THE VEIL OF CORPORATE FICTION *

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PART I

Stating the rule:

SINCE the inquiry of the subject matter of this thesis is the scrutiny of the exception to the rule, rather than the rule itself, it will be well to inquire, to do justice to the work, into the very rule excepted. And since to pierce the veil of corporate fiction is the exception, then the rule must be that every corporation is veiled with corporate fiction.

> "A corporation is 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." (Section 2, Act No. 1459)

The section above stated is part of a law with its roots in Anglo-American jurisprudence wherein a corporation is defined as an artificial being by Chief Justice Marshall:

> "An artificial being, indivisible, intangible, and existing only in contemplation of law." (Darmouth College v. Woodward, 4 Wheat. U.S. 518, 636; 4 L. Ed. 629, 659)

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But as an artificial being, though owing its existence to law, it would appear as a living but inactive or static being. Hence, the corporate composition necessarily includes beings with intellectual faculties.

> "An artificial intellectual being, the mere creature of the law, composed generally of natural persons in their natural capacity; but may also be composed of persons in their political capacity of members of other corporations." (13 Am. Jur. 155)

Law writers are more or less agreed upon the theory that the corporation is an artificial intellectual being created by law. The majority of them, in ascribing to such corporation certain attributes as essential to its existence, has referred to the legal artifice the nomenclature of "fiction". However, there appears to be a mild confusion, but a confusion nontheless, regarding the kind of fiction a corporation purports to be. It is of utmost importance, notably for purposes of this work, to know the kind of fiction that may be disregarded, for to hold otherwise would be to entertain a dangerous concept in ignorance.

> "From an examination of cases as a whole, it may be observed that the word 'fiction' is applied in differing senses, and that the difference is important and confusing. Sometimes (a) the corporate entity is disregarded as a 'fiction' in looking through or beyond it to the real party and facts; (b) sometimes, less often, the abstract conception of an artificial being, apart from the persons who compose it, is pronounced a 'fiction'; (c) and sometimes, in attempting to assimilate corporations to partnerships and other associations, they are spoken of as 'fictions', i.e., a mere name for legal or jural relations between persons, or a mere 'method'. An understanding of the particular sense in which the court or a writer uses the word 'fiction' is therefore essential to any valuation of the fiction theory." (1 Fletcher, Cyclopedia of Corporation, Per. Ed., Sec. 24, p. 78)

Knowing the different interpretations of the corporate fiction made by law writers, it may be inferred that such

fiction may either be total or partial, absolute or relati and continuous or intermittent. The terms being in the selves clear, the difficulty to be solved is the kind corporate fiction treated by the courts in this jurisdictio And again, there is no other way of finding out than know whether the fiction of a corporation may be di regarded. In a leading case, our Supreme Court, quotin Fletcher, disregarded such a fiction.

> "If any general rule can be laid down, in the present state of authority, it is that a corporation will be looke upon as a legal entity as a general rule, and until sufficien reason to the contrary appears; but, when the notion o legal entity is used to defeat public convenience, justif wrong, protect fraud, or defend crime, the law will regar the corporation as an association of persons." [Roppel (Phil. Inc. v. Alfredo L. Yatco, 43 O. G. No. 11, p. 4604

A posteriori, when the corporate fiction can be dis regarded to be regarded "as an association of persons" then such fiction must be partial, relative, and inter mittent.

> "Those who for a particular case disregard the corporat entity, tacitly or expressly concede that the corporation not a total, absolute, and continuous fiction; otherwis there is no need to invent a fiction and then to disregar it." (1 Fletcher, Cyc. of Corp., Per. Ed., Sec. 24, p. 76

The fiction, then, is partial for it does not purpor to cover the entire corporation including its stockholder or the individuals who, as seen before, necessarily compos it. It is in part a fiction with respect to the corporat nature, i.e., a legal entity distinct and separate from th natural entities of its stockholders or members.

> "A corporation is for most purposes an entity distinct from its individual members or stockholders who, as natural persons, are merged in the corporate entity, and which remain unchanged and unaffected in its identity by changes in its individual membership. The corporate property is veste in the corporation itself and not in the stockholder. Th corporation is substituted for the natural persons who pro

> cured its creation and who have pecuniary interests in it; all its property is vested in, controlled, managed, and disposed of by it." (13 Am. Jur., Sec. 6, p. 157)
> "A corporation is regarded as a legal entity. It has a separate existence from the persons who compose it. There is said to be no identity between the owners and holders of the stock and the corporation itself." (1 Thompson, *Sec.* 9 [3*rd*] 14)

This distinction of the legal entity is generally accepted to extend to its rights and obligations.

> "It is generally accepted that the corporation is an entity distinct from the shareholders or members and with rights and liabilities not the same as theirs individually and severally, and the corporation and its officers are not the same personality." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 25, *p.* 84)

In this jurisdiction, our Supreme Court has upheld time and again in its decisions the concept stated above of the corporation as a legal entity with a distinct personality. In the leading case of Manila Gas Corp. v. Collector of Internal Revenue, (G.R. No. 42780), the court held that there was no double taxation in taxing the dividends received by the shareholders after having taxed the corporate profits because the corporation and the stockholders are not one but different persons, both enjoying a separate existence. The same doctrine was held in the case of Smith Co. v. Ford (G.R. No. 4220) where it was declared that the obligations of the corporation were different from those of its officers and consequently, the former was not liable for the latter's indebtedness. And in another equally important case, where the creditor of an insolvent corporation proceeded against the property of the principal officer, the court ruled:

> "Es indudable que Man Sun Lung, el demandado en la presente causa, es juridicamente diferente y distinto de Man Sun Lung and Co., Inc., declarada insolvente en el expediente de insolvencia correspondiente: el primero es una persona natural y la última es una persona jurídica con

personalidad distinta e independiente de la de aquél." (*Wi & Company v. Man Sun Lung*, 40 *O.G. No.* 10, 6 *Supp., p.* 10, 11)

It is not an absolute but a relative fiction becau the corporation is not free from limit, restriction, or qua ification. Neither can it exist nor be determined in it self. As seen before, it is... created by operation of law (Sec. 2, Act. No. 1459). Without a law, there canno be such a fiction. In a famous American case, Justic Holmes stated:

"It leads nowhere to call a corporation a fiction. If it a fiction, it is a fiction created by law with intent that it should be acted on as if true." (*Klien v. Tax Super* 282 *U.S.* 19, *L. ed.* 140, 51 *S. Ct.* 15)

The corporation fiction is restricted in the sense tha it cannot perform all acts which a natural person can do, such acts as may be attributed to were it an abso lute fiction. Since it was created by law, so must the law provide. It is empowered with... the rights of suc cession and the powers, attributes, and properties ex pressly authorized by law or incident to its existence (Sec. 2, Act. No. 1459). But it has no physical exist ence, for it is regarded as a person or legal entity onl by process of fiction.

"But that fiction or analogy between corporations and nat ural persons by no means extends so far that it can be said that every statute applicable to natural persons is ap plicable to corporation." (*Claude Neon Lights v. Phil. Adv Corp.*, 57 *Phil.* 607)

The very same fiction is not a continuous one bu rather intermittent since both man and law interven in its creation, disregard, and dissolution. The sphere of its activity is provided by law and the corporate act by man, as Fletcher so aptly stated... otherwise there is no need to invent a fiction and then to disregard it (1 Fletcher 78). It must be remembered, however, tha

his fiction has been established by law solely for con venience and justice and a detour from these ends will justify the courts to draw aside the curtain of fiction, ntertaining, thus, the concept of a dual personality.

"The doctrine that a corporation is a legal entity existing separate and apart from the persons composing it is a legal theory introduced for the purpose of convenience and to subserve the ends of Justice. The concept cannot, therefore, be extended to a point beyond its reason and policy, and when invoked in support of an end subversive of this policy, will be disregarded by the courts." (13 *Am. Jur., Sec. 7, p.* 160)

PART II

PIERCING THE CORPORATE VEIL

Stating the exception:

AS stated previously, the nature of a corporation is such that it will be regarded generally as a legal entity distinct and separate from the members or stockholders composing it but that this fiction is not without limitations. Whenever this creature of the law seeks to offend its creator or those whom the creator protects, it will be rightfully ignored, disregarded, and done away with. Due to the peculiar structure of corporate fiction, natural persons have time and again sought refuge behind the assumption that what the law creates it always protects. While it is true that the *patria potestas* principle could be extended to apply to corporations in the instant case, it is also true that this fiction, this child of the law, could be ignored and punished as if it were a stranger to the father.

Indeed, whenever the veil of corporate fiction becomes a cloak of fraud and injustice, the law will be justified

if it pierces the veil and draws aside the cloak to unmask the wrongdoer.

The Supreme Court, in the case of Koppel (Phil.), Inc., v. Alfredo Yatco (43 *O. G. No.* 11, *p.* 4604) quoted with approval the decision in an American leading case:

> "* * * 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." (*United States v. Milwaukee Refrigerator Transit Co.*, 142 *Fed.* 247, 255)

In the earlier case of Arnold v. Willits & Patterson (44 Phil. 634), the same court for the first time in Philippine jurisprudence enunciated the doctrine of disregard of corporate fiction, quoting another eminent authority on Corporation Law:

> "The proposition that a corporation has an existence separate and distinct from its membership has its limitations. It must be noted that this separate existence is for particular purposes. It must also be remembered that there can be no corporate existence without persons to compose it; there can be no association without associates. This separate existence is to a certain extent a legal fiction. Whenever necessary for the interest of the public or for the protection or enforcement of the rights of the membership, courts will disregard this legal fiction and operate upon both the corporation and the persons composing it." (1 *Thompson on Corp., 2nd ed., Sec.* 10)

For the most part of legal history in this jurisdiction, our courts have adapted a somewhat conservative stand in its attitude towards piercing the veil of corporate fiction. However, the situation is understandable, since the concept of corporation was altogether novel there being no entity under Spanish law exactly corresponding to the idea of corporation under English and American law, as held in the case of Harden v. Benguet Consolidated Mining Co. (58 Phil. 145). It was not until 1923 that the courts realized the danger of abusing corporate fiction and saw fit to disregard it (Arnold v. Willits & Patterson, supra). But from then on until the case of Filipinas Compañía de Seguros v. Huenefeld (G.R. No. L-2294), in 1951, a total of approximately seven decisions have been handed down by the Supreme Court, piercing the corporate veil.

Although proceeding cautiously, our courts appear to be more willing than ever before to disregard corporate fiction and are prone to do so, should there be sufficient reason therefore, to such an extent as would amount to a departure from the former stand of conservatism. This observation, however, should not be viewed in an extremely radical light but rather as the effect of a chain reaction of judicial thinking currently sweeping the courts of the United States.

In the case of Metropolitan Holding Co. v. Synder (C.C.A. 8th, 79 F. [2nd] 263, 103 A.L.R. 912), it was there held that there is a growing tendency upon the part of the courts to disregard corporate entity and to treat the stockholders as an association of individuals when the interests of justice are thereby served. In J.J. McCaskill Co. v. United States (216 U.S. 504, 515, 54 L. Ed. 590, 30 Sup. Ct. 386), the United States Supreme Court declared that the "growing tendency" is to look beyond the corporate form to the purpose of it and to the officers who are identified with it for that purpose. This modern trend of piercing the veil which enshrouds the assumption of corporate entity has been confirmed by no less an authority than Fletcher when he said:

> "* * * Practically all authorities agree that under some circumstances in a particular case the corporation may be disregarded as an intermediate between the ultimate person or persons or corporation and the adverse party, and should be disregarded in the interest of justice in such cases as fraud, contravention of law or contract, public wrong or to work out the equities among members of the corporation internally and involving no rights of the public or 3rd

person. There is a growing tendency of courts to do so." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 41, *p.* 134)

Despite this modern inclination, it is noteworthy to remember that while the concept of corporate fiction has its limitations, so are the courts restricted in disregarding such a fiction. In Boatright v. Steinite Radio Corp. (46 [2nd] 385), the court said that unless there are controlling reasons, or that unusual conditions exist, or that extraordinay circumstances are present, which require the courts to look behind the form to the substance, the corporate entity will be strictly observed.

"It will not be disregarded without just cause but in the interest of justice, or be disregarded against equity, or where there is no fraud or wrong to be avoided, or to aid or facilitate fraud or wrong or to defeat a just liability." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 41, *p.* 141)

Of course, it would be beyond the court's jurisdiction to decide upon issues other than the rights and liabilities of the litigants.

"It is important to note that in disregarding the corporation as a distinct entity, the courts do so for the purpose of adjudging the rights and liabilities of parties in the case. They have no jurisdiction to do more." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 41, *p.* 136)

A further restriction upon the courts is the existence of the disputable presumption at law that the persons composing the corporation and the corporation itself are separate and distinct entities.

"Whether the corporation shall be disregarded depends upon the questions of facts, to be appropriately pleaded, and the presumptions are that the stockholders or officers and the corporation are distinct entities." (1 Fletcher, Cyc. of Corp., Per. Ed., Sec. 41, pp. 142-143)

In determining the conditions and circumstances which would justify the piercing of the corporate veil and which would thereby rebut the presumption of corporate entity, facts showing the identity of both natural and juridical entities must be proved. As a matter of evidentiary guide, the main probative factors of identity are (1) stock ownership by one or common ownership of both corporations, (2) identity of directors and officers, (3) the manner of keeping books and records, and (4) methods of conducting business, as pointed out in the legal thesis, Note on Identity of Corporations and Ignoring One Insolvent (4 *Minn. Law Review, pp.* 219-227).

The point has been reached, after an authoritative discussion the means of which have been almost exhausted, where the inevitable conclusion at law is that the veil of corporate fiction can be pierced or disregarded and must be so done whenever sufficient reasons, conditions, and circumstances arise. But when can the veil of corporate fiction be pierced and disregarded? What are these sufficient reasons, conditions, and circumstances?

A search into law books and treaties written by competent legal scholars has yielded numerous issues the answers to which are included and classified into such categories as fraud, contravention of statute or law, contravention of contract, equitable titles or rights, internal corporate transactions among all shareholders or members where 3rd persons are not involved, and mere agencies and undisclosed principalships, and the like. For purposes of this work, the seventh instance is added, i.e., enemy corporations.

"A classification of the evidential facts on which the corporate entity will be disregarded is necessarily impossible beyond such categories as (a) fraud, (b) contravention of statute or law, (c) contravention of contract, (d) equitable titles or rights, (e) internal corporate transactions among all shareholders or members, where 3rd persons are not involved, (f) mere agencies and undisclosed principalships, and the like." (1 Fletcher, Cyc. of Corp., Per. Ed., Sec. 41, pp. 143-144)

PART III

WHEN TO DISREGARD CORPORATE FICTION

GROUNDS for disregarding corporate fiction:

1. Fraud
2. Contravention of Statute or Law
3. Contravention of Contract
4. Equitable Titles or Rights
5. Internal Corporate Transactions Among All Shareholders or Members, Where 3rd Persons Are Not Involved
6. Mere Agencies and Undisclosed Principalships and the Like
7. Enemy Corporations

1. FRAUD.

The general rule is that the corporate fiction will be disregarded if it is used as a cloak for fraud or illegality.

> "Thus, in an appropriate case and in the furtherance of the ends of justice, a corporation and the individual or individuals owning all its stock and assets will be treated as identical, the corporate entity being disregarded where used as a cloak or cover for fraud or illegality." (13 Am. Jur., Sec. 7, p. 160)

Such fraud may either be actual or constructive.

> "The courts have uniformly held, however, that corporate entity will be disregarded when it is asserted as a means of fraud, and will disregard it to let in defenses of fraud.

> Constructive fraud is enough." (1 Fletcher, Cyc. of Corp., Per. Ed., Sec. 41, pp. 166-167)

The courts will look behind the corporate form to protect the rights of 3rd persons.

> "Though a corporation is an entity distinct from its stockholders, the courts will, in exceptional cases, look behind the corporate form in order to redress fraud, protect the rights of 3rd persons, or prevent palpable injustice." (In re Coke Co., 88 F. [2d] 232)

In Higgins v. California Petroleum & Asphalt Co. (147 Cal. 363, 81 Pac. 1070), where constructive fraud existed, the court ruled that a conveyance to another corporation and by it to a third, all formed by the same persons, all having the same office rooms, and having substantially the same officers, was held constructively in fraud of the payments due under a lease, although actual fraud was not found, and all three corporations were held liable. In H. E. Briggs & Co. v. Harper Clay Products Co. (150 Wash. 235, 272 Pac. 962), the courts said that there must be commingling of affairs of dominant corporation or person as to work fraud upon the rights of 3rd persons, before piercing the veil of corporate entity will be justified and two corporations or private person and corporation can be held as one legal entity.

Likewise in Brunded v. Rice (49 *Ohio St.* 640, 32 N. E. 169), promoters and stockholders of a corporation formed for an illegal purpose and to shield them from the consequences of their illegal acts have been held liable for money illegally received by it in carrying out such illegal purposes. In the case of D. I. Felsenthal Co. v. Northern Assurance Co. (284 Ill. 343, 120 N. E. 288), it was ruled that an insured corporation will not be permitted to collect for a loss by a fire set by the owner of the corporation who is the only person to be benefited substantially by the insurance money.

The legal fiction will be treated as a sham where

property is transferred to a corporation organized by insolvent debtor to defraud his creditors.

> "In cases of property transferred to a corporation to defra creditors, it is not always easy to say whether any princi of law is involved other than that ordinarily in fo in transfers between individuals. It has been held th where a corporation is organized by an insolvent debt to defraud his creditors and he transfers property to in furtherance of his fraudulent purpose, the court ma treat the corporation as a sham and sustain levies on i property, or at least submit to the jury the questio whether the organization of the corporation and the transfe to it were fair or to defraud creditors." (13 Am. Jur Sec. 8, p. 162)

Our Supreme Court, in the case of Arnold v. Wi lits & Patterson (44 Phil. 634, 644), employed as authorit in its decision an American leading case which had bee quoted by both Fletcher and Thompson in their treati on Corporation Law.

> "So long as a proper use is made of the fiction that corporation is an entity apart from its stockholders, it harmless, and, because convenient, should not be calle in question; but where it is urged to an end subversi of its policy, or such is the issue, the fiction must be ignored and the question determined whether the act in questio though done by shareholders,—that is to say, by the perso uniting in one body,—was done simply as individuals, an with respect to their individual interests as shareholder or was done ostensibly as such, but, as a matter of fac to control the corporation, and affect the transaction o its business, in the same manner as if the act had bee clothed with all the formalities of a corporate act. Thi must be so, because, the stockholders having a dual capa city, and capable of acting in either, and a possible interes to conceal their character when acting in their corporat capacity, the absence of the formal evidence of the characte of the act cannot preclude judicial inquiry on the subject If it were otherwise, then in that department of the la fraud would enjoy an immunity awarded to it in n other." (State ex rel. v. Standard Oil Co., 49 Ohio Sta 137, 15 L.R.A. 147)

2. Contravention of Statute or Law.

The general rule is that the doctrine of separate entity will be ignored if such entity is used as a shield for criminal acts or in violation of the laws of the state.

> "The courts will certainly refuse to recognize the doctrine of separate entity where its recognition would operate as a shield for fraudulent or criminal acts or be subversive of the policy of the state." (1 Thompson, Sec. 10 [3d] 16)

The same rule has been applied to trusts and combinations in restraint of trade and commerce, public utilities, rebating and overcharges, evasion of taxes, and violation of labor laws.

> "Where the corporate form of organization is adopted or a corporate entity is asserted in an endeavor to evade a statute or to modify its intent, courts will disregard the corporation or its entity and look at the substance and reality of the matter. This has been applied to violation of laws against 'trusts' and combinations in restraint of trade and commerce, laws regulating public utilities, laws against rebating and overcharges, tax laws, and workmen's compensation law." (1 Fletcher, Cyc. of Corp., Per. Ed., Sec. 43, pp. 170-171)

With respect to the evasion of tax laws, the leading case of Koppel (Phil.) Inc. v. Yatco (43 O.G. No. 11, p. 4604) illustrates a satisfactory example: Koppel (Phil.) was organized in the Philippines engaging in the business of machinery and equipment. Of the 1,000 shares of stock of the domestic corporation, 995 shares were owned by Koppel Industrial Car & Equipment Co. of Pennsylvania, U.S.A. The other five shares were held by the directors in order to comply with the requirements of Act No. 1459. Notwithstanding the guise of a domestic corporation, the Collector of Internal Revenue demanded the sum of ₱64,122.31 from the plaintiff as its liability of 1½% under the Merchant Sales Tax. Koppel (Phil.) paid the amount under protest and brought this action

to recover said sum of money. Plaintiff contended th as a domestic corporation organized under Philippine la it had an existence distinct and separate from Kopp Industrial Car & Equipment Co. of Penn., U.S.A. Ther fore its existence cannot be collaterally attacked, muc less by the Philippine government. The Collector of In Revenue maintained that it was a mere branch of th parent corporation in the United States. The trial cou disregarded the existence of Koppel (Phil.) as a distinc and separate corporation from that of the parent cor poration. (Liable for sales tax)

Upon appeal, the Supreme Court ruled:

> "In the first assignment of error, appellant submits tha the trial court erred in not holding that it is a domestic corporation distinct and separate from and no a mere branch of Koppel Industrial Car & Equipmen Company. It contends that its corporate existence as a Phil ippine corporation cannot be collaterally attacked and tha the Government is stopped from so doing. As stated above the lower court did not deny legal personality to appellee for any and all purposes, but held in effect that in the transactions involved in this case the public interest and convenience would be defeated and what would amount to a tax evasion perpetrated, unless resort is had to the doctrine of 'disregard of the corporate fiction'. In other words, in looking through the corporate form to the ultimate persons or corporation behind that form, in the particular transaction which were involved in the case submitted to its determination and judgment, the court did do so in order to prevent the contravention of the local internal revenue laws, and the perpetration of what would amount to a tax evasion, inasmuch as it considered—and in our opinion, correctly—that appellant Koppel (Phil.) Inc., was a mere branch or agency or dummy ('hechura') of Koppel Industrial Car & Equipment Co. The court did not hold that the corporate personality of Koppel (Phil.) Inc., would also be disregarded in other cases or for other purposes." (pp. 461 O-4611)

In a similar case, the United States Supreme Cour declared that ownership by a parent corporation of all the stocks of its subsidiary does not warrant the disregard

their separate legal entity unless the subsidiary is so dominated and controlled that it is in fact a mere instrument of the parent, or unless the separate corporate structure is used to promote fraud or injustice (Page v. Haverty, 129 F. [2d] 512).

So may the veil of legal fiction be pierced in criminal actions against the accused.

> "It has also been said to be properly disregarded in criminal prosecutions against the real offender, although this may be criticized as circuitous reasoning to hold one responsible for his own crime." (1 Fletcher, Cyc. of Corp., Per. Ed., Sec. 41, p. 139)

In violations of penal laws, the officers or stockholders of a corporation acting in their capacity as such may be held directly liable for corporate acts constituting a crime, legal entity being ignored. The court said, speaking of the individuals who compose a corporation:

> "The benefit is theirs, the punishment is theirs, and both must attend and depend upon their conduct; and when they all act collectively as an aggregate body, without the least exception, and, so acting, reach results and accomplish purposes clearly corporate in their character, and affecting the vitality, the independence, the utility of the corporation itself, we cannot hesitate to conclude that there has been corporate conduct which the state may review, and not be defeated by the assumed innocence of a convenient fiction." (People v. North River Sugar Ref. Co., 121 N.Y. 582, 24 N.E. 834)

The same convenient fiction will be disregarded when money embezzled is mixed with the funds of an insolvent corporation where such legal entity is under the control and direct supervision of the embezzler. In affirming a conviction for embezzlement, the court declared that a person:

> "* * * can convert the money to his own use by putting it into the treasury and mingling it with the funds of an insolvent corporation, which is under his control and management, and of which he is a stockholder and officer in

charge... It is paid into that which is a mere instrumentali created by him under sanction of law, but as much und his control and as subservient to his will as the furnit of his office or the books of account in which he reco his transactions. Under such circumstances, there is room for the legal fiction of separate personality, or fo the distinction between the defendant's acts as officer the corporation and his acts as an independent natura person." (Milbrath v. State, 138 Wis. 354, 120 N. W. 252

3. CONTRAVENTION OF CONTRACT.

The general rule is that the corporation will be dis regarded as a separate, juridical person if its purpose is to evade liability under a valid contract. This principl is specially true in either one-man corporations or one man dominated corporations.

> "The courts will not permit a person under the guise o a corporation formed for that purpose to evade his individua contract." (13 Am. Jur., Sec. 8, p. 163)

In this jurisdiction, the Supreme Court in three im portant decisions, i.e., the cases of Arnold v. Willits & Patterson (supra), Earnshaw Docks & H. I. Works v Mabalacat Sugar Co. (54 Phil. 971), and Zamboanga Transportation Co. v. Bachrach Motor Co. (52 Phil. 244) have looked through the form and to the substance of corporate entity in issues dealing with the contravention of contracts entered into between the corporation and 3rd persons.

In the first case, Arnold was employed by the firm of Willits & Patterson as the agent of the partnership in the Philippines for five years at a minimum salary of $200 per month plus travelling expenses. The plaintiff faithfully discharged his duties, as a result of which the firm's business rapidly increased. Patterson then retired from business and Willits became the sole owner of all the partnership's assets. In San Francisco, Willits or ganized a corporation under the laws of California, owning all the capital stock except a few, and adapting the firm

me of Willits & Patterson. In Manila, he formed another rporation under the name of Willits & Patterson, Ltd., gain subscribing practically all its capital stock. Meanhile, there arose a dispute as to the construction of the ntract of employment between Arnold and the firm. However, in a letter, Willits finally confirmed the contract, defining in clear terms the employment of Arnold and his compensation. The statement of accounts showed that P106,277 were due to Arnold by the firm. Then the San Francisco corporation became involved in a financial crisis and all its assets were turned over to a "creditor's" committee which refused to allow the indebtedness to Arnold. After repeated demands and subsequent refusals, plaintiff brought this action to recover from the firm the stated amount.

The defendant, Willits, alleged that the letter confirming the terms of employment and compensation as signed by him was without the authority of the firm of Willits & Patterson and therefore did not bind the defendant corporation. The trial court rendered judgment in favor of the defendant and dismissing the complaint. Upon appeal, the Supreme Court, after quoting Thompson (supra) and the decision in State ex rel v. Standard Oil Co. (supra), reversed the judgment and held the defendant corporation liable for the debt, adapting the principle laid down in another American leading case:

> "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 to be the same" (*U.S. Gypsum Co. v. Mackay Wall Plaster Co.*, 199 *Pac.* 249)

In the second case, the plaintiff corporation supplied and rendered services and materials to the defendant company and the president of which was B.A. Green who also owned about fifty-five percent of the capital stock. In the course of the transactions between them, it appeared that Green, as president and general manager, used the letterhead containing the trade name "B.A. Green &

Co." when ordering for materials or services from th plaintiff. On the other hand, the bills were usually ad dressed to Mabalacat Sugar Co., with the addition o "B.A. Green & Co., Agents". However, there was a bal ance owing the Earnshaw Docks & H. I. Works of P15 384.53 which the defendant claimed as an obligation o B. A .Green & Co., and not of Mabalacat Sugar Co Hence, this present action to recover upon the contract

The court, in holding the defendant corporation li able, said:

> "The simplest view of the situation is perhaps that these orders were given by Green in his capacity as president and manager of the Mabalacat Sugar Company; and Green himself admits that he was empowered by the defendant corporation to run the business of the Mabalacat Sugar Company, to determine what purchases should be made for it, and make all necessary purchases. The superintendent of the plaintiff company, who received and acted upon the orders in question, knew that Green was general manager of the defendant corporation. The device of adopting the mask of a fictitious entity as the nominal agent of the defendant in the course of these incidents cannot obscure the true legal nature of the transactions between the plaintiff and the defendant, since it is the duty of the court to look through the form and into the substance. The credit in this case was extended upon the faith of the credit of the defendant company, and it was not the intention of the plaintiff to extend credit for so many thousands of pesos to the shade bearing the name of B.A. Green & Company." (*Earnshaw Docks & H. I. Works v. Mabalacat Sugar Co.,* 54 *Phil.* 971, 975)

In the third case, the plaintiff, Zamboanga Trans. Co. and the defendant, Bachrach Motor Co. had been engaging in business relations with each other for a period of about ten years. The defendant held in its favor several chattel mortgages upon trucks, automobiles, and spare parts purchased by the plaintiff on installment basis. Due to financial difficulties, the Zamboanga Trans. Co. appealed to Mons. Jose Clos, Bishop of Zamboanga and one of the principal stockholders of the corporation, and the Bishop agreed to put more security and entered into

new chattel mortgage with the defendant company. Jose Erquiaga, one of the largest stockholders and representing the majority of shares, president, director, general manager, legal adviser, and auditor of the Zamboanga Trans. Co., intervened in its behalf in the new agreement. The terms included the cancellation of the old mortgage in favor of the new contract, a revised schedule of payment with interests, and the authorization from the board of directors of the Zamboanga Trans. Co. empowering Erquiaga to execute the new mortgage. Without however securing the authority required, Erquiaga executed the new chattel mortgage in favor of the defendant corporation. Failure to meet the payments stipulated coupled with pressure by Bachrach Motor Co. caused Erquiaga to register the new mortgage and the cancellation of the old mortgages without the knowledge and consent of the board of directors of plaintiff company but with the approval of two directors. Upon discovery, this present action was instituted to have the new mortgage annulled. One of the grounds alleged in the complaint was existence of an oral agreement to the effect that the new chattel mortgage would not be valid until the board of directors had approved of it in a resolution. And since there had been no approval, the mortgage contract entered into by Erquiaga could not bind the plaintiff corporation. The trial court rendered judgment in favor of the plaintiff.

Upon appeal, the Supreme Court reversed the decision, disregarding the separate and distinct personality of the corporation and the persons composing it, notably Erquiaga:

> "While it is true that said last chattel mortgage contract was not approved by the board of directors of the Zamboanga Trans. Co., Inc., whose approval was necessary in order to validate it according to the by-laws of said corporation, the board powers vested in Jose Erquiaga as president, general manager, auditor, attorney or legal adviser, and one of the largest shareholders; the approval of his acts in connection with said chattel mortgage contract in question, with which two other directors expressed satis-

faction, one of which is also one of the largest shareholders, who together with the president constitute a majority. The payment made under said contract with the knowledge of said three directors are equivalent to a tacit approval of the board of directors of said chattel mortgage contract and binds the Zamboanga Trans. Co., Inc. In truth and in fact Jose Erquiaga, in his multiple capacity was and is the factotum of the corporation and may be said to be the corporation itself." (*Zamboanga Trans. Co. v. Bachrach Motor Co.*, 52 *Phil.* 244, 259)

Whether it be a one-man or dominated corporation, the evasion of liability under a corporate contract will urge the courts to disregard the legal fiction.

"With respect to one-man or dominated corporations, this qualification of the foregoing is necessary: the corporation may be disregarded and a liability cast on him, or he be entitled to look direct to the other party; because real facts and justice require it." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 25, *p.* 92)

Similarly, the acts of corporate officers who, to all intent and purposes, own the corporation will bind such legal entity; they cannot employ *ultra vires* as a shield to escape their obligations incurred by contract. In Zamboanga Trans. Co. v. Bachrach Motor Co. (supra), the court relied upon this authority:

"Where the chief officers of a corporation are in reality its owners, holding nearly all of its stock, and are permitted to manage the business by the directors, who are only interested nominally or to a small extent, and are controlled entirely by the officers, the acts of such officers are binding on the corporation, which cannot escape liability as to third persons dealing with it in good faith on the pretense that such acts were *ultra vires.*" (*Halley First National Bank v. G. V. B. Min. Co.*, 89 *Fed.* 439)

4. Equitable Titles or Rights.

The general rule is that the disregard of corporate fiction is a proceeding in equity. As seen previously, the

courts of this jurisdiction being tribunals of law and equity are prone to entertain cases that are of their nature equitable. But this doctrine applies to individuals and to corporations only if it sues upon the equities of all the stockholders.

"Most of the cases announcing this rule for disregarding the corporate entity have been in equity or equitable in nature, the doctrine being one of equity, but there is authority that the law will follow equity in this regard, although in one view that may be questioned. An accepted statement of this doctrine is: When the corporation sues upon legal titles or rights, the distinction of equities is observed, but when it sues upon equities of the whole body of stockholders the court looks to their equities." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 41, *p.* 138)

Likewise, corporate form will be disregarded in order to enforce a paramount and superior equity.

"The equitable rule that a form of a corporate entity may be disregarded where the ownership of all of its corporate stock is in one person is not of general application, but is commonly limited to those instances in which it becomes necessary to disregard a formal corporate existence to prevent fraud or imposition or to enforce a paramount and superior equity." (*Carozza v. Fed. Finance & Credit Co.*, 147 *Ma.* 223, 131 *Atl.* 332, 43 *A.L.R.* 1)

Local courts have not hesitated to "pierce the shard of corporate fiction" by applying the principles of equity in so doing. The measure recently taken is in confirmation of the modern tendency to draw aside the screen of legal personality, enriching to a certain extent the growing jurisprudence of this country.

In the case of Isabela Sugar Co., Inc. v. Lopez et al. (*Civil Case No.* 14831), where a writ of preliminary mandatory injunction was sought to prevent five majority directors of the Binalbagan Sugar Co. from enforcing a contract of management involving ₱2,500,000 executed between the BISCOM and the Philippine Planters' In-

vestment Co., a corporation owned and controlled by the same majority directors of the BISCOM, the court disregarded the corporate fiction of Planters' Inv. Co. to preclude the respondent directors from prejudicing the rights of the plaintiff corporation, minority stockholders of the BISCOM, under the "unfair" management contract. Brought on writ of certiorari, the Supreme Court denied the petition for want of merit in a resolution on November 7, 1951.

In granting the injunction, Judge Sanchez of Branch VII, Court of First Instance of Manila, said in his decision promulgated on October 26, 1951:

> "And, the Philippine Planters' Investment Co., Inc. cannot be used as a shield to justify a wrong. It cannot be used by the five common majority directors to play hide and seek with the BISCOM minority; it cannot be erected as a roadblock to prevent the working out of equities amongst the stockholders of that corporation; it cannot be used to freeze out the said substantial minority from corporate benefits. Really, the conception of corporate entity is not a thing so opaque that it cannot be seen through. *Keenan v. Eshleman,* 2 *Atl.* 2d., 904. In the interests of justice, the corporate entity—Philippine Planters' Investment Co., Inc.—should be disregarded. Fletcher observes that there is a 'growing tendency of courts to do so.' 1 *Fletcher,* 134. See also cases cited on pages 36-56, 1947 Supplement to Vol. 1 Fletcher.
>
> It thus results that, piercing the shard of corporate fiction, the blunt fact remains that the five defendant directors indirectly voted excessive compensation to themselves at a time when they performed the double role of giver and beneficiary. Courts frown upon such acts. 3 Fletcher, pp. 343-346. Kreitner v. Burweger, et al., 160 N.Y.S. 256, 260; McGourkey v. Toledo & O.C.R. Co., 36 L. ed. 1079, 1090; Davids v. Davids et al., 120 N.Y.S. 350, 353. It was wrong on their part to have done so. As Scaevola puts it, "Nadie se obliga a si mismo.' 20 Scaevola, 470-471. See also I Restatement of the Law of Contracts, p. 17; 12 Am. Jur. 514. Jacobson v. Brooklyn Lumber Co. 148 N.Y. 152; 10 Am. & Eng. Cyc. of Law, 790; Barnes v. Brown, 80 N.Y.S. pp. 253, 259; Butts v. Wood, 37 N.Y. 317." (pp. 26-27-28)

Where an individual who owns all of the corporate

stock uses the corporation as an instrumentality for mere convenience to transact his business, both equity and law are impelled to pierce the corporate veil.

> "It has been held that upon a sufficient showing that a corporation is but the instrumentality through which an individual, who is the sole owner of all of the corporate capital stock, for convenience transacts his business, equity, looking to the substance rather than to the form of the relation, and the law as well, will hold such corporation to the same extent and just as he would be bound in the absence of the existence of the corporation." (*Wenban Estate Inc. v. Hewlett,* 193 *Cal.* 675, 227 *Pac.* 723)

But where a corporation proceeds in equity, seeking judgment in its favor, the stockholders must have a standing in equity otherwise it will be denied the judgment sought. In an important decision penned by the former head of Harvard Law School, Dean Roscoe Pound said:

> "Where a corporation is proceeding in equity to assert rights of an equitable nature, or is seeking relief upon rules or principles of equity, the court of equity will not forget that the stockholders are the real and substantial beneficiaries of a recovery, and if the stockholders have no standing in equity, and are not equitably entitled to the remedy sought to be enforced by the corporation in their behalf, and for their advantage, the corporation will not be permitted to recover.
>
> * * * In equity, the substance of the matter is looked at, and if the beneficiaries of the judgment sought have no standing in equity to recover, we ought not to become befogged by the fiction of corporate individuality, and apply the principles of equity to reach an equitable result." (*Home Fire Insurance Co. v. Barber,* 67 *Neb.* 644, 669, 93 *N.W.* 1024, 60 *L.R.A.* 927, 108 *Am. St. Rep.* 716)

As stated in the beginning of Part II (*supra*), there is a growing tendency on the part of courts to disregard corporate entity. This tendency is based on the equitable principle of looking to the real party.

> "What is called 'the growing tendency to look beyond corporate forms' to the real party may be accounted for in

some cases by a desire of courts to give judgment against the impleaded defendant on facts and laws warranting it. Perhaps it might be said that the technical rules of parties are less strictly applied in modern practice, borrowing the equitable principle of looking to the real party." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 36, *p.* 125)

The legal fiction of a corporation cannot be availed of if such fiction is used to screen the corporation from just consequences of its wrongs. Equity will hold the members composing it liable for those consequences.

"This distinction between a corporation as being an impalpable entity, and a corporation as being the living persons of whom it consists, is for many purposes a substantial distinction necessarily involved in the creation and use of corporations, but for some purposes it is not only a fiction, but a useless and unreasonable fiction; and it is a settled principle that in certain cases, where the fiction can serve no purpose but to accomplish injustice, and to screen the corporation from the just consequences of its wrongs, the court will not permit this legal fiction to prevail against real substance." (*Star Burying Ground Assn. v. North Lane Cemetery Assn.*, 77 *Conn.* 83, 58 *Atl.* 467)

5. Internal Corporate Transactions Among All Shareholders or Members, Where 3rd Persons Are Not Involved.

The general rule is that the corporate personality will be ignored where the rights of only the stockholders are concerned, particularly in intra-corporate dealings.

"Entities will be disregarded either where the rights of creditors are involved or where only stockholders are concerned but not to treat one class of stockholders unjustly as against another. When the stockholders sell corporate assets, the contract may be regarded as theirs or binding on them, disregarding the corporation for that purpose. A corporation may be disregarded to look to its members as partners * * *.
Contracts in the corporate name, relating to corporate property, may be treated as personal contracts." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 41, *p.* 144)

Stockholders or members are estopped to say that formal action was not taken. They may not deny the propriety of their acts.

"The corporate entity and distinction from the members may be disregarded among themselves, no rights of creditors or third persons or the public being affected, more readily than otherwise. They may become estopped to say that formal action was not taken." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 46, *p.* 173)

In the case of Cagayan Fishing Development Co. v. Sandiko (65 *Phil.* 223) where Manuel Tabora, after executing three mortgages upon four parcels of land in favor of the Philippine National Bank, transferred the property to the plaintiff company which was still in the process of incorporation and which was composed by himself, his wife, and a few nominees, the Supreme Court disregarded and subsequently denied the corporate existence of the plaintiff corporation. Considered were the facts that: of ₱48,700 as the amount of capital stock, ₱45,000 were in Tabora's name and ₱500 in his wife's; both Tabora and his wife were directors and the latter was also the treasurer; despite the transfer made to the plaintiff company, the parcels of land remained registered in the name of Tabora; the transfer of the property to Sandiko and the insistence that the promissory note signed by the latter in favor of the company were made to evade attachment by P.N.B.; finally, the transfer made by the plaintiff company was effected prior to its incorporation.

Denying the corporate personality of Cagayan Fishing Development Co. at the time of the questioned transactions, the court said:

"That a corporation should have a full and complete organization and existence as an entity before it can enter into any kind of a contract or transact any business, would seem to be self-evident. * * * A corporation, until organized, has no being, franchises or faculties. Nor do those engaged in bringing it into being have any power to bind it by contract, unless so authorized by the charter. Until or-

ganized as authorized by the charter there is not a corporation nor does it possess franchises or faculties for it or others to exercise, until it acquires a complete existence." (*Citizens' Gent v. Manufacturers & Merchants' Mutual Insurance Company,* 107 *Ill.* 652, 658; *p.* 227)

But in a leading case, the Alabama Supreme Court held that the corporate entity is to be considered separate and distinct from the members even if the transaction in question occured prior to incorporation.

"The general doctrine is well established, and obtains both at law and in equity, that a corporation is a distinct entity to be considered separate and apart from the individuals who compose it, and is not to be affected by the personal rights, obligations, and transactions of its stockholders; and this, whether said rights accrued or obligations were incurred before or subsequent to incorporation." *Moore & Hardware Co. v. Towers Hardware Co.,* 87 *Ala.* 206, 6 *So.* 41, 13 *Am. St.* 23)

The conflict between these two authorities stems from the fact of incorporation, the issue being whether or not corporate existence may be disregarded. In the former case, it was completely disregarded. In the latter case, it was sustained. However, it is submitted that the decision in Cagayan v. Sandiko is more reasonable and in consonance with the established precepts of Corporation Law, since there the transaction before incorporation is qualified by the phrase "unless so authorized by the charter", as contended in the cited authority. On the other hand, the Moore v. Towers case makes an altogether unqualified, sweeping statement, in strict observance of corporate entity.

6. Mere Agencies and Undisclosed Principalships and the Like.

The general rule is that where a corporation is used as a mere agency, conduit, adjunct, or instrumentality

another corporation, its fiction will be done away with.

"A very numerous and growing class of cases wherein corporate entity is disregarded is that wherein it is so organized and controlled, and its affairs are so conducted, as to make it merely an instrumentality, agency, conduit, or adjunct of another corporation." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 43, *p.* 154)

The same principle applies where the corporation is the mere alter ego or business conduit of a person.

"Another rule is that, when the corporation is the mere alter ego, or business conduit of a person, it may be disregarded." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 41, *p.* 136)

Corporate fiction cannot be availed of if the corporation is but a branch or dummy (hechura) of another legal entity.

"In other words, in looking through the corporate form to the ultimate person or corporation behind that form, in the particular transactions which were involved in the case submitted to its determination and judgment, the court did do so in order to prevent the contravention of the local internal revenue laws, and the perpetration of what would amount to a tax evasion, inasmuch as it considered—and in our opinion, correctly—that appellant Koppel (Phil.) Inc., was a mere branch or agency or dummy ('hechura') of Koppel Industrial Car & Equipment Co." (*Koppel [Phil.] Inc. v. Alfredo Yatco, supra*)

A subsidiary or auxiliary corporation created as an agency of the parent corporation will be held identical with the latter, especially if the persons composing both entities are the same or if their systems of operation are unified.

"A subsidiary or auxiliary corporation which is created by a parent corporation merely as an agency for the latter may sometimes be regarded as identical with the parent corporation, especially if the stockholders or officers of the two corporations are substantially the same or their systems of operation unified." (13 *Am. Jur., Sec.* 8, *p.* 162)

In the case of interlocking corporations, our Supreme Court held both corporations liable for the acts wherein a 3rd person had suffered damages and the corporation proceeded against had no visible assets.

The facts in the case of Bachrach Motor Co., Inc. v. Jose Esteva and Teal Motor Co., Inc. (67 Phil. 16) were: Esteva bought from Teal Motor Co. 14 autotrucks, 11 trailers, and one Buick automobile for ₱105,730 on Sept. 1, 1927 and Jan. 1, 1930. On April 8, 1930, the liquidation showed that Esteva was still owing ₱54,500 as balance of the purchase price of the vehicles. Esteva executed twenty-two promissory notes secured by chattel mortgage on the vehicles in favor of Teal Motor Co. These notes were endorsed by the latter to Bachrach Motor Co., but reserving the mortgage to Teal. When Esteva defaulted in the payments, Teal foreclosed the mortgage and the vehicles were sold at public auction for ₱20,000. Then, the plaintiff company brought this action against the defendants for the recovery of the amount of ₱46,500 on the promissory notes.

The issue as to whether the foreclosure of mortgage by Teal Motor Co. was valid despite the consent of Esteva and the delivery of the vehicles was answered by the court in this manner: Sec. 3 of the Chattel Mortgage Law defines such a mortgage. In the law of chattel mortgages, the debt is the principal thing. The mortgage is but an incident to the debt. Separated from the debt, the mortgage has no determinate value. The mortgage cannot exist as an independent debt. If by special agreement it does not accompany the security assigned, it is *ipso facto* extinguished, and ceases to be a subsisting demand.

But in the instant case, there was an agreement to the contrary. Teal Motor Co. foreclosed the mortgage and Bachrach Motor Co. sued upon the promissory notes. What was the legal effect of this unique arrangement?

to the mortgage, it ceased to exist because there was no debt to which it could attach. The foreclosure proceedings were as a consequence a nullity.

> "In this connection it may be said that the evidence is sufficient to establish the interlocking relationship between the Teal Motor Co., Inc. and the Bachrach Motor Co., Inc. The action of Esteva would, therefore, lie against both corporations. This conclusion is the more evident when we realize that to hold otherwise might simply result in permitting Esteva to prove damages against the Teal Motor Co., Inc., a corporation with possibly no visible assets." (*Bachrach Motor Co. v. Esteva and Teal Motor Co.*, 67 *Phil.* 16, 25)

Holding companies, it is true, are separate corporate entities. But where the organization and control are such as to make them an adjunct of another corporation, their existence will be treated as a sham. The United States Supreme Court ruled:

> "A holding company has a separate corporate existence, and is to be treated as a separate entity, unless...such corporate existence is a mere sham or has been used as an instrument for concealing the truth, or where the organization and control are shown to be such as that it is but an instrumentality or adjunct of another corporation." (*Martin v. Development Co. of America,* 240 *Fed.* 42, 45)

The test with respect to the relation of principalship and subsidiary in corporation is found in the form in which management is exercised.

> "When the courts speak of 'disregarding the corporate entity or fiction' in this sense, they speak figuratively meaning that another corporation cannot be interposed as a 'shield' against the responsible party's liability. Courts have pointed out that what is called the metaphor of agency tends to confuse thought, unless regard is given to the actual submergence of independent management of the subsidiary by its own directors by a direct management by the principal corporation, and the test of this is said to be rather in the form in which it is exercised than in the

substance of control by stockholding." (1 *Fletcher, Cyc.* o *Corp., Per. Ed., Sec.* 43, *p.* 156)

Thus, in Lowendahl v. Baltimore & O.R. Co. (24 App. Div. 144, 287 N.Y. Supp. 62, 76), the court laid down the elements to be proved in order to disregard the corporate fiction in case of subsidiaries, to wit:

1) Control, not merely majority or complete stock ownership, but complete domination, not only of finances, but of policy and business practice in respect of transaction attacked, so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and
2) such control must have been used by the defendant to commit fraud or wrong, the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal right; and
3) the aforesaid control and breach of duty must proximately cause the injury or unjust laws complained of.

7. ENEMY CORPORATIONS.

The rule in this jurisdiction is that in time of war, the courts will not hesitate to pierce the veil of corporate fiction to determine the citizenship of the corporation by inquiring into the nationality of its controlling stockholders.

"For the purpose of determining the jurisdictional citizenship of the parties to the controversy, the national courts for a time looked back of the corporate party to the citizenship of its members." (1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 41, *p.* 147)

For a while there appeared to be a confusion among the courts in attempting to determine the particular doctrine to be applied. It was then held that the principle of the state of its creation would be equally determinative of the corporation's status as a domestic, foreign, or alien legal entity and that of its citizenship.

"The rule is well settled that the legal existence, the home, the domicile, the habitat, the residence, the citizenship of the corporation can only be in the state by which it was created, notwithstanding it may lawfully do business in other states. Therefore, as to all other states it is a foreign corporation, unless it is completely domesticated so as to become a new creation, and at least for jurisdictional purposes, corporations will be conclusively presumed to be citizens and residents of the state by which they were created." (8 *Fletcher, Cyc. of Corp. Per. Ed., Sec.* 4025, *p.* 440)

The staunch adherence to the doctrine and the court's refusal to look behind the form and into the citizenship of the corporate members were shown in the famous case of Continental Tyre & Rubber Co., Ltd. v. Daimler Co., Ltd. (1 K.B. 893) decided by an English court in 1915.

"The status of a corporation as domestic, foreign or alien, is not determined by the citizenship, domicile or alienage of its shareholders or members but by the place of the creation of the corporation." (*Cited in* 1 *Fletcher, Cyc. of Corp., Per. Ed., Sec.* 35, *p.* 124)

But finally the Supreme Court of the United States in the case of Clark v. Urbeesee Finanz Korporation (92 L. Ed. Adv. Op., No. 4, p. 148) decided on December 8, 1947 to reverse the previous doctrine and settled the controversy by adopting the control test. This was the authority relied upon by our Supreme Court in the leading case of Filipinas Compañía de Seguros v. Christern Huenefeld & Co., Inc. (G.R. No. L-2294) promulgated on May 25, 1951.

The facts are as follows: Hunefeld & Co. obtained from the petitioner after payment of premium a fire insurance policy in the sum of ₱100,000 on Oct. 1, 1941 covering merchandise contained in a building located at 711 Roman St., Binondo, Manila. On Feb. 27, 1942, during the Japanese occupation, the building and the insured goods were burned. The respondent submitted

his claim under the policy. The salvaged goods were sold at public auction, and after deducting the value the total loss suffered was placed at ₱92,650. However the petitioner refused to pay the claim on the ground that the policy ceased to be in force on the date the United States had declared war against Germany, the respondent corporation (though organized and created under Philippine laws) being controlled by German subjects and the petitioner being a corporation under American jurisdiction when said policy was issued in 1941. Nevertheless, in pursuance of an order of the Director of Bureau of Financing, Philippine Executive Commission, the petitioner had paid the respondent the amount of the claim on April 19, 1943.

The present action is to recover the amount paid, petitioner's theory being that the payment was made under pressure. Upon being dimissed by the trial court and affirmed by the Court of Appeal, the case was brought to the Supreme Court on certiorari. Discussing at length the decision of the appellate court, it declared:

> "The Court of Appeals overruled the contention of the petitioner that the respondent corporation became an enemy when the United States declared war against Germany, relying on English and American cases which held that a corporation is a citizen of the country or state by and under the laws of which it was created or organized. It rejected the theory that the nationality of private corporations is determined by the character of citizenship of its controlling stockholders.
>
> There is no question that the majority of the stockholders of the respondent corporation were German subjects. This being so, we have to rule that said respondent became an enemy corporation upon outburst of the war between the United States and Germany. The English and American cases relied upon by the Court of Appeals have lost force in view of the latest decision of the Supreme Court of the United States in Clark vs. Urbeesee Finanz Korporation decided on December 8, 1947, 92 Law Ed. Advance Opinions, No. 4, pp. 148-153, in which the control test has been adopted. In 'Enemy Corporations' by Martin Domke, a paper presented to the Second International Conference of the Legal Profession held at Hague (Netherlands) in August, 1948, the following enlightening passages appear:
>
> 'It was the English courts which first in the Daimler case applied this new concept of "piercing the corporate veil", which was adopted by the Peace Treaties of 1919 and the Mixed Arbitral Tribunals established after the First World War.'
>
> * * * In Clark v. Urbeesee Finanz Korporation, A.G., dealing with a Swiss corporation allegedly controlled by German interests, the court said: 'The property of all foreign interest was placed within the reach of the vesting power (of the Alien Property Custodian) not to appropriate friendly or neutral assets but to reach enemy interests which masqueraded under those innocent fronts...The power of seizure and vesting was extended to all property of any foreign country or national so that no innocent appearing device could become a Trojan horse.'" (*Filipinas Cia. de Seguros v. Huenefeld & Co., Inc., supra*)

PART IV

LOOKING THROUGH THE FORM

1. Fraud.

THE rule is that the corporation must be used for fraudulent purposes, before its legal fiction can be disregarded. Does it mean that the purposes of the corporation must be fraudulent or illegal, so that at the very onset of its existence or at any time thereafter the courts will be justified to look behind the fiction? Or does it refer to a situation wherein the corporation has to commit a fraudulent act, its legal object notwithstanding, before the veil of fiction can be pierced?

The latter interpretation is more reasonable. Only when the entity is used as a cloak for fraud or illegality will its fiction be ignored (13 *Am. Jur., Sec.* 7, *p.* 160, *supra*) or when it is asserted as a means of fraud (*Fletcher*

supra). Otherwise, there need not exist a corporation, t
the juridical entity would be denied existence by th
state, if at its incorporation, the purpose is to further frau
or is fraudulent in nature.

What about the element of damage? In using th
corporation as a shield for fraud, is it sufficient that dece
only has been perpetrated for the legal entity to be ignored
Or is damage likewise required as an essential condition

It is submitted that while it is true that damage neces
sarily exists as a *conditio sine qua non* in fraudulen
acts or to be more precise, as a necessary consequence o
fraud, it is equally true that fraud standing alone would
suffice the disregard of the legal fiction. Damage need no
be pleaded. It should be observed, however, that both
fraud and damage constitute in this jurisdiction, under
the Revised Penal Code, the crime of estafa or swindling
So that their presence in a given case purportedly employed
by a corporation would impel the courts to disregard the
corporate form for contraventing the statute or law in
order to punish the real offenders.

Although the term "fraud" would in itself mean actual
or legal fraud, it appears to be rather broad in scope
so as to require a minute appreciation of facts to determine
whether fraud exists or not.

But in discussing fraud, actual or constructive, there
should be a clear-cut description of the term employed,
a specific designation of its beginning and end. What
is actual fraud? Does it mean, for instance, fraud actually
committed? If that is so then the definition is not clearer
than the thing defined. It is submitting that actual or
positive fraud is downright dishonesty, dishonesty of some
sort or specific, intentional acts to deceive and deprive
another of his right, or in some manner injure him.
(*Grey Alba v. De la Cruz,* 17 *Phil.* 49) What of cons
tructive fraud? It refers to legal fraud, unintentional
deception, transactions which equity regards as wrongful
and to which it attributes the same or similar effects as

those which follow from actual fraud (*Estrellado and Alcantara v. Martinez,* 48 *Phil.* 256, 264).

With respect to contracts, there is fraud when, through insidious words or machinations of one of the contracting parties, the other is induced to enter into a contract which, without them, he would not have agreed to (*Art.* 1338, *Civil Code*). As a consequence of the decision in the case of Strong v. Repide (213 *U.S.* 419, 53 *L. Ed.* 853, 41 *Phil.* 947), the failure to disclose facts, when there is a duty to reveal them, as when the parties are bound by confidential relations, constitutes fraud (*Art.* 1339, *Civil Code*). However, misrepresentation made in good faith is not fraudulent but may constitute error (*Art.* 1343, *Civil Code*) and, therefore, constructive fraud.

In determining whether or not a conveyance made by or to a corporation is fraudulent, the badges of fraud will apply. The following are some indications of a dishonest sale: (1) the fact that the consideration of the conveyance is fictitious or inadequate. (2) a transfer made by a debtor after a suit has been begun and while it is pending against him. (3) a sale upon credit by an insolvent debtor. (4) evidence of large indebtedness or complete insolvency. (5) the transfer of all or nearly all of his property by a debtor, especially when he is insolvent or greatly embarrased financially. (6) the fact that the transfer is made between father and son, when there are present other of the above circumstances. (7) the failure of the vendee to take exclusive possession of all of the property. (*Oria v. McMicking,* 21 *Phil.* 243, 21 *Jur. Fil.* 250)

2. Contravention of Statute or Law.

What is envisioned in this ground seems to point to the violation of any existing law enforced in the state of corporate operation. The term "statute" is not to be restricted to tax or labor laws or those of public utilities or in restraint of trade and commerce, statutes enacted by the state which can be properly or usually violated

in the field of activity by corporations. It refers to an and all statutes the contravention of which a corporati is employed by natural persons as a veil for their wrongf acts.

Indeed, the corporation as a juridical person bea the stamp of immunity from criminal prosecution. Its ve nature affords that protection. The Supreme Court i the case of West Coast Life Ins. Co. v. Hurd (27 *Phi* 401) ruled that a corporation cannot be proceeded again criminally and that therefore the courts derive no authorit to bring corporations before them in criminal action nor to issue processes for that purpose.

However, the prohibition was granted only insofa as proceedings relate to the corporation, for in anothe prosecution (estafa), the officers, not the corporation, wer held criminally liable. In People v. Campos (40 *O.G.* 1 *S, No.* 18, *p.* 7) the court declared that while it is tru that by legal fiction, a corporation acquires its own pe sonality distinct from the members composing it, it i a well-known principle that a corporation can only ac through its officers or incorporators, and the accepted rule is that as regards a violation of the law, the office of a corporation answers criminally for his acts, and no the corporation to which he belongs, for being a fictitiou person, it cannot be prosecuted criminally. (*Cited in Pa dilla's Criminal Law, p.* 186, 1949 *Ed.*)

3. Contravention of Contract.

This is one ground that is frequently invoked by partie evidently prejudiced by the nonfulfillment of obligations In contracts entered into by natural persons, relief may be had with little difficulty under the provisions of Book IV of the Civil Code. Upon the face of the contract, the identity of the signatories to it remains altogether clear But in contracts between juridical persons or a juridical person and a natural person, the fiction created b operation of law comes into use as artifice to evade jus liability.

The defense usually put up is one regarding the precepts of agency, i.e., that of acting either beyond the scope of authority or with no authority whatever. So that if A, who practically owns all the shares of stock and actually controls the corporation, enters into contract with B, the former justifies his non-performance of the terms by alleging that he has no authority to bind the corporation and that therefore the corporation is not liable for his acts. In the instant case, the court should disregard the concept of distinct personalities and regard the corporation and A as one and the same person. Conversely, the same decision should hold if an insolvent corporation is used to escape obligations under a valid though apparently unauthorized contract.

But supposing B actually knew and was laboring under the impression that A, though owning and controlling the corporation, had no authority to bind the corporation, may B urge the disregard of the corporate fiction? Under the facts stated, the authorities appear to be in conflict. In the case of Arnold v. Willits & Patterson (*supra*), the court quoted a leading case:

> "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 to be the same." (*U.S. Gypsum Co. v. Mackay Wall Plaster Co., supra*)

But in Zamboanga Trans. Co. v. Bachrach Motor Co. (*supra*), the court adapted the decision in another leading case:

> "Where the chief officers of a corporation are in reality its owners, holding nearly all of its stock, and are permitted to manage the business by the directors, who are only interested nominally or to a small extent, and are controlled entirely by the officers, the acts of such officers are binding on the corporation, which cannot escape liability as to third persons dealing with it in good faith on the pretense that such acts were ultra vires." (*Halley First National Bank v. G.V.B. Min. Co., supra*)

In the Arnold case, the individual is deemed to be th corporation, so that mere contract with another will suffi to bind the corporation, irrespective of authority or noti thereof or want thereof. But in the Zamboanga cas good faith on the part of third persons is an essenti condition. The crux of the matter: Does notice of wa of authority constitute bad faith? It is submitted that i does not. Want of authority or notice thereof is immateria where the corporation and the individual are the same for the third person is in fact dealing with the corporation whether he has knowledge of it or not. But granting arguendo that there was bad faith, although a minute scrutiny of the facts is required, will it negative the frau dulent act of evading a just obligation under a valid contract? It is submitted again that it will not. Although the law does not countenance bad faith, yet in the case at bar, the wrongdoer derives neither benefit nor advantage from his acts. There is no unjust enrichment to be gained. The corporation remains liable, provided of course, the wrongdoer performs his part in the contractual relations. Pursuing, furthermore, the general tenets of law, when both parties have acted palpably in bad faith, they are deemed to have acted in good faith. Again, ignoring the dual role, the corporation cannot escape liability.

Good faith, or the lack of it, is in its last analysis a question of intention; but in ascertaining the intention by which one is actuated on a given occasion, courts are necessarily controlled by the evidence as to the conduct and outward acts by which alone the inward motive may, with safety, be determined. So it is that "the honesty of intention," "the honest lawful intent," which constitutes good faith implies a freedom from knowledge and circumstances which ought to put a person on inquiry, and so it is that proof of such knowledge overcomes the presumption of good faith in which the courts always indulge in the absence of proof to the contrary. "Good faith or the want of it, is not a visible, tangible fact that can be seen or touched, but rather a state or condition of mind which can only be judged of by actual or fancied tokens

signs." *Wilder vs. Gilman,* 55 *Vt.,* 504, 505; Cf. *Carmonas vs. Miller,* 108 *Cal.,* 250; *Breaux-Renoudet, Cypress Lumber Co. vs. Shadel,* 52 *La., Ann.,* 2094-2098; *Pinkerton Bros. Co. vs. Bromley,* 119 *Mich.,* 8, 10, 17 (*Leung Yee Strong Machinery Co. and Williamson,* 37 *Phil.* 644, 651)

4. Equitable Titles or Rights.

This ground of equitable titles or rights is more or less a blanket provision, where if other grounds have failed, it is a cause of last resort. As a matter of fact, the entire proceeding in piercing the corporate veil is predicated upon the unwritten law of equity. Instances abound where for want of a proper classification, cases are shelved into different categories though in reality are equitable principles put in motion.

When an individual who owns and controls a corporation deals with a third person and in so doing commits fraud, violates a law, or tries to evade liability, it is but equitable that such individual and the corporation be considered one and the same. In similar respect, the legal entity is disregarded in times of war in order to inquire as to the citizenship of controlling stockholders for purposes of determining whether the corporation is an enemy. Equity, not the law, demands such proceedings.

Applying the well-established rule of equity, therefore, an individual must come with clean hands if he seeks relief under this ground, for what he asks is pure and untrammelled equity. For the same reason, stockholders must have a standing in equity otherwise they will not be entitled to the remedy sought for (*Home Fire Ins. Co. v. Barber, supra*). However, if both parties are mutually culpable, as discussed under Contravention of Contract, the law, not equity, steps in to consider both as having acted in good faith.

5. Internal Corporate Transactions Among All Shareholders or Members, Where 3rd Persons Are not Involved.

In a contract of sale by the corporation or by the

controlling stockholders of corporate property, the stockholders are bound by the contract and may not later be allowed to impugn the validity or evade liability under the contract. However, this ground is not available to corporations which are substantially owned and controlled by an individual. The reason is obvious. The individual is deemed to be the corporation itself.

But supposing the contract entered into by the corporation was *ultra vires* may the stockholders put up this defense, thereby escaping liability? It is submitted that if the stockholders knew that such acts were *ultra vires*, they would nevertheless be bound, being estopped to claim otherwise. The doctrine of *ultra vires* should not be allowed to prevail where it would defeat the ends of justice or work a legal wrong. (*Coleman v. Hotel de France Co.*, 29 *Phil.* 323, 29 *Jur. Fil.* 343)

6. Mere Agencies and Undisclosed Principalships and the Like—

Under this ground, corporations which are mere *alter egos*, instrumentalities, agencies, adjuncts, or business conduits of an individual or of another corporation may be disregarded. Indeed, these are the reasons why some corporate entities are organized. It is submitted however that the fiction will be pierced only if used as a shield for fraud and illegality, not by the mere fact of *alter ego*. A perusal of Supreme Court decisions which have drawn aside the screen of corporate fiction bears out this conclusion. In examining the facts in Arnold, Koppel, Sandiko, and Zamboanga Trans. Co. cases, we find that the corporations were employed as *alter ego*, agency, and business conduit but these circumstances alone did not give rise to the piercing of the corporate veil. They were coupled with fraud, contravention of law, and evasion of liability under a valid contract. Surely, juridical persons have not been created by law for these ends.

Practically the same conditions exist in holding com-

panies, interlocking corporations, subsidiary entities, and monopolistic combinations. Although in this jurisdiction, courts have not had sufficient opportunity to examine these types of corporate personality owing to the limited knowledge of modern trade practice prevailing in commercial circles, the Supreme Court in two cases has viewed with suspicion the parent-subsidiary and the interlocking relationship between corporations (Koppel [Phil.] Inc. v. Yatco, supra; Bachrach Motor Co. v. Esteva and Teal Motor Co., supra), disregarding the concept of distinct personalities. Needless to say, the judicial distrust springs from examples that abound in American jurisprudence.

The case of Earnshaw Docks & H.I. Works v Mabalacat Sugar Co. (supra), mentioned in Contravention of Contract is an example of undisclosed principalship.

The problem propounded under this ground is: May the decision rendered against a corporation constitute a cause of action against stockholders who fully own the shares and control the business of the corporation when the latter is found to be without any assets or funds to satisfy said judgment, if the corporation is but *alter ego* of said controlling stockholders? Stated differently, should the controlling stockholders who for all practical purposes own and are the corporation, be allowed to use as a shield the legal fiction of corporate entity to evade the payment of a just obligation as ajudged in decision?

The question presupposes the following facts:

1. The corporation is owned and controlled by a handful of individuals;
2. The corporation is an *alter ego* of these individuals;
3. There is a judgment rendered against the corporation being without assets or funds to satisfy the judgment.

From one point of view, it is submitted that we should not lose sight of the legal concept of distinct cor-

porate personalities, that of the corporation itself and th
shareholder's, and that the distinction extends to right
and liabilities as well (Fletcher, Thompson, supra), an
that corporate property is vested in the corporation itself
and not in the stockholder (Am. Jur., supra). So that
if due to the indebtedness of the corporation, the cor
porate assets become exhausted, judgment creditors can
not proceed against the property of its officers or stock
holders (Smith Co. v. Ford, supra). This presupposes
that the shares of stock are about evenly distributed among
the individuals composing the legal entity. But suppose
the shares of stock are substantially in the hands of a
single person, thereby controlling the corporation, will
that individual be liable to the creditors of the insolvent
corporation in a judgment rendered against it? Again,
the judgment creditors will not be allowed to recover,
since the individual has a personality distinct and separ
from the corporation (*Wise & Co. v. Man Sun Lung, supra*).

What then is the effect of a concentration of cor
porate stock in one individual? Will it *ipso facto* make
the corporation an *alter ego* of the individual? Such
concentration will make it a one-man or dominated cor
poration. And since the corporation acts in behalf of
the stockholders and for their sole benefit, then it is in
this sense the *alter ego* of the individual. By the same
token, it is the *alter ego* of as many individuals as there
are stockholders. If a judgment creditor is not allowed to
proceed against the property of a thousand stockholders
of an insolvent corporation by the mere fact of their
number, there is no cogent reason why he should be
allowed in the case of a handful, say five, or even one in
dividual. To hold otherwise would be to destroy the ve
ry precepts of Corporation Law, i.e., an artificial being
created by operation of law (Sec. 2, Act No. 1459) for
the purposes of convenience and to subserve the ends of
justice (*Am. Jur., supra*).

Furthermore, mere concentration of stock in a cor

poration or individual does not warrant disregard of cor
porate fiction nor will the fact of *alter ego* be sufficient
unless such juridical person is employed as a shield for
fraud, contravention of law or contract, or to defeat a
superior equity (*Koppel [Phil.] Inc. v. Yatco; Arnold v. Willets & Paterson, Cagayan Fishing Development Co. v. Sandiko; Zamboanga Trans. Co. v. Bachrach Motor Co., Carroza v. Fed. Finance & Credit Co., supra*).

From the other point of view, it is submitted that the concept of law on separate existence of corporations and its membership has its limitations (Thompson, supra) as when it is used to defeat public convenience, justify wrong, protect fraud, or defend crime, in which case the law will regard the corporation as an association of persons (*United States v. Milwaukee Refrigerator Transit Co., supra*). This is especially true where the corporation is substantially owned and controlled by an individual or another corporation (*Arnold v. Willets & Patterson, supra*) in which case the creditor can proceed against the property of the stockholders if the corporation has no assets.

But is the mere fact that a corporation is the *alter ego* or agency or business conduit of an individual or corporation sufficient to hold such natural or juridical person liable for corporate indebtedness? *Alter ego* in this respect means the self-same or the extension of a personality. Applying it to a corporation, it denotes the absorption of the corporate entity by the personality of the individual, so that the corporation and the individual are merged in one single being, the acts of one attributable to either of them. Where it is so organized or controlled, the fiction is pierced and liability is fixed upon the individual or corporation, as held by Fletcher and the case of U.S. Gypsum Co. v. Mackay Wall Plaster Co. (*supra*).

To hold otherwise would be to make the assumed innocence of fiction created by law a mockery and a shard for evil practices, and in that department of the

law fraud would enjoy an immunity awarded to it
no other (*State ex rel. v. Standard Oil Co., supra*). The
would be, in the case at bar, an evasion of liability u
der a judgment rendered against it and an escape fro
the just consequencees of its wrong, the violation of pla
tiff's legal right.

And as a well-known authority puts it:

> "The statement that a corporation is an artificial perso
> or entity, apart from its members, is merely a descriptio
> in figurative language, of a corporation viewed as a co
> lective body: a corporation is really an association of pe
> sons, and no judicial dictum or legislative enactment ca
> alter this fact." (1 *Morawetz, Priv. Corp., Sec.* 227)

It is, therefore, submitted that, having these two view
in mind, the problem so propounded can be solved upo
the following premises:

It is not so much that there is a concentration o
shares and a consequent investment of control over th
corporation in an individual or a handful of persons bu
rather, that the corporate entity, regarded by fiction o
law as separate and distinct from the shareholders, i
being used as a device, a cloak to mask illegal, fraudu
lent or unjust acts or practices of certain persons tha
gives rise to the reason and the need for piercing th
veil of corporate fiction to the end that justice and equity
shall be done. To hold otherwise would be to take th
accident for the *essence,* and would eventually lead to
nullifying, for all purposes, the fiction of corporate exist
ence itself and defeating the objects of the law.

If, for instance, a corporation owns one hundred thou
sand shares distributed among one hundred persons, and
these persons employ their corporate entity to work fraud
or injustice upon third persons who are later attempted
to be precluded from a recovery of damage or a redres
of their wrongs by a plea of the corporation's bankrupt
it would seem undeniable that the courts will not hes
tate to withdraw the protecting mantle of corporate fic

on and thus subject the guilty parties to the sanctions
law. On the other hand, if those same stockholders
hould have employed their corporate existence for pur-
oses neither inequitable nor contrary to law, and should
hey have incurred liabilities with third persons which
hey are unable to satisfy by reason of a loss of assets,
t would seem equally undeniable that such a plea of
bankruptcy would give rise merely to the right to part-
icipate in whatever assets the corporation may still hold
upon liquidation in insolvency proceedings but most cer-
tainly would not give occasion to a piercing of the veil
of corporate fiction so as to transfer and impose the
liability of the corporation directly upon the stockholders.

Again, if instead of one thousand there should be
only one hundred stockholders among whom the stocks
are vested, under the same two situations above discussed
the same conclusions reached therein would seem to be
warranted. And if we pursue this reductive process fur-
ther we would ultimately come to the situation where
the shares of stock, except for a negligible number owned
by the directors of the same, are entirely in the hands
of a single individual. The rule in this last case would
naturally be the same as in the foregoing.

It should not be forgotten that the object of piercing
the corporate veil is justice and public interest in such
cases as fraud, contravention of law or contract, public
wrong, to work out the equities of shareholders or mem-
bers or to enforce a paramount or superior equity. It
should be remembered that the means must be subserv-
ient to this end.

Now, good faith on the part of all parties concerned
being assumed, if it would be unjust, as is not denied,
to fix liability upon a hundred, by what process of rea-
soning would it be just to so fix liability upon one or
five or a handful? Is the reasoning predicated upon the
accidental circumstance of number? Most certainly not.
But even conceding for sake of argument that the num-
ber makes for substantial basic distinctions, then why is

there no difference in treatment in the case of fraud? It can be deduced from these statements that a new element has been introduced, i.e., the use of legal fiction as a garment for intentional deception and illegality.

The existence of a corporation can be traced to the growth of productive enterprise. It is a challenge rising from economic demands to wealth. Men risk their belongings for personal and impersonal security. In establishing corporations or participating in their business, capital is employed for the proportionate benefits it may receive. For instance, in subscribing to a few shares of stock, the expected benefit is commensurate with the risk, thus a small return for a small investment. By the same principle an individual who courageously employs a large capital and in so doing, is said to substantially own the corporate entity, assumes the risk of losing all or increasing his capital. Why then should he be the subject of discrimination? Why should he be held primarily accountable for corporate acts where, under the same circumstances, the holder of a few shares would be totally overlooked? Is this his reward for such courageous risk? Can this be properly called justice or equity?

In view of the foregoing as well as of the reasons and authorities cited in the first point of view, we respectfully conclude that the decision rendered against the corporation may not constitute a cause of action against its stockholders.

7. ENEMY CORPORATIONS—

The ground which justifies the piercing of the veil of a corporation with an "enemy character" may be invoked, according to the rule, in times of war. The purpose is to determine the citizenship of the controlling stockholders of the entity. This is all very true in simple and ordinary corporations. But supposing the shares are not held by the stockholders but by another corporation, i.e., a holding corporation? Will the same rule apply?

It is submitted that the veil of both corporations may be pierced. This is so because of the equitable principle of looking to the real party (*Fletcher, supra*). But will equity apply to reasons of public policy? It is submitted that if it may be invoked and granted on account of private interests, *a fortiori,* will be for public interests.

Take the case of a corporation whose shares are held by individuals who are mere nominees of dominating persons who, in turn, are outsiders, may the screen of legal personality be drawn aside to allow the law to inquire further into the real party? It is submitted that the legal fiction may be pierced. Again, the principles of equity are called into operation. Furthermore, if natural persons are not allowed by law to be used as "dummies" or "hechuras" why should juridical persons be given the illegal privilege?

But the rule mentioned refers with particularity to "Times of war". May not the corporate veil be pierced during normalcy or peace time to determine whether such corporation is "alien"? Attention is directed to the prohibitive provisions of the Constitution on the disposition, exploitation, development, or utilization of our natural resources, on the transfer or assignment of private agricultural land save in cases of hereditary succession, and on the operation of public utility (*Sec.* 1 *and* 5, *Art. XIII; Sec.* 8, *Art. XIV of the Constitution*). Likewise, the same prohibition upon alien stockholders is asserted in Philippine coastwise trade and in transfer of public land acquired from the Government (*Act No.* 2761; *Sec.* 122, *Act No.* 2874) and in other statutory prohibitions.

Therefore, it is submitted that, with respect to the determination of citizenship of its stockholders, the curtain of fiction of a legal entity may be drawn aside by the courts.

"The same principle obtains in peace time when a state wishes to prevent its national industry, commerce or agriculture from passing into hands of aliens; the law then is bound to penetrate the screen of legal personality. (*Wolff, p.* 313)