

CONCLUSION

If anything is clear from the foregoing analysis, it is the theme, that contrary to the avowed intention of the tax authorities to minimize the taxpayer's discretion in the computation of his income tax liability, effective measures may still be pursued by a taxpayer desirous of reducing his income tax liability. The theoretical foundation of such techniques were laid down in cases justifying tax avoidance attempts of highly paid executives but there is no reason why they cannot also be invoked by lower paid workers and laborers. It is therefore crucial for employer and employee to get together and forge a compensation package that gives the employer a fair return for his capital, the employee the true worth of his labor, and the government its just dessert.

COMPANY DIRECTORS AS CONSTRUCTIVE TRUSTEES
Some Aspects of the Corporation Code of the Philippines

Pedro G. Herrera-Davila*

Corporate existence commences on the date on which the Securities and Exchange Commission issues a certificate of incorporation under its official seal.¹ From that moment the corporation becomes a *sui juris*; by this statutorily created fiction the acts of the corporation, together with the rights and obligations arising therefrom, are its own — separate and distinct from those of its shareholders, directors and officers.² Conversely, acts of the latter do not affect the corporation unless certain legal requirements are complied with.³ There are exceptions to this principle of separate corporate personality whereby courts impute to the directors and officers, as well as those others purporting to act for the corporation, personal liability for the consequences of their acts. This process is commonly called "piercing the corporate veil".⁴ Similarly, consequences of the acts of natural persons will be imputed to the corporate *persona* in some instances.⁵ In this essay we will examine some of those instances when company directors will be held personally liable for their acts performed in their capacity as members of the board of directors.

The Corporation Code of the Philippines⁶ provides:

*Lecturer, Ateneo College of Law; A.B., L.L.B., Ateneo; M.A. (Law), D.L.S., University of Cambridge.

¹Section 19, Corporation Code of the Philippines; Batas Pambansa Blg. 68, approved 1 May 1980.

²Mindanao Motor Line, et al. v. Court of Industrial Relations, G.R. No. 18418, 29 November 1962. 62.

³Campos and Lopez-Campos, Notes and Selected Cases on Corporation Law. Community Publishers, Inc., Manila, Philippines, 1969.

⁴McConnel v. Court of Appeals, 59 O.G. 3925 (1961); Collector of Internal Revenue v. University of the Visayas, G.R. No. 13554, 30 November 1964; U.S. v. Milwaukee Refrigeration Transit Co., et al., 142 Fed. 247 (1905); Ballantine, on Corporations, cited in Campos and Lopez-Campos, *ibid.*, at 99.

⁵The corporation may, through its stockholders, ratify unauthorized acts of individuals purporting to act on its behalf, thereby adopting said acts as its own. (Battelle v. Northwestern Cement and Concrete Pavement Co., 37 Minn. 89, 33 N.W. 327; Builder's Duntile Co. v. Dunn Mfg. Co., Wy. 569, 17 S.W. 2d 715 (1929); Campos and Lopez-Campos, *op. cit.*, at 213 and 179. See also, Sections 32-34, Corporation Code of the Philippines.

⁶Corporation Code of the Philippines.

"SEC. 31. Liability of directors, trustees or officers. — Directors or trustees who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation or acquire any personal or pecuniary interest in conflict with their duty as such directors, or trustees shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons.

* When a director, trustee or officer attempts to acquire or acquires, in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed in him in confidence, as to which equity imposes a disability upon him to deal in his own behalf, he shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation." [Emphasis supplied.]

The liability thus imposed is in favor of the corporation as the constructive trustor; it may be imposed by the corporation in a legal action or by the shareholders through derivative suits. This provision mandates a statutorily created constructive trust (as opposed to implied trusts) over profits which would have otherwise accrued to the corporation had the director not acquired or attempted to acquire the adverse interest, contrary to the dictates of equity. In such cases the corporation is the *cestui que trust* of all those benefits acquired by the director as well as the unrealized profits and value of losses incurred by the corporation. These provisions of the Corporation Code are in clear recognition of the principle at equity embodied in Article 22 of Republic Act No. 386⁷ which states, in effect, that a constructive trustee cannot retain benefits he has received which would otherwise belong to the constructive trustor. Thus, paragraph 160 of the American Restatement of Restitution provides:

"Where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises."

And, in the celebrated case of *Beatty v. Guggenheim Exploration Co.*, [(1919) 225 N.Y. 380 (at 386)] Justice Cardozo stated succinctly:

"A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee."

⁷Civil Code of the Philippines (R.A. 386).

Article 22. "Every person who through an act or performance by another or any other means, acquires or comes into possession of something at the expense of the latter without just or legal ground, shall return the same to him."

Further, the Corporation Code ordains in unequivocal terms:

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

Perhaps the situation most widely recognized as giving rise to a constructive trust is when the fiduciary obtains a benefit as a result of a breach of the duty of loyalty he owes to his principal.⁸ The corporation, a fictional *persona* existing by virtue of legislative fiat and thus, by its nature, is incapable of acting on its own, acts through agents who are natural persons. Principal among such agents are the members of the board of directors; all directors have a strictly fiduciary relationship with their corporation. Thus, the principles governing the relationship between agents and principals as well as trustors and trustees are crucial in the management of corporate affairs. The cardinal rule for company directors is that they are fiduciaries who must exercise not only care and diligence but utmost good faith in managing the corporation.⁹

When a director willfully and knowingly votes for or assents to a patently unlawful act of the corporation, thereby causing damage (*daño*) to the company, liability attaches and he must pay indemnity to the extent suffered by the corporation, and others.¹⁰ The director must have known that the (proposed) corporate act was unlawful and he must have voted *in favor* of the act willingly. Thus, it is incumbent upon the plaintiff in an action to enforce a constructive trust to show that his act in voting for the proposed corporate act or, *ex post facto*, assenting thereto, was not tainted with vitiation. And it is not enough that the act in controversy is found to be unlawful in retrospect: it must have been patently unlawful at the time he cast his vote or manifested his acquiescence to the act. Akin to *scienter*, this element must be proven for the successful prosecution of the case and in order to justify an order for restitution. Finally, because no liability attaches

⁸Section 34, Corporation Code of the Philippines; *Beatty v. Guggenheim Exploration Co.*, 225 N.Y. 380; Goff and Jones, *The Law on Restitution*, London, Professor Gareth Jones, 84 L.Q.R. (1968) 472. [England]

⁹*Legarda v. La Provisora*, 66 Phil. 723.

¹⁰Article 20, R.A. 386.

where there is *damnum sine injuria esse potest*, the corporation must show that it has suffered and lay the basis for the award of damages. And although it may not be essential to quantify damages with mathematical exactitude, there must be a factual basis upon which the constructive trust will be imposed and damages estimated (e.g., damage to the corporation's goodwill, reputation, credit standing, etc.). In any case, quantification of the indemnity for which the director becomes liable should be guided by the principle of *restitutio in integrum* so that all benefits received by him should be re-conveyed to the corporation. Liability in excess of what he has actually received must be predicated on adequately laid factual bases, properly pleaded and proven at the trial.

As noted above, a director becomes liable as a constructive trustee if he is found guilty of gross negligence or bad faith in directing the affairs of the corporation. Being a fiduciary, the duties of care and good faith imposed on him are far beyond the standards of *exacta diligentia de bonus paterfamilias* and *bona fides*. A director must exercise *exactissima diligentia* and utmost good faith in corporate management. Although Philippine courts adhere to the principle of *bonae fidei non congruit de apicibus juris disputare*, it can be anticipated that they will look for the highest standards of diligence in an inquiry into a director's fiduciary relationship with the corporation he represents and a constructive trust is the subject matter of litigation.

The last paragraph of Section 31 and Section 34 of the Corporation Code are addressed to acquisitions or attempts at acquisition by directors of property, adverse interests, or business opportunities which should belong to the corporation. It is significant that an actual acquisition is not essential for a constructive trust to arise and liability to attach to the director concerned. Section 31 ordains that if there are profits which would have accrued to the corporation but did not materialize because a director attempted to acquire in violation of his duty (of loyalty to the corporation), any interest adverse to the corporation, he becomes liable and must account for all those "unrealized profits". The nobility of this idea is unquestionable; the salutary effects it may have on the conduct of company directors are substantial. Nevertheless, what appears to be controversial is the quantum of those "profits which would otherwise have accrued to the corporation."

When a director purchases property from the corporation while he is acting in his capacity as director, he is both a purchaser and vendor by virtue of his fiduciary position. Since it is almost impossible to determine whether or not a fiduciary obtained some advantage in purchasing property from his principal, the sale will almost invariably be set aside at the instance of the beneficiaries. It becomes irrelevant that the trustee was honest and that the price paid in the transaction was fair since the crucial question remains as to

any benefit which may have been obtained by the constructive trustee. The director may escape liability only if he can convince the court that he did not, in fact, derive any benefit from the transaction. Where the transaction is impeachable under the principles discussed above, the sale is nevertheless not void. It is merely voidable at the instance of the corporation. In case avoidance of the sale is obtained by the company, it may have the property re-conveyed to it (together with the fruits or other income that may have accrued to it) in exchange for the purchase price and interest thereon as well as the value of any improvements introduced by the director in the premises; or, the court may order mutual restitution on such other terms as it may deem just and equitable in the circumstances.

A director who acquires an interest⁷ adverse to that of the corporation will not be able to benefit thereby for he is duty-bound not to compete with his corporation. Where he has breached his duty of loyalty by engaging in such competition, the firm may obtain an injunction restraining such competition. Under Section 34 of the Corporation Code the company may hold the director liable for any profits the director may have realized out of his competition under a constructive trust.

In the area of remuneration of directors, the Corporation Code mandates that the board of directors serve without compensation, except for reasonable *per diems*. However, there are exceptions to this rule.¹² The payment of such remuneration may be authorized by a vote of stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholders' meeting.¹³ Or the director may contract with the corporation for such remuneration as in the case of a director who concurrently serves as an officer of the corporation. However, such a contract will be scrutinized very closely by the courts and a contract by a director merely to perform his duties as such would probably be unenforceable by him for lack of sufficient consideration inasmuch as he was merely contracting to carry out an existing legal duty. A director may retain benefits received by him by virtue of his shareholding in the company since these would accrue to him whether or not he is a director. And, a director of a company who is appointed by the board to a directorship in a subsidiary may retain both sets of director's fees/per diems.

The precise nature of the liability of a director to account for remuneration

¹¹ Articles 19-22, R.A. 386.

¹² Section 30, Corporation Code of the Philippines.

¹³ Ibid.