SHAREHOLDERS' DERIVATIVE SUITS IN THE PHILIPPINES: AN APPRAISAL IN THE LIGHT OF COMPARATIVE LAW AND PRACTICE

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I. INTRODUCTION

The corporate system vests power and control in the hands of a few men who are collectively known as "management." Corporate management is an institution created by law because of the obvious impracticability for all the shareholders who, in the final analysis, are the beneficial owners of the corporation to manage its affairs. Corporate management consists of the board of directors and the senior officers of the corporation.[1]

Since power is always susceptible of abuse, the omnipresent problem is how to prevent or remedy possible abuses by those in the corporate hierarchy which may be injurious to the corporation and to the shareholders. In most such cases, there is a corporate right of action but in some situations there is only an individual right of action by the shareholders.

When the injury is suffered directly by an individual shareholder, as when his right to vote is unlawfully withheld or his right to inspect corporate books arbitrarily denied, an action may be brought by the injured stockholder in his own name and for his own benefit against the corporation, and this is called a shareholder's individual suit.[2] When the injury is suffered directly by several shareholders, one of them may bring suit in his own behalf and in behalf of all other

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[1] Act No. 1459 (The Corporation Law of the Philippines), effective April 1, 1906, provides: Sec. 28. "Unless otherwise provided in this Act, the corporate powers of all corporations formed under this Act shall be exercised, all business conducted and all property of such corporation controlled and held by a board of not less than five nor more than eleven directors to be elected from among the holders of stock, or, where there is no stock, from the members of the corporation." Sec. 33. "Immediately after the election, the directors of a corporation must organize by the election of a president, who must be one of their number, a secretary or clerk who shall be a resident of the Philippines and a citizen of the Philippines or of the United States, and such other officers as may be provided for in the by-laws. The directors and officers so elected shall perform the duties enjoined on them by law and by the by-laws of the corporation. A majority of the directors shall constitute a quorum for the transaction of corporate business, and every decision of a majority of the quorum duly assembled as a board shall be valid as a corporate act."

[2] SALONGA, PRIVATE CORPORATIONS, 321 (1952).

shareholders similarly situated. This is called a shareholder's representative or class suit.[3] But when the injury is inflicted upon the corporation itself by those who are in control, as when the corporate assets are wasted or used in a manner contrary to the provisions of its charter, resulting in the impairment of the value of the stockholders' shares, the corporation has the right to file the suit to redress the wrong. But if by reason of the control wielded by those who are in power, it aribtrarily refuses to sue, a shareholder may compel the assertion of the right which the corporation fails to assert by filing a suit in behalf and for the benefit of the corporation. This is known as the shareholders' derivative suit.[4]

Difficult questions of substantive law and methods of procedure arise in connection with shareholders' derivative suits. It is the purpose of this study to consider those questions and to suggest possible answers with the hope that the power to check traditionally belonging to the shareholders may be more than a teasing illusion.

More specifically, we shall consider the following problems:

1. The origin of the common law procedural device known as the shareholders' derivative suit and how it came into being in the Philippines where the civil law system prevails.
2. The nature and function of the derivative suit.
3. The conditions required to maintain a derivative suit.
4. The role of the corporation in a derivative suit.
5. The procedural aspects of the suit, such as jurisdiction and venue; the proper pleadings to be filed; the defenses available to the defendants; the extent of relief that may be granted; indemnification of the parties for costs, attorney's fees and expenses of litigation.

II. DERIVATIVE SUITS VIEWED THROUGH TIME

The right of individual stockholders to maintain suits for and in behalf of the corporation was not recognized until 1843 with the promulgation of the decision in the leading English case of *Foss v. Harbottle*.[5] In that case, the defendants who were the directors of the corporation sold lands owned by them to the corporation at excessive prices. A stockholder brought suit in his name and in the name of

[3] *Ibid.*; 13 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, Sec. 5939 (1961).

[4] SALONGA, *op. cit., supra* note 2, at 323; BAKER AND CARY, CORPORATIONS, CASES AND MATERIALS, 627 (1959); 13 Fletcher, *op. cit., supra* note 3, at Sec. 5939.

[5] 2 HARE 461 (1843).

other defrauded stockholders, and for the benefit of the corporation, against the directors, for a breach of their fiduciary duty to the corporation. Although the case was dismissed on the ground, among others, that the complaint had not proved that the corporation was under the control of the guilty parties nor had he proved that the corporation itself was unable to institute the action, the court broadly intimated that a case might arise when a suit instituted by a defrauded stockholder would be entertained and redress given by the courts.

Apparently taking the cue from this case and impelled by the utter inadequacy of suits instituted by the corporation itself, defrauded stockholders began to institute actions in behalf of the corporation and urged the courts of equity to grant relief.[6]

Twelve years after the *Foss* case, the Supreme Court of the United States upheld the jurisdiction of courts of equity to entertain suits against corporations at the instance of one or more shareholders and to apply preventive remedies by injunction to restrain those who administer them from doing acts which would amounts to a violation of the charter or to prevent any misapplication of capital or profits which might result in lessening the dividends of stockholders or the value of their shares.[7] And in 1881, the same Court summed up the circumstances necessary to entitle a stockholder to file a derivative action.[8]

The notion of the corporation as that is known in Anglo-American law was introduced into the Philippines by the United States shortly after the establishment of American sovereignty over the islands.[9] Pursuant to a provision of the Philippine Bill of 1902,[10] the Philippine Commission enacted on April 1, 1906, a general law authorizing the creation of corporations in the Philippines.[11] It was avowedly designed to stimulate the introduction of the American concept of corporation as the standard commercial entity in the Philippines and to hasten the day when the *sociedad anonima* of the Spanish law would

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[6] COOK, CORPORATIONS, Sec. 644 (5th Ed. 1903).
[7] Dodge v. Woolsey, 18 How. (U.S.) 331 (1855).
[8] Hawes v. Oakland, 104 U.S. 450 (1881).
[9] During the Spanish regime, the Code of Commerce of Spain which was extended to the Philippines on August 6, 1888, contained provisions for the establishment and regulation of what is known as the *sociedad anomina*. Art. 153, 154, 155 and 156. Although the *sociedad anomina* had certain features similar to corporations, e.g. limited liability of shareholders, it did not exactly correspond to the notion of the corporation in English and American Law. See Harden v. Benguet Consolidated Mining Co., 58 Phil. 141, 147 (1933). For instance, the equitable remedy known as shareholders' derivative suits was not recognized.
[10] Sec. 74 (July 1, 1902).
[11] Act No. 1459 (April 1, 1906).

become obsolete.[12] This statute has been described as "a sort of codification of American corporation law."[13]

An examination of the Philippine Corporation Law will reveal the sad fact that there is absolutely nothing therein which expressly or even impliedly recognizes the right of a shareholder to maintain a derivative action. This right was first recognized in the Philippines in the case of *Pascual v. Orozco*.[14] In that case, the defendants, as members of the board of directors of the Bank of the Philippine Islands, fraudulently and to the great prejudice of the bank and its stockholders, appropriated huge sums of money to their use from the profits of the bank. A minority stockholder demanded that they refund to the bank the sums so misappropriated but they refused, and having exhausted every remedy within the corporation, he brought an action for the benefit of the bank and all the other stockholders thereof against the directors. Relying upon American precedents, the Philippine Supreme Court held that "the plaintiff, by reason of the fact that he is a stockholder in the bank (corporation) has a right to maintain a suit for and on behalf of the bank, but the extent of such right must depend upon when, how, and for what purpose he acquired the shares which he now owns."

In the light of the silence of the Corporation statute, one might ask how common law actions in equity, such as a stockholders' derivative action, can be given recognition by a court in the Philippines where the civil law system prevails. The same question was posed before the Supreme Court of the Philippines as early as 1915 and it answered it in this fashion:

> "Under the system of procedure which obtains in the Philippine Islands, both legal and equitable relief is dispensed in the same tribunal. We have no courts of law and courts of equity as they are known and distinguished in England and the United States. All cases (law and equity) are presented and tried in the same manner, including their final disposition in the Supreme Court."[15]

Furthermore, considering that most of the laws of the Islands, like the Philippine Corporation Law, are of American origin, "they can only be construed and applied," said the Supreme Court, "with the aid of the common law from which they are derived and to breathe

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[12] Harden v. Benguet Consolidated Mining Co., 58 Phil. 141 (1933).
[13] *Ibid.*
[14] 19 Phil. 82 (1911).
[15] U.S. v. Tamparong, 31 Phil. 321, 327 (1915).

the breath of life into some of the institutions introduced into these Islands under American sovereignty, recourse must be had to the rules, principles, and doctrines of the common law."[16]

III. THE NATURE AND FUNCTION OF THE DERIVATIVE SUIT

As a general rule, where an injury has been caused to the corporation by the wrongful acts of those managing it and a cause of action exists in favor of the corporation, suit must be brought by the corporate management in the corporate name, and cannot be brought by a stockholder in his own behalf, or in behalf of himself and others.[17] In equity, however, the rule is not as inflexible as it is at law and in a proper case, a court of equity will look beyond the corporate body as a legal entity distinct from its members, and disregarding the fiction, will recognize the fact that a corporation is in reality an association of individuals for the purpose of private gain, like an ordinary partnership and while they do not have the legal title to the assets of the corporation, they are nevertheless the beneficial owners. And if an injury is committed or threatened against the corporation which will constitute a violation of the equitable rights of stockholders, and for any reason a dissenting stockholder cannot obtain redress or relief through the corporation, a court of equity will grant appropriate relief in a suit brought by him in his own behalf or in behalf of himself and other stockholders who may come in and be made parties and for the benefit of the corporation. Such a suit is generally brought and sustained because the corporation is under the control of the persons who have committed, or threatened to commit the wrongs complained of.[18]

This procedural device known as the stockholders' derivative suit was therefore created in answer to an urgent need for adequate stockholder control within the corporate structure, without doing violence to the fundamental theory that the stockholders may have all the profits but shall turn over the complete management of the enterprise to their representatives and agents, called directors.[19] For if a share-

[16] U.S. v. Cuna, 12 Phil. 241 (1908).

[17] Smith v. Hurd, 12 Metc. 371 (Mass. 1847); Hawes v. Oakland, *supra* note 8, Johnson v. Ingersoll, 63 F. 2d 86 (1933); Liken v. Shaffer, 64 F. Supp. 432 (1946). The fact that a stockholder is or becomes the owner of all of the corporation's stock does not authorize him to sue in his own behalf on a cause of action belonging to the corporation. Brodsky v. Frank, 342 111. 110, 173 N.E. 775, 777 (1930).

[18] 13 FLETCHER, *op. cit., supra* note 3, at Sec. 5945.

[19] Ramirez v. Orientalist Co., 38 Phil. 634 (1918).

holder were allowed to sue in his own behalf and for his own benefit, he would be usurping the functions which he himself has entrusted to the governing body of the corporation.[20]

Other reasons cited in support of the proposition that a stockholder of a corporation has no personal right of action against directors or officers who have defrauded or mismanaged it are the following: to avoid multiplicity of suits by each injured shareholder, to protect the corporate creditors, and to protect the other stockholders since a corporate recovery should benefit all equally.[21]

Being thus a suit in behalf and for the benefit of the corporation, it follows that if recovery is allowed, the judgment shall, as a general rule, be entered in favor of the corporation,[22] not in favor of each stockholder. Courts will not allow direct proportional recoveries in favor of individual shareholders because whatever amount recovered is an asset of the corporation and the creditors are entitled to first priority over them.[23] Furthermore, if the corporation has no profits, an individual award for damages would amount to a return of capital to the shareholders and thus violate the Philippine Corporation Law[24] which prohibits the division or distribution of the corporation's capital stock or property other than actual profits among the stockholders until after the payment of the corporate debts and the termination of its existence by limitation or lawful dissolution.

The minority shareholders' suit has a dual character.[25] It is representative, in one sense, because the plaintiff undertakes to act not only for his own benefit but also for the benefit of the other stockholders. It is derivative, in a primary sense, because the right which the stockholder seeks to enforce is not his but that of the corporation.[26] Because of its representative character, a decree issued by the court will generally bind all the shareholders, regardless of whether they

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[20] SALONGA, *op. cit., supra* note 2, at 326.

[21] Watson v. Button, 235 F. 2d 235 at 237 (C.A. 9th 1956). There are exceptional cases in which a court may find it equitable to allow a stockholder — usually a former stockholder — to recover directly for a wrong to the corporation. See Matthews v. Headley Chocolate Co., 100 A. 645 (1917) and Watson v. Button, 235 F. 2d 235 (C.A. 9th. 1956).

[22] Liken v. Shaffer, *supra* note 17.

[23] Evangelista v. Santos, 86 Phil. 387 (1950).

[24] Act No. 1459, Sec. 16, *supra* note 1.

[25] As a theoretical proposition, a stockholder's suit combines two causes of action, namely, the stockholder's right in equity to compel the assertion of a corporate right when the management refuses to act, and the enforcement of said cause of action in favor of the corporation. See Swanson v. Traer, 354 U.S. 114 (1957); BALLANTINE, LAW OF CORPORATIONS, 343-344 (1946).

[26] SALONGA, *op. cit., supra* note 2, at 327; Baker and Cary, *op. cit., supra* note 4, at 635.

intervened in the action or not. Because it is derivative, the plaintiff is required to show in court that the suit involves an injury to the corporation, for which no redress is otherwise available.

IV. CONDITIONS REQUIRED TO MAINTAIN A DERIVATIVE SUIT

In order that a derivative action may be maintained, it is necessary: (1) that a cause of action in favor of the corporation exist, (2) that all intra-corporate remedies to compel the corporation to sue have been exhausted, (3) that the suitor be a shareholder of the beneficiary corporation, and (4) that security for expenses be given by the complainant in certain cases. We shall consider these requisites *ad seriatim*.

1. *The existence of a cause of action in favor of the corporation.*

As has been noted previously, when a stockholder files a derivative action, he stands in the corporation's shoes and therefore must ground the suit on the corporation's rights and a wrong done thereto.[28] The injury complained of must primarily be to the corporation rather than to the stockholders.[29]

In other words, when a stockholder institutes a derivative suit, it is the same, in legal effect, as if the corporation itself had sued.[30] Consequently, if the corporation does not have a cause of action, there can be no recovery in a stockholders' derivative suit.[31]

The particular grounds for relief in the Philippines include cases where directors or corporate officers commit a breach of trust by wasting or dissipating the funds of the corporation, fraudulently disposing of its assets, or performing *ultra vires* acts.[32] In the United States, the wrongful act that may be sued for, in a proper case, may be either (1) an *ultra vires* or illegal act of the corporate officers or the majority stockholders, (2) a fraudulent or unfair act of the corporate officers or majority stockholders, or (3) the wrongful act of a third person.[33]

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[27] SALONGA *op. cit., supra* note 2, at 327; *Angeles v. Santos*, 64 Phil. 697, 707 (1937). See also Glenn, *"The Stockholder's Suit, Corporate and Individual Grievances*, 33 YALE L. J. 580, 582 (1924).

[28] Otis & Co. v. Pennsylvania R.R. Co., 57 F. Supp. 680 (1944).

[29] Evangelista v. Santos, *supra* note 23, at 393.

[30] Liken v. Shaffer, *supra* note 17; Dewing v. Perdicaries, 96 U.S. 193, 198 (1877).

[31] Outing v. Plum, 235 N.W. 559 (1931); Liken v. Shaffer, *supra* note 17.

[32] Angeles v. Santos, 64 Phil. 697 (1937); Republic Bank v. Cuaderno, G.R. No. L-22399, March 30, 1967.

[33] 13 FLETCHER, *op. cit., supra* note 3, at Sec. 5951, p. 439.

But where the acts complained of involve a mere error of judgment or discretion, the stockholder cannot file a derivative action in the Philippines[34] in the same manner that a stockholder in the United States could not file a derivative suit based upon such grounds.[35]

The Philippine Supreme Court has not had occasion to rule on whether the wrongful act of a third person prejudicial to the corporation is a proper subject for a derivative action, although in the United States it has been held that as affecting the right of a minority stockholder to sue as a representative of the corporation, there is no essential distinction between a wrong done by a third person to the corporation and wrong done by its officers, directors or stockholders.[36]

Thus, in the United States, a stockholder may sue third persons in the corporation's behalf to recover damages for negligence or fraud resulting in injury to the corporation,[37] to recover damages for wrongful conversion of corporate property,[38] to set aside an *ultra vires* or fraudulent conveyance of corporate assets to an assignee,[39] to compel specific performance of a contract between a third party and the corporation,[40] or to enjoin the enforcement of an unconstitutional regulation where the corporate officers are unwilling or afraid to resist.[41]

2. Exhaustion of all intra-corporate remedies by the shareholder.

Since the injury is primarily to the corporation, the responsibility and authority to sue on behalf and for the benefit of the corporation devolves primarily upon the management — the directors and officers — by whom and through whom the corporation acts.[42] The question whether to sue or not is primarily a matter of sound business judgment. As Mr. Justice Brandeis said:

> "Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management, and is left to the discretion of the directors, in the absence of the instruction by vote of the stockholders. Courts interfere seldom to control such discretion *intra vires* the corporation, except where the directors

[34] Angeles v. Santos, *supra* note 32.
[35] 13 Fletcher, *op. cit., supra* note 3, at Sec. 5951, p. 439.
[36] See 13 FLETCHER, *op. cit., supra* note 3, at Sec. 5850, p. 241.
[37] Colquitt v. Howard, 11 Ga. 556 (1852).
[38] Steele Lumber Co. v. Laurens Lumber Co., 98 Ga. 329, 24 S.E. 775 (1895).
[39] People's Savings Bank v. Colorado Mining & Exchange Bldg. Co., 8 Colo. App. 354, 46 Pac. 620 (1896).
[40] March v. Eastern R. Co., 40 N.H. 548 (1860).
[41] Greenwood v. Union Freight R. Co., 105 U.S. 13; Weidenfeld v. Sugar Run R. Co., 48 Fed. 615 (1881)
[42] Act No. 1459, Sec. 28, *supra* note 1.

> are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment."[43]

If the directors and officers elect to bring the suit in behalf of the corporation, then the stockholders' derivative suit will not lie.[44] If they fail to act, the stockholder must demand that they do so and only if they refuse can he file the suit.[45] It does not mean that the board's refusal to act, *ipso facto*, clears the way for a suit by the demanding stockholder on behalf of the corporation. "For if it were so, the making of the demand would become a meaningless mechanical operation. If the directors who constitute a majority of the board and who reject the demand are dishonest, guilty of a breach of trust, were participants in the fraudulent acts relied upon by the stockholder as a basis for the legal action which he demands, or are subject to the control of the alleged wrongdoers, then equitable jurisdiction may be invoked and he may proceed to file the suit himself. However, if the majority are honest, not guilty of a breach of trust, not subject to the control of the alleged wrongdoers, and were not participants in the fraud charged, he may not sue."[46]

Of course, where the demand upon the board of directors for any redressive measure would be a useless formality or would be impracticable, it may be dispensed with. Thus, in the case of *Everett v. Asia Banking Corporation*,[47] the Philippine Supreme Court held that since the corporation is "under the complete control of the principal defendants in the case," as alleged in the complaint and admitted in the demurrer, "it is obvious that a demand upon the Board of Directors to institute action and prosecute the same effectively would have been useless, and the law does not require litigants to perform useless acts." And in *Angeles v. Santos*,[48] the same Court held that "where a majority of the board of directors wastes or dissipates the funds of the corporation or fraudulently disposes of the properties, or performs, *ultra vires acts*, the court, in the exercise of its equity jurisdiction, and upon showing that intra-corporate remedy is unavailing, will entertain a suit filed by the minority members, for and

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[43] United Copper Securities Co. v. Amalgamated Copper Co., 244 U.S. 261, 263 (1917).

[44] General Investment Corp. v. Arriner, 19 N.Y.S. 2d 566 (1940).

[45] Evangelista v. Santos, *supra* note 23.

[46] Swanson v. Traer, 249 F. 2d 854 (C.A. 8th Cir. 1957).

[47] 49 Phil. 512, 527 (1926). Where the suit is aimed to nullify the action taken by the manager and the board of directors, any demand for intra corporate remedy would be futile. Republic Bank v. Cuaderno, *supra* note 32.

[48] *Supra* note 32, at 707.

in behalf of the corporation, to prevent waste and dissipation and the commission of illegal acts and otherwise redress the injuries of the minority stockholders against the wrongdoing of the majority."

These cases are merely a reaffirmation of the rule obtaining in the United States to the effect that a complainant in a shareholders' suit must either allege a demand upon the board of directors to bring the action and their failure to do so or show a sufficient reason for not making such a demand.[49]

The states of California[50] and Wisconsin[51] require that the plaintiff allege that he has either informed the corporation or the board of directors in writing of the ultimate facts of each cause of action against each director or delivered to the corporation or the board a true copy of the complaint which he proposes to file and the reasons for his failure to obtain such action or the reasons for not making such effort.

The Philippine court decisions do not say categorically whether a demand upon the board of directors is necessary before a derivative action can be maintained. In *Pascual v. Orozco*,[52] the case was dismissed because of non-compliance with the contemporaneous ownership requirement. *Evangelista v. Santos*[53] was likewise dismissed because the action was not brought in behalf and for the benefit of the corporation. In *Everett v. Asia Banking Corporation*,[54] the Court simply ruled that the failure of the plaintiff to make demand upon the board of directors was not fatal since it would have been useless because they were in complete control of the corporation. The same ruling was made in the case of *Angeles v. Santos*.[55] The leading case in the Supreme Court of the United States held that "if time permits, or has permitted, the [plaintiff] must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it." The Federal Rules of Civil Procedure require that a shareholder's bill must "set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees

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[49] Hawes v. City of Oakland, *supra* note 8; Bartlett v. New York, New Haven & Hartford R.R. Co., 109 N.E. 452 (1915).
[50] Cal. Corp. Codes Ann., Sec. 834 (a) (2).
[51] Wis. Statutes, Sec. 180.405.
[52] *Supra* note 14.
[53] *Supra* note 23.
[54] *Supra* note 47.
[55] *Supra* note 32. See also Republic Bank v. Cuaderno, supra note 32.
[56] Hawes v City of Oakland, *supra* note 8.

and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."[57]

The Federal cases do not indicate clearly what is meant by the phrase "if necessary, from the shareholders." "Most of the federal cases . . . have required application to the general body of stockholders even in situations where non-ratifiable fraudulent actions have been involved."[58]

In one case,[59] where co-defendant had sizable ownership of stock of defendant, and defendant's remaining shareholders were large in number and widely diffused geographically, and remaining shareowners as a body were unable, under state law, to cause defendant to prosecute an action against its co-defendant in a consolidated shareholders' derivative action, it was held that demand on such remaining shareholders, within the federal rule requiring that complaint in such cases must set forth efforts of plaintiff to secure from shareholders such action as they desire and the reasons for his failure to obtain such action or the reasons for not making such effort, was unnecessary.

In the state courts, there is a conflict of authority, some courts holding that there is no necessity for a demand upon the stockholders as a body, at least where they retain no control of the corporate business except by means of an annual election of officers,[60] while others require that a demand must be made even where there is an interested board.

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[57] Rule 23 (b).

[58] Escoett v. Aldecress Country Club, 16 N.J. 438, 109A. 2d 277, 282 (1954). See also Haffer v. Voit, 219 F. 2d 704 (6th Cir. 1955).

[59] Gottesman v. General Motors, 268 F. 2d 194 (C.A. 2nd Cir. 1956).

[60] Shaw v. Staight, 107 Minn. 152, 119 N.W. 951 (1909); Planten v. National Nassau Bank of New York, 174 App. Div. 254, 160 N.Y.S. 297 (1916). But if the subject matter of the complaint is within the immediate control, direction, or power of confirmation of the stockholders, it must be brought to their attention before suit is brought unless such application would be clearly useless. Abraham v. Parkins, 36 F. Supp. 238 (1940).

[61] Mayer v. Adams, 141 A. 2d 458 (Del. 1957) applying Delaware rules of court; S. Solomont & Sons, Trust Inc. v. New England Theatres Operating Corp., 326 Mass. 99, 93 N.E. 2d 241 (1950). In Pomerantz v. Clark 101 F. Supp. 341, 344 (D. Mass. 1951), it was held that "the fundamental basis of the rule is the Massachusetts view that neither an individual member nor a court is usually best fitted to determine whether it is to the interest of a corporation publicly to enforce corporate claims even if those claims are founded on plainly unlawful conduct participated in by corporate officers or directors." The only exception to this rule is "Where he shows that the majority of the voting stock is under the control of the alleged wrongdoers." Carroll v. New York, New Haven & Hartford, R.R., 141 F. Supp. 456, 458 (D. Mass. 1956).

One line of cases distinguish between causes of action which can be ratified by the stockholders as a body and those that cannot be ratified, holding that an appeal to the stockholders is not necessary where the breach of duty cannot be so ratified.[62] The New York rule is that a fraud by directors cannot be ratified by a majority of the stockholders however disinterested they may be.[63] Ohio expressly rejected this rule in *Claman v. Robertson*,[64] saying that actual fraud of directors can be ratified by the majority of the shareholders otherwise the courts and the corporations of the state would be plagued with "strike" litigations and might even make it possible for a minority to deprive the corporation of a valuable right which may arise from the fraudulent transaction. The rule of non-ratification has been the subject of much discussion in several law review articles.[65]

3. *The suitor must be a stockholder of the beneficiary corporation.*

The complainant must, of necessity, be a shareholder in the corporation for whose benefit the derivative action is brought.[66] The Philippine courts do not say specifically how many shares of stock the complainant must have in order to be entitled to sue, although in one case[67] a single shareholder with ten shares of stock in a large publicly-held banking corporation was allowed to sue with respect to wrongful transactions occurring after he acquired his shares.

An American textwriter on corporations[68] says: "Any holder of a single share may bring suit to protect his interest in the corporation. All the shareholders may properly join as complainants, but this is not necessary." And the fact that the plaintiff-stockholder is a corporation rather than an individual does not affect the right to bring a stockholder's suit.[69]

The question whether an unregistered shareholder or one who has merely an equitable interest in the stock of the corporation is qualified to file a derivative action has not been presented in the Philippines. It would seem however, that he may not in the light of the pro-

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[62] Steinberg v. Adams, 90 F. Supp. 604 (1950), applying Delaware law.
[63] Continental Securities v. Belmont, 206 N.Y. 7, 99 N.E. 138 (1912).
[64] 164 Ohio St. 61, 128 N.E. 2d 429 (1955).
[65] See: 4 U .CHI L. REV. 495; 53 HARV. L. REV. 1368; 31 B. U. L. REV. 1368.
[66] SALONGA, *op. cit., supra* note 2, at 334.
[67] Pascual v. Orozco, *supra* note 14. In Republic Bank v. Cuaderno, *supra* note 32, the Philippine Supreme Court said that "the smallness of plaintiff's holdings is no ground for denying him relief."
[68] MORAWETZ, PRIVATE CORPORATIONS 407 (1886).
[69] Motor Terminals, Inc. v. National Car Co., 182 F. 2d 732 (C.A. 3rd Cir. 1952).

nouncement in one case[70] to the effect that an unregistered transfer does not entitle the transferee to the rights of a shareholder of record as against the corporation.

In the United States, there is a division of authority, some courts holding that only a stockholder of record is qualified to maintain a derivative action,[71] although the weight of authority seems to be that not only an unregistered shareholder but also the owner of an equitable interest in corporate stock may likewise maintain such action.[72]

A more crucial question arises: should the complainant be a stockholder at the time the alleged wrong was committed or is it sufficient that he be one at the time of the institution of the action?

In the case of *Pascual v. Orozco*,[73] the Supreme Court of the Philippines answered the question thus:

> "A stockholder in a corporation who was not such at the time of the transaction complained of, or whose shares had not devolved upon him since by operation by law, cannot maintain suits of this character, unless such transactions continue and are injurious to the stockholder, or affect him especially and specifically in some other way."

In that case, the defendants who were directors and officers of a banking corporation, without the knowledge or consent of the stockholders, deducted their respective compensation from the gross income instead of from the net profits of the corporation as provided for in the articles of incorporation, thereby defrauding the banks and its stockholders of several hundred thousand pesos. Plaintiff, a minority stockholder of the bank, filed suit in his own name for the benefit of the bank and for all the other stockholders thereof, alleging as first cause of action the fraud committed by the defendant directors described above, and as second cause of action, that defendants' immediate predecessors had also committed the same fraud, and that the defendants were the only persons interested in the bank who knew of the fraudulent appropriations by their precedessors but that they wholly neglected to take any action in the premises or inform the stockholders about it. The Court found that the plaintiff bought the shares and became a stockholder of the bank only in September, 1903, although the complaint asked for relief from the alleged fraudulent acts from the year 1899 to 1907 inclusive. The Court then held:

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[70] Uson v. Diosomito, 61 Phil. 535 (1935). See also SALONGA, *op. cit., supra* note 2, at 433; 2 MARTIN, PHILIPPINE COMMERCIAL LAWS 1652 (1961).
[71] See 13 FLETCHER, *op. cit., supra* note 3, at Sec. 5976, citing cases.
[72] *Ibid.*; BAKER & CARY, *op. cit., supra* note 4, at 673.
[73] *Supra* note 14, at 101.

> "It is self-evident that the plaintiff in the case at bar was not, before he acquired in September, 1903, the shares which he now owns, injured or affected in any manner by the transactions set forth in the second cause of action [from 1899 to 1902]. His vendor could have complained of these transactions, but he did not choose to do so. The discretion whether to sue to set them aside, or to acquiesce in and agree to them, is, in our opinion, incapable of transfer. If the plaintiff himself had been injured by the acts of defendants' predecessors that is another matter. He ought to take things as he found them when he voluntarily acquired his ten shares. If he was defrauded in the purchase of shares he should sue his vendor."[74]

The Court then remanded the case to the lower court for further proceedings with respect to the first cause of action, i.e., those transactions which were made after plaintiff became a stockholder.

In reaching its conclusion, the Philippine Supreme Court relied heavily upon American precedents, particularly the cases of *Hawes v. Oakland*,[75] and *Home Fire Insurance Co. v. Barber*.[76] Quoting a passage from Justice Miller's opinion in the *Hawes* case, to wit:

> "The efforts to induce such action as plaintiff desires on the part of the directors, or of the stockholders when that is necessary, and the cause of failure in these efforts, and all allegations that plaintiff was a shareholder at the time of the transactions of which he complains, or that the shares have devolved upon him since by operation of law and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case in which it could otherwise have no cognizance, should be in the bill, which should be verified by affidavit."

the Supreme Court observed that it was obviously based on "sound reason and good authority."

The contemporaneous-ownership rule is followed in the United States Federal courts[77] and in a majority of the state courts by statute, rule of court or independent reasoning.[78]

Among the states that permit a shareholder who acquired his shares after the transaction of which he complains of to file a derivative action are Massachusetts,[79] Alabama,[80] and New Hampshire.[81]

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[74] *Id.* at 100.
[75] *Supra* note 8, 456.
[76] 67 Neb. 644, 93 N.W. 1024 (1903).
[77] Hawes v. Oakland, *supra* note 8; Federal Rules of Civil Procedure, Rule 23 (b).
[78] See 13 FLETCHER, *op. cit.*, *supra* note 3, at Sec. 5981, p. 519; Baker and Cary, *op. cit.*, *supra* note 4 at 672.
[79] Peterson v. Hopson, 306 Mass. 597, 29 N.E. (2d) 140 (1940).
[80] Parsons v. Joseph, 92 Ala. 403, 8 So. 788 (1891).
[81] Winsor v. Bailey, 55 N.H. 218 (1875).

An intermediate position which is followed in Illinois,[82] is that a stockholder who has acquired his shares after the occurrence of the alleged acts of mismanagement may maintain a derivative suit only if the mismanagement and its effect continue and are injurious to him.

The contemporaneous-ownership rule has been subject to severe criticism both in the United States and in the Philippines.

Among the criticisms leveled against the rule in the United States are that: (1) it is inconsistent with the doctrine that the suit is on behalf of the corporation and merely a 'propulsive suit' to compel the corporation to sue on its own cause of action,[83] (2) it loses sight of the fact that the cause of action for the wrongdoing of directors and officers is a part of the assets in which a stockholder has an indivisible interest transferable by a transfer of his certificate,[84] (3) it is based in part on jurisdictional considerations which are peculiar to federal courts, and is based in part on the common law doctrines of champerty and maintenance which have become obsolete.[85]

A Filipino textwriter on Corporations is quite critical of the adoption by the Philippine Supreme Court[86] of the contemporaneous rule. He says:

> "When the transferor transfers his certificates 'the transaction still stands a continuing wrong impairing the surplus of the company and affecting the stock.' Where dividends are payable only out of balance sheet surplus, as in the case of the Philippines, a single loot committed by the management can so deplete the treasury as to require a long time of saving and frugality to put back the corporation into a position where it can prudently pay out dividends. Under such circumstances, why should a purchaser immediately subsequent to the loot, be barred from complaining? Again, if the rule were to the effect that innocent transferees cannot complain, it would not be hard to imagine a situation where a few minority stockholders, free from management control and the only source of potential complaint, could be induced by the management acting through third persons, to part with their shares for a tempting price, and thus save the wrongdoers from future embarrassment even if these shares subsequently fall into the hands of the general public."[87]

The Philippine Supreme Court has indicated that not only the time and manner in which the complainant acquired his stock but also

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[82] Duncan v. National Tea Co., 14 Ill. App. 2d 280, 144 N. E. 2d 771, 775 (1957); Goldberg v. Ball, 305 Ill. App. 273, 27 N.E. 2d. 575 (1940).
[83] Hornstein, *New Aspects of Stockholder's Derivative Suits*, 47 COLUM. L. REV. 1, 7 (1947).
[84] Peterson v. Hopson, *supra* note 79.
[85] 13 FLETCHER, *op. cit.*, *supra* note 3, at Sec. 5981, p. 519.
[86] Pascual v. Orozco, *supra* note 14.
[87] SALONGA, *op. cit.*, *supra* note 2, at 337.

the purpose for which he acquired the same are relevant in determining his capacity to sue. "Where stock is acquired for the purpose of bringing suit . . . the complainant is a mere interloper and entitled to no consideration."[88]

According to Ballantine, "the purpose with which a shareholder obtains his shares or began his litigation and the extent of his interest should at most be considered as a circumstance tending to discredit his case."[89]

The Supreme Court of the Philippines has likewise intimated that it will look into the motives of the complainant in bringing a shareholder's suit and those not brought in good faith in the interest of the corporation will be dismissed.[90]

In the United States, "the rule generally prevailing is that, where a suitor is entitled to relief in respect to the matter concerning which he sues, his motives are immaterial; that the legal pursuit of his rights, no matter what his motives in bringing the action cannot be deemed either illegal or inequitable; and that he may always insist upon his strict rights and demand their enforcement."[91]

4. *The complainant must give security for expenses in certain cases.*

As we have already noted,[92] there is no provision in the Corporation Law of the Philippines on derivative suits. Derivative suits are purely a creation of the courts. But in none of the cases decided by the Supreme Court has the question been touched upon as to whether the complaining stockholder in a derivative action is required to give security for the expenses of the corporation in connection with the action.

Nevertheless, where the plaintiff seeks some special remedy, such as injunction or receivership for the corporation, the Rules of Court of the Philippines require the plaintiff to file a bond conditioned for the payment of damages which be sustained by the defendant should the court finally decide that the plaintiff was not entitled to the relief prayed for.[93]

The security-for-expenses requirement is of recent vintage. New York pioneered on this frontier in 1944 with the enactment of Section

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[88] Pascual v. Orozco, *supra* note 14, at 99.
[89] BALLANTINE, LAW OF CORPORATIONS, Sec. 149, p. 355 (1946).
[90] Pascual v. Orozco, *supra* note 14.
[91] Johnson v. King Richardson Co., 36 F. 2d 675 (1930).
[92] *Supra* p. 5.
[93] Rule 58, Sec. 4; Rule 59, Sec. 3.

61-B of the New York General Corporation Law. The Section is worth quoting:

> "In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of $50,000, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to section 64 of this chapter, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

Since then, California,[94] Colorado,[95] Maryland,[96] North Dakota,[97] New Jersey,[98] Pennsylvania,[99] and Wisconsin,[100] have passed similar statutes.

The background of security-for-expenses statutes is set out in detail in *Cohen v. Beneficial Industrial Loan Corp.*[101]

> "As business enterprise increasingly sought the advantages of incorporation, management became vested with almost uncontrolled discretion in handling other people's money. The vast aggregate of funds committed to corporate control came to be drawn to a considerable extent from numerous and scattered holders of small interests. The director was not subject to an effective accountability. That created strong temptation for managers to profit personally at expense of their trust. The business code became all too tolerant of such practices. Corporate laws were lax and were not self-enforcing, and stockholders, in face of gravest abuses, were singularly impotent in obtaining redress of abuses of trust.
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> "Equity came to the relief of the stockholder, who had not standing to bring civil action at law against faithless directors and managers. Equity, however, allowed him to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own. It required him first to demand that

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94 Cal. Corp. Code, Sec. 834.
95 Colorado Corporation Act, Sec. 45.
96 Maryland Rules of Civil Procedure, Rule 328 (b).
97 North Dakota Rev. Code, Sec. 10-1948.
98 New Jersey Rev. Statutes, Sec. 14:3-15.
99 Pudon's Pa. Statutes Ann., Tit. 12, Sec. 1322.
100 Wisconsin Statutes, Sec. 180.405.
101 337 U.S. 541 (1949).

> the corporation vindicate its own rights but when, as was usual, those who perpetrated the wrongs also were able to obstruct any remedy, equity would hear and adjudge the corporation's cause through its stockholder with the corporation as defendant, albeit a rather nominal one. This remedy born of stockholder helplessness was long the chief regulator of corporate management and has afforded no small incentive to avoid at least grosser forms of betrayal of stockholders' interest. It is argued, and not without reason, that without it there would be little practical check on such abuses.
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> "Unfortunately, the remedy itself provided opportunity for abuse which was not neglected. Suits sometimes were brought not to redress real wrongs, but to realize upon their nuisance value. They were bought off by secret settlements in which any wrongs to the general body of share owners were compounded by the suing stockholder, who was mollified by payments from corporate assets. These litigations were aptly characterized in professional slang as 'strike suits.' And it was said that these suits were more commonly brought by small and irresponsible than by large stockholders, because the former put less to risk and a small interest was more often within the capacity and readiness of management to compromise than a large one."

Governor Dewey, in approving Section 61-B of the New York Corporation Law, said:

> "These two bills represent an effort to meet the problem created by the baseless so-called 'strike' stockholder suit against corporation directors and officers.
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> "In recent years a veritable racket of baseless law suits accompanied by many unethical practices has grown up in this field. Worse yet, many suits that were well based have been brought not in the interest of the corporation or of its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or in its stockholders. Secret settlements — really pay-offs for silence — have been the subjects of common suspicion.
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> "These bills represent a healthy experiment in cleansing our law courts of disreputable practices."[102]

V. THE ROLE OF THE CORPORATION

It is rather unfortunate that the decisions of the Philippine Supreme Court do not clearly depict the part that the corporation plays in a derivative action. In the case of *Angeles v. Santos*,[103] the issue was raised as to whether the corporation is a necessary party in a derivative suit. Instead of squarely facing the issue, the Supreme Court said:

> "The contention of the defendants in the case at bar that the Parañaque Rice Mill, Inc. should have been brought in as a neces-

[102] Baker and Cary, *op. cit.*, *supra* note 4, at 680.
[103] *Supra* note 32.

> sary party and the action maintained in its name and in its behalf directly states the general rule, but not the exception recognized by this court in the case of *Everett v. Asia Banking Corporation* (49 Phil. 527)."

The Court then quoted a passage from the decision in the Everett case[104] which reads thus:

> "Invoking the well-known rule that shareholders cannot ordinarily sue in equity to redress wrongs done to the corporation, but that the action must be brought by the Board of Directors, the appellees argue — and the court below held — that the corporation Teal & Company is a necessary party plaintiff and that the plaintiff stockholders, not having made any demand on the Board to bring the action, are not the proper parties plaintiff. But, like most rules, the rule in question has its exceptions. It is alleged in the complaint, and, consequently, admitted through the demurrer that the corporation Teal & Company is under the complete control of the principal defendants in the case, and, in these circumstances it is obvious that a demand upon the Board of Directors to institute action and prosecute the same effectively would have been useless and the law does not require litigants to perform useless acts."

It is readily apparent that the *Everett* case does not really state an exception to the general rule. For there is nothing said in that case which authorizes the exclusion of the beneficiary corporation as a party in the derivative action. What the *Everett* case did establish is the proposition that when the company is under the complete control of the defendant directors, a demand upon them to institute the action and prosecute the same effectively would be unnecessary for it would have been useless, and the law does not require litigants to perform useless acts.

In the recent case of *Republic Bank v. Cuaderno*,[105] the question arose as to whether the corporation should be made a party plaintiff or a party defendant in a derivative action. Again, instead of resolving the question squarely, the Supreme Court said:

> "There remains the procedural question whether the corporation itself must be made party defendant. The English practice is to make the corporation a party plaintiff, while in the United States, the usage leans in favor of its being joined as party defendant (see Editorial Note, 51 LRA [NS] 123). Objections can be raised against either method. Absence of corporate authority would seem to militate against making the corporation a party plaintiff, while joining it as defendant places the entity in the awkward position of resisting an action instituted for its benefit. What is important is that the corporation should be made a party,

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[104] *Supra note* 47, at 527.
[105] *Supra* note 32.

> in order to make the Court's judgment binding upon it, and thus bar future relitigation of the issues. On what side the corporation appears loses importance when it is considered that it lay within the power of the trial court to direct the making of such amendments of the pleadings, by adding or dropping parties, as may be required in the interest of justice (Revised Rule 3, Sec. 11). Misjoinder of parties is not a ground to dismiss an action. (Ibid.)."

The usual practice in the United States is to name the beneficiary corporations as a party defendant, although in substance it is a party plaintiff. The flexibility of equity procedure in the United States permits an affirmative judgment to be entered in favor of one defendant against other defendants.[106]

The corporation is merely a "formal defendant", however, while the other defendant from whom a recovery is really sought is the "actual defendant".[107]

There are very cogent reasons why the corporation should be made a party to the suit. If the complaining stockholder is successful, the corporation is logically entitled to the benefit of the decree, but it can only be benefited if it is a party of record.[108] If the complaining stockholder is unsuccessful, the corporation, if not made a party to the proceedings, can renew the unsuccessful litigation although involving the same subject matter.[109] As stated by the Philippine Supreme Court, it is important that the corporation should be made a party "in order to make the Court's judgment binding upon it, and thus bar future relitigation of the issues."[110]

The determination of the part that should be played by the corporation is one of considerable difficulty. During the initial stages of the trial, it is difficult to determine the merit of the complaining stockholder's position. It may well be that he is acting in the best interest of the corporation. Consequently, the corporation cannot properly be an active participant in the litigation.[111] It is required to adopt

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[106] Dean v. Kellogg, 294 Mich. 200, 292 N.W. 704 (1940); See also: BALLANTINE, *op. cit., supra* note 89, Sec. 154, p. 366; Winer, *Jurisdiction in Stockholder's Suits.* 22 VA L. REV. 153, 160; *Necessity of Joinder of Corporations in Representative Suit Against the Directors,* 44 YALE L. REV. 1091.

[107] Groel v. United Electric Co. of New Jersey, 70 N.J. Eq. 616, 61 A 1061 (1905).

[108] Salonga, *op cit., supra* note 2, at 340.

[109] Ballantine, *op. cit., supra* note 89, at Sec. 154, p. 366. The decree must protect the directors against any further suit, and this will not be true unless it be a party to the suit. Philippon v. Derby, 85 F. 2d 27, 30 (C.C.A. 2d 2936); Dean v. Kellog, *supra* note 106.

[110] Republic Bank v. Cuaderno, *supra* note 32.

[111] SALONGA, *op. cit., supra* note 2, at 341; BALLANTINE, *op. cit., supra* note 89, at Sec. 154, p. 367.

a neutral or passive role with only a limited power to defend itself while its volunteer representative conducts for its benefit the litigation which its management has failed or refused to bring.[112]

It has been argued that since the complaining stockholder has the right of control,[113] the corporation need not answer nor take any steps in the proceedings.[114] It is further argued that the corporation is a nominal party only and its being joined as a party is simply for the protection of the defendants, so that when final judgment is rendered, the individual defendants may thereby be protected from a second suit on the same causes of action brought by the corporation. But that does not vest in the corporation the right to step in and by answer attempt to defeat what is practically its own suit and causes of action.[115]

As a corollary to this theory, it is regarded as improper to use corporate funds to give financial aid or to assist in the defense of directors and officers.[116] The reason is that the complaining stockholder is entitled to a fair opportunity to prosecute his suit without having the resources of the corporation turned aginst him.[117] As aptly stated by one court, the corporaton should not be made "to effect what is practically its own suit and causes of action" with the defendants imposing upon it "the burden of fighting their battle."[118]

On the other hand, in *McHarg v. Commonwealth Finance Corp.*,[119] an opposite view was taken, the court holding that: "this is a representative action, and the corporation is a necessary party to the action; but because a minority stockholder charges a wrongdoing by directors of a corporation which, if he succeeds in the action, will inure to the benefit of the corporation, he does not thereby become possessed of the right to dictate the defense or manner of defense that the corporation may undertake."

In *Otis & Co. v. Pennsylvania R. R.*,[120] the Federal District Court, after examining the various arguments, arrived at the following con-

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112 BALLANTINE, *op. cit., supra* note 89, at Sec. 154, p. 367.

113 Solimine v. Hollander, 129 N.J. Eq. 264, 19 A 2d. 344. 345, 346 (1941); Washington, *The Company's Role in Stockholders' Derivative Suits*, 25 CORNELL L. Q. 361; note 48 YALE L. J. 661 (1934).

114 BALLANTTINE, *op. cit., supra* note 89, at Sec. 154, p. 367.

115 Meyers v. Smith, 190 Minn. 157, 251 N.W. 20, 21 (1933). See, however, Republic v. Cuaderno, *supra* note 32, where the Philippine Supreme Court stated that in derivative suits, the suing stockholder is regarded as a nominal party, with the corporation as the real party in interest.

116 *Ibid;* Slutzker v. Reber, 132 N.J. Eq. 412, 28 A 2d 528 (1942); Chabot & Richard Co. v. Chabot, 109 Me. 403, 84 A. 892 (1912).

117 BALLANTINE, *op. cit., supra* note 89, at Sec. 154, p. 367.

118 Supra note 115.

119 44 S.D. 144, 182 N.W. 705, 706 (1921).

120 57 F. Supp. 680 (E.D. Pa. 1944).

clusion: "Analytically the all important question when the corporation seeks to defend is that of the nature of the complaint and the interest of the corporation in the controversy. When fraud is the complaint against the directors, the essence of the corporation's interest is, and ought to be, in having the truth of the charges determined and in recovering all funds of which it was deprived . . . The corporation has no reason, then, to make affirmative defenses, except perhaps in a limited capacity. See Groel v. United Electric Co. of N.J., 1905, 70 N.J. Eq. 616, 61 Atl. 1061, 1064, 1065. Similarly, when the cause of action is such as to endanger rather than advance corporate interests, an answer setting forth affirmative defenses seems proper. See (1934) Yale L. J. 661, 662; and cf. Washington, Stockholders' Derivative Suits (1940) 25 Cornell L. Q. 361."

Thus, where the complaint seeks to place the corporation in receivership, it has been held that since the consequence of granting this petition would be the interruption of the normal corporate business, the corporation may actively resist said petition, with the aid of counsel, though this may result in directly providing assistance to the individual defendants.[121]

The Philippine Supreme Court has consistently held that receivership is a drastic remedy and should be granted only for very strong reasons. The general rule is that extreme caution must be observed in petitions for appointment of receivers.[122] Before granting the petition, the consequences or effects thereof should be considered in order to avoid causing irreparable injustice or injury to others who are entitled to as much consideration as those seeking it.[123] Consequently, the corporation is entitled to be heard and to oppose the petition for receivership.

It is a curious fact that in the case of *Angeles v. Santos*,[124] the Supreme Court of the Philippines sustained the action of the trial court in granting an *ex parte* order of receivership without affording the corporation an opportunity to oppose the same (as a matter of fact the corporation was not even made a party to the proceeding) with the court statement:

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[121] Godley v. Crandall & Godley Co., 181 App. Div. 75, 168 N.Y.S. 251 (1917), aff'd. 227 N.Y. 656, 126 NE. 908 (1920); Espositio v. Riverside Sand & Gravel Co., 287 Mass. 185, 191 N.E. 363 (1934).

[122] Tuason v. Concepcion, 54 Phil. 408 (1930); Ylarde v. Enriquez, 78 Phil. 527 (1947).

[123] Claudio v. Zandueta, 64 Phil. 812 (1939); Velasco v. Go Chuico & Co., 28 Phil. 394 (1914).

[124] *Supra* note 32.

> "The appointment of a receiver upon application of the minority stockholders is a power to be exercised with great caution. But this does not mean that the rights of the minority stockholders may be entirely disregarded, and where the necessity has arisen, the appointment of a receiver for a corporation is a matter resting largely in the sound discretion of the trial court."

VI. PROCEDURAL ASPECTS OF THE DERIVATIVE SUIT

1. *Jurisdiction and venue.*

In order that a court may try a derivative suit, it must have jurisdiction over the subject matter of the action and of the parties thereto. Jurisdiction over the subject matter is the power of the court to hear and determine the cause of action and to grant the relief sought and this power is conferred upon it by law.[125] In the Philippines, derivative actions are cognizable originally by the Court of First Instance which is a court of general original jurisdiction,[126] unless the subject matter of the action involves an amount which does not exceed ten thousand pesos, exclusive of interest and cost in which case it may be originally instituted in the Municipal or City Courts.[127] Jurisdiction over the person of the plaintiff is acquired from the time he files his complaint.[128] Jurisdiction over the person of the defendant is acquired by his voluntary appearance in court and his submission to its authority, or by the coercive power of legal process (service of summons) exerted over his person.[129]

Venue is the place where the action must be instituted.[130] In the Court of First Instance, the action may be commenced and tried where the defendant or any of the defendants resides or may be found, or where the plaintiff or any of the plaintiffs resides, at the election of the plaintiff.[131] In Municipal or City Courts, the venue is the place of execution of the agreement or contract sued upon or if the action is not upon a written contract, then in the municipality or city where the defendant or any of the defendants resides or may be served with summons.[132]

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[125] 1 MORAN, COMMENTS ON THE RULES OF COURT OF THE PHILIPPINES 32-33 (1963).

[126] Republic Act No. 296, Sec. 44 (1948), as amended by Republic Act No. 2613, Sec. 3 (1959) [Philippines].

[127] Republic Act 296, Sec. 88 (b) (1948), as amended by Republic Act No. 2613, Sec. 10 (1959) and Republic Act No. 3828 (1963) [Philippines].

[128] Manila Railroad Co. v. Attorney General, 20 Phil. 523 (1911).

[129] Banco Español Filipino v. Palanca, 37 Phil. 921 (1918). Infante v. Toledo, 44 Phil. 834 (1918); Rules of Court of the Philippines, Rule 14, Sec. 23 (1964).

[130] 1 MORAN, *op. cit.*; *supra* note 125, at 184.

[131] Rules of Court of the Philippines, Rule 4, Sec. 2 (b) (1964).

[132] *Id.*, Rule 4, Sec. 1 (b) (1964).

In the Philippines, no complex jurisdictional problems are presented in the case of derivative actions because the action may proceed without including the corporation as a party,[133] and furthermore a unitary system of government exists.[134]

In the United States, however, because of the federal system of government,[135] and the requirement that the corporation must be included as a party defendant,[136] the complaining stockholder is bedeviled by a number of jurisdictional problems.

Because of the requirement that the corporation must be included as a party in the action, it is necessary that the court acquire jurisdiction over it.[137] However, this requirement of indispensability can make it virtually impossible for a shareholder to vindicate the corporate right of action if the corporation and the defendant can not be served in the same jurisdiction.[138]

The difficulties of obtaining jurisdiction over all defendants in the state courts can often be overcome by bringing derivative suits in the federal courts based on diversity of citizenship.[139] Federal requirements must of course be satisfied. Thus, to invoke federal diversity jurisdiction, there must traditionally be complete diversity of citizenship between each plaintiff and each defendant.[140]

Aside from the jurisdictional problem, the suing shareholder must also satisfy the venue and service of process requirements. Ordinarily, a diversity suit must be brought in the judicial district where all plaintiffs or all defendants reside,[141] and service of process must be made within the territorial limits of the state in which the federal court sits.[142] The United States Congress, apparently realizing the difficulties that have beset the stockholder, has relaxed these requirements by enacting special rules applicable to derivative actions. Thus, the

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133 *Supra*, page 31.
134 See Constitution of the Philippines, 1 Phil. Anno. Laws, 1956.
135 See Constitution of the United States of America.
136 Dean v. Kellogg, supra, note 106.
137 *Ibid.*, 13 Fletcher, *op cit., supra* note 3, at Sec. 5986, p. 528.
138 BAKER AND CARY, *op. cit., supra* note 4, at 690.
139 *Id.* at 962. Federal jurisdiction may also be invoked where a federal question is involved or where there are other grounds of federal jurisdiction. 13 FLETCHER *op. cit., supra* note 3, at Sec. 5987, p. 529.
140 BAKER AND CARY *op. cit., supra* note 4, at 692. Traditionally, a corporation has ben regarded as a citizen of the state of incorporation, regardless of the citizenship of its stockholders. Louisville, C. & C. Railroad v. Letson, 43 U.S. (2 How.) 496. But since the 1958 amendments to the Judicial Code, for diversity purposes, it is also deemed to be a citizen of the state where it has its principal place of business. 13 Fletcher, *op. cit., supra* note 3, at Sec. 5987, p. 532.
141 28 U.S.C.A., Sec. 1391 (a).
142 Federal Rules of Civil Procedure, Sec. 4 (f).

stockholder may sue in any federal district court "where the corporation might have sued the same defendants,"[143] and service upon the corporation may now be made "in any district where it is organized or licensed to do business or is doing business."[144]

In Delaware, the method used to compel the appearance of non-resident directors of a Delaware corporation in a Delaware Court is to seize their stock,[145] since the situs of stock of all corporations existing under the laws of that State are regarded as in the state.[146]

In Michigan, corporations organized under the laws of that state are required to appoint the resident agent of such corporations as their attorney in fact to receive service of process in actions arising out of or founded upon any action of the corporation or of such person as director, manager, etc.[147]

2. *The Pleadings: Complaint, Motion to Dismiss, Answer and Defenses.*

a. *The Complaint.*

The stockholder's complaint, in addition to naming all the necessary parties to the action,[148] must contain sufficient allegations to show that all the requisites to support the derivative action have been complied with.

Thus, it must allege the existence of a sufficient cause of action in favor of the corporation with the same thoroughness and particularity as would be necessary if the corporation itself was filing the action,[149] it must allege that all intra-corporate remedies have been exhausted,[150] it must allege that the plaintiff was a stockholder at the time of the transaction complained of, or that although he was not a stockholder at the time of the transaction complained of, his shares devolved upon him by operation of law or that such transaction continue and are injurious to him or affect him especially in some other way,[151] and finally, it must allege that plaintiff is willing to give security in those cases where security is required.[152]

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143 28 U.S.C.A., Sec. 1401.
144 28 U.S.C.A., Sec. 1695.
145 Baker and Cary, *op. cit., supra* note 4, at 691; Johnston v. Green, 121 A. 2d 919 (1956).
146 Delaware Code, Title 8, Sec. 169.
147 Baker and Cary, *op. cit., supra* note 4, at 691 citing Act No. 156 (Michigan 1955).
148 Rules of Court of the Philippines, Rule 3, Sec. 2.
149 *Supra*, p. 10-12.
150 *Supra*, p. 13-18.
151 *Supra*, p. 19-26.
152 *Supra*, p. 26-29.

The prayer of the complaint should be framed in such fashion as to ask only for specific relief,[153] but "it may add a general prayer for such further or other relief as may be deemed just or equitable."[154] The reason for this general prayer is that if the specific relief sought is not proper under the facts alleged as plaintiff's cause of action, then the court, under the general prayer, may grant such other relief as the law and the facts proven may warrant.[155]

The Federal Rules of Civil Procedure[156] require that the complaint in a stockholders' suit in the federal court (1) shall be verified by oath, (2) shall aver "that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law", (3) shall aver "that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction," and (4) shall "set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees, and, if necessary, from the shareholders, such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort." These requirements apply equally well to a suit commenced in a state court and afterwards transferred to a federal court.[157]

The complainant must allege a cause of action in favor of the corporation.[158] The relationship of defendants to the corporation and to the wrong must also be alleged.[159] The facts which entitle the stockholder to sue in place of the corporation must likewise be alleged.[160]

b. *Motion to Dismiss and Answer.*

Defects or objections which are apparent on the face of the complaint should be raised by a motion to dismiss.[161] Specific denials, affirmative defenses and objections not apparent on the face of the complaint should be raised by answer.[162]

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[153] Rosales v. Reyes Ordovez, 25 Phil. 495 (1913); Cabigao v. Lim, 50 Phil. 844 (1924); Baguioro v. Barrios, 77 Phil. 120 (1946).

[154] Rules of Court of the Philippines, Rule 6, Sec. 3.

[155] 1 MORAN, *op. cit.*, supra note 125, at 217.

[156] Rule 23 (b).

[157] Watts v. Alexander, Morrison & Co., 34 F 2d 66 (1929); Hitchings v. Cobalt Central Mines Co., 189 Fed. 241 (1910).

[158] Continental Securities v. Belmont, 206 N.Y. 7, 99 N.E. 138 (1912); Briggs v. Kennedy Mayonnaise Products, Inc., 209 Minn. 312, 297 N.W. 342 (1941).

[159] Steinberg v. Carey, 285 App. Div. 1131, 140 N.Y.S. 2d 574 (1955).

[160] Waller v. Waller, 187 Md. 185, 49 A 2d. 449 (1946); Briggs v. Kenedy Mayonnaise Products, Inc., *supra* note 158.

[161] Rules of Court of the Philippines, Rule 16, Sec. 1.

[162] *Id.*, Rule 6; Sec. 4 and 5.

c. *Defenses.*

Any defense that would be good against the corporation if it were suing is good against a claim asserted in its behalf.[163] Thus, if for any reason the corporation is estopped from suing, or its action barred, the suit by the stockholder is likewise affected.[164] However, the claim of the corporation cannot be barred by the conduct or situation of the particular stockholder or stockholders instituting the proceedings.[165]

The defenses that are most frequently raised aside from defenses on the merits are (1) the statute of limitations, (2) laches, and (3) acquiescence.

(1) *Statute of limitations.*

Whenever, the court is faced with the problem of the statute of limitations, it has to make an initial characterization as to what statute of limitations should be applied — law or equity. This is necessary because the statute of limitations in the Philippines apparently distinguishes between equitable and legal actions,[166] and although a stockholder's derivative action is an equitable remedy, there may be legal causes of action joined with the action.

Unfortunately, for want of a case posing this problem, the Philippine Supreme Court has not yet spelled out its position on this matter.

In the United States, a few states have now adopted special statutes of limitations applicable to actions against directors, officers and shareholders of corporations.

The New York Practice Act[167] provides that "an action, legal or equitable, by or on behalf of a corporation against a director, officer

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[163] Kessler v. Ensley Land Co., 148 F. 1019 (5th Cir. 1906).

[164] Chaplin v. Selznick, 186 Misc. 66, 58 N.Y.S. 2d 453 (1945); 13 FLETCHER, *op. cit., supra* note 3, at Sec. 5947, p. 432.

[165] Liken v. Shaffer, *supra* note 17.

[166] Republic Act No. 386, The Civil Code of the Philippines, effective August 30, 1950) [Philippines] provides:

"Art. 1144. The following actions must be brought within 10 years from the time the right of action accrues.
(1) Upon a written contract.
(2) Upon an obligation created by law.
(3) Upon a judgment."

"Art. 1146. The following actions must be instituted within 4 years:
(1) Upon an injury to the rights of the plaintiff.
(2) Upon a quasi-delict."

"Art. 1149. All other actions whose periods are not fixed in this Code or in other laws must be brought within 5 years from the time the right of action accrues."

Equitable actions would seem to fall under article 1149.

[167] Section 48 (8).

or stockholder, or a former director, officer or stockholder" must be commenced within six years after the cause of action accrued, if it is an action for accounting or fraud or to enforce any liability except "one to recover damages for waste or for an injury to property or for an accounting in connection therewith", in which cases it must be brought within three years after the cause of action accrued.

As a general rule, the cause of action accrues as of the date of the commission of the wrongful act "regardless of the date of the discovery or of the continuance in control by" the defendants.[168] It is likewise provided that causes of action for fraud do not accrue until discovery by the plaintiff or the person through whom he claims, but this provision has been inapplicable to cases in which the directors have knowledge of the fraud even though the directors are persons controlled by the wrongdoer.[169]

In Michigan, it is provided that no director shall be held liable after six years from the date of the delinquency or two years from the time of discovery by the person complaining, whichever shall occur sooner.[170]

A more difficult problem arises in determining when the statute of limitations begins to run, especially in cases of fraud. The Philippine statute of limitations[171] provides that an action on the ground of fraud may be brought within four years, "but the right of action in such case shall not be deemed to have accrued until discovery of the fraud." Since a derivative action is filed in behalf of and for the benefit of the corporation, the crucial question is: as of what time is the fraud supposed to have been discovered by the corporation?

A noted writer on Philippine Corporation Law[172] answers this question as follows:

> "Knowledge on the part of the wrongdoing directors should not be imputed to the corporation. The reasons are obvious. The corporation would be powerless to act as long as the directors are in control. Moreover, they should not be allowed to profit by their own misdeeds and plead their own wrongful failure to

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168 Pollack v. Warner Bros. Pictures, Inc., 266 App. Div. 118, 41 N.Y.S. 2d. 225 (1943); Austrian v. Williams, 198 F. 2d. 697 (C.A. 2d 1952), cert. den. 344 U.S. 909 73 S. Cit. 328 (1952).

169 *Lever v. Guaranty Trust Co. of New York*, 289 N.Y. 615, 43 N.E. 2d. 837 (1942). See note, 56 COLUM. L. REV. at 117 (1956) wherein the New York statute was criticized as failing to provide for cases where there is knowledge of the wrongful transaction on the part of the shareholders and whether the defendant directors continue in their position in control of the corporation.

170 Comp. Laws, Sec. 450.47 (1948).

171 Republic Act No. 386, Art. 1152.

172 SALONGA, *op. cit.*, supra note 2, at 346.

> bring suits against themselves. But the statute would run as of the time a new independent director is elected to the board and the facts are available to him, regardless of whether the stockholders had no knowledge. In the absence of an independent director, the statute of limitations begins to run only when the stockholders can be charged with knowledge of the facts constituting the fraud. It is plain that the knowledge of one shareholder should not be imputed to all."

A similar view is expressed by Professors Lattin and Jennings.[173]

(2) *Laches.*

Senator Salonga observes that "the most common, and by far the most effective defense [in a derivative suit] is that of laches. It not infrequently happens that the complaining stockholder had knowledge of the wrong perpetrated by the corporate directors or the controlling stockholders and took no timely steps to have the wrong redressed. His attempt later to attack the transaction may be barred by laches, though the cause of action in fact be meritorious."[174] However, "the dismissal does not disqualify an unstained stockholder from bringing a suit in all respects identical to the first. If the so-called unstained stockholder brings the suit, and a favorable judgment is obtained, the stockholder who was disqualified on account of laches indirectly benefits from the recovery by the corresponding increase in the value of his share, just as if he was an unstained stockholder."[175]

In the United States, the authorities are divided as to the effect of laches as a defense. Some courts hold that mere lapse of time, without more, is not sufficient. The delay must have substantially and actually prejudiced the rights of the defendants.[176] Other jurisdictions hold that a stockholder is not barred by mere lapse of time, unless barred by the statute of limitations.[177]

(3) *Acquiescence.*

Where the complaining stockholder has personally assented to or participated in the wrongful transaction, reason and fairness dictate

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[173] "In fraud cases, the running of the statute commences from the time of 'discovery' of the fraud which means the knowledge of the innocent directors or knowledge of the shareholders as a class rather than that of the plaintiff shareholder, must be considered." LATTIN & JENNINGS, CORPORATIONS, 814 (1959).

[174] SALONGA, *op. cit., supra* note 2, at 347.

[175] *Ibid.*

[176] McLean v. Bradley, 282 F. 1011 (N.D. Ohio, 1922), aff'd. 299 F. 379 (C.C.A. 6th Cir. 1924); Overfield v. Pennroad Corp., 42 F. Supp. 586, 613, 615 (1941); See also LATTIN & JENNINGS, *op cit., supra* note 173, at 814.

[177] Pollitz v. Wabash R. Co., 207 N.Y. 113 (1921).

that he should be precluded from suing to set the transaction aside. This is the general rule in the Philippines.[178]

The same rule prevails in the United States. It has been held that a stockholder who, with knowledge of the facts, has given his consent to, or acquiesced in the injurious acts of the directors, officers or a majority of the stockholders, cannot ordinarily attack such acts afterwards.[179] However, more than the mere form of an assent is required. The assent must be as broad as the thing complained of, and does not extend to ulterior unknown things, or to all the antecedents or consequences of it.[180]

If no other stockholder has joined as plaintiff, the suit may be dismissed against the acquiescing plaintiff.[181] But the dismissal does not bar an unstained stockholder from bringing another suit similar to the first.[182]

3. *Control: Intervention, Consolidation, Settlement, Dismissal, and Stay of Proceedings.*

Where the institution of a derivative action is proper but has not been actually undertaken, all qualified stockholders have an equal right to bring an action on behalf of the corporation. But once a stockholder files the complaint setting the judicial machinery in motion, the privilege of other stockholder to do likewise has been deemed by some courts to be suspended, though not extinguished.[183]

Consequently, if the suit is discontinued by the plaintiff-stockholder, *co instante,* the suspension ceases, and the others regain the privilege. But while it is not discontinued, a suit arising out of the same right of action presented before a competent tribunal may be dismissed by the court on the ground of *lis pendens.*[184] Under the Rules of Court of the Philippines:

> "Defendant may, within the time for pleading, file a motion to dismiss the action on any of the following grounds: . . .
> (d) That there is another action pending between the same parties for the same cause."[185]

The defendants, however, are not entitled to a dismissal as a matter of right even in such a case, for the court may order consolidation

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178 SALONGA, *op. cit., supra* note 2, at 347.
179 13 FLETCHER, *op. cit., supra* note 3, at Sec. 5862, p. 260.
180 *Id.,* at p. 268.
181 *Id.,* at 269.
182 See Salonga, *op. cit., supra* note 2, at 347.
183 *Id.* at 342.
184 *Id.* at 343. See also MORAN, *op. cit., supra* note 125,
185 Rules of the Philippines, Rule 16, Sec. 1.

of all the suits, or it may order a joint hearing or trial of all the matters in issue in the actions,[186] or the subsequent actions may simply be stayed pending the determination of the initial action.[187]

As heretofore noted,[188] the plaintiff-stockholder has the right of control over the whole proceedings. Like every right, it is susceptible of abuse. He may resort to a private settlement with the wrongdoers, in which he is "bought off" or his share purchased by them at a price greatly in excess of its actual market value.[189] He then asks for the dismissal of the suit or simply neglects to prosecute it in which event the action will be dismissed upon motion of the defendants or by the court *motu proprio*.[190] It is also possible for the corporate management to instigate a friendly stockholder to sue obscurely on a valid claim against them, in the hope they would be forever released from accountability by a judgment rendered after an inadequate presentation of the case. In those situations, intervention by other shareholders may well prevent a collusive proceeding from ripening into a bald imposition upon the court.[191]

Under the Philippine Rules of Court, "a person may, at any period of a trial, be permitted by the court, in its discretion, to intervene in an action, if he has a legal interest in the matter in litigation, or in the success of either of the parties, or an interest against both, or where he is so situated as to be adversely affected by a distribution or other disposition of property in the custody of the court or of an officer thereof."[192]

An intervening stockholder, as distinguished from the original plaintiff-stockholder, need not allege prior demand upon the corporation nor exhaustion of intra-corporate remedies before he can move to intervene.[193]

The question of who has the right of control after the intervention is permitted by the courts has not been resolved in the Philippines.

The plaintiff does not have the absolute right to dismiss or compromise a derivative suit. While there is no specific provision of law

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[186] Rules of Court of the Philippines, Rule 31, Sec. 1; Dresdner v. Goldman Sachs Trading Corp., 240 App. Div. 242, 269 N.Y.S. 360 (1934).
[187] Dresdner v. Goldman Sachs Trading Corp. *supra* note 186.
[188] *Supra*, note 113.
[189] See Salonga, *op. cit. supra* note 2, at 343.
[190] Rules of Court of the Philippines, Rule 17, Sec. 1 & 3.
[191] See Salonga, *op cit., supra* note 2, at 344.
[192] Rules of Court of the Philippine, Rule 12, Sec. 2.
[193] De Pinto v. Provident Security Life Insurance Corporation, 323 F. 2d. 826; 19 Am. Jur. 2d p. 103.

governing dismissals and compromises in a derivative action, Philippine courts may invoke the provision of the Rules of Court which states that a "class suit shall not be dismissed or compromised without the approval of the court."[194]

Although a derivative suit is not a class suit, it may, for purposes of the laws on civil procedure, be deemed to be one. After all, the cited provision of the Philippine Rules of Court on class suit was taken from Rule 23 of the American Federal Rules of Civil Procedure which governs the procedure on derivative suits in the federal courts.

Under the Federal Rules of Civil Procedure, it is provided that after the judicial machinery is set into motion, the control of the litigation is with the court, and the "action shall not be dismissed or compromised without the approval of the court."[195] It has been held that after other stockholders join as parties, the original plaintiff has no more control of the suit than the added plaintiffs.[196] Thus, the suit cannot be voluntarily discontinued without the consent of the other stockholders who have been joined as parties,[197] nor may a settlement with the original plaintiffs be binding upon the other stockholders.[198] Furthermore, if the original plaintiff unreasonably neglects to prosecute the action[199] or abandons it,[200] the stockholder who has come in as plaintiff may be allowed to take charge.[201]

Where there is no other shareholder who joins in the action, the rule in New York and in some jurisdiction where there is no statutory provision or rule of court regarding this matter, is that the plaintiff has complete dominion of the action and is free to stipulate with the defendants for a continuance or discontinuance and may dismiss or compromise and settle for his individual damages.[202] The impact of this doctrine was, however, cushioned by the decision in *Clarke v. Greenberg*,[203] wherein it was held that the proceeds acquired by a stockholder in a derivative suit as a result of a private settlement belong to the corporation and not to the individual plaintiff-stockholder.

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194 Rules of Court of the Philippines, Rule 17, Sec. 1.
195 Rule 23 (c). See also Wisconsin Stat., Sec. 180.405 (2) and (3).
196 Goodwin v. Von Cotzhausen, 171 Wis. 351, 177 N.W. 618 (1920).
197 White v. British Type Investors, 130 N.J. Eq. 157. 21 A 2d. 681 (1938).
198 United States Lines Inc. v. United States Lines Co., 96 F. 2d 148 (1938).
199 *Supra* note 197.
200 *Supra* note 198.
201 See BAKER AND CARY, *op. cit., supra* note 4, at 697.
202 See 13 FLETCHER, *op. cit., supra* note 3, at Sec. 6020, p. 623 and cases cited.
203 296 N.Y. 146, 71 N.E. 2d. 443 (1947).

Other cases hold that the plaintiff in a derivative suit has no absolute right to dismissal as he acts in a highly fiduciary character as to the corporation which is the real party in interest. His position as plaintiff is compared to that of guardian *ad litem* suing for an incompetent person. The sole authority to determine whether the action ought to be dismissed is with the court.[204]

4. *Judgment: Extent of Relief, Conclusiveness.*

In the Philippines, the plaintiff is entitled to as much relief as the law and the facts proved may warrant although the relief is not specifically demanded.[205] Although in a derivative action, the plaintiff is the individual shareholder, he is merely the "instigator" of the action,[206] i.e., the one who sets the judicial machinery in motion in behalf of the corporation.[207]

Consequently, since the suits is in behalf and for the benefit of the corporation, the relief will be exactly the same as the corporation might have had if it had been the plaintiff itself.[208] And any judgment that may be rendered shall be decreed in favor of the corporation.[209]

No proportionate judgment can be allowed a stockholder, as a general rule, because the recovery is an asset of the corporation, and its creditors have first claim upon it; and that to award such recovery directly to the stockholders leaving the creditor unpaid, would be fraudulent as to them.[210]

There are cases, however, which hold that direct relief to the plaintiff-stockholders in a derivative suit is proper where other stockholders either assented to defendents' acts or waived their rights.[211]

It is of course the rule, both in the Philippines[212] and in the United States[213] that a judgment or decree in a stockholder's derivative suit upon the same subject matter and upon the same cause of action is a

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204 Whitten v. Dabney, 171 Cal. 621, 630, 154 P. 312, 316 (1915). See also Goodwin v. Castleton, 19 Wash. 2d 748, 144 P. 2d 725 (1944).
205 2 MORAN, *op. cit., supra* note 125, at 217.
206 Potter v. Walker, 252 App. Div. 244 (1937).
207 Overfield v. Pennroad Corporation, *supra* note 176.
208 Collins v. Penn-Wyoming Copper Co., 203 F. 726 (1912).
209 See Liken v. Shaffer, supra note 17.
210 *Ibid.*
211 Backus v. Finkelstein, 23 F. 2d 357 (1927); Bailey v. Jacobs, 325 Pa. 187, 189 A. 320 (1937); Chounis v. Laing, 125 W. Va. 275, 23 S.E. 2d. 628, 640 (1942).
212 Rules of Court, Rule 39, Sec. 49 (b).
213 Liken v. Shaffer *supra* note 17.

bar to other such suits on the same subject matter and upon the same cause of action. In other words, the judgment or decree is *res judicata.*

In order that a judgment rendered in a case may be conclusive in a subsequent case, the following requisites must be present:

> "(a) It must be a final judgment or order;
>
> (b) The court rendering the same must have jurisdiction of the subject matter and of the parties;
>
> (c) It must be a judgment or order on the merits;
>
> (d) There must be between the two cases identity of parties, identity of subject matter, and identity of cause of action."[214]

There are, however, a number of decisions in the United States holding that a decree in a stockholders' suit brought by named stockholders, but not in behalf of other stockholders who might join, is not *res judicata* as to such other stockholders and that the decree does not bind other stockholders on whose behalf it is brought but who do not join as plaintiffs.[215]

5. *Costs, attorney's fees and indemnification.*

a. *Costs.*

Both in the Philippines[216] and in the United States[217] the ordinary rules of costs in equity apply. Where the suit is successful, they are ordinarily awarded to the plaintiff and against all the defendants or against the corporate directors, officers or stockholders whose conduct rendered the litigation necessary.[218] But where the suit is unsuccessful, costs are awarded against the unsuccessful plaintiffs.[219] Costs may be denied to both parties in a proper case.[220]

It should be noted, however, that in assessing costs, the suit is the plaintiff-stockholder's, as distinguished from the cause of action which is the corporation's, and hence the costs go to the plaintiffs or against them as individuals *per capita* and not *pro rata* on their shares.[221] And an intervenor cannot be taxed with costs which accrued before he joined the action.[222]

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214 2 MORAN, *op. cit., supra* note 125, at 323.
215 See 13 FLETCHER, *op. cit., supra* note 2, at Sec. 6043, p. 668.
216 Angeles v. Santos, *supra* note 32.
217 See 13 FLETCHER, *op cit, supra* note 3, at Sec. 6044.
218 *Ibid.*
219 *Ibid.*
220 Pascual v. Orozco, supra note 14.
221 Edwards v. Bay State Gas Co. of Delaware, 130 Fed. 242.
222 Whitten v. Dabney, *supra* note 204.

b. *Attorney's fees and other expenses of complainant.*

It is obvious that if the complaining stockholder loses, he is not entitled to attorney's fees, the reason being that "he is at best a self-appointed champion of a fancied wrong."[223]

But in those cases where the plaintiff-shareholder prevailed, the Philippine Supreme Court did not award attorney's fees to such shareholder. This may, in part, be attributed to the fact that prior to the adoption of the new Civil Code in 1950[224] the general rule in the Philippines was that each party to the action must bear his own expenses of litigation and pay his own lawyer.[225] With the enactment of the new Civil Code, attorney's fees and expenses of litigation may now be recovered by the prevailing party against the losing party in certain special cases, e.g., when the defendant's act or omission has compelled the plaintiff to litigate with third persons or to incur expenses to protect his interest; where the defendant acted in gross and evident bad faith in refusing to satisfy the plaintiff's plainly valid, just and demandable claim; and in any other case where the court deems it just and equitable that attorney's fees and expenses of litigation should be recovered.[226]

Notwithstanding the very liberal provisions of the new Civil Code on attorney's fees, the courts in the Philippines have been very reluctant in implementing it because of their fear, albeit, far-fetched, that litigation would be encouraged.[227]

Granting that an allowance for attorney's fees is proper, the delicate question of how much should be awarded emerges. If the contract between the plaintiff and his counsel is on a straight or fixed fee basis, it will ordinarily control "unless found to be unconscionable or unreasonable."[228] If it is on a contingent basis, courts tend to be more liberal in their awards, and although the stockholder and the lawyer may have fixed a percentage of whatever amount may be recovered, the courts will inquire into the importance of the subject matter of the controversy, the extent of the services rendered, and the professional standing of the attorney.[229]

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223 SALONGA, *op. cit., supra* note 2, at 349. See also Hutchinson Box Board & Paper Co. v. Van Horn, 299 F. 2d. 424.
224 Republic Act No. 386 (August 30, 1950) [Philippines].
225 See 4 GARCIA AND ALBA, CIVIL CODE OF THE PHILIPPINES 2441 (1952).
226 Republic Act No. 386, Art. 2208 (August 30, 1050) [Phil.].
227 See *supra* note 225.
228 Rules of Court of the Philippines, Rule 138, Sec. 24.
229 *Ibid.*

The general rule in the United States is that if the plaintiff-shareholder succeeds in obtaining money or property for the corporation by means of a derivative action, he is entitled to reimbursement out of the proceeds for reasonable attorney's fees and other reasonable litigation expenses, such as accountant's fees.[230] Even if there are no proceeds out of which reimbursement can be made, he is entitled to reimbursement by the corporation if the litigation has benefited it in some way, as for example by bringing about the cancellation of a disadvantageous contract,[231] or the prevention of an *ultra-vires* act.[232] But in no instance is the stockholder himself entitled to separate compensation.[233]

In derivative actions, there is generally no contractual relationship as to legal services except between the complainant who commences the litigation and his attorneys.[234] Plaintiff-shareholders do not represent the corporation in the sense of agents who may bind it by contract for a contingent fee in the event of success and consequently, the suing stockholder cannot enter into an agreement to bind the corporation to the payment of either costs or attorney's fees in the event the suit proves unsuccessful.[235] In such case, the plaintiff's attorney gets nothing from the corporation and usually gets little or nothing from the client.[236]

The determination of allowances for attorney's fees is left to the discretion of the court.[237] In determining such allowances, "consideration should be given to the amount recovered for the corporation; the time fairly required and employed on the case with reference to the intricacy, novelty and complexity of issues; the difficulty encountered in unearthing the facts and the skill and resourcefulness of opposing counsel; the prevailing rate of compensation for those with the skill, experience and standing of attorney's accountants or others involved; the contingent nature of the fees, with the accompanying

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230 See BAKER AND CARY, *op. cit., supra* note 4, at 717; 13 FLETCHER, *op. cit., supra* note 3, at Sec. 6045.

231 See Baker and Cary, *op. cit., supra* note 4, at 717. See also *Runswick v. Floor,* 208 P 2d 948.

232 13 FLETCHER, *op. cit., supra* note 3, at Sec. 6045. In Goodwin v. Castleton, 150 ALR 859, reimbursement for payment of counsel's fees was also granted in cases of settlement.

233 Eisenberg v. Central Zone Property Corp., 1 App. Div. 2d. 353, 149 N.Y.S. 2d 840 (1956).

234 13 FLETCHER, *op. cit., supra* note 3, at Sec. 6045; BAKER AND CARY, *op. cit., supra* note 4, at 717.

235 13 FLETCHER, *op. cit., supra* note 3, at Sec. 6045.

236 BAKER AND CARY, *op. cit., supra* note 4, at 717.

237 *Ibid.*

risk of wasting hours of work, overhead and expenses; and the benefits accruing to the public from suits such as this."[238]

It has been said that "allowances in causes of this kind, however, should not be niggardly for appetite for effort in corporate therapeutics should, as in salvage and bankruptcy cases, be encouraged."[239]

c. *Indemnification of defendant directors, etc.*

On the other side of the ledger, if the complaining stockholder loses, the question arises whether the corporate directors and officers who defended the suit and who won should be indemnified for the expenses, including attorney's fees, which they incurred in the litigation.

There is nothing said in the Philippine Corporation Law on this point and the cases decided by the Supreme Court on derivative suits are likewise silent.

In the Philippines, the directors and officers of a corporation are regarded as its agents and though not strictly trustees, they occupy a fiduciary relation towards it.[240] Under Philippine Law, there appears to be a consistent policy of reimbursement of the expense incurred by fiduciaries, particularly where they incur expenses in the successful defense of a suit.[241]

Senator Salonga makes out a strong case in support of reimbursement for corporate directors and officers who succeed in defending a suit. He says:

> "[A] fiduciary who successfully shows, on the merits of the case, that his acts were motivated by good faith and within the reasonable bounds of business judgment, has demonstrated his fidelity and should not in fairness be required to pay for such demonstration, when he has by hypothesis invited no challenge.
>
> "That the litigation expenses should be charged to the corporate funds is understandable and just. If the complaining stockholder wins, all are benefited in proportion to their interest. The

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[238] 13 FLETCHER, *op. cit., supra* note 3, at Sec. 6045, p. 684. See also Angoff v. Goldfine, 270, F 2d 185 (C.A. 2nd Cir. (1959).

[239] Murphy v. North American Light & Power Co., 33 F. Supp. 567, 571 (S.D.N.Y. 1940) where a fee of $ 200,000.00 was awarded to two attorneys in a suit which resulted in a $900,000.00 benefit to the corporation. *Contra*: Eisenberg v. Central Zone Property Corp., *supra* note 233, at 842 where the court held: "There is a serious question in our mind, as a matter of public policy, whether a stockholder instituting a derivative action against a corporation should be allowed compensation as an attorney in the litigation. Certainly the institution of such action and the undertaking of litigation for the purposes of seeking a counsel fee should not be encouraged."

[240] 2 MARTIN, PHILIPPINE COMMERCIAL LAWS 394 (1958).

[241] See Rules of Court of the Philippines, Rule 85, Sec. 6 and 7. See also 3 MORAN, *op. cit., supra* note 125, at 416-420.

converse should likesewise be true. Furthermore, this would be an effective discouragement to strike suits. A rule that would permit one to claim benefits, without making him assume the corresponding burdens, may well promote irresponsibility.

"If absolute denial of reimbursement were the rule, some undesirable results would inevitably follow: (1) corporations in great need of capable men may not be able to engage their services; (2) or the same corporations may be able to obtain their services through the use of some subterfuges which is worse; (3) or, if these subterfuges are not resorted to it may well be that stockholders will eventually stand to lose by the lack of enterprise and initiative on the part of managers who may not dare introduce novel ideas at the risk of facing an expensive litigation, and without hope of reimbursement even if they can prove that the ideas benefited the corporation."[242]

Whether the Philippine courts will extend the same measure of benefit to corporate directors and officers as they do to other fiduciaries is difficult to predict. It should be noted that in those instances where fiduciaries are allowed reimbursement, there is a statute or rule of court specifically allowing the same.[243]

There is a dictum in the early Philippine case of *Maage v. Anderson*,[244] to the effect that in the absence of a clear, definite and certain authority from the corporation itself, the manager of a corporation has no legal right to charge the corporation with the legal expenses which he incurred in defending himself in a criminal action in which he was the sole defendant. However, to infer from this broad proposition that if there is a clear, definite and certain authority from the corporation itself, all the legal expenses incurred by a corrate officer or director in any suit or proceeding may be reimbursed, would perhaps be going a bit too far.

It has been held in the Philippines that an officer, agent, or servant of a corporation who does an act forbidden by law is responsible for it in his own person. And when the corporation itself is forbidden to do an act, the prohibition extends to the board of directors and to each director, separately and individually.[245]

In the United States, the authorities are again divided on the question whether successful directors and officers are entitled to indemnity for the reasonable expenses of defending themselves in a shareholder's derivative suit.

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[242] SALONGA, *op. cit., supra* note 2, at 350.
[243] *Supra* note 241.
[244] 49 Phil. 429 (1926).
[245] People v. Concepcion, 44 Phil. 126 (1922); People v. Tan Boon Kong, 54 Phil. 607 (1930).

In one of the early cases which had come to grips with the problem, it was held that "if no case is made against defendants it is not improper or unjust that the corporation should pay for the defense of the action."[246]

Later, in the off-cited case of *New York Dock Co. v. McCollom*,[247] the New York Supreme Court held that there was no obligation "based upon equitable considerations" which would justify application for reimbursement, "but if a director can clearly and persuasively demonstrate to the court upon an application for reimbursement or when called upon to refund corporate money already received by way of reimbursement, that in conducting his own defense successfully he has conserved some substantial interest of the corporation which otherwise might have been missed, the court may direct or confirm reimbursement as the case may be."

Thereafter, in *Solimine v. Holander*,[248] a New Jersey court reached the opposite conclusion, upholding the common law right of a director to reimbursement for the expenses of resisting unjust charges of misconduct in office . Relying upon this case and the case of *In re E. C. Warner Co.*,[249] the third Circuit Court of Appeals concluded that the trend was in favor of the innocent directors' common-law right of indemnification.[250]

Professor Bishop of the Yale Law School observes that "the common law governing a director's right to indemnification is a welter of confusion. After the *McCollom* case had, as it were, focused the confusion, there was a not unnatural cry for legislation."[251]

Three policy reasons have been advanced for indemnifying a director for successfully resisting charges filed against him, namely: (1) to encourage innocent directors to resist unjust charges and provide them an opportunity to hire competent counsel; (2) to induce "responsible business men to accept the post of directors"; and (3) to discourage in large measure stockholders' litigation of the strike variety.[252]

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[246] Figge v. Bergenthal, 130 Wis. 594, 625, 109 N.W. 581, 592 (1907).
[247] 173 Misc. 106, 16 N.Y.S. 2d 844 (Sup. Ct. 1939).
[248] 129 N.J. Eq. 264, 19 A. 2d 344 (1941).
[249] 232 Minn. 207, 45 N.W. 2d. 388 (1950).
[250] Mooney v. Willys-Overland Motors, Inc., 204 F. 2d 888, 899 (C.A. 3d 1953).
[251] Bishop, *Current Status of Corporate Directors' Right to Indemnification*, 69 HARV. L. REV. 1057, 1068 (1956).
[252] BAKER AND CARY, *op. cit.*, *supra* note 4, at 727.

Twenty-seven states and the District of Columbia have now enacted indemnification statutes.[253] According to Professor Bishop, basically, the statutes are of two types, although they present a somewhat bewildering variety of detail. The commoner type simply provides that the corporation shall have power to indemnify in certain cases, or that it may, by action of its stockholders, make such provision in its charter or by-laws: e.g. Del. Code Ann. Tit. 8., 122 (10), 1953; N.J. Rev. Stat. Sec. 14:3-14. The others grant to directors, officers, or employees a right to indemnification in certain cases: e.g. Calif. Corp. Code Ann., Sec. 830; Pa. Stat. Ann., Tit. 12, Sec. 1323. New York is one of a small number of states which have both types. New York's statutes are fairly typical.[254]

Section 63 of the New York Corporation Law provides that the certificate of incorporation, an amendment to the certificate of incorporation adopted by a majority vote of the stockholders, another certificate filed pursuant to law, the by-laws, or a resolution in a specific case, may authorize the indemnication by the corporation of directors, officers, or employees for the reasonable expenses, including attorney's fees, actually and necessarily incurred in the defense of any action, suit or proceeding by reason of their corporate office, unless they are adjudged liable for negligence or misconduct in the performance of their duties. Such rights of indemnification shall not be deemed exclusive of any other rights which they may be entitled apart from the statute. Section 64 supplements the previous section by providing a right to have such expenses for the defense of the action, suit or proceeding, assessed against the corporation. Section 65 provides that the application for assessment of expenses may be made either (a) in the same action, suit or proceeding in which the expenses were incurred, or (b) in a separate proceeding before the supreme court. Section 66 requires that notice of the application must be made to the corporation and the court may also direct that notice be given to such persons as it may designate and in such manner as it may require. Section 67 defines the extent of the court's power to grant the application.

A number of criticisms have been leveled against the New York statute, among them being, that it "draws no distinction between suits in the right of the corporation and suits by third parties,"[255] that it

[253] See 13 FLETCHER, *op. cit., supra* note 3, at Sec. 6045.
[254] Bishop, *op. cit., supra* note 251 at 1069.
[255] *Id.* at 1074. See also BAKER AND CARY, *op. cit., supra* note 4, at 728.

does not clearly define the limits of the freedom of a corporation to provide for indemnification,[256] and that it fails to define the meaning of the words "negligence or misconduct in the performance of his duties."[257]

"In this welter of uncertainty," Professor Bishop suggests a caveat to corporate directors "not to place too much reliance upon the statutory panacea," because "the director's best protection will probably continue to lie in carefully drawn charter or by-law provisions, perhaps supplemented in special cases by *ad hoc* contracts."[258]

Philippine corporations do not ordinarily include provisions for indemnification in their charter or by-laws.

VII. POSSIBLE ALTERNATIVES TO THE SHAREHOLDERS' SUIT

Dissatisfaction with the shareholders' suit as a device to insure the faithful compliance of the fiduciary duties of corporate directors and officers and to check the abuses of management, as being expensive, hazardous and clumsy[259] has brought forth a number of suggestions to substitute or supplement it.

Justice Douglas of the United States Supreme Court suggests that investors throughout the country unite to form an agency to investigate and prosecute charges of wrongdoing by the management.[260] Berlack advocates the establishment of a government agency with similar functions.[261] Dean Roscoe Pound suggests that the Attorney-General be vested with the power to invoke the visitorial power traditionally possessed by courts of equity over corporations.[262] Hornstein urges that dissolution of corporations be imposed more frequently as a penalty for corporations dealing unfairly with the minority.[263] Washington suggests the creation of a committee within the corporation charged with the duty of investigation and mediation which might be com-

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256 Bishop, *op. cit., supra* note 251, at 1070.
257 *Id.* at 1076.
258 *Id.* at 1079.
259 Washington, *Stockholders' Derivative Suits: The Company's Role and a Suggestion*, 25 CORNELL L. Q. 361, 375. See also Berlack, *Stockholders' Suits, A Possible Substitute*, 35 MICH. L. REV. 597, 600 (1936).
260 Douglas, Directors Who Do Not Direct, 47 HARV. L. REV., 1305, 1326 (1934).
261 Berlack, *op. cit., supra* note 259, at 608.
262 Pound, Visitatorial Jurisdiction Over Corporations In Equity, 49 HARV. L. REV. 369, 395 (1936).
263 Hornstein, *A Remedy for Corporate Abuses — Judicial Power to Wind Up A Corporation at the Suit of a Minority Stockholder*, 40 COLUM. L. REV. 220, 226-230 (1940).

posed of a director, a lawyer, and an accountant, to be chosen annually by the stockholders.[264]

It is believed that none of the foregoing suggestions would be workable in the Philippines at this time. A national investors' protective group as suggested by Justice Douglas would doubtless be directed chiefly towards corporations in which its members had investments.[265] One such agency in the United States[266] has had little opportunity to prove its worth.[267]

The suggestion of Berlack that a government agency be established to investigate and prosecute charges of wrongdoing by the management would not be effective in the Philippines. Past events and current trends indicate that government regulatory agencies, including the Securities and Exchange Commission, can hardly be relied upon to do this task, for most of them are staffed with political hirelings who are generally incompetent, indifferent and in many cases subject to political pressure.

Past experience with the office of the Solicitor General of the Philippines indicates that the likely result of Dean Pound's suggestion to invest him with power to invoke visitorial powers of courts of equity would be a "do nothing" policy.[268] Under the Rules of Court of the Philippines,[269] the Solicitor-General is empowered to institute *quo warranto* proceedings against a corporation for violation of law or corporate charter and for misusing corporate rights, privileges or franchises. Since that office was organized almost half a century ago, it appears that the power was exercised very rarely[270] and probably may never have been exercised at all if not for the fact that the abuses of power in those instances were so flagrant and scandalous.

Neither can the idea of imposing the death penalty on offending corporations be an effective remedy. The average dissatisfied stockholder does not want to liquidate the corporation — he can probably sell his stock on the market for more than he would derive from a forced break-up of the corporation. Furthermore, dissolution of the corporation might produce real harm to the community, particularly

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264 Washington, *op. cit., supra* note 259, at 377-378.
265 *Id.* at 375.
266 American Investors Union, Inc., New York City.
267 Washington, *op. cit., supra* note 259, at 375.
268 See LATTIN & JENNINGS, *op. cit., supra* note 173, at 842.
269 Rule 66, Sec. 2, 3 and 4.
270 See Government v. Philippine Sugar Estates Dev. Co. 38 Phil. 15 (1918) and Government v. El Hogar Filipino, 50 Phil. 399 (1927).

to its employees, without substantially benefiting the minority stockholder.[271]

Washington's suggestion that a committee within the corporation be created to investigate possible abuses by management is worth pursuing. If one can find sufficient men in the Philippines of integrity and stature, the suggestion can be implemented. But until such men can be found, it may perhaps be better to improve the remedy we have at hand — derivative suit — rather than go looking for more in the woods.

VIII. CONCLUSION AND RECOMMENDATIONS

The state of the law on shareholder's derivative suits in the Philippines leaves much to be desired. There is not a single provision of the Philippine Corporation Law on the subject of derivative suits and the cases decided by the Supreme Court have not established clearly defined principles on this matter.

As we have noted previously, only less than a dozen derivative suits have been filed in the country since the introduction of the corporate mechanism at the turn of the century. This may indicate that the shareholders have found the remedy unsatisfactory or inadequate in its present form. On the other hand, it is safe to assume that the number of abuses perpetrated by management upon the unwary or apathetic investors is legion.

In the light of these circumstances, the need to breathe the breath of life into the shareholders' derivative suit becomes imperative if the corporate mechanism is to continue.

It is, therefore, recommended that a new chapter on derivative suits be added to the present Philippine Corporation Law containing, among others, the following features:

First. That derivative actions may be brought not only for the wrongful acts of corporate directors, officers and majority shareholders, but also for those of third persons which are prejudicial to the interests of the corporation.

The case law in the Philippines allows derivative actions to be brought for the wrongful acts of corporate directors, officers and shareholders but is silent with regard to the wrongful acts of third persons. It is believed that an injury to the corporation must be redressed regardless of who causes it.

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[271] See Washington, *op. cit., supra* note 259, at 376.

Second. That in any derivative suit instituted by a stockholder, he must allege and prove that a demand upon the board of directors to bring the action was made and that they failed or refused to do so or that it must be shown that a sufficient reason exists for not making such demand.

It is believed that the "Federal rule" requiring that a demand be made upon the shareholders if necessary and if time permits should not be adopted in the Philippines because of the general indifference of Filipino investors and because of the impracticability of getting them all together.

Third. That the contemporaneous-ownership requirement should be jettisoned and replaced by the simple requirement that in any derivative action, it is sufficient if the plaintiff alleges and proves that he is a stockholder of the corporaton at the time of the institution of the action.

As heretofore noted, the plaintiff-shareholder in a derivative action is merely the "instigator" of the suit because it is the corporation itself and not he personally that has suffered the injury. Consequently, the fact that he was not a shareholder at the time of the transaction complained of does not alter the fact that an injury has been done to the corporation. The fear expressed by the Philippine Supreme Court that stockholders would buy stock simply for the purpose of bringing suit may be dispelled by providing that any recovery goes to the corporate till and not to the plaintiff-shareholder's pocket and by providing that any settlement or compromise of the suit must be with the approval of the court and that the proceeds of such settlement be turned over to the corporation.

Fourth. That instead of requiring the plaintiff-shareholder to put up security for costs and expenses, it is sufficient to provide that in case the derivative suit is found to be malicious and palpably unfounded or unjustified, the plaintiff be made to pay all the court costs and reasonable expenses, including attorney's fees, incurred by the defendants.

It is submitted that, whatever may be the merits of the security-for-costs statutes, none should be adopted in the Philippines. Although Philippine corporate practice follows the American trend, the Filipino stockholder has not yet attained as high a level of sophistication as his American counterpart and there is no sufficient basis for believing that in the foreseeable future, collusive and "strike suits" which are the mischiefs sought to be prevented by this type of statutes, will come

to bear in the Islands, as evidenced by the fact that there have been only less than a dozen derivative suits in the Philippines, none of which was of the strike variety. This does not mean, however, that collusive and "strike suits" are altogether unlikely in the future, but this potential danger can be sufficiently guarded against by other methods already adverted to.

Fifth. That the corporation in whose behalf and for whose benefit the derivative action is instituted should be made a party defendant to the suit if it is unwilling to join as co-plaintiff. Only by making the corporation a party of record can it benefit from the proceeds of the action. Likewise, the need to protect the actual defendants, i.e. the wrongdoers, against any further suit by the corporation makes the inclusion of the corporation in the suit all the more imperative.

The extent of the participation of the corporation in the suit should be left to the discretion of the court and should not be made the subject of legislative restrictions. In the exercise of this discretion, the courts should always take into account the nature of the complaint and the interest of the corporation in the controversy; and permit the corporation to be an active participant only when the cause of action is such as to endanger rather than advance corporate interests.

Sixth. A statute of limitations specially applicable to derivative actions must be enacted by providing that any action, legal or equitable, by or on behalf of a corporation against a director, officer or stockholder or a third person for an injury to the corporation, shall be barred if not commenced within six years after the cause of action accrued. The cause of action accrues as of the date of the discovery of the act complained of by the party who is otherwise entitled to bring the action.

Under this rule, knowledge on the part of the wrongdoing directors would not be imputed to the corporation. The statute would begin to run only as of the time a new independent board of directors acquire knowledge of the wrong. In the absence of an independent board, the statute would begin to run only as of the time a complaining shareholder acquires knowledge thereof.

Seventh. That if the plaintiff-shareholder prevails, he shall be entitled to reimbursement for the reasonable costs, attorney's fees and other expenses of litigation incurred by him. Such reimbursement shall be taken out of the proceeds of the action, but if the action is one which does not involve a money judgment, then from the corporation's treasury.

It is but just that the plaintiff-shareholder be reimbursed. Moreover, the prospect of reimbursement would encourage shareholders to be more militant in exercising their traditional right to check corporate management. The limitation of the reimbursement to "reasonable" amounts would be a sufficient deterrent to purely speculative or malicious actions.

Eight. The litigation expenses incurred by the corporate directors, officers and shareholders who successfully defend the action on the merits of the case should likewise be reimbursed by the corporation. In cases of settlement, courts should have the discretion to award reimbursement.

Simple justice and the need to induce capable and responsible men to serve as directors are cogent reasons for the incorporation of this feature.

In making the foregoing recommendations, we have been met with the difficult task of balancing conflicting claims and interests and "finding out by experience and developing by reason the modes of adjusting relations and ordering conduct which will give the most effect to the whole scheme of interests with the least friction and the least waste."[272] We shall leave it to the ultimate decision-makers to judge whether these recommendations have struck a "happy balance."

[272] POUND, SOCIAL CONTROL THROUGH LAW, 134 (1942).