

**PARADISE SAUNA, MASSAGE CORPORATION AND JUANITO UY,
PLAINTIFF-APPELLEE, VS. ALEJANDRO NG AND THE INTERMEDIATE
APPELLATE COURT, DEFENDANT-APPELLANT.**

G.R. No. 66394. February 05, 1990

Ponente: GUTIERREZ, JR., J.

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GUTIERREZ, JR., J.:

Whether or not the contract between the petitioners and the private respondent is a lease or a management contract is the issue in this petition for review. The petitioners assail the decision of the then Intermediate Appellate Court in AC-GR CV No. 65264 which affirmed in toto the judgment of the Court of First Instance of Manila, Branch XII declaring the said contract as one of lease.

The disputed letter-contract signed by petitioner Juanita Uy in his capacity as President of the petitioner corporation reads:

"Mr. Alejandro Ng
No. 8-A Boston Street
Quezon City

Dear Mr. Ng,

By authority of the Board of Directors, you are hereby appointed to MANAGE and ADMINISTER the PARADISE SAUNA and MASSAGE CORPORATION effective January 1, 1976, under a commission basis over and above the amount of EIGHT THOUSAND PESOS (P8,000.00) which should be remitted to us not later than the first five (5) days of each month starting January 1, 1976. In addition, you are to fulfill the following terms and conditions:

1. You are to remit the amount of Sixteen Thousand Pesos (P16,000.00) immediately after accepting this appointment as a guarantee bond for the faithful performance of your duties and responsibilities. However, this amount shall be returned to you after the duration of your appointment which will be up to September 30, 1979. Otherwise, it will be forfeited if you do not comply with all your duties and responsibilities.
2. Further, all government licenses, permits, utilities and services in the premises such as water, gas, electricity, telephone, additional air conditioning units and the installation and repairs thereof and all other repairs therein during your management shall be for your account;
3. The sole control and management of the premises shall belong to you and you are not responsible to Anybody nor to Any Board of Directors except to me alone;
4. You are empowered to make any renovation, repairs and improvements but expenses shall be for your account as well as to change or add personnels therein;
5. Please take all good care of all the equipment and facilities presently existing therein and see to it that they are always in good working condition; Otherwise, the loss and damage on any of this equipment and facilities

shall be borne by you;

6. In case, however, that you will not be in a position to continue Managing and Administering the business profitably due to any Government Rules, Decree or Regulations or Force Majeure, this appointment shall be suspended for a period of 3 months for the purpose of determining whether or not you can still continue managing the same.

Hoping that you find the same satisfactory and good luck.

(Sgd) JUANITO A. UY

President/Director" (Rollo, p. 135)

This case arose from the petitioners' act of allegedly terminating the respondent's appointment as manager-administrator as a result of his alleged failure to comply with the terms and conditions of his appointment. The termination took effect on January 15, 1977.

Private respondent Ng, on January 21, 1977 filed with the Court of First Instance of Manila, Branch XII, a case for specific performance and damages with prayer for a writ of preliminary mandatory injunction and attorney's fees against the petitioner. The case was docketed as Civil Case No. 106511.

On January 28, 1977, the private respondent amended his complaint to one for breach of contract with damages with the same prayer for a writ of preliminary injunction and attorney's fees.

The amended complaint alleged, among others, that on December 30, 1975, the petitioners agreed to lease in favor of the private respondent their business called "Paradise Sauna and Massage Corporation" located at E. Rodriguez, Sr. Avenue, Quezon City and that they entered into a contract whereby the latter shall have full control and management of the said business effective January 1, 1976 until September 30, 1979; that as lessee of the said business with full and sole control thereof, private respondent's principal obligation consists of only paying the petitioners the sum of eight thousand pesos (P8,000.00) not later than the first five (5) days of each month as rentals and remitting to the latter the sum of sixteen thousand pesos (P16,000.00) as guarantee bond; that as such lessee, the private respondent assumed control and management of the petitioner's business on January 1, 1976, hired and paid personnel to beef up its operations and tried religiously to comply with his obligations like paying for his account all government licenses, permits, utilities and services in the premises such as water, gas, electricity and telephone; that the private respondent paid all the monthly rentals due the petitioners until December 1976; that the petitioner refused to accept the rental for January 1977 and asked the private respondent to vacate and leave the premises instead thereby terminating his services and forfeiting his guarantee bond of sixteen thousand pesos (P16,000.00); that on January 16, 1977, the petitioners, assisted by Metrocom soldiers, entered the private respondent's office and through intimidations forcibly ejected him from the premises, assumed full control and supervision of the business and put another person in his place who immediately took possession of all cash sales for the day; that the private respondent returned to the business premises the following day but he was refused entry and there was a notice to all the employees in front of the premises signed by the petitioners to the effect that the private respondent's services had been terminated and that another person had been appointed to take his place; that for having breached their contract, the private respondent suffered damages in the amount of not less than P100,000.00 representing unrealized profits from the operation of the business, forfeiture of the guarantee bond and value of his personal properties placed in the business which the petitioners appropriated to themselves; that the private respondent shall prove further actual damages in the course of the trial resulting from the petitioners' failure to reinstate the former immediately; and that the private respondent is entitled to moral damages in the amount of P50,000.00 and attorney's fees in the amount of P30,000.00.

In their answer, the petitioners counter-alleged, among others, that the petitioner corporation is the operator of the

sauna bath and massage establishment in question, that petitioner Uy was the former manager and administrator of the said establishment which was then fully equipped and staffed with more than thirty (30) personnel consisting of hospitality attendants and boy helpers; that the petitioner corporation is paying P4,000.00 as lease rentals for the premises occupied by it, that in his capacity as President-Director of the petitioner corporation and in his desire to expand the operations of the same, petitioner Uy relinquished his position as manager-administrator of the said establishment in favor of the private respondent as evidenced by the letter dated December 30, 1975 addressed to the latter; that private respondent's appointment as manager-administrator was terminated on January 15, 1977 for violations of the terms and conditions of his appointment, namely, failure to pay water and electric bills, failure to pay the salaries of the employees of the petitioner corporation, failure to supply the provisions necessary for the conduct of the petitioners' sauna and massage business like lotion, towels and blankets, failure to perform efficiently as manager-administrator of the petitioner corporation by managing the Rajah Sauna Bath in Ermita, Manila simultaneously with his management of the petitioner corporation and by inducing the petitioners' customers to patronize the said Rajah Sauna Bath instead of the petitioner corporation.

After trial, the lower court, on December 23, 1978 rendered judgment in favor of the private respondent with the following dispositive portion:

"IN VIEW OF THE FOREGOING CONSIDERATIONS, the Court hereby renders judgment:

(a) declaring the letter-contract, Exhibit A, as a contract of lease covering the paradise sauna bath and massage clinic, and not a contract of employment; (b) directing defendants to forthwith return the management and operation of the paradise sauna bath and massage clinic to the plaintiff, so that plaintiff can operate and manage the same for the unexpired term of the lease of Two (2) Years, Eight (8) Months and Fifteen (15) days; (c) declaring the forfeiture by defendants of the plaintiff's deposit of P16,000.00 as null and void and declaring it as subsisting for the purpose of which it was put up by plaintiff, if Exhibit A is made to continue, as decreed in par. (b) hereof, otherwise, if or for any reason Exhibit A can not continue to be in force, directing defendants to jointly and severally pay to plaintiff the said sum of P16,000.00.; (d) directing the defendants to account for and return to the plaintiff all the articles listed in Exhibit R, consisting of pages 1, 2 and 3, or in default thereof, to jointly and severally pay to the plaintiff in the following manner and in the following amount, as far as it is practicable, to wit:

(1)

P4,650.00— for the cost of two television (sic) and the refrigerator, with an allowance of 30% for depreciation costs, with interest thereon at the legal rate from date of this decision until it is fully paid;

(2)

P11,540.30— Cost price of certain items listed in page 1 of Exhibit R as recited elsewhere in the body of this decision, with interest thereon at the legal rate from the date of this decision until it is fully paid;

(e) directing the defendants to account for and to return to the plaintiff the one rice cooker, one gas lantern, one medicine cabinet with assorted medicines, one Akai Tape Recorder, Sixteen glass tumblers, five coffee cups, four intercom, two telephone hands (sic), one Video, one color vibrator, eight drawerlocks, one electric fan with stand, one steel cabinet with lock, 40 pieces nameplates with pictures, 30 cans Acaho, and two speakers with cabinet, all of which are listed on page 1 of Exhibit R, and in default of such delivery, directing defendants to pay jointly and severally the reasonable value thereof taking into consideration the present costs of such items, with allowances of at least thirty per cent for their depreciation costs, with interests thereon at 6% per annum from date of this decision until it is fully paid;

(f) directing defendants to account for and return to plaintiffs all the articles listed in page 2 of Exhibit R, or in default thereof, directing defendants to pay, jointly and severally to plaintiff the sum of P1,313.42, with

interest thereon at 6% per annum from the date of this decision, until it is fully paid;

(g) directing the defendants to account for and return to plaintiff all of Items 1 to 17 listed on page 2 of Exh. R, or in default thereof, to pay jointly and severally the plaintiff the sum of P2,968.03, with interest thereon of 6% per annum from date of this decision until it is fully paid;

(h) directing the defendants to account for and return to plaintiff all of the last six items listed on page 2 of Exhibit R, or in default thereof, to pay jointly and severally the plaintiff the total costs of P7,999.55, with an allowance of 30% for their depreciation costs, and with interest thereon at 6% per annum until it is fully paid;

(i) directing the defendants to account for and return to plaintiff all the articles listed on page 3 of Exhibit R, or in default thereof, to jointly and severally pay to the plaintiff the cost price of P1,313.43, with interest thereon at the legal rate from date of this decision until it is fully paid;

(j) directing the defendants to pay jointly and severally to the plaintiff the sums of P50,000.00 as moral damages and P50,000 as exemplary damages;

(k) directing the plaintiff to pay defendants the sum of P28,572.45; with legal interest thereon from date of this decision until it is fully paid. This sum shall be set off and made to reduce plaintiff's entitlement as awarded by this Court;

(l) dismissing all other claims which the parties have against each other for lack of merit;

Costs against defendants." (Pp. 111 to 114, Record on Appeal). (At pp. 24-27, Rollo)

On appeal, the then Intermediate Appellate Court, on November 29, 1983, affirmed in toto the decision of the trial court. The subsequent motion for reconsideration by the petitioners was denied. Hence, this petition which presents three main arguments.

Firstly, the petitioners contend that the respondent Court sanctioned a legal error made by the trial court which is the reformation of Exhibit A from management contract to a lease contract contrary to Art. 1367 of the New Civil Code. In support of their contention, they averred that when respondent Ng filed an action for specific performance then for breach of contract later, he should have been presumed to have admitted the due execution and contents of the letter-contract marked as Exhibit A whereby he was appointed as manager-administrator of the petitioner corporation and he should never have been allowed to deny the contents thereof for purposes of reforming the said instrument.

Article 1367 of the Civil Code states that:

"Article 1367 — When one of the parties has brought an action to enforce the instrument, he cannot subsequently ask for its reformation."

The above quoted provision of law invoked by the petitioners cannot apply to respondent Ng's case. When Ng amended his original complaint for specific performance which calls for an enforcement of Exhibit A to one for breach of contract, he did so as a matter of right since no responsive pleading had been filed yet by the petitioners. The original complaint was filed on January 21, 1977 and was amended on January 28, 1977. The answer of the petitioners to the original complaint was filed only on February 4, 1977. Under Section 2, Rule 10 of the Revised Rules of Court, "a party may amend his pleading once as a matter of course at any time before a responsive pleading is served x x x." When a pleading is amended, the original one is deemed abandoned. Hence, the amended pleading replaces the original one which no longer forms part of the record and the trial of the case is made on the basis of the amended pleading only (see *Ruymann and Farris v. Director of Lands et al.*, 34 Phil. 428 [1916]). In the case at bar, respondent Ng, in his amended complaint brought an action for breach of contract not to enforce his rights as manager-administrator but as lessee of the petitioner corporation. In the course of the trial,

parol evidence was introduced to prove that the contract in question was not a management contract as it appeared on its face but a lease contract.

Rule 130, Sec. 7 of the Revised Rules of Court provides that:

“SEC. 7. Evidence of written agreements. — When the terms of an agreement have been reduced to writing, it is to be considered as containing all such terms, and, therefore, there can be, between the parties and their successors - in - interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases:

(a) Where a mistake or imperfection of the writing, or its failure to express the true intent and agreement of the parties, or the validity of the agreement is put in issue by the pleadings;

(b) When there is an intrinsic ambiguity in the writing.

The term “agreement” includes wills. (*Italics supplied*)

In the instant case, the failure of a contract to express the true intent and agreement of the parties is raised. The fact that the allegations of respondent Ng with respect to his rights as lessee of the petitioner corporation were made on the basis of Exhibit A which was marked as Annex “A” in the amended complaint meets the procedural requirement that said failure be put in issue by the pleadings.

In ruling that the subject contract is a lease contract and not a management contract, we adopt the findings of fact made by the trial court and affirmed by the respondent court.

The claim of the petitioners that respondent Ng is their manager-administrator is untenable since it fails to pass the control test pertinent to the existence of an employer-employee relationship. The control test asks whether the employer controls or has reserved the right to control the employee not only as to the result of the work but also as to the means and methods by which the said work is to be accomplished (*Social Security System v. Court of Appeals*, 156 SCRA 383 [1987]). Such control by the petitioners over respondent Ng is lacking. Exhibit A is in the nature of a lease contract under Art. 1643 of the Civil Code which states that:

"Art. 1643. In the lease of things, one of the parties binds himself to give another the enjoyment or use of a thing for a price certain, and for a period which may be definite or indefinite. However, no lease for more than ninety-nine (99) years shall be valid."

We find no reason to disturb the findings of the two courts below that the disputed contract is a lease contract. The reasons given are:

(1) The respondent paid the petitioners a fixed P8,000.00 monthly even when the business suffers a loss. The P8,000.00 was paid at the start of the month with no attention paid to operating expenses, profits, and losses.

(2) The monthly receipts received by the petitioners from Alejandro Ng state that they were given for rentals from January to October 1976. The receipts for November and December substitute the word “commission” for “rental”. The respondent explained the change by stating that petitioner Uy changed the receipt as he realized that subleasing the premises to Ng was a violation of the contract with the owner and the latter might discover the violation. The receipts were prepared by the petitioners but signed in the presence of the respondent when payment was made.

(3) The respondent was responsible for all licenses, permits, utilities and services, including the installation and repair of all equipment such as airconditioning units. He had sole control and management and did not report to anybody.

Anent the argument that the respondent Court, in helping petitioner Uy severally liable with the petitioner

corporation, departed from the rule that a stockholder or officer of a corporation has a personality distinct from the corporation, we hold that the corporate entity theory cannot apply in the instant case where it is being invoked as a cloak or shield for illegality. (see *Tan Boon Bee & Co., Inc. v. Judge Jarencio*, 163 SCRA 205 [1988]). There is proof obtaining in the case at bar as to the real nature of Exhibit A. Thus, being a party to a simulated contract of management, petitioner Uy cannot be permitted to escape liability under the said contract by using the corporate entity theory. This is one instance when the veil of corporate entity has to be pierced to avoid injustice and inequity.

Lastly, the petitioners argue that the respondent Court's award of moral and exemplary damages was contrary to law as there was no showing of bad faith. In this case, the petitioners manner of barring respondent Ng from his place of business with the use of Metrocom soldiers instead of availing of the proper legal action constituted bad faith as contemplated by law considering that the petitioners were aware of the real nature of the contract in question. The amount of P8,000.00 given monthly to the petitioners was received as "rentals" and not as "commissions." Only the later receipts indicated that the P8,000.00 was for payment of "commission" and respondent Ng explained that the change in the phraseology of the receipts was due to the fact that petitioner Uy wanted them to be so written since subleasing would constitute a violation of the latter's contract with the owner of the business premises. Moral damages are recoverable in cases of breach of contract where the defendant acted fraudulently or in bad faith (Art. 2220, New Civil Code). Exemplary damages, as well may be awarded in contracts if the defendant acted in a wanton, fraudulent, reckless, oppressive or malevolent manner (Art. 2232, New Civil Code).

We feel, however, the amount of moral and exemplary damages may be reduced considering the circumstances of the case. Mr. Uy was unhappy about the continued life of the lease arrangement and Mr. Ng was aware of this. In some instances, rental payments were not made promptly at the start of the month. Three checks initially bounced. Damage to the central airconditioning system and other equipment was not repaired. Mr. Ng also operated another massage and sauna parlor — The Rajah Sauna Bath in Ermita — and Mr. Uy was convinced that personnel and customers of Paradise Sauna were being enticed by the respondent to the other place thus eroding the goodwill and patronage of the complaining establishment. All of these, however, mitigate but do not justify the acts accompanying the termination of the contract.

WHEREFORE, IN VIEW OF THE FOREGOING, the instant petition is DISMISSED. The judgment appealed from is AFFIRMED with the MODIFICATION that the award of moral and exemplary damages is hereby reduced to a total of P20,000. The term of the lease having expired, the order to return the massage clinic to the private respondent is DELETED.

SO ORDERED.

Fernan, C.J., (Chairman), Feliciano, and Cortes, JJ., concur.
Bidin, J., no part. He participated in the appealed decision.

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