him.[239]

The foregoing discretionary grounds are not exhaustive, as illustrated in the case of *Franbar Holdings v. Patel.*[240] In this case, even though the existence of an alternative remedy is not among the grounds for refusal specified under the Companies Act 2006, the Court refused the permission to continue derivative claim on the ground that, among others, an alternative

[232] *Id.* § 263 (3) (a).
[233] *Id.* § 263 (3) (b).
[234] *Id.* § 263 (3) (c).
[235] *Id.* § 263 (3) (d).
[236] *Id.* § 263 (3) (e).
[237] *Id.* § 263 (3) (f).
[238] Wooldridge & Davies, *supra* note 2, at 7.
[239] Companies Act 2006, § 239 (3); *id.* at 239 (4).
[240] Franbar Holdings Ltd. v Patel & Ors, EWHC 1534 (Ch) (High Court Chancery Division Jul. 2, 2008).

remedy of unfair prejudice existed, explaining further that a hypothetical director would thus be less inclined to pursue the derivative claim.[241]

Some commentators regard the two-stage procedure, which requires a member to seek the court's permission, as a shift in the control of corporate litigation in favor of judicial control.[242] The requirement of finding a *prima facie* case in conjunction with the mandatory and discretionary grounds for refusing permission both empower the court to quickly dismiss meritless claims or harassment claims.[243] During the reform procedure of the Companies Act 2006, the parliament believed that the package of reforms introduced achieved the balance between providing for a modern, flexible and accessible derivative claim mechanism and providing safeguards against abuse.[244] However, in reality, the cumulative effect of the two-stage procedure, the requirement to show a prima facie case, and the enumerated mandatory and discretionary grounds for refusing permission would run counter the very objectives of having a more accessible, fast, and cost-effective statutory derivative claims mechanism.[245]

3.4.2 Philippine Jurisprudence and Interim Rules

The Supreme Court in *San Miguel Corp. v. Kahn* [246] summed up for the first time all the requisites for a proper derivative suit, which were previously strewn across a vast body of case law.[247] The first requisite is the "dual stockholder-status test"[248] where the party bringing suit should be a shareholder both at the time of the transaction complained of as well as at the

[241] *Id.*
[242] Arad Reisberg, *supra* note 81.
[243] *Id.*
[244] *Id.* citing Lord Goldsmith (n39, col 884): "we have put forward a package that strikes the right balance between a degree of long-stop accountability for the directors—which is what derivative action is, not a first resort but the last—and freedom from frivolous claims" ibid col 887. Available at: http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060509/text/60509-35.htm.
[245] *Id.*
[246] San Miguel Corp. v. Ernest Kahn, No. G.R. No. 85339 (Supreme Court of the Philippines Aug. 11, 1989).
[247] VILLANUEVA, CESAR, *supra* note 5, at 480. The
[248] *Id.* at 485.

time of filing the suit, irrespective of the number of shares held.[249] The second requisite is the exhaustion of intra-corporate remedies, which means that stockholder must have made a specific demand on the board of directors for relief in connection with corporate act complained of, and was denied of the same.[250] The third requisite is that the cause of action belongs to the corporation and not to the stockholder.[251] The court affirmed the foregoing requisites in subsequent jurisprudence.[252]

In 2001, the Supreme Court restated the jurisprudential requisites for bringing derivative suits under Rule 8 of the Interim Rules.[253] First, it is required that the plaintiff is a stockholder at the time the act complained of occurred as well as at the time the suit was filed, and "remains as such during the pendency of the action."[254] Second, it is required that the plaintiff should have exhausted all intra-corporate remedies that may be available under the Articles of Incorporation or By-laws.[255] The Interim Rules added two additional requirements to the jurisprudential requisites summed up by the Supreme Court in *San Miguel v. Kahn*[256]: that there be no appraisal rights available for the act or transaction complained of (third requirement); and that the suit is not a nuisance or harassment suit (fourth requirement).[257] The aforementioned jurisprudential requirement that the relief sought must belong to the corporation is not explicitly mentioned in the Interim Rules, but is implied on the basis of the nature of derivative suits.

[249] *San Miguel Corp. v. Ernest Kahn* citing *Candido Pascual v. Eugenio Del Saz Orozco*, G.R. No. L-5174 (Supreme Court of the Philippines Mar. 17, 1911); and *Republic v. Cuaderno*, 19 SCRA 671.
[250] *Id.* citing *Everett v. Asia Banking Corp*., 49 Phil. 512 (1926) and *Angeles v. Santos*, 64 Phil. 697 (1937).
[251] *Id.* citing *Evangelista v. Santos*, 86 Phil. 387 (1950).
[252] VILLANUEVA, CESAR, *supra* note 3, at 481 citing *R.N Symaco Trading Corp. v. Santos*, 467 SCRA 312 (2005), *Filipinas Port Services, Inc. v. Go*, 518 SCRA 453 (2007), *Reyes v. Regional Trial Court of Makati Branch 142*, 561 SCRA 593 (2008), *Hi-Yield Realty, Inc. v. Court of Appeals*, 590 SCRA 548 (2009).
[253] Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799, AM NO 01-2-04-SC (2001).
[254] *Id.*
[255] *Id.*
[256] *San Miguel Corp. v. Ernest Kahn*.
[257] *Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799.*

Additionally, the Interim Rules also provides that the derivative action cannot be discontinued, compromised or settled without approval of the court, which shall determine whether the interest of the stockholders will be substantially affected by the discontinuance, compromise or settlement, and may direct for publication or for notice be sent to stockholders it deems affected.[258] While there is no problem with requiring court approval, the reason cited for requiring it—primarily for the interest of stockholders—runs counter the settled principle in jurisprudence that derivative suits are for the benefit of the corporation, and not for the benefit of the stockholders.[259]

The Interim Rules provides under Rule 4 that prior to the hearing, there shall be a pre-trial conference wherein the parties shall be required to submit their respective pre-trial briefs.[260] The purpose of the pre-trial conference is to ascertain any possibility for amicable settlement or other forms of dispute resolution.[261] At this stage, the court may order the parties to simultaneously file their respective memoranda after examination of the pleadings, affidavit and other evidence submitted by the parties.[262] Thereafter, the court may, if it deems proper, already render either a full or partial judgment as warranted by the evidence presented during the pre-trial.[263] The pre-trial stage can be somewhat likened to the first stage of permission application to continue derivative claim under the Companies Act 2006 wherein a *prima facie* case must be established, but only in the sense that these are both mandatory[264] and preliminary. The difference is that in the first stage of the English permission application for continuing derivative claim, the company is not yet involved, which was designed to avoid unwarranted interference in the affairs of the company.[265] In the Philippines, however, the

[258] *Id.*
[259] VILLANUEVA, CESAR, *supra* note 5, at 482.
[260] *Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799.*
[261] *Id.*
[262] *Id.*
[263] *Id.*
[264] *Id.*, Rule 4.
[265] LAW COMMISSION, *supra* note 57, at 139, 143.

pre-trial stage of the derivative suit requires the participation of the company in the discovery, submission of pre-trial briefs, and proposals for amicable settlement or referral to mediation or other alternative modes of dispute resolution.[266]

3.4.3 English Law versus Philippine Jurisprudence and Interim Rules

The two-stage proceeding and the *prima facie* case requirement under the Companies Act 2006 guard against unnecessary interference to the board of directors as it manages the company's affairs.[267] At the first stage, the court examines whether the permission application presents a *prima facie* case solely on the basis of the applicant's evidence.[268] The company is initially not yet involved, and the court decides on whether applicant was able to establish a *prima facie* case without submissions from or attendance by the company.[269] Only after this first stage would the company become part of the proceedings. This is in contrast with the aforementioned procedure expressed in the Philippine Interim Rules, which readily makes the corporation part of the proceeding, even at the initial pre-trial stage.

Unlike the Philippine Interim Rules, the Companies Act 2006 does not explicitly require the exhaustion of intra-corporate remedies. Under the Philippine Interim Rules, the plaintiff must have alleged with some particularity in his complaint that he already made sufficient demand upon the corporate officers for appropriate relief, that he expressed his intention to sue if relief is denied, and that his demand was nevertheless denied.[270] The intentions are to make the derivative suit the last resort[271] and to safeguard against harassment suits—which are the same intentions for the two-stage proceeding for permission application to continue derivative claim under Companies Act 2006 and behind the mandatory and discretionary grounds for

[266] *Interim Rules of Procedure Governing Intra-Corporate Controversies Under R.A. No. 8799, Rule 4.*
[267] LAW COMMISSION, *supra* note 57, at 143.
[268] Companies Act 2006, § 261 (2).
[269] Practice Direction 19C - Derivative Claims, para. 5.
[270] DE LEON, HECTOR S. & DE LEON, JR., HECTOR M., *supra* note 29, at 501.
[271] *Id.*

refusing permission. In this regard, both jurisdictions have instituted procedural safeguards to prevent abuse of derivative litigation.

It is remarkable how the Companies Act 2006 provides for procedural safeguards preventing abuse of derivative claim mechanism, and yet there is no spelled out prohibition against nuisance suits under the Companies Act 2006 similar to that of the Philippine Interim Rules. According to the unpublished *Analysis of Responses to the Consultation Paper No. 142* prepared by the Law Commission, the unsatisfactory operation of the Foss Rule operated as a deterrent to minority shareholders from bringing proceedings.[272] Moreover, according to the Law Commission *Shareholder Remedies Consultation Paper No. 142*, as a result of the obscure and complex law Foss Rule, derivative claims in England were rare,[273] which denotes that nuisance derivative litigation is not a problem in the English jurisdiction. The study recorded by John Armour, another company law scholar, in his working paper *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, revealed a statistical mean of only 1.5 decided cases per year.[274] Armour further notes that in none of this cases were the claimants successful.[275]

It is worth noting that existence of nuisance suits was not among the identified issues to be resolved by the Law Commission during the reform process of the Companies Act 2006.[276] Thus, while procedural safeguards against unmeritorious claims are statutorily provided for under the Companies Act, these safeguards are more preventive rather than curative measures because nuisance derivative litigation is not the current burden of English jurisdiction. The

[272] Shareholder Remedies - Analysis of Responses to Consultation Paper No. 142 in Respect of Main Issues to Be Resolved 3 (*in* Law Commission Archives, 226-425-24, 1997): 81% of the respondents considered that the Foss Rule was unsatisfactory.
[273] LAW COMMISSION, SHAREHOLDER REMEDIES 7 (Consultation Paper No 142, 1996).
[274] John Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, SSRN Scholarly Paper ID 1133542 14 (Social Science Research Network), Apr. 1, 2008: The author surveyed transcripts of available decisions on derivative claims from 1990-2006 on LexisNexis, WestlawUK, and Lawtel .
[275] *Id.*
[276] *Id.* at 3–14: The questions were essentially focused on whether or not there should be a new derivative action and whether it should replace the common law right to bring a derivative action.

problem is that the English derivative claim mechanism has become inaccessible in view of its complexity.[277]

3.5 Derivative Claims versus Direct Shareholder Claims

3.5.1 English Statutory Law and Common Law

The company, being a separate legal entity, has rights different from those of its shareholders.[278] Thus, where a wrong is suffered by an individual shareholder, and not by the company, the individual shareholder should bring a direct claim for his personal injury.[279]

In a situation wherein the company suffers a loss, and as a consequence thereof, for example, the value of shareholder's shares decreases, the shareholder is said to have suffered a reflective loss of the company's direct loss.[280] The English court in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)*[281] held that such a shareholder is prohibited from claiming losses that were merely reflective of the company's losses, which only the company has the exclusive right to claim.[282] A shareholder can only claim for losses that are separate and distinct from the company's losses.[283] However, a critical problem with the principle is the difficulty in distinguishing the reflective loss and the independent and separate loss.[284]

The Companies Act 2006 provides specifically that in determining whether to grant permission for filing of derivative claim, the court will take into consideration whether the act or omission upon which the claim is based gives rise to a personal cause of action, rather than

[277] LAW COMMISSION, *supra* note 57, at 40.
[278] LI, *supra* note 45, at 20.
[279] *Id.*
[280] *Id.*
[281] (1982) Ch 204.
[282] LI, *supra* note 45, at 20.
[283] *Id.*
[284] Xiaoning Li, p. 20 citing Davis)2003 p. 456.

on behalf of the company.[285] Thus the court will not entertain derivative claims that do not have a corporate cause of action. In any case, the remedy of unfair prejudice is available to members who suffered direct injury on the basis of unfairly prejudicial acts of company directors.[286]

3.5.2 Philippine Jurisprudence

Suits by stockholders or members of a corporation based on wrongful or fraudulent acts of directors or third persons are categorized in the Philippine jurisdiction into individual suits, class suits, and derivative suits.[287]

An *individual suit* is appropriate where the wrong is done to the stockholder personally and not to the other stockholders or the corporation, such as in the case where a stockholder is refused of his right to inspect the books and records of the corporation.[288]

Conversely, a *class or representative suit* is appropriate for the protection of all stockholders belonging to the same group when the wrong committed is suffered by a group of stockholders, but not suffered by the corporation itself, such as where preferred stockholders' rights are violated.[289] When the wrong done is against the corporation itself, the cause of action does not belong to the individual stockholder or member, but to the corporation.[290]

In view of the distinct and separate personality of the corporation from its stockholders and members, it should rightfully initiate the suit against the wrongdoer.[291] Otherwise, not only will the separate legal personality doctrine be violated, but there may also be a risk of

[285] Companies Act 2006 §263(3)(f)
[286] Companies Act 2006, § 994 (1).
[287] JOSÉ C. CAMPOS & MARIA CLARA LOPEZ- CAMPOS, THE CORPORATION CODE: COMMENTS, NOTES, AND SELECTED CASES 819–20 (Central Lawbook Pub. Co. 1990).
[288] CAMPOS & CAMPOS, *supra* note 287.
[289] *Id.*
[290] *Id.*
[291] *Id.*

multiplicity of suits and violation of creditor priority rights.[292] However, where the wrongful acts are committed by the directors themselves, a shareholder may find it futile to seek relief because the directors are vested by law with the right to decide whether or not the corporation should sue and, in the protection of their own interest, will never consent to suing themselves, leaving the corporation without a remedy.[293] In this case, a shareholder has the right to sue on behalf of a corporation in the form of a *derivative suit***.**[294] It has been jurisprudentially upheld as an effective remedy instituted by shareholder on behalf of the corporation for vindication of corporate injuries and protection of corporate rights.[295]

In some decisions,[296] the Supreme Court held that "for a derivative suit to prosper, it is required that the minority shareholder who is suing for and on behalf of the corporation must allege in his complaint that he is suing on a derivative cause of action on behalf of the corporation and *all other shareholders similarly situated who wish to join*"[297] as if it were a class suit brought for the benefit of the stockholders, when it should have been brought for the sole benefit of the corporation.[298] In a latter case, the Supreme Court held differently, clarifying that proper filing of derivative suit does not require that all the shareholders are named as indispensable parties.[299] It is sufficient that a member or a minority of such members brings the derivative suit on behalf of the corporation, which is the real party-in-interest, while the shareholders are only nominal parties.[300]

[292] *Id.*
[293] *Id.*
[294] *Id.*
[295] R.N. Symaco Trading Corp. v. Luisito Santos, No. G.R. No. 142474 (Supreme Court of the Philippines Aug. 18, 2005).
[296] Western Institute Technology, Inc. v. Salas, 278 SCRA 216 (1997); Tam Wing Tak v. Makasiar, 350 SCRA 475 (2001); Gochan v. Young, 354 SCRA 207; and Chua v. Court of Appeals, 443 SCRA 312 (2005)
[297] VILLANUEVA, CESAR, *supra* note 5, at 488.
[298] *Id.*
[299] *R.N. Symaco Trading Corp. v. Luisito Santos*.
[300] *Id.*

In *Asset Privatization Trust v. Court of Appeals*[301] the Supreme Court enumerated other reasons, apart from the doctrine of separate juridical personality, behind not allowing direct individual suit to prosper when derivative suit is the proper remedy: the possibility that the same may result to premature distribution of assets which may prejudice corporate creditors; undue interference with the duty to file a derivative suit for the protection of the corporation that primarily belongs to the board of directors; potential multiplicity of suits; and confusion in the amount of damages recoverable by the corporation as a result of the partial recovery by the individual member.[302]

3.5.3 English Statutory Law and Common Law versus Philippine Jurisprudence

Since both jurisdictions uphold the established separate juridical personality principle, both jurisdictions distinguish derivative claims from direct shareholder claims. Consequently, for derivative litigation to prosper in both jurisdictions, it is required that the injury must be suffered directly by the corporation or company. The difference between the two jurisdictions, however, is that the English law provides for the remedy of unfair prejudice for members who suffer direct injury on the basis of unfairly prejudicial acts of company directors. This unfair prejudice remedy, as will be discussed below in part 3.6.1, have been used to circumvent, to some extent, the restrictive derivative claim mechanism and functioned as an alternative remedy to derivative claims.

[301] Asset Privatization Trust v. Court of Appeals, G.R. No. 121171 (Supreme Court of the Philippines Dec. 29, 1998).
[302] *Id.*

3.6 Alternative Remedy to Derivative Litigation

3.6.1 English Law: Unfair Prejudice

Prior to the Companies Act 2006, minority shareholders whose claims were barred by the Foss Rule often resorted to section 459 of the 1985 Companies Act, which provided for the rather flexible unfair prejudice remedy.[303] Section 994 of the Companies Act 2006 restates section 459 of the 1985 Companies Act.[304] This is a more encompassing remedy that is available in cases when the company's affairs are conducted in a manner, which is unfairly prejudicial to the interest of all or some of the company's shareholders.[305]

The interests protected by the unfair prejudice remedy are not legal interests, but merely "legitimate expectation" of a shareholder.[306] For example in small private companies, legitimate expectation does not have to be in a form of illegality or breach of the company's constitution, but may be in a form of breach of an informal agreement.[307] Among the acts that constitute unfair prejudice remedy are: exclusion of minority shareholder from management, misappropriation or diversion of corporate assets, failure to provide information, improper increase in share capital, excessive remuneration, and nonpayment or inadequate payment of dividends.[308]

Moreover, compared with derivative claims, the alternative unfair prejudice remedy is more viable because the court is given a broad discretion to grant remedies—the most sought after of which is the order for purchase of members' shares,[309] which is unavailable in derivative

[303] LI, *supra* note 45, at 35.
[304] Department of Trade and Industry, *supra* note 39, at 194.
[305] LI, *supra* note 45, at 36.
[306] *Id.*
[307] *Id.* at 37.
[308] *Id.* at 38.
[309] Companies Act 2006, § 996 (2) (e).

claims. As Reisberg contends, such availability of less stringent alternative remedies becomes a deterrent to minority shareholder from bringing derivative claims.[310]

3.6.2 Philippine Law: Non-Existence of an Alternative Remedy

There is no counterpart of the English unfair prejudice remedy under the Philippine corporate law. This is one of the main factors why, even though the right to file derivative suit is not explicitly provided for under the Philippine law, it is more utilized in the Philippine jurisdiction than in the English jurisdiction.

Exclusive only to close[311] corporations, there are two more remedies available in addition to bringing a derivative suit.[312] The first remedy is withdrawal from the close corporation wherein the stockholder can compel the corporation to purchase his shares at fair value, which should not be less than their par or issued value, provided that the corporation has sufficient assets in its books to cover its debt and liabilities exclusive of capital stock.[313] The second remedy is compelling the dissolution of the corporation by way of written petition to the Securities and Exchange Commission under the ground that directors, officers or those in controls of the corporation acted illegally, or fraudulently, or dishonestly, or oppressively, or unfairly prejudicial to the corporation or any stockholder, or whenever corporate assets are being misapplied or wasted.[314]

[310] Reisberg, Arad, Derivative Actions in Corporate Governance 274 (Oxford University Press 2007).
[311] Corporation Code of the Philippines, BATAS PAMBANSA BLG 68 § 96 (1980) defines close corporation as "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 Code]; 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."
[312] *Id.* § 105.
[313] *Id.*
[314] *Id.*; VILLANUEVA, CESAR, *supra* note 5, at 493.

3.6.3 Unfair Prejudice versus Nonexistence of an Alternative Remedy

The presence of an alternative remedy to derivative claims in the English jurisdiction, which has been more often resorted to in practice and which has gained a reputation of being more accessible, weakens the utility of the English derivative claim mechanism. As illustrated in the Philippine jurisdiction, the lack of a comprehensive statutory basis for bringing derivative claims does not hinder shareholders from bringing derivative suits. This is because the absence of a competing alternative remedy akin to unfair prejudice of the English jurisdiction in effect gives the derivative suit mechanism in the Philippines a dominant position—it being the sole and default remedy after exhaustion of intra-corporate remedies.

3.7 Judicial Non-Interference and Business Judgment Rule

3.7.1 English Law: Judicial Non-Interference

The Companies Act 2006 codified the enumeration the directors' duties for the first time in English legislative history.[315] With the exception of duty to exercise reasonable care, skill and diligence—which is not considered to be a fiduciary duty[316]—the codified duties are "enforceable in the same way as any other fiduciary duty owed to a company by its directors."[317]

During the reform process of the Companies Act 2006, the Law Commission specifically recommended that breach of duty or negligence should be specifically made available as basis for corporate cause of action in derivative claims.[318] It is considered that corporate-decision making exercised by a director, for example, on what will promote the success of the company, is an exercise of a director's good faith judgment, and thus an application of

[315] Dbe, *supra* note 188, at 173.
[316] Department of Trade and Industry, *supra* note 39, at 50.
[317] Companies Act 2006, § 178 (2).
[318] Dbe, *supra* note 188, at 164, 172.

business judgment.[319] Therefore, although the "business judgment rule" is not an English concept, but an American concept, it has an analogous concept in the English law in the form of judicial non-interference policy. Under this policy, the English courts will not interfere in disputes concerning reasonable corporate decision-making done in good faith unless it results in a breach of duty or negligence, which causes the company injury or loss.[320] In this manner, the English policy of judicial non-interference is fairly akin to the business judgment rule, which has been adopted under the Philippine corporate law.[321]

3.7.2 Philippine Law and Jurisprudence: Business Judgment Rule

In *Angeles v. Santos*, the Supreme Court explained that the board of directors is a creation of the stockholders and derives its power to control and direct the corporation from the stockholders who delegate the said power. Thus, the board of directors occupies a fiduciary position and as such should carefully and diligently administer the affairs of the corporation in good faith, and should protect the interests of both the majority and minority shareholders.[322]

The Philippine Corporation Code recognizes the business judgment rule, which provides that the board of directors of the corporation shall exercise all corporate powers, including the right to decide whether or not to file an action on behalf of the corporation.[323] As an exception, however, to the business judgment rule, the minority stockholders may bring a derivative suit when it is apparent that the board of directors of the corporation may not be relied on to properly exercise business judgment.[324] For example, in *Chua v. CA*[325] and in

[319] Arad Reisberg, *supra* note 81.
[320] Dbe, *supra* note 188, at 170.
[321] Arad Reisberg, *supra* note 81.
[322] *Angeles v. Santos, No. 64 Phil. 697 (Supreme Court of the Philippines 1937).*
[323] VILLANUEVA, CESAR, *supra* note 5, at 475.
[324] *Id.* at 476.
[325] Francis Chua v. Court of Appeals, No. G.R. No. 150793 (Supreme Court of the Philippines Nov. 19, 2004).

Filipinas Port Services, Inc. v. Go[326] the Supreme Court held that if a corporation has a defense of action but the corporate officials who are in a position to assert it refuse to do so or are the ones who should be sued, then a stockholder may intervene and bring an action for the benefit and on behalf of the corporation.[327]

3.7.3 Judicial Non-Interference versus Business Judgment Rule

The judicial non-interference policy under the English company law can be said to be the counterpart doctrine of the business judgment rule, which originated from the American corporate law and which has been adopted under the Philippine corporate law.[328] Thus, in both English and Philippine jurisdictions, the decision of the directors shall neither be challenged nor overturned by the courts, unless the act complained of constitutes a valid cause of action for the institution of a derivative litigation, and provided that the procedural requisites for bringing derivative litigation have been complied with.

During the reform process of the Companies Act 2006, the Law Commission was consciously striking a balance between the ability of the directors to run the company without undue interference from shareholders, and the need to protect the interest of minority shareholders.[329] It is evident, however, that the Law Commission tilted the scale in favor of management in its recommendations that the derivative claim should be the last resort and should be subject to tight judicial control at all stages.[330]

[326] Filipinas Port Services v. Victoriano S. Go, No. G.R. No. 161886 (Supreme Court of the Philippines Mar. 16, 2007).
[327] *Francis Chua v. Court of Appeals*; *Filipinas Port Services v. Victoriano S. Go*.
[328] Arad Reisberg, *supra* note 81.
[329] *Id.*
[330] *Id.*

3.8. Costs to Bringing Derivative Litigation

3.8.1 English Law

The Code of Civil Procedure provides for the general rule that *costs follow the event*, which means that the unsuccessful party will be ordered to pay the winning party's costs, apart from his own costs.[331] The expense of litigation is in itself a major disincentive in the bringing of derivative claims.[332] An even greater disincentive is the abovementioned *"loser pays rule"*.[333]

Moreover, the awareness that the company and other shareholders will merely "free ride" on the efforts exerted and litigation expenses shouldered by the shareholder plaintiff[334] is likewise a disincentive because: first, there is no guarantee of success in litigation; second, should the claim be successful, the shareholder plaintiff will not actually be able to benefit directly[335] because the benefit will accrue to the company, while the shareholder will indirectly only receive a pro rata share of the gains in proportion to the size of his shareholding.[336] In effect, minority shareholders almost have no incentive to exert effort, time and money in bringing a derivative claim.[337]

The Court, as an exception to the *costs follow the event* general rule, has discretion to order the company on whose behalf the claim is brought to indemnify the claimant against liability for costs incurred in the permission application or in the derivative claim or both.[338] This is an offshoot of the *Wallersteiner v. Moir*[339] case wherein the Court of Appeal held that the shareholder plaintiff is entitled to be indemnified by the company for litigation expenses

[331] Civil Procedure Rules, rule 44.2 (2) (a); LI, *supra* note 45, at 74.
[332] REISBERG, ARAD, *supra* note 310, at 222.
[333] *Id.*
[334] *Id.*
[335] LI, *supra* note 45, at 74.
[336] REISBERG, ARAD, *supra* note 310, at 222.
[337] *Id.*; LI, *supra* note 45, at 74.
[338] Civil Procedure Rules, pt. 19.9E; Civil Procedure Rules rule 44.2 (2) (b); *id.* rule 44.2 (1).
[339] Wallersteiner v Moir (No 2), No. [1975] QB 373.

incurred in pursuing derivative claim on behalf of the company.[340] However, this is a mere exception, and as previously mentioned, the Court retains discretion as to the amount.[341] Thus, the economic burden on the shareholder is not entirely removed.[342]

In England, a contingency fee arrangement is defined as a lawyer's fee that is calculated on the basis of the percentage of monetary award recovered, forfeiting the fee in case the case is lost.[343] Traditionally, contingency fee arrangements have been considered contrary to public policy in England and thus deemed unlawful.[344] To date, contingency fee arrangements have not been available to English derivative claimants.[345] Recently, however, the English law introduced the conditional fee (*no win, no fee*) arrangements.[346] This means that if the case wins, the lawyers may be paid a specific percentage of the costs; while the lawyers get nothing if they do not win.[347] In theory, conditional fee agreements can be used to fund derivative claims, although this is not yet an established practice.[348]

3.8.2 Philippine Law

The Philippine Code of Civil Procedure provides that "costs ordinarily follow the results of suit",[349] which is the same as the English Civil Procedure Rules. Hence, if the suit prospers, costs are awarded to the plaintiff and against the defendant directors; but if the suit does not prosper, costs are awarded against the unsuccessful plaintiff.[350] As an exception, the court may order either party to pay the costs of an action, or that the costs be divided, as may be

[340] *Id.*
[341] Civil Procedure Rules, rule 44.2 (1) (b).
[342] LI, *supra* note 45, at 74.
[343] 1 RUPERT M. JACKSON, REVIEW OF CIVIL LITIGATION COSTS, at vi (The Stationery Office 2010).
[344] HANS C. HIRT, THE ENFORCEMENT OF DIRECTORS' DUTIES IN BRITAIN AND GERMANY: A COMPARATIVE STUDY WITH PARTICULAR REFERENCE TO LARGE COMPANIES 133 (P. Lang 2004).
[345] DAVID KERSHAW, COMPANY LAW IN CONTEXT TEXT AND MATERIALS 637 (Oxford University Press 2012).
[346] HIRT, *supra* note 344, at 133.
[347] KERSHAW, *supra* note 345, at 637.
[348] HIRT, *supra* note 344, at 134.
[349] Rules of Court, Rule 142, Section 1.
[350] Emmanuel Tipon, *Shareholders Derivative Suits in the Philippines: An Appraisal in the Light of Comparative Law and Practice*, 43 PHILIPP. LAW J. 486 (1968).

equitable.[351] Costs may also be denied to both parties in proper cases.[352] It is notable that despite the impact of the cost of litigation, the Philippine derivative suit mechanism is still more resorted than the English mechanism.

Contrary to the English jurisdiction, contingency fee arrangements are permitted in the Philippine jurisdiction.[353] This is because these arrangements redound to the benefit of the poor client and the lawyer in a case where the client has meritorious cause but the only way he can pay legal fees is through a contingency fee arrangement payable out of the litigation proceeds.[354] In addition, contingency fee arrangements are sanctioned by Canon 13 of the Canons of Professional Ethics,[355] subject to reasonableness of the fees.[356]

The lack of scholarly work and absence of reference in jurisprudence regarding the correlation between contingency fees and its impact on frequency of derivative suits in the Philippines is indicative of the fact that while contingency fees are considered valid in the Philippine jurisdiction,[357] this fee mechanism is not exploited in the Philippine jurisdiction in the same manner as it is in the American jurisdiction, wherein lawyers end up chasing derivative actions in view of the financial incentive.[358]

[351] Rules of Court, Rule 142, Section 1.
[352] Candido Pascual v. Eugenio Del Saz Orozco, No. G.R. No. L-5174 (Supreme Court of the Philippines Mar. 17, 1911).
[353] Atty. Victoriano v. Orocio v. Edmund P. Anguluan, No. G.R. No. 179892–93 (Jan. 30, 2009) citing *Rayos v. Hernandez*, G.R. No. 169079, 12 February 2007, 515 SCRA 517, 528; *Sesbreo v. Court of Appeals*, 314 Phil. 884, 893 (1995); *Taganas v. National Labor Relations Commission*, G.R. No. 118746, 7 September 1995, 248 SCRA 133, 136; *Licudan v. Court of Appeals*, G.R. No. 91958, 24 January 1991, 193 SCRA 293, 299; *Director of Lands v. Larrazabal and Ababa*, 177 Phil. 467, 478 (1979).
[354] *Id.*
[355] *Id.*
[356] *Roxas v. De Zuzuarregui, Jr.*, G.R. No. 152072, 31 January 2006, 481 SCRA 258, 278-279 citing Canons 13 and 20 of the Code of Professional Responsibility.
[357] Evangelina Masmud v. National Labor Relations Commission and Atty. Rolando Go, Jr., No. G.R. No. 183385 (Supreme Court of the Philippines Feb. 13, 2009).
[358] *Why Do Shareholder Derivative Suits Remain Rare in Continental Europe*, 37 BROOKLYN J. INT. LAW 852 (2012).

3.8.3 English Law versus Philippine Law

Both jurisdictions adhere to the *costs follow the event* rule, which does not provide any incentive on the part of the member or shareholder to bring derivative litigation because this effectively burdens him with advancing the cost of litigation and potentially paying both parties' costs.

Winning the case is not a sufficient incentive either because, as another company law scholar, Hans Hirt, explains, only the company may benefit from derivative litigation.[359] The shareholders merely benefit indirectly, as a result of the increase in the company's share price.[360] Yet even then, as aforementioned, the benefit is only proportionate to the size of their shareholding.[361] Taken together, the lack of sufficient incentive to win the case and the burden imposed by the cost of litigation create a roadblock to bringing derivative litigation. As Reisberg puts it, "It would be a rare shareholder indeed who would fly in the face of this lethal mix of disincentives to commence litigation."[362]

To motivate the bringing of derivative litigation to vindicate corporate wrong, shareholder plaintiff needs a positive incentive, which can be in the form of financial rewards through fee rules mechanism.[363] A better rule than *costs follow the event* would have been for each party bears his own cost. Although, understandably, the *costs follow the event* rule was adopted to discourage frivolous suits, it now operates as a deterrent to bringing even the meritorious kind of derivative litigation.

There is no report in connection with the Philippine jurisdiction's employment of contingency fee arrangements in relation to derivative suits, the recognition of the Philippine jurisdiction

[359] HIRT, *supra* note 344, at 134.
[360] *Id.*
[361] REISBERG, ARAD, *supra* note 300, at 222.
[362] *Id.*
[363] *Id.* at 223.

of the legitimacy of such arrangements puts it in a better position than the English jurisdiction, which does not sanction such arrangements. However, as a general rule, the fee mechanism has a direct correlation on the frequency of suit. [364] If fees and cost of litigation are favorable to the shareholder plaintiff, it will encourage derivative litigation.[365] This is illustrated by the high incentive to bring derivative litigation in jurisdictions that recognize contingency fee arrangements. Nevertheless, such arrangements should be employed with caution to avoid lawyers' ambulance-chasing tendencies.

[364] *Id.*
[365] *Id.*

CHAPTER 4 - CONCLUSION AND RECOMMENDATION

> "I agree that this appeal should be allowed although the legal route which has led me to this conclusion is not at all points identical with that traversed by the Master of Rolls. After all, that is the beauty of the common law; it is a maze and not a motorway." - Lord Justice Diplock, *Morris v. Martin*[366]

The right to file a derivative suit in the Philippines has remained a common law right for more than a century. In England, the right to file derivative claims has been shaped by *Foss v. Harbottle*, which grew more complex as it developed in common law for more than one and a half centuries. In 2007, Part 11 of the Companies Act 2006 that codified the right to bring derivative claims in England came into force. Ironically, derivative claims in England still continue to be uncommon, whereas derivative suits in the Philippines continue to be brought by shareholders even in the absence of a statutory derivative suit mechanism. In 2001, the Philippine Supreme Court recapitulated the jurisprudential requisites under the Interim Rules, which only captures the procedural aspect of instituting derivative suits. The substantive law on derivative claims, however, stayed based on case law. In 2015, six bills have been consolidated under Senate Bill No. 2945 entitled *An Act Amending Batas Pambansa Blg. 68 or the Corporation Code of the Philippines*, which is currently at the second reading stage in the Senate. However, no proposal for codification of the substantive law on derivative suits was mentioned in any part of the consolidated bill, committee report or senate hearing on the proposed amendments of the Corporation Code.

As discussed in the methodology part of this thesis, the better law is that which fulfills its function better than others. The Philippine common law derivative suit mechanism fulfills its function more than the English statutory derivative claim mechanism. The Philippine mechanism does not unnecessarily restrict the shareholders from availing of the remedy and,

[366] Morris v. Martin, No. 1 QB 716 (1966).

at the same time, it employs necessary procedural safeguards to guard against unmeritorious suits. Hence, it is more utilized than the English counterpart,

There are several factors that contributed to why the Philippine mechanism is more resorted to. For instance, the requirement under the Companies Act 2006 to establish a *prima facie* case at the first stage, lest the application for permission to continue derivative claim be dismissed, deters company members from bringing a claim. The absence of this requisite in the Philippine jurisdiction makes its derivative suit mechanism more accessible.

Another factor that adversely affects the functionality of the English derivative claim mechanism is the restrictiveness of the statutory provisions embodying it. The two-stage procedure as well as the mandatory and discretionary grounds for refusing application for permission to continue derivative claim, for example, were enacted in Part 11 of the Companies Act 2006 as procedural safeguards against unmeritorious claims. However, its restrictiveness becomes a deterring factor to members from bringing meritorious claims.

A major factor that decreases the functionality of the English derivative claim mechanism is the existence of a more accessible alternative remedy: the unfair prejudice remedy. The absence of a similar alternative remedy in the Philippine jurisdiction increases the utility of derivative suits since it is the sole and default remedy after all intra-corporate remedies have been exhausted.

Cost is another big factor that decreases the functionality of derivative litigation. Both jurisdictions adhere to the *costs follow the event* or *lose pays rule*. As a result, members and shareholders in both jurisdictions is not incentivized to bring derivative litigation. It is worth noting, however, that despite the impact of the cost of litigation, corporate shareholders in the

Philippines continue to resort more to derivative litigation than the company members in England.

In comparing the contrasting approaches to derivative litigation of the two jurisdictions using the functional comparative law method, it is the conclusion of this thesis that the Philippine derivative suit mechanism is the one which better fulfills the function of derivative litigation—which is to give a member or shareholder the right to bring action for and on behalf of the company or corporation when it fails to take action to redress an injury or wrong that it suffered. It is recognized that up to now, derivative claims remain rare in England.

This notwithstanding, England's effort to statutorily recognize the right to bring derivative claims is commendable and should be learned from. This codification effort is in accordance with the Law Commission's recommendations to provide for a "more modern, flexible and accessible criteria"[367] in derivative claim procedure than those in the Foss Rule. The beauty of the Philippine common law derivative suit mechanism is that it is flexible and accessible. The downside, however, is that is like a maze that is quite difficult to navigate. Because the substantive law on bringing derivative suits is not statutorily recognized in the Philippines, the acts that constitute cause of action in derivative suits are not specifically defined and enumerated in a single legal source but are scattered in various court decisions. The consequences of lack of concrete statutory guidelines are lack of predictability as to how courts will decide and inconsistencies in the body of case law. Thus, it would be best practice for the Philippines to statutorily recognize the substantive law on derivative suits.

It is true that if something is not broke, it does not have to be fixed. However, there is always room for improvement. Hence, it is likewise the conclusion and recommendation of this thesis that the Philippines should follow the English codification example and provide for statutory

[367] Department of Trade and Industry, *supra* note 39, at 74.

derivative suit mechanism in the Corporation Code. It is recommended, however, that the statutory provisions be tailored to the Philippine setting and should not be worded in a restrictive manner as in the Companies Act 2006. Moreover, the existing jurisprudential requisites in conjunction with what is already provided for in the Interim Rules should be taken into consideration. This statutory recognition will bring about an improved mechanism that is more accessible, coherent, predictable and easier to navigate, compared with the existing mechanism that is wholly based on extensive case law.

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