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G.R. No. 117416. December 08, 2000

Ponente: QUISUMBING, J.

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QUISUMBING, J.:

This petition for review on certiorari assails the decision[1] of the Court of Appeals dated October 8, 1993, and its resolution[2] dated September 22, 1994 in CA G.R. SP No. 29225, which affirmed the Securities and Exchange Commission's decision stating thus:

"WHEREFORE, the appealed decision of the hearing officer in SEC Case No. 2581 is hereby MODIFIED as follows:

- Piercing the veil of corporate fiction among GCC, CCC Equity and the franchise companies - Commercial Credit Corporation of North Manila, Commercial Credit Corporation of Cagayan Valley, Commercial Credit Corporation of Olongapo City, and Commercial Credit Corporation of Quezon City - is not proper for being without merit; and
- The declaration that petitioning franchise corporations and individual petitioners are not liable for the payment of bad accounts assigned to, and discounted by GCC is SET ASIDE for being in excess of jurisdiction."[3]

The facts of this case as gleaned from the records are as follows:

On March 11, 1957, Commercial Credit Corporation was registered with SEC as a general financing and investment corporation. CCC made proposals to several investors for the organization of franchise companies in different localities. The proposed trade names and indicated areas were: (a) Commercial Credit Corporation - Cagayan Valley; (b) Commercial Credit Corporation - Olongapo City; and (c) Commercial Credit Corporation - Quezon City.

Petitioners herein invested and bought majority shares of stocks, while CCC retained minority holdings. Management contracts were executed between each franchise company and CCC, under the following terms and conditions: (1) The franchise company shall be managed by CCC's resident manager. (2) Management fee equivalent to 10% of net profit before taxes shall be paid to CCC. (3) All expenses shall be borne by the franchise company, except the salary of the resident manager and the cost of credit investigation. (4) CCC shall set prime rates for discounting or rediscounting of receivables. Apart from these, each investor was required to sign a continuing guarantee for bad accounts that might be incurred by CCC due to discounting activities.

In 1974, CCC attempted to obtain a quasi-banking license from Central Bank of the Philippines. But there was a hindrance because Section 1326 of CB's "Manual of Regulations for Banks and Other Financial Intermediaries,"

states:

Sec. 1326. General Policy. Dealings of a bank with any of its directors, officers or stockholders and their related interests should be in the regular course of business and upon terms not less favorable to the bank than those offered to others. (Emphasis supplied)

The above DOSRI regulation and set guidelines are entitled to make sure that lendings by banks or other financial institutions to its own directors, officers, stockholders or related interests are above board. In view of said hindrance, what CCC did was divest itself of its shareholdings in the franchise companies. It incorporated CCC Equity to take over the administration of the franchise companies under new management contracts. In the meantime, CCC continued providing a discounting line for receivables of the franchise companies through CCC Equity. Thereafter, CCC changed its name to General Credit Corporation (GCC).

The companies' operations were on course until 1981, when adverse media reports unraveled anomalies in the business of GCC. Upon investigation, petitioners allegedly discovered the dissipation of the assets of their respective franchise companies. Among the alleged fraudulent schemes by GCC involved transfer or assignment of its uncollectible notes and accounts; utilization of spurious commercial papers to generate paper revenues; and release of collateral in connivance with unauthorized loans. Furthermore, GCC allegedly divested itself of its assets through a questionable offset of receivables arrangement with one of its creditors, Resource and Finance Corporation.

On February 24, 1984, petitioners filed a suit against GCC, CCC Equity and RFC. Petitioners prayed for (1) receivership, (2) an order directing GCC and CCC Equity solidarily to pay petitioners and depositors for the losses they sustained, and (3) nullification of the agreement between GCC and RFC.

On June 6, 1984, all respondents, except CCC Equity, filed a motion to dismiss asserting that SEC lacked jurisdiction, and that petitioners were not the real parties in interest. Both motions, for receivership and for dismissal, were subsequently denied by the hearing officer.

On February 23, 1990, the hearing officer ordered "piercing the corporate veil" of GCC, CCC Equity, and the franchise companies. He later declared that GCC was not liable to individual petitioners for the losses, since as investors they assumed the risk of their respective investments. The franchise companies and the individual petitioners were held not liable to GCC for the bad accounts incurred by the latter through the discounting process. The decretal portion of his order reads:

"WHEREFORE, judgment is hereby rendered, as follows:

- Declaring GCC, CCC-Equity and the franchised companies - Commercial Credit Corporation of North Manila, Commercial Credit Corporation of Cagayan Valley, Commercial Credit Corporation of Olongapo City and Commercial Credit Corporation of Quezon City - as one corporation;
- Declaring that the petitioning franchised companies are not liable for the payment of bad accounts assigned to, and discounted by GCC;
- Declaring the individual petitioners who executed continuing guaranties to secure the obligation of the franchised companies to GCC arising from the discounting accounts should not be held liable thereon;
- Declaring that GCC is not liable to individual petitioners for the investments they made in the franchised companies;
- Dismissing the petition with respect to respondent Resource Finance Corporation, Generoso Villanueva and Leonardo Alejandrino."[4]

In an en banc decision, dated October 6, 1992, the SEC reversed the ruling of its hearing officer. Petitioners appealed to the Court of Appeals. On October 8, 1993, the appellate court affirmed respondent SEC's decision. Petitioners moved for a reconsideration, but it was denied on September 22, 1994.

Hence, the instant petition raising the following issues:

- WHETHER THE COURT OF APPEALS ERRED GRAVELY IN FAILING TO RULE THAT GCC'S FRAUD UPON PETITIONERS AND MISMANAGEMENT OF THE FRANCHISE COMPANIES WARRANT THE PIERCING OF ITS VEIL OF CORPORATE FICTION.
- WHETHER THE COURT OF APPEALS ERRED GRAVELY IN FAILING TO RULE THAT ONLY THE SEC HAS JURISDICTION OVER THE ISSUE OF WHETHER INDIVIDUAL PETITIONERS MAY BE HELD LIABLE ON THE SURETY AGREEMENTS FOR BAD ACCOUNTS INCURRED BY GCC THROUGH THE DISCOUNTING PROCESS.
- WHETHER THE COURT OF APPEALS ERRED GRAVELY IN FAILING TO REVERSE AND SET ASIDE THE 06, OCTOBER 1992 SEC DECISION.

Petitioners pray for the piercing of the corporate fiction of GCC, CCC Equity, RFC and the franchise companies. They allege that (1) GCC was the alter-ego of CCC Equity and the franchise companies; (2) GCC created CCC Equity to circumvent CB's DOSRI Regulation; and (3) GCC mismanaged the franchise companies. Ultimately, petitioners pray that the SEC en banc reinstate the decision of the hearing officer absolving individual investors of their respective liabilities attached to the continuing guaranty of bad debts. They pray that should the afore-stated companies be considered as one, then petitioners' liabilities should be nullified.

SEC en banc decided against the petitioners, saying:

"Where one corporation is so organized and controlled and its affairs are conducted so that it is, in fact, a mere instrumentality or adjunct of the other, the fiction of the corporate entity of the instrumentality may be disregarded... [T]he control and breach of duty must proximately cause the injury or unjust loss for which the complaint is made.

The test may be stated as follows:

In any given case, except express agency, estoppel, or direct tort, three elements must be proved:

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

The absence of any one of these elements prevents `piercing the corporate veil.'"[5]

The SEC stated further that:

"The second element required for the application of the instrumentality rule is not present in this case. Upon close scrutiny of the various testamentary and documentary evidence presented during trial, it may be observed that petitioner's claim of dissipation of assets and resources belonging to the franchise companies has not been reasonably supported by said evidence at hand with the Commission. In fact, the disputed decision of the hearing officer dealt mainly with the aspect of control exercised by GCC over the franchise companies without

a concrete finding of fraud on the part of the former to the prejudice of individual petitioners' interests. As previously discussed, mere control on the part of GCC through CCC Equity over the operations and business policies of the franchise companies does not necessarily warrant piercing the veil of corporate fiction without proof of fraud. In order to determine whether or not the control exercised by GCC through CCC Equity over the franchise companies was used to commit fraud or wrong, to violate a statutory or other positive legal duty, or dishonest and unjust act in contravention of petitioners' legal rights, the circumstances that caused the bankruptcy of the franchise companies must be taken into consideration."^[6]

As a general rule, a corporation will be looked upon as a legal entity, unless and until sufficient reason to the contrary appears. 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.^[7] Also, the corporate entity may be disregarded in the interest of justice in such cases as fraud that may work inequities among members of the corporation internally, involving no rights of the public or third persons. In both instances, there must have been fraud, and proof of it. For the separate juridical personality of a corporation to be disregarded, the wrongdoing must be clearly and convincingly established.^[8] It cannot be presumed.^[9]

We agree with the findings of the SEC concurred in by the appellate court that there was no fraud nor mismanagement in the control exercised by GCC and by CCC Equity, over the franchise companies. Whether the existence of the corporation should be pierced depends on questions of facts, appropriately pleaded. Mere allegation that a corporation is the alter ego of the individual stockholders is insufficient. The presumption is that the stockholders or officers and the corporation are distinct entities. The burden of proving otherwise is on the party seeking to have the court pierce the veil of the corporate entity.^[10] In this, petitioner failed.

Petitioners contend that the issue of whether the investors may be held liable on the surety agreements for bad accounts incurred by GCC through the discounting process cannot be isolated from the fundamental issue of validly piercing GCC's corporate veil. They argue that since these surety agreements are intra-corporate matters, only the SEC has the specialized knowledge to evaluate whether fraud was perpetrated.

We note, however, that petitioners signed the continuing guaranty of the franchise companies' bad debts in their own personal capacities. Consequently, they are responsible for their individual acts. The liabilities of petitioners as investors arose out of the regular financing venture of the franchise companies. There is no evidence that these bad debts were fraudulently incurred. Any taint of bad faith on the part of GCC in enticing investors may be resolved in ordinary courts, inasmuch as this is in the nature of a contractual relationship. Changing petitioners' subsidiary liabilities by converting them to guarantors of bad debts cannot be done by piercing the veil of corporate identity.

Private respondents claim they had actually filed collection cases against most, if not all, of the petitioners to enforce the suretyship liability on accounts discounted with then CCC (now GCC).^[11] In such cases, the trial court may determine the validity of the promissory notes and the corresponding guarantee contracts. The existence of the corporate entities need not be disregarded.

On the matter of jurisdiction, we agree with the Court of Appeals when it held that:

"... [T]he ruling of the hearing officer in relation to the liabilities of the franchise companies and individual petitioners for the bad accounts incurred by GCC through the discounting process would necessarily entail a prior interpretation of the discounting agreements entered into between GCC and the various franchise companies as well as the continuing guaranties executed to secure the same. A judgment on the aforementioned liabilities incurred through the discounting process must likewise involve a determination of the validity of the said discounting agreements and continuing guaranties in order to properly pass upon the enforcement or implementation of the same. It is crystal clear from the aforecited authorities and

jurisprudence[12] that there is no need to apply the specialized knowledge and skill of the SEC to interpret the said discounting agreements and continuing guaranties executed to secure the same because the regular courts possess the utmost competence to do so by merely applying the general principles laid down under civil law on contracts.

x x x

The matter of whether the petitioners must be held liable on their separate suretyship is one that belongs to the regular courts. As the respondent SEC notes in its comment, `the franchised companies accounts discounted by GCC would arise even if there is no intra-corporate relationship between the parties. In other words, the controversy did not arise out of the parties' relationships as stockholders. The Court agrees. This matter is better left to the regular courts in which the private respondents have filed suits to enforce the suretyship agreements allegedly executed by the petitioners."[13]

Not every conflict between a corporation and its stockholders involves corporate matters that only the SEC can resolve. In *Viray vs. Court of Appeals*, 191 SCRA 308, 323 (1990), we stressed that a contrary interpretation would dissipate the powers of the regular courts and distort the meaning and intent of PD No. 902-A.

"It is true that the trend is toward vesting administrative bodies like the SEC with the power to adjudicate matters coming under their particular specialization, to insure a more knowledgeable solution of the problems submitted to them. This would also relieve the regular courts of a substantial number of cases that would otherwise swell their already clogged dockets. But as expedient as this policy may be, it should not deprive the courts of justice of their power to decide ordinary cases in accordance with the general laws that do not require any particular expertise or training to interpret and apply. Otherwise, the creeping take-over by the administrative agencies of the judicial power vested in the courts would render the Judiciary virtually impotent in the discharge of the duties assigned to it by the Constitution."

Finally, we note that petitioners were given ample opportunity to present evidence in support of their claims. But mere allegations do not constitute convincing evidence. We find no sufficient reason to overturn the decisions of both the SEC and the appellate court.

WHEREFORE, the instant petition is DENIED for lack of merit. The assailed decision and resolution of the Court of Appeals dated October 8, 1993 and September 22, 1994, respectively, are AFFIRMED. Costs against petitioners.

SO ORDERED.

Bellosillo, (Chairman), Mendoza, Buena, and De Leon, Jr., JJ., concur.

[1] Rollo, pp. 61-83.

[2] Id. at 85-88.

[3] Id. at 122.

[4] Id. at 101-102.

[5] Id. at 110-111; citing Vol. 1, *Fletcher Cyclopedic Corporations*, p. 490.

[6] Rollo, p. 116.

[7] Volume 1, *Fletcher Cyclopedic Corporations*, Chapter 2, Section 41.

[8] *Matuguina Integrated Wood Products, Inc. vs. Court of Appeals*, 263 SCRA 490, 509 (1996).

[9] Id. citing *Del Rosario vs. NLRC*, 187 SCRA 777 (1990).

[10] Volume 1, *Fletcher Cyclopedia Corporations*, Chapter 2, Section 41.3.

[11] *Rollo*, p. 68.

[12] *Bañez vs. Dimensional Construction Trade and Development Corporation*, 140 SCRA 249 (1985); *Union Glass and Container Corporation vs. Securities and Exchange Commission*, 126 SCRA 31 (1983); *DMRC Enterprises vs. Este Del Sol Mountain Reserve, Inc.* 132 SCRA 293 (1984).

[13] Id. at 81-82.

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