

Yu vs. Yukayguan (2009)

Summary Cases:

- [Yu vs. Yukayguan](#)

Subject: Derivative suit; Liquidation proceedings; A derivative suit is fundamentally distinct and independent from liquidation proceedings; Respondents did not comply with the requirements for filing a derivative suit; Affidavits of witnesses and documentary evidence should be submitted, at the latest, with the parties' pre-trial briefs;

Facts:

Petitioners are members of the Yu Family while respondents are composed of the Yukayguan Family. Anthony Yu is the older half-brother of Joseph Yukayguan, both of them being the patriarchs of their respective families.

Both families are stockholders of Winchester Industrial Supply, Inc. (Winchester, Inc.), a domestic corporation engaged in the operation of a general hardware and industrial supply and equipment business.

On 15 October 2002, respondents Yukayguan filed against petitioners Yu a verified Complaint for Accounting, Inspection of Corporate Books and Damages through Embezzlement and Falsification of Corporate Records and Accounts before the RTC of Cebu. The Complaint was filed by respondents, in their own behalf and as a derivative suit on behalf of Winchester, Inc.

According to Joseph Yukayguan, Anthony Yu was one of the incorporators, holding 1,000 shares of stock worth P100,000. Anthony paid for the said shares of stock with Joseph's money, thus, making the former a mere trustee of the shares for the latter. On 14 November 1984, Anthony ceded 800 of his 1,000 shares of stock to Joseph, as well as Yu Kay Guan, Siao So Lan, and John S. Yu. Anthony remained as trustee for Joseph of the 200 shares of stock in Winchester, Inc., still in Anthony's name.

Joseph also averred that although he appeared as the Secretary and Treasurer in the corporate records of Winchester, Inc., petitioners actually controlled and ran the said corporation as if it were their own family business. Petitioner Rosita Yu handled the money market placements of the corporation to the exclusion of Joseph. Petitioners were also misappropriating the funds and properties of Winchester, Inc. by understating the sales, charging their personal and family expenses to the said corporation, and withdrawing stocks for their personal use without paying for the same.

Respondents sought the appointment of a Management Committee and the freezing of all corporate funds by the trial court.

By way of special and affirmative defenses, petitioners contended that respondents had no cause of action against them. The Complaint was purely intended for harassment and should be dismissed under Section 1(j), Rule 16 of the Rules of Court for failure to comply with conditions precedent before its filing: (1) there was no allegation in the Complaint that earnest efforts were exerted to settle the dispute between the parties, (2) being a derivative suit, it failed to allege that respondents exerted effort to exhaust all available remedies in the Articles of Incorporation and By-Laws of Winchester, Inc., as well as in the Corporation Code, (3) as for inspection of corporate books, it lacked the allegation that respondents made a previous demand upon petitioners to inspect the corporate books but petitioners refused.

In amicable settlement of their dispute, the petitioners and respondents agreed to a division of the stocks in trade, the real properties, and the other assets of Winchester, Inc. In partial implementation of the amicable settlement, the said assets were equally distributed among the parties. As a result, the stockholders and members of the Board of Directors of Winchester, Inc. passed, on 4 January 2003, a unanimous Resolution dissolving the corporation as of said date.

However, respondents later manifestation before the RTC that they were repudiating the settlement, in view of the failure of the parties thereto to divide the remaining assets of Winchester, Inc. Consequently, respondents moved to have the case set for pre-trial. Both parties agreed that the RTC may already render a judgment based on the pleadings.

After both parties submitted their respective memorandas, the RTC rendered its Decision dismissing the case. The RTC declared that respondents failed to show that they had complied with the essential requisites for filing a derivative suit as set forth in Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies. Also, respondents had likewise failed to comply with the requisites entitling them to the inspection of corporate books and records.

The Court of Appeals (CA) initially affirmed the RTC decision dismissing the complaint. Respondents filed a Motion for Reconsideration (MR) which the CA granted. Accordingly, oral arguments were heard and Position Papers were submitted. Thereafter, the CA ruled that a remand of the case to the RTC was necessary for the proper disposition of the corporate assets “in view of the formal dissolution of the corporation which leaves unresolved up to the present the settlement of the properties and assets.”

Held:

Derivative suit

1. The general rule is that where a corporation is an injured party, its power to sue is lodged with its board of directors or trustees. Nonetheless, an individual stockholder is permitted to institute a derivative suit on behalf of the corporation wherein he holds stocks in order to protect or vindicate corporate rights, whenever the officials of the corporation refuse to sue, or are the ones to be sued, or hold the control of the corporation.

2. In a derivative suit, the suing stockholder is regarded as a nominal party, with the corporation as the real party in interest. A derivative action is a suit by a shareholder to enforce a corporate cause of action. The corporation is a necessary party to the suit. And the relief which is granted is a judgment against a third person in favor of the corporation. Similarly, if a corporation has a defense to an action against it and is not asserting it, a stockholder may intervene and defend on behalf of the corporation.

3. By virtue of Republic Act No. 8799, otherwise known as the Securities Regulation Code, jurisdiction over intra-corporate disputes, including derivative suits, is now vested in the Regional Trial Courts designated by this Court [as special commercial courts] pursuant to A.M. No. 00-11-03-SC promulgated on 21 November 2000.

4. A stockholder's right to institute a derivative suit is not based on any express provision of the Corporation Code, or even the Securities Regulation Code, but is impliedly recognized when the said laws make corporate directors or officers liable for damages suffered by the corporation and its stockholders for violation of their fiduciary duties. Hence, a stockholder may sue for mismanagement, waste or dissipation of corporate assets because of a special injury to him for which he is otherwise without redress. In effect, the suit is an action for specific performance of an obligation owed by the corporation to the stockholders to assist its rights of action when the corporation has been put in default

by the wrongful refusal of the directors or management to make suitable measures for its protection. The basis of a stockholder's suit is always one in equity.

5. **Section 1, Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies** lays down the following **requirements** which a stockholder must comply with in filing a **derivative suit**:

Sec. 1. Derivative action. - A stockholder or member may bring an action in the name of a corporation or association, as the case may be, provided, that:

(1) He was a stockholder or member at the time the acts or transactions subject of the action occurred and at the time the action was filed;

(2) He exerted all reasonable efforts, and alleges the same with particularity in the complaint, to exhaust all remedies available under the articles of incorporation, by-laws, laws or rules governing the corporation or partnership to obtain the relief he desires;

(3) No appraisal rights are available for the act or acts complained of; and

(4) The suit is not a nuisance or harassment suit.

Liquidation proceedings

6. Liquidation is a necessary consequence of the dissolution of a corporation. It is specifically governed by **Section 122 of the Corporation Code**, which reads:

***"SEC. 122. Corporate liquidation.** - Every corporation whose charter expires by its own limitation or is annulled by forfeiture or otherwise, or whose corporate existence for other purposes is terminated in any other manner, shall nevertheless be continued as a body corporate for three (3) years after the time when it would have been so dissolved, for the purpose of prosecuting and defending suits by or against it and enabling it to settle and close its affairs, to dispose of and convey its property and to distribute its assets, but not for the purpose of continuing the business for which it was established.*

At any time during said three (3) years, said corporation is authorized and empowered to convey all of its property to trustees for the benefit of stockholders, members, creditors, and other persons in interest. From and after any such conveyance by the corporation of its property in trust for the benefit of its stockholders, members, creditors and others in interest, all interest which the corporation had in the property terminates, the legal interest vests in the trustees, and the beneficial interest in the stockholders, members, creditors or other persons in interest.

Upon winding up of the corporate affairs, any asset distributable to any creditor or stockholder or member who is unknown or cannot be found shall be escheated to the city or municipality where such assets are located.

Except by decrease of capital stock and as otherwise allowed by this Code, no corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities."

7. Following the voluntary or involuntary dissolution of a corporation, liquidation is the process of settling the affairs of said corporation, which consists of adjusting the debts and claims, that is, of collecting all that is due the corporation, the settlement and adjustment of claims against it and the payment of its just

debts. Winding up the affairs of the corporation means the collection of all assets, the payment of all its creditors, and the distribution of the remaining assets, if any among the stockholders thereof in accordance with their contracts, or if there be no special contract, on the basis of their respective interests.

8. The manner of liquidation or winding up may be provided for in the corporate by-laws and this would prevail unless it is inconsistent with law. It may be undertaken by the corporation itself, through its Board of Directors; or by trustees to whom all corporate assets are conveyed for liquidation; or by a receiver appointed by the SEC upon its decree dissolving the corporation.

A derivative suit is fundamentally distinct and independent from liquidation proceedings

9. In accordance with respondents' allegation in their Position Paper (on MR) that the parties subsequently filed with the SEC, and the SEC already approved, a petition for dissolution of Winchester, Inc., the Court of Appeals remanded the case to the RTC so that all the corporate concerns between the parties regarding Winchester, Inc. could be resolved towards final settlement. In one stroke, with the use of sweeping language, which utterly lacked support, the Court of Appeals converted the derivative suit between the parties into liquidation proceedings.

10. Glaringly, a derivative suit is fundamentally distinct and independent from liquidation proceedings. They are neither part of each other nor the necessary consequence of the other. There is totally no justification for the Court of Appeals to convert what was supposedly a derivative suit instituted by respondents, on their own behalf and on behalf of Winchester, Inc. against petitioners, to a proceeding for the liquidation of Winchester, Inc.

11. Even if the parties did submit a petition for the dissolution of Winchester, Inc. and the same was approved by the SEC, the Court of Appeals was still without jurisdiction to order the final settlement by the RTC of the remaining corporate concerns. It must be remembered that the Complaint filed by respondents before the RTC essentially prayed for the accounting and reimbursement by petitioners of the corporate funds and assets which they purportedly misappropriated for their personal use; surrender by of the corporate books for the inspection of respondents; and payment of damages. There was nothing in respondents' Complaint which sought the dissolution and liquidation of Winchester, Inc. Hence, the supposed dissolution of Winchester, Inc. could not have resulted in the conversion of respondents' derivative suit to a proceeding for the liquidation of said corporation, but only in the dismissal of the derivative suit based on either compromise agreement or mootness of the issues.

Respondents did not comply with the requirements for filing a derivative suit

12. The wordings of Section 1, Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies are simple and do not leave room for statutory construction. The second paragraph thereof requires that the stockholder filing a derivative suit should have exerted all reasonable efforts to exhaust all remedies available under the articles of incorporation, by-laws, laws or rules governing the corporation or partnership to obtain the relief he desires; and to allege such fact with particularity in the complaint. The obvious intent behind the rule is to make the derivative suit the final recourse of the stockholder, after all other remedies to obtain the relief sought had failed.

13. A perusal of respondents' Complaint before the RTC would reveal that the same did not allege with particularity that respondents exerted all reasonable efforts to exhaust all remedies available under the articles of incorporation, by-laws, laws or rules governing Winchester, Inc. The allegation of Joseph in his Affidavit of his repeated attempts to talk to petitioner Anthony regarding their dispute hardly constitutes "all reasonable efforts to exhaust all remedies available." Respondents did not refer to or mention at all

any other remedy under the articles of incorporation or by-laws of Winchester, Inc., available for dispute resolution among stockholders, which respondents unsuccessfully availed themselves of. And the Court is not prepared to conclude that the articles of incorporation and by-laws of Winchester, Inc. absolutely failed to provide for such remedies.

14. Moreover, the fact that Winchester, Inc. is a family corporation should not in any way exempt respondents from complying with the clear requirements and formalities of the rules for filing a derivative suit. There is nothing in the pertinent laws or rules supporting the distinction between family corporations vis-a-vis other types of corporations, in the institution by a stockholder of a derivative suit.

15. The Court further notes that, with respect to the third and fourth requirements of Section 1, Rule 8, the respondents' Complaint failed to allege, explicitly or otherwise, the fact that there were no appraisal rights available for the acts of petitioners complained of, as well as a categorical statement that the suit was not a nuisance or a harassment suit.

Affidavits of witnesses and documentary evidence should be submitted, at the latest, with the parties' pre-trial briefs.

16. Respondent Joseph's Supplemental Affidavit and additional evidence were inadmissible since they were only appended by respondents to their Memorandum (submitted for judgment on the pleadings) before the RTC. Section 8, Rule 2 of the Interim Rules of Procedure Governing Intra-Corporate Controversies is crystal clear that parties should attach the affidavits of witnesses and other documentary evidence to the appropriate pleading, which generally should mean the complaint for the plaintiff and the answer for the respondent. Affidavits and documentary evidence not so submitted must already be attached to the respective pre-trial briefs of the parties.

17. True, the parties in the present case agreed to submit the case for judgment by the RTC, even before pre-trial, in accordance with Section 4, Rule 4 of the Interim Rules of Procedure Governing Intra-Corporate Controversies. Even then, the provision still requires, before the court makes a determination that it can render judgment before pre-trial, that the parties had submitted their pre-trial briefs and the court took into consideration the pleadings, affidavits and other evidence submitted by the parties. Hence, cases wherein the court can render judgment prior to pre-trial, do not depart from or constitute an exception to the requisite that affidavits of witnesses and documentary evidence should be submitted, at the latest, with the parties' pre-trial briefs. Taking further into account that under Section 4, Rule 4 of the Interim Rules of Procedure Governing Intra-Corporate Controversies parties are required to file their memoranda simultaneously, the same would mean that a party would no longer have any opportunity to dispute or rebut any new affidavit or evidence attached by the other party to its memorandum. To violate the above-quoted provision would, thus, irrefragably run afoul the former party's constitutional right to due process.

18. Respondents neither alleged nor proved that the documents in question fall under any of the three exceptions to the requirement that affidavits and documentary evidence should be attached to the appropriate pleading or pre-trial brief of the party, which is particularly recognized under Section 8, Rule 2 of the Interim Rules of Procedure Governing Intra-Corporate Controversies.