

POWER HOMES UNLIMITED CORPORATION, Petitioner, vs. SECURITIES AND EXCHANGE COMMISSION AND NOEL MANERO, Respondents.

G.R. No. 164182. February 26, 2008

Ponente: PUNO, CJ.

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PUNO, CJ.:

This petition for review seeks the reversal and setting aside of the July 31, 2003 Decision[1] of the Court of Appeals that affirmed the January 26, 2001 Cease and Desist Order (CDO)[2] of public respondent Securities and Exchange Commission (SEC) enjoining petitioner Power Homes Unlimited Corporation's (petitioner) officers, directors, agents, representatives and any and all persons claiming and acting under their authority, from further engaging in the sale, offer for sale or distribution of securities; and its June 18, 2004 Resolution[3] which denied petitioner's motion for reconsideration.

The facts: Petitioner is a domestic corporation duly registered with public respondent SEC on October 13, 2000 under SEC Reg. No. A200016113. Its primary purpose is:

To engage in the transaction of promoting, acquiring, managing, leasing, obtaining options on, development, and improvement of real estate properties for subdivision and allied purposes, and in the purchase, sale and/or exchange of said subdivision and properties through network marketing.[4]

On October 27, 2000, respondent Noel Manero requested public respondent SEC to investigate petitioner's business. He claimed that he attended a seminar conducted by petitioner where the latter claimed to sell properties that were inexistent and without any broker's license.

On November 21, 2000, one Romulo E. Munsayac, Jr. inquired from public respondent SEC whether petitioner's business involves "legitimate network marketing."

On the bases of the letters of respondent Manero and Munsayac, public respondent SEC held a conference on December 13, 2000 that was attended by petitioner's incorporators John Lim, Paul Nicolas and Leonito Nicolas. The attendees were requested to submit copies of petitioner's marketing scheme and list of its members with addresses.

The following day or on December 14, 2000, petitioner submitted to public respondent SEC copies of its marketing course module and letters of accreditation/authority or confirmation from Crown Asia, Fil-Estate Network and Pioneer 29 Realty Corporation.

On January 26, 2001, public respondent SEC visited the business premises of petitioner wherein it gathered documents such as certificates of accreditation to several real estate companies, list of members with web sites, sample of member mail box, webpages of two (2) members, and lists of Business Center Owners who are qualified to acquire real estate properties and materials on computer tutorials.

On the same day, after finding petitioner to be engaged in the sale or offer for sale or distribution of investment contracts, which are considered securities under Sec. 3.1 (b) of Republic Act (R.A.) No. 8799 (The Securities Regulation Code),^[5] but failed to register them in violation of Sec. 8.1 of the same Act,^[6] public respondent SEC issued a CDO that reads:

WHEREFORE, pursuant to the authority vested in the Commission, POWER HOMES UNLIMITED, CORP., its officers, directors, agents, representatives and any and all persons claiming and acting under their authority, are hereby ordered to immediately CEASE AND DESIST from further engaging in the sale, offer or distribution of the securities upon the receipt of this order.

In accordance with the provisions of Section 64.3 of Republic Act No. 8799, otherwise known as the Securities Regulation Code, the parties subject of this Cease and Desist Order may file a request for the lifting thereof within five (5) days from receipt.^[7]

On February 5, 2001, petitioner moved for the lifting of the CDO, which public respondent SEC denied for lack of merit on February 22, 2001.

Aggrieved, petitioner went to the Court of Appeals imputing grave abuse of discretion amounting to lack or excess of jurisdiction on public respondent SEC for issuing the order. It also applied for a temporary restraining order, which the appellate court granted.

On May 23, 2001, the Court of Appeals consolidated petitioner's case with CA-G.R. [SP] No. 62890 entitled *Prosperity.Com, Incorporated v. Securities and Exchange Commission (Compliance and Enforcement Department), Cristina T. De La Cruz, et al.*

On June 19, 2001, petitioner filed in the Court of Appeals a Motion for the Issuance of a Writ of Preliminary Injunction. On July 6, 2001, the motion was heard. On July 12, 2001, public respondent SEC filed its opposition. On July 13, 2001, the appellate court granted petitioner's motion, thus:

Considering that the Temporary Restraining Order will expire tomorrow or on July 14, 2001, and it appearing that this Court cannot resolve the petition immediately because of the issues involved which require a further study on the matter, and considering further that with the continuous implementation of the CDO by the SEC would eventually result to the sudden demise of the petitioner's business to their prejudice and an irreparable damage that may possibly arise, we hereby resolve to grant the preliminary injunction.

WHEREFORE, let a writ of preliminary injunction be issued in favor of petitioner, after posting a bond in the amount of P500,000.00 to answer whatever damages the respondents may suffer should petitioner be adjudged not entitled to the injunctive relief herein granted.^[8]

On August 8, 2001, public respondent SEC moved for reconsideration, which was not resolved by the Court of Appeals.

On July 31, 2003, the Court of Appeals issued its Consolidated Decision. The disposition pertinent to petitioner reads:^[9]

WHEREFORE, x x x the petition for certiorari and prohibition filed by the other petitioner Powerhomes Unlimited Corporation is hereby DENIED for lack of merit and the questioned Cease and Desist Order issued by public respondent against it is accordingly AFFIRMED IN TOTO.

On June 18, 2004, the Court of Appeals denied petitioner's motion for reconsideration;^[10] hence, this petition for review.

The issues for determination are: (1) whether public respondent SEC followed due process in the issuance of the

assailed CDO; and (2) whether petitioner's business constitutes an investment contract which should be registered with public respondent SEC before its sale or offer for sale or distribution to the public.

On the first issue, Sec. 64 of R.A. No. 8799 provides:

Sec. 64. Cease and Desist Order. – 64.1. The Commission, after proper investigation or verification, *motu proprio* or upon verified complaint by any aggrieved party, may issue a cease and desist order without the necessity of a prior hearing if in its judgment the act or practice, unless restrained, will operate as a fraud on investors or is otherwise likely to cause grave or irreparable injury or prejudice to the investing public.

We hold that petitioner was not denied due process. The records reveal that public respondent SEC properly examined petitioner's business operations when it (1) called into conference three of petitioner's incorporators, (2) requested information from the incorporators regarding the nature of petitioner's business operations, (3) asked them to submit documents pertinent thereto, and (4) visited petitioner's business premises and gathered information thereat. All these were done before the CDO was issued by the public respondent SEC. Trite to state, a formal trial or hearing is not necessary to comply with the requirements of due process. Its essence is simply the opportunity to explain one's position. Public respondent SEC abundantly allowed petitioner to prove its side.

The second issue is whether the business of petitioner involves an investment contract that is considered security^[11] and thus, must be registered prior to sale or offer for sale or distribution to the public pursuant to Section 8.1 of R.A. No. 8799, viz:

Section 8. Requirement of Registration of Securities. – 8.1. Securities shall not be sold or offered for sale or distribution within the Philippines, without a registration statement duly filed with and approved by the Commission. Prior to such sale, information on the securities, in such form and with such substance as the Commission may prescribe, shall be made available to each prospective purchaser.

Public respondent SEC found the petitioner "as a marketing company that promotes and facilitates sales of real properties and other related products of real estate developers through effective leverage marketing." It also described the conduct of petitioner's business as follows:

The scheme of the [petitioner] corporation requires an investor to become a Business Center Owner (BCO) who must fill-up and sign its application form. The Terms and Conditions printed at the back of the application form indicate that the BCO shall mean an independent representative of Power Homes, who is enrolled in the company's referral program and who will ultimately purchase real property from any accredited real estate developers and as such he is entitled to a referral bonus/commission. Paragraph 5 of the same indicates that there exists no employer/employee relationship between the BCO and the Power Homes Unlimited, Corp.

The BCO is required to pay US\$234 as his enrollment fee. His enrollment entitles him to recruit two investors who should pay US\$234 each and out of which amount he shall receive US\$92. In case the two referrals/enrollees would recruit a minimum of four (4) persons each recruiting two (2) persons who become his/her own down lines, the BCO will receive a total amount of US\$147.20 after deducting the amount of US\$36.80 as property fund from the gross amount of US\$184. After recruiting 128 persons in a period of eight (8) months for each Left and Right business groups or a total of 256 enrollees whether directly referred by the BCO or through his down lines, the BCO who receives a total amount of US\$11,412.80 after deducting the amount of US\$363.20 as property fund from the gross amount of US\$11,776, has now an accumulated amount of US\$2,700 constituting as his Property Fund placed in a Property Fund account with the Chinabank. This accumulated amount of US\$2,700 is used as partial/full down payment for the real property chosen by the BCO from any of [petitioner's] accredited real estate developers.^[12]

An investment contract is defined in the Amended Implementing Rules and Regulations of R.A. No. 8799 as a "contract, transaction or scheme (collectively 'contract') whereby a person invests his money in a common

enterprise and is led to expect profits primarily from the efforts of others.”[13]

It behooves us to trace the history of the concept of an investment contract under R.A. No. 8799. Our definition of an investment contract traces its roots from the 1946 United States (US) case of *SEC v. W.J. Howey Co.*[14] In this case, the US Supreme Court was confronted with the issue of whether the Howey transaction constituted an “investment contract” under the Securities Act’s definition of “security.”[15] The US Supreme Court, recognizing that the term “investment contract” was not defined by the Act or illumined by any legislative report,[16] held that “Congress was using a term whose meaning had been crystallized”[17] under the state’s “blue sky” laws[18] in existence prior to the adoption of the Securities Act.[19] Thus, it ruled that the use of the catch-all term “investment contract” indicated a congressional intent to cover a wide range of investment transactions.[20] It established a test to determine whether a transaction falls within the scope of an “investment contract.”[21] Known as the Howey Test, it requires a transaction, contract, or scheme whereby a person (1) makes an investment of money, (2) in a common enterprise, (3) with the expectation of profits, (4) to be derived solely from the efforts of others.[22] Although the proponents must establish all four elements, the US Supreme Court stressed that the Howey Test “embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”[23] Needless to state, any investment contract covered by the Howey Test must be registered under the Securities Act, regardless of whether its issuer was engaged in fraudulent practices.

After *Howey* came the 1973 US case of *SEC v. Glenn W. Turner Enterprises, Inc. et al.*[24] In this case, the 9th Circuit of the US Court of Appeals ruled that the element that profits must come “solely” from the efforts of others should not be given a strict interpretation. It held that a literal reading of the requirement “solely” would lead to unrealistic results. It reasoned out that its flexible reading is in accord with the statutory policy of affording broad protection to the public. Our R.A. No. 8799 appears to follow this flexible concept for it defines an investment contract as a contract, transaction or scheme (collectively “contract”) whereby a person invests his money in a common enterprise and is led to expect profits not solely but primarily from the efforts of others. Thus, to be a security subject to regulation by the SEC, an investment contract in our jurisdiction must be proved to be: (1) an investment of money, (2) in a common enterprise, (3) with expectation of profits, (4) primarily from efforts of others.

Prescinding from these premises, we affirm the ruling of the public respondent SEC and the Court of Appeals that the petitioner was engaged in the sale or distribution of an investment contract. Interestingly, the facts of *SEC v. Turner*[25] are similar to the case at bar. In *Turner*, the SEC brought a suit to enjoin the violation of federal securities laws by a company offering to sell to the public contracts characterized as self-improvement courses. On appeal from a grant of preliminary injunction, the US Court of Appeals of the 9th Circuit held that self-improvement contracts which primarily offered the buyer the opportunity of earning commissions on the sale of contracts to others were “investment contracts” and thus were “securities” within the meaning of the federal securities laws. This is regardless of the fact that buyers, in addition to investing money needed to purchase the contract, were obliged to contribute their own efforts in finding prospects and bringing them to sales meetings. The appellate court held:

It is apparent from the record that what is sold is not of the usual “business motivation” type of courses. Rather, the purchaser is really buying the possibility of deriving money from the sale of the plans by Dare to individuals whom the purchaser has brought to Dare. The promotional aspects of the plan, such as seminars, films, and records, are aimed at interesting others in the Plans. Their value for any other purpose is, to put it mildly, minimal.

Once an individual has purchased a Plan, he turns his efforts toward bringing others into the organization, for

which he will receive a part of what they pay. His task is to bring prospective purchasers to “Adventure Meetings.”

The business scheme of petitioner in the case at bar is essentially similar. An investor enrolls in petitioner’s program by paying US\$234. This entitles him to recruit two (2) investors who pay US\$234 each and out of which amount he receives US\$92. A minimum recruitment of four (4) investors by these two (2) recruits, who then recruit at least two (2) each, entitles the principal investor to US\$184 and the pyramid goes on.

We reject petitioner’s claim that the payment of US\$234 is for the seminars on leverage marketing and not for any product. Clearly, the trainings or seminars are merely designed to enhance petitioner’s business of teaching its investors the know-how of its multi-level marketing business. An investor enrolls under the scheme of petitioner to be entitled to recruit other investors and to receive commissions from the investments of those directly recruited by him. Under the scheme, the accumulated amount received by the investor comes primarily from the efforts of his recruits.

We therefore rule that the business operation or the scheme of petitioner constitutes an investment contract that is a security under R.A. No. 8799. Thus, it must be registered with public respondent SEC before its sale or offer for sale or distribution to the public. As petitioner failed to register the same, its offering to the public was rightfully enjoined by public respondent SEC. The CDO was proper even without a finding of fraud. As an investment contract that is security under R.A. No. 8799, it must be registered with public respondent SEC, otherwise the SEC cannot protect the investing public from fraudulent securities. The strict regulation of securities is founded on the premise that the capital markets depend on the investing public’s level of confidence in the system.

IN VIEW WHEREOF, the petition is DENIED. The July 31, 2003 Decision of the Court of Appeals, affirming the January 26, 2001 Cease and Desist Order issued by public respondent Securities and Exchange Commission against petitioner Power Homes Unlimited Corporation, and its June 18, 2004 Resolution denying petitioner’s Motion for Reconsideration are AFFIRMED. No costs.

SO ORDERED.

Sandoval-Gutierrez, Corona, Azcuna, and Leonardo-De Castro, JJ., concur.

[1] Penned by Associate Justice Eloy R. Bello, Jr., concurred in by then Presiding Justice Cancio C. Garcia and Associate Justice Mariano C. Del Castillo; rollo, pp. 104-112.

[2] CED Case No. 20-2486, signed by “Order of the Commission” Emilio B. Aquino, Director, Compliance and Enforcement Department; rollo, pp. 42-52.

[3] Ibid., id. at 134-135.

[4] Id. at 107.

[5] Sec. 3.1. “Securities” are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character. It includes:

x x x x

(b) Investment contracts, x x x x

[6] Sec. 8.1. – Securities shall not be sold or offered for sale or distribution within the Philippines, without a

registration statement duly filed with and approved by the Commission. Prior to such sale, information on the securities, in such form and with such substance as the Commission may prescribe, shall be made available to each prospective purchaser.

[7] Rollo, pp. 107-108.

[8] Id. at 84.

[9] See Note 1; the Court shall only discuss the petition of Power Homes Unlimited Corporation as the other petitioner did not elevate its case before the Supreme Court.

[10] See Note 3.

[11] See Note 4.

[12] Rollo, pp. 33-34.

[13] Rule 3, 1 (G), Definition of Terms Used in the Rules and Regulations.

[14] 328 U.S. 293, 66 S.Ct. 1100, 163 A.L.R. 1043, 90 L.Ed. 1244 (1946), where investment contract was defined as “a contract, transaction or scheme whereby a person invests money in a common enterprise expecting profits to accrue solely from the efforts of the promoter or third parties.”

[15] Id. at 297.

[16] Id. at 298.

[17] Id.

[18] From 1911 to 1931, forty-seven of forty-eight states enacted statutes regulating the sales of securities. One advocate of the laws purportedly asserted that “securities salesmen were so dishonest that they would attempt to sell ‘building lots in the blue sky.’” Thus, the statutes came to be known as the “blue sky” laws. (Paul G. Mahoney, The Origins of the Blue Sky Laws: A Test of Competing Hypotheses, 46 J.L. & Econ. 229 [2003].)

[19] See Note 14.

[20] Id.

[21] Id. at 298-299.

[22] Id.

[23] Id. at 299.

[24] 474 F.2d 476, Fed.Sec. L. Rep. P 93, 748.

[25] Id.

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