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Republic of the Philippines
Supreme Court
Manila

SECOND DIVISION

GERARDO LANUZA, JR. AND ANTONIO O. OLBES, Petitioners,	**G.R. No. 174938** Present:
- versus -	VELASCO, JR.,* BRION, *Chairperson,* PERALTA,** MENDOZA, and LEONEN, *JJ.*
BF CORPORATION, SHANGRI-LA PROPERTIES, INC., ALFREDO C. RAMOS, RUFO B. COLAYCO, MAXIMO G. LICAUCO III, AND BENJAMIN C. RAMOS, Respondents.	Promulgated: OCT 01 2014

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DECISION

LEONEN, *J.*:

Corporate representatives may be compelled to submit to arbitration proceedings pursuant to a contract entered into by the corporation they represent if there are allegations of bad faith or malice in their acts representing the corporation.

This is a Rule 45 petition, assailing the Court of Appeals' May 11, 2006 decision and October 5, 2006 resolution. The Court of Appeals affirmed the trial court's decision holding that petitioners, as directors,

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* Designated additional member per Raffle dated September 3, 2014.
** Designated additional member per Raffle dated September 24, 2014.

should submit themselves as parties to the arbitration proceedings between BF Corporation and Shangri-La Properties, Inc. (Shangri-La).

In 1993, BF Corporation filed a collection complaint with the Regional Trial Court against Shangri-La and the members of its board of directors: Alfredo C. Ramos, Rufo B. Colayco, Antonio O. Olbes, Gerardo Lanuza, Jr., Maximo G. Licauco III, and Benjamin C. Ramos.[1]

BF Corporation alleged in its complaint that on December 11, 1989 and May 30, 1991, it entered into agreements with Shangri-La wherein it undertook to construct for Shangri-La a mall and a multilevel parking structure along EDSA.[2]

Shangri-La had been consistent in paying BF Corporation in accordance with its progress billing statements.[3] However, by October 1991, Shangri-La started defaulting in payment.[4]

BF Corporation alleged that Shangri-La induced BF Corporation to continue with the construction of the buildings using its own funds and credit despite Shangri-La's default.[5] According to BF Corporation, Shangri-La misrepresented that it had funds to pay for its obligations with BF Corporation, and the delay in payment was simply a matter of delayed processing of BF Corporation's progress billing statements.[6]

BF Corporation eventually completed the construction of the buildings.[7] Shangri-La allegedly took possession of the buildings while still owing BF Corporation an outstanding balance.[8]

BF Corporation alleged that despite repeated demands, Shangri-La refused to pay the balance owed to it.[9] It also alleged that the Shangri-La's directors were in bad faith in directing Shangri-La's affairs. Therefore, they should be held jointly and severally liable with Shangri-La for its obligations as well as for the damages that BF Corporation incurred as a result of Shangri-La's default.[10]

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1 *Rollo*, pp. 47, 160–176.
2 Id. at 46–47, 161.
3 Id. at 166.
4 Id. at 47, 167.
5 Id.
6 Id.
7 Id. at 168.
8 Id.
9 Id. at 170.
10 Id. at 171.

On August 3, 1993, Shangri-La, Alfredo C. Ramos, Rufo B. Colayco, Maximo G. Licauco III, and Benjamin C. Ramos filed a motion to suspend the proceedings in view of BF Corporation's failure to submit its dispute to arbitration, in accordance with the arbitration clause provided in its contract, quoted in the motion as follows:[11]

> 35. Arbitration
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> (1) Provided always that in case any dispute or difference shall arise between the Owner or the Project Manager on his behalf and the Contractor, either during the progress or after the completion or abandonment of the Works as to the construction of this Contract or as to any matter or thing of whatsoever nature arising thereunder or in connection therewith (including any matter or thing left by this Contract to the discretion of the Project Manager or the withholding by the Project Manager of any certificate to which the Contractor may claim to be entitled or the measurement and valuation mentioned in clause 30(5)(a) of these Conditions or the rights and liabilities of the parties under clauses 25, 26, 32 or 33 of these Conditions), the owner and the Contractor hereby agree to exert all efforts to settle their differences or dispute amicably. Failing these efforts then such dispute or difference shall be referred to arbitration in accordance with the rules and procedures of the Philippine Arbitration Law.
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> xxx xxx xxx
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> (6) The award of such Arbitrators shall be final and binding on the parties. The decision of the Arbitrators shall be a condition precedent to any right of legal action that either party may have against the other. . . .[12] (Underscoring in the original)

On August 19, 1993, BF Corporation opposed the motion to suspend proceedings.[13]

In the November 18, 1993 order, the Regional Trial Court denied the motion to suspend proceedings.[14]

On December 8, 1993, petitioners filed an answer to BF Corporation's complaint, with compulsory counterclaim against BF Corporation and cross-claim against Shangri-La.[15] They alleged that they had resigned as members of Shangri-La's board of directors as of July 15, 1991.[16]

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11 Id. at 18–19, 47.
12 Id. at 191–192.
13 Id. at 47.
14 Id. at 19, 47.
15 Id.
16 Id. at 47.

After the Regional Trial Court denied on February 11, 1994 the motion for reconsideration of its November 18, 1993 order, Shangri-La, Alfredo C. Ramos, Rufo B. Colayco, Maximo G. Licauco III, and Benjamin Ramos filed a petition for certiorari with the Court of Appeals.[17]

On April 28, 1995, the Court of Appeals granted the petition for certiorari and ordered the submission of the dispute to arbitration.[18]

Aggrieved by the Court of Appeals' decision, BF Corporation filed a petition for review on certiorari with this court.[19] On March 27, 1998, this court affirmed the Court of Appeals' decision, directing that the dispute be submitted for arbitration.[20]

Another issue arose after BF Corporation had initiated arbitration proceedings. BF Corporation and Shangri-La failed to agree as to the law that should govern the arbitration proceedings.[21] On October 27, 1998, the trial court issued the order directing the parties to conduct the proceedings in accordance with Republic Act No. 876.[22]

Shangri-La filed an omnibus motion and BF Corporation an urgent motion for clarification, both seeking to clarify the term, "parties," and whether Shangri-La's directors should be included in the arbitration proceedings and served with separate demands for arbitration.[23]

Petitioners filed their comment on Shangri-La's and BF Corporation's motions, praying that they be excluded from the arbitration proceedings for being non-parties to Shangri-La's and BF Corporation's agreement.[24]

On July 28, 2003, the trial court issued the order directing service of demands for arbitration upon all defendants in BF Corporation's complaint.[25] According to the trial court, Shangri-La's directors were interested parties who "must also be served with a demand for arbitration to give them the opportunity to ventilate their side of the controversy, safeguard their interest and fend off their respective positions."[26] Petitioners' motion for reconsideration of this order was denied by the trial court on January 19, 2005.[27]

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17 Id. at 218.
18 Id. at 227.
19 Id. at 228.
20 Id. at 244.
21 Id. at 20, 48.
22 Id. at 48.
23 Id. at 22, 48–49.
24 Id. at 22, 49.
25 Id. at 23, 49.
26 Id. at 99.
27 Id. at 24, 50.

Petitioners filed a petition for certiorari with the Court of Appeals, alleging grave abuse of discretion in the issuance of orders compelling them to submit to arbitration proceedings despite being third parties to the contract between Shangri-La and BF Corporation.[28]

In its May 11, 2006 decision,[29] the Court of Appeals dismissed petitioners' petition for certiorari. The Court of Appeals ruled that Shangri-La's directors were necessary parties in the arbitration proceedings.[30] According to the Court of Appeals:

> [They were] deemed not third-parties to the contract as they [were] sued for their acts in representation of the party to the contract pursuant to Art. 31 of the Corporation Code, and that as directors of the defendant corporation, [they], in accordance with Art. 1217 of the Civil Code, stand to be benefited or injured by the result of the arbitration proceedings, hence, being necessary parties, they must be joined in order to have complete adjudication of the controversy. Consequently, if [they were] excluded as parties in the arbitration proceedings and an arbitral award is rendered, holding [Shangri-La] and its board of directors jointly and solidarily liable to private respondent BF Corporation, a problem will arise, i.e., whether petitioners will be bound by such arbitral award, and this will prevent complete determination of the issues and resolution of the controversy.[31]

The Court of Appeals further ruled that "excluding petitioners in the arbitration proceedings . . . would be contrary to the policy against multiplicity of suits."[32]

The dispositive portion of the Court of Appeals' decision reads:

> **WHEREFORE,** the petition is ***DISMISSED.*** The assailed orders dated July 28, 2003 and January 19, 2005 of public respondent RTC, Branch 157, Pasig City, in Civil Case No. 63400, are ***AFFIRMED.***[33]

The Court of Appeals denied petitioners' motion for reconsideration in the October 5, 2006 resolution.[34]

On November 24, 2006, petitioners filed a petition for review of the May 11, 2006 Court of Appeals decision and the October 5, 2006 Court of Appeals resolution.[35]

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28 Id.
29 Id. at 46–53.
30 Id. at 24–25, 52.
31 Id. at 52.
32 Id.
33 Id. at 52–53.
34 Id. at 25, 64.
35 Id. at 12, 13–15.

The issue in this case is whether petitioners should be made parties to the arbitration proceedings, pursuant to the arbitration clause provided in the contract between BF Corporation and Shangri-La.

Petitioners argue that they cannot be held personally liable for corporate acts or obligations.[36] The corporation is a separate being, and nothing justifies BF Corporation's allegation that they are solidarily liable with Shangri-La.[37] Neither did they bind themselves personally nor did they undertake to shoulder Shangri-La's obligations should it fail in its obligations.[38] BF Corporation also failed to establish fraud or bad faith on their part.[39]

Petitioners also argue that they are third parties to the contract between BF Corporation and Shangri-La.[40] Provisions including arbitration stipulations should bind only the parties.[41] Based on our arbitration laws, parties who are strangers to an agreement cannot be compelled to arbitrate.[42]

Petitioners point out that our arbitration laws were enacted to promote the autonomy of parties in resolving their disputes.[43] Compelling them to submit to arbitration is against this purpose and may be tantamount to stipulating for the parties.[44]

Separate comments on the petition were filed by BF Corporation, and Maximo G. Licauco III, Alfredo C. Ramos and Benjamin C. Ramos.[45]

Maximo G. Licauco III Alfredo C. Ramos, and Benjamin C. Ramos agreed with petitioners that Shangri-La's directors, being non-parties to the contract, should not be made personally liable for Shangri-La's acts.[46] Since the contract was executed only by BF Corporation and Shangri-La, only they should be affected by the contract's stipulation.[47] BF Corporation also failed to specifically allege the unlawful acts of the directors that should make them solidarily liable with Shangri-La for its obligations.[48]

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36 Id. at 26–28.
37 Id.
38 Id. at 28.
39 Id. at 28–29.
40 Id. at 29.
41 *Rollo,* pp. 29–30, *citing Heirs of Augusto Salas, Jr. v. Laperal Realty Corporation,* 378 Phil. 369 (1999) [Per J. De Leon, Jr., Second Division]; *Del Monte Corporation-USA v. Court of Appeals*, 404 Phil. 192 (2001) [Per J. Bellosillo, Second Division]; *Agan, Jr. v. Philippine International Air Terminals Co., Inc.,* 450 Phil. 744 (2003) [Per J. Puno, En Banc].
42 *Rollo,* p. 32.
43 Id. at 34–35.
44 Id. at 35.
45 Id. at 292–301, 327–332.
46 Id. at 293–294.
47 Id. at 295.
48 Id. at 299–300.

Meanwhile, in its comment, BF Corporation argued that the courts' ruling that the parties should undergo arbitration "clearly contemplated the inclusion of the directors of the corporation[.]"[49]

BF Corporation also argued that while petitioners were not parties to the agreement, they were still impleaded under Section 31 of the Corporation Code.[50] Section 31 makes directors solidarily liable for fraud, gross negligence, and bad faith.[51] Petitioners are not really third parties to the agreement because they are being sued as Shangri-La's representatives, under Section 31 of the Corporation Code.[52]

BF Corporation further argued that because petitioners were impleaded for their solidary liability, they are necessary parties to the arbitration proceedings.[53] The full resolution of all disputes in the arbitration proceedings should also be done in the interest of justice.[54]

In the manifestation dated September 6, 2007, petitioners informed the court that the Arbitral Tribunal had already promulgated its decision on July 31, 2007.[55] The Arbitral Tribunal denied BF Corporation's claims against them.[56] Petitioners stated that "[they] were included by the Arbitral Tribunal in the proceedings conducted . . . notwithstanding [their] continuing objection thereto. . . ."[57] They also stated that "[their] unwilling participation in the arbitration case was done *ex abundante ad cautela*, as manifested therein on several occasions."[58] Petitioners informed the court that they already manifested with the trial court that "any action taken on [the Arbitral Tribunal's decision] should be without prejudice to the resolution of [this] case."[59]

Upon the court's order, petitioners and Shangri-La filed their respective memoranda. Petitioners and Maximo G. Licauco III, Alfredo C. Ramos, and Benjamin C. Ramos reiterated their arguments that they should not be held liable for Shangri-La's default and made parties to the arbitration proceedings because only BF Corporation and Shangri-La were parties to the contract.

In its memorandum, Shangri-La argued that petitioners were impleaded for their solidary liability under Section 31 of the Corporation

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49 Id. at 327.
50 Id. at 328.
51 Id. at 328.
52 Id.
53 Id.
54 Id. at 328–329.
55 Id. at 365–366.
56 Id. at 365–366.
57 Id. at 367.
58 Id.
59 Id.

Code. Shangri-La added that their exclusion from the arbitration proceedings will result in multiplicity of suits, which "is not favored in this jurisdiction."[60] It pointed out that the case had already been mooted by the termination of the arbitration proceedings, which petitioners actively participated in.[61] Moreover, BF Corporation assailed only the correctness of the Arbitral Tribunal's award and not the part absolving Shangri-La's directors from liability.[62]

BF Corporation filed a counter-manifestation with motion to dismiss[63] in lieu of the required memorandum.

In its counter-manifestation, BF Corporation pointed out that since "petitioners' counterclaims were already dismissed with finality, and the claims against them were likewise dismissed with finality, they no longer have any interest or personality in the arbitration case. Thus, there is no longer any need to resolve the present *Petition*, which mainly questions the inclusion of petitioners in the arbitration proceedings."[64] The court's decision in this case will no longer have any effect on the issue of petitioners' inclusion in the arbitration proceedings.[65]

The petition must fail.

The Arbitral Tribunal's decision, absolving petitioners from liability, and its binding effect on BF Corporation, have rendered this case moot and academic.

The mootness of the case, however, had not precluded us from resolving issues so that principles may be established for the guidance of the bench, bar, and the public. In *De la Camara v. Hon. Enage*,[66] this court disregarded the fact that petitioner in that case already escaped from prison and ruled on the issue of excessive bails:

> While under the circumstances a ruling on the merits of the petition for certiorari is not warranted, still, as set forth at the opening of this opinion, the fact that this case is moot and academic should not preclude this Tribunal from setting forth in language clear and unmistakable, the obligation of fidelity on the part of lower court judges to the unequivocal command of the Constitution that excessive bail shall not be required.[67]

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60 Id. at 464.
61 Id. at 467-468.
62 Id.
63 Id. at 437–441.
64 Id. at 439.
65 Id.
66 148-B Phil. 502 (1971) [Per J. Fernando, En Banc].
67 Id. at 506.

This principle was repeated in subsequent cases when this court deemed it proper to clarify important matters for guidance.[68]

Thus, we rule that petitioners may be compelled to submit to the arbitration proceedings in accordance with Shangri-La and BF Corporation's agreement, in order to determine if the distinction between Shangri-La's personality and their personalities should be disregarded.

This jurisdiction adopts a policy in favor of arbitration. Arbitration allows the parties to avoid litigation and settle disputes amicably and more expeditiously by themselves and through their choice of arbitrators.

The policy in favor of arbitration has been affirmed in our Civil Code,[69] which was approved as early as 1949. It was later institutionalized by the approval of Republic Act No. 876,[70] which expressly authorized, made valid, enforceable, and irrevocable parties' decision to submit their controversies, including incidental issues, to arbitration. This court recognized this policy in *Eastboard Navigation, Ltd. v. Ysmael and Company, Inc.*:[71]

> As a corollary to the question regarding the existence of an arbitration agreement, defendant raises the issue that, even if it be granted that it agreed to submit its dispute with plaintiff to arbitration, said agreement is void and without effect for it amounts to removing said dispute from the jurisdiction of the courts in which the parties are domiciled or where the dispute occurred. It is true that there are authorities which hold that "a clause in a contract providing that all matters in dispute between the parties shall be referred to arbitrators and to them alone, is contrary to public policy and cannot oust the courts of jurisdiction" (Manila Electric Co. *vs.* Pasay Transportation Co., 57 Phil., 600, 603), **however, there are authorities which favor "the more intelligent view that arbitration, as an inexpensive, speedy and amicable method of settling disputes, and as a means of avoiding litigation, should receive every encouragement from the courts which may be extended without contravening sound public policy or settled law" (3 Am. Jur., p. 835). Congress has officially adopted the modern view when it reproduced in the new Civil Code the provisions of the old Code on Arbitration.**

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68 *See Salonga v. Paño*, 219 Phil. 402, 430 (1985) [Per J. Gutierrez, Jr., En Banc]; *Angel v. Inopiquez*, 251 Phil. 131, 136 (1989) [Per J. Bidin, Third Division]; *Chavez v. Public Estates Authority*, 433 Phil. 506, 522 (2002) [Per J. Carpio, En Banc]; *Alliance for Rural and Agrarian Reconstruction, Inc. v. COMELEC*, G.R. No. 192803, December 10, 2013, 712 SCRA 54, 75–76 [Per J. Leonen, En Banc].

69 CIVIL CODE, art. 2028–2046.

70 AN ACT TO AUTHORIZE THE MAKING OF ARBITRATION AND SUBMISSION AGREEMENTS, TO PROVIDE FOR THE APPOINTMENT OF ARBITRATORS AND THE PROCEDURE FOR ARBITRATION IN CIVIL CONTROVERSIES, AND FOR OTHER PURPOSES (June 19, 1953).

71 102 Phil. 1 (1957) [Per J. Bautista, Angelo, En Banc].

> **And only recently it approved Republic Act No. 876 expressly authorizing arbitration of future disputes.**[72] (Emphasis supplied)

In view of our policy to adopt arbitration as a manner of settling disputes, arbitration clauses are liberally construed to favor arbitration. Thus, in *LM Power Engineering Corporation v. Capitol Industrial Construction Groups, Inc.*,[73] this court said:

> Being an inexpensive, speedy and amicable method of settling disputes, arbitration — along with mediation, conciliation and negotiation — is encouraged by the Supreme Court. Aside from unclogging judicial dockets, arbitration also hastens the resolution of disputes, especially of the commercial kind. It is thus regarded as the "wave of the future" in international civil and commercial disputes. Brushing aside a contractual agreement calling for arbitration between the parties would be a step backward.
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> **Consistent with the above-mentioned policy of encouraging alternative dispute resolution methods, courts should liberally construe arbitration clauses. Provided such clause is susceptible of an interpretation that covers the asserted dispute, an order to arbitrate should be granted. Any doubt should be resolved in favor of arbitration.**[74] (Emphasis supplied)

A more clear-cut statement of the state policy to encourage arbitration and to favor interpretations that would render effective an arbitration clause was later expressed in Republic Act No. 9285:[75]

> **SEC. 2. *Declaration of Policy*.** - It is hereby declared the policy of the State to actively promote party autonomy in the resolution of disputes or the freedom of the party to make their own arrangements to resolve their disputes. **Towards this end, the State shall encourage and actively promote the use of Alternative Dispute Resolution (ADR) as an important means to achieve speedy and impartial justice and declog court dockets.** As such, the State shall provide means for the use of ADR as an efficient tool and an alternative procedure for the resolution of appropriate cases. Likewise, the State shall enlist active private sector participation in the settlement of disputes through ADR. This Act shall be without prejudice to the adoption by the Supreme Court of any ADR system, such as mediation, conciliation, arbitration, or any combination thereof as a means of achieving speedy and efficient means of resolving cases pending before all courts in the Philippines which shall be governed by such rules as the Supreme Court may approve from time to time.

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72 Id. at 16–17.

73 447 Phil. 705 (2003) [Per J. Panganiban, Third Division].

74 Id. at 714.

75 AN ACT TO INSTITUTIONALIZE THE USE OF AN ALTERNATIVE DISPUTE RESOLUTION SYSTEM IN THE PHILIPPINES AND TO ESTABLISH THE OFFICE FOR ALTERNATIVE DISPUTE RESOLUTION, AND FOR OTHER PURPOSES (April 2, 2004).

. . . .

> **SEC. 25.** ***Interpretation of the Act.*** - In interpreting the Act, **the court shall have due regard to the policy of the law in favor of arbitration.** Where action is commenced by or against multiple parties, one or more of whom are parties who are bound by the arbitration agreement although the civil action may continue as to those who are not bound by such arbitration agreement. (Emphasis supplied)

Thus, if there is an interpretation that would render effective an arbitration clause for purposes of avoiding litigation and expediting resolution of the dispute, that interpretation shall be adopted.

Petitioners' main argument arises from the separate personality given to juridical persons *vis-à-vis* their directors, officers, stockholders, and agents. Since they did not sign the arbitration agreement in any capacity, they cannot be forced to submit to the jurisdiction of the Arbitration Tribunal in accordance with the arbitration agreement. Moreover, they had already resigned as directors of Shangri-La at the time of the alleged default.

Indeed, as petitioners point out, their personalities as directors of Shangri-La are separate and distinct from Shangri-La.

A corporation is an artificial entity created by fiction of law.[76] This means that while it is not a person, naturally, the law gives it a distinct personality and treats it as such. A corporation, in the legal sense, is an individual with a personality that is distinct and separate from other persons including its stockholders, officers, directors, representatives,[77] and other juridical entities.

The law vests in corporations rights, powers, and attributes as if they were natural persons with physical existence and capabilities to act on their own.[78] For instance, they have the power to sue and enter into transactions or contracts. Section 36 of the Corporation Code enumerates some of a corporation's powers, thus:

> **Section 36.** *Corporate powers and capacity.* – Every corporation incorporated under this Code has the power and capacity:
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> 1. To sue and be sued in its corporate name;

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[76] CORP. CODE, sec. 2.

[77] *See Heirs of Fe Tan Uy v. International Exchange Bank*, G.R. No. 166282, February 13, 2013, 690 SCRA 519, 525 [Per J. Mendoza, Third Division].

[78] CORP. CODE, sec. 2.

> 2. Of succession by its corporate name for the period of time stated in the articles of incorporation and the certificate of incorporation;
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> 3. To adopt and use a corporate seal;
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> 4. To amend its articles of incorporation in accordance with the provisions of this Code;
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> 5. To adopt by-laws, not contrary to law, morals, or public policy, and to amend or repeal the same in accordance with this Code;
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> 6. In case of stock corporations, to issue or sell stocks to subscribers and to sell treasury stocks in accordance with the provisions of this Code; and to admit members to the corporation if it be a non-stock corporation;
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> 7. To purchase, receive, take or grant, hold, convey, sell, lease, pledge, mortgage and otherwise deal with such real and personal property, including securities and bonds of other corporations, as the transaction of the lawful business of the corporation may reasonably and necessarily require, subject to the limitations prescribed by law and the Constitution;
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> 8. To enter into merger or consolidation with other corporations as provided in this Code;
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> 9. To make reasonable donations, including those for the public welfare or for hospital, charitable, cultural, scientific, civic, or similar purposes: Provided, That no corporation, domestic or foreign, shall give donations in aid of any political party or candidate or for purposes of partisan political activity;
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> 10. To establish pension, retirement, and other plans for the benefit of its directors, trustees, officers and employees; and
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> 11. To exercise such other powers as may be essential or necessary to carry out its purpose or purposes as stated in its articles of incorporation. (13a)

Because a corporation's existence is only by fiction of law, it can only exercise its rights and powers through its directors, officers, or agents, who are all natural persons. A corporation cannot sue or enter into contracts without them.

A consequence of a corporation's separate personality is that consent by a corporation through its representatives is not consent of the representative, personally. Its obligations, incurred through official acts of its representatives, are its own. A stockholder, director, or representative does not become a party to a contract just because a corporation executed a contract through that stockholder, director or representative.

Hence, a corporation's representatives are generally not bound by the terms of the contract executed by the corporation. They are not personally liable for obligations and liabilities incurred on or in behalf of the corporation.

Petitioners are also correct that arbitration promotes the parties' autonomy in resolving their disputes. This court recognized in *Heirs of Augusto Salas, Jr. v. Laperal Realty Corporation*[79] that an arbitration clause shall not apply to persons who were neither parties to the contract nor assignees of previous parties, thus:

> A submission to arbitration is a contract. As such, the Agreement, containing the stipulation on arbitration, binds the parties thereto, as well as their assigns and heirs. But only they.[80] (Citations omitted)

Similarly, in *Del Monte Corporation-USA v. Court of Appeals*,[81] this court ruled:

> The provision to submit to arbitration any dispute arising therefrom and the relationship of the parties is part of that contract and is itself a contract. As a rule, contracts are respected as the law between the contracting parties and produce effect as between them, their assigns and heirs. Clearly, only parties to the Agreement . . . are bound by the Agreement and its arbitration clause as they are the only signatories thereto.[82] (Citation omitted)

This court incorporated these rulings in *Agan, Jr. v. Philippine International Air Terminals Co., Inc.*[83] and *Stanfilco Employees v. DOLE Philippines, Inc., et al.*[84]

As a general rule, therefore, a corporation's representative who did not personally bind himself or herself to an arbitration agreement cannot be forced to participate in arbitration proceedings made pursuant to an agreement entered into by the corporation. He or she is generally not considered a party to that agreement.

However, there are instances when the distinction between personalities of directors, officers, and representatives, and of the corporation, are disregarded. We call this piercing the veil of corporate fiction.

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79 378 Phil. 369 (1999) [Per J. De Leon, Jr., Second Division].
80 Id. at 375.
81 404 Phil. 192 (2001) [Per J. Bellosillo, Second Division].
82 Id. at 201.
83 450 Phil. 744 (2003) [Per J. Puno, En Banc].
84 621 Phil. 22 (2009) [Per J. Brion, Second Division].

Piercing the corporate veil is warranted when "[the separate personality of a corporation] is used as a means to perpetrate fraud or an illegal act, or as a vehicle for the evasion of an existing obligation, the circumvention of statutes, or to confuse legitimate issues."[85] It is also warranted in alter ego cases "where a corporation is merely a farce since it is a mere alter ego or business conduit of a person, or where the corporation 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."[86]

When corporate veil is pierced, the corporation and persons who are normally treated as distinct from the corporation are treated as one person, such that when the corporation is adjudged liable, these persons, too, become liable as if they were the corporation.

Among the persons who may be treated as the corporation itself under certain circumstances are its directors and officers. Section 31 of the Corporation Code provides the instances when directors, trustees, or officers may become liable for corporate acts:

> Sec. 31. Liability of directors, trustees or officers. - Directors or trustees who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation or acquire any personal or pecuniary interest in conflict with their duty as such directors or trustees shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders or members and other persons.
>
> When a director, trustee or officer attempts to acquire or acquires, in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed in him in confidence, as to which equity imposes a disability upon him to deal in his own behalf, he shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation. (n)

Based on the above provision, a director, trustee, or officer of a corporation may be made solidarily liable with it for all damages suffered by the corporation, its stockholders or members, and other persons in any of the following cases:

a) The director or trustee willfully and knowingly voted for or assented to a patently unlawful corporate act;

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85 *Heirs of Fe Tan Uy v. International Exchange Bank*, G.R. No. 166282, February 13, 2013, 690 SCRA 519, 526 [Per J. Mendoza, Third Division].

86 *Pantranco Employees Association (PEA-PTGWO) v. National Labor Relations Commission*, 600 Phil. 645, 663 (2009) [Per J. Nachura, Third Division].

b) The director or trustee was guilty of gross negligence or bad faith in directing corporate affairs; and

c) The director or trustee acquired personal or pecuniary interest in conflict with his or her duties as director or trustee.

Solidary liability with the corporation will also attach in the following instances:

a) "When a director or officer has consented to the issuance of watered stocks or who, having knowledge thereof, did not forthwith file with the corporate secretary his written objection thereto";[87]

b) "When a director, trustee or officer has contractually agreed or stipulated to hold himself personally and solidarily liable with the corporation";[88] and

c) "When a director, trustee or officer is made, by specific provision of law, personally liable for his corporate action."[89]

When there are allegations of bad faith or malice against corporate directors or representatives, it becomes the duty of courts or tribunals to determine if these persons and the corporation should be treated as one. Without a trial, courts and tribunals have no basis for determining whether the veil of corporate fiction should be pierced. Courts or tribunals do not have such prior knowledge. Thus, the courts or tribunals must first determine whether circumstances exist to warrant the courts or tribunals to disregard the distinction between the corporation and the persons representing it. The determination of these circumstances must be made by one tribunal or court in a proceeding participated in by all parties involved, including current representatives of the corporation, and those persons whose personalities are impliedly the same as the corporation. This is because when the court or tribunal finds that circumstances exist warranting the piercing of the corporate veil, the corporate representatives are treated as the corporation itself and should be held liable for corporate acts. The corporation's distinct personality is disregarded, and the corporation is seen as a mere aggregation of persons undertaking a business under the collective name of the corporation.

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87 *Heirs of Fe Tan Uy v. International Exchange Bank*, G.R. No. 166282, February 13, 2013, 690 SCRA 519, 526 [Per J. Mendoza, Third Division].

88 Id.

89 Id. at 527.

Hence, when the directors, as in this case, are impleaded in a case against a corporation, alleging malice or bad faith on their part in directing the affairs of the corporation, complainants are effectively alleging that the directors and the corporation are not acting as separate entities. They are alleging that the acts or omissions by the corporation that violated their rights are also the directors' acts or omissions.[90] They are alleging that contracts executed by the corporation are contracts executed by the directors. Complainants effectively pray that the corporate veil be pierced because the cause of action between the corporation and the directors is the same.

In that case, complainants have no choice but to institute only one proceeding against the parties. Under the Rules of Court, filing of multiple suits for a single cause of action is prohibited. Institution of more than one suit for the same cause of action constitutes splitting the cause of action, which is a ground for the dismissal of the others. Thus, in Rule 2:

> **Section 3.** *One suit for a single cause of action*. — A party may not institute more than one suit for a single cause of action. (3a)
>
> **Section 4.** *Splitting a single cause of action*; *effect of*. — If two or more suits are instituted on the basis of the same cause of action, the filing of one or a judgment upon the merits in any one is available as a ground for the dismissal of the others. (4a)

It is because the personalities of petitioners and the corporation may later be found to be indistinct that we rule that petitioners may be compelled to submit to arbitration.

However, in ruling that petitioners may be compelled to submit to the arbitration proceedings, we are not overturning *Heirs of Augusto Salas* wherein this court affirmed the basic arbitration principle that only parties to an arbitration agreement may be compelled to submit to arbitration.

In that case, this court recognized that persons other than the main party may be compelled to submit to arbitration, e.g., assignees and heirs. Assignees and heirs may be considered parties to an arbitration agreement entered into by their assignor because the assignor's rights and obligations are transferred to them upon assignment. In other words, the assignor's rights and obligations become their own rights and obligations. In the same way, the corporation's obligations are treated as the representative's obligations when the corporate veil is pierced.

Moreover, in *Heirs of Augusto Salas*, this court affirmed its policy against multiplicity of suits and unnecessary delay. This court said that "to

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[90] Rules of Court, Rule 2, sec. 2.

split the proceeding into arbitration for some parties and trial for other parties would "result in multiplicity of suits, duplicitous procedure and unnecessary delay."[91] This court also intimated that the interest of justice would be best observed if it adjudicated rights in a single proceeding.[92] While the facts of that case prompted this court to direct the trial court to proceed to determine the issues of that case, it did not prohibit courts from allowing the case to proceed to arbitration, when circumstances warrant.

Hence, the issue of whether the corporation's acts in violation of complainant's rights, and the incidental issue of whether piercing of the corporate veil is warranted, should be determined in a single proceeding. Such finding would determine if the corporation is merely an aggregation of persons whose liabilities must be treated as one with the corporation.

However, when the courts disregard the corporation's distinct and separate personality from its directors or officers, the courts do not say that the corporation, in all instances and for all purposes, is the same as its directors, stockholders, officers, and agents. It does not result in an absolute confusion of personalities of the corporation and the persons composing or representing it. Courts merely discount the distinction and treat them as one, in relation to a specific act, in order to extend the terms of the contract and the liabilities for all damages to erring corporate officials who participated in the corporation's illegal acts. This is done so that the legal fiction cannot be used to perpetrate illegalities and injustices.

Thus, in cases alleging solidary liability with the corporation or praying for the piercing of the corporate veil, parties who are normally treated as distinct individuals should be made to participate in the arbitration proceedings in order to determine if such distinction should indeed be disregarded and, if so, to determine the extent of their liabilities.

In this case, the Arbitral Tribunal rendered a decision, finding that BF Corporation failed to prove the existence of circumstances that render petitioners and the other directors solidarily liable. It ruled that petitioners and Shangri-La's other directors were not liable for the contractual obligations of Shangri-La to BF Corporation. The Arbitral Tribunal's decision was made with the participation of petitioners, albeit with their continuing objection. In view of our discussion above, we rule that petitioners are bound by such decision.

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91 *Heirs of Augusto Salas, Jr. v. Laperal Realty Corporation*, 378 Phil. 369, 376 (1999) [Per J. De Leon, Jr., Second Division].

92 Id.

WHEREFORE, the petition is **DENIED.** The Court of Appeals' decision of May 11, 2006 and resolution of October 5, 2006 are **AFFIRMED.**

SO ORDERED.

MARVIC M.V.F. LEONEN
Associate Justice

WE CONCUR:

PRESBITERO J. VELASCO, JR.
Associate Justice

ARTURO D. BRION
Associate Justice
Chairperson

DIOSDADO M. PERALTA
Associate Justice

JOSE CATRAL MENDOZA
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ARTURO D. BRION
Associate Justice
Acting Chairperson, Second Division

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Acting Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ANTONIO T. CARPIO
Acting Chief Justice