procedural device to protect them is likewise provided for in the Constitution. The reason is obvious. By including in the Constitution a right to an effective remedy to protect social and economic rights, we spare them from the possible curtailment or destruction by the vagaries of shifting political majorities in the legislature. After all, these are human rights, deemed to spring from and adhere to the very nature, person, and dignity of man. They are not within the competence of society to abrogate – even by majority vote; they are in fact sometimes called "rights over society."

Furthermore, there can be no clearer way of showing the degree of seriousness and determination to see the realization and fulfillment of the social and economic rights enshrined in the fundamental law than to provide for an effective procedural remedy to enforce them.

The Philippine Constitution provides the basis for the Philippine writ of *amparo*, by introducing a new provision in Article VIII, Section 5(5), that empowers the Supreme Court to: "Promulgate rules concerning the protection and enforcement of constitutional rights..." This formulation was the idea of former Chief Justice Roberto Conception, Chairman of the Judiciary Committee of the Constitutional Commission, in connection with the proposal for a writ of *amparo*.

RESTATEMENT OF THE DOCTRINE OF PIERCING THE VEIL OF CORPORATE FICTION

CESAR L. VILLANUEVA*

INTRODUCTION

The title of this paper may expectedly lead to the impression that the main thrust would be to rehash existing decisions on the doctrine of piercing the veil of corporate fiction. Although that would be the process, the aim of this paper is to place more emphasis on the complementary relationship of the piercing doctrine to the *main doctrine* that a corporation has a juridical personality separate and distinct from the stockholders or members who compose it.

Looking at the number of decisions rendered by the Supreme Court where it has pierced the veil of corporate fiction, compared with the handful of decisions by which it has refused to apply the piercing doctrine and instead affirmed the main doctrine of separate juridical personality, may give one the impression that when the issue is whether or not to treat the corporation as a separate person, the main doctrine has lost some of its vitality, and that the piercing doctrine has grown lush and vital.

It is always comforting to note, especially for businessmen to whom the corporate entity has undoubtedly become the most popular medium by which to pursue business transactions, that the viability and vitality of a doctrine is to be tested not by the times it has been challenged and overcome in court decisions, but by the usefulness and frequency of its use in the market place. The enormity of the number of Supreme Court decisions applying the piercing doctrine does not even begin to show the thousands upon thousands of daily transactions negotiated and completed without a hitch employing the corporate entity.

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When dealing with piercing cases, it is always important to note that the aim which is, or at least would be, sought by the Supreme Court is not to use the doctrine as a ram to break down the ramparts of the main doctrine of separate juridical personality, but, more proper, for the ancillary piercing doctrine to act as a regulating valve by which to preserve the powerful engine that is the main doctrine of separate juridical personality.

It is important, therefore, to consider that the vitality of the main doctrine of separate juridical personality is essential in preserving and promoting the corporate entity by which the business community can continue to harness capital resources and undertake either risky or large-scale enterprises. And that the development of the piercing doctrine should not compete with, but rather, complement and vitalize and the main doctrine of separate juridical personality.

I. The Main Doctrine of Separate Juridical Personality

Since its introduction in the Philippines in 1906,[1] the corporation has been defined 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."[2] This same definition has been adopted by Section 2 of the present Corporation Code.[3]

The codal definition of the corporation is the basis of the main doctrine that a corporation has a personality separate and distinct from the stockholders or members who compose it. When studying Corporation Law, there is little direct consciousness that the doctrine of separate juridical personality also finds basis in Article 44 of the Civil Code which recognizes as juridical persons "[c]orporations, partnerships, and associations for private interests or purposes to which the law grants a juridical personality, separate and distinct from that of each shareholder, partner, or member."

[1] ACT No. 1459 passed by the then Philippine Commission, known as the CORPORATION LAW.

[2] Section 2, ACT No. 1459, and Section 2, BATAS PAMBANSA BLG. 25, CORPORATION CODE, Section 2 (1980).

[3] BATAS PAMBANSA BLG. 25 (1980).

The granting of a separate juridical personality to the corporate entity has been considered as the attribute or privilege most characteristic of the corporation.[4]

Unlike the cumbersome personality of its nearest rival, the partnership, the separate juridical personality of the corporation has features that have made it most attractive to businessmen: right of succession, limited liability, centralized management, and generally free transferability of shares of stock. Therefore, an undermining of the separate juridical personality of the corporation, such as the application of the piercing doctrine, necessarily dilutes any or all of these attributes. The main theory of separate juridical personality is, therefore, a legal creation; it is a fiction that readily gives way to the reality of the situation.

The stability of the main doctrine of separate juridical personality is inextricably linked with the attractiveness of the corporation as an efficient medium by which businessmen can pursue business enterprises. And the undermining of the main doctrine would also compel businessmen to enter into inefficient and costly contractual relations to fill in the gaps created by a flawed main doctrine.

The Supreme Court has not been wanting in paying lip service to the main doctrine of separate juridical personality, especially in recent years, when it seems, at every turn, that a proposition to pierce the veil of corporate fiction has become a knee-jerk reaction in most litigations involving corporate parties. However, as shown hereunder, the Supreme Court has not really taken a clear and direct path on this doctrine *vis-a-vis* the piercing doctrine.

In *Stockholders of F. Guanzon and Sons, Inc. v. Register of Deeds of Manila*,[5] the distribution of the corporate properties to the stockholders was deemed not in the nature of a partition among co-owners, but rather, a disposition by the corporation to the stockholders, as opposite parties to a contract. It held that "[a] corporation is a juridical person distinct from the members composing it [and that] [p]roperties registered in the name of the corporation are owned by it as an entity separate and distinct from its members. While shares of stock constitute the personal property, they do not represent property of the corporation. x x x A share of stock only typifies an aliquot part

[4] BALLANTINE, Sec. 287.

[5] 6 SCRA 373 (1962).

of the corporation's property, or the right to share in its proceeds to that extent when distributed according to law and equity, but its holder is not the owner of any part of the capital of the corporation, nor is he entitled to the possession of any definite portion of its property or assets. The stockholder is not a co-owner or tenant in common of the corporate property."[6]

Manila Gas Corp. v. Collector of Internal Revenue[7] held that the tax exemptions granted to a corporation do not pertain to its stockholders due to the separate corporate personalities. "A corporation has a personality distinct from that of its stockholders, enabling the taxing power to reach the latter when they receive dividends from the corporation. It must be considered as settled in this jurisdiction that dividends of a domestic corporation which are paid and delivered in cash to foreign corporations as stockholders are subject to the payment of the income tax, the exemption clause to the charter [of the domestic corporation] notwithstanding."[8]

Likewise, attempts by stockholders to intervene in suits against their corporations have been struck down in *Magsaysay-Labrador v. Court of Appeals*[9] on the basic premise that a party may intervene under remedial provisions if he has a legal interest in the matter in litigation; but that stockholders' right in corporate property is purely inchoate and will not entitle them to intervene in a litigation involving corporate property.

Magsaysay-Labrador held that a majority stockholder's interest in corporate property, "if it exists at all, x x x is indirect, contingent, remote, conjectural, [in]consequential and collateral. At the very least, their interest is purely inchoate, or in sheer expectancy of a right in the management of the corporation and to share in the profits thereof and in the properties and assets thereof on dissolution, after payment of the corporate debts and obligations."[10] "While a share of stock represents a proportionate or aliquot interest in the property of the corporation, it does not vest the owner thereof with any legal right or title to any of the property, his interest in the corporate property

[6] *Id.* at 375-376.

[7] 62 Phil. 895 (1936).

[8] Id. at 898

[9] 180 SCRA 266 (1989).

[10] *Magsaysay-Labrador v. Court of Appeals*, 180 SCRA 266, 271 (1989).

being equitable and beneficial in nature. Shareholders are in no legal sense the owners of corporate property, which is owned by the corporation as a distinct legal person."[11]

In *Saw v. Court of Appeals*,[12] the Supreme Court refused the petition for intervention filed by the stockholders in a collection case covering the loans of the corporation on the ground that the interest of shareholders in corporate property is purely inchoate; and this purely inchoate interest will not entitle them to intervene in a litigation involving corporate property.[13]

And *vice-versa* in *Sulo ng Bayan v. Araneta Inc.*[14] where an attempt by a non-stock and non-profit corporation organized for the benefit of its members to bring suit in behalf of its members for the recovery of certain parcels of land owned by the members was not allowed by the Supreme Court.

In *Traders Royal Bank v. Court of Appeals*,[15] actions sought to make officers and stockholders liable for corporate debts on the basis of such relationship alone have been turned down by the Supreme Court. "The corporate debt or credit is not the debt or credit of the stockholder nor is the stockholder's debt or credit that of the corporation."[16] *Cruz v. Dalisay*[17] held that the mere fact that one is president of the corporation does not render the property he owns or possesses the property of the corporation, since the president, as [an] individual, and the corporation are separate entities.[18]

In *Good Earth Emporium, Inc. v. Court of Appeals*,[19] the Supreme Court, in refusing to allow execution of a judgment debt of a corporation against the officer, held that being an officer or stockholder

[11] *Magsaysay citing* Ballantine 288-289; *Pascual v. Del Sanz Orozco*, 19 Phil. 82, 86 (1911).

[12] 195 SCRA 740 (1991).

[13] *Id.* at 744-745.

[14] 72 SCRA 347 (1976).

[15] 177 SCRA 789 (1989). The mere fact that an individual bound himself as surety for a corporations obligations does not vest the SEC exclusive jurisdiction over said individuals or over the latter's person or property in a rehabilitation and recievership proceedings pending with the SEC over the Corporate entity (*Traders Royal Bank v. Court of Appeals*, 177 SCRA 788, 792 [1989]).

[16] *Id.* at 792.

[17] 152 SCRA 487 (1987).

[18] *Id.* at 486. See also *Sulong Bayan, Inc. v. Araneta, Inc.* 72 SCRA 347, 354-355 (1976).

[19] 194 SCRA 544 (1991).

of a corporation does not by itself make one's property also that of the corporation, and *vice-versa*, for they are separate entities, and that shareholders are in no legal sense the owners of corporate property which is owned by the corporation as a distinct legal person.[20]

Development Bank of the Philippines v. National Labor Relations Commission[21] held that ownership of a majority of capital stock and the fact that a majority of directors of a corporation are the directors of another corporation creates no employer-employee relationship, nor does it make the controlling stockholder liable for the employees' claims that pertain to the subject corporation. Earlier, *Lidell & Co. v. Collector of Internal Revenue*[22] expressed the principle that mere ownership by a single stockholder or by another corporation of all or nearly all of the capital stock of the corporation is not by itself sufficient ground for disregarding the separate corporate personality.[23] Likewise, *Umali v. Court of Appeals*[24] held that the mere fact that the businesses of two or more corporations are interrelated is not a justification for disregarding their separate personalities, absent sufficient showing that the corporate entity was purposely used as a shield to defraud creditors and third persons of their rights.[25] Substantial ownership in the capital stock of a corporation entitling the shareholder a significant vote in the corporate affairs allows them no standing or claims pertaining to corporate affairs.[26]

II. Application of the Piercing Doctrine

A. When Applicable

The main doctrine of separate juridical personality is to be tempered by the supporting doctrine of piercing the veil of corporate fiction. Since both theories were transported to Philippine jurisdiction as part and parcel of the implantation of the American Corporation

[20] *Id.* at p. 550, citing *Traders Royal Bank v. Court of Appeals*, 152 SCRA 482 [1989] and *Cruz v. Dalisay*, 152 SCRA 482 [1989].

[21] 186 SCRA 841 (1990).

[22] 2 SCRA 632, 640 (1961).

[23] See also *Palay, Inc v. Clave*, 124 SCRA 638 (1983); *Pabalan v. National Labor Relations Commission*, 184 SCRA 495 (1990).

[24] 189 SCRA 529, 543 (1990).

[25] *Id.* at 543. Also *Diatagon Labor Federation v. Ople*, 101 SCRA 534 (1980).

[26] *PNB v. Phil. Neg. Oil Co.*, 49 Phil. 857, 853, and 862 (1927).

Law, the source of the piercing doctrine is also common law. But the magical words by which the piercing doctrine has come to be known[27] found their origins in the case of *United States v. Milwaukee Refrigerator Transit Co.*:[28]

> If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.[29]

The main value of the piercing doctrine to both corporate practitioners and their clients has always been to show them how to avoid both the application the courts of the doctrine to their particular situation as well as the consequences of said application, which is mainly to hold the associates in the venture personally liable for corporate obligations. Therefore, the discussions below study the main features of each of the three general classes of piercing, so that in actual practice counsel and their clients would know how to properly structure their transactions to avoid incurring the "ire" of judicial bodies.

B. Consequences of Piercing

Umali has held that when the piercing doctrine is applied in a case, the consequences would be that the members or stockholders of the corporation will be considered as the corporation, that is, liability will attach directly to the officers and stockholders.[30] However, earlier on, *Koppel (Philippines), Inc. v. Yatco*[31] ruled that the particular application of the piercing doctrine to a particular case does not deprive the corporation of legal personality for any and all purposes, but only for the particular transaction or instance in which the doctrine was applied.

[27] So common-place has the incatation been that even our own Supreme Court when it says the magic words does not even cite the case of *United States v. Milwaukee Refrigerator Transit Co.*, 142 Fed. 247 [1905]).

[28] 142 Fed. 247 (1905).

[29] *Id.* at 255.

[30] *Umali v. Court of Appeals*, 189 SCRA 529 (1990).

[31] 77 Phil. 496 (1946).

Since the piercing doctrine was fashioned to prevent fraud, or injustice, it would have no application in situations where no fraud or injustice would be prevented by the application of such doctrines, as to make officers and stockholders liable for corporate debts. Thus, in *Umali,*[32] the Supreme Court rejected the plea to pierce the veil of corporate fiction to achieve a remedy of declaring void foreclosure proceedings on the ground that "the legal corporate entity is disregarded only if it is sought to hold the officers and stockholders directly liable for a corporate debt or obligation. In the instant case, petitioners do not seek to impose a claim against the individual members of the three corporations which desire to enforce an alleged right against the petitioners."[33]

The application of the piercing doctrine is not a contravention of the principle that the corporate personality cannot be collaterally attacked. *Koppel*[34] held that when the piercing doctrine is applied against a corporation in a particular case, the court does "not deny legal personality x x x for any and all purposes, but [holds] in effect that in the transaction involved in [the] case the public interest and convenience should be defeated and what would amount to a tax evasion perpetrated, unless resort is had to the doctrine of 'disregard the corporate fiction.' In other words, in looking through the corporate form to the ultimate person or corporation behind that form, in the particular transactions that were involved in the case submitted to its determination and judgment, the court did so in order to prevent the contravention of the local internal revenue laws, and the perpetration of what would amount to a tax evasion x x x. The court did not hold that the corporate personality of Koppel (Philippines), Inc. would also be disregarded in other cases or for other purposes. It would have had no power to hold so."[35] The application of the piercing doctrine is, therefore, within the ambit of the principle of *res adjudicata* that binds only the parties to the case only to the matters actually resolved therein. Thus, even when a corporation's legal personality had been pierced in another case, it was held in *Tantongco v. Kaisahan ng mga Manggagawa sa La Campana and CIR*[36] that such corporation still

[32] 189 SCRA 529 (1990).

[33] *Id.* at 543.

[34] 77 Phil. 496 (1946).

[35] *Id.* at 504-505.

[36] 106 Phil. 199 (1959).

possessed such separate juridical personality in any other case. It therefore seemed logical to hold, as *Cruz v. Dalisay*[37] held, that, piercing the veil of corporate fiction is a remedy not available to administrative agencies. In *Cruz,* the executing sheriff, when he could not locate properties of the corporation to enforce a judgment debt, chose to pierce the veil of corporate fiction and levied on the properties of the president and majority stockholder of the corporation. The Supreme Court overruled such actuation because the sheriff had usurped a "power belonging to the court."

However, as will be discussed hereunder, the pronouncement in *Cruz* does not square with previous decisions of the Supreme Court where administrative application or the piercing doctrine, such as by the Bureau of Internal Revenue to uphold tax assessments,[38] have been upheld by the Supreme Court. Properly, therefore, the more appropriate application of *Cruz* would be that the administrative determination of the facts upon which the piercing doctrine is to be applied is subject to judicial or quasi-judicial review, as the case may be.

III. CLASSIFICATION OF THE PIERCING CASES

A review of the piercing cases decided by the Supreme Court would point out their classification into three major areas:[39]

(a) When the corporate entity is used to commit fraud or to do a wrong ("fraud cases");

(b) When the corporate entity is merely a farce, since the corporation is merely the alter ego, business conduit or instrumentality of a person or another entity ("alter ego cases"); and

[37] 192 SCRA 487 (1987).

[38] *Koppel (Philippines, Inc. v. Yatco,* 77 Phil. 496 (1946); *Yutivo Sons Hardware v. Court of Tax Appeals,* 1 SCRA 160 (1961); *Lidell & co. v. Collector of Internal Revenue,* 2 SCRA 632 (1961); *Commissioner of Internal Revenue v. Norton and Harrison,* 11 SCRA 714 (1954).

[39] Adolfo S. Azcuna in his article *"The Doctrine of Piercing the Veil of Corporate Fiction: A Review and Analysis of Philippine Supreme Court Decision from Willets to Ramirez"* (18 ATENEO L.J. Vol. 1, 9) groups them only into two: (1) when the corporate entity is used to promote fraud, injustice, illegality of wrong; and (2) the corporate entity is a mere alter ego, business, conduit, branch or agency of a person, natural or another corporation.1 (at 34).

However, *Umali v. Court of Appeals,* 189 SCRA 529 (1990), has impliedly recognized three (3) groupings (at 542).

(c) When the piercing the corporate fiction is necessary to achieve justice or equity ("equity cases").

Although when the corporate entity is used to commit a wrong or to achieve fraud, necessarily an alter ego scenario is likewise achieved, the main distinction between the fraud cases or piercing from the mere alter ego cases of piercing is that in the former, there is always an element of malice or the presence of an evil motive, while in the latter case, even in the absence of an evil motive, piercing would be allowed. The third category of equity cases has mainly become the "dumping ground" or perhaps the "added flourish" of the Supreme Court when it has to apply the piercing doctrine but cannot find it convenient to do so because no evil had been sought to be achieved, but, at the same time, the corporate juridical personality of the corporation has always been respected.

The three cases of piercing may appear together as in the case of *R.F. Sugay v. Reyes*[40] where an attempt by the corporation to avoid liability by distancing itself from the acts of its President, Mr. Romulo F. Sugay, alleging that he acted as agent for another corporation, was brushed aside by the Supreme Court when it held that the "dual roles of Romulo F. Sugay should not be allowed to confuse the facts relating to employer-employee relationship x x x[i]t being a legal truism that when the veil of corporate fiction is made a shield to perpetrate a fraud and/or confuse legitimate issues (in this case, the relation of employer-employee), the same should be pierced. Verily, the R.F. Sugay & Co., Inc. is a business conduit of R.F. Sugay."[41]

IV. FRAUD CASES

Gregorio Araneta, Inc. v. Tuason de Paterno and Vidal[42] held that the piercing doctrine is employed to prevent the commission of fraud and cannot be employed to perpetuate a fraud. In that case, Tuason sold lots to G. Araneta Inc. Subsequently, the corporation filed a case against Tuason to compel delivery of clean title to said lots. Tuason claimed that the sale was made to her agent, Jose Araneta, president of the corporation, and therefore the corporate fiction should be disregarded,

[40] SCRA 700 (1964).

[41] *Id.* at 705.

[42] 91 Phil. 786 (1952).

since the sale was invalid for being made to an agent of the seller.[43] The Supreme Court ruled that corporate fiction will not be disregarded because the corporate entity was used neither to perpetuate fraud nor to circumvent the law, and the disregard of the technicality would pave the way for the evasion of a legitimate and binding commitment, especially since Tuason was fully aware of the position of Mr. Araneta in the corporation at the time of the sale.

Since the piercing doctrine is meant to prevent the commission of fraud, it cannot apply when it would allow persons or entities to gain advantages.[44]

In addition, the piercing doctrine offers a remedy of last resort and will not be applied, even in case of fraud, if other remedies are available to the parties. Thus, in *Umali* the Supreme Court refused to apply the piercing doctrine since the petitioners were "merely seeking the declaration of the nullity of the foreclosure sale, which relief may be obtained without having to disregard the aforesaid corporate fiction attaching to respondent corporations, [especially since] petitioners failed to establish by clear and convincing evidence that private respondents were purposely formed and operated, and thereafter transacted with petitioners, with the sole intention of defrauding the latter."[45]

In *Commissioner of Internal Revenue v. Norton and Harrison*[46] where the parent corporation owned all the outstanding stocks of the subsidiary corporation; where parent corporation financed all the operations of the subsidiary; where the parent treated the subsidiary's employees as its own; where the officers of both corporations were located in the same compound; where the Board of the subsidiary was constituted in such a way as to enable the parent to actually direct and manage the subsidiary's affairs, because the same officers comprised the Boards for both corporations; and where the fiction of

[43] Under Article 1491 of the REPUBLIC ACT NO. 386, CIVIL CODE OF THE PHILIPINES, a purchase by an agent of the property of the principal is void.

[44] In *Burnett Commisioner v. Clarke*, 287 US 410, 53 S.Ct. 207, 77 L.Ed. 397, the United States Supreme Court refused to allow a taxpayer to use the piercing doctrine to gain a tax advantage. Clarke indorsed his notes for a corporation of which he was majority stockholder. He sustained losses by virtue of such endorsement. Such losses cannot be deducted from his income tax returns, because first, it did not result from any operation of any trade or business a corporation and its stockholders are generally to be treated as separate entities, and second, only under exceptional circumstances can the difference be diregarded.

[45] 189 SCRA 529, 543 (1990).

[46] 11 SCRA 714 (1954).

corporate entity was being used as a shield for tax evasion by making it appear that the original sale was made by the parent corporation to the subsidiary corporation in order to gain a tax advantage, the courts will not hesitate to pierce the veil of corporate fiction and treat as void the sales between the two corporations.

Since *Norton and Harrison* is a fraud case, one begins to wonder why there was a need to show that the subsidiary corporation was being used as an instrumentality or conduit of the parent corporation, since even in the absence of such evidence, piercing to prevent fraud (i.e., tax evasion) would have been warranted. Must fraud cases necessarily be accompanied by alter-ego elements to make a fraud case stick for application of the piercing doctrine?

It would seem not to be necessarily so, because fraud is a matter of proof, and often it is a state of the mind being founded on *malice*. It becomes necessary, therefore, that in order to establish the state of mind of the stockholders to make them liable for corporate debts, or, as in the case of *Norton and Harrison*, in order to consider two separate entities as one and the same, there is an imperative need to detail the circumstances which show that the corporate fiction is being used consciously as a means to commit a fraud. In short, the alter-ego circumstances are needed to prove the malicious intent of the parties.

In *Namarco v. Associated Finance Co.*[47] it was held that where a stockholder, who has absolute control over the business and affairs of the corporation, entered into a contract with another corporation through fraud and false representations, such stockholder shall be liable jointly and severally with his co-defendant corporation even when the contract sued upon was entered into on behalf of the corporation.

Namarco demonstrates an instance when a fraud case overlaps with an alter ego case, as the Supreme Court held: "We feel perfectly justified in 'piercing the veil of corporation fiction' and in holding Sycip personally liable, jointly and severally with his co-defendant, for the sums of money adjudged in favor of the applicant. It is settled law in this and other jurisdictions that when the corporation is the mere *alter ego* of a person, the corporate fiction may be disregarded; the same being true when the corporation is controlled and its affairs so conducted, as to make it merely an instrumentality, agency, or conduit of another."[48]

[47] 19 SCRA 962 (1967).

[48] *Id.* at 965.

Other than having entered into a fraudulent contract in the name of the corporation – a transaction which normally would never have been approved by the board of directors – Sycip was not found to have engaged consistently in the practice of using the corporation as an alter ego. Therefore, in fraud cases, the alter ego concept may be employed even for a single transaction to do evil. This is unlike pure alter ego cases where the courts go into systematic findings of utter disregard of and disrespect for the separate juridical person of the corporation.

In *Palacio v. Fely Transportation Co.*,[49] where it was found that an incorporator's main purpose in forming the corporation was to evade his subsidiary civil liability resulting from the conviction of his driver, the Supreme Court held a corporation liable for such subsidiary civil liability by rejecting its defense that it had a separate juridical personality and could not, as a result, be held liable for the personal liabilities of its stockholder. The Court considered, as part of the attempt to do fraud the fact that the only property of the corporation was the jeep owned by the main stockholder who was involved in the accident.

A. Liability of Officers

The general rule is laid down in *Palay, Inc. v. Clave*:[50] unless "sufficient proof exists on record" that an officer (in this case, a president and controlling stockholder) has "used the corporation to defraud private respondent" he cannot be made personally liable "just because he appears to be the controlling stockholder."[51] "Mere ownership by a single stockholder or by another corporation of all or nearly all of the capital stock of a corporation is not of itself sufficient ground for disregarding the separate corporate personality."[52]

Pabalan v. National Labor Relations Commission[53] held that "[t]he settled rule is that the corporation is vested by law with a personality separate and distinct from the persons composing it, including its officers, as well as from that of any other entity to which it may be

[49] 5 SCRA 1011 (1962).

[50] 124 SCRA 638 (1983).

[51] *Id.* at 648-649.

[52] *Id.* at 649.

[53] 184 SCRA 495 (1990).

related x x x [and an officer] acting in good faith within the scope of his authority x x x cannot be held personally liable for damages."[54]

Pabalan refused to hold the officers of the corporation liable for corporate obligations on employee's wages, since "[i]n this particular case complainants did not allege or show that petitioners, as officers of the corporation deliberately and maliciously designed to evade the financial obligations of the corporation to its employees, or used the transfer of the employees as a means to perpetrate an illegal act, or as a vehicle for evasion of existing obligations, the circumvention of statutes, or to confuse legitimate issues."[55]

In *R.F. Sugay v. Reyes*[56] an attempt by the corporation to avoid liability by distancing itself from the acts of its President was struck down by the Supreme Court which held that a corporation may not distance itself from the acts of a senior officer: "the dual roles of Romulo F. Sugay should not be allowed to confuse the facts."[57] To the same effect is the ruling in *Paradise Sauna Massage Corporation v. Ng*[58] where it was held that an officer-stockholder who is a party signing in behalf of the corporation to a fraudulent contract cannot claim the benefit of separate juridical entity: "Thus, being a party to a simulated contract of management, petitioner Uy cannot be permitted to escape liability under the said contract by using the corporate entity theory. This is one instance when the veil of corporate entity has to be pierced to avoid injustice and inequity."[59]

However, in the field of labor, liability of corporate officers for corporate obligations to employees seems to have taken two different strains.

In *A.C. Ransom Labor Union-CCLU v. National Labor Relations Commission*,[60] the Supreme Court, interpreting the Labor Code, held that since a corporate employer is an artificial person, it must have an *officer* who can be presumed to be the *employer*, being the "person acting in the interest of (the) employer" as provided in the Labor Code.

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[54] *Id.* at p. 499.

[55] *Id.* at 500.

[56] 12 SCRA 700 (1964).

[57] *Id.* at 705.

[58] 181 SCRA 719 (1990).

[59] *Id.* at 729.

[60] 142 SCRA 269 (1986).

Therefore, *A.C. Ransom* held that "the responsible officer of the employer corporation can be held personally, not to say even criminally, liable for the non-payment of backwages; and that in the absence of definite proof as to the identity of an officer or officers of the corporation directly liable for failure to pay backwages, the responsible officer is the president of the corporation jointly and severally with other presidents of the same corporation.

In effect, *A.C. Ransom* would hold a corporate officer liable for corporate obligations by the mere fact that he is the highest officer, even when there is no proof that he acted in the particular matter for the corporation.

In *Del Rosario v. National Labor Relations Commission*,[61] the Supreme Court, stating that the doctrine in *A.C. Ransom* was inapplicable without further explanation, refused to allow a writ of execution against the properties of officers and stockholders for a judgment rendered against the corporation, which was later found to be without assets, on the ground that "[b]ut for the separate juridical personality of a corporation to be disregarded, the wrongdoing must be clearly and convincingly established. It cannot be presumed." In addition, it was held that "[t]he distinguishing marks of fraud were therefore clearly apparent in *A.C. Ransom*. A new corporation was created, owned by the same family, engaging in the same business, and operating in the same compound." In short, *Del Rosario* re-affirmed the original doctrine before the *A.C. Ransom* pronouncement that in order for a corporate officer or stockholder to be held liable for corporate debts, it must clearly be shown that he had participated in the fraudulent act.

This principle was reinforced in *Western Agro Industrial Corporation v. Court of Appeals*[62] which held that a corporate officer cannot be made personally liable for a corporate debt simply because he had executed the contract for and in behalf of the corporation. It explained that when a corporate officer acts in behalf of a corporation, pursuant to his authority, there results "a corporate act for which only the corporation should be made liable for any obligations arising from them."[63]

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[61] 187 SCRA 777 (1990).

[62] 188 SCRA 709 (1990).

[63] *Id.* at 718.

Two months after *Del Rosario*, the Supreme Court, in *Maglutac v. National Labor Relations Commission*,[64] held a corporate officer liable for the claims against the corporation, relying upon the *A.C. Ransom* ruling, but only with respect to the doctrine that the responsible officer of a corporation who had a hand in illegally dismissing an employee should be held personally liable for the corporate obligations arising from such act.

B. *In Summary*

From all the foregoing, what clearly comes out as the guiding rule is that piercing is allowed in fraud cases only when the following elements are present:

(a) there must have been fraud or an evil motive in the affected transaction, and the mere proof of control of the corporation, by itself, would not authorize piercing; and

(b) the main action should seek the enforcement of pecuniary claims pertaining to the corporation against corporate officers or stockholders.

Fraud cases requiring the application of the piercing doctrine should, therefore, be properly read as viewing the corporate entity from outside, from the perspective of those in the business community who have to deal with corporations on the other side of the bargaining table. If shady businessmen can hide behind the fortress of the separate juridical personality, then it would make dealings with corporations more tentative since the outside party must demand additional assurances (such as joint and solidary undertakings by key officers and stockholders or corporate liabilities) from the players behind the corporation.

Applying the piercing doctrine in fraud cases, therefore, is an assurance to the public that deals with the corporation that, in cases of mischief by the actors behind the corporate entity, the public would have a remedy against the very actors themselves. This safety hatch, in fact, makes the corporate entity attractive not only for the businessmen who employ it, but also for the parties who have to contract with such corporate entities.

In addition, a basic public policy abounds in fraud cases of piercing, similar to the doctrine of why, in criminal corporate acts, it is the actor

[64] 189 SCRA 767 (1990).

behind the corporation, and not the corporate entity, that is liable for the criminal prosecution. Without the fraud cases of piercing, the corporate entity would become a shield behind which unscrupulous businessmen may hide and perhaps even become dangerously aggressive in undertaking shady deals, because there would be no risk of personal liability for their fraudulent acts. To maintain separate juridical personality under such circumstances would, therefore, encourage fraudulent activities within society. Instead of making the corporation an attractive medium, the dastardly deals closed through exploited corporate entities could put corporations at the periphery or, perhaps, even in the underworld of business dealings.

V. ALTER EGO CASES

The first Philippine case to apply the piercing doctrine is actually *Arnold v. Willets and Patterson, Ltd.*,[65] and it was clearly an alter ego case.[66] It expressed the language of the piercing doctrine when applied to alter-ego cases:

> Where the stock of a corporation is owned by one person whereby the corporation functions only for the benefit of such individual owner, the corporation and the individual should be deemed the same.[67]

In *Arnold*, the creditors' committee of the corporation opposed the payment of compensation due to the plaintiff Arnold under a contract-letter signed by the president and controlling stockholder Willit but without board approval. The Supreme Court upheld the validity of the contract and "[a]lthough the plaintiff was the president of the local corporation, the testimony is conclusive that both of them were what is known as a one-man corporation, and Willits, as the owner of all the stocks, was the force and dominant power which controlled them."[68]

In *La Campana Coffee Factory v. Kaisahan ng Manggagawa*,[69] Tan Tiong and his family owned and controlled two corporations, one

[65] 44 Phil. 664 (1923).

[66] The Court found that "There is no claim or pretense that ther was any fraud or collusion between plaintiff and Willits, and it is very apparent that Exhibit B was to the mutual interests of both parties." *Id*, at 643.

[67] *Id.* at 645 citing U.S. v. Mackay Wall Plaster, Co., 199 Pac. 249.

[68] *Id.* at 641.

[69] 93 Phil. 160 (1953).

engaged in the sale of coffee, and the other, in starch. Both corporations had one office, one management, and one payroll. The laborers of both corporations were interchangeable. The 60 members of the labor association in the coffee and starch factories demanded for higher wages and addressed their grievances to "La Campana Starch and Coffee Factory." La Campana Coffee Factory sought the dismissal of the petition on the ground that the starch and coffee factory are two distinct juridical persons. The Court disregarded the fiction of corporate existence, as the two companies are but one.

It should be noted that cases like *La Campana Coffee Factory*, where the issue is the jurisdiction of the Court of Industrial Relations to hear the matter, show that, unlike in fraud cases where there must be a pecuniary claim as enunciated in *Umali*, in alter ego cases, no such pecuniary claim need be involved to allow the courts to apply the piercing doctrine.

The same was true in *Marvel Building v. David*,[70] where corporate properties were about to be sold by the Bureau of Internal Revenue (BIR) in order to enforce payment of the tax liabilities of its stockholder, Castro. The Court found that Castro and ten others had incorporated Marvel Building Corporation. It seems that the ten other incorporators were mere dummies. The Court upheld the BIR's finding that the corporation was a mere alter ego of Castro, as it appeared that she had enormous profits, and accordingly, had the motive to set up such a title-holding shield: that duplicate stock certificates had been issued to various purported stockholders lacking the means to pay their alleged subscriptions and no receipts were issued for subscriptions paid; that no stockholder's or director's meeting was ever held; that the books of account treated everything as belonging to and controlled by Castro. Although it would seem that *Marvel* should be classified as a fraud case (evasion of taxes), this would not seem to be so under that case.

In *Yutivo Sons Hardware v. Court of Tax Appeals*[71] Yutivo Sons and Hardware Co. imported cars and trucks, which it sold to Southern Motors, Inc. Sales taxes were paid by Yutivo on this first sale. Southern Motors sold the vehicles to the public. The Collector of Internal Revenue sought to impose the sales tax not on the basis of Yutivo's sales to Southern Motors, but on Southern Motors' sale to the public. To this, the Supreme Court agreed; although, it found that Southern Motors was not organized to perpetuate fraud. However, Southern Motors was, indeed, actually owned and controlled by Yutivo as to make it a mere subsidiary or branch of the latter. Yutivo, through officers and directors common to it and Southern Motors, exercised full control over the cash funds, policy, expenditures, and obligations of the latter.

[70] 94 Phil. 376 (1954).

[71] 1 SCRA 160 (1961).

In *Lidell & Co. v. Collector of Internal Revenue*,[72] Lidell & Co. was engaged in importing and retailing cars and trucks. Frank Lidell owned 98% of its stocks. Later, Lidell Motors was organized to do retailing for Lidell & Co. Frank's wife owned almost all of its stocks. Since then, Lidell & Co. paid sales tax on the basis of its sales to Lidell Motors, but the Collector of Internal Revenue considered the sales by Lidell Motors to the public as the basis for the original sales tax. The Court agreed with the Collector. Frank owned both corporations as his wife could not have had the money to pay for her subscriptions. This fact alone, however, is not sufficient to warrant piercing. In this case, Lidell Motors was the medium created by Lidell & Co. to reduce its tax liability. A taxpayer has the legal right either to decrease, by means which the law permits, the amount of what otherwise would be his taxes or to altogether avoid paying taxes; but the separate personality of a dummy corporation serving no business purpose other than as a blind will be disregarded.

Yutivo and *Lidell* (and therefore *Marvel*) are alter ego cases and not fraud cases; although, the clear intention of the parties was to minimize taxes, and the Supreme Court clearly decreed that no imposition of surcharge by the BIR due to fraud was proper in these cases. The Supreme Court held in a language so sweet to the ears of businessmen and tax lawyers that "the legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted x x x [and] a taxpayer may gain advantage of doing business through a corporation if he pleases, but the revenue officers in proper cases, may disregard the separate corporate entity where it serves but as a shield for tax evasion and treat the person who actually may take the benefits of the transactions as the person accordingly taxable."[73]

[72] SCRA 632 (1961).

[73] *Id.* at 641, citing *Gregory v. Helvering*, 293 U.S. 465, 7 L.Ed. 596, 599, 55 S.Ct.

Thus, no less than the Supreme Court has stated that the use of the corporate entity to gain an advantage (such as minimizing taxes due) is not by itself a fraudulent scheme. The corporate entity is there for both businessmen and lawyers to tinker with in order to gain every advantage available under the law, and that alone is not a reprehensible act.

In *Ramirez Telephone Corp. v. Bank of America*,[74] Ramirez had unpaid rents due Herbosa. The latter sought to garnish Ramirez's bank account, but no such personal account existed, and only an account in the name of Ramirez Telephone Corp. could be found and was garnished. The Supreme Court held that the corporate bank account can be garnished despite the fact that Ramirez himself leased Herbosa's premises because of the following: (1) although Ramirez was the tenant, the company, in truth, occupied the premises; (2) Ramirez paid the rent with checks of the telephone company; and (3) 75% of the shares of the company belonged to Ramirez and his wife.

In *Madrigal Shipping v. Oglivie*,[75] the crew members of SS Bridge brought an action against Madrigal Shipping Company for payment of their salaries. It seemed, however, that Madrigal & Co. was the registered owner of SS Bridge. The Supreme Court held that, granting that it was not the Madrigal Shipping Co. that owned SS Bridge but Madrigal & Co., a corporation with a juridical personality distinct from the former, yet as the former was the subsidiary of the latter, and, as found by the facts, a business conduit for the latter, the fiction of corporate existence may be disregarded to make the former liable for the claims.

In *McConnel v. Court of Appeals*,[76] a forcible entry case, the corporation was ordered to pay damages, but such corporation was later found to be without sufficient assets, so the defendant went after the properties of the stockholders. The Supreme Court decided to pierce and held the stockholders liable for the deficiency. Although it held that mere ownership of all or nearly all of the stocks does not make a corporation a business conduit of the stockholders, in that case, the operation of the corporation was so merged with those of the stockholders as to be practically indistinguishable. Furthermore, they

[74] 29 SCRA 191 (1969).

[75] Supreme Court Advanced Decision, October, 1958 issue; 55 O.G. No. 35, p. 7331.

[76] 1 SCRA 722 (1961).

had the same office, the funds were held by the stockholders, and the corporation had no visible assets.

One cannot be sure whether *McConnel* is clearly an alter ego case or a fraud case of piercing, since the Supreme Court has cited and fused the magical *Milwaukee* chants on piercing in fraud cases together with the alter ego formula. No fraud seems to have been intimated in the decision, since the conclusion was based more on the findings of the lower court that "the evidence clearly shows that these *persons completely dominated and controlled the corporation and that functions of the corporation were solely for their benefits.*"[77]

However, it is in *McConnel* where the Supreme Court took special notice of the fact that "[t]he corporation itself had no visible assets, as correctly found by the trial court, *except perhaps the toll house, the wire fence around the lot and the signs thereof. It was for this reason that the judgment against it could not be fully satisfied.*"[78] Does the incorporation of an entity without reasonable assets to support the undertaking or venture for which it is organized constitute a fraud against the corporate creditors? From the decision in *McConnel*, it would not seem so, since after noting the lack of visible assets of the corporation, the Supreme Court held:

> The facts thus found can not be varied by us, and conclusively show that the corporation is a mere instrumentality of the individual stockholders, hence, the latter must individually answer for the corporate obligations. While the mere ownership of all or nearly all of the capital stock of a corporation [does not make it] a mere business conduit of the stockholder, that conclusion is amply justified where it is shown, as the case before us, that the operations of the corporation were so merged with those of the stockholders as to be practically indistinguishable from them. To hold the latter liable for the corporation's separate entity, but merely to apply the established principle that such entity can not be invoked or used for purposes that could not have been intended by the law that created that separate personality.[79]

Under-capitalizing a corporate entity, as distinguished from siphoning off corporate assets, is, therefore, a species of alter ego cases, especially so when it is never considered prudent business practice

[77] *Id.* at 725.

[78] *Id.* at 726.

[79] *Id.* at 726.

for ventures to shoulder all the capital needed for the venture when credit therefor is available. Thus, leveraging is an accepted and, indeed, idealized business practice. More importantly, most corporate creditors extend credit to the corporation after having studied the financial statements of the corporation, and the allegation of under-capitalization would have been apparent from such statements. Corporate creditors, therefore, extend credit fully aware of the risk involved in case of under-capitalization, and the element of fraud generally does not attain by that fact alone.

A. *Parent-Subsidiary Relationship*

The alter ego doctrine has been applied unevenly in the area of the parent-subsidiary relationship. We start with the premise laid down in *Lidell & Co. v. Collector of Internal Revenue*:[80]

> It is of course accepted that the mere fact that one or more corporations are owned and controlled by a single stockholder is not of itself sufficient ground for disregarding separate corporate entities. Authorities support the rule that it is lawful to obtain a corporate charter, even when a single substantial stockholder, to engage in a specific activity, and such activity may co-exist with other private activities of the stockholder. If the corporation is a substantial one, conducted lawfully and without fraud on another, its separate entity is to be respected.[81]

While ownership of the controlling capital stock of the corporation by itself would not authorize piercing, this control feature, existing together with other factors, has been given much weight by the courts in their decision to pierce.

Thus, in *Koppel (Phil.), Inc. v. Yatco*,[82] the Supreme Court found that virtual control of the shareholdings of a corporation would lead to certain legal conclusions, as a result:

> x x x. We cannot overlook the fact that in the practical working of corporate organizations of the class to which these two entities belong, the holder or holders of the controlling part of the capital stock of the corporation, particularly where the control is determined by the virtual ownership of the totality of the shares, dominate not only the selection of the Board of Directors but, more often than not, also the action of the board. Applying this to the instant case, we can not conceive how the Philippine corporation could effectively go against the policies, decisions, and desires of the American corporation x x x. Neither can we conceive how the Philippine corporation could avoid following the directions of the American corporation in every other transaction where they both had to intervene, in view of the fact that the American corporation held 99.5 per cent of the capital stock of the Philippine corporation x x x.[83]

Fortunately, the pronouncements in *Koppel* should not constitute precedents in alter ego cases simply because *Koppel* actually involved a fraud case of piercing, and there were, in fact, numerous findings in the decision where the subsidiary corporation was made an instrumentality of the parent corporation.[84]

The afore-quoted *Lidell* pronouncements have been reaffirmed in *Development Bank of the Philippines v. National Labor Relations Commission*[85] where, despite the fact that DBP was the majority stockholder of Philippine Smelters Corporation (PSC), that majority of PSC's board members came from DBP, and that DBP was the mortgagee to practically all the properties of PSC, in order, the Supreme Court still refused to pierce the veil of corporation fiction to make DBP liable for the claims of PSC's employees: "We do not believe that these circumstances are sufficient indicia of the existence of an employer-employee relationship as would confer jurisdiction over the case of the labor arbiter." To the same effect is the earlier ruling in *Diatagon Labor Federation v. Ople*.[86]

However, in *Philippine Veterans Investment Development Corporation v. Court of Appeals*[87] things took a different turn.[88] In that case,

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[80] 2 SCRA 632 (1961).

[81] *Id.* at p. 640.

[82] 77 Phil. 497 (1946).

[83] *Id.* at 508-509.

[84] The subsidiary corporation bore the expenses of the parent company; used its own inventory to cover orders from the parent company; answered for the drafts of the parent company; had key officers residing in the United States; and employed simple booking entries for credits due from the parent company.

[85] 186 SCRA 841 (1990).

[86] 101 SCRA 534 (1980).

[87] 181 SCRA 669 (1990).

[88] I am always frightened by Supreme Court decisions that seeks to oversimplify things, as Justice Cruz enunciated in his opening statement in *Philippine Veterans Investment Development Corporation* (181 SCRA 669, 670): "The concept of piercing the veil of corporate fiction is a mystique to many people, especially the layman, but it is not as esoteric as all that is this case will demonstrate."

PHIVIDEC sold its controlling equity interests in PRI to PHILSUCOM, with a stipulation that PHIVIDEC shall hold PHILSUCOM free and harmless against all liabilities of PRI. PHILSUCOM subsequently formed the Panay Railways, Inc. to operate the railway assets acquired from PHIVIDEC. Borres, a prior creditor of PRI, sued both PRI and Panay Railways, and the latter, in turn, filed a third-party complaint against PHIVIDEC. In the judgment, PHIVIDEC was held liable with PRI on the claims of Borres.

PHIVIDEC contended before the Supreme Court that it cannot be held liable for the debts of PRI since it is an entirely distinct and separate corporation from PRI; although, the latter is its subsidiary. It also argued that the transfer of shares of stock of PRI to PHILSUCOM did not divest PRI of its juridical personality or of its capacity to direct its own affairs and conduct its own business under the control of its own board of directors, and that, by the same token, it is answerable for its own obligations, which cannot be passed on to PHIVIDEC as the latter's own liability.

Aside from the fact that PHIVIDEC agreed expressly to hold PHILSUCOM (and also consequently the latter's subsidiary Panay Railways, Inc. which filed a third-party complaint against PHIVIDEC) free and harmless against claims arising before the transfer of PRI, the Supreme Court held for the piercing of the corporate fiction on the following principle:

> Where it appears that two business enterprises are owned, conducted, and controlled by the same parties, both law and equity will, when necessary to protect the rights of third persons, disregard the legal fiction that two corporations are distinct entities, and treat them as identical.[89]

The factual basis used by the Supreme Court in order to enforce the above-quoted doctrine is the finding of the trial court that "PHIVIDEC's act of selling PRI to PHILSUCOM shows that PHIVIDEC had complete control of PRI's business."[90] Perhaps there were other considerations in the lower court's findings showing that indeed PHIVIDEC had complete control over PRI, but they certainly were not mentioned in the Supreme Court's decision. It is, therefore, unfortunate, and perhaps even tragic, that to allow a piercing under the alter

[89] *Id.* at 673, citing *Jabney v. Belmont Country Club Properties, Inc.* 279 Pac. 829.

[90] *Id.* at 674

ego doctrine, the Supreme Court would use the sale by a parent company of its shareholdings in a subsidiary to demonstrate complete control over the subsidiary. The result of such a doctrine would be that in cases of "equity transfers" as discussed below, contrary to the ruling in *Edward J. Nell Company v. Pacific Farms, Inc.*,[91] the applicable rule would be that the transferor is always liable for the corporate liabilities of the corporation whose shares are transferred, in complete derogation of the main doctrine of separate juridical personality.

Logically, a stockholder always has complete and near-absolute control over the share he holds in a corporation. But that does not necessarily mean that he has complete control over the affairs and transactions of the corporation. Perhaps the Supreme Court forgot its own pronouncement that shares of stock in a corporation do not translate into any interest in corporate properties, as it held in *Stockholders of F. Guanzon and Sons Inc. v. Register of Deeds of Manila*,[92] *Magsaysay-Labrador v. Court of Appeals*,[93] *Saw v. Court of Appeals*,[94] and *Sulo ng Bayan, Inc. v. Araneta, Inc.*[95]

B. *Transfer of Business Enterprise*

There is a species of alter ego cases which deserves separate discussion. Often, a business enterprise, apart from the juridical personality under which it operates, has a "separate being" of its own. Properly, a business enterprise comprises more than just the properties of the business, but includes a "being" that covers the employees, the goodwill, the list of clientele suppliers, among others, which give it a value separate and distinct from its owners or the juridical entity under which it operates. This is what is termed as the "economic unit," "the enterprise," "the going concern," or the "financial unit" recognized in other disciplines such as economics and accounting. Thus, in accounting, although a business enterprise is carried on in the form of a single proprietorship (and therefore has no separate juridical personality), it is considered and accounted for as a separate accounting unit apart from the other assets and business of the proprietor.

[91] 15 SCRA 415 (1965).

[92] 6 SCRA 373 (1962).

[93] 180 SCRA 266 (1989).

[94] 195 SCRA 740 (1991).

[95] 72 SCRA 347 (1976).

In fact, a business enterprise is by itself a "concern" that has a separate economic or selling value from its owners, and businessmen's evaluation of whether to purchase such enterprise or not do not only look at the properties of the business but many other intangibles that really have no economic or monetary value (except when expressed as goodwill in accounting), such as the moral and technical competence of the employees and middle-management, the list of its valued clientele, etc. And although formal jurisprudential doctrine refuses to recognize a separate existence of the business enterprise other than the juridical personality that the State grants to corporations[96] and partnerships,[97] such separate existence of the business enterprise does exist and is recognized in the business world.

In *A.D. Santos v. Vasquez,*[98] where the Supreme Court upheld a judgment in suit for workmen's compensation against the corporate taxi cab company, despite the testimony of the claimant that he was employed not by the taxi cab company, but rather by the majority stockholder in his personal capacity, it observed that, although in truth, the majority stockholder operated the business under a sole proprietorship scheme, he subsequently transferred operations to the taxi cab company.

In *San Teodoro Development Enterprise, Inc. v. Social Security System,*[99] although the business enterprise was originally held under a partnership scheme and later the business was transferred to a corporation, the business enterprise was deemed to have been in operation for the required two-year period as to come under the coverage of the SSS law.

> On the strength of the foregoing facts, the Social Security Commission found that the dissolution of the partnership and the organization of the corporation were effected in such sequence as to insure the smooth and orderly transfer of the business from the partnership to the corporation without interruption in the function of the business; that the entire business of the partnership, including the materials and equipment used in connection therewith, consideration; and that even the name of the corporation was the same as the tradename of the partnership, and apparently their employees are also the same. All these, the Commission said, coupled with the fact that four out of the five members of the partnership do not only own the controlling stock of the corporation, indicates in a conclusive manner that there was merely a change in the juridical personality of the entity operating the business, so that it may be said that the substance of the juridical person owning and operating the business remain the same if its legal personality has changed.[100]

Although there was no fraud intended, *San Teodoro* held that the possibility of fraud allowed the application of the piercing doctrine.

To the same effect is *Laguna Trans. Co., Inc. v. Social Security System*[101] where the Supreme Court held that "[t]he corporation continued the same transportation business of the unregistered partnership, using the same lines and equipment. There was, in effect, only a change in the form of the organization of the entity engaged in the business of transportation of passengers."[102] It further held that "While it is true that the corporation once formed is conferred a juridical personality separate and distinct from the persons composing it, it is but a legal fiction introduced for purposes of convenience and to subserve the ends of justice. The concept cannot be extended to a point beyond its reasons and policy and, when invoked in support of an end subversive of this policy, will be disregarded by the courts."[103]

Edward J. Nell Company v. Pacific Farms, Inc.[104] held, that generally, where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, except: (1) where the purchaser expressly or impliedly agrees to assume such debts; (2) where the transaction amounts to a consolidation or merger of the corporation; (3) where the purchasing corporation is merely a continuation of the selling corporation; and (4) where the transaction is entered into fraudulently in order to escape liability for such debts.

Properly evaluating the pronouncements in *Edward J. Nell* in so far as it involves the transfer of business concerns, the following rules

[96] *Tayag v. Benguet Consolidated, Inc.,* 26 SCRA 242 (1968). It rejected the genossenchaft theory of Friedman that would recognize the corporate entity as the "reality of the group as a social and legal entity independent of state recognition and concession."

[97] *Ang Pue & Co. v. Sec. of Commerce and Industry,* 5 SCRA 645 (1962). The formation of a corporate entity or a pertnership is not a matter of right, but rather of a privilege.

[98] 22 SCRA 1158 (1968).

[99] 8 SCRA 96 (1963).

[100] *Id.* at 99-100.

[101] 107 Phil. 833 (1960).

[102] *Id.* at 837.

[103] *Id.* at 837, citing 13 Am. Jur. 160.

[104] 15 SCRA 415 (1965).

apply to the enforceability of liabilities against the transferee regardless of the separate juridical personality of such transferee:

(a) In a pure "assets only" transfer, the transferee is not liable for the debts and liabilities of the transferor, except where the transferee expressly or impliedly agrees to assume such debts;

(b) In a transfer of the "business enterprise," the transferee is liable for the debts and liabilities of the transferor; and

(c) In an "equity transfer," the transferee is not liable for the debts and liabilities of the transferor, except where the transferee expressly or impliedly agrees to assume such debts.

It is logical in an "assets only" transfer that the transferee would not be liable for the debts and liabilities of his transferor, for indeed, there is no privity of contract over the debt obligations between the transferee and the transferor's creditors. Indeed, modification of an obligation with the substitution of a new debtor, would necessarily require the consent of the person who is sought to be substituted as the new debtor. The law governing the transfer of liabilities in an "asset only" transfer is the Law on Contracts.

In a "business enterprise" transfer, by jurisprudential decree, the transferee is liable for the debts and liabilities of his transferor. Indeed, the purpose of the jurisprudential doctrine is to protect the creditors of the business by allowing them a remedy against the new controller or owner of the business. Otherwise, creditors would be left holding the empty bag since they may not be able to recover from the transferor who has "disappeared with the loot," nor against the transferee who can claim that he is a purchaser in good faith and for value. The doctrine recognizes the reality in the business world that, although no formal mortgage contract is executed, creditors and suppliers extend credit to the business because they see the business enterprise's earning capacity and assets as a "security" that they will be repaid. The doctrine, therefore, places the burden on the shoulder of the person who is in the best position to protect himself, namely, the transferee, who can obtain certain guarantees and protection from his transferor. The doctrine also finds support in the Bulk Sales Law[105] which declares as void and fraudulent the bulk sale without applying the proceeds of the purchase

[105] ACT 3952, as amended by Rep. Act No. 111.

to the pro-rata payment of *bona fide* claims of the creditors of the vendor.

The "business enterprise" transfer doctrine was also enunciated in *Laguna Trans. Co., Inc. v. Social Security System*[106] where the Supreme Court held:

> Finally, the weight of authority supports the view that where the corporation was formed by, and consisted of members of a partnership whose business and property was conveyed and transferred to the corporation for the purpose of continuing its business, in payment for which corporate stock was issued, such corporation is presumed to have assumed partnership debts, and is *prima facie* liable therefor (*Stowell v. Garden City News Corps.* 57 P.2d 12; *Chicago Smelting & Refining Corp. v. Sullivan*, 246 IU, App. 538; *Ball v. Bros.* 83 June 19, N.Y. Supp. 692). The reason for the rule is that members of the partnership may be said to have simply put on a new coat, or taken on a corporate cloak, and the corporation is a mere continuation of the partnership.[107]

The logic of the "equity transfer" finds support in the main doctrine of separate juridical personality, that by purchasing the shares in a corporation that owns a business, the stockholder does not, by that reason alone, become the owner directly of the business assets and does not, therefore, become personally liable for the debts and liabilities of the business.

In *Philippine Veterans Investment Development Corporation v. Court of Appeals*,[108] PHIVIDEC was held liable for the obligations of its subsidiary (which had sold its holdings to PHILSUCOM) mainly because it executed an agreement to hold PHILSUCOM free and harmless against claims arising before the transfer.

Thus, in *Edward J. Nell*, the creditor sought to make the transferee corporation liable for the corporate obligations on the ground that it was a mere alter ego of the corporation that had been purchased, "because [the transferee corporation] had purchased all or substantially all of the shares of stock, as well as the real and personal properties of the [subject corporation]." The Supreme Court held that since "there

[106] 107 Phil. 833 (1960).

[107] *Id.* at 838-839 citing 8 FLETCHER, CYCLOPEDIA ON CORPORATIONS 402-11.

[108] 181 SCRA 669 (1990).

is neither proof nor allegation that appellee expressly or impliedly agreed to assume the debt [of the subject corporation] or that the sale of either the shares of stock or the assets of [the subject corporation] to the appellee has been entered into fraudulently, in order to escape liability for the debt of the [subject corporation]," then whether it is an "assets only" purchase or an "equity transfer," there is no basis to hold the transferee corporation liable for the debts and liabilities of the subject corporation.

C. *Disturbing Developments Adopting the **Umali** Doctrine*

Under fraud cases, *Umali v. Court of Appeals*[109] held that piercing the veil of corporate fiction is available only if it is sought to hold the officers and stockholders directly liable for a corporate debt or obligation.

The doctrine in *Umali* which is a fraud case, seems to have followed the doctrine in *Diatagon Labor Federation v. Ople*[110] where the Supreme Court struck down the holding of the Director of Labor Relations treating two corporations as a single bargaining unit "because the two companies are indubitably distinct entities with separate juridical personalities," despite clear showing of a close relationship between them, which in many other cases decided by the Supreme Court would have been enough basis to pierce.[111] We can only surmise that such refusal to pierce was because the issue involved was not money or damage claims, nor did it seek to hold any corporate officer or stockholder liable, but merely "whether two companies should be regarded as a single collective bargaining unit."[112]

Lately, in the case of *Indophil Textile Mill Workers Union v. Calica*,[113] the finding that two corporations business are related, that some of the employees of the two corporations are interchanged, and that the physical plants, offices, and facilities are situated in the same compound were not considered bases to pierce the veil of corporate fiction

[109] 189 SCRA 529, 542 (199).

[110] 101 SCRA 535 (1980).

[111] The employees were formerly employees of one of the corporations transferred to the other; even after the transfer, the affected employees continued to use the pay envelopes and identification cards of their former employer; the two companies had common management and represented by the same lawyers.

[112] 101 SCRA 535.

[113] 205 SCRA 697 (1992).

in order to treat the two corporations as one bargaining unit. In arriving at this conclusion, the Supreme Court relied not only upon *Diatagon Labor Federation*, but also on the doctrine in *Umali* that "the legal corporate entity is disregarded only if it is sought to hold the officers and stockholders directly liable for a corporate debt or obligation."

However, *Umali* is a fraud case and the doctrine enunciated there finds rational support, because piercing in fraud cases is resorted to in order to enforce liability on the persons employing fraud. But both *Diatagon Labor Federation* and *Indophil Textile Mill* are merely alter ego cases, and the requirement that a monetary claim should be interposed should not have been made applicable, especially in the light of other alter ego cases decided by the Supreme Court applying the piercing doctrine even when the issue involved merely one on jurisdiction.

D. *In Summary*

From all the foregoing, there seems to be four policy bases for piercing the veil of corporate fiction in alter ego cases:

Firstly, even when the controlling stockholder or managing officers intend consciously to do no evil, the use of the corporation as an alter ego and, in some cases, as the private checkbooks of the controlling stockholders, is in direct violation of the central principle in Corporation Law of treating the corporation as a separate juridical entity from its members and stockholders. Thus, those whose acts and actuations directly violate this central doctrine make themselves personally liable for having themselves been the ones to cast off the protective characteristic of limited liability of the separate juridical personality.

Secondly, and more importantly, by not respecting the separate juridical personality of the corporation, then others who deal with the corporation are also not expected to be bound by the separate juridical personality of the corporation and may treat the interests of both the controlling stockholder or officer and the corporation as the same. This is justified by the fact that the lack of respect for the separate affairs of the corporation makes it difficult for the public to monitor exactly which properties and funds pertain to the corporation and those which pertain separately to the stockholders or officers; and that to allow such random interchange of assets and funds would probably lead to the defraudation of the creditors who deal with the corporation. Although no actual fraud is committed, unless the alter ego cases are upheld, then it is up to the dealing public to carefully keep tab or close accounting of what assets do pertain to the corporation.

Such a situation would increase overseeing transaction costs to those who deal with corporate entities if the burden is placed on their shoulders, and in fact would make the corporate entity a less attractive medium with which to transact business. The application of the piercing doctrine to alter ego cases, therefore, does provide for a more efficient mechanism, because it throws the burden on the person or persons who are in the best position to account properly and treat at arms-length corporate properties and affairs.

Thirdly, piercing in alter ego cases may avail even when no monetary claim is sought to be enforced against the stockholders or officers of the Corporation. Note must be taken of the disturbing developments in *Diatagon Labor Federation* and *Indophil Textile* adopting the *Umali* doctrine in fraud cases to alter ego cases.

Fourthly, when the underlying business enterprise does not really change and only the medium by which that business enterprise is changed, then there would be occasion to pierce the veil of corporate fiction to allow the business creditors to recover from whoever has actual control of the business enterprise.

V. EQUITY CASES

Equity cases applying the piercing doctrine is what I have termed as the "dumping ground," where no fraud or alter ego circumstances can be culled by the Supreme Court to warrant piercing. The main feature of equity cases is the need to render justice in the situation at hand or to brush aside merely technical defenses. Often, equity cases of piercing appear in combination with other types of piercing.

In *Telephone Engineering and Service Co., Inc. v. Workmen's Compensation Commission*,[114] the veil of corporate fiction could not be availed of, and piercing was allowed when the corporate fiction was but a mere scheme to confuse legitimate issues, such as when the defense of separate juridical personality is interposed for the first time on appeal.

In *Emilio Cano Enterprises v. Court of Industrial Relations*[115] where a suit for reinstatement was filed against the corporate officers in such

[114] 104 SCRA 354 (1981).

[115] 13 SCRA 291 (1965).

capacities, but which did not include the corporation, the judgment debt was sought to be enforced against the corporate assets. Although Emilio Cano Enterprises is essentially an alter ego case, the Supreme Court had occasion to apply the rationale for equity cases of piercing, thus:

> x x x .Verily, the order against them [the corporate officers] is in effect against the corporation. No benefit can be attained if this case were to be remanded to the court a quo merely in response to a technical substitution of parties for such would only cause an unwarranted delay that would work to Honorata's prejudice. This is contrary to the spirit of the law which enjoins a speedy adjudication of labor cases disregarding as much as possible the technicalities of the procedure. We, therefore, find unmeritorious the relief herein prayed for.[116]

In *A.D. Santos v. Vasquez*,[117] a suit for workmen's compensation was filed by taxi driver Vasquez against A.D. Santos, Inc. Vasquez testified that Amador Santos was his employer. A.D. Santos, Inc. contended that Amador is the only one liable. The Court, however, held A.D. Santos, Inc. liable. Indeed, Amador was, at one time, the sole owner and operator of the taxi business that employed Vasquez, which was later transferred to A.D. Santos, Inc. But such testimony should not be allowed to confuse the facts relating to employer-employee relationship, for when the veil of corporate fiction is used to "confuse legitimate issues," the same should be pierced.

VII. THE PIERCING DOCTRINE AND THE DUE PROCESS CLAUSE

The final item that will be discussed is the procedural aspect of applying the piercing doctrine in conjunction with the due process clause. Often, the piercing doctrine is sought against the controlling stockholders or officers after a judgment debt against the corporation cannot be enforced, because the corporation is found to be without sufficient assets. It has been rightly argued in several cases that to enforce a writ of execution to a judgment rendered against the stockholders or officers would be in violation of the due process clause in

[116] *Id.* at 293.

[117] 22 SCRA 1158 (1968).

cases where such stockholders or officers were not even summoned as parties to the case brought against the corporation.

Thus, in *McConnel v. Court of Appeals,*[118] when the judgment debt could not be satisfied from corporate assets, an entirely new case was filed by the judgment creditor against both the corporation and the controlling stockholders, and pleaded therein the application of the piercing doctrine to make the stockholders liable for the judgment debt of the corporation.

In *Emilio Cano Enterprises v. Court of Industrial Relations,*[119] a suit for reinstatement was filed against Emilio Cano and Rodolfo Cano in their capacities as officers of Emilio Cano Enterprises, Inc., which did not include the corporation as defendant. The Court rendered judgment against the two for reinstatement, due to the fact that the stockholders belong to a single family. A writ of execution of the judgment debt was issued and was directed against the properties of the corporation, instead of against properties belonging to the respondent officers. The Supreme Court denied the action to quash the writ of execution on the ground that the judgment sought to be enforced was not rendered against the corporation which has a juridical personality separate and distinct from its officers. The Supreme Court held that a factor that should not be overlooked is that the officers were sued, not in their private capacities, but as officers of the corporation, and "[h]aving been sued officially their connection with the case must be deemed to be impressed with the representation of the corporation."[120] As a corporation is a fiction, it can only act through its officers, so there would be no denial of due process in this case even if the corporation was not made a party defendant.

In *Namarco v. Associated Finance Co., Inc.,*[121] where corporate liability was sought to be enforced against the President who fraudulently entered into a contract in the name of the corporation, the piercing of the veil of corporate fiction was sought with the President being already made a defendant at the onset, together with the corporation.

In *Jacinto v. Court of Appeals,*[122] it was held that the piercing doctrine may be applied by the courts even when the complaint does not seek

[118] 1 SCRA 723 (1961).

[119] 13 SCRA 291 (1965).

[120] *Id.* at 292.

[121] 19 SCRA 962 (1967).

[122] 198 SCRA 211 (1991).

its enforcement, so long as evidence is adduced during trial as the basis for its application can be had. In other words, there must be evidential basis for the application of the piercing doctrine during the trial on the merits.

Again, in the field of labor, the doctrine takes a different twist when invoking the piercing doctrine to make stockholders and officers liable for corporate debts at the point of execution.

This issue was raised in *A.C. Ransom Labor Union-CCLU v. National Labor Relations Commission,*[123] where corporate officers were sought to be made personally liable for a judgment for back wages rendered against the corporation. In allowing judgment to be executed against officers who were not parties to the case filed against the corporation, the Supreme Court relied upon the provisions of the Labor Code that defined the liable "employer" to "include any person acting in the interest of an employer, directly or indirectly."[124] The Court held:

> x x x Since RANSOM is an artificial person, it must have an officer who can be presumed to be the employer, being the person acting in the interest of the employer RANSOM. The corporation, only in the technical sense, is the employer.
>
> The responsible officer of an employer corporation can be held personally, not to say even criminally, liable for a non-payment of back wages. That is the policy of the law. x x x [125]

The reasoning on this issue in *A.C. Ransom* still fails to answer how a party, even when he is indicated by statutory language to be responsible for an act, can be held liable when he has not even been given his day in court under the due process clause.

That is the reason why subsequently *Del Rosario v. National Labor Relations Commission*[126] refused to apply the *A.C. Ransom* pronouncement and denied enforcement of a writ of execution because it found that "[i]n the case before us, not only has there been failure to establish fraud, but it has also not been shown that petitioner is the corporate

[123] 142 SCRA 269 (1986).

[124] *Id.* at 273, *citing* Article 212(c) of Presidential Decree No. 442, as amended, LABOR CODE OF THE PHILIPPINES.

[125] *Id.* at 273-274.

[126] 187 SCRA 777 (1990).

officer responsible for private respondent's predicament."[127] In other words, to warrant application of the piercing doctrine in order to hold a corporate officer or stockholder liable for corporate debts or obligations, evidence must be shown that such officer or stockholder was responsible for the corporate act, and that stage can only come during the hearing on the merits.

In *Western Agro Industrial Corporation v. Court of Appeals*[128] where the corporate officer was sued with the corporation to enforce a corporate obligation, the Supreme Court refused to apply the piercing doctrine to make the corporate officer liable for the corporate obligation since "[i]n this case there is no showing that [the corporate officer] was not authorized by the corporation to enter into purchase contracts x x x [and] [m]oreover, the respondent corporation has not shown any circumstances which would necessitate the piercing of the corporate veil so as to make [the corporate officer] personally liable for the obligations incurred by the petitioner."[129] The conclusion is clear. If in a clear case were a corporate officer or stockholder is made a party jointly with the corporation to enforce corporate debts and obligations, such corporate officer or stockholder cannot be made personally liable without evidence adduced to warrant the piercing, such as fraud, then all the more can corporate officers and stockholders not be belatedly made personally liable for a corporate judgment debt at the point of execution. For, indeed, the tribunal is, at that point, without further jurisdiction to receive evidence on the merits.

This very issue was raised in *Pabalan v. National Labor Relations Commission*[130] where the corporate officers sought to be made personally liable for a judgment rendered against the corporation argued that no jurisdiction was acquired over them "as they have not been served with summons and thus they where deprived of due process."[131] In addressing this issue, the Supreme Court held:

> The Court finds these grounds to be devoid of merit. As the record shows while originally it was PIF which was impleaded as respondent before the labor arbiter, petitioners also appeared in their

[127] *Id.* at 782.

[128] 188 SCRA 709 (1990).

[129] *Id.* at 718.

[130] 184 SCRA 495 (1990).

[131] *Id.* at 498.

> behalf through counsel. Thereafter when the supplemental position paper was filed by complainants, petitioners were impleaded respondents to which they filed an opposition in as much as they filed their own supplemental position papers. They were therefore properly served with summons and they were not deprived of due process.[132]

In other words, when confronted with the issue of due process, the Supreme Court would consider it a legitimate and serious issue and would determine, as it did in Pabalan, whether such constitutional guarantee has been violated.

VIII. FINAL OBSERVATIONS

Of the three types of piercing cases, it would seem, therefore, that the most restrictive one are the fraud cases, since the Supreme Court has required, first, that allegations of fraud must be clearly proven to make a stockholder or officer liable for corporate debts, second, and that piercing is available only when there is a claim for recovery against such stockholders or officers. The alter ego cases of the piercing doctrine tend to have wider latitude in their application and even without intending to do malice or just by being practical in costing by taking shortcuts, such as housing together two or more corporate businesses under closely inter-related operations, the controlling stockholders or officers may find themselves liable personally for corporate debts. The most unwieldy class, of course, are the equity cases, when often, in a fit of laziness, the courts may just pierce and without carefully going through the facts of the case to rely on other doctrines to do justice. Fortunately, the equity cases often are resorted to as additional grounds (supportive roles) in fraud and alter ego cases; however, the tendency to abuse this type of piercing cases is there.

But all three types of piercing have an underlying theme that often does not catch one's attention. In all of the cases discussed, the effect of piercing has always been to make the active or intervening stockholder or officer liable for corporate debts and obligations. Therefore, what is clear, especially for publicly-listed companies, is that the main doctrine of separate juridical personality, and all its ancillary attributes, including limited liability, remains firm and formidable to mere passive investors in a corporation.

[132] *Id.* at 498-499.