Office of the President of the Philippines
GOVERNANCE COMMISSION
FOR GOVERNMENT OWNED OR CONTROLLED CORPORATIONS

2-1021-07-07-2014-009127

GCG MEMORANDUM CIRCULAR NO. 2012 – 10 (3RD ISSUE)[1]

SUBJECT : DIRECTORS' & OFFICERS' LIABILITY INSURANCE (DOLI)

DATE : 07 January 2014

I. UNDERLYING STATE POLICY AND PRINCIPLES

1. GOCCs as Significant Tools for Economic Development

Section 2 (*Declaration of Policy*) of Republic Act No. 10149, officially designated as the *"GOCC Governance Act of 2011"* (R.A. No. 10149), embodies the State's recognition of the potential of GOCCs to be "significant tools for economic development," and declares "the policy of the State to actively exercise its ownership rights in GOCCs and to promote growth by ensuring that operations are consistent with national development policies and programs."

2. GOCC Governing Boards Primarily Tasked with Control and Supervision of GOCCs

Towards achieving that State policy, Section 2 of the Act further mandates *inter alia* that "the State shall ensure that . . . [t]he [G]overning [B]oards of every GOCC and its subsidiaries are competent to carry out [their] functions, **fully accountable to the State as its fiduciary**, and act in the best interest of the State."[2]

3. Directors/Trustees and Officers Are "Fiduciaries of the State"

By express declaration under Section 19 of R.A. No. 10149, the members of the Boards of Directors/Trustees and the Officers of GOCCs are designated as "**fiduciaries of the State** . . . [with] the legal obligation and duty to always act in the best interest of the GOCC, with utmost good faith in all its dealings with the property and monies of the GOCC."[3]

Further, Section 20 of the Act provides that members of the Boards of Directors/Trustees and Officers of GOCCs occupy "*Trustee Relations to the Properties, Interests and Monies of the GOCC.*"[4]

4. Directors/Trustees and Officers Assume Fiduciary Duties of the Highest Level in Relation to the State and the GOCC

Section 19 of R.A. No. 10149 imposes at the highest levels, "to **always** act in the best interest of the GOCC, **with utmost good faith** in all [their] dealings with

[1]Original issuance was on 28 August 2012. Re-issuance was on 05 December 2012.
[2]*Emphasis supplied.*
[3]*Emphasis supplied.*
[4]Section title.

the property and monies of the GOCC," the following fiduciary duties and obligations on the members of the Board and Officers of covered GOCC:

(a) "Act with **utmost and undivided loyalty to the GOCC**"[5] (*Duty of Loyalty*);

(b) "Act with due care, **extraordinary diligence, skill and good faith** in the conduct of the business of the GOCC"[6] (*Duty of Diligence*);

(c) Avoid conflicts of interest and declare any interest they may have in any particular matter before the Board[7] (*Duty of Loyalty and Transparency*);

(d) Apply sound business principles to ensure the financial soundness of the GOCC (*Duty of Competence*);[8] and

(e) Elect and/or employ only Officers who are fit and proper to hold such office with due regard to the qualifications, competence, experience and integrity[9] (*Principle that "Management is primarily accountable to the Board"*).

Section 21 of the Act reiterates the standard of diligence required of Directors/Trustees and Officers: "The members of the Board and Officers must exercise extraordinary diligence in the conduct of the business and in dealing with the properties of the GOCC. Such degree of diligence requires using the **utmost diligence of [a] very cautious person with due regard for all circumstances**."[10]

II. Obligation and Authority of the GOCC to Provide DOLI Coverage for Directors/Trustees and Officers

Since the underlying principle of public corporate governance embodied in R.A. No. 10149 is to the effect that "*The Governing Board of GOCCs is primarily accountable to the State and other Stakeholders, and the Management is primarily accountable to the Board,*" it has become imperative therefore that GOCCs provide the members of their Boards and their Officers, not only the necessary staff support to allow them to fulfill their role as fiduciaries of the State, but also insurance coverage under the commercially accepted term "**Directors' and Officers' Liability Insurance**" (**DOLI**) to afford both the GOCC and the members of their Governing Boards and Officers the means to pursue their fiduciary duties and obligations "to always act in the best interest of the GOCC, with utmost good faith in all [their] dealings with the property and monies of the GOCC."[11]

The recognition of the obligation of GOCCs, as well as their authority, to

[5]Sec. 19(a), R.A. No. 10149; *emphasis supplied.*
[6]Sec. 19(b), R.A. No. 10149. *emphasis supplied.*
[7]Sec. 19(c), R.A. No. 10149.
[8]Sec. 19(d), R.A. No. 10149.
[9]Sec. 19(e) R.A. No. 10149.
[10]*Emphasis supplied.*
[11]Sec. 19, R.A. No. 10149.

provide DOLI for the members of the Governing Boards and Officers has been expressed under Section 31 of the **CODE OF CORPORATE GOVERNANCE FOR GOCCs** promulgated by the Commission as GCG Memorandum Circular No. 2012-07, thus:

VI.

OBLIGATIONS OF THE GOCC TO DIRECTORS AND OFFICERS

SEC. 31. *Providing for Staff Support to Directors.* – Each GOCC shall provide the members of its Governing Board with reasonable support staff and office facilities to allow them to properly discharge their duties and responsibilities.

SEC. 32. *Obtaining of Directors and Officers Liability Insurance (DOLI).* – Having imposed the highest level of responsibility and accountability on the members of the Board and Officers, *i.e.*, that of extraordinary diligence, it is equitable that when the GOCC itself and/or the members of the Board and Management are sued before tribunals on matters that are within the official functions and capacity and on matters where business judgment has been exercised in good faith, that there be proper recovery of the costs of litigation and the judgment liability imposed. It is prudent measure therefore for every GOCC to obtain "Directors and Officers Liability Insurance" (DOLI) coverage for itself and the members of the Governing Board and Officers against contingent claims and liabilities that may arise from, as well as the expenses that may be incurred in prosecuting, the actions that may be filed against the GOCC arising from the actions of the Governing Board and/or Management that may cause loss or damage to third parties.

Nothing in this section shall be construed as to authorize the reimbursement or the incurring of costs, such as the payment of premiums on DOLI coverage, by the GOCC on the litigation expenses incurred and the judgment liability decreed against a Director or Officer for breach of any of his fiduciary duties or for fraud committed in the performance of his or her duties to the GOCC and/or its stakeholders.

III. INSTITUTION OF THE DOLI SYSTEM IN THE GOCC SECTOR

5. Meaning and Legal Significance of "DOLI"

For purposes hereof, "*Directors' & Officers' Liability Insurance (DOLI)*" refers to an indemnity coverage for GOCCs which, and their Directors/Trustees and Officers who, are sued or included as parties to any action or proceeding, whether it be court litigation, court-mandated mediation or any form of alternative dispute resolution (ADR) as covered by the ADR Law (Republic Act No. 9285), brought against the government agency or instrumentality pursuant to a provision of law, executive order or regulation by reason of their being Directors/Trustees or Officers.

The basis for the grant of such indemnity is that such Directors/Trustees and Officers act in the best interest of the GOCC so that any suit against them, as such, are really suits against the GOCC.

Where the DOLI coverage is proper and lawful, the premiums paid by the GOCC constitute valid (allowable) expense on the part of the GOCC.

6. Authority to Obtain DOLI Coverage

All GOCCs covered by R.A. No. 10149 and those supervised by DBM, even when acting through their Governing Boards, shall have authority to obtain DOLI coverage for the GOCC itself and/or members of their Governing Boards and Officers, under the following terms and conditions:

(a) The premiums on DOLI coverage shall constitute part of the annual Corporate Operating Budget of the GOCC, or in supplementary budget when the circumstances so necessitate it;

(b) Procurement of the DOLI coverage shall be consistent with all applicable procurement laws, rules and regulations, GSIS Law[12], and Admin. Order No. 33 s. 1987; and

(c) As an alternative, and when the circumstances so warrant it and clearly evidenced by actuarial and feasibility studies commissioned by the Board, a GOCC may provide for "self-insurance" by constituting a "Directors' and Officers' Liability Fund" under the terms provided for herein.

A GOCC may obtain a DOLI proposal coverage from an Insurance Commission-accredited provider with terms better than what the GSIS may provide or which GSIS is unwilling to match <u>within a period of thirty (30) calendar days from date of written application</u>, and such non-GSIS DOLI coverage is valid and lawful pursuant to Section 5 of Republic Act (R.A.) No. 656, otherwise known as the Property Insurance Law, which among others, would require obtaining a declination letter from GSIS.

7. "Directors/Trustees" and "Officers" Allowed DOLI Coverage

As used in this memorandum, the terms "*Board of Directors/Trustees*" or "*Board*" or "*Governing Board*" ("*Board*") refer to the collegial body that exercises the corporate powers, conducts all business and controls or holds all properties, of a GOCC, whether it be formally referred to as the "Board of Directors" or "Board of Trustees" or some other term in its Charter, Articles of Incorporation or By-laws.[13]

7.1. Directors/Trustees. – Both *Ex Officio* and Appointive Directors shall be afforded DOLI coverage by the GOCC, as defined below:

(a) "*Appointive Directors*" refer to: (1) in the case of Chartered GOCCs, all members of its Board of Directors/Trustees who are not *ex officio* members thereof; (2) in the case of Nonchartered GOCCs, members of its Board of Directors/Trustees whom the State nominates, or is entitled to nominate, to the extent of its percentage shareholdings in such GOCC; and (3) in the case of Affiliates, members of its Board of Directors/Trustees whom the GOCC nominates, or is entitled to nominate, to the extent of its percentage shareholdings in such Affiliate.[14]

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[12] P.D. No. 1146 as amended by R.A. No. 8291.

[13] Taken from Section 1 (*Definition of Terms*) of the Code of Corporate Governance for GOCCs, GCG Memorandum Circular No. 2012-07

[14] Sec. 3(b), R.A. No. 10149.

(b) "*Ex Officio Board Member*" (*Ex Officio Director*) refers to any individual who sits or acts as a member of the Board of Directors/Trustees by virtue of one's title to another office, and without further warrant or appointment.[15]

(c) *Alternates of Ex Officio Board Members* as authorized under Section 14 of R.A. No. 10149.

7.2. Officers. – Only the following employees of the GOCC shall fall within the term "Officer" to be entitled to DOLI coverage:[16]

(a) "*Board Officers*" refer to Officers whose primary task is to serve the Board or to pursue the immediate functions of the Board, such as the Chairman, Vice-Chairman and the Corporate Secretary;[17]

(b) "*Executive Officers*" refers to the CEO or whoever is the highest ranking officer in the GOCC, and such other corporate officer of the GOCC as expressly provided for in its Charter (for a Chartered GOCC) or By-laws (for a Nonchartered GOCC), and such other senior officers, such as the Vice-President, Chief Financial Officer, Chief Investment Officer, and General Manager,[18] whose positions are equivalent to the rank of Director (SG 25), Assistant Secretary or Undersecretary in the National Government Sector. As distinguished from Board Officers, Executive Officers primarily form part of the Management of the GOCC;[19]

(c) "*Frontline Employees*" refers to employees of the GOCC who fall below the equivalent rank of a Director (SG 25) but who are assigned by the Management to undertake frontline services that exposes them to suit and other claims in pursuing the mandates of the GOCC; and

(d) Members of the Bids and Awards Committee (BAC) pursuant to the *"Government Procurement Reform Act"* (Republic Act No. 9184), similar committees under the BOT Law (R.A.) and the Revised NEDA JV Guidelines, and Asset Disposal Committees.

As used in this memorandum, the term "*Officers*" refers to Executive Officers, Board Officers, Frontline Employees and BAC Members.

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[15] Sec. 3(i), R.A. No. 10149.
[16] Sec. 2(g), E.O No. 24 (s.2011).
[17] Taken from Section 1 (*Definition of Terms*) of the Code of Corporate Governance for GOCCs, GCG Memorandum Circular No. 2012-07
[18] Adopted from Sec. 2(q), R.A. No. 10149. *See Gurrea v. Lezama*, 103 Phil. 553 (1958), *Pamplona Plantation Co. v. Acosta*, 510 SCRA 249 (2006).
[19] Taken from Section 1 (*Definition of Terms*) of the Code of Corporate Governance for GOCCs, GCG Memorandum Circular No. 2012-07

IV. DOLI COVERAGE FOR GOCCs

The DOLI coverage which a GOCC may procure as constituting legitimate company expenditure, may be of two types or both types, namely:

(a) With the GOCC as the Beneficiary;

(b) With the Directors/Trustees and Officers as the Beneficiaries.

As a general proposition, therefore, a GOCC may procure DOLI for the purpose of protecting the GOCC itself, its Directors/Trustees and Officers, against the cost of litigation and judgment liability arising from official acts of its Governing Board and Management.

8. DOLI With GOCC as Beneficiary

The portion of the DOLI coverage that reimburses the GOCC from the litigation costs incurred and the damages suffered due to or arising from the breach of a director/trustee/officer of his fiduciary duties would be a legitimate and valid coverage under the principle that every GOCC is expected to take reasonable protection against the damages caused by its Directors/Trustees and/or Officers even for fraud committed by them or those in breach of their fiduciary duties. Such DOLI coverage for the GOCC is similar to the requirement for every responsible public officer to be bonded.

Nothing in this Memorandum shall be construed as relieving any director/trustee/officer from direct personal liability arising from the breach of his fiduciary duties.

9. DOLI With Directors/Trustees and Officers as Beneficiaries

Not all DOLI premium payments constitute valid (allowable) expense on the part of the GOCC. Premium payments for a DOLI that cover costs incurred and judgment liability for a Director's/Trustee's or Officer's breach of fiduciary duties or for fraud committed in the performance of duties is not a valid expense to cover.

The hallmark principles of responsibility and accountability in corporate governance, and the demands that every Director/Trustee or Officer has the duty to act in the best interest of the GOCC, to act with due care, extraordinary diligence, skill and good faith in the conduct of the business of the GOCC, demand that every erring Director/Trustee or Officer must be held personally to account for and therefore cannot be insulated from the effects of his malfeasance or misfeasance through a DOLI coverage.

9.1. Proper Coverage of DOLI. – By way of illustration, without any intention to make the listing exclusive, the following are examples of proper DOLI coverage:

(a) Costly litigations brought about by employees who have been the proper subject of disciplinary actions.

(b) Unwarranted or non-meritorious complaints filed with the Ombudsman or other disciplinary agencies for the purpose merely of taking defensive measures to compel settlement.

(c) In the case of GFIs, costly litigations brought about by disgruntled clients or desperate borrowers seeking to evade foreclosure or repossession of their mortgaged assets.

9.2. Improper Coverage of DOLI. – By way of illustration, which by no means is intended to be exclusive, the following cases are examples of improper DOLI coverage:

(a) One that protects Directors/Trustees and/or Officers from the costs of litigation and liability judgment where it is clear that the GOCC, acting through its Board of Directors or Management, has offended its charter or caused unreasonable damage to its identified stakeholders.

An example of an unwarranted DOLI coverage would be as follows: "The insurer shall pay the loss of the insured (*i.e.*, Directors/Trustees or Officers) resulting from any claim first made against the insured during the policy period for any wrongful act done in the insured's capacity as a Director/Trustee or Officer."

Such a DOLI coverage may be viewed to promote irresponsibility on the part of the members of the Board or Management who act without care or with gross negligence, or even with fraud, taking comfort in the mistaken belief that the DOLI coverage will protect them from personal obligation to reimburse the GOCC the damages it has been adjudged to pay to the aggrieved stakeholder(s).

This is especially so when the DOLI policy defines the term "wrongful act" as 'any actual or alleged breach of duty, breach of trust, neglect, error, misstatement, misleading statement, omission, breach or warranty of authority or other act by the directors, officers or employees in their respective capacities as a director, officer or employee of the company or as a director, or officer of any outside entity, or any matter claimed against them solely because of their status as a director, officer or employee of the company."

(b) The use of DOLI as an "indemnity benefit", *i.e.* indemnification for loss or damages suffered, for Directors/Trustees and Officers of a GOCC, for they are public officials for whom government funds cannot be expended by way of insurance premium payment for their personal benefit (unless mandated by law).

9.3. Rationale Behind Prohibition on Improper DOLI Coverage

GOCCs cannot, through DOLI coverage, lawfully provide protection or indemnity rights to their Directors/Trustees and Officers for illegal, dishonest, fraudulent or any other acts which constitute a breach of their fiduciary duties.

Such principle is mandated under Section 4 (*Norms of Conduct of Public Officials and Employees*) of the **CODE OF CONDUCT AND ETHICAL STANDARDS FOR PUBLIC OFFICIALS AND EMPLOYEES**,[20] thus:

> SEC. 4. *Norms of Conduct of Public Officials and Employees.* – (A) Every public official and employee shall observe the following as standards of personal conduct in the discharge and execution of official duties:
>
> (a) *Commitment to public interest.* – Public officials and employees shall always uphold the public interest over and above personal interest. <u>*All* government resources and powers of their respective offices must be employed and used efficiently, effectively, honestly and economically, particularly to avoid wastage in public funds and revenues.</u>[21] x x x

Premium payments for a DOLI that covers indemnity for the costs incurred and the judgment liability imposed for a Director's/Trustee's or Officer's breach of his/her fiduciary duties or for fraud committed in the performance of his duties are not valid expenses on the part of the GOCC.

On the other hand, the portion of the DOLI coverage that reimburses the GOCC itself from the fraudulent acts or the breach of duties of Directors and Officers would be legitimate and valid, and the payment of the premiums corresponding thereto would be legitimate expenses on the part of the GOCC. The rationale for this position is that every GOCC is expected to take reasonable protection against the damages caused by its Directors and/or Officers for fraud or breach of fiduciary duties committed.

10. Proper Structuring of Reimbursement Mechanism

It is important that in the actual implementation of the reimbursement process under a GOCC's DOLI coverage, only reasonable and legitimate reimbursable expenses be made, and that Directors/Trustees and Officers are not reimbursed or covered for litigation costs that actually constitute a breach of their fiduciary duties.

More often than not, the determination of whether the Directors/Trustees and/or Officers have breached their fiduciary duties comes only at the time when a judgment becomes final and executory, and which has gone through many years of litigation and exhausting appeals process.

In some of the GOCCs that have procured DOLI coverage from the Government Service Insurance System (GSIS), when there is a need to put a reimbursement process during the process of litigation, the amounts reimbursed are treated first as personal loans or advances to the Directors/Trustees and/or Officers involved.

If final judgment exonerates the Directors/Trustees and/or Officers from allegation of fraud or breach of fiduciary duties, the advances are closed on the DOLI account. Whereas, if the final judgment indicates clearly that the Directors/Trustee and/or Officers were guilty of fraud or were in breach of his fiduciary duties, then the advances shall remain a personal loan which they must pay-off.

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[20]R.A. No. 6713.
[21]*Emphasis supplied.*

Each GOCC shall adopt a type of reimbursement mechanism for its DOLI coverage that would best preserve the principles of public accountability.

V. DIRECTORS/TRUSTEES AND OFFICERS LIABILITY FUND

The Commission recognizes that some GOCCs may find themselves in a situation where under the mandates of their charters, taking out DOLI coverage from accredited insurance providers may not be a feasible alternative brought about by various circumstances, among which may be, but need not be limited to, the following:

(a) The premium costs may have proven to be prohibitive for the GOCC's situation that a procurement process would not attract accredited insurance providers.

(b) The commercially prevailing "deductible claim" terms may actually leave the GOCC absorbing from its corporate coffers much of the costs of litigations for which it has already paid high premium rates.

(c) The reimbursement process afforded by the insurance company may in fact be a long and tedious process that undermines the annual budget of the GOCC.

Under unique circumstances prevailing in the case of a GOCC, the Governing Board may find it more feasible and efficient that instead of obtaining solely a DOLI coverage, the GOCC may establish a "DIRECTORS/TRUSTEES AND OFFICERS LIABILITY FUND" based on a proper feasibility study submitted by a reputable risk agency or individual consultant taking into consideration the provisions of R.A. No. 9184, and the terms and conditions that may be mandated by the Commission on Audit (COA), and the following conditions:

(1) Amortization to the Fund shall come from the GOCC's budget;

(2) The Fund shall be contributed into a specific and non-revocable Trust Fund to be established by the GOCC with a GFI;

(3) The Trust Instrument covering the Fund shall provide for the same allowable coverage as those under a DOLI policy or may cover only the items that are within the deductible franchise claim provision under an existing DOLI coverage, with the GFI-Trustee administering the disbursement from such Fund;

(4) In the case where a GFI is setting up such Fund for itself and its Directors/Trustees and Officers, it shall appoint another accredited GFI to assume the role of Trustee for such Fund; and

(5) Formal Guidelines shall be promulgated by the Governing Board of the GOCC defining the essential items for the DOLF, *i.e.*, the cap on the fund, overseeing legal fund committee, evaluation of adequacy of fund, coverage, expenses covered, allowable indemnification

amounts, procedure for availment, booking of the advances, etc., which must be submitted to the GCG for formal approval.

To be clear, it is within the authority of the Governing Board of every GOCC to adopt a scheme which may be wholly DOLI-covered, or wholly DOLF-covered, or a combination of both, in order to ensure the most optimum coverage for the GOCC, taking into consideration the corporate operating environment, as well as the GOCC's litigation history.

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