

## Liabilities of a Stock Market Investor

### The Facts

Petitioner corporation was engaged in business as a broker and dealer of securities of listed companies at the Philippine Stock Exchange Center. On April 8, 1997, respondent opened a *cash* account with petitioner for his transactions in securities and, on April 10, started trading on that account. As a result of his trading activities, he accumulated an outstanding obligation in favor of the corporation in the principal sum of ₱6,617,036.22 as of April 30, 1997.

Respondent failed to settle his account upon the lapse of the required period and the extension given by petitioner, prompting it to sell his securities on May 6, 1997, to offset his unsettled obligations.

After the sale of his securities and the application of the proceeds against his account, his remaining accountabilities to petitioner totalled ₱3,364,313.56. This obligation he failed to settle despite its demands.

The trial court and the Court of Appeals (CA) both held that the parties were in *pari delicto* and, hence, without recourse against each other. The lower courts said that petitioner had violated Sections 23 and 25 of the Revised Securities Act (RSA) and Rule 25-1 of the Rules Implementing the Act (RSA Rules). The violation was committed when it failed 1) to require respondent to pay for his stock purchases within three (T+3) or four days (T+4) from trading; and 2) to request from the

appropriate authority an extension of time for the payment of his cash purchases. The trial court noted that despite his nonpayment within the required period, petitioner did not cancel his purchases. Neither did it require him to deposit cash payments before it executed buy and/or sell orders subsequent to the first unsettled transaction.

## **The Issues**

Two issues were raised by the parties: (1) whether the *pari delicto* rule was applicable to the present case; and (2) whether the trial court had jurisdiction over the case.

### **First Issue:**

#### ***Pari Delicto***

Sections 23 and 25 and Rule 25-1, otherwise known as the “mandatory close-out rule,”[\[1\]](#) clearly vested an obligation, not just a right, in petitioner. That obligation was to cancel or otherwise liquidate a customer’s order, if payment was not received within three days from the date of purchase. *Subsequent* to an unpaid order, the broker should require its customer to deposit funds in the account sufficient to cover each purchase, prior to the execution of the transaction. These duties were imposed upon the broker to ensure faithful compliance with the margin requirements of the law, which forbade the broker from extending undue credit to a “cash” customer.

#### ***Respondent Liable for the First But Not for the Subsequent Trade***

Nonetheless, these margin requirements were applicable only to transactions entered into by the parties *subsequent* to the initial trades of April 10 and 11, 1997.

Thus, petitioner could still collect from respondent to the extent of the difference between his outstanding obligation as of April 11, 1997, less the proceeds from the mandatory sellout of the shares pursuant to the RSA Rules. Its right to collect was justified under the general law on obligations and contracts.[\[2\]](#)

Petitioner could not be denied the right to collect, as the initial transactions had been entered into pursuant to the instructions of respondent. His obligation for stock transactions made and entered into on April 10 and 11, 1997, remained outstanding. Those transactions were valid, and the obligations he incurred in regard to his stock purchases *on those dates* subsisted. At the time, there was yet no violation of the RSA. Petitioner committed a fault only when it failed 1) to liquidate the transactions on April 14 and 15, 1997, or the fourth day following the stock purchases; and 2) to complete its liquidation no later than ten days after, by applying the proceeds as payment for his outstanding obligation.[\[3\]](#)

Elucidating further, since the buyer was not able to pay for the transactions that had taken place on April 10 and 11 -- that is, at T+4 -- the broker was duty-bound to advance the payment to the settlement banks, without prejudice to its right to collect from the client later on.[\[4\]](#)

It should be clear that Congress had imposed the margin requirements to protect the general economy, not to give the customer a free ride at the expense of the broker.[\[5\]](#) Not to require respondent to pay for his April 10 and 11 trades would put a premium on his circumvention of the laws and would enable him to enrich himself unjustly at the expense of petitioner.

By failing to ensure his payment of his first purchase transactions within the period prescribed by law, thereby allowing him to make subsequent purchases, petitioner effectively converted his cash account into a credit account. The extension

or maintenance of credits on nonmargin transactions, however, were specifically prohibited under Section 23(b). Thus, petitioner was remiss in its duty and could not be said to have come to court with “clean hands,” insofar as it intended to collect on transactions *subsequent* to the initial trades of April 10 and 11, 1997.

### ***Respondent Equally Guilty for Subsequent Trades***

On the other hand, respondent was found to be equally guilty of entering into transactions in violation of the RSA and RSA Rules. The Court was not prepared to accept his self-serving assertions of being an “innocent victim” in *all* the transactions. Obviously, he knowingly speculated on the market by taking advantage of the “no-cash-out” arrangement extended to him by petitioner.

It was respondent’s privilege to gamble or speculate, as he apparently did by asking for extensions of time and refraining from giving orders to his broker to sell, in the hope that the prices would rise. Sustaining his argument would have amounted to relieving him of the risks of his own speculation and saddling petitioner with the consequences after the result turned out to be unfavorable.[\[6\]](#) His conduct as an investor was precisely the sort deplored by the law. Thus, with respect to his counterclaim for damages for having been allegedly induced by petitioner to generate additional purchases despite his outstanding obligations, the Court held that he deserved no legal or equitable relief.

In the final analysis, both parties had acted in violation of the law and did not come to court with clean hands as regards the transactions subsequent to the initial one made on April 10 and 11, 1997. In this case, the *pari delicto* rule applied only to transactions entered into *after* those initial trades.

Pursuant to RSA Rule 25-1, petitioner should have liquidated the transactions

(sold the stocks) on the fourth day after (at T+4) and completed its liquidation not later than ten days following the last day for the customer to pay (effectively at T+14). Respondent's outstanding obligation, therefore, was to be determined on the basis of the closing prices -- at T+14 -- of the stocks purchased.

## **Second Issue:**

### ***Jurisdiction***

The instant controversy related to acts committed by the parties in the course of their business relationship. An ordinary civil case seeking to enforce rights arising from the Agreement (AOF) between the parties, the suit was intended to enable petitioner to collect on the alleged outstanding debt incurred by respondent for his stock purchases.

To be sure, the RSA and its Rules were to be read into the Agreement that the parties had entered into. Thus, to determine whether they had fulfilled their obligations under this Agreement, the Court passed upon their compliance with the RSA and its Rules. In no way did it thereby deprive the Securities and Exchange Commission (SEC) of the authority to determine willful violations of the RSA and impose appropriate sanctions, as provided under Sections 45 and 46 of the Act.

Thus, the Court upheld the SEC in its Opinion, as follows:

“As to the issue of jurisdiction, it is settled that a party cannot invoke the jurisdiction of a court to secure affirmative relief against his opponent and after obtaining or failing to obtain such relief, repudiate or question that same jurisdiction.

“Indeed, after voluntarily submitting a cause and encountering an adverse decision on the merits, it is too late for petitioner to question the jurisdictional power of the court. It

is not right for a party who has affirmed and invoked the jurisdiction of a court in a particular matter to secure an affirmative relief, to afterwards deny that same jurisdiction to escape a penalty.”<sup>[7]</sup>

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— GR No. 160016, February 27, 2006, per Panganiban, *CJ.* Unanimously concurred in by the other members of the First Division: Justices Consuelo Ynares-Santiago, Ma. Alicia Austria-Martinez, Romeo J. Callejo Sr., and Minita V. Chico-Nazario.

<sup>[1]</sup> See SEC’s Comment, p. 33; *rollo*, p. 439.

<sup>[2]</sup> See *Dominion Insurance Corp. v. CA*, 376 SCRA 239, February 6, 2002, in which the respondent had deviated from the instructions of the principal in the settlement of the claims of the insured. The Court held that while the respondent was prohibited by the law on agency from obtaining reimbursement, his right to recover was nonetheless held justified under the Civil Code, Art. 1236, par. (2), which provides:

“Whoever pays for another may demand from the debtor what he has paid, except that if he paid without the knowledge or against the will of the debtor, he can recover only insofar as the payment has been beneficial to the debtor.”  
(Emphasis supplied.)

<sup>[3]</sup> RSA Rule 25-1.

<sup>[4]</sup> Comment of the SEC dated September 27, 2005, p. 21; *rollo*, p. 427.

<sup>[5]</sup> See *Utah State University v. Bear, Stearns & Co.* (10<sup>th</sup> Circular, 1977) 549 F2d 164, January 24, 1977.

<sup>[6]</sup> *Insular Financing & Business Corp. v. Imperial*, 74 Phil. 331, August 31, 1943.

<sup>[7]</sup> Comment of the SEC, *supra* at note 34, p. 37; *rollo*, p. 443.