THIRD DIVISION

[G.R. No. 210906. October 16, 2019]

AGO REALTY & DEVELOPMENT CORPORATION (ARDC), EMMANUEL F. AGO, and CORAZON CASTAÑEDA-AGO, *petitioners, vs.* **DR. ANGELITA F. AGO, TERESITA PALOMA-APIN, and MARIBEL AMARO,** *respondents.*

[G.R. No. 211203. October 16, 2019]

DR. ANGELITA F. AGO, *petitioner, vs.* **AGO REALTY & DEVELOPMENT CORPORATION, EMMANUEL F. AGO, CORAZON C. AGO, EMMANUEL VICTOR C. AGO, and ARTHUR EMMANUEL C. AGO,** *respondents.*

SYLLABUS

1. MERCANTILE LAW; THE CORPORATION CODE; CORPORATIONS; POWERS; THE POWER TO SUE IS LODGED IN THE BOARD OF DIRECTORS, ACTING AS A COLLEGIAL BODY; A CASE INSTITUTED BY A CORPORATION WITHOUT AUTHORITY FROM ITS BOARD OF DIRECTORS IS SUBJECT TO DISMISSAL ON THE GROUND OF FAILURE TO STATE A CAUSE OF ACTION.— While corporations are subjected to the State's broad regulatory powers, it is their directors and officers who are tasked with addressing questions of internal policy and management. **The business of a corporation is conducted by its board of directors, and so long as the board acts in good faith, the State, through the courts, may not interfere with its management decisions**. This finds support in Section 23 of the Corporation Code, which provides that a corporation exercises its powers, conducts its business, and controls and holds its property through its board of directors. As creatures of the law, corporations only possess those powers that are granted through statute, either expressly or by way of implication, or those that are incidental to their existence. One of the powers expressly granted by law to

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corporations is the power to sue. As with other corporate powers, **the power to sue is lodged in the board of directors**, acting as a collegial body. Thus, in the absence of any clear authority from the board, charter, or by-laws, no suit may be maintained on behalf of the corporation. A case instituted by a corporation without authority from its board of directors is subject to dismissal on the ground of failure to state a cause of action.

2. ID.; ID.; ID.; DERIVATIVE SUITS; MINORITY STOCKHOLDERS MAY BRING SUITS ON BEHALF OF CORPORATIONS WHERE THE BOARD OF DIRECTORS ITSELF IS A PARTY TO THE WRONG, EITHER BECAUSE IT IS THE AUTHOR THEREOF OR BECAUSE IT REFUSES TO TAKE REMEDIAL ACTION.—As an exception to the x x x rule, jurisprudence has recognized certain instances when **minority stockholders may bring suits on behalf of corporations**. Where the board of directors itself is a party to the wrong, either because it is the author thereof or because it refuses to take remedial action, equity permits individual stockholders to seek redress. These actions have come to be known as **derivative suits**. In *Chua v. Court of Appeals*, the Court defined a derivative suit as "**a suit by a shareholder to enforce a corporate cause of action**."

3. ID.; ID.; ID.; ID.; IN DERIVATIVE SUITS, THE CORPORATION IS THE REAL PARTY IN INTEREST AS IT IS THE VICTIM OF THE WRONG, WHILE THE RELATOR-STOCKHOLDER IS MERELY A NOMINAL PARTY; THE JUDGMENT RENDERED IN THE SUIT MUST CONSTITUTE *RES JUDICATA* AGAINST THE CORPORATION, EVEN THOUGH IT REFUSES TO SUE THROUGH ITS BOARD OF DIRECTORS.— In derivative suits, it is the corporation that is the victim of the wrong. As such, it is the corporation that is properly regarded as the real party in interest, while the relator-stockholder is merely a nominal party. The corporation must be impleaded so that the benefits of the suit accrue to it and also because it must be barred from bringing a subsequent case against the same defendants for the same cause of action. Stated otherwise, the judgment rendered in the suit must constitute *res judicata* against the corporation, even though it refuses to sue through its board of directors.

4. ID.; ID.; ID.; ID.; AN INDIVIDUAL STOCKHOLDER IS PERMITTED TO INSTITUTE A DERIVATIVE SUIT ON

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BEHALF OF THE CORPORATION WHEREIN HE HOLDS STOCK IN ORDER TO PROTECT OR VINDICATE CORPORATE RIGHTS, WHENEVER OFFICIALS OF THE CORPORATION REFUSE TO SUE OR ARE THE ONES TO BE SUED OR HOLD THE CONTROL OF THE CORPORATION; WHERE THE ACTS COMPLAINED OF CONSTITUTE A WRONG TO THE CORPORATION ITSELF, THE CAUSE OF ACTION BELONGS TO THE CORPORATION AND NOT TO THE INDIVIDUAL STOCKHOLDER OR MEMBER.— [N]ot every wrong suffered by a stockholder involving a corporation will vest in him or her the standing to commence a derivative suit. In *Cua, Jr., et al. v. Tan, et al.*, the Court explained when such actions lie, *viz.*: Suits by stockholders or members of a corporation based on wrongful or fraudulent acts of directors or other persons may be classified into individual suits, class suits, and derivative suits. Where a stockholder or member is denied the right of inspection, his suit would be individual because the wrong is done to him personally and not to the other stockholders or the corporation. Where the wrong is done to a group of stockholders, as where preferred stockholders' rights are violated, a class or representative suit will be proper for the protection of all stockholders belonging to the same group. **But where the acts complained of constitute a wrong to the corporation itself, the cause of action belongs to the corporation and not to the individual stockholder or member**. Although in most every case of wrong to the corporation, each stockholder is necessarily affected because the value of his interest therein would be impaired, this fact of itself is not sufficient to give him an individual cause of action since the corporation is a person distinct and separate from him, and can and should itself sue the wrongdoer. Otherwise, not only would the theory of separate entity be violated, but there would be multiplicity of suits as well as a violation of the priority rights of creditors. Furthermore, there is the difficulty of determining the amount of damages that should be paid to each individual stockholder. However, in cases of mismanagement **where the wrongful acts are committed by the directors or trustees themselves, a stockholder or member may find that he has no redress because the former are vested by law with the right to decide whether or not the corporation should sue, and they will never be willing to sue themselves**. The corporation would thus be helpless to seek

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remedy. Because of the frequent occurrence of such a situation, the common law gradually recognized the right of a stockholder to sue on behalf of a corporation in what eventually became known as a "derivative suit." **It has been proven to be an effective remedy of the minority against the abuses of management**. Thus, an individual stockholder is permitted to institute a derivative suit on behalf of the corporation wherein he holds stock in order to protect or vindicate corporate rights, whenever officials of the corporation refuse to sue or are the ones to be sued or hold the control of the corporation. In such actions, the suing stockholder is regarded as the nominal party, with the corporation as the party in interest.

5. ID.; ID.; ID.; ID.; THE INSTITUTION OF A DERIVATIVE SUIT NEED NOT BE PRECEDED BY A BOARD RESOLUTION.— The record reveals that the complaint *a quo* was filed by Emmanuel, *et al*. While the caption states that ARDC was also one of the plaintiffs, there is nothing showing that the corporation's Board of Directors had authorized the filing of the case. Thus, the case is deemed as instituted by Emmanuel, *et al*. without ARDC's acquiescence. x x x [T]he corporate power to sue is exercised by the board of directors. For this purpose, the board may authorize a representative of the corporation to perform all necessary physical acts, such as the signing of documents. Such **authority may be derived from the by-laws or from a specific act of the board of directors**, *i.e.*,a board resolution. x x x. However, in derivative suits, the recognized rule is different. **Since the board is guilty of breaching the trust reposed in it by the stockholders, it is but logical to dispense with the requirement of obtaining from it authority to institute the case and to sign the certification against forum shopping**. It has been held that when "the corporation x x x is under the complete control of the principal defendants in the case, x x x it is obvious that a demand upon the [board] to institute an action and prosecute the same effectively would [be] useless, and the law does not require litigants to perform useless acts." **Thus, the institution of a derivative suit need not be preceded by a board resolution**.

6. ID.; ID.; ID.;ID.; BEFORE INSTITUTING A DERIVATIVE SUIT, THE RELATOR-STOCKHOLDER MUST EXERT ALL REASONABLE EFFORTS TO EXHAUST ALL REMEDIES AVAILABLE UNDER THE ARTICLES OF INCORPORATION,

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THE BY-LAWS, AND THE LAWS OR RULES GOVERNING THE CORPORATION OR PARTNERSHIP TO OBTAIN THE RELIEF HE OR SHE DESIRES AND SUCH FACT MUST BE ALLEGED WITH PARTICULARITY IN THE COMPLAINT; RATIONALE; ATTEMPTS BETWEEN STOCKHOLDERS TO AMICABLY SETTLE A CORPORATE DISPUTE HARDLY CONSTITUTE "ALL REASONABLE EFFORTS TO EXHAUST ALL REMEDIES AVAILABLE".— Before instituting a derivative suit, the relator-stockholder must exert all reasonable efforts to exhaust all remedies available under the articles of incorporation, the by-laws, and the laws or rules governing the corporation or partnership to obtain the relief he or she desires. Such fact must then be alleged with particularity in the complaint. "The obvious intent behind the rule is to make the derivative suit the final recourse of the stockholder, after all other remedies to obtain the relief sought had failed." In their petition, Emmanuel, *et al.* allege that they exerted all reasonable efforts to exhaust all remedies available to them. They point to the fact that they invited Angelita to a meeting to amicably settle the dispute. Indeed, the record shows that Emmanuel, Corazon, and Angelita came together for a special stockholders' meeting on August 11, 2006. However, their attempt to resolve the dispute turned sour when Angelita walked out before the meeting even started. Contrary to the postulation of Emmanuel and Corazon, their attempt to settle the dispute with Angelita can hardly be considered "all reasonable efforts to exhaust all remedies available." In *Yu, et al. v. Yukayguan, et al.*, the Court rejected the argument that attempts between stockholders to amicably settle a corporate dispute constitute "all reasonable efforts to exhaust all remedies available." x x x. More importantly, an apparent remedy available to Emmanuel, *et al.* was to cause ARDC itself, through its Board of Directors, to directly institute the case. Because of their controlling interest in the corporation, Emmanuel, *et al*. could have prevailed upon the board to pass a resolution authorizing any of them to file the case and sign the certification against forum shopping.

7. ID.; ID.; ID.; ID.; A WRONG DONE TO A CORPORATION MUST BE VINDICATED THROUGH LEGAL ACTION COMMENCED BY THE BOARD OF DIRECTORS, BUT WHERE THE BOARD'S DECISION IS TANTAMOUNT TO BREACHING THE TRUST REPOSED IN IT BY THE MINORITY, THE

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AGGRIEVED MINORITY STOCKHOLDERS, IN A DERIVATIVE CAPACITY, MAY SUE OR DEFEND ON BEHALF OF THE CORPORATION.— The derivative suit has proven to be an effective tool for the protection of the minority shareholder's corporate interest. It is essentially an exception to the rule that a wrong done to a corporation must be vindicated through legal action commenced by the board of directors. Through the voting procedure found in the Corporation Code, the majority shareholders exercise control over the board of directors. In *Gamboa v. Finance Secretary Teves, et al.*, the Court, in no uncertain terms, declared that: "[i]ndisputably, one of the rights of a stockholder is the right to participate in the control or management of the corporation. This is exercised through his vote in the election of directors because it is the board of directors that controls or manages the corporation." Hence, **in the normal course of things, when a corporation is wronged, the board will readily litigate in order to protect the majority's corporate interests**. For the minority, on the other hand, this may not be the case. There may be situations where a corporation is wronged, but the board of directors refuses to take remedial action. The board's refusal may be based on valid business considerations, such as that the costs of litigation exceed the potential judgment award. But **in situations where the board's decision is tantamount to breaching the trust reposed in it by the minority, equity necessitates that the aggrieved stockholders be given a remedy**. Thus, the minority, in a derivative capacity, may sue or defend on behalf of the corporation.

8. **ID.; ID.; ID.; ID.; WHERE A CORPORATION UNDER THE EFFECTIVE CONTROL OF THE MAJORITY IS WRONGED, BOARD-SANCTIONED LITIGATION SHOULD TAKE PRECEDENCE OVER DERIVATIVE ACTIONS; MAJORITY STOCKHOLDERS WHO HAVE UNDISPUTED CORPORATE CONTROL CANNOT RESORT TO DERIVATIVE SUITS WHEN THERE IS NOTHING WHICH PREVENTS THE CORPORATION ITSELF FROM FILING THE CASE.—**Due to their control over the board of directors, the majority should not ordinarily be allowed to resort to derivative suits. **Where a corporation under the effective control of the majority is wronged, board-sanctioned litigation should take precedence over derivative actions**. **After all, the law expressly vests the**

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power to sue in the board of directors, and a remedy based on equity, such as the derivative suit, can prevail only in the absence of one provided by statute. In other words, majority stockholders who have undisputed corporate control cannot resort to derivative suits when there is nothing preventing the corporation itself from filing the case. In the complaint they filed before the Legazpi City RTC, **Emmanuel, *et al.* alleged that, together, they own 70% of ARDC's shares of capital stock**. In support of their allegation, they attached to their complaint the corporation's General Information Sheet, which shows that, out of ARDC's 5,000 shares of stock, 3,500 belong to Emmanuel, *et al.* collectively, while only 1,500 belong to Angelita. Clearly, the case before the RTC was instituted by the stockholders holding the controlling interest in ARDC. However, **the wrong done directly to ARDC was a wrong done only indirectly to the inchoate corporate interests of Emmanuel, *et al***. If ARDC truly desired to vindicate its rights, it should have done so through its Board of Directors. **Considering the majority shareholdings of the plaintiffs *a quo*, their interests should have been protected by the board through affirmative action**.

9. ID.; ID.; ID.; ID.; MAJORITY SHAREHOLDERS CANNOT BE ALLOWED TO BYPASS THE FORMATION OF A BOARD AND DIRECTLY CONDUCT CORPORATE BUSINESS THEMSELVES, AS CORPORATIONS EXERCISE THEIR POWERS THROUGH THEIR GOVERNING BOARDS.— Being necessary to the legitimate operation of business, the board of directors is an organ that is indispensable to the corporate vehicle. If this case were allowed to prosper as a derivative suit, the non-election of boards of directors would be incentivized, and the stability brought by "centralized management" eroded. **Majority shareholders cannot be allowed to bypass the formation of a board and directly conduct corporate business themselves**. **The Court cannot stress enough that the law mandates corporations to exercise their powers through their governing boards**. Hence, if a person or group of persons truly desires to conduct business through the corporate medium, then he, she, or they, as a matter of law, must form a board of directors. To allow Emmanuel, *et al.* to forego the election of directors, and directly commence and prosecute this case would not only downplay the key role of the board in corporate affairs, but also undermine the theory of separate juridical personality.

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10. ID.; ID.; ID.; A WRONG DONE TO A CORPORATION DOES NOT VEST IN ITS SHAREHOLDERS A CAUSE OF ACTION AGAINST THE WRONGDOER; MAJORITY SHAREHOLDERS WHO FOREGO THE ELECTION OF BOARD OF DIRECTORS CANNOT BE ALLOWED TO MAINTAIN THE SUIT THEMSELVES, ON BEHALF OF THE CORPORATION, AS THEY SHOULD NOT BE ALLOWED TO USE A DERIVATIVE SUIT TO SHORTCUT THE LAW.— It is axiomatic that a corporation is an entity with a legal personality separate and distinct from the people comprising it. Accordingly, a wrong done to a corporation does not vest in its shareholders a cause of action against the wrongdoer. Since the corporation is the real party in interest, it must seek redress itself. As stated above, a case instituted by the stockholders would be subject to dismissal on the ground that the complaint fails to state a cause of action. Here, because ARDC is the victim of the act complained of, the cause of action does not lie with Emmanuel, *et al*. The corporation should have filed the case itself through its board of directors. However, this could not be done since those responsible for the institution of this case never bothered to elect a governing body to wield ARDC's powers and to manage its affairs. Their omission cannot be without consequence. Verily, **by virtue of their admitted controlling interest in ARDC, Emmanuel, *et al.* could have come together and formed a board of directors consisting of all five of the corporation's stockholders**. Even without Angelita's participation, such a board would have been able to validly conduct business and, accordingly, could have sanctioned the filing of the complaint before the Legazpi City RTC. The aggrieved stockholders cannot now come before the Court, claiming that their remedy is a derivative suit. **Their failure to elect a board ultimately resulted in their failure to exhaust all legal remedies to obtain the relief they desired**. Since this case could have been brought by ARDC, through its board, its stockholders cannot maintain the suit themselves, purporting to sue in a derivative capacity. **Emmanuel, *et al.* should not be allowed to use a derivative suit to shortcut the law**.

11. ID.; ID.; ID.; ID.; A CLOSE CORPORATION MAY TASK ITS STOCKHOLDERS WITH THE MANAGEMENT OF BUSINESS, ESSENTIALLY DESIGNATING THEM AS DIRECTORS, PROVIDED ITS ARTICLES OF

INCORPORATION CONTAINS A PROVISION TO THAT EFFECT.— Neither can Emmanuel, *et al.* take refuge in their assertion that ARDC is a close family corporation. They claim that the stockholders of a close corporation may take part in the active management of corporate affairs. Hence, they, as ARDC's stockholders, are legally invested with the power to sue for the corporation. As correctly claimed, under Section 97 of the Corporation Code, a close corporation may task its stockholders with the management of business, essentially designating them as directors. However, the law is clear that a close corporation must do so through a provision to that effect contained in its articles of incorporation. Nowhere in ARDC's Articles of Incorporation can such a provision be found. **There is nothing that expressly or impliedly allows Emmanuel, *et al.* and Angelita, or any of them, to manage the corporation**. Hence, the merger of stock ownership and active management that Emmanuel, *et al.* rely on cannot be applied to ARDC.

12. ID.; ID.; ID.; ID.; A FAMILY CORPORATION IS NOT EXEMPT FROM COMPLYING WITH THE REQUIREMENTS AND FORMALITIES OF THE RULES FOR FILING A DERIVATIVE SUIT.— [A]ssuming *arguendo* that ARDC is a close family corporation, the same cannot be considered a justification for noncompliance with the requirements for the filing of a derivative suit. In *Ang v. Sps. Ang*, the Court declared: The fact that [SMBI] is a family corporation does not exempt private respondent Juanito Ang from complying with the Interim Rules. In the x x x *Yu* case, the Supreme Court held that a family corporation is not exempt from complying with the clear requirements and formalities of the rules for filing a derivative suit. There is nothing in the pertinent laws or rules which state that there is a distinction between x x x family corporations x x x and other types of corporations in the institution by a stockholder of a derivative suit.

13. ID.; ID.; ID.; CORPORATE OFFICERS; THE DESIGNATION OF A PERSON AS PRESIDENT IS INEFFECTUAL WHERE THE CORPORATION DOES NOT HAVE A BOARD OF DIRECTORS, AS THE LAW REQUIRES THE PRESIDENT OF A CORPORATION TO CONCURRENTLY HOLD OFFICE AS A DIRECTOR.— Emmanuel's designation as President was ineffectual because ARDC did not have a board of directors. Section 25 of the Corporation Code explicitly requires the

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president of a corporation to concurrently hold office as a director. This only serves to further highlight the key role of the board as a corporate manager. By designating a director as president of the corporation, the law intended to create a close-knit relationship between the top corporate officer and the collegial body that ultimately wields the corporation's powers.

14. CRIMINAL LAW; REVISED PENAL CODE; MALICIOUS PROSECUTION; DEFINED AS AN ACTION FOR DAMAGES BROUGHT BY ONE AGAINST WHOM A CRIMINAL PROSECUTION, CIVIL SUIT, OR OTHER LEGAL PROCEEDING HAS BEEN INSTITUTED MALICIOUSLY AND WITHOUT PROBABLE CAUSE, AFTER THE TERMINATION OF SUCH PROSECUTION, SUIT, OR OTHER PROCEEDING IN FAVOR OF THE DEFENDANT THEREIN; FOR AN ACTION BASED ON MALICIOUS PROSECUTION TO PROSPER, IT IS INDISPENSABLE THAT THE INSTITUTION OF THE PRIOR LEGAL PROCEEDING BE IMPELLED OR ACTUATED BY BAD FAITH OR LEGAL MALICE.— Jurisprudence has defined malicious prosecution as "an action for damages brought by one against whom a criminal prosecution, civil suit, or other legal proceeding has been instituted maliciously and without probable cause, after the termination of such prosecution, suit, or other proceeding in favor of the defendant therein."While generally associated with criminal actions, "the term has been expanded to include unfounded civil suits instituted just to vex and humiliate the defendant despite the absence of a cause of action or probable cause." For an action based on malicious prosecution to prosper, it is indispensable that the institution of the prior legal proceeding be impelled or actuated by legal malice. Here, it was never shown that the institution of the case against Angelita was tainted with bad faith or malice. Since it is settled that she introduced improvements on ARDC's property without its consent, it follows that the complaint was not baseless at all. However, because the case was not brought by the corporation, but by its stockholders, its dismissal was properly decreed by the trial court.

15. ID.; ID.; ID.; THE DISMISSAL OF THE CASE INSTITUTED BY THE STOCKHOLDERS WITHOUT THE CONSENT OF THE CORPORATION DOES NOT *PER SE* MAKE THAT CASE ONE OF MALICIOUS PROSECUTION AND SUBJECT THEM

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TO THE PAYMENT OF MORAL DAMAGES; SINCE IT IS NOT A SOUND PUBLIC POLICY TO PLACE A PREMIUM ON THE RIGHT TO LITIGATE, NO DAMAGES CAN BE CHARGED ON THOSE WHO EXERCISE SUCH PRECIOUS RIGHT IN GOOD FAITH, EVEN IF DONE ERRONEOUSLY.— The fact that Emmanuel, *et al*. brought the case without the consent of the corporation cannot be equivalent to malice. Surely, they could have elected a board of directors to run ARDC's affairs, but their failure to do so, coupled with the filing of the complaint before the RTC, should not make them liable for moral damages. After all, the fact that a case is dismissed does not *per se* make that case one of malicious prosecution and subject the plaintiff to the payment of moral damages. Since it is not a sound public policy to place a premium on the right to litigate, no damages can be charged on those who exercise such precious right in good faith, even if done erroneously.

16. CIVIL LAW; DAMAGES; ATTORNEY'S FEES; AWARD OF ATTORNEY'S FEES, DELETED.— Neither does the Court see any cogent reason to award attorney's fees in favor of Angelita. Certainly, she only has herself to blame for the filing of the case before the RTC. If she did not introduce improvements on ARDC's property, Emmanuel, *et al.* would have no reason to institute an action against her. Since she treated corporate property as if it was her own, she should have reasonably expected retaliatory action from the other shareholders. Hence, the CA was correct to delete the award of attorney's fees.

APPEARANCES OF COUNSEL

Fortun Narvasa & Salazar for Ago Realty & Development Corporation.

Aquende Ralla & Associates for Dr. Angelita Ago and Maribel Amaro.

Antonio Bron for Teresita Paloma-Apin.

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D E C I S I O N

REYES, A., JR., *J.*:

Grounded on equity, the derivative suit has proven to be an effective tool for the protection of minority shareholders. Such actions have for their object the vindication of a corporate injury, even though they are not brought by the corporation, but by its stockholders. That said, derivative suits remain an exception. As a general rule, corporate litigation must be commenced by the corporation itself, with the imprimatur of the board of directors, which, pursuant to the law, wields the power to sue. Therefore, since the derivative suit is a remedy of last resort, it must be shown that the board, to the detriment of the corporation and without a valid business consideration, refuses to remedy a corporate wrong. A derivative suit may only be instituted after such an omission. Simply put, derivative suits take a back seat to board-sanctioned litigation whenever the corporation is willing and able to sue in its own name.

On appeal are the September 26, 2013 Decision[1] and the January 10, 2014 Resolution[2] rendered by the Court of Appeals (CA) in CA-G.R. CV No. 99771.

The Factual Antecedents

Petitioner Ago Realty & Development Corporation (ARDC) is a close corporation.[3] Its stockholders are petitioner Emmanuel F. Ago (Emmanuel); his wife, petitioner Corazon C. Ago (Corazon); their children, Emmanuel Victor C. Ago and Arthur Emmanuel C. Ago (collectively Emmanuel, *et al.*); and Emmanuel's sister, respondent Angelita F. Ago (Angelita). Per

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[1] *Rollo* (G.R. No. 210906), pp. 52-79. The assailed decision was penned by Associate Justice Remedios A. Salazar-Fernando, with Associate Justices Normandie B. Pizarro and Manuel M. Barrios concurring.

[2] *Id.* at 83-84.

[3] *Id.* at 172.

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ARDC's General Information Sheet,[4] their respective stockholdings are as follows:

	Number of Subscribed Shares	Amount
Emmanuel	2,498	₱249,800.00
Corazon	1,000	₱100,000.00
Victor	1	₱100.00
Arthur	1	P100.00
Angelita	1,500	₱150,000.00
TOTAL	**5,000**	**₱500,000.00**

This controversy arose when **Angelita introduced improvements on Lot No. H-3, titled in the name of ARDC, without the proper resolution from the corporation's Board of Directors**. The improvements also encroached on Lot No. H-1 and Lot No. H-2, which also belonged to ARDC.[5]

Consequently, on August 11, 2006, ARDC and Emmanuel, *et al.* filed a complaint[6] before the Legazpi City Regional Trial Court (RTC). They essentially alleged that Angelita, in connivance with Teresita P. Apin (Teresita), Maribel Amaro (Maribel), and certain local officials of Legazpi City, introduced unauthorized improvements on corporate property. For her part, Teresita was accused of operating a restaurant named "Kicks Resto Bar" in the improvements,[7] while Maribel was impleaded as Angelita's employee.[8] On the other hand, the local officials were impleaded as defendants since they were responsible for issuing the permits relative to the improvements introduced by Angelita and the business concerns thereon.[9]

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[4] *Id.* at 183.

[5] *Id.* at 169.

[6] *Id.* at 161-182.

[7] *Id.* at 171.

[8] *Id.* at 163.

[9] *Id.* at 165-172.

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On September 15, 2006, Teresita filed her answer. She denied all the material allegations and averred that her restaurant was operating not on Lot No. H-3, as stated in the complaint, but on Lot No. 1-B, which is not ARDC's property.[10]

On February 9, 2007, after their motion to dismiss was denied,[11] Angelita and Maribel filed their answer.[12] Angelita admitted to introducing improvements on the subject lots. She narrated that sometime in the 1960s, Emmanuel and Corazon immigrated to the United States, leaving the management of ARDC's properties to her. She thus took control of the corporation's properties and introduced improvements thereon, particularly a semi-permanent multipurpose structure[13] and a fence designed to protect the lot.[14]

Angelita further claimed that the suit was brought because she refused to heed to Emmanuel's demand that she buyout his shares in ARDC for $6,000,000.00. After she failed to satisfy the unreasonable demand, Emmanuel, through two letters sent by counsel, allegedly accused her of introducing improvements on ARDC's property and allowing Teresita to operate a restaurant business thereon, without the necessary authorization from the corporation's Board of Directors. For such acts, Emmanuel supposedly demanded damages amounting to ₱10,000,000.00.[15]

Anent Maribel's inclusion as defendant, it was argued that the plaintiffs had no cause of action against her since the complaint failed to point out any act for which she should be held accountable. Being a mere employee of Angelita, she had no participation in the acts complained of.[16]

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[10] *Id*. at 55.

[11] *Id*. at 56.

[12] *Id*.

[13] *Id*. at 57.

[14] *Id*. at 56-57.

[15] *Id*. at 58.

[16] *Id*.

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Notably, a defense common to all the defendants was that ARDC never authorized the institution of the suit. Without a resolution emanating from the corporation's Board of Directors, it was argued that Emmanuel, *et al.* had no legal standing to bring the case since the lots in question belonged to ARDC.

On July 24, 2007, the local officials of Legazpi City were dropped as defendants on motion of Emmanuel, *et al.* Hence, the case against them was dismissed.[17]

After the pre-trial conference was terminated on July 31, 2007, trial on the merits ensued.[18]

The RTC's Ruling

On September 20, 2012, the RTC rendered a Decision[19] dismissing the complaint and holding Emmanuel and Corazon jointly and severally liable for damages. Finding ARDC to be the real party in interest, the trial court ruled that the plaintiffs had no cause of action.[20] Since Emmanuel, *et al.* brought the case without the proper resolution from the Board of Directors,[21] it was held that they were not authorized to sue on behalf of the corporation.[22] **The RTC gave consideration to the undisputed fact that the properties in litigation belonged to ARDC, concluding that Emmanuel, *et al.*, in their individual capacities, were not the real parties in interest**.[23]

Next, the trial court found that Teresita's restaurant business was not operating on ARDC's property. The finding was based

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[17] *Id*. at 59.

[18] *Id*.

[19] *Id*. at 248-264.

[20] *Id*. at 256.

[21] *Id*. at 253.

[22] *Id*. at 256.

[23] *Id*.

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on Corazon's admission that the restaurant was built on Lot No. 1-B, contrary to what was alleged in the complaint.[24]

Lastly, the suit was held to be baseless, thus entitling the defendants to damages and attorney's fees.[25] Angelita was awarded moral damages since Emmanuel's claims caused her embarrassment and tarnished her reputation in Bicol. Maribel was likewise awarded moral damages because the suit took her by surprise, made her restless, resulted in a rise in her blood pressure, and caused her to figure in an accident.[26] However, Teresita's claim for moral and exemplary damages failed, as she did not take the witness stand.[27] Nevertheless, she,[28] Angelita, and Maribel[29] were awarded attorney's fees on the ground that the action was clearly unfounded.

The *fallo* of the RTC's Decision reads:

> WHEREFORE, in view of the foregoing, the court hereby orders:
>
> 1. That the herein-entitled complaint be **DISMISSED** as it is hereby **DISMISSED** and
>
> 2. That Emmanuel F. Ago and Corazon Casta[ñ]eda-Ago be ordered to pay jointly and solidarily the following in damages:
>
> A. To Teresita Paloma Apin, the amount of ₱150,000.00 in attorney's fees;
>
> B. To each of Dr. Angelita F. Ago and Maribel Amaro, the amount of ₱100,000.00 in moral damages; and,
>
> C. To both Dr. Angelita F. Ago and Maribel Amaro, the amount of ₱200,000.00 in attorney's fees.
>
> SO ORDERED.[30] (Emphasis in the original)

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[24] *Id.* at 259.

[25] *Id.*

[26] *Id.* at 263.

[27] *Id.* at 261.

[28] *Id.*

[29] *Id.* at 263.

[30] *Id.* at 264.

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The CA's Ruling

On September 26, 2013, the CA rendered the herein assailed Decision affirming the RTC's ruling anent the plaintiffs' lack of cause of action, but deleting the lower court's award of moral damages and attorney's fees. **The appellate court held that the case partook of the nature of a derivative suit.** As such, **Emmanuel, *et al.* needed the imprimatur of ARDC's Board of Directors to institute the action**.[31] While they were able to present a resolution purportedly authorizing the filing of the case, the CA refused to give credence thereto on the ground that the same was passed by the corporation's stockholders, and not its Board of Directors.[32]

As for the award of moral damages, the CA held that the case was not totally baseless considering that Angelita indeed introduced substantial improvements on ARDC's property. The filing of the case was thus held to be free from malicious intent.[33] Likewise, the award of attorney's fees was erroneous since there was no factual or legal basis for its grant.[34]

The CA, therefore, disposed of the case, *viz*.:

> **WHEREFORE**, the Decision dated September 20, 2012 of the Regional Trial Court of Legazpi City, Branch 1, in Civil Case No. 10585 is **AFFIRMED WITH MODIFICATION**, in that, the award of moral damages and attorney's fees in favor of the defendants-appellees is **DELETED**.
>
> **SO ORDERED**.[35] (Emphasis in the original)

After the CA denied their respective motions for reconsideration through the herein assailed Resolution, ARDC,

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[31] *Id*. at 72.

[32] *Id*. at 73.

[33] *Id*. at 77.

[34] *Id*. at 78.

[35] *Id*.

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Emmanuel, and Corazon,[36] on the one hand, and Angelita,[37] on the other, filed the instant consolidated petitions for review on *certiorari*, raising the following issues:

The Issues

In G.R. No. 210906 (filed by ARDC and Emmanuel, *et al.*):

Whether or not Emmanuel, *et al.* may sue on behalf of ARDC absent a resolution or any other grant of authority from its Board of Directors sanctioning the institution of the case.[38]

In G.R. No. 211203 (filed by Angelita):

Whether or not the grant of moral damages and attorney's fees in favor of Angelita is warranted.[39]

The Court's Ruling

The petitions have no merit. Hence, the CA's decision stands.

The historical development of corporation law in the Philippines

Towards the end of the Spanish occupation, the application of the Spanish Code of Commerce was extended to the Philippine Islands.[40] This introduced the *sociedad anónima*, a juridical entity formed "upon the execution of the public instrument in which its articles of agreement appear, and the contribution of funds and personal property."[41] Just as today's corporations, *sociedades anónimas* could own and deal in property, as well as sue and be sued.[42]

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[36] *Id*. at 16-47.

[37] *Rollo* (G.R. No. 211203), pp. 43-77.

[38] *Rollo* (G.R. No. 210906), pp. 23-25.

[39] *Rollo* (G.R. No. 211203), p. 60.

[40] *Philippine Corporate Law*, Cesar L. Villanueva, p. 4 (2013).

[41] *Mead v. McCullough*, 21 Phil. 95, 106 (1911), cited in Villanueva.

[42] *Id*.

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With the conclusion of the Treaty of Paris, Spain ceded the Philippines to the United States.[43] The Americans brought with them their notion of the corporation through the enactment of Act No. 1459, "a sort of codification of American corporate law."[44] Their attention was caught by the fact that Spanish law did not provide for an entity that was precisely equivalent to the American or English corporation.[45] To them, the *sociedad anónima* was an inadequate business medium.

Appropriately named the Corporation Law, Act No. 1459 took effect on April 1, 1906 and was to serve as the principal corporate regulatory statute for the next 74 years. The law defined a corporation as "an artificial being created by operation of law, having the right of succession and the powers, attributes, and properties expressly authorized by law or incident to its existence,"[46] a definition that is still used to this day. It contained special provisions expressly penalizing the employment of persons in involuntary servitude[47] and the unlicensed transaction of business by a foreign corporation.[48]

However, as Act No. 1459 was unable to keep up with modern commerce, it was replaced by *Batas Pambansa Blg*. 68, otherwise known as the Corporation Code. The new law codified various jurisprudential pronouncements made under its predecessor, clarified the obligations of corporate directors and officers, and defined close corporations, providing special rules for their formation and the ownership of their stock. It also dispensed with the old restrictions pertinent to agricultural and mining corporations, the limitations on corporate ownership of

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[43] Encyclopedia Britannica, Treaty of Paris< https://www.britannica.com/event/Treaty-of-Paris-1898>visited October 10, 2019.

[44] *Harden v. Benguet Consolidated Mining Co*., 58 Phil. 141, 146 (1933).

[45] *Id.* at 145.

[46] Act No. 1459, Sec. 2.

[47] Act No. 1459, Sec. 15.

[48] Act No. 1459, Sec. 69.

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real property, and the penal clauses integrated into certain provisions of the law.[49]

The Corporation Code was the law in effect at the time the factual antecedents of this case occurred.

The most recent edition of our corporation law came with the passage of Republic Act No. 11232, or the Revised Corporation Code, which took effect on February 23, 2019. This new piece of legislation introduced many significant changes to the corporate regulatory regime in this jurisdiction. Notably, it removed the requirement to incorporate with at least five incorporators,[50] the minimum capitalization requirement for stock corporations,[51] and the 50-year limit on the duration of the corporate term.[52] Also, in an effort to strengthen corporate governance, the new law requires corporations imbued with public interest to allocate a certain percentage of their board seats to independent directors,[53] as well as to elect a compliance officer to ensure adherence to all relevant laws and regulations.[54]

Corporate powers are exercised by the board of directors

If there is one constant that has been observed from the introduction of the Spanish Code of Commerce to the enactment of the Revised Corporation Code, it is that "[c]orporations are creatures of the law."[55] They owe their existence to the sovereign powers of the State, exercised by the Legislature, which—by general law or, in certain instances, direct act—prescribes the

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[49] *Philippine Corporate Law*, Cesar L. Villanueva, pp. 7-8 (2013).

[50] REPUBLIC ACT NO. 11232, Sec. 10.

[51] REPUBLIC ACT NO. 11232, Sec. 12.

[52] REPUBLIC ACT NO. 11232, Sec. 11.

[53] REPUBLIC ACT NO. 11232, Sec. 22.

[54] REPUBLIC ACT NO. 11232, Sec. 24.

[55] *Cagayan Fishing Development Co., Inc. v. Sandiko*, 65 Phil. 223, 227 (1937).

manner of their formation or organization.[56] Throughout their lifetimes, corporations are subject to a plethora of regulatory requirements, such as those involving annual reports,[57] voting in stockholders' or directors' meetings,[58] and, depending on the industry where the firm operates, limitations on foreign ownership.[59] As so aptly put in *Ang Pue & Co., et al. v. Sec. of Comm. and Industry*,[60] "[t]o organize a corporation x x x is not a matter of absolute right but a privilege which may be enjoyed only under such terms as the State may deem necessary to impose."[61]

While corporations are subjected to the State's broad regulatory powers, it is their directors and officers who are tasked with addressing questions of internal policy and management.[62] **The business of a corporation is conducted by its board of directors, and so long as the board acts in good faith, the State, through the courts, may not interfere with its management decisions**.[63] This finds support in Section 23 of the Corporation Code, which provides that a corporation exercises its powers, conducts its business, and controls and holds its property through its board of directors.[64]

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[56] *Philippine Corporate Law*, Cesar L. Villanueva, p. 17 (2013).

[57] See: *Batas Pambansa Blg.* 68, Sec. 141.

[58] See: *Batas Pambansa Blg.* 68, Secs. 49-59.

[59] See: REPUBLIC ACT No. 7042.

[60] 115 Phil. 629 (1962).

[61] *Id.* at 631-632.

[62] *Phil. Stock Exchange, Inc. v. The Hon. CA*, 346 Phil. 218, 234 (1997).

[63] *Id.*

[64] **Sec. 23.** ***The board of directors or trustees.*** —Unless otherwise provided in this Code, the corporate powers of all corporations formed under this Code shall be exercised, all business conducted and all property of such corporations controlled and held by the board of directors x x x.

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As creatures of the law, corporations only possess those powers that are granted through statute, either expressly or by way of implication, or those that are incidental to their existence.[65]

One of the powers expressly granted by law to corporations is the power to sue.[66] As with other corporate powers, **the power to sue is lodged in the board of directors**, acting as a collegial body.[67] Thus, in the absence of any clear authority from the board, charter, or by-laws,[68] no suit may be maintained on behalf of the corporation. A case instituted by a corporation without authority from its board of directors is subject to dismissal on the ground of failure to state a cause of action.[69]

In certain instances, however, the stockholders may sue on behalf of the corporation

As an exception[70] to the foregoing rule, jurisprudence has recognized certain instances when **minority stockholders may bring suits on behalf of corporations**.[71] Where the board of directors itself is a party to the wrong, either because it is the author thereof or because it refuses to take remedial action, equity permits individual stockholders to seek redress.[72] These actions have come to be known as **derivative suits**. In *Chua v. Court of Appeals*,[73] the Court defined a derivative suit as "**a suit by a shareholder to enforce a corporate cause of action.**"[74]

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[65] *Umale, et al. v. ABS Realty Corp.*, 667 Phil. 351, 363 (2011).

[66] *Batas Pambansa Blg.* 68, Sec. 36(1).

[67] *Shipside, Inc. v. Court of Appeals*, 404 Phil. 981, 994 (2001).

[68] *Social Security System v. Commission on Audit*, 433 Phil. 946, 955-956 (2002).

[69] *Societe Des Produits, Nestle, S.A. v. Puregold Price Club, Inc.*, 817 Phil. 1030, 1042 (2017).

[70] *Philippine Corporate Law*, Cesar L. Villanueva, p. 230 (2013).

[71] *Ching, et al. v. Subic Bay Golf and Country Club, Inc., et al.*, 742 Phil. 606, 620-621 (2014).

[72] *Cua, Jr., et al. v. Tan, et al.*, 622 Phil. 661, 714 (2009).

[73] 485 Phil. 644 (2004).

[74] *Id.* at 655.

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In derivative suits, it is the corporation that is the victim of the wrong. As such, it is the corporation that is properly regarded as the real party in interest, while the relator-stockholder is merely a nominal party.[75] The corporation must be impleaded so that the benefits of the suit accrue to it and also because it must be barred from bringing a subsequent case against the same defendants for the same cause of action.[76] Stated otherwise, the judgment rendered in the suit must constitute *res judicata* against the corporation, even though it refuses to sue through its board of directors.[77]

That said, not every wrong suffered by a stockholder involving a corporation will vest in him or her the standing to commence a derivative suit.[78] In *Cua, Jr., et al. v. Tan, et al.*,[79] the Court explained when such actions lie, *viz*.:

> Suits by stockholders or members of a corporation based on wrongful or fraudulent acts of directors or other persons may be classified into individual suits, class suits, and derivative suits. Where a stockholder or member is denied the right of inspection, his suit would be individual because the wrong is done to him personally and not to the other stockholders or the corporation. Where the wrong is done to a group of stockholders, as where preferred stockholders' rights are violated, a class or representative suit will be proper for the protection of all stockholders belonging to the same group. **But where the acts complained of constitute a wrong to the corporation itself, the cause of action belongs to the corporation and not to the individual stockholder or member**. Although in most every case of wrong to the corporation, each stockholder is necessarily affected because the value of his interest therein would be impaired, this fact of itself is not sufficient to give him an individual cause of action

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[75] *Villamor, Jr. v. Umale*, 744 Phil. 31, 47 (2014).

[76] *Asset Privatization Trust v. Court of Appeals*, 360 Phil. 768, 805 (1998), citing *Commercial Law of the Philippines*, Aguedo F. Agbayani, Vol. III, p. 566, citing Ballantine, pp. 366-367.

[77] *Id*.

[78] *Florete, et al. v. Florete, et al.*, 778 Phil. 614, 636 (2016).

[79] *Supra*.

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since the corporation is a person distinct and separate from him, and can and should itself sue the wrongdoer. Otherwise, not only would the theory of separate entity be violated, but there would be multiplicity of suits as well as a violation of the priority rights of creditors. Furthermore, there is the difficulty of determining the amount of damages that should be paid to each individual stockholder.

However, in cases of mismanagement **where the wrongful acts are committed by the directors or trustees themselves, a stockholder or member may find that he has no redress because the former are vested by law with the right to decide whether or not the corporation should sue, and they will never be willing to sue themselves**. The corporation would thus be helpless to seek remedy. Because of the frequent occurrence of such a situation, the common law gradually recognized the right of a stockholder to sue on behalf of a corporation in what eventually became known as a "derivative suit." **It has been proven to be an effective remedy of the minority against the abuses of management**. Thus, an individual stockholder is permitted to institute a derivative suit on behalf of the corporation wherein he holds stock in order to protect or vindicate corporate rights, whenever officials of the corporation refuse to sue or are the ones to be sued or hold the control of the corporation. In such actions, the suing stockholder is regarded as the nominal party, with the corporation as the party in interest.[80] (Emphasis and underscoring supplied)

Here, the CA held that since the cause of action belongs to ARDC, the properties in question being titled in its name, the case instituted by Emmanuel, *et al.* was derivative in nature. As such, they should have first secured a board resolution authorizing them to bring suit.[81] Emmanuel, *et al.* counter, arguing that a derivative suit does not require the imprimatur of the board of directors.[82] Since, in derivative suits, the corporation is usually under the control of the wrongdoers, it would be absurd to require the stockholders to obtain board authority prior to the commencement of litigation.

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[80] *Id*. at 715-716.

[81] *Rollo* (G.R. No. 210906), pp. 72-73.

[82] *Id*. at 26.

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Emmanuel, *et al.* are correct.

A board resolution is not needed for the institution of a derivative suit

The record reveals that the complaint *a quo* was filed by Emmanuel, *et al*. While the caption states that ARDC was also one of the plaintiffs, there is nothing showing that the corporation's Board of Directors had authorized the filing of the case. Thus, the case is deemed as instituted by Emmanuel, *et al.* without ARDC's acquiescence.

As discussed above, the corporate power to sue is exercised by the board of directors. For this purpose, the board may authorize a representative of the corporation to perform all necessary physical acts, such as the signing of documents.[83] Such **authority may be derived from the by-laws or from a specific act of the board of directors**, *i.e.*, a board resolution.[84]

In *Rep. of the Phils. v. Coalbrine Int'l. Phils., Inc., et al.*,[85] the Court dismissed a complaint for damages instituted by a corporation because the managing director who signed the certification against forum shopping failed to show that the board of directors authorized her to do so. Ruling that the lack of such certification was prejudicial to the corporation's cause, the Court held that the managing director should have first obtained a valid board resolution sanctioning the filing of the case and the signing of the certification.

However, in derivative suits, the recognized rule is different. **Since the board is guilty of breaching the trust reposed in it by the stockholders, it is but logical to dispense with the requirement of obtaining from it authority to institute the case and to sign the certification against forum**

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[83] *Rep. of the Phils. v. Coalbrine Int'l. Phils., Inc., et al.*, 631 Phil. 487, 495 (2010).

[84] *Id*.

[85] *Id*.

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shopping. It has been held that when "the corporation x x x is under the complete control of the principal defendants in the case, x x x it is obvious that a demand upon the [board] to institute an action and prosecute the same effectively would [be] useless, and the law does not require litigants to perform useless acts."[86] **Thus, the institution of a derivative suit need not be preceded by a board resolution**.

But, given that authority from the board of directors can be dispensed with in derivative suits, can the case filed by Emmanuel, *et al.* even be classified as such in the first place?

Emmanuel, *et al.* argue that they have the right to file a derivative suit on behalf of ARDC.[87] Since the corporation was the victim of the wrong committed by Angelita, *i.e.*, the introduction of improvements on its property without its consent, a derivative suit lies as the appropriate remedy.

On this score, they err.

The derivative suit is an equitable remedy and one of last resort

The right of stockholders to bring derivative suits is not based on any provision of the corporation Code or the Securities regulation Code, but is a right that is implied by the fiduciary duties that directors owe corporations and stockholders.[88] **Derivative suits are, therefore, grounded not on law, but on equity**.[89]

In *Hi-Yield Realty, Incorporated v. Court of Appeals, et al.*,[90] a corporation, through its controlling stockholder and without authority from its board of directors, entered into loan obligations

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[86] *Everett v. Asia Banking Corporation*, 49 Phil. 512, 527 (1926).

[87] *Rollo* (G.R. No. 210906), p. 30.

[88] *Florete, et al. v. Florete, et al., supra* note 78, at 635.

[89] *Ching, et al. v. Subic Bay Golf and Country Club, Inc., et al., supra* note 71, at 621.

[90] 608 Phil. 350 (2009).

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that later led to the foreclosure of its property. A minority stockholder then instituted a petition to annul the subject mortgage deeds and the consequent foreclosure sales. The complaint alleged that the suing minority stockholder had been excluded from corporate affairs and that attempts between him and the other stockholders to compromise the case had failed. Since the board of directors did nothing to rectify the corporation's questionable transactions, the Court allowed the institution of the complaint as a derivative suit.

In *Gochan v. Young*,[91] minority stockholders instituted a complaint against directors and officers who appropriated for themselves corporate funds through excessive salaries and cash advances. It was stated that the capital of the corporation was impaired, as the firm was prevented from using its own funds in the conduct of its regular business. The Court held that the suit was correctly classified as derivative in nature since the relator-stockholders had clearly alleged injury to the corporation. The fact that the plaintiffs alleged damage to themselves in their personal capacities on top of the damage done to the corporation merely gave rise to an additional cause of action, but it did not disqualify them from filing a derivative suit.

In *San Miguel Corporation v. Kahn*,[92] a significant number of shares of San Miguel Corporation (SMC) were acquired by 14 other companies. SMC tried to repurchase shares through its wholly-owned foreign subsidiary, Neptunia Corporation Limited (Neptunia). However, the shares had been sequestered by the Presidential Commission on Good Government (PCGG) on the ground that they were owned by one of the cronies of former President Ferdinand E. Marcos. Later, SMC's Board of Directors passed a resolution assuming Neptunia's liability for the purchase of the subject shares. The board opined that there was nothing illegal about the assumption of liability since Neptunia was wholly-owned by SMC. Subsequently, Eduardo de los Angeles (De

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[91] 406 Phil. 663 (2001).

[92] 257 Phil. 459 (1989).

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los Angeles), director and minority stockholder of SMC, brought a derivative suit challenging the board resolution as constituting an improper use of corporate funds. When the case reached the Court, it was held that De los Angeles had properly resorted to a derivative suit. It was of no moment that he owned only 20 SMC shares or that he was elected to the board of directors by the PCGG. Since the case concerned the validity of the assumption by SMC of the indebtedness of Neptunia, a cause of action that indeed belonged to the former corporation, the Court held that De los Angeles could maintain the suit on behalf of SMC.

Despite derivative suits being grounded on equity, they cannot prosper in the absence of any or some of the requisites enumerated in the Interim Rules of Procedure for Intra-Corporate Controversies,[93] *viz*.:

Rule 8
DERIVATIVE SUITS

Section 1. *Derivative action*. — A stockholder or member may bring an action in the name of a corporation or association, as the case may be, provided, that:

(1) He was a stockholder or member at the time the acts or transactions subject of the action occurred and the time the action was filed;

(2) He exerted all reasonable efforts, and alleges the same with particularity in the complaint, to exhaust all remedies available under the articles of incorporation, by-laws, laws or rules governing the corporation or partnership to obtain the relief he desires;

(3) No appraisal rights are available for the acts or acts complained of; and

(4) The suits is not a nuisance or harassment suit.[94]

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[93] *Ching, et al. v. Subic Bay Golf and Country Club, Inc., et al., supra* note 71.

[94] A.M. No. 01-2-04-SC, March 13, 2001.

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The second requisite does not obtain in this case.

Before instituting a derivative suit, the relator-stockholder must exert all reasonable efforts to exhaust all remedies available under the articles of incorporation, the by-laws, and the laws or rules governing the corporation or partnership to obtain the relief he or she desires. Such fact must then be alleged with particularity in the complaint.[95] "The obvious intent behind the rule is to make the derivative suit the final recourse of the stockholder, after all other remedies to obtain the relief sought had failed."[96]

In their petition, Emmanuel, *et al.* allege that they exerted all reasonable efforts to exhaust all remedies available to them. They point to the fact that they invited Angelita to a meeting to amicably settle the dispute.[97] Indeed, the record shows that Emmanuel, Corazon, and Angelita came together for a special stockholders' meeting on August 11, 2006. However, their attempt to resolve the dispute turned sour when Angelita walked out before the meeting even started.[98]

Contrary to the postulation of Emmanuel and Corazon, their attempt to settle the dispute with Angelita can hardly be considered "all reasonable efforts to exhaust all remedies available."

In *Yu, et al. v. Yukayguan, et al.*,[99] the Court rejected the argument that attempts between stockholders to amicably settle a corporate dispute constitute "all reasonable efforts to exhaust all remedies available." It was held that:

> The allegation of respondent Joseph in his Affidavit of his repeated attempts to talk to petitioner Anthony regarding their dispute hardly constitutes "all reasonable efforts to exhaust all remedies available."

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[95] *Yu, et al. v. Yukayguan, et al.*, 607 Phil. 581, 612 (2009).

[96] *Id*.

[97] *Rollo* (G.R. No. 210906), p. 32.

[98] *Id.* at 253.

[99] *Supra* note 95.

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Respondents did not refer to or mention at all any other remedy under the articles of incorporation or by-laws of Winchester, Inc., available for dispute resolution among stockholders, which respondents unsuccessfully availed themselves of. And the Court is not prepared to conclude that the articles of incorporation and by-laws of Winchester, Inc. absolutely failed to provide for such remedies.[100]

More importantly, an apparent remedy available to Emmanuel, *et al.* was to cause ARDC itself, through its Board of Directors, to directly institute the case. Because of their controlling interest in the corporation, Emmanuel, *et al.* could have prevailed upon the board to pass a resolution authorizing any of them to file the case and sign the certification against forum shopping.

The derivative suit has proven to be an effective tool for the protection of the minority shareholder's corporate interest. It is essentially an exception to the rule that a wrong done to a corporation must be vindicated through legal action commenced by the board of directors.

Through the voting procedure found in the Corporation Code,[101] the majority shareholders exercise control over the board of directors. In *Gamboa v. Finance Secretary Teves, et al.*,[102] the Court, in no uncertain terms, declared that:

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[100] *Id*.

[101] **Sec. 24. *Election of directors or trustees*.** — x x x. In stock corporations, every stockholder entitled to vote shall have the right to vote in person or by proxy the number of shares of stock standing, at the time fixed in the by-laws, in his own name on the stock books of the corporation, or where the by-laws are silent, at the time of the election; and said stockholder may vote such number of shares for as many persons as there are directors to be elected or he may cumulate said shares and give one candidate as many votes as the number of directors to be elected multiplied by the number of his shares shall equal, or he may distribute them on the same principle among as many candidates as he shall see fit: Provided, That the total number of votes cast by him shall not exceed the number of shares owned by him as shown in the books of the corporation multiplied by the whole number of directors to be elected x x x.

[102] 668 Phil. 1 (2011) cited in *Roy v. Chairperson Herbosa, et al.*, 800 Phil. 459 (2016).

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"[i]ndisputably, one of the rights of a stockholder is the right to participate in the control or management of the corporation. This is exercised through his vote in the election of directors because it is the board of directors that controls or manages the corporation."[103] Hence, **in the normal course of things, when a corporation is wronged, the board will readily litigate in order to protect the majority's corporate interests**. For the minority, on the other hand, this may not be the case. There may be situations where a corporation is wronged, but the board of directors refuses to take remedial action. The board's refusal may be based on valid business considerations, such as that the costs of litigation exceed the potential judgment award. But **in situations where the board's decision is tantamount to breaching the trust reposed in it by the minority, equity necessitates that the aggrieved stockholders be given a remedy**. Thus, the minority, in a derivative capacity, may sue or defend[104] on behalf of the corporation.

Due to their control over the board of directors, the majority should not ordinarily be allowed to resort to derivative suits. **Where a corporation under the effective control of the majority is wronged, board-sanctioned litigation should take precedence over derivative actions. After all, the law expressly vests the power to sue in the board of directors,**[105] **and a remedy based on equity, such as the derivative suit, can prevail only in the absence of one provided by statute**.[106] In other words, majority stockholders who have undisputed corporate control cannot resort to derivative suits when there is nothing preventing the corporation itself from filing the case.

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[103] *Id*. at 53.

[104] *Chua v. Court of Appeals*, *supra* note 73, at 655.

[105] See: *Batas Pambansa Blg*. 68, Sec. 23.

[106] *Tirazona v. Philippine Eds Techno-Service, Inc. (PETInc.) and/or Kubota, et al.*, 596 Phil. 683, 692 (2009); and *Brito, Sr. v. Dianala, et al.*, 653 Phil. 200, 210 (2010).

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In the complaint they filed before the Legazpi City RTC, **Emmanuel, *et al.* alleged that, together, they own 70% of ARDC's shares of capital stock.**[107] In support of their allegation, they attached to their complaint the corporation's General Information Sheet,[108] which shows that, out of ARDC's 5,000 shares of stock, 3,500 belong to Emmanuel, *et al*. collectively, while only 1,500 belong to Angelita.

Clearly, the case before the RTC was instituted by the stockholders holding the controlling interest in ARDC. However, **the wrong done directly to ARDC was a wrong done only indirectly to the inchoate corporate interests of Emmanuel, *et al***.[109] If ARDC truly desired to vindicate its rights, it should have done so through its Board of Directors. **Considering the majority shareholdings of the plaintiffs *a quo*, their interests should have been protected by the board through affirmative action.**

However, **this could not happen because ARDC did not have a board of directors**. On this point, the record is bereft of any showing that ARDC's stockholders ever met to elect its governing board. Before the trial court, Emmanuel admitted that ARDC never held any stockholders' meetings from the time it was incorporated until 2005, *viz*.:

Q Mr. Ago, you would also agree with me that from 1989 until 2000 you had no meeting of stockholders in Ago Realty and Development Corporation?
A No.

Q Do you mean to say that you had meeting?
A There were no meetings.

Q Similarly in 2000, 2001, 2003 until 2005[,] there were no meetings of stockholders in Ago Realty and Development Corporation[?]

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[107] *Rollo* (G.R. No. 210906), p. 163.

[108] *Id*. at 183.

[109] *Angeles v. Santos*, 64 Phil. 697, 707 (1937).

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A No, there was no meeting.

Q And you would confirm or you would agree with me that there was no election likewise of Ago Realty and Development Corporation as far as its corporate officers are concerned?
A Yes.

Q And that was from 1989 until 2005?
A Yes.

Q Likewise, during that period from 1989 up to 2005[,] there were no board resolutions interpreted x x x or issued by Ago Realty and Development Corporation?
A No, there's no need.[110] (Citation omitted)

There is likewise no showing that ARDC held an election for its Board of Directors from 2005 until the filing of the complaint before the RTC. While Emmanuel, Corazon, and Angelita came together for a special stockholders' meeting on August 11, 2006, no election was held then. As mentioned earlier, Angelita walked out before the meeting started, and Emmanuel and Corazon were only able to pass a stockholders' resolution purportedly authorizing the institution of the instant case.[111] However, as amply discussed above, a corporation's power to sue is lodged in its board of directors. Hence, the resolution, not emanating from the board, was inefficacious.

The failure of ARDC's majority stockholders to elect a board of directors must be taken against them. To be sure, **there was nothing preventing Emmanuel, *et al.* from holding a meeting for the purpose of electing a board, even in Angelita's absence or over her objection**. It is admitted that the plaintiffs *a quo* hold a majority of ARDC's capital stock, by virtue of which they could have constituted a board to exercise the corporation's powers.[112] If they had done so, the instant case could have been instituted by ARDC itself.

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[110] *Rollo* (G.R. No. 210906), p. 75.

[111] *Id*. at 253.

[112] See: *Batas Pambansa Blg.* 68, Sec. 24.

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The role of the board of directors is impressed with such importance that corporate business cannot properly be conducted without it

Being necessary to the legitimate operation of business, the board of directors is an organ that is indispensable to the corporate vehicle. If this case were allowed to prosper as a derivative suit, the non-election of boards of directors would be incentivized, and the stability brought by "centralized management"[113] eroded. **Majority shareholders cannot be allowed to bypass the formation of a board and directly conduct corporate business themselves. The Court cannot stress enough that the law mandates corporations to exercise their powers through their governing boards.** Hence, if a person[114] or group of persons truly desires to conduct business through the corporate medium, then he, she, or they, as a matter of law, must form a board of directors. To allow Emmanuel, *et al.* to forego the election of directors, and directly commence and prosecute this case would not only downplay the key role of the board in corporate affairs, but also undermine the theory of separate juridical personality.

It is axiomatic that a corporation is an entity with a legal personality separate and distinct from the people comprising it.[115] Accordingly, a wrong done to a corporation does not vest in its shareholders a cause of action against the wrongdoer. Since the corporation is the real party in interest, it must seek redress itself. As stated above, a case instituted by the stockholders would be subject to dismissal on the ground that the complaint fails to state a cause of action.[116]

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[113] *Philippine Corporate Law*, Cesar L. Villanueva, p. 23 (2013).

[114] Recently, Republic Act No. 11232 revised the Corporation Code, removing minimum number of incorporators required to form a corporation.

[115] *Situs Dev't. Corp., et al. v. Asiatrust Bank, et al.*, 691 Phil. 707, 722 (2012).

[116] *Pacaña-Contreras, et al. v. Rovila Water Supply, Inc., et al.*, 722 Phil. 460, 470 (2013).

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Here, because ARDC is the victim of the act complained of, the cause of action does not lie with Emmanuel, *et al.* The corporation should have filed the case itself through its board of directors. However, this could not be done since those responsible for the institution of this case never bothered to elect a governing body to wield ARDC's powers and to manage its affairs. Their omission cannot be without consequence. Verily, **by virtue of their admitted controlling interest in ARDC, Emmanuel, *et al.* could have come together and formed a board of directors consisting of all five of the corporation's stockholders**. Even without Angelita's participation, such a board would have been able to validly conduct business[117] and, accordingly, could have sanctioned the filing of the complaint before the Legazpi City RTC. The aggrieved stockholders cannot now come before the Court, claiming that their remedy is a derivative suit. **Their failure to elect a board ultimately resulted in their failure to exhaust all legal remedies to obtain the relief they desired**. Since this case could have been brought by ARDC, through its board, its stockholders cannot maintain the suit themselves, purporting to sue in a derivative capacity. **Emmanuel, *et al.* should not be allowed to use a derivative suit to shortcut the law.**

Neither can Emmanuel, *et al.* take refuge in their assertion that ARDC is a close family corporation. They claim that the stockholders of a close corporation may take part in the active management of corporate affairs. Hence, they, as ARDC's

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[117] **Sec. 25.** ***Corporate officers, quorum.*** — x x x.

The directors or trustees and officers to be elected shall perform the duties enjoined on them by law and the by-laws of the corporation. Unless the articles of incorporation or the by-laws provide for a greater majority, a majority of the number of directors or trustees as fixed in the articles of incorporation shall constitute a quorum for the transaction of corporate business, and every decision of at least a majority of the directors or trustees present at a meeting at which there is a quorum shall be valid as a corporate act, except for the election of officers which shall require the vote of a majority of all the members of the board.

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stockholders, are legally invested with the power to sue for the corporation.

As correctly claimed, under Section 97 of the Corporation Code,[118] a close corporation may task its stockholders with the management of business, essentially designating them as directors. However, the law is clear that a close corporation must do so through a provision to that effect contained in its articles of incorporation. Nowhere in ARDC's Articles of Incorporation[119] can such a provision be found. **There is nothing that expressly or impliedly allows Emmanuel, *et al.* and Angelita, or any of them, to manage the corporation**. Hence, the merger of stock ownership and active management that Emmanuel, *et al.* rely on cannot be applied to ARDC.

Further, assuming *arguendo* that ARDC is a close family corporation, the same cannot be considered a justification for noncompliance with the requirements for the filing of a derivative suit. In *Ang v. Sps. Ang*,[120] the Court declared:

> The fact that [SMBI] is a family corporation does not exempt private respondent Juanito Ang from complying with the Interim Rules. In the x x x *Yu* case, the Supreme Court held that a family corporation is not exempt from complying with the clear requirements and formalities of the rules for filing a derivative suit. There is nothing in the pertinent laws or rules which state that there is a distinction

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[118] **Sec. 97. *Articles of incorporation.*** — x x x.

The articles of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors. So long as this provision continues in effect:

x x x x x x x x x

2. Unless the context clearly requires otherwise, the stockholders of the corporation shall be deemed to be directors for the purpose of applying the provisions of this Code[.]

[119] *Rollo* (G.R. No. 211203), pp. 266-273.

[120] 711 Phil. 680 (2013).

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between x x x family corporations x x x and other types of corporations in the institution by a stockholder of a derivative suit.[121] (Citation omitted)

The next contention of Emmanuel, *et al.* is that Emmanuel, as President of ARDC, had the authority to institute the case and sign the certification against forum shopping. In support of their argument, they point to the By-laws of ARDC, which provide that the President is authorized "[t]o represent the corporation at all functions and proceedings" and "[t]o perform such other duties as are incident in his office or are entrusted by the Board of Directors."[122] They assert that jurisprudence has consistently recognized the legal standing of the president to bring corporate litigation.[123]

The argument deserves scant consideration.

Emmanuel's designation as President was ineffectual because ARDC did not have a board of directors. Section 25 of the Corporation Code explicitly requires the president of a corporation to concurrently hold office as a director.[124] This only serves to further highlight the key role of the board as a corporate manager. By designating a director as president of the corporation, the law intended to create a close-knit relationship between the top corporate officer and the collegial body that ultimately wields the corporation's powers.

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[121] *Id.* at 692-693.

[122] *Rollo* (G.R. No. 210906), p. 33.

[123] *Id.* at 32-35.

[124] **Sec. 25.** ***Corporate officers, quorum.*** — Immediately after their election, the directors of a corporation must formally organize by the election of a **president, who shall be a director**, a treasurer who may or may not be a director, a secretary who shall be a resident and citizen of the Philippines, and such other officers as may be provided for in the by-laws. Any two (2) or more positions may be held concurrently by the same person, except that no one shall act as president and secretary or as president and treasurer at the same time.

x x x (Emphasis supplied)

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The lower courts correctly refused to award damages

Turning now to Angelita's petition, she argues that the CA erred in deleting the award of moral damages and attorney's fees. According to her, the case filed before the Legazpi City RTC was totally baseless and unfounded.[125] To support her assertion, she points to the fact that Emmanuel and Corazon sued without the authority of ARDC's Board of Directors.[126] Essentially, Angelita claims that the filing of the case *a quo* amounted to malicious prosecution.

The argument fails to persuade.

Jurisprudence has defined malicious prosecution as "an action for damages brought by one against whom a criminal prosecution, civil suit, or other legal proceeding has been instituted maliciously and without probable cause, after the termination of such prosecution, suit, or other proceeding in favor of the defendant therein."[127] While generally associated with criminal actions, "the term has been expanded to include unfounded civil suits instituted just to vex and humiliate the defendant despite the absence of a cause of action or probable cause."[128] For an action based on malicious prosecution to prosper, it is indispensable that the institution of the prior legal proceeding be impelled or actuated by legal malice.[129]

Here, it was never shown that the institution of the case against Angelita was tainted with bad faith or malice. Since it is settled that she introduced improvements on ARDC's property without its consent, it follows that the complaint was not baseless at all. However, because the case was not brought by the

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[125] *Rollo* (G.R. No. 211203), p. 62.

[126] *Id*.

[127] *Heirs of Yasoña v. De Ramos*, 483 Phil. 162, 168 (2004).

[128] *Bayani v. Panay Electric Co., Inc.*, 386 Phil. 980, 986 (2000).

[129] *Id*. at 987.

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corporation, but by its stockholders, its dismissal was properly decreed by the trial court.

The fact that Emmanuel, *et al.* brought the case without the consent of the corporation cannot be equivalent to malice. Surely, they could have elected a board of directors to run ARDC's affairs, but their failure to do so, coupled with the filing of the complaint before the RTC, should not make them liable for moral damages. After all, the fact that a case is dismissed does not *per se* make that case one of malicious prosecution and subject the plaintiff to the payment of moral damages.[130] Since it is not a sound public policy to place a premium on the right to litigate, no damages can be charged on those who exercise such precious right in good faith, even if done erroneously.[131]

Neither does the Court see any cogent reason to award attorney's fees in favor of Angelita. Certainly, she only has herself to blame for the filing of the case before the RTC. If she did not introduce improvements on ARDC's property, Emmanuel, *et al.* would have no reason to institute an action against her. Since she treated corporate property as if it was her own, she should have reasonably expected retaliatory action from the other shareholders. Hence, the CA was correct to delete the award of attorney's fees.

WHEREFORE, the September 26, 2013 Decision and January 10, 2014 Resolution rendered by the Court of Appeals in CA-G.R. CV No. 99771 are **AFFIRMED**.

SO ORDERED.

Peralta (Chairperson), Hernando, and *Inting, JJ.*, concur.

Leonen, J., on wellness leave.

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[130] *Peralta v. Raval*, 808 Phil. 115, 136 (2017).

[131] *"J" Marketing Corp. v. Sia, Jr.*, 349 Phil. 513, 517 (1998).