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Office of the President of the Philippines
GOVERNANCE COMMISSION
FOR GOVERNMENT OWNED OR CONTROLLED CORPORATIONS
Room 479, Mabini Hall, Malacañang Compound, Manila, Philippines 1005

15 January 2013

OFFICE OF THE EXECUTIVE SECRETARY
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HON. JOSE A. NUÑEZ, JR.
Chairman
DEVELOPMENT BANK OF THE PHILIPPINES
Sen. Gil Puyat Avenue corner Makati Avenue,
Makati City, P.O. Box 1996

RE: THE TERM "*EXTRAORDINARY DILIGENCE*" AND DIRECTORS AS AGENTS OF THE BANK AND OFFICERS AS SUB-AGENTS OF DIRECTORS

DEVELOPMENT BANK OF THE PHILS.
OFFICE OF THE CHAIRMAN
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Dear Chairman Nuñez,

We write to formally reply to your letter dated 10 December 2012,[1] raising certain issues which you raised for our clarification and/or consideration, particularly on the following:

(a) Presumption of liability of Directors and Officers;

(b) Directors being agents of the bank and the Officers being sub-agents of the Directors;

Requirement of "Extraordinary Diligence" in the Conduct of the Duties of Directors and Officers

In your letter you stated that while you agree with the jurisprudential meaning of the term "*extraordinary diligence*" as used in Article 1733 of the Civil Code, and that such definition should also be applied to Sections 19(b) and 21 of Republic Act (R.A.) No. 10149 (the *GOCC Governance Act of 2011*), you also "wish to point out that while the presumption of liability with respect to common carriers is expressly provided for by law, there is no provision in the GCG Act or in any other law which provides for presumption of liability on the part of members of the Board of Directors or the officers in the event of loss or damage suffered by the Bank." Your position is that "the presumption of the liability has to be expressly provided by law and can never be implied."

We agree with your position that currently there is no statutory provision that provides a presumption of liability on the part of members of the Governing Boards of GOCCs covered by R.A. No. 10149.

The discussions in our letter of 28 February 2012 was meant to convey the state of affairs now under R.A. No. 10149 and the Code of Corporate Governance for GOCCs that in case of damage or loss caused to a GOCC, the burden of proof is still with the party who alleges that such was caused due to the negligence, fraud or bad faith of the members of the Governing Board and the acting officers. But the burden

[1] The Commission officially received a copy of your letter on 13 December 2012.

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that is now placed on the shoulders of those who allege such fault is now so much lighter since both R.A. No. 10149 (and the Governance Code) clearly mandates that the Governing Board of every GOCC (and that Management is accountable to the Board) under a regime that provides that as fiduciaries of the State, directors and officers shall 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*. The highest degree of care required of directors and officers being that of "extraordinary" means that all that the petitioner has to show is that damage or loss has been caused to the GOCC and by the rule of evidence, the burden of proof now passes to the members of the Governing Board and acting officers to show that they acted with "extraordinary diligence."

Once damage or loss to the GOCC has been proven, then the logical question would be, if indeed the Governing Board has exercised it duty of care with extraordinary diligence, why has such a damage or loss occurred. The only logical presumption is either to prove *force majeure* (a burden that is now placed on the part of the Governing Board) or to show that they have exercised extraordinary diligence. Remembering that the exercise of extraordinary diligence means under R.A. No. 10149 to "*always act* in the best interest of the GOCC, with *utmost good faith* in all its dealing with the property and monies of the GOCC,"[2] and that "Such degree of diligence requires using the *utmost diligence of [a] very cautious person with due regard for all the circumstances*."[3]

You are correct in your position that there is no statutory rule that provides a presumption that members of Governing Boards of GOCCs have not exercised extraordinary diligence in conducting the affairs of the GOCCs. However, once damage or loss has been proven to have been incurred by the GOCC, the burden of proof that one has exercised extraordinary diligence passes to the members of the Governing Boards who are accused of having caused the damage or loss—indeed, the duty of care with extraordinary diligence is a very high standard set by the law that it requires of members of the Governing Board.

In this connection, we wish to confirm that under the Code of Corporate Governance for GOCCs (GCG Memorandum No. 2012-07) that was approved by the President in December, 2012, the term "*Extraordinary Diligence*" has been defined as follows:

> "*Extraordinary Diligence*" refers to the measure of care and diligence that must be exercised by the Directors and Officers in discharging their functions, in conducting the business and dealing with the properties and monies of GOCCs, which is deemed met when Directors and Officers act using the utmost diligence of a very cautious person taking into serious consideration all the prevailing circumstances and Material Facts, giving due regard to the legitimate interests of all affected Stakeholders.[4]

Directors as Agents of the Bank and the Officers
Being Sub-Agents of the Governing Board

You posited in your letter that there is "no agency relationship between the Bank and the directors, and therefore, no sub-agency relationship exists between the

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[2] Sec. 19, R.A. No. 10149, *emphasis supplied.*
[3] Sec. 21, R.A. No. 10149, *emphasis supplied.*
[4] Sec. 1, Code of Governance for GOCCs; *emphasis supplied.*

directors and the offices of the bank" because there is "no provision in the GCG Act which states that the provisions of the Civil Code on Agency shall apply in any manner to GOCCs". We do not agree with this position.

(a) *Directors and Officers Are Saddled with "Fiduciary Duties"*

We presume that you will agree with us that Directors and Officers of GOCCs and GFIs occupy a fiduciary position relative to the company and its stockholders (primarily the State). Thus, R.A. No. 10149 provides for the following fiduciary duties of Directors and Officers:

- Section 19, which carries the title "*Fiducary Duties of the Board and Officers*," provides that members of the Board of Directors/Trustees and the Officers of GOCCs "As fiduciaries of the State . . . have the legal obligation and duty to always act in the best interest of the GOCC," which define the duties of diligence and loyalty;
- Section 19(a) provides that Directors and Officers shall "Act with utmost and undivided loyalty to the GOCC," which defines the duty of loyalty;
- Section 19(b) provides that Directors and Officers shall "Act with due care, extraordinary diligence, skill and good faith in the conduct of the business of the GOCC," which defines the duty of diligence or care;
- Section 19(c) provides that Directors and Officers shall "Avoid conflict of interest and declare any interest they may have in any particular matter before the Board," which defines the duty of loyalty;
- Section 19(d) provides that Directors and Officers shall "Apply sound business principles to ensure the financial soundness of the GOCC," which defines the duty of diligence or care;
- Section 20 defines the role of Directors and Officers in relation to properties and monies that are due to the GOCCs as holding a "*Trustee Relation to the Properties, Interests and Monies of the GOCC*;" and
- Section 21 provides that Directors and Officers "must exercise extraordinary diligence in the conduct of the business and in dealing with the properties of the GOCC[; s]uch degree of diligence requires using the utmost diligence of [a] very cautious person with due regard for all the circumstances," which reiterates the duty of diligence or care.

The imposition of "duties" on Directors and Officers, as distinguished from "obligations", means that the same arise from *a relationship* with the party or parties to whom such duties are owed to. Therefore, R.A. No. 10149, in defining the "duties" of Directors and Officers, recognizes a fiduciary relationship with two distinct parties: the GOCC itself, and the State as the primary stockholder of the GOCC.

Under the law, the basis of fiduciary duties of a person can arise either from an "Agency" position with respect to the principal (the GOCC), or from a "Trustee" position with respect to the entrustor and the beneficiary (the State).

In order to properly address the issues you raise, we will discuss the nature of such relationships separately.

(b) *Basis of the Fiduciary Relationship with the GOCC Itself*

You state in your letter that "We respectfully posit the view that no such agency relationship exists between the Bank and the directors." If that were true, then *What is the legal basis of the fiduciary relationship of the Governing Board to the GOCC?*

Firstly, the established jurisprudence under the Corporation Code of the Philippines[5] is that the Board of Directors/Trustees constitutes the agency by which the corporation functions and operates in the commercial world.

To illustrate, in *AF Realty Dev., Inc. v. Dieselman Freight Services, Inc.*,[6] the Supreme Court held that "Just as a natural person may authorize another to do certain acts in his behalf, so may the board of directors of a corporation validly delegate some of its functions to individual officers or agents appointed by it. Thus, contracts or acts of a corporation must be made either by the board of directors or by a corporate agent duly authorized by the board. Absent such valid delegation/authorization, the rule is that the declarations of an individual director relating to the affairs of the corporation, but not in the course of, or connected with, the performance of authorized duties of such director, are held not binding on the corporation."[7]

In *ABS-CBN Broadcasting Corp. v. Court of Appeals*,[8] the Supreme Court has characterized the power of the Board of Directors as follows:

> Under the Corporation Code, unless otherwise provided by said Code, corporate powers, such as the power to enter into contracts, are exercised by the Board of Directors. However, the Board may delegate such powers to either an executive committee or officials or contracted managers. The delegation, except for the executive committee, must be for specific purposes. The delegation to officers makes the latter agents of the corporation; accordingly, the general rules of agency as to the binding effects of their acts would apply. For such officers to be deemed fully clothed by the corporation to exercise a power of the Board, the latter must specially authorize them to do so.[9]

Secondly, to consider Governing Boards not being the primary Agency of the Chartered GOCC defies the very grant under their charters of all corporate powers of the GOCC in the Governing Boards, or in the case of Nonchartered GOCCs, defies the very language under Section 23 of the Corporation Code which provides that all corporate powers, all corporate properties and all corporate business is vested directly in the Board of Directors/Trustees.

To grant to a person, a committee, or a group the exercise of the powers and prerogatives of the owner-principal is the classic definition and coverage of Agency: "By the contract of agency a person binds himself to render some service or to do something in representation or on behalf of another, with the consent or authority of

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[5] Section 30 of R.A. No. 10149 provides that the Corporation Code applies suppletorily to covered GOCCs: "The provisions of 'The Corporation Code of the Philippines' and the provisions of the charters of the relevant GOCC, insofar as they are not inconsistent with the provisions of this Act, shall apply suppletorily to GOCCs."

[6] 373 SCRA 385 (2002).

[7] *Ibid*, at p. 399. *Reiterated in Manila Metal Container Corp v. PNB*, 511 SCRA 444 (2006); *Cebu Mactan Members Center, Inc. v. Tsukahara*, 593 SCRA 172 (2009); *Banate v. Philippine Countryside Rural Bank*, 625 SCRA 21 (2010);

[8] 301 SCRA 572 (1999).

[9] *Ibid*, at p. 594.

the latter."[10] Is there any doubt that the Governing Boards of GOCCs always act in representation and in behalf of the GOCCs, which by law have a separate juridical personality?

Thirdly, to propose that the members of the Governing Boards are not agents of the GOCC would presume that they act in the world as their own principal, which would mean that they become primarily liable for the contracts and legal relationships and transactions they pursue in the name of the GOCC.

The business judgment rule under both Private Corporation Law and Public Corporation Law provides that directors do not become personally liable for the contracts and transactions they enter into in behalf of the company they represent. The basis of this rule on non-personal liability is found in Agency Law which states "The agent who acts as such is not personally liable to the party with whom he contracts, unless he expressly binds himself or exceeds the limits of his authority without giving such party sufficient notice of his powers."[11]

To posit therefore that when Governing Boards enter into contracts and transactions on behalf of the GOCC, but not as agents of the GOCC, is to defy the authority granted to them under their charters and/or under Section 23 of the Corporation Code. And if the Governing Boards directly, or through their authorized representative, enter into such contracts and transactions not as agents of the GOCC, then what prevents the members of the Governing Boards from being personally held liable for such contracts and transactions?

Finally, if the proposition is that the Governing Boards exercise fiduciary duties to the GOCCs, not as agents, but as trustee, then it does not make sense to enter into contracts in the name of the GOCCs. By definition, a "trustee" has been vested with title to the properties under trust—insofar as the world is concerned he is the naked or legal title holder of the properties under trust, and he exercises the prerogatives of ownerships.

This is not a fair description of the position of Governing Boards vis-a-vis the GOCC and the properties and business enterprise that it holds. Title to all assets and properties are still in the name of the GOCC, and in fact all contracts, as well as all rights obtained and obligations assumed pursuant to such contracts, are in the name of the GOCC. In a true trust relationship, titles to the properties under trust, and all transactions pursued are in the name of the trustee who holds naked or legal title thereto.

The legal acts of Boards of Directors/Trustees with respect to the GOCCs, their monies, properties and business enterprise, is by definition and by structure, done as Primary Agents of the GOCCs — they act, contract, borrow, dispose of, sue or defend suits, expressly on behalf of and in the names of the GOCCs; they do not purport to act on their own behalf, but in representation of the GOCCs. As has been expressed in timeless fashion by the Supreme Court: "The underlying principle of the contract of agency is to accomplish results by using the services of others – to do a great variety of things like selling, buying, manufacturing, and transporting. Its purpose is to extend the personality of the principal or the party for whom another acts and from whom he or she derives the authority to act."[12]

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[10] Article 1868, Civil Code of the Philippines.
[11] Article 1897, Civil Code of the Philippines.
[12] *Eurotech Industrial Technologies, Inc. v. Cuizon*, 521 SCRA 584, 592 (2007). *Also Rallos v. Felix Go Chan & Sons Realty Corp.*, 81 SCRA 251 (1978); *Orient Air Service & Hotel Representatives v. Court of Appeals*, 197 SCRA 645 (1991), *Litonjua, Jr.*

Therefore, since Officers also act and enter into contracts in the name of and in behalf of the GOCCs, there is also no doubt that they occupy a position of agency vis-a-vis the GOCCs they represent. We will go back to this point in the discussion below.

(c) *Basis of the Fiduciary Relationship with the State*

In order to complete the discussions, we now touch on the issue that if Directors and Officers have been expressly denominated as "fiduciaries of the State," and that since they do not enter into contracts and transactions in the name of the State (but in behalf of the GOCCs) then: *What is the nature of the fiduciary relationship of Directors and Officers vis-a-vis the State?* It is our proposition that the nature of that relationship is that of being trustees of the State as the primary stockholder of the GOCCs.

For private stock corporations, under the "*Stockholder Theory*" it has been held by the Supreme Court that the primary obligation of the Board of Directors of a corporation is "to seek the maximum amount of profits for the corporation," and characterized the Director's position as a "position of trust" and that in case a Director's interests conflict with those of the corporation, he cannot sacrifice the latter for that of his own advantage and benefit.[13] The Court also held in another case that the fiduciary or trust relationship "is not a matter of statutory or technical law. It springs from the fact that Directors have the control and guidance of corporate affairs and property and hence of the property interests of the stockholders."[14] Therefore, it is the grant of the powers to the Board of Directors under Section 23 of the Corporation Code (or in the appropriate provisions of the charters for Chartered GOCCs) that necessarily brings about its fiduciary obligations to the stockholders who thereby have beneficial title or interest in the corporate enterprise.

(d) *Nature of the Relationship of the Governing Board and the Officers*

Contrary to the impression expressed in your letter that "no sub-agency relationship exists between directors and officers of the Bank," we wish to draw your attention to the following provisions of R.A. No. 10149 which clearly provides that Officers of every covered GOCC are sub-agents of the Governing Board by virtue of their having been appointed into office by the Governing Board, thus:

- Section 18 which provides that "The CEO or the highest-ranking officer provided in the charters of the GOCCs, shall be elected annually by the members of the Board from among its ranks [and that such] CEO shall be subject to the disciplinary powers of the Board and may be removed by the Board for cause."

- Section 19(e) which provides that the Governing Boards shall "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."

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v. Eternit Corp., 490 SCRA 204 (2006); *Doles v. Angeles*, 492 SCRA 607 (2006); *Eurotech Industrial Technologies, Inc. v. Cuizon*, 521 SCRA 584 (2007); and *Philex Mining Corp. v. Commissioner of Internal Revenue*, 551 SCRA 428 (2008).

[13] *Prime White Cement Corp. v. Intermediate Appellate Court*, 220 SCRA 103, 110 (1993).

[14] *Ibid, quoting from Gokongwei v. SEC*, 89 SCRA 336 (1979).

- Section 22, entitled "*Power of the Board of Directors/Trustees to Discipline, Remove Officers of GOCC,*" which provides that "the Board shall have the authority to discipline the CEO, or order the removal from office, upon majority vote of the members of the Board who actually took part in the investigation and deliberation."

Since Officers of GOCCs do not act or enter into contracts for themselves nor on behalf of their Governing Boards, but always on behalf of the GOCCs they represent, there can be no doubt that Officers assume an "agency position" vis-a-vis the GOCCs which they represent. But since they are not appointed to their position by the principals (*i.e.*, the GOCCs), nor is corporate powers vested in them directly under Section 23 of the Corporation Code (or in the appropriate charter provisions of Chartered GOCCs), they cannot be deemed to be the primary agents of the GOCCs. In fact, there seems to be no doubt that the Governing Boards of GOCCs are the primary agents of the GOCCs represented.

The Officers of every GOCC, starting from the CEO down to the lowest officer position, therefore come into an agency relationship with the GOCC pursuant to their nomination/election or appointment by the Governing Boards. Officers therefore assume their fiduciary roles as the appointees of the Governing Boards—they therefore are the sub-agents of the Governing Board, exercising the powers given to them by the Governing Board. *What is therefore the nature of the responsibility of the Governing Board with respect to the Officers whom they appoint or elect into office?*

Under applicable Agency Law, the rule is that "The agent may appoint a substitute if the principal has not prohibited him from doing so; but he shall be responsible for the acts of the substitute."[15]

A similar rule is found in Section 19(d) of R.A. No. 10149 that provides that among the fiduciary duties of GOCC Governing Boards is to "Elect and/or employ only Officers who are fit and proper to hold such office with due regard to the qualifications, competence and integrity." It is clear therefore, that Governing Boards are fiduciary responsible for the acts of Officers who have been found to be without proper qualifications, or who lack competence and integrity, to have therefore caused loss or damage to the GOCC.

Implementing rules for the responsibility of Governing Boards for the acts of their Officers are now found in Article III of the Governance Code, thus:

- Section 5, which provides that "the Governing Board is primarily responsible for the governance of the GOCC. Consequently, it is the Board and not Management, that is primarily accountable to the State for the operation and performance of the GOCC."

- Section 6, entitled "*Board Duty to Properly Select and Provide Independent Check on Management,*" which provides in part that "it is the duty of every Governing Board to ensure that they elect and/or employ only Officers who are fit and proper to hold such offices with due regard to their qualifications, competence, experience and integrity. The Board is therefore obliged to provide an independent check on Management."

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[15] Article 1892, Civil Code of the Philippines.

- Section 7, entitled "*Mandate and Responsibility for the GOCC's Performance*," which provides that "Although the day-to-day management of the affairs of the GOCC may be with Management, the Board is, however, responsible for providing policy directors, *monitoring and overseeing Management action*."[16]

Finally, Section 18 under Article IV (*Management*) of the Governance Code provides that: "Management is responsible to the Board for implementing the infrastructure for the GOCC's success;" and Section 19 (*Management Primarily Accountable to the Board*) provides that: "Management is primarily accountable to the Board for the operations of the GOCC."

The above-quoted provisions of R.A. No. 10149 and the Code of Corporate Governance institutionalize the principle in Agency Law that an agent becomes responsible and personally liable for the acts of the sub-agents it appoints.

These principles are not in conflict with the DBP Charter (*i.e.* Section 9f) which provides that the Board of Directors shall have the duty to appoint officers from the rank of the Vice President and other more senior officer positions, excluding the Chairman and the Vice Chairman, since the Board is given the duty and discretion to elect and/or employ only Officers who are fit and proper to hold such offices depending on their own evaluation of their qualifications, competence, experience and integrity.

We apologize for the length of our reply, but we do so as part of the role of the GCG to expound the tenets, principles and best practices constituting the reforms that have been introduced into Philippine Public Corporate Governance under the aegis of the *GOCC Governance Act of 2011*. We will be publishing this response in the GCG website for the benefit of all principals and stakeholders within the GOCC Sector who are affected by the same issues covered herein.

We trust that this response would truly be helpful to the Board of Directors in pursuing good corporate governance reforms within DBP.

Very truly yours,

BY AUTHORITY OF THE COMMISSION:

CESAR L. VILLANUEVA
Chairman

[16] *Italics supplied.*

MA. ANGELA E. IGNACIO
Commissioner

RAINIER B. BUTALID
Commissioner

cc: Executive Secretary PAQUITO N. OCHOA, JR.
DOF Secretary CESAR V. PURISIMA
DBM Secretary FLORENCIO B. ABAD