Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City
Office of the General Counsel

April 21, 2014

SEC-OGC Opinion No. 14-04
Re: Qualification/Disqualification of Board of Directors; Conflict of Interest

DR. SHIRLEY JANE D. CHUA-PANGANIBAN
President/CEO
Mid/East Scientific Medical Equipment & Services, Inc.
Tropicana Suites 1630 L. Ma. Guerrero St.
Malate, Manila

Dear Dr. Chua-Panganiban,

This refers to your letter dated 25 June 2013 requesting for opinion regarding a conflict of interest of one of the members of your Board of Directors.

In your letter, you mentioned that on 21 December 2012, a corporate entity under the name of *Equilife Medical Equipment Supplies & Services, Inc. ("Equilife")* was registered with the Commission which has a similar primary purpose with your corporation, and which is eighty percent (80%) owned by Ma. Ysabel E. Valenzuela, the daughter of one of your Board of Directors, Abelardo H. Valenzuela III ("Mr. Valenzuela"). You further stated that *Equilife* is engaged in a business that is directly and substantially competing with your corporation by offering the same services that your company is rendering, thus, some of your clients did not renew their subsisting contracts with your corporation in favor of *Equilife* which adversely affected your business operations. You claim that this is possibly done through the efforts of Mr. Valenzuela, considering that as Director, he may have direct access to your corporation's business and trade plans.

Consequently, it is your lawyer's position that the act of Mr. Valenzuela constitutes a conflict of interest citing the case decided by the Supreme Court in *John Gokongwei, Jr. v. Securities and Exchange Commission, et al.*[1] which held that:

> (1) A director shall not be directly or indirectly interested as a stockholder in any other firm, company, or association which competes with the subject corporation.

[1] G.R. No. L-45911, 11 April 1979.

(2) **A director shall not be the immediate member of the family of any stockholder in any other firm, company, or association which competes with the subject corporation.**

(3) A director shall not be an officer, agent, employee, attorney, or trustee in any other firm, company, or association which compete with the subject corporation.

(4) A director shall be of good moral character as an essential qualification to holding office.

(5) No person who is an attorney against the corporation in a law suit is eligible for service on the board.

Accordingly, you now seek our opinion whether there exists a conflict of interest.

Please be advised that pursuant to SEC Memorandum Circular No. 15, Series of 2003, the Commission refrains from rendering an opinion on the matter stated in your request involving as it does the substantial and contractual rights of private parties who would, in all probability, contest the same in court if the opinion turns out to be adverse to their interest. Such is the nature of your query which involves rights that are litigious in nature and may thereafter lead to an intra-corporate issue, jurisdiction over which is already transferred to the Regional Trial Courts, pursuant to Section 5.2 of the Securities and Regulation Code ("SRC"). However, for purposes of information only, the following are imparted.

It is important to note that "every corporation has the inherent power to adopt by-laws for its internal government, and to regulate the conduct and prescribe the rights and duties of its members towards itself and among themselves in reference to the management of its affairs".[2] Thus, under section 47(5) of the Corporation Code, a corporation may prescribe in its by-laws the qualifications of its directors, officers and employees.

Accordingly, the qualification that "a director shall not be the immediate member of the family of any stockholder in any other firm, company, or association which competes with the subject corporation" is a qualificational by-law provision which may be added to

[2] *Ibid.*

those specified in the Corporation Code, (i.e. Section 23[3] and Section 27[4]), pursuant to the case of *Gokongwei v. Securities and Exchange Commission et al.*[5] Thus, corporations have the power to make by-laws declaring a person employed in the service of a rival company to be ineligible for the corporation's Board of Directors and a provision which renders ineligible, or if elected, subjects to removal, a director if he be also a director in a corporation whose business is in competition with or is antagonistic to the other corporation is valid.[6] However, these qualifications become effective only when the by-laws of the Corporation expressly provides for the same.

In this connection, as a general proposition, the Corporation Code provides the liability and accountability of directors as follows:

> **Sec. 31.** ***Liability of directors, trustees or officers.*** - Directors or trustees who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation or acquire any personal or pecuniary interest in conflict with their duty as such directors or trustees shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons.
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> When a director, trustee or officer attempts to acquire or acquires, in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed in him in confidence, as to which equity imposes a disability upon him to deal in his own behalf, he shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation.
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> **Sec. 34.** ***Disloyalty of a director.*** - Where a director, by virtue of his office, acquires for himself a business opportunity which should belong to the corporation, thereby obtaining profits to the prejudice of such corporation, he must account to the latter for all such profits by refunding the same, unless his

[3] xxx Every director must own at least one (1) share of the capital stock of the corporation of which he is a director, which share shall stand in his name on the books of the corporation. Any director who ceases to be the owner of at least one (1) share of the capital stock of the corporation of which he is a director shall thereby cease to be a director. Trustees of non-stock corporations must be members thereof. a majority of the directors or trustees of all corporations organized under this Code must be residents of the Philippines.

[4] No person convicted by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years, or a violation of this Code committed within five (5) years prior to the date of his election or appointment, shall qualify as a director, trustee or officer of any corporation.

[5] *Supra*, note 1.

[6] *Ibid.*

act has been ratified by a vote of the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock. This provision shall be applicable, notwithstanding the fact that the director risked his own funds in the venture.

In any case, it shall be understood that the foregoing opinion is rendered based solely on the facts and circumstances disclosed and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon courts, whether of similar or dissimilar circumstances.[7] If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Very truly yours,

CAMILO S. CORREA
General Counsel

[7] Paragraph 7, SEC Memorandum Circular No. 15, Series of 2003, Re: Requests for Legal Opinions.