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Quisumbing (Chairperson), Ynares-Santiago,[*] *Chico-Nazario,*[**] and *Leonardo-de Castro,*[***] *JJ.,* concur.

THIRD DIVISION

[G.R. No. 177549. June 18, 2009]

ANTHONY S. YU, ROSITA G. YU and JASON G. YU, *petitioners, vs.* **JOSEPH S. YUKAYGUAN, NANCY L. YUKAYGUAN, JERALD NERWIN L. YUKAYGUAN, and JILL NESLIE L. YUKAYGUAN, [on their own behalf and on behalf of] WINCHESTER INDUSTRIAL SUPPLY, INC.,** *respondents*.

SYLLABUS

1. COMMERCIAL LAW; CORPORATIONS; DERIVATIVE SUIT, NATURE OF.— 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. In such actions, the suing stockholder is regarded as a nominal party, with the corporation

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[*] Designated additional Member of the Second Division per Special Order No. 645 dated May 15, 2009.

[**] Designated additional Member of the Second Division effective June 3, 2009 per Special Order No. 658 dated June 3, 2009.

[***] Designated additional Member of the Second Division effective May 11, 2009, per Special Order No. 635 dated May 7, 2009.

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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. 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 pursuant to A.M. No. 00-11-03-SC promulgated on 21 November 2000.

2. ID.; ID.; CORPORATE LIQUIDATION, EXPLAINED.— **[L]iquidation** is a necessary consequence of the dissolution of a corporation. It is specifically governed by Section 122 of the Corporation Code, x x x 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. More particularly, it entails the following: 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. 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.

3. ID.; ID.; A DERIVATIVE SUIT CANNOT BE CONVERTED INTO A LIQUIDATION PROCEEDING; CASE AT BAR.— [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. While it may be true that the parties earlier reached an amicable settlement, in which they agreed to already distribute the assets of Winchester, Inc., and in effect liquidate said corporation, it must be pointed out that respondents themselves repudiated said amicable settlement before the RTC, even after the same had been partially implemented; and moved that their case be set for pre-trial. Attempts to again amicably settle the dispute between the parties before the Court of Appeals were unsuccessful. Moreover, the decree of the Court of Appeals to remand the case to the RTC for the "final settlement of corporate concerns" was solely grounded on respondents' allegation in its Position Paper that the parties had already filed before the SEC, and the SEC approved, the petition to dissolve Winchester, Inc. The Court notes, however, that there is absolute lack of evidence on record to prove said allegation. Respondents failed to submit copies of such petition for dissolution of Winchester, Inc. and the SEC Certification approving the same. It is a basic rule in evidence that each party must prove his affirmative allegation. Since it was respondents who alleged the voluntary dissolution of Winchester, Inc., respondents must, therefore, prove it. This respondents failed to do. Even assuming *arguendo* that 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 the petitioners of the corporate books for the inspection of respondents; and payment by petitioners to respondents 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.

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4. ID.; ID.; A STOCKHOLDER'S RIGHT TO INSTITUTE A DERIVATIVE SUIT, EXPLAINED.— The Court has recognized that 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. However, it cannot prosper without first complying with the legal requisites for its institution.

5. ID.; ID.; INTERIM RULES OF PROCEDURE GOVERNING INTRA-CORPORATE CONTROVERSIES; NON-COMPLIANCE WITH THE REQUIREMENTS BEFORE FILING A DERIVATIVE SUIT.— 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. The allegation of respondent 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

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the articles of incorporation and by-laws of Winchester, Inc. absolutely failed to provide for such remedies. Neither can this Court accept the reasons proffered by respondents to excuse themselves from complying with the second requirement under Section 1, Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies. They are flimsy and insufficient, compared to the seriousness of respondents' accusations of fraud, misappropriation, and falsification of corporate records against the petitioners. 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, and the difference in the requirements for, family corporations *vis-à-vis* other types of corporations, in the institution by a stockholder of a derivative suit. The Court further notes that, with respect to the third and fourth requirements of Section 1, Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies, 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.

6. ID.; ID.; ID.; ATTACHMENT OF AFFIDAVITS AND OTHER DOCUMENTARY EVIDENCE TO THE APPROPRIATE PLEADINGS OR TO THE PRE-TRIAL BRIEFS, REQUIRED; REASON.— According to the afore-quoted provision, the 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. That the parties should have already identified and submitted to the trial court the affidavits of their witnesses and documentary evidence by the time of pre-trial is strengthened by the fact that Section 1, Rule 4 of the Interim Rules of Procedure Governing Intra-Corporate Controversies require that the following matters should already be set forth in the parties' pre-trial briefs x x x. Also, according to Section 2, Rule 4 of the Interim Rules of Procedure Governing Intra-Corporate Controversies, it is the

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duty of the court to ensure during the pre-trial conference that the parties consider in detail, among other things, objections to the admissibility of testimonial, documentary, and other evidence, as well as objections to the form or substance of any affidavit, or part thereof. Obviously, affidavits of witnesses and other documentary evidence are required to be attached to a party's pre-trial brief, at the very last instance, so that the opposite party is given the opportunity to object to the form and substance, or the admissibility thereof. This is, of course, to prevent unfair surprises and/or to avoid the granting of any undue advantage to the other party to the case.

7. ID.; ID.; ID.; SUPPLEMENTAL AFFIDAVITS AND ADDITIONAL DOCUMENTARY EVIDENCE APPENDED ONLY TO THE MEMORANDUM ARE INADMISSIBLE.— [T]he afore-quoted 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. In the instant case, therefore, respondent Joseph's Supplemental Affidavit and the additional documentary evidence, appended by respondents only to their Memorandum submitted to the RTC, were correctly adjudged as inadmissible by the Court of Appeals in its 15 February 2006 Decision for having been belatedly submitted. 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.

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APPEARANCES OF COUNSEL

Mario Y. Cavada for petitioners.
Zosa & Quijano Law Office for respondents.

D E C I S I O N

CHICO-NAZARIO, *J.*:

Before Us is a Petition for Review on *Certiorari*[1] under Rule 45 of the Rules of Court, which seeks to reverse and set aside the Resolutions dated 18 July 2006[2] and 19 April 2007[3] of the Court of Appeals in CA-G.R. SP No. 00185. Upon herein respondents' motion, the Court of Appeals rendered the assailed Resolution dated 18 July 2006, reconsidering its Decision[4] dated 15 February 2006; and remanding the case to the Regional Trial Court (RTC) of Cebu City, Branch 11, for necessary proceedings, in effect, reversing the Decision[5] dated 10 November 2004 of the RTC which dismissed respondents' Complaint in SRC Case No. 022-CEB. Herein petitioners' Motion for Reconsideration of the Resolution dated 18 July 2006 was denied by the appellate court in the other assailed Resolution dated 19 April 2007.

Herein petitioners are members of the Yu Family, particularly, the father, Anthony S. Yu (Anthony); the wife, Rosita G. Yu (Rosita); and their son, Jason G. Yu (Jason).

Herein respondents composed the Yukayguan Family, namely, the father, Joseph S. Yukayguan (Joseph); the wife, Nancy L.

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[1] *Rollo*, pp. 2-18.

[2] Penned by Associate Justice Vicente L. Yap with Associate Justices Arsenio J. Magpale and Apolinario D. Bruselas, Jr., concurring; *rollo*, pp. 20-23.

[3] Penned by Associate Justice Arsenio J. Magpale with Associate Justices Agustin S. Dizon and Francisco P. Acosta, concurring; *rollo*, pp. 25-26.

[4] *Rollo*, pp. 32-43.

[5] Penned by Judge Silvestre A. Maamo, Jr.; *rollo*, pp. 27-30.

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Yukayguan (Nancy); and their children Jerald Nerwin L. Yukayguan (Jerald) and Jill Neslie Yukayguan (Jill).

Petitioner Anthony is the older half-brother of respondent Joseph.

Petitioners and the respondents were all 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 filed against petitioners a verified Complaint for Accounting, Inspection of Corporate Books and Damages through Embezzlement and Falsification of Corporate Records and Accounts[6] before the RTC of Cebu. The said Complaint was filed by respondents, in their own behalf and as a derivative suit on behalf of Winchester, Inc., and was docketed as SRC Case No. 022-CEB. The factual background of the Complaint was stated in the attached Affidavit executed by respondent Joseph.

According to respondents,[7] Winchester, Inc. was established and incorporated on 12 September 1977, with petitioner Anthony as one of the incorporators, holding 1,000 shares of stock worth ₱100,000.00.[8] Petitioner Anthony paid for the said shares of stock with respondent Joseph's money, thus, making the former

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[6] CA *rollo*, pp. 39-45.

[7] *Id.* at 46-48.

[8] The incorporators and their respective numbers of shares were as follows:

Name	No. of shares	Amount
Eugene Yutankin	3,000	₱ 300,000.00
Hao Bun Yam	3,000	₱ 300,000.00
Co To	2,000	₱ 200,000.00
Vicenta Lo Chiong	1,000	₱ 100,000.00
Anthony S. Yu	1,000	₱ 100,000.00
	10,000	₱1,000,000.00 (Records, p. 14.)

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a mere trustee of the shares for the latter. On 14 November 1984, petitioner Anthony ceded 800 of his 1,000 shares of stock in Winchester, Inc. to respondent Joseph, as well as Yu Kay Guan,[9] Siao So Lan, and John S. Yu.[10] Petitioner Anthony remained as trustee for respondent Joseph of the 200 shares of stock in Winchester, Inc., still in petitioner Anthony's name.

Respondents then alleged that on 30 June 1985, Winchester, Inc. bought from its incorporators, excluding petitioner Anthony, their accumulated 8,500 shares in the corporation.[11] Subsequently, on 7 November 1995, Winchester, Inc. sold the same 8,500 shares to other persons, who included respondents Nancy, Jerald, and Jill; and petitioners Rosita and Jason.[12]

Respondents further averred that although respondent Joseph 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 handled the money market placements of the corporation to the exclusion of respondent Joseph, the designated Treasurer

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[9] Father of petitioner Anthony and respondent Joseph.

[10] CA *rollo*, p. 78.

[11] In accordance with the recital of facts in the Complaint, if the 1,000 shares of Anthony Yu were to be subtracted from the total number of shares issued by Winchester, Inc., the other incorporators would have a total of 9,000 shares. However, according to the Deed of Sale dated 30 June 1985 (Records, p. 16), only 8,500 shares were sold to Winchester, Inc. by the following shareholders:

Name	No. of shares
Irinea Yutankin	3,000
Hao Bun Yam	3,000
Yu Kim Sing	1,500
Vicenta Lo Chiong	1,000
	8,500

[12] CA *rollo*, pp. 56-57.

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of Winchester, Inc. 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 attached to the Complaint various receipts[13] to prove the personal and family expenses charged by petitioners to Winchester, Inc.

Respondents, therefore, prayed that respondent Joseph be declared the owner of the 200 shares of stock in petitioner Anthony's name. Respondents also prayed that petitioners be ordered to: (1) deposit the corporate books and records of Winchester, Inc. with the Branch Clerk of Court of the RTC for respondents' inspection; (2) render an accounting of all the funds of Winchester, Inc. which petitioners misappropriated; (3) reimburse the personal and family expenses which petitioners charged to Winchester, Inc., as well as the properties of the corporation which petitioners withheld without payment; and (4) pay respondents' attorney's fees and litigation expenses. In the meantime, respondents sought the appointment of a Management Committee and the freezing of all corporate funds by the trial court.

On 13 November 2002, petitioners filed an Answer with Compulsory Counterclaim,[14] attached to which was petitioner Anthony's Affidavit.[15] Petitioners vehemently denied the allegation that petitioner Anthony was a mere trustee for respondent Joseph of the 1,000 shares of stock in Winchester, Inc. in petitioner Anthony's name. For the incorporation of Winchester, Inc., petitioner Anthony contributed ₱25,000.00 paid-up capital, representing 25% of the total par value of the 1,000 shares he subscribed to, the said amount being paid out of petitioner Anthony's personal savings and petitioners Anthony and Rosita's conjugal funds. Winchester, Inc. was being co-managed by petitioners and respondents, and the attached receipts, allegedly

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[13] Annexes E to Q; CA *rollo*, pp. 60-77.

[14] CA *rollo*, pp. 79-86.

[15] *Id.* at 87-91.

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evidencing petitioners' use of corporate funds for personal and family expenses, were in fact signed and approved by respondent Joseph.

By way of special and affirmative defenses, petitioners contended in their Answer with Compulsory Counterclaim that respondents had no cause of action against them. Respondents' Complaint was purely intended for harassment. It should be dismissed under Section 1(j), Rule 16[16] of the Rules of Court for failure to comply with conditions precedent before its filing. *First*, there was no allegation in respondents' Complaint that earnest efforts were exerted to settle the dispute between the parties. *Second*, since respondents' Complaint purportedly constituted a derivative suit, it noticeably 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. And *third*, given that respondents' Complaint was also 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. Prayed for by petitioners, in addition to the dismissal of respondents' Complaint, was payment of moral and exemplary damages, attorney's fees, litigation expenses, and cost of suit.

On 30 October 2002, the hearing on the application for the appointment of a Management Committee was commenced. Respondent Joseph submitted therein, as his direct testimony, the same Affidavit that he executed, which was attached to the respondents' Complaint. On 4 November 2002, respondent Joseph was cross-examined by the counsel for petitioners. Thereafter, the continuation of the hearing was set for 29 November

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[16] Rule 16, Section 1(j) of the Rules of Court provides:

Section 1. *Grounds.* — Within the time for but before filing the answer to the complaint or pleading asserting a claim, a motion to dismiss may be made on any of the following grounds:

x x x x x x x x x

(j) That a condition precedent for filing the claim has not been complied with.

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2002, in order for petitioners to adduce evidence in support of their opposition to the application for the appointment of a Management Committee.[17]

During the hearing on 29 November 2002, the parties manifested before the RTC that there was an ongoing mediation between them, and so the hearing on the appointment of a Management Committee was reset to another date.

In amicable settlement of their dispute, the petitioners and respondents agreed to a division of the stocks in trade,[18] the real properties, and the other assets of Winchester, Inc. In partial implementation of the afore-mentioned amicable settlement, the stocks in trade and real properties in the name of Winchester, Inc. were equally distributed among petitioners and respondents. As a result, the stockholders and members of the Board of Directors of Winchester, Inc. passed, on 4 January 2003, a unanimous Resolution[19] dissolving the corporation as of said date.

On 22 February 2004, respondents filed their pre-trial brief.[20]

On 25 June 2004, petitioners filed a Manifestation[21] informing the RTC of the existence of their amicable settlement with respondents. Respondents, however, made their own manifestation before the RTC that they were repudiating said settlement, in view of the failure of the parties thereto to divide the remaining assets of Winchester, Inc. Consequently, respondents moved to have SRC Case No. 022-CEB set for pre-trial.

On 23 August 2004, petitioners filed their pre-trial brief.[22]

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[17] Records, p. 52.

[18] The Court understood this term to refer to the inventories of the general hardware and industrial supply and equipment business.

[19] CA *rollo*, p. 214.

[20] Records, pp. 225-231.

[21] *Rollo*, pp. 55-56.

[22] Records, pp. 234-240.

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On 26 August 2004, instead of holding a formal pre-trial conference and resuming the hearing on the application for the appointment of a Management Committee, petitioners and respondents agreed that the RTC may already render a judgment based on the pleadings. In accordance with the agreement of the parties, the RTC issued, on even date, an Order[23] which stated:

ORDER

During the pre-trial conference held on August 26, 2004, counsels of the parties manifested, agreed and suggested that a judgment may be rendered by the Court in this case based on the pleadings, affidavits, and other evidences on record, or to be submitted by them, pursuant to the provision of Rule 4, Section 4 of the Rule on Intra-Corporate Controversies. The suggestion of counsels was approved by the Court.

Accordingly, the Court hereby orders the counsels of the parties to file simultaneously their respective memoranda within a non-extendible period of twenty (20) days from notice hereof. Thereafter, the instant case will be deemed submitted for resolution.

x x x x x x x x x

Cebu City, August 26, 2004.

(signed)
SILVESTRE A. MAAMO, JR.
Acting Presiding Judge

Petitioners and respondents duly filed their respective Memoranda,[24] discussing the arguments already set forth in the pleadings they had previously submitted to the RTC. Respondents, though, attached to their Memorandum a Supplemental Affidavit[25] of respondent Joseph, containing assertions that refuted the allegations in petitioner Anthony's Affidavit, which was earlier submitted with petitioners' Answer with Compulsory Counterclaim. Respondents also appended to their Memorandum

[23] *Rollo*, p. 62.

[24] CA *rollo*, pp. 177-202, 94-106.

[25] *Id.* at 107-110.

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additional documentary evidence,[26] consisting of original and duplicate cash invoices and cash disbursement receipts issued by Winchester, Inc., to further substantiate their claim that petitioners were understating sales and charging their personal expenses to the corporate funds.

The RTC subsequently promulgated its Decision on 10 November 2004 dismissing SRC Case No. 022-CEB. The dispositive portion of said Decision reads:

> WHEREFORE, in view of the foregoing premises and for lack of merit, this Court hereby renders judgment in this case **DISMISSING** the complaint filed by the [herein respondents].
>
> The Court also hereby dismisses the [herein petitioners'] counterclaim because it has not been indubitably shown that the filing by the [respondents] of the latter's complaint was done in bad faith and with malice.[27]

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:

> (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.

As to respondents' prayer for the inspection of corporate books and records, the RTC adjudged that they had likewise

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[26] *Id.* at 111-128.

[27] *Rollo,* p. 30.

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failed to comply with the requisites entitling them to the same. Section 2, Rule 7 of the Interim Rules of Procedure Governing Intra-Corporate Controversies requires that the complaint for inspection of corporate books or records must state that:

(1) The case is for the enforcement of plaintiff's right of inspection of corporate orders or records and/or to be furnished with financial statements under Sections 74 and 75 of the Corporation Code of the Philippines;

(2) A demand for inspection and copying of books and records and/or to be furnished with financial statements made by the plaintiff upon defendant;

(3) The refusal of defendant to grant the demands of the plaintiff and the reasons given for such refusals, if any; and

(4) The reasons why the refusal of defendant to grant the demands of the plaintiff is unjustified and illegal, stating the law and jurisprudence in support thereof.

The RTC further noted that respondent Joseph was the corporate secretary of Winchester, Inc. and, as such, he was supposed to be the custodian of the corporate books and records; therefore, a court order for respondents' inspection of the same was no longer necessary. The RTC similarly denied respondents' demand for accounting as it was clear that Winchester, Inc. had been engaging the services of an audit firm. Respondent Joseph himself described the audit firm as competent and independent, and believed that the audited financial statements the said audit firm prepared were true, faithful, and correct.

Finding the claims of the parties for damages against each other to be unsubstantiated, the RTC thereby dismissed the same.

Respondents challenged the foregoing RTC Decision before the Court of Appeals *via* a Petition for Review under Rule 43 of the Rules of Court, docketed as CA-G.R. SP No. 00185.

On 15 February 2006, the Court of Appeals rendered its Decision, affirming the 10 December 2004 Decision of the RTC. Said the appellate court:

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After a careful and judicious scrutiny of the extant records of the case, together with the applicable laws and jurisprudence, WE see no reason or justification for granting the present appeal.

x x x x x x x x x

x x x [T]his Court sees that the instant petition would still fail taking into consideration all the pleadings and evidence of the parties except the supplemental affidavit of [herein respondent] Joseph and its corresponding annexes appended in [respondents'] memorandum before the Court *a quo*. The Court *a quo* have (sic) outrightly dismissed the complaint for its failure to comply with the mandatory provisions of the Interim Rules of Procedure for Intra-Corporate Controversies particularly Rule 2, Section 4(3), Rule 8, Section [1(2)] and Rule 7, Section 2 thereof, which reads as follows:

RULE 2
COMMENCEMENT OF ACTION AND PLEADINGS

Sec. 4. *Complaint.* — The complaint shall state or contain:

x x x x x x x x x

(3) the law, rule, or regulation relied upon, violated, or sought to be enforced;

x x x x x x x x x

RULE 8
DERIVATIVE SUITS

Sec. 1. *Derivative action.* — x x x

x x x x x x x x x

(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.

x x x x x x x x x

RULE 7
INSPECTION OF CORPORATE BOOKS AND RECORDS

Sec. 2. *Complaint* — In addition to the requirements in Section 4, Rule 2 of these Rules, the complaint must state the following:

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(1) The case is set (sic) for the enforcement of plaintiff's right of inspection of corporate orders or records and/or to be furnished with financial statements under Sections 74 and 75 of the Corporation Code of the Philippines;

(2) A demand for inspection and copying of books [and/or] to be furnished with financial statements made by the plaintiffs upon defendant;

(3) The refusal of the defendant to grant the demands of the plaintiff and the reasons given for such refusal, if any; and

(4) The reasons why the refusal of defendant to grant the demands of the plaintiff is unjustified and illegal, stating the law and jurisprudence in support thereof.

x x x x x x x x x

A perusal of the extant record shows that [herein respondents] have not complied with the above quoted provisions. [Respondents] should be mindful that in filing their complaint which, as admitted by them, is a derivative suit, should have first exhausted all available remedies under its (sic) Articles of Incorporation, or its by-laws, or any laws or rules governing the corporation. **The contention of [respondent Joseph] that he had indeed made several talks to (sic) his brother [herein petitioner Anthony] to settle their differences is not tantamount to exhaustion of remedies. What the law requires is to bring the grievance to the Board of Directors or Stockholders for the latter to take the opportunity to settle whatever problem in its regular meeting or special meeting called for that purpose which [respondents] failed to do.** x x x The requirements laid down by the Interim Rules of Procedure for Intra-Corporate Controversies are mandatory which cannot be dispensed with by any stockholder of a corporation before filing a derivative suit.[28] (Emphasis ours.)

The Court of Appeals likewise sustained the refusal by the RTC to consider respondent Joseph's Supplemental Affidavit and other additional evidence, which respondents belatedly submitted with their Memorandum to the said trial court. The appellate court ratiocinated that:

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[28] *Id.* at 37-39.

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With regard to the claim of [herein respondents] that the supplemental affidavit of [respondent] Joseph and its annexes appended to their memorandum should have been taken into consideration by the Court *a quo* to support the reliefs prayed [for] in their complaint. (sic) This Court rules that **said supplemental affidavit and its annexes is** (sic) **inadmissible**.

A second hard look of (sic) the extant records show that during the pre-trial conference conducted on August 26, 2004, the parties through their respective counsels had come up with an agreement that the lower court would render judgment based on the pleadings and evidence submitted. This agreement is in accordance with Rule 4, Sec. 4 of the Interim Rules of Procedure for Intra-Corporate Controversies which explicitly states:

> SECTION. 4. Judgment before pre-trial. — If, after submission of the pre-trial briefs, the court determines that, **upon consideration of the pleadings, the affidavits and other evidence submitted by the parties**, a judgment may be rendered, the court may order the parties to file simultaneously their respective memoranda within a non-extendible period of twenty (20) days from receipt of the order. Thereafter, the court shall render judgment, either full or otherwise, not later than ninety (90) days from the expiration of the period to file the memoranda.
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> x x x x x x x x x

Clearly, the supplemental affidavit and its appended documents which were submitted only upon the filing of the memorandum for the [respondents] were not submitted in the pre-trial briefs for the stipulation of the parties during the pre-trial, hence, it cannot be accepted pursuant to Rule 2, Sec. 8 of the same rules which reads as follows:

> SEC. 8. Affidavits, documentary and other evidence. — Affidavits shall be based on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify on the matters stated therein. The affidavits shall be in question and answer form, and shall comply with the rules on admissibility of evidence.
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> Affidavits of witnesses as well as documentary and other evidence shall be attached to the appropriate pleading; Provided,

> however, that affidavits, documentary and other evidence not so submitted may be attached to the pre-trial brief required under these Rules. **Affidavits and other evidence not so submitted shall not be admitted in evidence**, except in the following cases:
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> (1) Testimony of unwilling, hostile, or adverse party witnesses. A witness is presumed *prima facie* hostile if he fails or refuses to execute an affidavit after a written request therefor;
>
> (2) If the failure to submit the evidence is for meritorious and compelling reasons; and
>
> (3) Newly discovered evidence.
>
> In case of (2) and (3) above, the affidavit and evidence must be submitted not later than five (5) days prior to its introduction in evidence.

There is no showing in the case at bench that the supplemental affidavit and its annexes falls (sic) within one of the exceptions of the above quoted proviso, hence, inadmissible.

It must be noted that in the case at bench, like any other civil cases, "the party making an allegation in a civil case has the burden of proving it by preponderance of evidence." Differently stated, upon the plaintiff in [a] civil case, the burden of proof never parts. That is, appellants must adduce evidence that has greater weight or is more convincing that (sic) which is offered to oppose it. In the case at bar, no one should be blamed for the dismissal of the complaint but the [respondents] themselves for their lackadaisical attitude in setting forth and appending their defences belatedly. To admit them would be a denial of due process for the opposite party which this Court cannot allow.[29]

Ultimately, the Court of Appeals decreed:

WHEREFORE, judgment is hereby rendered **DISMISSING** the instant petition and the assailed Decision of the Regional Trial Court (RTC), 7th Judicial Region, Branch II, Cebu City, dated November 10, 2004, in SRC Case No. 022-CEB is **AFFIRMED *in toto***. Cost against the [herein respondents].[30]

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[29] *Id.* at 39-42.

[30] *Id.* at 43.

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Unperturbed, respondents filed before the Court of Appeals, on 23 February 2006, a Motion for Reconsideration and Motion to Set for Oral Arguments the Motion for Reconsideration,[31] invoking the following grounds:

(1) The [herein respondents] have sufficiently exhausted all remedies before filing the present action; and

(2) [The] Honorable Court erred in holding that the supplemental affidavit and its annexes is (sic) inadmissible because the rules and the lower court expressly allowed the submission of the same in its order dated August 26, 2004 x x x.[32]

In a Resolution[33] dated 8 March 2006, the Court of Appeals granted respondents' Motion to Set for Oral Arguments the Motion for Reconsideration.

On 4 April 2006, the Court of Appeals issued a Resolution[34] setting forth the events that transpired during the oral arguments, which took place on 30 March 2006. Counsels for the parties manifested before the appellate court that they were submitting respondents' Motion for Reconsideration for resolution. Justice Magpale, however, still called on the parties to talk about the possible settlement of the case considering their familial relationship. Independent of the resolution of respondents' Motion for Reconsideration, the parties were agreeable to pursue a settlement for the dissolution of the corporation, which they had actually already started.

In a Resolution[35] dated 11 April 2006, the Court of Appeals ordered the parties to submit, within 10 days from notice, their intended amicable settlement, since the same would undeniably affect the resolution of respondents' pending Motion for Reconsideration. If the said period should lapse without the

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[31] *Id.* at 57-61.

[32] *Id.* at 57.

[33] CA *rollo*, pp. 434-435.

[34] *Rollo*, pp. 65-66.

[35] *Id.* at 67-68.

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parties submitting an amicable settlement, then they were directed by the appellate court to file within 10 days thereafter their position papers instead.

On 5 May 2006, respondents submitted to the Court of Appeals their Position Paper,[36] stating that the parties did not reach an amicable settlement. Respondents informed the appellate court that prior to the filing with the Securities and Exchange Commission (SEC) of a petition for dissolution of Winchester, Inc., the parties already divided the stocks in trade and the real assets of the corporation among themselves. Respondents posited, though, that the afore-mentioned distribution of the assets of Winchester, Inc. among the parties was null and void, as it violated the last paragraph of Section 122 of the Corporation Code, which provides that, "[e]xcept by a decrease of capital stock and as otherwise allowed by the Corporation Code, no corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities." At the same time, however, respondents brought to the attention of the Court of Appeals that the parties did eventually file with the SEC a petition for dissolution of Winchester, Inc., which the SEC approved.[37]

Respondents no longer discussed in their Position Paper the grounds they previously invoked in their Motion for Reconsideration of the Court of Appeals Decision dated 15 February 2006, affirming *in toto* the RTC Decision dated 10 November 2004. They instead argued that the RTC Decision in question was null and void as it did not clearly state the facts and the law on which it was based. Respondents sought the remand of the case to the RTC for further proceedings on their derivative suit and completion of the dissolution of Winchester, Inc., including the legalization of the prior partial distribution among the parties of the assets of said corporation.

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[36] CA *rollo*, pp. 486-494.

[37] The certificate of dissolution of respondent Winchester, Inc. was not, however, made part of the records of the case before the Court of Appeals or this Court.

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Petitioners filed their Position Paper[38] on 23 May 2006, wherein they accused respondents of attempting to incorporate extraneous matters into the latter's Motion for Reconsideration. Petitioners pointed out that the issue before the Court of Appeals was not the dissolution and division of assets of Winchester, Inc., thus, a remand of the case to the RTC was not necessary.

On 18 July 2006, the Court of Appeals rendered the assailed Resolution, granting respondents' Motion for Reconsideration. The Court of Appeals reasoned in this wise:

> After a second look and appreciation of the facts of the case, *vis-à-vis* the issues raised by the [herein respondents'] motion for reconsideration and in view of the formal dissolution of the corporation which leaves unresolved up to the present the settlement of the properties and assets which are now in danger of dissipation due to the unending litigation, this Court finds the need to remand the instant case to the lower court (commercial court) as the proper forum for the adjudication, disposition, conveyance and distribution of said properties and assets between and amongst its stockholders as final settlement pursuant to Sec. 122 of the Corporation Code after payment of all its debts and liabilities as provided for under the same proviso. This is in accord with the pronouncement of the Supreme Court in the case of ***Clemente, et. al vs. Court of Appeals, et al.*** where the high court ruled and which WE quote, *viz*:
>
> > "the corporation continues to be a body corporate for three (3) years after its dissolution for purposes of prosecuting and defending suits by and against it and for enabling it to settle and close its affairs, culminating in the disposition and distribution of its remaining assets. It may, during the three-year term, appoint a trustee or a receiver who may act beyond that period. The termination of the life of a juridical entity does not by itself cause the extinction or diminution of the rights and liabilities of such entity x x x nor those of its owners and creditors. If the three-year extended life has expired without a trustee or receiver having been expressly designated by the corporation within that period, the board of directors (or trustees) x x x may be permitted to so continue as "trustees" by legal implication to complete the corporate liquidation. Still

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[38] CA *rollo*, pp. 497-504.

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> in the absence of a board of directors or trustees, those having any pecuniary interest in the assets, including not only the shareholders but likewise the creditors of the corporation, acting for and in its behalf, **might make proper representation with the Securities and Exchange Commission, which has primary and sufficiently broad jurisdiction in matters of this nature, for working out a final settlement of the corporate concerns**."

In the absence of a trustee or board of director in the case at bar for purposes above mentioned, the lower court under Republic Act No. [8799] (otherwise known as the Securities and Exchange Commission) as implemented by A.M. No. 00-8-10-SC (Transfer of Cases from the Securities and Exchange Commission to the Regional Trial Courts) which took effect on October 1, 2001, is the proper forum for working out the final settlement of the corporate concern.[39]

Hence, the Court of Appeals ruled:

WHEREFORE, premises considered, the motion for reconsideration is **GRANTED**. The order dated February 15, 2006 is hereby **SET ASIDE** and the instant case is **REMANDED** to the lower court to take the necessary proceedings in resolving with deliberate dispatch any and all corporate concerns towards final settlement.[40]

Petitioners filed a Motion for Reconsideration[41] of the foregoing Resolution, but it was denied by the Court of Appeals in its other assailed Resolution dated 19 April 2007.

In the Petition at bar, petitioners raise the following issues:

I.

WHETHER OR NOT THE ASSAILED RESOLUTIONS[,] WHICH VIOLATED THE CONSTITUTION OF THE PHILIPPINES, JURISPRUDENCE AND THE LAW[,] ARE NULL AND VOID[.]

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[39] *Rollo,* pp. 21-22.

[40] *Id.* at 22.

[41] CA *rollo,* pp. 512-519.

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II.

WHETHER OR NOT THE ASSAILED RESOLUTIONS WAS (sic) ISSUED WITHOUT JURISDICTION[.]

III.

WHETHER OR NOT THE HONORABLE COURT OF APPEALS SERIOUSLY ERRED IN REMANDING THIS CASE TO THE LOWER COURT FOR THE REASON CITED IN THE ASSAILED RESOLUTIONS, AND WITHOUT RESOLVING THE GROUNDS FOR THE [RESPONDENTS'] MOTION FOR RECONSIDERATION. (sic) INASMUCH AS [THE] REASON CITED WAS A NON-ISSUE IN THE CASE.

IV.

WHETHER OR NOT REMANDING THIS CASE TO THE REGIONAL TRIAL COURT VIOLATES THE SUMMARY PROCEDURE FOR INTRA-CORPORATE CASES.[42]

The crux of petitioners' contention is that the Court of Appeals committed grievous error in reconsidering its Decision dated 15 February 2006 on the basis of extraneous matters, which had not been previously raised in respondents' Complaint before the RTC, or in their Petition for Review and Motion for Reconsideration before the appellate court; *i.e.*, the adjudication, disposition, conveyance, and distribution of the properties and assets of Winchester, Inc. among its stockholders, allegedly pursuant to the amicable settlement of the parties. The fact that the parties were able to agree before the Court of Appeals to submit for resolution respondents' Motion for Reconsideration of the 15 February 2006 Decision of the same court, independently of any intended settlement between the parties as regards the dissolution of the corporation and distribution of its assets, only proves the distinction and independence of these matters from one another. Petitioners also contend that the assailed Resolution dated 18 July 2006 of the Court of Appeals, granting respondents' Motion for Reconsideration, failed to clearly and distinctly state the facts and the law on which it was based. Remanding the case to the RTC, petitioners maintain, will violate the very essence

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[42] *Rollo*, pp. 71-72.

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of the summary nature of the Interim Rules of Procedure Governing Intra-Corporate Controversies, as this will just entail delay, protract litigation, and revert the case to square one.

The Court finds the instant Petition meritorious.

To recapitulate, the case at bar was initiated before the RTC by respondents as a **derivative suit**, on their own behalf and on behalf of Winchester, Inc., primarily in order to compel petitioners **to account for and reimburse to** the said corporation the corporate assets and funds which the latter allegedly misappropriated for their personal benefit. During the pendency of the proceedings before the court *a quo*, the parties were able to reach an **amicable settlement** wherein they agreed to **divide the assets** of Winchester, Inc. among themselves. This amicable settlement was already partially implemented by the parties, when respondents **repudiated** the same, for which reason the RTC proceeded with the case on its merits. On 10 November 2004, the RTC promulgated its Decision **dismissing** respondents' Complaint for failure to comply with essential pre-requisites before they could avail themselves of the remedies under the Interim Rules of Procedure Governing Intra-Corporate Controversies; and for inadequate substantiation of respondents' allegations in said Complaint after consideration of the pleadings and evidence on record.

In its Decision dated 15 February 2006, the Court of Appeals **affirmed**, on appeal, the findings of the RTC that respondents did not abide by the requirements for a derivative suit, nor were they able to prove their case by a preponderance of evidence. Respondents filed a **Motion for Reconsideration** of said judgment of the appellate court, insisting that they were able to meet all the conditions for filing a derivative suit. Pending resolution of respondents' Motion for Reconsideration, the Court of Appeals urged the parties to **again strive to reach an amicable settlement** of their dispute, but the parties were **unable to do so**. The parties were not able to submit to the appellate court, within the given period, any amicable settlement; and filed, instead, their **Position Papers**. This effectively meant that the parties opted to submit respondents' Motion for Reconsideration

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of the 15 February 2006 Decision of the Court of Appeals, and petitioners' opposition to the same, for resolution by the appellate court on the merits.

It was at this point that the case took an unexpected turn.

In accordance with respondents' allegation in their Position Paper 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.

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. In such actions, 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.[43] 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 pursuant to A.M. No. 00-11-03-SC promulgated on 21 November 2000.

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[43] *Chua v. Court of Appeals*, G.R. No. 150793, 19 November 2004, 443 SCRA 259, 266-267.

In contrast, **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.

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.[44] More particularly, it entails the following:

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[44] See *China Banking Corp. v. M. Michelin & Cie*, 58 Phil. 261, 266 (1933).

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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. 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.[45]

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.[46]

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.

While it may be true that the parties earlier reached an amicable settlement, in which they agreed to already distribute the assets of Winchester, Inc., and in effect liquidate said corporation, it must be pointed out that respondents themselves repudiated said amicable settlement before the RTC, even after the same had been partially implemented; and moved that their case be set for pre-trial. Attempts to again amicably settle the dispute between the parties before the Court of Appeals were unsuccessful.

Moreover, the decree of the Court of Appeals to remand the case to the RTC for the "final settlement of corporate concerns" was solely grounded on respondents' allegation in its Position Paper that the parties had already filed before the SEC, and the SEC approved, the petition to dissolve Winchester, Inc. The

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[45] Campos, *THE CORPORATION CODE: COMMENTS, NOTES AND SELECTED CASES* (Vol. 2, 1990 ed.), p. 415.

[46] *Id.* at 415-416.

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Court notes, however, that there is absolute lack of evidence on record to prove said allegation. Respondents failed to submit copies of such petition for dissolution of Winchester, Inc. and the SEC Certification approving the same. It is a basic rule in evidence that each party must prove his affirmative allegation. Since it was respondents who alleged the voluntary dissolution of Winchester, Inc., respondents must, therefore, prove it.[47] This respondents failed to do.

Even assuming *arguendo* that 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 the petitioners of the corporate books for the inspection of respondents; and payment by petitioners to respondents 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.

Clearly, in issuing its assailed Resolutions dated 18 July 2006 and 19 April 2007, the Court of Appeals already went beyond the issues raised in respondents' Motion for Reconsideration. Instead of focusing on whether it erred in affirming, in its 15 February 2006 Decision, the dismissal by the RTC of respondents' Complaint due to respondents' failure to comply with the requirements for a derivative suit and submit evidence to support their allegations, the Court of Appeals unduly concentrated on respondents' unsubstantiated allegation that Winchester, Inc.

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[47] See *Genuino Ice Co., Inc. v. Magpantay*, G.R. No. 147790, 27 June 2006, 493 SCRA 195, 205.

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was already dissolved and speciously ordered the remand of the case to the RTC for proceedings so vitally different from that originally instituted by respondents.

Despite the foregoing, the Court still deems it appropriate to already look into the merits of respondents' Motion for Reconsideration of the 15 February 2006 Decision of the Court of Appeals, for the sake of finally putting an end to the case at bar.

In their said Motion for Reconsideration, respondents argued that: (1) they had sufficiently exhausted all remedies before filing the derivative suit; and (2) respondent Joseph's Supplemental Affidavit and its annexes should have been taken into consideration, since the submission thereof was allowed by the rules of procedure, as well as by the RTC in its Order dated 26 August 2004.

As regards the first ground of sufficient exhaustion by respondents of all remedies before filing a derivative suit, the Court subscribes to the ruling to the contrary of the Court of Appeals in its Decision dated 16 February 2006.

The Court has recognized that 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. However, it cannot prosper without first complying with the legal requisites for its institution.[48]

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[48] *Bitong v. Court of Appeals*, 354 Phil. 516, 545 (1998).

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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.

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. to obtain the relief they desire.

Respondents assert that their compliance with said requirement was contained in respondent Joseph's Affidavit, which was attached to respondents' Complaint. Respondent Joseph averred in his Affidavit that he tried for a number of times to talk to petitioner Anthony to settle their differences, but the latter would not listen. Respondents additionally claimed that taking further remedies within the corporation would have been idle ceremony, considering that Winchester, Inc. was a family corporation and it was impossible to expect petitioners to take action against themselves who were the ones accused of wrongdoing.

The Court is not persuaded.

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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.

The allegation of respondent 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.

Neither can this Court accept the reasons proffered by respondents to excuse themselves from complying with the second requirement under Section 1, Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies. They are flimsy and insufficient, compared to the seriousness of respondents' accusations of fraud, misappropriation, and falsification of corporate records against the petitioners. 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, and the difference in the requirements for, family corporations *vis-à-vis* other types of corporations, in the institution by a stockholder of a derivative suit.

The Court further notes that, with respect to the third and fourth requirements of Section 1, Rule 8 of the Interim Rules of Procedure Governing Intra-Corporate Controversies, the

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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.

As to respondents' second ground in their Motion for Reconsideration, the Court agrees with the ruling of the Court of Appeals, in its 15 February 2006 Decision, that respondent Joseph's Supplemental Affidavit and additional evidence were inadmissible since they were only appended by respondents to their Memorandum before the RTC. Section 8, Rule 2 of the Interim Rules of Procedure Governing Intra-Corporate Controversies is crystal clear that:

> Sec. 8. *Affidavits, documentary and other evidence*. — Affidavits shall be based on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify on the matters stated therein. The affidavits shall be in question and answer form, and shall comply with the rules on admissibility of evidence.
>
> **Affidavits of witnesses as well as documentary and other evidence shall be attached to the appropriate pleading**, Provided, however, that **affidavits, documentary and other evidence not so submitted may be attached to the pre-trial brief required under these Rules**. **Affidavits and other evidence not so submitted shall not be admitted in evidence**, except in the following cases:
>
> (1) Testimony of unwilling, hostile, or adverse party witnesses. A witness is presumed *prima facie* hostile if he fails or refuses to execute an affidavit after a written request therefor;
>
> (2) If the failure to submit the evidence is for meritorious and compelling reasons; and
>
> (3) Newly discovered evidence.
>
> In case of (2) and (3) above, the affidavit and evidence must be submitted not later than five (5) days prior to its introduction in evidence. (Emphasis ours.)

According to the afore-quoted provision, the parties should attach the affidavits of witnesses and other documentary evidence to the appropriate pleading, which generally should mean the

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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. That the parties should have already identified and submitted to the trial court the affidavits of their witnesses and documentary evidence by the time of pre-trial is strengthened by the fact that Section 1, Rule 4 of the Interim Rules of Procedure Governing Intra-Corporate Controversies require that the following matters should already be set forth in the parties' pre-trial briefs:

> Section 1. *Pre-trial conference, mandatory nature*. —Within five (5) days after the period for availment of, and compliance with, the modes of discovery prescribed in Rule 3 hereof, whichever comes later, the court shall issue and serve an order immediately setting the case for pre-trial conference, and directing the parties to submit their respective pre-trial briefs. The parties shall file with the court and furnish each other copies of their respective pre-trial brief in such manner as to ensure its receipt by the court and the other party at least five (5) days before the date set for the pre-trial.
>
> The parties shall set forth in their pre-trial briefs, among other matters, the following:
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> x x x x x x x x x
>
> (4) Documents not specifically denied under oath by either or both parties;
>
> x x x x x x x x x
>
> (7) Names of witnesses to be presented and the summary of their testimony as contained in their affidavits supporting their positions on each of the issues;
>
> (8) All other pieces of evidence, whether documentary or otherwise and their respective purposes.

Also, according to Section 2, Rule 4 of the Interim Rules of Procedure Governing Intra-Corporate Controversies,[49] it is the

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[49] Section 2, of Rule 4 provides:

> Sec. 2. *Nature and purpose of pre-trial conference*. — During the pre-trial conference, the court shall, with its active participation, ensure that the parties consider in detail all of the following:

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duty of the court to ensure during the pre-trial conference that the parties consider in detail, among other things, objections to the admissibility of testimonial, documentary, and other evidence, as well as objections to the form or substance of any affidavit, or part thereof.

Obviously, affidavits of witnesses and other documentary evidence are required to be attached to a party's pre-trial brief, at the very last instance, so that the opposite party is given the opportunity to object to the form and substance, or the admissibility thereof. This is, of course, to prevent unfair surprises and/or to avoid the granting of any undue advantage to the other party to the case.

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:

> Sec. 4. *Judgment before pre-trial.* — If **after submission of the pre-trial briefs**, the court determines that, **upon consideration of the pleadings, the affidavits and other evidence submitted by the parties**, a judgment may be rendered, the court may order the parties **to file simultaneously their respective memoranda** within a non-extendible period of twenty (20) days from receipt of the order. Thereafter, the court shall render judgment, either full or otherwise, not later than ninety (90) days from the expiration of the period to file the memoranda.

Even then, the afore-quoted 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

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x x x x x x x x x

(6) Objections to the admissibility of testimonial, documentary and other evidence;

(7) Objections to the form or substance of any affidavit, or part thereof.

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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.

In the instant case, therefore, respondent Joseph's Supplemental Affidavit and the additional documentary evidence, appended by respondents only to their Memorandum submitted to the RTC, were correctly adjudged as inadmissible by the Court of Appeals in its 15 February 2006 Decision for having been belatedly submitted. 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.

WHEREFORE, premises considered, the Petition for Review under Rule 45 of the Rules of Court is hereby *GRANTED*. The assailed Resolutions dated 18 July 2006 and 19 April 2007 of the Court of Appeals in CA-G.R. SP No. 00185 are hereby *REVERSED AND SET ASIDE*. The Decision dated 15 February 2006 of the Court of Appeals is hereby *AFFIRMED*. No costs.

SO ORDERED.

Ynares-Santiago (Chairperson), Velasco, Jr., Nachura, and *Peralta, JJ.,* concur.