Pre-week Notes in Commercial Law
(including ponencias of Justice Ben Caguioa[1])

Based on the 2022 Bar Examination Syllabus
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I. INSURANCE (P.D. No. 162, as amended by R.A. No. 10607)

A. Basic Concepts

What is an insurance contract?

A contract of insurance is an agreement whereby one undertakes, for a consideration, to indemnify another against loss, damage, or liability arising from an unknown or contingent event.[2]

Philippine Health Care Providers, Inc. is a domestic corporation whose primary purpose is "to establish, maintain, conduct and operate a prepaid group practice health care delivery system or a health maintenance organization to take care of the sick and disabled persons enrolled in the health care plan and to provide for the administrative, legal, and financial responsibilities of the organization." Individuals enrolled in its health care programs pay an annual membership fee and are entitled to various preventive, diagnostic, and curative medical services provided by its duly licensed physicians, specialists, and other professional technical staff participating in the group practice health delivery system at a hospital or clinic owned, operated, or accredited by it.

The Commissioner of Internal Revenue ordered Philippine Health Care Providers to pay documentary stamp tax (DST) on its health care agreements. It moved for reconsideration arguing that DST is imposed only on a company engaged in the business of fidelity bonds and insurance policies. Philippine Health Care Providers, Inc., as a health maintenance organization (HMO), is a service provider and not an insurance company.

Is Philippine Health Care Providers, Inc. (now Maxicare) engaged in the business of insurance?

No, Maxicare, as an HMO, is not engaged in insurance business. The basic distinction between medical service corporations and ordinary health and accident insurers is that the former undertake to provide prepaid medical and health services through participating physicians and accredited establishments, thus relieving subscribers of any further financial burden, while the latter only undertake to indemnify an insured for medical expenses up to, but not beyond, the schedule of rates contained in the policy. The mere presence of risk would be insufficient to override the primary purpose of the business to provide medical services as needed, with payment made directly to the provider of these services. Even if Maxicare assumes the risk of paying the cost of these services, it nevertheless cannot be considered as being engaged in the insurance business. Assumption of the expense by Maxicare is not confined to the happening of a contingency but includes incidents even in the absence of illness or injury.

Since indemnity of the insured was not the focal point of the agreement but the extension of medical services to the members at an affordable cost, it did not partake of the nature of a contract of insurance.

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[1] In red font

[2] Section 2, Insurance Code.

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Even if a contract contains all the elements of an insurance contract, if its primary purpose is the rendering of service, it is not a contract of insurance. Under the principal purpose test, the test applied is whether the assumption of risk and indemnification of loss (which are elements of an insurance business) are the principal object and purpose of the organization or whether they are merely incidental to its business. If these are the principal objectives, the business is that of insurance. But if they are merely incidental, and service is the principal purpose, then the business is not insurance.

Therefore, since Maxicare substantially provides health care services rather than insurance.

What may be insured against?

Any contingent or unknown event, whether past or future, which may damnify a person having an insurable interest, or create a liability against him, may be insured against, subject to the relevant provisions of the Insurance Code.[3]

Insurable Interest

What is insurable interest?

Insurable interest is that interest which a person is deemed to have in the subject matter of the insurance where he has a relation or connection to it such that the person will derive pecuniary benefit or advantage from the preservation of the subject matter or will suffer pecuniary loss or damage from its destruction, termination, or injury by the happening of the event insured against it.[4]

If person procuring interest has no insurable interest in the subject matter of the insurance, the insurance is void. He will not stand to suffer any loss or damage by the happening of the event insured

a. In life/health

Upon whose life or health does a person have insurable interest in?

Every person has an insurable interest in the life and health:

"(a) Of himself, of his spouse, and of his children;
"(b) Of any person on whom he depends wholly or in part for education or support, or in whom he has a pecuniary interest;
"(c) Of any person under a legal obligation to him for the payment of money, or respecting property or services, of which death or illness might delay or prevent the performance; and
"(d) Of any person upon whose life any estate or interest vested in him depends.[5]

A person can take insurance on his own life and designate anyone as beneficiary except those disqualified to receive donation under Article 739 of the Civil Code. The beneficiary in this case can be anyone, such as a distant relative or a friend, who need not have any insurable interest in the life of the insured.

[3]Section 3, Insurance Code.
[4]44 C.J. S. 870.
[5]Section 10.

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Who are the persons specified in Article 739 and as such, cannot be designated beneficiary of the insured?

The persons specified in Article 739 of the Civil Code are:

a. persons in illicit relations –– adultery or concubinage (no need for conviction);[6]

b. persons found guilty of adultery or concubinage;

c. public officer or his wife, descendants, or ascendants.

If any person, other than those disqualified to receive donation under Article 739 of the Civil Code, is designated beneficiary can the lawful spouse and legitimate children of the insured complain of denial of their legitime?

The lawful spouse and legitimate children cannot complain of denial of their legitime because the proceeds of the life insurance policy do not form part of the estate of the insured. Neither can they claim the insurance proceeds because they are not privy to the contract.

Moreover, under Section 53 of the Insurance Code, the insurance proceeds shall be applied exclusively to the proper interest of the person in whose name or for whose benefit it is made unless otherwise specified in the policy.

Heirs of Loreto Maramag, his legal wife and his legitimate children filed a case for revocation and/or reduction of insurance proceeds alleging that Eva de Guzman Maramag (Eva) was a concubine of Loreto and a suspect in the killing of the latter, thus, she is disqualified to receive any proceeds from his insurance policies and that illegitimate children of Loreto were entitled only to one-half of the legitime of the legitimate children.

Who are entitled to the proceeds of the insurance policy?

The illegitimate children, designated as beneficiaries, are entitled to the insurance proceeds, to the exclusion of the legitimate children. Section 53 of the Insurance Code states that the insurance proceeds shall be applied exclusively to the proper interest of the person in whose name or for whose benefit it is made unless otherwise specified in the policy. Pursuant thereto, it is obvious that the only persons entitled to claim the insurance proceeds are either the insured, if still alive; or the beneficiary, if the insured is already deceased, upon the maturation of the policy.

The legitimate heirs of Loreto who were not designated as beneficiaries in the life insurance policy are considered third parties to the insurance contract, and thus not entitled to the proceeds thereof. The insurers have no legal obligation to turn over the proceeds to them. The revocation of the common law spouse of Loreto as beneficiary is of no moment considering that the designation of the illegitimate children as beneficiaries remains valid. Because no legal proscription exists in naming as beneficiaries the children of illicit relationships by the insured, the shares of Eva in the insurance proceeds, whether forfeited by the court in view of the prohibition on donations under Article 739 of the Civil Code or by the insurers themselves for reasons based on the insurance contracts, must be awarded to the said illegitimate children.[7]

The ruling in *Insular Life Assn. Co., Ltd. v. Ebrado* that the proceeds should be paid to the legal spouse in case of a common law spouse is designated beneficiary is not entirely

[6]Insular Life Assn. Co., Ltd. v. Ebrado, G.R. No. L-44059, October 28, 1977; BAR 1981.

[7]Heirs of Loreto Maramag v. Eva Verna De Guzman Maramag, *et al*., G.R. No. 181132, June 5, 2009; 1998 and 2019 Bar exams.

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correct. The proceeds should be payable to the estate which includes not only the spouse but the children as well.

Can a person take insurance on the life of another person and designate himself as the beneficiary?

A person can take an insurance on the life of another person and designate himself as the beneficiary provided that he has pecuniary interest in the person he is insuring. In other words, the insured must be any of the persons under Section 10 (b to d).

Blanco took out a P1M life insurance policy naming his friend and creditor, Montenegro, as his beneficiary. When Blanco died, his outstanding loan obligation to Montenegro was only P50,000.00. Blanco's executor contended that only P50,000.00 out of the insurance proceeds should be paid to Montenegro and the balance of P950,000.00 should be paid to Blanco's estate.

Is the executor's contention correct? Reason out your answer.

The contention of the executor is incorrect. The beneficiary of a life insurance need not have any insurable interest in the life of the insured. Any person can take insurance on his own life like what Blanco did and designate anyone as his beneficiary except those disqualified to be donees under Article 739 of the Civil Code. Blanco's friend and creditor does not fall within the disqualification.

It would have been different if it was Montenegro, as creditor, who took out an insurance policy on the life of Blanco, as a debtor. In that case, Montenegro's insurable interest in the life of Blanco would be only to the extent of P50,000.00, which is the amount of his credit.[8]

b) Of any person on whom he depends wholly or in part for education or support, or in whom he has a pecuniary interest;

Carlo and Bianca met in the La Boracay festivities. Immediately, they fell in love with each other and got married soon after. They have been cohabiting blissfully as husband and wife, but they did not have any offspring. As the years passed by, Carlo decided to take out an insurance on Bianca's life for P1,000,000.00 with him (Carlo) as sole beneficiary, given that he did not have a steady source of income and he always depended on Bianca both emotionally and financially. During the term of the insurance, Bianca died of what appeared to be a mysterious cause so that Carlo immediately requested for an autopsy to be conducted. It was established that Bianca died of a natural cause. More than that, it was also established that Bianca was a transgender all along – a fact unknown to Carlo.

Can Carlo claim the insurance benefit?

Yes. Carlo can claim the insurance benefit. If a person insures the life or health of another person with himself as beneficiary, all his rights, title, and interests in the policy shall automatically vest in the person insured. Carlo, as the husband of Bianca, has an insurable interest in the life of the latter because he depended upon Bianca wholly or in part for support. The fact that Bianca is a transgender is irrelevant. It is Carlo's reliance on Bianca for support which establishes Carlo's insurable interest in the life of Bianca.[9]

[8] BAR 1987.
[9] BAR 2014.

c) Of any person under a legal obligation to him for the payment of money, or respecting property or services, of which death or illness might delay or prevent the performance.

Give examples.

An employer corporation has an insurable interest on its manager where the death of the manager will be detrimental to the corporation's operations.[10]

d) Of any person upon whose life any estate or interest vested in him depends.

Thus, the usufructuary may insure the life of the owner of the naked title if his right to the usufruct will be extinguished upon death of the latter.

To whom will the proceeds of the life insurance policy be payable?

The proceeds of the life insurance policy are payable as follows:

a. In case a beneficiary is unlawfully designated, the proceeds shall payable to the estate of the insured (not only to the lawful spouse of the insured although she has a share in the estate of the insured). It is because the policy remains valid. Only the designation is void.[11]
b. In case of joint designation of beneficiaries, the share of the unlawfully designated beneficiary shall form additional part of the share of the lawfully designated beneficiary. Thus, the share of the common law spouse shall be forfeited in favor of the designated illegitimate children.[12]
c. In case of joint designation of lawfully designated beneficiaries, proceeds shall be divided based on terms of policy. If the policy is silent, the proceeds shall be divided equally between or among the beneficiaries.
d. In case a beneficiary is lawfully designated and the insured dies ahead of the beneficiary, the proceeds are payable to the beneficiary unless he is the principal, accessory or accomplice in willfully bringing about the death of the insured.
e. In such a case, interest of the beneficiary shall be forfeited and the share forfeited shall pass on to the other beneficiaries, unless otherwise disqualified. In the absence of other beneficiaries, the proceeds shall be paid in accordance with the policy contract. If the policy contract is silent, the proceeds shall be paid to the estate of the insured.[13] Note that the insurer is still liable.[14]
f. In case the beneficiary predeceases the insured, make a distinction between irrevocable and revocable beneficiary. If irrevocable, the proceeds shall inure to the benefit of the legal representatives of the beneficiary. If revocable, the proceeds shall inure to the estate of the insured. If the policy is silent as to whether designation is irrevocable or revocable, the proceeds shall inure to the estate of the insured because the designation is revocable unless otherwise specified in the policy.
g. The beneficiary's interest in a life insurance endowment policy will only accrue if the insured dies before the end of the endowment period. If the insured survives, the proceeds are payable to him.

In Property

[10] El Oriente Fabrica de Tabacos, Inc. v. Juan Posadas, G.R. No. 34774, September 21, 1931.
[11] 2012 Bar.
[12] Maramag v. Maramag, *supra*.
[13] Section 12.
[14] 2008 Bar.

What does insurable interest in property consist of?

Every interest in property, whether real or personal, or any relation thereto, or liability in respect thereof, of such nature that a contemplated peril might directly damnify the insured, is an insurable interest.[15]

An insurable interest in property may consist in:
"(a) An existing interest;
"(b) An inchoate interest founded on an existing interest; or
"(c) An expectancy, coupled with an existing interest in that out of which the expectancy arises.[16]

A mere contingent or expectant interest in anything, not founded on an actual right to the thing, nor upon any valid contract for it, is not insurable.[17]

The measure of an insurable interest in property is the extent to which the insured might be damnified by loss or injury thereof.[18]

Give examples of existing interest.

a. A carrier or depository of any kind has an insurable interest in a thing held by him as such, to the extent of his liability but not to exceed the value thereof.[19]

b. Both the mortgagor and mortgagee may insure the mortgaged property against fire. The mortgagor may insure it up to the extent of the value while the mortgagee up to the extent of the mortgage debt.

Give examples of inchoate interest founded on existing interest.

a. The judgment creditor, after levy of the judgment debtor's property, may insure it because the debtor may not exercise his right of redemption. He has inchoate interest because he may acquire ownership of the levied property in case of failure of the debtor to redeem. The judgment creditor and the judgment debtor both have insurable interest on the property which can be separately covered by fire insurance. In case of loss before expiration of the redemption period, the owner and the judgment creditor may recover on their separate insurance. If the loss occurs after expiration of the redemption period, only the judgment creditor may claim on the insurance.

b. A general creditor, however, has no insurable interest on the debtor's property. This is because prior to the levy, the general creditor's interest on the debtor's property is a mere contingent or expectant interest not founded on an actual right to the thing, nor upon any valid contract for it.

Give examples of expectancy coupled with existing interest out of which the expectancy arises.

1. Growing crops.

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[15]Section 13.
[16]Section 14; 2019 Bar.
[17]Section 16.
[18]Section 17.
[19]Section 18.

2. Expected freightage of the common carrier.
3. Profits of a partnership for a partner.

When should insurable interest exist in property and in life and health?

An interest in property insured must exist when the insurance takes effect, and when the loss occurs, but need not exist in the meantime; and interest in the life or health of a person insured must exist when the insurance takes effect, but need not exist thereafter or when the loss occurs.[20]

Distinguish insurable interest in property insurance from insurable interest in life insurance.

a. In property insurance, the actual value of the interest therein is the limit of the insurance that can validly be placed thereon. In life insurance, there is no limit to the amount of insurance that may be taken upon life except in case of a creditor securing the life of the debtor in which case the insurance should be limited to the amount of the debt.
b. In property insurance, an interest insured must exist when the insurance takes effect and when the loss occurs but need not exist in the meantime. In life insurance, it is enough that insurable interest exists at the time when the contract is made but it need not exist at the time of loss.
c. The beneficiary in property insurance must have insurable interest over the property insured and such insurable interest must be covered by the insurance policy. In life insurance, if the insured procured insurance on his own life, he can designate anyone as beneficiary (except those disqualified to receive donation) even though the latter has no insurable interest in the life of the insured.[21]

On January 4, 2019, Mr. P joined Alpha Corporation (ALPHA) as President of the company. ALPHA took out a life insurance policy on the life of Mr. P with Mutual Insurance Company, designating ALPHA as the beneficiary. ALPHA also carried fire insurance with Beta Insurance Co. on a house owned by it, but temporarily occupied by Mr. P again with ALPHA as beneficiary.

On September 1, 2019, Mr. P resigned from ALPHA and purchased the company house he had been occupying. A few days later, a fire occurred resulting in the death of Mr. P and the destruction of the house.

What are the rights of ALPHA (a) against Mutual Life Insurance Company on the life insurance policy?

ALPHA can recover against Mutual Life Insurance Co. in the life insurance policy as its insurable interest in the life of the person insured, Mr. P, existed when the insurance took effect. In life insurance, insurable interest need not exist thereafter or when the loss occurred.[22]

Alpha, however, cannot recover on the fire insurance because at the time of the loss, it had no more insurable interest having sold the property to Mr. P. In property insurance, it is not enough that the insured must have insurable interest at the time of the issuance of the policy but also at the time of loss.

[20] Section 19.
[21] BAR 2002.
[22] BAR 1984.

Discuss the insurable interest of the mortgagor and mortgagee on the mortgaged property and the right to recover under insurance policies.

a. The mortgagor has insurable interest on the property up to the extent of the value of the mortgaged property while the mortgagee has insurable interest on the same property but only up to the extent of the amount of the debt secured by the mortgage.[23]
b. Consequently, they can separately procure fire insurance policy on the same property to the extent of their respective insurable interest. This will not result in double insurance or over-insurance in the context of the Insurance Code.

If the mortgagor obtained an open policy, then he could claim an amount corresponding to the extent of the damage, but not to exceed the face value of the insurance policy; however, if he obtained a valued policy then he could claim an amount based on the agreed upon valuation of the property.

a. Unless the policy otherwise provides, where a mortgagor of property effects insurance in his own name providing that the loss shall be payable to the mortgagee, or assigns a policy of insurance to a mortgagee, the insurance is deemed to be upon the interest of the mortgagor, who does not cease to be a party to the original contract, and any act of his, prior to the loss, which would otherwise avoid the insurance, will have the same effect, although the property is in the hands of the mortgagee, but any act which, under the contract of insurance, is to be performed by the mortgagor, may be performed by the mortgagee therein named, with the same effect as if it had been performed by the mortgagor.[24]
b. If an insurer assents to the transfer of an insurance from a mortgagor to a mortgagee, and, at the time of his assent, imposes further obligations on the assignee, making a new contract with him, the acts of the mortgagor cannot affect the rights of said assignee.[25]
c. If the mortgagor procures fire insurance policy without designating the mortgagee as beneficiary, the mortgagor shall obtain the proceeds of insurance in case of loss. The mortgagee is not entitled to the insurance proceeds because he is not the beneficiary and/or the insurance policy was not assigned to him. But, as a mortgagee, he has a lien on the insurance proceeds.
d. If the mortgagor procures fire insurance policy and designated the mortgagee as the beneficiary, in case of loss, the mortgagee shall be entitled to the proceeds of the insurance. The loan shall be extinguished to the extent of the amount of the insurance. The insurer shall be subrogated to the rights of the mortgagor if any.
e. If the mortgagor procures fire insurance and designated the mortgagee as beneficiary up to the extent of the mortgage debt, the insurer is not liable if the mortgagor deliberately set the insured property on fire. The mortgagee is bound by the acts of the mortgagor and cannot recover.[26]
f. If the mortgagor and the mortgagee separately obtained fire insurance and the mortgagor designated the mortgagee as the beneficiary in the fire insurance, any act done by the mortgagor that will avoid the insurance is binding on the mortgagee but he can still recover on the fire insurance he separately procured.
g. If the mortgagor obtained fire insurance but the loss occurs after the redemption period, the mortgagor can no longer recover on the insurance because he has no more insurable interest at the time of loss.

[23]Geagonia v. Court of Appeals, 241 SCRA 152 (1995).
[24]Section 8, Insurance Code.
[25]Section 9.
[26]Section 8.

h. Assume that the mortgagor procured fire insurance after his default and the mortgagee thereafter obtained his own fire insurance. If the mortgagor obtained a loan from a general creditor to pay the redemption price then assigned the policy to the general creditor and the loss occurs, the mortgagor cannot recover on his fire insurance because he has no more insurable interest on the property at the time of loss, having assigned his policy to the creditor. The general creditor cannot recover on the fire insurance policy assigned to him because he has no insurable interest at the time of the issuance of the policy. The mortgagee can obtain the proceeds of the fire insurance he obtained separately.

To secure a loan of P10M, O mortgaged his building to C. in accordance with the loan arrangements, O had the property insured with Acme Insurance Company for P10M with C as the beneficiary. C also took an insurance on the building upon his own interest with Beta Insurance Co. for P5M.

The building was totally destroyed by fire, a peril insured against in both insurance policies. It was subsequently determined that the fire had been intentionally started by O and that, in violation of the loan agreement, O had been storing inflammable materials in the building.

How much can C recover from either or both insurance companies? What happens to the P10M debt of O to C?

C cannot recover from Acme Insurance Co. unless the policy otherwise provides, where a mortgagor of property effects insurance in his own name providing that the loss shall be payable to the mortgagee, the insurance is deemed to be upon the interest of the mortgagor. Any act of the mortgagor prior to the loss which would otherwise avoid the insurance will have the same effect. Apart from the storing of the inflammable materials, the act of the owner-mortgagor, O, caused the peril insured against.

With respect to the Beta Insurance Co., C can recover the full amount of P5M since the act of O in intentionally starting the fire that caused the loss cannot be attributable to the mortgagee, C. The act of O in storing inflammable in the building contrary to the loan agreement does not affect the insurance policy, unless the insurance policy itself prohibited any storing of inflammable materials.

The P10M debt of O to C will be affected by the amount which C is able to collect from the insurance companies. If C is unable to recover any amount, the full amount of the debt remains. If C is able to recover P5M from Beta insurance Co., C, the mortgagee is not allowed to retain his claim against O, the mortgagor, but it passes by subrogation to the insurer to the extent of the money paid.[27] In this case, Beta Ins. Co. will become entitled to collect P5M from O, and O will continue to remain.

"A" owns a house valued at P5,000,000.00 which he had insured against fire for P7,500,000.00. He obtained a loan from "B" in the amount of P3,500,000.00, and to secure payment thereof, he executed a deed of mortgage on the house, but without assigning the insurance policy to the latter. For "A's" failure to pay the loan upon maturity, "B" initiated foreclosure proceedings and in the ensuing public sale, the house was sold by the sheriff to "B" as highest bidder. Immediately upon issuance of the sheriff's certificate of sale in his favor, "B" insured the house against fire for P3,500,000.00 with another insurance company. In order to redeem the house, "A" borrowed P3,500,000.00 from "C" and, as security device, he assigned the insurance

[27]Palileo v. Cosio, G.R. No. L-7667, November 28, 1955.

policy of P7,500,000.00 to "C". However, before "A" could pay "B" his obligation, the house was accidentally and totally burned.

Do "A", "B", and "C" have any insurance interest in the house? May "A", "B", and "C" recover under the policies? If so, how much?

As to A: He has insurable interest in his house, an existing interest, but only for P5,000,000.00, the value of the said house. But, when he assigned it to C, said A had no more interest in his insurance policy, and A cannot anymore recover on said insurance policy.

As to B: He has insurable interest on A's house, having an interest founded upon an existing interest, for P3,500,000.00, the amount of mortgage debt.

As to C: He has no insurable interest on A's house when the insurance took effect and his interest is a mere contingent or expectant interest not founded on an actual right or valid contract to A's house. Hence, C cannot recover.[28]

Double Insurance and overinsurance

What is double insurance?

A double insurance exists where the same person is insured by several insurers separately in respect to the same subject and interest.[29]

A businessman in the grocery business obtained from First Insurance an insurance policy for P5M to fully cover his stocks-in-trade from the risk of fire.

Three (3) months later, a fire of accidental origin broke out and completely destroyed the grocery including his stocks-in-trade. This prompted the businessman to file with First Insurance a claim for P5M representing the full value of his goods.

First Insurance denied the claim because it discovered that at the time of the loss, the stock-in-trade were mortgaged to a creditor who likewise obtained from Second Insurance Company for insurance coverage for the stocks at their full value of P5M.

First Insurance refused to pay claiming that double insurance is contrary to law. Is this contention tenable?

The contention of First Insurance that double insurance is contrary to law is untenable. There is no law prohibiting double insurance. Moreover, in the problem at hand, there is no double insurance because the insured with the First Insurance is different from the insured with the Second Insurance Company. There is likewise no identity of insurable interests. For the mortgagor, his interest is the ownership of the mortgaged property. For the mortgagee, it is the loan secured by the mortgage.[30]

Reputable is the forwarder of Wyeth's goods. Pursuant to their contract of carriage, Reputable insured Wyeth's goods with Malayan. Wyeth also has its own insurance policy from the Philippines First Insurance Co., Inc. (Phil First). During the life of these insurance policies, the truck carrying Wyeth's goods was hijacked. Thus, Phil First paid Wyeth on its policy and sued Reputable and Malayan for reimbursement.

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[28] 1982 modified BAR exam question.
[29] Section 95; 2008 Bar.
[30] BAR 1999.

Seeking to avoid liability, Malayan invoked Section 5 of the SR Policy and argued that in as much as there was already a marine policy issued by Phil First securing the same subject matter against loss and that since the monetary coverage/value of the marine policy is more than enough to indemnify the hijacked cargo, Phil First alone must bear the loss.

Is there double insurance?

None. Double insurance exists where the same person is insured by several insurers separately in respect to the same subject and interest. The requisites in order for double insurance to arise are as follows: 1) The person insured is the same; 2) Two or more insurers insuring separately; 3) There is identity of subject matter; 4) There is identity of interest insured; and 5) There is identity of the risk or peril insured against.

In the present case, while it is true that the Marine Policy and the SR Policy were both issued over the same subject matter, i.e. goods belonging to Wyeth, and both covered the same peril insured against, it is, however, beyond cavil that the said policies were issued to two different persons or entities. Wyeth is the recognized insured of Phil First under its Marine Policy, while Reputable is the recognized insured of Malayan under the SR Policy. The interest of Wyeth over the property subject matter of both insurance contracts is also different and distinct from that of Reputable. The policy issued by Phil First was in consideration of the legal and/or equitable interest of Wyeth over its own goods. On the other hand, what was issued by Malayan to Reputable was over the latter's insurable interest over the safety of the goods, which may become the basis of the latter's liability in case of loss or damage to the property.[31]

Armando Geagonia, as the owner of Norman's Mart, obtained insurance from Country Bankers Insurance Corporation. The insurance policy contained the condition that the insured shall give notice to Country Bankers of any insurance or insurances already effected, or which may subsequently be effected, covering any of the property or properties insured, and unless such notice be given and the particulars of such insurance or insurances be stated therein or endorsed in this policy before the occurrence of any loss or damage, all benefits under this policy shall be deemed forfeited.

The building subject of fire insurance was razed by fire. Country Bankers refused to pay alleging that Geagonia did not inform it of a previous insurance obtained by its creditor Cebu Tesing Textiles over the same property and in violation of Condition 3.

Is the policy avoided by the failure of Geagonia to inform Country Bankers of other insurance policies over the property?

No. Condition 3 or the Other Insurance Clause of the policy is a condition which is not proscribed by law. Such a condition is a provision which invariably appears in fire insurance policies and is intended to prevent an increase in the moral hazard. However, in order to constitute a violation, the other insurance must be upon the same subject matter, the same interest therein, and the same risk.

A double insurance exists where the same person is insured by several insurers separately in respect of the same subject and interest. The insurable interest on the mortgaged property of a mortgagor which covers the full value of the property and the interests of a mortgagee which extends only to value of debt are distinct and separate. Since

[31] Malayan Insurance v. Philippine First Insurance Co., G.R. No. 184300, July 11, 2012.

the two policies of the PFIC do not cover the same interest as that covered by the policy of the private respondent, no double insurance exists. The non-disclosure then of the former policies was not fatal to the Geagonia's right to recover on the Country Banker's policy.[32]

4. **Multiple or several interests on same property**

What is the nature of the liability of the several insurers in double insurance? Explain.

In double insurance, the insurers are considered as co-insurers. Each one is bound to contribute ratably to the loss in proportion to the amount for which he is liable under his contract.[33]

It was held that where the insurance policy specifies as a condition the disclosure of existing co insurers, non-disclosure thereof is a violation that entitles the insurer to avoid the policy. This condition is common in fire insurance policies and is known as the "other insurance clause".

The rationale behind the incorporation of "other insurance" clause in fire policies is to prevent over-insurance and thus avert the perpetration of fraud. When a property owner obtains insurance policies from two or more insurers in a total amount that exceeds the property's value, the insured may have an inducement to destroy the property for the purpose of collecting the insurance. The public as well as the insurer is interested in preventing a situation in which a fire would be profitable to the insured.[34]

Terrazas de Pation Verde, a condominium building, has a value of P50M. The owner insured the building against fire with three (3) insurance companies for the following amounts:

1. **Northern Insurance Corp. — P20M**
2. **Southern Insurance Corp. — P30M**
3. **Eastern Insurance Corp. — P50M**

a. **Is the owner's taking of insurance for the building with three (3) insurers valid? Discuss.**
b. **The building was totally razed by fire. If the owner decides to claim from Eastern Insurance Corp. only P50M, will the claim prosper? Explain.**
c. **Can the owner claim from Northern Insurance and Southern Insurance Corporation?**

Answer:

a. The taking of insurance from the three (3) insurers is valid, there being no stipulation against obtaining additional insurance. It is a case of "double insurance."

   Double insurance is valid. What is prohibited is for the insured to recover more than his interest or value of the property as this will violate the indemnity principle of an insurance contract.

[32]Armando Geagonia v. Court of Appeals and Country Bankers Insurance Corporation, G.R. No. 114437, February 6, 1995.

[33]BAR 2005.

[34] Multi-Ware Manufacturing Corporation v. Cibeles Corporation, G.R. No. 230528, February 1, 2021

b. Yes, the owner may legally claim the entire P50M from Eastern Insurance Corp. The Insurance Code provides that where the insured is over-insured by double insurance, the insured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may select, up to the amount for which the insurers are severally liable under their respective contracts. Each insurer is bound, as between himself and the other insurers, to contribute ratably to the loss in proportion to the amount for which he is liable under his contract.[35]

c. If the owner has been paid in full by Eastern Insurance, he can no longer recover from any of Northern and Southern Insurance Corporations. Otherwise, the owner can recover P20M and P30M, respectively.

The owner can choose who he wants to claim against to recover the full indemnity provided that the claim will not exceed the face value of the insurer's respective insurance policies.[36]

B. Perfection of the Contract of Insurance

1. Offer and acceptance/consensuality

Jason is the proud owner of a newly-built house worth P5 million. As a protection against any possible loss or damage to his house, Jason applied for a fire insurance policy thereon with Shure Insurance Corporation (Shure) on October 11, 2016 and paid the premium in cash. It took the company a week to approve Jason's application. On October 18, 2016, Shure mailed the approved policy to Jason which the latter received five (5) days later. However, Jason's house had been razed by fire which transpired a day before his receipt of the approved policy. Jason filed a written claim with Shure under the insurance policy. Shure prays for the denial of the claim on the ground that the theory of cognition applies to contracts of insurance.

Decide Jason's claim with reasons.

No. What governs insurance contract is the cognition theory whereby the insurance contract is perfected only from the time the applicant came to know of the acceptance of the offer by the insurer. In this case, the loss occurred a day prior to Jason's knowledge of the acceptance by Shure of Jason's application. There being not perfected insurance contract, Jason is not entitled to recover from Shure.[37]

2. Premium Payment

What is the cash and carry rule under the Insurance Code?

Under the cash and carry rule, an insurance policy is generally not binding unless the premium thereof has not been paid. This is based on Section 77 of the Insurance Code which provides that an insurer is entitled to payment of the premium as soon as the thing insured is exposed to the peril insured against. Notwithstanding any agreement to the contrary, no policy or contract of insurance issued by an insurance company is valid and binding unless and until the premium thereof has been paid.

On September 27, 1996, Development Insurance and Surety Corporation (insurance company) issued a comprehensive commercial vehicle policy to Jaime Gaisano. His company, Noah's Ark, immediately processed the payments and issued a check,

[35] BAR 2008.
[36] BAR 2012.
[37] BAR 2016, 2011.

representing the payment of premium and other charges, dated September 27, 1996 payable to the insurance company's agent, Trans-Pacific, on the same day. However, nobody from Trans-Pacific picked up the check that day. Trans-Pacific informed Noah's Ark that its messenger would get the check the next day, September 28.

In the evening of September 27, 1996, while under the official custody of Noah's Ark, the vehicle was stolen. Oblivious of the incident, Trans-Pacific picked up the check on September 28 and issued an official receipt dated September 28, 1996.

Is there a binding insurance contract?

No, there is no dispute that the check was delivered to and was accepted by insurance company's agent, Trans-Pacific, only on September 28, 1996. No payment of premium had thus been made at the time of the loss of the vehicle on September 27, 1996. While Jaime Gaisano claims that Trans-Pacific was informed that the check was ready for pick-up on September 27, 1996, the notice of the availability of the check, by itself, does not produce the effect of payment of the premium. At the time of loss, there was no payment of premium yet to make the insurance policy effective. Jaime Gaisano also failed to establish the fact of a grant by respondent of a credit term in his favor, or that the grant has been consistent.[38]

Can an insurance policy be binding even if the premium is unpaid?

Premium is the consideration for the undertaking of the insurer to indemnify the insured against a specified peril. Thus, as a general rule, the insurance policy is not valid and binding unless the premium thereof has been paid.

The rule, however, admits of exceptions. They are as follows:

a. Whenever the grace period applies in the case of a life or an industrial life policy.[39]
b. Whenever under the broker and agency agreements with duly licensed intermediaries, a 90-day credit extension is given. No credit extension to a duly licensed intermediary should exceed 90 days from date of issuance of the policy.[40]
c. An acknowledgment in a policy or contract of insurance or the receipt of premium is conclusive evidence of its payment, so far as to make the policy binding, notwithstanding any stipulation therein that it shall not be binding until the premium is actually paid.[41]
d. In a contract of suretyship, the suretyship or bond shall not be valid and binding unless and until the premium therefor has been paid, except where the obligee has accepted the bond, in which case the bond becomes valid and enforceable irrespective of whether or not the premium has been paid by the obligor to the surety.[42]
e. When there is an agreement allowing the insured to pay the premium in instalments and partial payment has been made at the time of the loss.[43]
f. In case of estoppel as when there is a long-standing business practice of allowing the insured to pay the premiums after issuance of the policy and was relied upon in good faith by the insured.[44]

[38] Jaime T. Gaisano v. Development Insurance and Surety Corporation, G.R. No. 190702, February 27, 2017.
[39] Section 77.
[40] Section 77, IC.
[41] Section 79.
[42] Section 179, IC.
[43] Makati Tuscany Condominium Corporation v. Court of Appeals, G.R. No. 95546, November 6, 1992; BAR 2015.
[44] UCPB General Insurance Co., Inc. v. Masagana Telamart, Inc., G.R. No. 137172, April 4, 2001; BAR 2013.

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g. If a cover note issued is issued to temporarily bind the insurance pending issuance of the policy.[45]
Grace period in life or industrial life policy[46]

Credit extension

Capital Insurance & Surety Co., Inc. (Capital Insurance) delivered to Plastic Era Manufacturing Co., Inc., (Plastic Era) its open Fire Policy No. 22760 wherein the former undertook to insure the latter's building, equipment, raw materials, products and accessories. The policy expressly provides that if the property insured would be destroyed or damaged by fire after the payment of the premiums, at any time between the 15th day of December 1960 and one o'clock in the afternoon of the 15th day of December 1961, the insurance company shall make good all such loss or damage in an amount not exceeding P100,000.00. When the policy was delivered, Plastic Era failed to pay the corresponding insurance premium. However, through its duly authorized representative, it executed acknowledgment receipt of Plastic Era's promissory note.

The property insured by Plastic Era was destroyed by fire. In due time, the latter notified Capital Insurance of the loss of the insured property by fire and accordingly filed its claim for indemnity, but was denied.

Is there a contract of insurance between Capital Insurance and Plastic Era?

Yes, by accepting the promise of Plastic Era to pay the insurance premium within 30 days from the effective date of policy, Capital Insurance has implicitly agreed to modify the tenor of the insurance policy and in effect, waived the provision therein that it would only pay for the loss or damage in case the same occurs after the payment of premium. Considering that the insurance policy is silent as to the mode of payment, Capital Insurance is deemed to have accepted the promissory note in payment of the premium. This rendered the policy immediately operative on the day it was delivered. In effect, Capital Insurance extended credit to Plastic Era.[47]

It should be noted that in the Capital Insurance case, the check which was issued in payment of the premium was dishonored due to insufficiency of funds and yet insurer was made liable because it clearly granted a credit extension to the insured and the loss occurred during the extension period.

Is the insurer liable if the loss occurred while the check it received from the insured representing premium payment remained unencashed?

Yes, the insurer is liable because the acceptance of the check is tantamount to extension of credit.

Will your answer be the same if the loss occurred before the maturity date of the post-dated check?

My answer will be the same. The insurer remains liable.

What if the check was dishonored due to insufficiency of funds, is the insurer still liable?

[45] Section 52, IC.
[46] *See* discussion on life insurance.
[47] Capital Insurance & Surety Co., Inc. v. Plastic Era Co., Inc., *et al.,* G.R. No. L-22375, July 28, 1975.

If the check was dishonored before or after the loss, the insurer is not liable because the dishonor of the check is tantamount to non-payment of premium which prevented the effectivity of the insurance contract, unless the insurer granted a credit extension and the loss occurred during such period.[48]

The overriding consideration is whether the insurer granted a credit extension to the insured by accepting a promissory note or a check as a mode of premium payment and the loss occurred during the credit extension period.

Acknowledgement of premium payment

Antonio Chua obtained from American Home a fire insurance covering the stock-in-trade of his business. The insurance was due to expire on March 25, 1990. On April 5, 1990, Chua issued a check for P2,983.50 to American Home's agent, James Uy, as payment for the renewal of the policy. The official receipt was issued on April 10. In turn, the latter a renewal certificate. A new insurance policy was issued where petitioner undertook to indemnify respondent for any damage or loss arising from fire up to P200,000.00 March 20, 1990 to March 25, 1991. The business was completely razed by fire. Antonio Chua filed an insurance claim with American Home and four other co-insurers. American Home refused to honor the claim alleging that there was no existing contract because Antonio Chua did not pay the premium.

Is American Home liable to Antonio Chua?

Yes, Section 78 of the Insurance Code explicitly provides that an acknowledgment in a policy or contract of insurance of the receipt of premium is conclusive evidence of its payment, so far as to make the policy binding, notwithstanding any stipulation therein that it shall not be binding until the premium is actually paid. This section establishes a legal fiction of payment and should be interpreted as an exception to Section 77.[49]

Acknowledgement of premium payment when none was received is also a form of estoppel.

Acceptance by the obligee of the bond issued by the surety

In one case, the check issued to the surety company for premium payment bounced for insufficiency of funds and yet the Supreme Court ruled that the surety is liable to the oblige under its issued bond because the same had been delivered to and accepted by the obligee.[50]

Agreement for partial premium payment

Does payment by installment of premiums invalidate the insurance contract?

Premium may be paid on installments, if allowed by the insurance policy. It was ruled that where there is an agreement allowing the insured to pay the premium in installments and partial payment has been made at the time of the loss, the transaction is exempted from the cash and carry rule.[51] In that case, the insurer accepted all installment payments for three years. Such acceptance of payments speaks loudly of the insurer's intention to honor the policies it issued to the insured. Certainly, basic principles of equity and fairness would not

[48]Capital Insurance and Surety Co, *ibid.*; BAR 2014.
[49]American Home Assurance v. Antonio Chua, G.R. No. 130421, June 28, 1999.
[50]Philippine Pryce Assurance Corporation v. Court of Appeals, G.R. No. 107062, February 21, 1994.
[51]Makati Tuscany Condominium Corporation v. Court of Appeals, G.R. No. 95546, November 6, 1992.

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allow the insurer to continue collecting and accepting the premiums, although paid on installments, and later deny liability on the lame excuse that the premiums were not prepaid in full.[52]

Thus, if the premium is payable on four installments, the insured may recover the full amount if the loss occurred after the first installment payment even pending full payment of the balance without prejudice to the insured's obligation to pay the remaining amount of the premium.

However, if the policy indicates that failure to pay in full any of the scheduled installments on or before the due date shall render the insurance policy void and ineffective as of such date, then the failure to make premium payment on the first due date resulted in a void and ineffective policy. Hence, there is no credit extension to consider as the provision itself expressly cuts off the inception of the insurance policy in case of default.[53]

It was also held that the insurer is not liable for the payment of the insurance proceeds if the policy provides for payment of premium in full. Accordingly, where the premium has only been partially paid and the balance paid only after the peril insured against has occurred, the insurance contract did not take effect and the insured cannot collect at all on the policy.[54]

Similarly, if the insured paid the premium, the insurer's liability attaches correspondingly. There is a valid and binding policy or contract of insurance and the insured may demand indemnification in case of loss. There is no credit on the premium to speak of and, therefore, none which the insurer can demand because he has already been paid. Second, if the insured did not pay the premium and the parties did not agree that the insurer's liability has attached, then there is no valid or binding contract of insurance. The insured cannot demand indemnification if loss occurs and neither can the insurer demand payment of the premium. Third, if the insured did not actually pay the premium but the parties have agreed that the insurer's liability has attached, then the insured is considered to have extended credit on the premium. When the insured accepts the terms of the credit, there is a valid and binding contract of insurance. The insured must pay the premium before the end of the credit term; otherwise, he cannot demand indemnification in case of loss. The insurer may demand the premium, whether or not loss occurred.[55]

Estoppel

Masagana Telemart obtained from UCPB five (5) insurance policies on its Manila properties. The policies were effective from May 22, 1991 to May 22, 1992. On June 13, 1992, Masagana's properties were razed by fire. On July 13, 1992, Masagana Telemart tendered five checks as renewal premium payments. A receipt was issued. On July 14, 1992, Masagana Telemart made its formal demand for indemnification for the burned insured properties. UCPB then rejected Masagana's claims under the argument that the fire took place before the tender of payment and that it did not result in the renewal of the policies. Thus, Masagana Telemart filed a complaint against UCPB. On trial, it was found that Masagana Telemart, which had procured insurance coverage from UCPB for a number of years, had been granted a 60 to 90-day credit term for the renewal of the policies. Such a practice had existed up to the

[52]*Supra.*

[53]Philam Insurance Inc. Now Chartis Philippines Insurance Inc. v. Parc Chateau Condominium Unit Owners Association and/or Eduardo Colet, G.R. No. 201116, March 4, 2019.

[54]Sps. Antonio and Violeta Tibay, *et al.* v. Court of Appeals and Fortune Life and General Insurance Inc., Co., G.R. No. 119655, May 24, 1996; Section 77, Insurance Code.

[55] Chartis Philippines Insurance, Inc. v. Cyber City Teleservices, Ltd, G.R. No. 234299, March 03, 2021

time the claims were filed. Most of the premiums have been paid for more than 60 days after the issuance.

Must Section 77 of the Insurance Code be strictly applied despite practice of granting 60 to 90 day credit for payment of premium?

Yes, Section 77 of the Insurance Code admits of exception and the first is provided in the section itself that is in case of life or industrial life policy whenever the grace period provision applies. The second is that covered by Section 78 which provides that any acknowledgment in a policy of the receipt of premium is conclusive evidence of its payment so far as to make the policy binding, notwithstanding any stipulation therein that it shall not be binding until premium is actually paid. Third exception was laid in *Makati Tuscany Condominium Corporation v. Court of Appeals,* wherein the Court ruled that Section 77 may not apply if parties have agreed to the payment in installments and partial payment has been made at the time of loss. The said case also provided the fourth exception, that is the insurer may grant credit extension for payment of premium. This means that if the insurer has granted the insured a credit term for the payment of the premium and loss occurs before the expiration of the term, recovery on the policy should be allowed even the premium is paid after the loss but within the credit term. As fifth exception, estoppel bars it from taking refuge under Section 77 since Masagana Telemart relied in good faith on such practice.[56]

Facts similar to the Masagana ruling should be decided on a case-by-case basis. It is submitted that just because the insurer, in certain cases, accommodated late payments from the insured does not conclusively bind the insurer to the same kind of arrangement all through out, particularly, if there is a clear and categorical rejection of the application for renewal because there was no corresponding timely premium payment.

It would have been different if the insured issued a check or a promissory note, duly accepted by the insurer to indicate its conformity to the credit extension. The validity, if not fairness, of a credit extension based on supposed previous arrangements is debatable, to say the least.

Issuance of cover notes

What are cover notes?

Cover notes are issued to bind insurance temporarily pending the issuance of the policy. Within 60 days after issue of a cover note, a policy shall be issued in lieu thereof, including within its terms the identical insurance bound under the cover note and the premium therefor.

Cover notes may be extended or renewed beyond such 60 days with the written approval of the Commissioner if he determines that such extension is not contrary to and is not for the purpose of violating any provisions of the Insurance Code.[57]

Because it sustained damages, Pacific Timber Export sent a demand letter to the insurance company to seek payment under a Cover Note previously executed between the parties but was denied on the ground that the Cover Note under which Pacific Timber Export bases its claim is null and void for lack of valuable consideration. Can the insurer be held liable under a Cover Note despite non-payment of premium?

[56]UCPB General Insurance Co., Inc. v. Masagana Telemart, Inc., G.R. No. 137172, April 4, 2001; BAR 2013.
[57]Section 52, IC.

Yes. The non-payment of premium on the cover note is no cause for Pacific Timber to lose what is due it as if there had been payment of premium, for non-payment by it was not chargeable against its fault. Had all the logs been lost during the loading operations, but after the issuance of the cover note, liability on the note would have already arisen even before payment of premium. This is how the cover note as a binder should legally operate, otherwise, it would serve no practical purpose in the realm of commerce, and is supported by the doctrine that where a policy is delivered without requiring payment of the premium, the presumption is that a credit was intended and policy is valid.[58]

D. Rescission of Insurance Contracts

1. Concealment

What is the effect of concealment?

A concealment, whether intentional or unintentional, entitles the injured party to rescind a contract of insurance.[59]

The basis of the rule vitiating the contract in cases of concealment is that it misleads or deceives the insurer into accepting the risk, or accepting it at the rate of premium agreed upon; The insurer, relying upon the belief that the assured will disclose every material fact within his actual or presumed knowledge, is misled into a belief that the circumstance withheld does not exist, and he is thereby induced to estimate the risk upon a false basis that it does not exist. The principal question, therefore, must be, Was the assurer misled or deceived into entering a contract obligation or in fixing the premium of insurance by a withholding of material information or facts within the assured's knowledge or presumed knowledge?[60]

Ignacio Saturnino and his children filed an action to recover the face value of an insurance policy issued by Phil-Am Life on the life of Estefania A. Saturnino. The policy sued upon is one for 20-year endowment non-medical insurance. This kind of policy dispenses with the medical examination of the applicant usually required in ordinary life policies. However, detailed information is called for in the application concerning the applicant's health and medical history. Saturnino died of pneumonia, secondary to Influenza. Ignacio demanded payment of the face value of the policy, but was rejected. It appears that two months prior to the issuance of the policy, Saturnino was operated on for cancer, involving complete removal of the right breast. Notwithstanding the fact of her operation, Estefania A. Saturnino did not make a disclosure thereof in her application for insurance. Ignacio contend that there was no fraudulent concealment of the truth inasmuch as the insured herself did not know, since her doctor never told her, that the disease for which she had been operated on was cancer. Ignacio Saturnino and his children filed an action to recover the face value of an insurance policy issued by Phil-Am Life on the life of Estefania A. Saturnino. Is there concealment?

Yes, in the first place, concealment of the fact of the operation itself was fraudulent, as there could not have been any mistake about it, no matter what the ailment. Secondly, in order to avoid a policy, it is not necessary to show actual fraud on the part of the insured. In this jurisdiction, concealment, whether intentional or unintentional entitled the insurer to rescind the contract of insurance, concealment being defined as "*negligence to communicate that which a party knows and ought to communicate*." The basis of the rule vitiating the contract in cases of concealment is that it misleads or deceives the insurer into accepting

[58]Pacific Timber Export Corporation v. Court of Appeals, *et al.,* G.R. No. L-38613, February 25, 1982.
[59]Section 27, IC.
[60]Insular Life Assurance Co., Ltd. v. Heirs of Alvarez, G.R. Nos. 207526 and 210156.

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the risk, or accepting it at a rate of premium agreed upon. The insurer, relying upon the belief that the insured will disclose every material fact within his actual or presumed knowledge, is misled into a belief that the circumstances withheld does not exist, and he is thereby induced to estimate the risk upon a false basis that it does not exist.[61]

X applied for life insurance with Metropolitan Life Insurance Company. The application contained this question: "Have you ever had any ailment or disease of x x x (b) the stomach or intestines, liver, kidney, or genitourinary organ?" X, a laundrywoman who has no medical knowledge answered "No". the application was approved, premium was paid and six (6) months later, X died from cancer of the stomach. The post medical examination of X shows that she had the cancer at the time she applied for a policy. Can the beneficiary of X collect on the policy? Reasons.

The beneficiary of X cannot collect on the policy. Concealment, as a defense against liability by the insurer, may either be intentional or unintentional. Lack of knowledge on the part of the insured about her ailment will not preclude the insurer from raising the defense. The insurer may be held in estoppel only if, having known of the concealed or misrepresented fact, still accepts the payment of premium which is not the situation in this case.[62]

What is the test of materiality?

Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries.[63]

Should the fact/s concealed be the proximate cause of the loss in order to constitute concealment?

No, the facts concealed need not be the proximate cause of the loss in order to constitute concealment. Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries. The test is whether the matters concealed would have definitely affected the insurer's action on the application of the insured, either by approving it with the corresponding adjustment for a higher premium or rejecting the same.[64]

Cite cases/instances constituting concealment even though the facts concealed were not the proximate cause of the loss.

a. When the insured answered that he consulted a doctor for cough and flu complications but the insurer discovered that two weeks prior to his application for insurance, he was examined and confined at the Lung Center of the Philippines, where he was diagnosed for renal failure, even though the insured died in a plane crash.[65]

b. When the insured consulted a doctor and was diagnosed as suffering from "sinus tachycardia"; then consulted the same doctor again and this time was found to have

[61]Ignacio Saturnino v. Philippine American Life Insurance Company, G.R. No. L-16163, February 28, 1963.
[62]BAR 1989.
[63]Section 31, IC.
[64]Sunlife Assurance Company of Canada v. Court of Appeals, G.R. No. 105135, June 22, 1995.
[65]Sunlife Assurance Company of Canada v. Court of Appeals, G.R. No. 105135, June 22, 1995; Bar 1996..

"acute bronchitis", even though the cause of the death was "congestive heart failure," "anemia," and "chronic anemia."[66]

c. When the insured did not mention in his application for life insurance that he had suffered from viral hepatitis the previous year even though he had fully recovered from the disease, the medical examination performed by the insurance company's physician did not reveal such previous illness, and showed that he was healthy and was an insurable risk, even though he died of an automobile accident.[67]

What facts need not be communicated to each other in a contract of insurance?

Neither party to a contract of insurance is bound to communicate information of the matters following, except in answer to the inquiries of the other:

"(a) Those which the other knows;
"(b) Those which, in the exercise of ordinary care, the other ought to know, and of which the former has no reason to suppose him ignorant;
"(c) Those of which the other waives communication;
"(d) Those which prove or tend to prove the existence of a risk excluded by a warranty, and which are not otherwise material; and
"(e) Those which relate to a risk excepted from the policy and which are not otherwise material.[68]

Information of the nature or amount of the interest of one insured need not be communicated unless in answer to an inquiry, except as prescribed by Section 51.[69]

Neither party to a contract of insurance is bound to communicate, even upon inquiry, information of his own judgment upon the matters in question.[70]

A fire insurance policy in favor of the insured contained a stipulation that the insured shall give notice to the company of any insurances already effected or which may subsequently be effected, covering the property insured and that unless such notice be given before the occurrence of any loss, all benefits shall be forfeited. The face of the policy bore the annotation "Co-insurance declared." The things insured were burned. It turned out that several insurances were obtained on the same goods for the same term. The insurer refused to pay on the ground of concealment. May the insured recover? Reason.

Yes, the insured may recover since there is no concealment. The face of the policy bore already the annotation, "Co-insurance declared" which is a notice to the insurer as to the existence of other insurance contracts on the property insured.[71]

Kwong Nam applied for a 20-year endowment insurance on his life with his wife, Ng Gan Zee as beneficiary. On the same date, Asian Crusader, upon receipt of the required premium from the insured, approved the application and issued the corresponding policy. Kwong Nam died of cancer of the liver with metastasis. All premiums had been paid at the time of his death.

[66]Thelma *Vda. de* Canilang v. Court of Appeals and Great Pacific Life Assurance Corporation, G.R. No. 92492, June 17, 1993.
[67]BAR 1983.
[68]Section 30, IC.
[69]Section 34, IC.
[70]Section 35, IC.
[71]Gen. Insurance & Surety Corporation v. Ng Hua, G.R. No. L-14373, January 30, 1960; BAR 1979.

Ng Gan Zee presented a claim for payment of the face value of the policy. Asian Crusader Life Assurance denied the claim on the ground that the answers given by the insured to the questions in his application for life insurance were untrue, claiming Kwong Nam's misrepresentation when he answered "No" to the question appearing in the application for life insurance. Also, it was alleged that Kwong Nam was examined in connection with his application for life insurance, but he gave the medical examiner false and misleading information as to his ailment and previous operation by saying that it was associated with ulcer of the stomach. Asian Crusader contended that he was operated on for peptic ulcer 2 years before the policy was applied for and that he never disclosed such an operation.

Was there concealment?

No, concealment exists where the assured has knowledge of fact material to the risk, and honesty, good faith, and fair dealing require that he should communicate it to the assurer, but he designedly and intentionally withholds the same. In the absence of evidence that the insured had sufficient medical knowledge as to enable him to distinguish peptic ulcer and a tumor, his statement that said tumor was associated with ulcer of the stomach, should be construed as an expression made in good faith of his belief as to the nature of his ailment and operation.[72]

2. Misrepresentations/Omissions

What is the effect of false representation?

If a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to rescind the contract from the time when the representation becomes false.[73]

A representation as to the future is to be deemed a promise, unless it appears that it was merely a statement of belief or expectation.

Manuel Florendo filed an application for comprehensive pension plan with Philam Plans, Inc. Ma. Lourdes S. Florendo, his wife, was stated as beneficiary. Philam Plans issued Pension Plan Agreement. Eleven months later, Manuel died of blood poisoning.

Subsequently, Lourdes filed a claim with Philam Plans but it declined the claim and found that Manuel was on maintenance medicine for his heart and had an implanted pacemaker. Further, he suffered from diabetes mellitus and was taking insulin. Lourdes contends that Manuel had concealed nothing since Perla, the soliciting agent, knew that Manuel had a pacemaker implanted on his chest in the 70s or about 20 years before he signed up for the pension plan and that it is the soliciting agent who filled up the form.

Is there misrepresentation?

Yes, when the insured sign the pension plan application, he adopted as his own the written representations and declarations embodied in it. It is clear from these representations that he concealed his chronic heart ailment and diabetes. Philam Plans has every right to act on the faith of that certification. Assuming that it was the insurance agent

[72]Ng Gan Zee v. Asian Crusader Life Assurance Corporation, G.R. No. L-30685, May 30, 1983.
[73]Section 45, IC.

Perla who filled up the application form, Manuel is still bound by what it contains since he certified that he authorized her action.[74]

Is proof of fraudulent intent on the part of the insured necessary in order to entitle the insurer to rescind the policy?

The Insurance Code dispensed with proof of fraudulent intent in case of rescission due to concealment but not so in case of rescission due to false representation.[75]

This is neither because intent to defraud is intrinsically irrelevant in concealment, nor because concealment has nothing to do with fraud. To the contrary, it is because in insurance contracts, concealing material facts is inherently fraudulent: "if a material fact is actually known to the [insured], its concealment must of itself necessarily be a fraud. When one knows a material fact and conceals it, "it is difficult to see how the inference of a fraudulent intent or intentional concealment can be avoided." Thus, a concealment, regardless of actual intent to defraud, "is equivalent to a false representation." [76]

Jose Alvarez applied for and was granted a housing loan by UnionBank. This loan was secured by a promissory note, a real estate mortgage over the property of Alvarez and a mortgage redemption insurance taken on the life of Alvarez with UnionBank as beneficiary. Alvarez was among the mortgagors included in the list of qualified debtors covered by the Group Mortgage Redemption Insurance that UnionBank had with Insular Life.

Alvarez died and subsequently, UnionBank filed with Insular Life a death claim under Alvarez's name pursuant to the Group Mortgage Redemption Insurance. Insular Life denied the claim after determining that Alvarez was not eligible for coverage of Group Mortgage Redemption Insurance as he was supposedly more than 60 years old at the time of his loan's approval. With the claim's denial, the monthly amortizations of the loan stood unpaid. Subsequently, the lot was foreclosed and sold at a public auction with UnionBank as the highest bidder.

The Heirs of Alvarez filed a complaint for specific performance to demand against Insular Life to fulfill its obligation as an insurer under the Group Mortgage Redemption Insurance, and for nullification of foreclosure against UnionBank. Was there concealment?

None. Section 26 defines concealment as a neglect to communicate that which a party knows and ought to communicate. However, Alvarez did not withhold information on or neglect to state his age. He made an actual declaration and assertion about it. What this case involves, instead, is an allegedly false representation. If indeed Alvarez misdeclared his age such that his assertion fails to correspond with his factual age, he made a false representation, not a concealment. As such, fraudulent intent on the part of the insured must be established to entitle the insurer to rescind the contract. The Insurance Code dispenses with proof of fraudulent intent in cases of rescission due to concealment, but not in cases of rescission due to false representation. When abundance of documentary evidence can be referenced to demonstrate a design to defraud, presenting singular document with erroneous entry does not qualify as clear and convincing proof of fraudulent intent. Insular Life basically relied on the Health Statement form personally accomplished by Alvarez wherein he wrote that his birth year was 1942. The Court, however, posited that Alvarez

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[74]Ma. Lourdes Florendo v. Philam Plans, Inc., *et al.,* G.R. No. 186983, February 22, 2012.

[75]Insular Life Assurance Co., Ltd. v. Heirs of Alvarez, G.R. Nos. 207526 and 210156, October 3, 2018; Manulife v. Ibanez, November 28, 2016.

[76]Insular Life, *ibid.*

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must have accomplished and submitted many other documents when he applied for the housing loan and executed supporting instruments like the promissory note, real estate mortgage, and Group Mortgage Redemption Insurance. A design to defraud would have demanded his consistency. He needed to maintain appearances across all documents. However, the best that Insular Life could come up with before the Regional Trial Court and the Court of Appeals was a single document. The Court of Appeals was straightforward, *i.e.*, the most basic document that Alvarez accomplished in relation to Insular Life must have been an insurance application form. Strangely, Insular Life failed to adduce even this document — a piece of evidence that was not only commonsensical, but also one which has always been in its possession and disposal.[77]

Incidentally, the Supreme Court also ruled that the foreclosure of the mortgage was void. UnionBank approved Alvarez's loan and real estate mortgage, and endorsed the mortgage redemption insurance to Insular Life. Fully aware of considerations that could have disqualified Alvarez, it nevertheless acted as though nothing was irregular. It itself acted as if, and therefore represented that, Alvarez was qualified. Yet, when confronted with Insular Life's challenge, it readily abandoned the stance that it had earlier maintained and capitulated to Insular Life's assertion of fraud.

When should the insurer rescind the policy on account of concealment or misrepresentation?

Whenever a right to rescind a contract of insurance is given to the insurer on account of concealment or misrepresentation, such right must be exercised previous to the commencement of an action on the contract.[78]

Explain the Incontestability Clause.

The incontestability clause in life insurance policy is based on Section 48 of the Insurance Code:

"Whenever a right to rescind a contract of insurance is given to the insurer by any provision of this chapter, such right must be exercised previous to the commencement of an action on the contract.

After a policy of life insurance made payable on the death of the insured shall have been in force during the lifetime of the insured for a period of two years from the date of its issue or of its last reinstatement, the insurer cannot prove that the policy is *void ab initio* or is rescindable by reason of the fraudulent concealment or misrepresentation of the insured or his agent."

It means that after two years from date of issuance of the policy or its last reinstatement, the insurer must make good on the policy, even though the policy was obtained by fraud, concealment, or misrepresentation.[79] It basically precludes the insurer from rescinding the policy on account of concealment or misrepresentation.

What are the requisites of the incontestability clause?

The requisites are:

a. The insurance is a life insurance payable on the death of the insured.

[77]Insular Life Assurance Co., Ltd. v. Heirs of Alvarez, G.R. Nos. 207526 and 210156, October 3, 2018.
[78]Section 48, IC.
[79]Sunlife of Canada (Philippines), Inc. v. Sibya, *et al.*, G.R. No. 211212, June 8, 2016; BAR 2012.

The clause is therefore not applicable to annuity because the annuitant pays lump sum to the insurer and gets a certain amount from the insurer every year until the annuitant/insured dies.

b. The policy is in force for at least 2 years from its date of issue as appearing in the policy or of its last reinstatement.

The two-year period is not reckoned from date of receipt but from issuance of the policy or last reinstatement.

In January 2016, Mr. H was issued a life insurance policy by XYZ Insurance Co., wherein his wife, Mrs. W, was designated as the sole beneficiary. Unbeknownst to XYZ Insurance Co., however, Mr. H had been previously diagnosed with colon cancer, the fact of which Mr. H had concealed during the entire time his insurance policy was being processed. In January 2019, Mr. H unfortunately committed suicide. Due to her husband's death, Mrs. W, as beneficiary, filed a claim with XYZ Insurance Co. to recover the proceeds of the late Mr. H's life insurance policy. However, XYZ Insurance Co. resisted the claim, contending that: (1) The policy is void ab initio because Mr. H fraudulently concealed or misrepresented his medical condition, i.e., his colon cancer; and (2) As an insurer in a life insurance policy, it cannot be held liable in case of suicide. Rule each of XYZ Insurance Co.'s contentions.

Rule each of XYZ Insurance Co.'s contentions.

The first contention is not tenable. Under the incontestability clause, after a policy of life insurance made payable upon the death of the insured shall have been in force during the lifetime of the insured for a period of two (2) years from the issuance of the policy or last reinstatement, the insurer must make good on the policy even though the policy was obtained through fraud, concealment, or misrepresentation.[80] Even if Mr. H had concealed or misrepresented that he was previously diagnosed with colon cancer, XYZ can no longer rescind the policy since it had been in force already for three (3) years.

On the second contention, XYZ Insurance is liable despite the suicide of Mr. H. Under the Insurance Code, the insurer is liable when suicide is committed after the policy has been in force for a period of two (2) years from the date of issue or its last reinstatement.[81] In this case, Mr. H committed suicide three (3) years after issuance of the policy. Thus, XYZ should be liable to the beneficiary of Mr. H.[82]

Can the incontestability clause be invoked after the death of the insured if the death occurred before two (2) years from issuance of the policy or last reinstatement?

In *Tan v. Court of Appeals*, the Supreme Court ruled that the so-called "incontestability clause" precludes the insurer from raising the defenses of false representations or concealment of material facts insofar as health and previous diseases are concerned if the insurance has been in force for at least two (2) years during the insured's lifetime. The phrase "during the lifetime" found in Section 48 of the Insurance Law simply means that the policy is no longer considered in force after the insured has died. The key phrase in the second paragraph of Section 48 is "for a period of two years". The policy was issued on November 6,

[80]Section 48 Insurance Code; Manila Bankers v. Aban, G.R. No. 175666, July 29, 2013; Sun Life of Canada v. Sibya, G.R. No. 211212, June 8, 2016.

[81]Section 180-A, IC.

[82]BAR 2019; 2013.

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1973 and the insured died on April 26, 1975. The policy was thus in force for a period of only one year and five months. Considering that the insured died before the two-year period has lapsed, Philippine American Life Insurance Company is not, therefore, barred from proving that the policy is void *ab initio* by reason of the insured's fraudulent concealment or misrepresentation.[83]

In other words, the clause can be invoked even after the death of the insured and not just during his lifetime. The rescission need not be always done during the lifetime of the insured. The incontestability clause will only set in after two (2) years from issuance of the policy or last reinstatement.

However, in the case of *Manila Bankers Life Insurance Corporation v. Aban,*[84] it was held that after the two-year period lapsed, or when the insured dies within the period, the insurer must make good on the policy, even though the policy was obtained by fraud, concealment, or misrepresentation.

In Aban, more than two years had lapsed from the issuance of the policy, thus, the incontestability clause had lapsed. However, the Supreme Court also said that if the insured died within the two-year period from the issuance of the policy (not after two [2] years), the insurer can no longer rescind the policy on account of misrepresentation and/or concealment. It may be said that this part of the decision is only an *obiter dictum* because two (2) years had lapsed anyway, and the incontestability clause already applied.

However, that principle was reiterated in *Sun Life of Canada v. Sibya*.[85] In this case, the insured applied for life insurance. He disclosed in his application that he sought advice for kidney problem but failed to disclose that he was confined for renal failure. Three months from issuance of the policy, he died of gunshot wounds. The Supreme Court held that there was no concealment given the information that he disclosed and that he further authorized the insurer to conduct investigation on his medical background. And even assuming that there was concealment, the insurer must make good on the policy because the insured died within the two-year period, citing *Manila Bankers v. Aban*.

Based on *Aban* and *Sibya* cases, there are now two (2) incontestability clauses.

1. Two (2) years had lapsed from issuance of the policy or last reinstatement.
2. The insured died within two (2) years from issuance of the policy.

The second application, however, goes against the rationale of the incontestability clause. It precludes the insurer from conducting investigation if the insured committed concealment and/or misrepresentation, particularly if the insured died shortly after the issuance of the policy. It is submitted that this ruling should be re-assessed.

On July 3, 1993, Delia Sotero (Sotero) took out a life insurance policy from Ilocos Bankers Life Insurance Corporation (Ilocos Life) designating Cresencia Aban (Aban), her niece, as her beneficiary.

On April 10, 1996, Sotero died. Aban filed a claim for the insurance proceeds on July 9, 1996. Ilocos Life conducted an investigation into the claim and came out with the following findings:

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[83]Emilio Tan, Juanito Tan, Alberto Tan, and Arturo Tan v. Court of Appeals and Philippine American Life Insurance Company, G.R. No. 48049, June 29, 1989.

[84]G.R. No. 175666.

[85]G.R. No. 211212, June 8, 2016.

1. **Sotero did not personally apply for insurance coverage, as she was illiterate.**
2. **Sotero was sickly since 1990.**
3. **Sotero did not have the financial capability to pay the premium on the policy.**
4. **Sotero did not sign the application for insurance.**
5. **Aban was the one who filed the insurance application and designated herself as the beneficiary.**
   For the above reasons and claiming fraud, Ilocos Life denied Aban's claim on April 16, 1997, but refunded the premium paid on the policy.

a. **May Sotero validly designate her niece as beneficiary?**
b. **May the incontestability period set even in cases of fraud as alleged in this case?**
c. **Is Aban entitled to claim the proceeds under the policy?**

a. Yes. Sotero may validly designate her niece, Aban, as beneficiary. When the insured takes insurance on his own life, he can designate anyone as beneficiary except those disqualified to receive donation under Article 739 of the Civil Code. Aban does not fall within the disqualification.

b. Yes. The "incontestability clause" is a provision in Insurance Code which provides that after a policy of life insurance made payable on the death of the insured shall have been in force during the lifetime of the insured for a period of two (2) years from the date of its issue or of its last reinstatement, the insurer cannot prove that the policy is void *ab initio* or is rescindable by reason of fraudulent concealment or misrepresentation of the insured or his agent.

   In this case, the policy was issued on August 30, 1993, and the insured died on April 10, 1996. The insurance policy was thus in force for a period of three (3) years, seven (7) months and 24 days. Considering that the insured died after the two-year period, Ilocos is, therefore, barred from proving that the policy is void *ab initio* by reason of the insured's fraudulent concealment or misrepresentation.

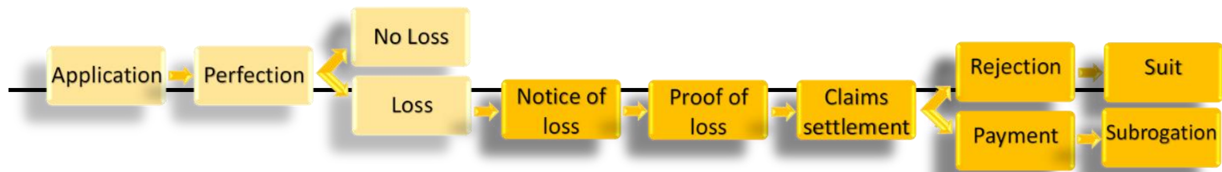
c. Yes, Aban is entitled to claim the proceeds. After the two-year period lapsed, or when the insured dies within the period, the insurer must make good on the policy, even though the policy was obtained by fraud, concealment, or misrepresentation, as in this case, when the insured did not personally apply for the policy as she was illiterate and that it was the beneficiary who filled up the insurance application designating herself as beneficiary.[86]

What are the defenses not barred by the incontestability clause?

These defenses are not barred by the incontestability clause:
a. Lack of Insurable interest;
b. Premium was not paid;
c. The death was due to excepted risk, (like suicide);
d. The insured employed vicious fraud (as in another person took the physical exams for the insured);
e. Failure to comply with conditions imposed by the insurer; and
f. Time specified in the contract to make claims is not complied with.

[86]Manila Bankers Life Insurance Corporation v. Aban, G.R. No. 175666; BAR 2014.

D. Rights and obligations of parties



Notice and Proof of Loss

When is an insurer liable for a loss?

An insurer is liable for a loss in the following cases:

a. If the proximate cause of the loss is the risk or peril insured against.[87]

b. If the immediate cause of the loss is the risk or peril insured against unless the proximate cause is an excepted peril.[88]

Thus, if an explosion occurs in Building A and as a result, fire coming therefrom spreads to Building B where the property insured against fire is located, the insured may recover unless explosion is an excepted peril.

c. Where the thing insured is rescued from a peril insured against that would otherwise have caused a loss, if, in the course of such rescue, the thing is exposed to a peril not insured against, which permanently deprives the insured of its possession, in whole or in part; or where a loss is caused by efforts to rescue the thing insured from a peril insured against.[89]

Thus, if in the course of the efforts to save personal effects from fire, the risk insured against, the insured temporarily stored the property in a secluded area, but stolen by looters, as the insured returns to the fire scene to try to save more properties, the insured may recover for the loss of the stolen property, even though robbery is not a peril insured against.

d. Loss caused by the negligence of the insured, or of the insurance agents or others.[90]

When is the insurer not liable despite the occurrence of a loss?

An insurer is not liable for a loss caused by the willful act or through the connivance of the insured;[91] for a loss of which the peril insured against was only a remote cause,[92] or if the loss is caused by an excepted risk.[93]

It was held that insurable interest in property is not limited to property ownership in the subject matter of the insurance. Where the interest of the insured in, or his relation to, the property is such that he will be benefitted by its continued existence, or will suffer a direct pecuniary loss by its destruction, his contract of insurance will be upheld, although he has no legal or equitable title. When Milestone removed its parts and machines, Milestone still had an actual and real interest in the preservation of the corrugating machines while the

[87]Section 86, Insurance Code, as amended.
[88]Section 88, *ibid.*
[89]Section 87, *ibid.*
[90]Section 89, *ibid.*
[91]Section 89, *ibid.*
[92]Section 86, *ibid.*
[93]Section 88, *ibid.*

Toll Manufacturing Agreement (TMA) is not effectively terminated. Non-preservation will render Milestone liable for breach of contract as no corrugated carton boxes would be manufactured in favor of Asgard under the TMA.

Since the damage or loss caused by Milestone (one of the co-insured) to Asgard's corrugating machines was willful or intentional, UCPB Insurance is not liable under the Policy. To permit Asgard to recover from the Policy for a loss caused by the willful act of the insured is contrary to public policy, i.e., denying liability for willful wrongs.[94]

Alfredo took out a policy to insure his commercial building against fire. The broker for the insurance company agreed to give a 15-day credit to pay the insurance premium. Upon delivery of the policy on May 15, 2020, Alfredo issued a postdated check payable on May 30, 2006. On May 28, 2020, a fire broke out and destroyed the building owned by Alfredo.

- **a. May Alfredo recover on the insurance policy?**
- **b. Would your answer in a) be the same if it as found that the proximate cause of the fire was an explosion and that fire was but the immediate cause of the loss and there is no excepted peril under the policy?**
- **c. If the fire was found to have been caused by Alfredo's own negligence, can he still recover on the policy?**

Reason briefly in a, b, and c.

- a. Yes, Alfredo may recover on the policy. It is valid to stipulate that the insured will be granted credit term for the payment of premium and the risk insured against occurred during the credit extension period.
- b. Yes, recovery under the insurance contract is allowed if the proximate or immediate cause of the loss is the risk insured against except where the proximate cause was an excepted peril.
- c. Yes, mere negligence on the part of the insured will not prevent recovery under the insurance policy. The law merely prevents recovery when the cause of loss is the willful act of the insured, alone, or in connivance with others.[95]

What happens in case of non-submission or delay in the submission of the notice and/or proof of loss?

The insurer shall be relieved of liability in case of non-submission or delay in the submission of the notice and/or proof of loss, unless the delay in the presentation to an insurer of notice or proof of loss is waived by the insurer or it omits to take objection promptly and specifically upon that ground.[96]

All defects in a notice of loss, or in preliminary proof thereof, which the insured might remedy, and which the insurer omits to specify to him, without unnecessary delay, as grounds of objection, are waived.[97]

Pursuant to the fire insurance policy, Usiphil Incorporated filed with Finman General Assurance an insurance claim for the loss of the insured properties due to fire. Usiphil also submitted its Sworn Statement of Loss and Formal Claim together

[94] UCPB General, Insurance Co., Inc. v. Asgard Corrugated Box Manufacturing Corporation, G.R. No. 244407, January 26, 2021,

[95]BAR 2007.

[96]Section 93, *ibid.*

[97]Section 92, *ibid.*

with Proof of Loss as compliance with the requirements of H.H. Bayned, the adjuster appointed by Finman General. However, Finman General refused to pay the insurance claim on the ground that Usiphil Incorporated failed to comply with Policy Condition No. 13 which provides that within 60 days after the loss, unless time is extended, the insured shall render a signed and sworn statement of proof of loss.

Does Usiphil comply with the condition as regards submission of documents to prove loss?

Yes. A perusal of the records shows that Usiphil, after the occurrence of the fire, immediately notified Finman General Assurance thereof. Thereafter, Usiphil submitted the following documents: (1) Sworn Statement of Loss and Formal Claim; and (2) Proof of Loss. The submission of these documents constitutes substantial compliance with the above provision. Indeed, as regards the submission of documents to prove loss, substantial compliance with the requirements will always be deemed sufficient.

In *Industrial Personnel and Management Services, Inc. v. Country Bankers Insurance Corporation*,[98] the Supreme Court reiterated the rule that substantial compliance with the requirements under the policy suffices.

The facts are as follows:

Industrial Personnel and Management Services, Inc. (IPAMS) began recruiting registered nurses for work deployment in the United States of America (U.S.). By reason of the advances made to the nurse applicants, the latter were required to post surety bond. The purpose of the bond is to guarantee the following during its validity period: (a) that they will comply with the entire immigration process, (b) that they will complete the documents required, and (c) that they will pass all the qualifying examinations for the issuance of immigration visa. The Country Bankers Insurance Corporation (Country Bankers) and IPAMS agreed to provide bonds for the said nurses. The surety bonds issued specifically state that the liability of the Country Bankers, shall be limited only to actual damages arising from Breach of Contract by the applicant. A Memorandum of Agreement (MOA) was executed by the said parties which stipulated the various requirements for collecting claims from Country Bankers. On the basis of the MOA, IPAMS submitted its claims under the surety bonds issued by Country Bankers. For its part, Country Bankers, upon receipt of the documents enumerated under the MOA, paid the claims to IPAMS. According to IPAMS, starting 2004, some of its claims were not anymore settled by Country Bankers as it insisted on the production of official receipts of IPAMS on the expenses it incurred for the application of nurses.

It was held that the statement of accounts, in lieu of official receipts, sufficed to allow the insured to recover.[99]

When should the insurer make the insurance payment to the insured?

Insurance payment should be made within the following periods:

LIFE insurance – The proceeds of a life insurance policy shall be paid immediately upon maturity of the policy, unless such proceeds are made payable in installments or as an annuity, in which case the installments, or annuities shall be paid as they become due:

[98]G.R. No. 194126, October 17, 2018.

[99]Industrial Personnel and Management Services, Inc. v. Country Bankers Insurance Corporation, G.R. No. 194126, October 17, 2018.

Provided, however, That in the case of a policy maturing by the death of the insured, the proceeds thereof shall be paid within 60 days after presentation of the claim and filing of the proof of death of the insured.[100]

PROPERTY – The amount of any loss or damage for which an insurer may be liable, under any policy other than life insurance policy, shall be paid within 30 days after proof of loss is received by the insurer and ascertainment of the loss or damage is made either by agreement between the insured and the insurer or by arbitration; but if such ascertainment is not had or made within 60 days after such receipt by the insurer of the proof of loss, then the loss or damage shall be paid within 90 days after such receipt.[101]

What happens in case of delay in the payment of insurance claim?

Refusal or failure to pay the claim within the time prescribed will entitle the beneficiary to collect interest on the proceeds of the policy for the duration of the delay at the rate of twice the ceiling prescribed by the Monetary Board, unless such failure or refusal to pay is based on the ground that the claim is fraudulent.[102]

In case of any litigation for the enforcement of any policy or contract of insurance, it shall be the duty of the Commissioner or the Court, as the case may be, to make a finding as to whether the payment of the claim of the insured has been unreasonably denied or withheld; and in the affirmative case, the insurance company shall be adjudged to pay damages which shall consist of attorney's fees and other expenses incurred by the insured person by reason of such unreasonable denial or withholding of payment plus interest of twice the ceiling prescribed by the Monetary Board of the amount of the claim due the insured, from the date following the time prescribed in Section 248 or in Section 249, as the case may be, until the claim is fully satisfied. *Provided,* That failure to pay any such claim within the time prescribed in said sections shall be considered *prima facie* evidence of unreasonable delay in payment.[103]

In *Stronghold Insurance v. Pamana Island Resort,*[104] it was held that given the provisions of the Insurance Code, which is a special law, the applicable rate of interest shall be that imposed in a loan or forbearance of money as imposed by BSP even irrespective of the nature of the insurer's liability. In the past years, the rate was at 12%. However, in light of Circular 799 issued by the BSP on June 21, 2013 decreasing interest on loans or forbearance of money, the declared rate of 12% per annum shall be reduced to 6% per annum starting July 1, 2013, the effectivity of the circular.

The insurer then is liable to pay 12% per annum on the insurance proceeds for the duration of the delay. Delay should be construed after the lapse of the period to pay as set forth by law.

Prescription of Action

What is the remedy available to the insured in case his insurance claim is rejected by the insurer?

In case of denial of the insurance claim, the insured may file an action for specific performance against the insurer within the prescriptive period allowed by law.

[100]Section 248, Insurance Code.
[101]Section 249, Insurance Code.
[102]Sections 248 and 249, Insurance Code.
[103]Section 250, *ibid.*
[104]G.R. No. 174838, June 1, 2016.

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The prescriptive period to file a legal action against the insurer, for an action based on breach of an insurance policy, is ten years from accrual of cause of action, unless the policy reduced such period, but in no case, shorter than one (1) year from accrual of cause of action.

A condition, stipulation, or agreement in any policy of insurance, limiting the time for commencing an action thereunder to a period of less than one (1) year from the time when the cause of action accrues, is void.[105]

When does the cause of action of the insured accrue?

The cause of action accrues from the rejection of the insurance claim.

In one case, the Supreme Court ruled that the condition contained in an insurance policy that claims must be presented within one year after rejection is not merely a procedural requirement but an important matter essential to a prompt settlement of claims against insurance companies as it demands that insurance suits be brought by the insured while the evidence as to the origin and cause of destruction have not yet disappeared.

Case law teaches that the prescriptive period for the insured's action for indemnity should be reckoned from the "final rejection" of the claim. The "final rejection" simply means denial by the insurer of the claims of the insured and not the rejection or denial by the insurer of the insured's motion or request for reconsideration. The rejection referred to should be construed as the rejection in the first instance.

The contention of the insured that its action has not yet prescribed and that the suit is deemed to have been commenced on the date that the original complaint was filed is untenable. An amended complaint supersedes an original one. As a consequence, the original complaint is deemed withdrawn and no longer considered part of the record.

The settled rule is that the filing of an amended pleading does not retroact to the date of the filing of the original pleading; hence, the statute of limitation runs until the submission of the amendment. It is true that as an exception, this Court has held that an amendment which merely supplements and amplifies facts originally alleged in the complaint relates back to the date of the commencement of the action and is not barred by the statute of limitations which expired after the service of the original complaint. Thus, when the amended complaint does not introduce new issues, cause of action, or demands, the suit is deemed to have commenced on the date the original complaint was filed.

In the present case, the Court finds that the exception does not apply to insured's case as to allow the period of prescription to run and for prescription to ultimately set in. As the Amended Complaint superseded the original complaint, the suit of the latter is deemed to have been commenced on the date of filing of the Amended Complaint, during which time, prescription had already set in as insured had only until January 24, 2010 within which to file its insurance claim.[106]

Jose Ledesma, Geronima Pulmano, and Amelia Generao were insured with Summit Guaranty and Insurance Company for purposes of Third Party Liability. They all filed, in separate cases, notice of claim with Summit Guaranty. However, the petitioner failed to act on their claim. Consequently, Ledesma and Pulmano filed a complaint before the Insurance Commission. Summit Guaranty contends that the two (2) periods prescribed in the Section 384 of the Insurance Code, that is, the six-

[105]Section 63, *ibid.*
[106] Alpha Plus International Enterprises Corp. v. Philippine Charter Insurance Corp, G.R. No. 203756, February 10, 2021,

month period for filing the notice of claim and the one-year period for bringing an action or suit – are mandatory and must always concur. Petitioner company argues that under this law, even if the notice of claim was timely filed with the insurance company within the six-month period, the action or suit that follows, if filed beyond the one-year period should necessarily be dismissed on the ground of prescription.

Has the cause of action already prescribed?

No, there is absolutely nothing in the law which mandates that the two (2) periods must always concur. On the contrary, it is very clear that the one-year period is only required "in proper cases." It appears that the insurer disregarded this very significant phrase when it made its own interpretation of the law. Had the lawmakers intended it to be the way petitioner company assumes it to be, then the phrase "in proper cases" would not have been inserted.

Also, the cause of action did not accrue until claim was finally rejected by the insurance company. This is because before such final rejection there is no real necessity for bringing suit. The one-year period should be counted from the date of rejection by the insurer as this is the time when the cause of action accrues. In the cases at bar, no denial of the claims was ever made and hence there has yet been no accrual of cause of action. Therefore, the prescription has not yet set in.[107]

When does the prescriptive period for the insured's action for indemnity be reckoned from?

The prescriptive period for the insured's action for indemnity should be reckoned from the "final rejection" of the claim. "Final rejection" simply means denial by the insurer of the claims of the insured and not the rejection or denial by the insurer of the insured's motion or request for reconsideration.[108] The request for reconsideration does not suspend the running of the prescriptive period stipulated in the insurance policy. The reason for this rule is to insure that claims against insurance companies are promptly settled and that insurance suits are brought by the insured while the evidence as to the origin and cause of the destruction has not yet disappeared.[109]

However, where the delay in bringing the suit against the insurance company was not caused by the insured or its subrogee but by the insurance company itself, it is unfair to penalize the insured or its subrogee by dismissing its action against the insurance company on the ground of prescription. In one case, the insured sent a notice of claim to the insurance company two months after the accident. However, it was only a year later that the insurer replied to the insured's letter informing it that they could not take appropriate action on the insured's claim because the attending adjuster was still negotiating the case. It was held that prescription has not set in.[110]

Subrogation

What is subrogation? What is the statutory basis of the right of the insurer to subrogation?

[107]Summit Guaranty and Insurance Company Inc. v. Hon. Jose de Guzman, *et al.*, G.R. No. L-50997, June 30, 1987.

[108]H.H. Hollero Construction, Inc. v. Government Service Insurance System and Pool of Machinery Insurers, G.R. No. 152334, September 24, 2014. Sun Life Office, Ltd. v. Court of Appeals, G.R. No. 89741, March 13, 1991.

[109]BAR 1996.

[110]Country Bankers Insurance Corporation v. Travellers Insurance and Surety Corporation, G.R. No. 82509, August 16, 1989.

The basis of subrogation is Article 2207 of the Civil Code of the Philippines which provides that "if the plaintiff's property has been insured and he has received indemnity from the insurance company for the injury or loss arising out of the wrong or breach of contract complained of, the insurance company shall be subrogated to the rights of the insured against the wrongdoer or the person who has violated the contract. If the amount paid by the insurance company does not fully cover the injury or loss, the aggrieved party shall be entitled to recover the deficiency from the person causing the loss of injury."

Is the consent of the wrongdoer necessary to enable the insurer to acquire the right of subrogation?

Subrogation does not require the consent of the wrongdoer. It is an equitable assignment of right that accrues to the insurer after valid payment is made to the insured as a result of the happening of the risks insured against.[111] Payment by the insurer to the assured operates as an equitable assignment to the former of all remedies which the latter may have against the third party whose negligence or wrongful act caused the loss. The right of subrogation is not dependent upon, nor does it grow out of, any privity of contract or upon written assignment of claim. It accrues simply upon payment of the insurance claim by the insurer.[112]

The doctrine of subrogation has its roots in equity. It is designed to promote and to accomplish justice; and is the mode that equity adopts to compel the ultimate payment of a debt by one who, in justice, equity, and good conscience, ought to pay.[113]

In other words, where the insurer was made to pay the insured for a loss covered by the insurance contract, such insurer can run after the third person who caused the loss through subrogation. The basis for conferring the right of subrogation to the insurer is the equitable assignment that results from the insurer's payment of the insured.[114]

Is the consent of the insured necessary for the right of subrogation to exist?

No, after payment to the insured, the insurer is entitled to go after the person that violated its contractual commitment to answer for the loss insured against. As previously stated, when the insurance company pays for the loss, such payment operates as an equitable assignment to the insurer of the property and all remedies which the insured may have for the recovery thereof. That right is not dependent upon, nor does it grow out of, any privity of contract, or upon written assignment of claim, and payment to the insured makes the insurer an assignee in equity.[115]

L" borrows P50,000.00 from "M" payable 360 days after date, at 12% interest per annum. To secure the loan, "L" mortgages his house and lot in favor of "M". To protect himself from certain contingencies, "M" insures the house for the full amount of the loan with Rock Insurance Company. A fire breaks out and burns the house and "M" collects from the insurance company the full value of the insurance.

Upon maturity of the loan, the insurance company demands payment from "L". The latter refuses to pay on the ground that the loan had been extinguished by the

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[111]BAR 2014.

[112]Pan Malayan Insurance Corporation v. Court of Appeals, *et al.,* G.R. No. 81026, April 3, 1990. Aboitiz Shipping Corporation v. Insurance Company of North America, G.R. No. 168402, August 6, 2008. Philippine American General Insurance Company, Inc. v. Court of Appeals, *et al.*, G.R. No. 116940, June 11, 1997; Equitable Insurance Corporation v. Transmodal International, Inc., G.R. No. 223592, August 7, 2017.

[113]Malayan Insurance Co., Inc. v. Rodelio Alberto, *et al.*, G.R. No. 194320, February 1, 2012.

[114]BAR 2011.

[115]Fireman's Fund Insurance Company v. Jamila & Company, Inc., G.R. No. L-27427, April 7, 1976.

insurance payment which "M" received from the insurance company. He argues that he has not entered into any loan or contract of whatever nature with the insurance company. He further contends that it is bad enough to lose a house but it is worse if one has to pay off a paid obligation to somebody who has not extended any loan to him. Besides, he states, that the insurance payment should inure to his benefit because he owns the house.

Pass upon the merits of "L's" contentions.

Neither the loan of L was extinguished by the insurance payment which M received from the insurance company; nor the insurance payment inures to L's benefit; what was then insured was the interest of M, the secured creditor, and not the interest of L, so the proceeds shall be applied exclusively to the proper interest of M.

L's argument that he has not entered into any loan or contract of whatever nature with the insurance company is also untenable. When the secured creditor's interest in the mortgaged property of the mortgagor, L, was insured and said property would be burned, the insurance company had to pay the insured, M, and payment by the insurer to the insured creates legal subrogation and makes the insurer an assignee on equity to run after the mortgagor, L. Said right of the insurer is not dependent upon nor does it grow out of, any privity of contract, or upon written assignment of claim, and payment to insured makes the insurer an assignee in equity; thus, L's consent to said subrogation is not necessary.[116]

Honda Trading Phils. Ecozone Corporation (Honda Trading) ordered 80 bundles of Aluminum Alloy Ingots. The goods were loaded in two container vans which were, in turn, received in Jakarta, Indonesia by Nippon Express Co., Ltd. for shipment to Manila. Aside from insuring the entire shipment with Tokio Marine & Nichido Fire Insurance Co., Inc. (TMNFIC), Honda Trading also engaged the services of Keihin-Everett to clear and withdraw the cargo from the pier and to transport and deliver the same to its warehouse at Laguna. Meanwhile, Keihin-Everett had an Accreditation Agreement with Sunfreight Forwarders whereby the latter undertook to render common carrier services for the former and to transport inland goods within the Philippines.

The shipment arrived in Manila and was caused to be released from the pier by Keihin-Everett and turned over to Sunfreight Forwarders for delivery to Honda Trading. En route to the latter's warehouse, the truck carrying the containers was hijacked and the container van was reportedly taken away.

Claiming to have paid Honda Trading's insurance claim for the loss it suffered, Tokio Marine filed a complaint for damages against Keihin-Everett. Tokio Marine maintained that it had been subrogated to all the rights and causes of action pertaining to Honda Trading. Keihin-Everett denied liability for the lost shipment on the ground that the loss thereof occurred while the same was in the possession of Sunfreight Forwarders.

Is subrogation proper?

Yes, the Insurance Policy itself expressly made Tokio Marine as the party liable to pay the insurance claim of Honda Trading pursuant to the Agency Agreement entered into by and between Tokio Marine and TMNFIC. The Agency Agreement shows that TMNFIC had subsequently changed its name to that of Tokio Marine. By agreeing to this stipulation in the Insurance Policy, Honda Trading binds itself to file its claim with Tokio Marine and

[116]Article 2207, N.C.C.; Fireman's Fund Insurance Co. v. Jamila & Co., G.R. No. L-1976, April 7, 1976; BAR 1980.

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thereafter to accept payment from it. Since the insurance claim for the loss sustained by the insured shipment was paid by Tokio Marine as proven by the Subrogation Receipt — showing the amount paid and the acceptance made by Honda Trading, it is inevitable that it is entitled, as a matter of course, to exercise its legal right to subrogation as provided under Article 2207 of the Civil Code.[117]

How much may the insurer recover from the wrongdoer as a result of subrogation?

The insurer, after paying the claim of the insured under the insurance policy, is subrogated merely to the rights of the assured. As subrogee, it can recover only the amount that is recoverable by the latter. In one case, a shipment was covered by a bill of lading which stipulated, among others, that the carrier's liability with respect to lost or damaged shipments is expressly limited to the C.I.F. value of the goods, upon arrival at the Port of Manila, several cartons were received in bad order condition, hence the consignee filed a claim with the carrier as well as the insurer but the carrier refused, so it was the insurer that paid the value of the insured goods, including other expenses in connection therewith. Thereafter, the insurer sued the carrier, to collect what it paid the insured. It was held that after paying the claim of the insured for damages under the insurance, the insurer is subrogated merely to the rights of the insured. As subrogee, it can recover only the amount that is recoverable by the latter. Since the right of the assured is limited by the provisions in the bill of lading, a suit by the insurer as a subrogee is necessarily subject to like limitations.[118]

In another case, it was held that the failure of the insurer to present sufficient proof that the subrogor sustained damages, which would have entitled it to indemnity, precludes recovery on the part of the insurer. The rights of a subrogee cannot be superior to the rights possessed by a subrogor. Consequently, an insurer indemnifies the insured based on the loss or injury the latter actually suffered from. If there is no loss or injury, then there is no obligation on the part of the insurer to indemnify the insured. Should the insurer pay the insured and it turns out that indemnification is not due, or if due, the amount paid is excessive, the insurer takes the risk of not being able to seek recompense from the alleged wrongdoer.[119]

In this particular case, the Philippine Associated Smelting and Refining Corporation (PASAR) had not established by an iota of evidence the amount of loss or actual damage it suffered by reason of seawater wettage of the 777.29 metric tons of copper concentrates. In spite of no proof of loss, Malayan paid the claim of PASAR in the amount of P33,934,948.75. The Supreme Court ruled that Malayan cannot make the common carrier answerable for its mistake in indemnifying PASAR. This is in line with the principle that a subrogee steps into the shoes of the insured and can recover only if the insured likewise could have recovered.[120]

In what instances is the insurer not entitled to the right of subrogation?

The insurer is not entitled to the right of subrogation in the following cases:

i. In life insurance, because subrogation exists only when insurance is contract of indemnity.
   ii. When the proximate cause of the loss was the negligence of the insured himself. The insured can recover because only gross negligence bars recovery but there is no subrogation if there is no wrongdoer or violator of the contract.

[117]Keihin-Everett Forwarding v. Tokio Marine Malayan Insurance, *et al.*, G.R. No. 212107, October 28, 2019.
[118]St. Paul Fire & Marine Insurance Co. v. Macondray & Co., Inc., *et al.*, G.R. No. L-27796, March 25, 1976.
[119]Loadstar Shipping Company v. Malayan Insurance, G.R. No. 185565, November 26, 2014.
[120]Loadstar Shipping Company and Loadstar International Company v. Malayan Insurance, *ibid.*

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iii. When the insurer pays the insured for a loss due to a risk not covered by the policy or payment should not have been made at all because there is no loss, thereby effecting voluntary payment.[121]
iv. Where the insurer pays the assured the value of the lost goods without notifying the carrier who has in good faith settled the assured's claim for loss, the settlement is binding on both the assured and the insurer, and the latter cannot bring an action against the carrier on his supposed right of subrogation.[122]
v. When the insured releases the wrongdoer, the insurer is released from liability. If the release was done after the insured received the payment from the insurer, insurer can recover from insured.

If the insured received partial indemnity amount from the wrongdoer but the latter was completely released by the insured, the latter cannot recover the deficiency from the insurer.

Manila Mahogany Manufacturing Corporation insured its Mercedes Benz car with Zenith Insurance Corporation. The car was bumped and damaged by a truck owned by San Miguel Corporation (SMC). For the damage caused, Zenith Insurance paid Manila Mahogany. However, Zenith Insurance was not able to collect from SMC, because it so happened that SMC already paid Manila Mahogany for which it executed a release claim discharging SMC from all actions or claims. Hence, Zenith Insurance demanded for the return of the money it paid Manila Mahogany, but the latter refused prompting Zenith Insurance to file a complaint against Manila Mahogany.

Is Zenith entitled to the return of the money?

Yes. The right of subrogation can only exist after the insurer has paid the insured. If the insurance proceeds are not sufficient to cover the damages suffered by the insured, then he may sue the party responsible for the damage for the remainder. Since the insurer can be subrogated to only such rights as the insured may have, should the insured, after receiving payment from the insurer, release the wrongdoer who caused the loss, the insurer loses his rights against the latter. But in such a case, the insurer will be entitled to recover from the insured whatever it has paid to the latter, unless the release was made with the consent of the insurer.[123]

Within what period should the right of subrogation be exercised?

In *Vector Shipping Corporation v. American Home Assurance Company*,[124] the Supreme Court ruled that after payment by the insurer to the insured, it is subrogated to the rights of the latter. Its right of subrogation under Article 2207 of the Civil Code in relation to Article 1144 gives rise to a cause of action created by law. The prescriptive period for cause of action based on law (such as subrogation) is 10 years. Thus, the insurer has 10 years from the date it indemnified the insured to file the action against the wrongdoer.

However, the Supreme Court abandoned the *Vector ruling in Vicente Henson, Jr. v. UCPB General Insurance*,[125] an *en banc* decision, where it was held the insurer only steps into the shoes of the insured. No new obligation was created between the insurer and the wrongdoer. The rights of a subrogee cannot be superior to the rights possessed by a

[121] Pan Malayan Insurance Corporation v. Court of Appeals, *et al.,* G.R. No. 81026, April 3, 1990.
[122] Pan Malayan Insurance Corporation v. Court of Appeals, *et al.,* G.R. No. 81026, April 3, 1990.
[123] Manila Mahogany Manufacturing Corporation v. Court of Appeals, G.R. No. L-52756, October 12, 1987; BAR 1994.
[124] G.R. No. 159213, July 3, 2013.
[125] G.R. No. 223134, August 14, 2019.

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subrogor. Therefore, for purposes of prescription, the insurer inherits only the remaining period within which the insured may file an action against the wrongdoer. The Supreme Court said, however, that the *Henson* doctrine is prospective in application.

The facts of this case are as follows:

From 1989 to 1999, National Arts Studio and Color Lab (NASCL) leased the front portion of a two-storey building owned by Vicente Henson Jr. (Henson). In 1999, NASCL gave up its lease and instead leased the right front portion and the entire second-floor of the building. Meanwhile, Copylandia Office Systems Corp. (Copylandia) moved in to the ground floor.

A water leak occurred in the building causing injury to the various equipment of Copylandia. As the said equipment were insured, Copylandia filed a claim with its insurer, UCPB General Insurance Co., Inc. (UCPB). UCPB paid the claim and, as subrogee, demanded from NASCL for the amount of the payment it made. Since the demand proved to be futile, UCPB filed a complaint for damages against NASCL.

Meanwhile, Henson transferred ownership of the building to Citrinne Holdings, Inc. (CHI), where he was a stockholder and President. UCPB amended its complaint impleading CHI as a defendant. Thereafter, UCPB filed a motion praying Henson, instead of CHI, be impleaded as a defendant. CHI opposed the complaint on the ground of prescription, arguing that since UCPB's cause of action is based on *quasi-delict,* it must be brought within four (4) years from its accrual on May 9, 2006.

On the issue of whether the claim of UPCB already prescribed, the Supreme Court ruled that the claim has not yet prescribed following the *Vector ruling*. Although in this case, the Court deemed it necessary to abandon the ruling in *Vector* that an insurer may file an action against the tortfeasor within 10 years from the time the insurer indemnifies the insured, the abandonment of the *Vector* doctrine should be prospective in application for the reason that judicial decisions applying or interpreting the laws or the Constitution, until reversed, shall form part of the legal system of the Philippines.

The rule now is, following the principles of subrogation, the insurer only steps into the shoes of the insured. No new obligation was created between the insurer and the wrongdoer. The rights of a subrogee cannot be superior to the rights possessed by a subrogor. Therefore, for purposes of prescription, the insurer inherits only the remaining period within which the insured may file an action against the wrongdoer. The indemnification of the insured by the insurer only allows it to be subrogated to the former' s rights, and does not create a new reckoning point for the cause of action that the insured originally has against the wrongdoer. Thus, applying prospectively, the prescription period to claim indemnification from a tortfeasor is only four (4) years.[126]

This should mean that if tortious act was committed on January 8, 2020, the insured party has up to January 8, 2024 to file the complaint for against the tortfeasor. If the insurer pays the the insured on June 8, 2020, the insurer does not have a fresh period of four years from June 8, 2020 to enforce its right of subrogation but only the remaining period from June 8, 2020 to January 8, 2024.

Life insurance

When is life insurance payable?

[126]Vicente Henson, Jr. v. UCPB General Insurance Co., G.R. No. 223134, August 14, 2019.

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An insurance upon life may be made payable on the death of the person, or on his surviving a specified period, or otherwise contingently on the continuance or cessation of life.

Every contract or pledge for the payment of endowments or annuities shall be considered a life insurance contract for purposes of the Insurance Code.[127]

Is the insurer in a life insurance liable in case of suicide by the insured?

The insurer in a life insurance contract shall be liable in case of suicide only when it is committed after the policy has been in force for a period of two (2) years from the date of its issue or of its last reinstatement, unless the policy provides a shorter period: *Provided, however,* that suicide committed in the state of insanity shall be compensable regardless of the date of commission.[128]

The insurer, however, is not liable if suicide in an excepted risk.

X, in January 30, 2009, or two (2) years before reaching the age of 65, insured his life for P20M. For reason unknown to his family, he took his own life two (2) days after his 65th birthday. The policy contains no excepted risk. Which statement is most accurate?

a. **the insurer will be liable.**
b. the insurer will not be liable.
c. the state of sanity of the insured is relevant in cases of suicide in order to hold the insurer liable.
d. the state of sanity of the insured is irrelevant in cases of suicide in order to hold the insurer liable.[129]

Sun Insurance issued a Personal Accident Policy to Felix Lim, Jr. with a face value of P200,000.00 with his wife, Nerissa, as beneficiary. On October 6, 1982, Lim "accidentally" shot himself in the head and was killed on the spot. According to his secretary, Lim pointed the gun at her as a joke and assured her that it was not loaded, then he put the gun to his temple and fired it.

Sun Insurance agreed that it was not suicide, but argued that it was not an accident and is therefore not covered by the insurance. Sun Insurance argued that one of the four exceptions in the said insurance contract includes bodily injury consequent upon the insured person attempting to commit suicide or "willfully exposing himself to needless peril" except in an attempt to save a human life, and that the mere act of pointing the gun to his temple showed that Felix willfully exposed himself to danger.

Is Lim's death covered by the insurance policy?

Yes, "Accident/Accidental" in insurance contracts are construed and considered according to the ordinary understanding and common usage and speech: That which happens by chance or fortuitously, without intention or design, and which is unexpected, unusual, and unforeseen. There is nothing in the policy that relieves the insurer of the responsibility to pay the indemnity agreed upon if the insured is shown to have contributed to his own accident. Indeed, most accidents are caused by negligence. Lim was unquestionably negligent and that negligence cost him his own life. But it should not

[127] Section 182, IC.
[128] Section 183, *ibid.*
[129] BAR 2012.

prevent his wife from recovering from the insurance policy he obtained precisely against accident.[130]

Compulsory motor vehicle liability insurance

What is the basis for compulsory motor vehicle liability insurance?

The basis of compulsory motor vehicle liability insurance is Article 387 of the Insurance Code which provides that it shall be unlawful for any land transportation operator or owner of a motor vehicle to operate the same in the public highways unless there is in force in relation thereto a policy of insurance or guaranty in cash or surety bond issued to indemnify the death, bodily injury, and/or damage to property of a third-party or passenger, as the case may be, arising from the use thereof.

What is the extent of liability of the insurer under a motor vehicle insurance policy?

The insurer's liability is measured by the terms of the policy. It is not solidarily liable with the tortfeasor.

Poe was run over by a truck which was insured with Malayan Insurance. Heirs of Poe then filed a complaint against the owner of the truck and Malayan Insurance. Malayan Insurance while admitting that it is the insurer of the truck, it asserts that its liability is limited, and it should not be held solidarily liable with the owner for all the damages awarded to the aggrieved parties.

Is Malayan Insurance solidarily liable with the truck owner?

No, where the insurance contract provides for indemnity against liability to third persons, the liability of the insurer is direct and third persons can directly sue the insurer. The direct liability of the insurer under indemnity contracts against third party liability does not mean, however, that the insurer can be held solidarily liable with the insured and/or the other parties found at fault, since they are being held liable under different obligations. The liability of the insured carrier or vehicle owner is based on tort, in accordance with the provisions of the Civil Code; while that of the insurer arises from contract, particularly, the insurance policy. The third-party liability of the insurer is only up to the extent of the insurance policy and that required by law; and it cannot be held solidarily liable for anything beyond that amount. Any award beyond the insurance coverage would already be the sole liability of the insured and/or the other parties at fault. However, Malayan did not produce evidence to prove its limited liability so the Court concluded that it had agreed to fully indemnify third-party liabilities.[131]

No Fault Indemnity Clause

What do you understand by the "no fault indemnity" provision in the Insurance Code? What are the rules on claims under said provision?

The "no fault indemnity" in the Insurance Code provides that any claim for death or injury to a passenger or to a third party should be paid without the necessity of proving fault or negligence of any kind, subject to the following rules:

a. The total indemnity in respect of any person shall not be less than P15,000;

[130] Sun Insurance Office, Ltd. v. Court of Appeals and Nerissa Lim, G.R. No. 92383, July 17, 1992.
[131] Heirs of George Poe v. Malayan Insurance Company, G.R. No. 156302, April 7, 2009.

b. The following proofs of loss, when submitted under oath, shall be sufficient evidence to substantiate the claim:
   i. Police report of accident; and
   ii. Death certificate and evidence sufficient to establish the proper payee; or
   iii. Medical report and evidence of medical or hospital disbursement in respect of which refund is claimed.
c. Claim may be made against one motor vehicle only. In the case of an occupant of a vehicle, claim, shall lie against the insurer of the vehicle in which the occupant is riding, mounting or dismounting from. In any other case, claim shall lie against the insurer of the directly offending vehicle. In all cases, the right of the party paying the claim to recover against the owner of the vehicle responsible for the accident shall be maintained.[132]

X is a passenger of a jeepney for hire being driven by Y. The jeepney collided with another passenger jeepney being driven by Z who was driving recklessly. As a result of the collision, X suffered injuries. Both passenger jeepneys are covered by Comprehensive Motor Vehicular Insurance Coverage. If X wants to claim under the "no fault indemnity clause", against whom will his claim lie?

The claim shall lie against the insurer of the passenger jeepney driven by Y because X was his passenger.[133]

Jose, driving his own car together with his wife Maria, were on their way home from their respective offices when a car driven by Pedro hit them from behind which was in turn hit by a gasoline tanker driven by Mario, causing the car of Jose to turn-turtle, thus, resulting in the death of Maria. All motor vehicles being insured, Jose filed his claim for the death of Maria against the "NO FAULT" Insurance, Section 378 of the Insurance Code.

Will Jose's claim for the death of Maria against insurers of said three motor vehicles prosper and up to what amount? Reasons.

Jose's claim for the death of Maria against the insurer of said three (3) motor vehicles will not prosper. According to Section 378 of the Insurance Code:

> "Any claim for death or injury to any passenger or third-party pursuant to the provisions of this chapter shall be paid without necessity of proving fault or negligence of any kind; Provided, that for purposes of this section.
> x x x
>
> (iii) Claim may be made against one motor vehicle only. In the case of an occupant of a vehicle, claim shall lie against the insurer of the vehicle in which the occupant is riding, mounting or dismounting from. Clearly, in the instant case, the NO-FAULT claim against the vehicle in which the deceased was riding is the one authorized, but the claim against the other vehicle will not prosper.

Jose may claim only up to an amount not less than P15,000.00 pursuant to Section 391 of R.A. No. 10607.

If Jose includes in the claim damage for his car, will the claim prosper? Why?

Jose's claim for damages for his car will not prosper. As may be clearly gleaned from Section 378 of the Insurance Code on NO-FAULT Insurance applies only to "any claim for death or injury to any passenger or third party".[134]

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[132] Section 391, IC; BAR 1989.
[133] BAR 2012.
[134] BAR 1977.

"X" owns and operates several passenger jeepneys in Metro Manila. He entered into a contract with Gold Mine Insurance & Surety Co., insuring the operation of his jeepneys against accidents with third party-liability.

During the effectivity of the insurance, one of his jeepneys bumped "B", who had just alighted from another passenger jeepney whose driver unloaded passengers in the middle of the street. "B" suffered bodily injury as a consequence and filed a claim against the insurance company. The latter refused to pay on the ground that the driver of the jeepney from which passenger "B" alighted was guilty of negligence in unloading in the middle of the street, and that the driver of the insured operator was not at fault.

Can passenger "B" recover from the insurance company? Explain.

Yes, passenger "B" may recover from the insurance company. The insurance covers the operation of "X's" jeepneys against accidents with third parties; therefore, the insurance covers the liability for death or body injuries of third persons, like what happened to "B", and the claim shall be against the insurer of the directly offending vehicle (X's vehicle). Furthermore, any claim of this nature shall be paid without necessity of proving fault or negligence of any kind, provided that the total indemnity in respect of any person shall be in accordance as provided under the law.[135]

Driving his car one night, A crossed an intersection as the signal light turned green. Suddenly he saw an old woman crossing the street just a few feet from his car. He applied his brakes immediately, but just the same, he hit the woman who turned out to be senile already. He brought her to the nearest hospital where she was confined for three (3) days due to her injuries. Upon her discharge, A had to pay the hospital bill which amounted to P2,000.00 including X-rays, doctor's fees and medicines.

Being covered by the compulsory liability policy required of all vehicle owners under the Insurance Code, A preferred the matter to his insurance company, which refused to reimburse him, claiming that since A was not at fault (it was admitted that he was not speeding or in any way negligent), there was no third-party liability for which the insurance company could be liable under A's policy. Is the insurance company liable to reimburse A for the hospital expenses? Explain.

Yes, the insurance company is liable provided A can present the police report of the accident and the medical report as well as the hospital receipts. The Insurance Code has the "no-fault" provision imposing liability for any claim for death or injury to any third party under the compulsory motor vehicle liability insurance. Under the provision, the insurance company may be held liable for the maximum amount of P15,000.00 without necessity of proving fault or negligence of any kind, provided the aforementioned proofs are submitted under oath.[136]

X was riding a suburban utility vehicle (SUV) covered by a comprehensive motor vehicle liability insurance (CMVLI) underwritten by FastPay Insurance Company when it collided with a speeding bus owned by RM Travel, Inc. the collision resulted in serious injuries to X; Y, a passenger of the bus; and Z, a pedestrian waiting for a ride at the scene of the collision. The police report established that the bus was the offending vehicle. The bus had a CMVLI policy issued by Dragon Insurance Corporation, X, Y and Z jointly sued RM Travel and Dragon Insurance for indemnity

[135]BAR 1981.
[136]Section 391, Insurance Code.

under the Insurance Code of the Philippines. The lower court applied the "no-fault" indemnity policy of the statute, dismissed the suit against RM Travel, and ordered Dragon insurance to pay indemnity to all three plaintiffs. Do you agree with the court's judgment? Explain.

No. The cause of action of Y is based on the contract of carriage, while that of X and Z is based on torts. The court should not have dismissed the suit against RM Travel. The court should have ordered Dragon Insurance to pay each of X, Y, and Z to the extent of the insurance coverage. The excess of the claims of X, Y, and Z, over and above such insurance coverage, if any, should be answered or paid by RM Travel.[137]

There was a collision between the IH Scout, where private respondents were riding, and a Superlines bus. Private respondents sustained injuries. A complaint for damages was filed against Superlines, the bus driver and Perla Compania de Seguros, Inc., the insurer of the bus. The vehicle in which the private respondents were riding was insured with Malayan Insurance Co. Even before summons could be served, the judge issued an order for the Perla Compania de Seguros, Inc., to pay immediately within five (5) days the required amount under the "no-fault clause" as provided for in Section 378 of the Insurance Code. Perla Compania de Seguros, Inc., contends that under Section 378 of the Insurance Code, the insurer liable to pay the P5,000 is the insurer of the vehicle in which private respondents were riding, not petitioner.

Is Perla Compania de Seguros, Inc., liable?

No, the essence of "no fault indemnity" clause is to provide victims of vehicular accidents or their heir's immediate compensation pending final determination of who is responsible for the accident. From a reading of Section 378, the following rules on claims under the no fault indemnity provision, where the proof of fault or negligence is not necessary for payment of any claim for death or injury to passenger or third party, are: 1) claim may be made against one motor vehicle only; 2) if the victim is occupant of a vehicle, the claim shall be against the insurer of vehicle in which he is riding, mounting, or dismounting from; 3) in any other case, the claim shall lie against the insurer of directly offending vehicle; 4) in all cases, the right of other party paying the claim to recover against the owner of the vehicle responsible for the accident shall be maintained.[138]

Thus, because the basis of the court order is the no-fault indemnity clause, it should have been directed to the insurer of the vehicle where private respondents were riding.

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[137] BAR 2000.

[138] Perla Compania de Seguros Inc. v. Hon. Constante Ancheta, *et al.,* G.R. No. L-49699, August 8, 1988.

II. TRANSPORTATION LAW

A. COMMON CARRIERS

1. Concept

What is a common carrier?

A common carrier is a person, corporation, firm, or association engaged in the business of carrying or transporting passengers or goods or both, by land, water, or air for compensation, offering its services to the public.[139]

What is the test to determine whether a person is a common carrier?

The test to determine whether a person is a common carrier is: Does the person hold out to the public that it is engaged in the business of transporting or carrying passengers or goods, or both as a public employment and not a casual occupation? Is it open to the use and service of all members of the public who may require the service to the extent of its capacity? If it is open to the public, the carrier is a common carrier.[140]

It is not the quantity or extent of the business actually transacted, or the number and character of the conveyances used in the activity, but whether the undertaking is a part of the activity engaged in by the carrier that he has held out to the general public as his business or occupation. If the undertaking is a single transaction, not a part of the general business or occupation engaged in, as advertised and held out to the general public, the individual or the entity rendering such service is a private, not a common, carrier.[141]

The law makes no distinction between one whose principal business activity is the carrying of persons or goods or both, and one who does such carrying only as an ancillary activity (in local idiom, as "a sideline"). Article 1732 of the Civil Code also carefully avoids making any distinction between a person or enterprise offering transportation service on a regular or scheduled basis and one offering such service on an occasional, episodic, or unscheduled basis. Neither does Article 1732 distinguish between a carrier offering its services to the "general public," *i.e.*, the general community or population, and one who offers services or solicits business only from a narrow segment of the general population.[142]

It is also necessary that the common carrier be the owner of the vehicle/vessel who will carry out the carriage. The public is not required to inquire as to the ownership of the vehicle/vessel.[143]

LMN, Inc. operates a beach resort in a secluded island off the coast of Puerto Princesa City, Palawan. It operates three (3) motorized boats to ferry its guests from the city proper to the island resort and vice versa. During one rainy morning, the guests were informed that the ferry services for that day were cancelled due to a storm forecast. In order to appease the apparent dismay of most of the guests who will miss their flight back to Manila, the boat captain of one of LMN, Inc.'s motorized

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[139]BAR 1996; Article 1732 of the Civil Code.

[140]Marshall v. Public Service Commission, 195 A. 475, 129 Pa. Super. 272, *cited in* Perez, Quizzer in Transportation Law, p. 9, 2009 Ed.

[141]Spouses Teodoro and Nanette Pereña v. Spouses Teresita Philippine Nicolas and L. Zarate, G.R. No. 157917, August 29, 2012.

[142]Pedro De Guzman v. Court of Appeals, G.R. No. L-47822, December 22, 1988.

[143]Cebu Salvage case and Torres Madrid Brokerage case.

boats decided to push through with its trip back to the city. Shortly after the boat sailed, the storm hit and the winds and waves became stronger, causing engine trouble to the boat. Unfortunately, the boat capsized and sank, resulting in the death of one of the passengers, Mr. X.

This prompted Mr. X's heirs to file a complaint for damages against LMN, Inc., which they alleged to be a common carrier. In its defense, LMN, Inc. maintained that it is not a common carrier because its boats are not available to the general public but only ferry resort guests and employees.

May LMN, Inc. be considered a common carrier? Explain.

LMN is a common carrier. Common carriers are persons engaged in the business of transporting or carrying passengers or goods or both, by land, air, and water, offering their services to the public, for compensation. The test does not make a distinction whether the carrying is done as the principal or as an auxiliary activity or that the carriage was periodic, occasional, episodic or unscheduled or has limited clientele. It is not necessary that the transportation services be offered to the general public. Offering the services even to a narrow segment of the public suffices.[144] Thus, the fact that the transportation services are offered only to the guests of the beach resort is immaterial. Transportation is an integral part of LMN's business.

Are the following persons common carriers?

a) Freight forwarder; b) Shipowner; c) arrastre operator; d) customs broker; and e) trucking company.

a. **Freight forwarder** – A freight forwarder is not a common carrier. It merely chooses or selects the common carrier. A freight forwarder's liability is limited to damages arising from its own negligence in choosing the carrier; however, where the forwarder contracts to deliver goods to their destination instead of merely arranging for their transportation, it becomes liable as a common carrier for loss or damage to goods. A freight forwarder assumes the responsibility of a carrier, which actually executes the transport, even though the forwarder does not carry the merchandise itself.[145]

b. **Arrastre operator** – An arrastre operator is not a common carrier. The functions of an arrastre operator involve the handling of cargo deposited on the wharf or between the establishment of the consignee or shipper and the ship's tackle. Being the custodian of the goods discharged from a vessel, an arrastre operator's duty is to take good care of the goods and to turn them over to the party entitled to their possession.[146] The obligation of the arrastre operator is akin to a warehouseman.

c. **Customs Broker** – Although its principal function is to prepare the correct customs declaration and proper shipping documents as required by law, the transportation of goods is, nevertheless, an integral part of a customs broker, thus, the customs broker is also a common carrier. For to declare otherwise would be to deprive those with whom it contracts the protection which the law affords them

[144]Spouses Cruz v. Sun Holidays, G.R. No. 186312, June 29, 2010.

[145]Unsworth Transport International (Phils.), Inc. v. Court of Appeals and Pioneer Insurance and Surety Corporation, G.R. No. 166250, July 26, 2010.

[146]Westwind Shipping Corporation v. UCPB General Insurance Co., G.R. No. 2002289, November 25, 2013; Asian Terminals v. Daehan Fire and Marine Insurance, G.R. No. 171194, February 4, 2010.

notwithstanding the fact that the obligation to carry goods for its customers, is part and parcel of its business.[147]

Is a pipeline operator a common carrier?

Yes. It is engaged in the business of transporting or carrying goods, *i.e.*, petroleum products, for hire as a public employment. It undertakes to carry for all persons indifferently, that is, to all persons who choose to employ its services, and transports the goods by land and for compensation. The fact that the pipeline operator has a limited clientele does not exclude it from the definition of a common carrier. Moreover, the definition of "common carriers" in the Civil Code makes no distinction as to the means of transporting, as long as it is by land, water, or air. It does not provide that the transportation of the passengers or goods should be by motor vehicle.[148]

Are school bus operators common carriers?

Yes. Persons engaged in the business of transporting students from their respective residences to their school and back are considered common carrier. Despite catering to a limited clientele, they operate as common carriers because they hold themselves out as a ready transportation indiscriminately to the students of a particular school living within or near where they operate the service and for a fee.[149]

That a school bus operator is considered a common carrier should be viewed in the context by which the Supreme Court made such ruling. The school bus operator indiscriminately offered their transportation services even though to a narrow segment of the public only (like students whose parents reside in a particular residential subdivision only).

Is a travel agency a common carrier?

A travel agency is not a common carrier. It only arranges for the transportation of its clients for air carriage. As such, it is not bound to exercise extraordinary diligence in the performance of its obligations.[150]

Common carrier vs. private carrier

What is a private carrier?

A private carrier is one who, without making it his vocation or holding himself out to the public as ready to act for all who desire his services, undertakes, by special arrangement in a particular instance only, to transport persons or property from one destination to another, either gratuitously or for hire.[151]

Name two (2) characteristics which differentiate a common carrier from a private carrier.

Two (2) characteristics which differentiate a common carrier from a private carrier are:

[147]Westwind Shipping Corporation v. UCPB General Insurance Co., G.R. No. 2002289, November 25, 2013; A.F Sanchez Brokerage v. Court of Appeals, G.R. No. 147079, December 21, 2004

[148]First Philippine Industrial Pipeline v. Court of Appeals, G.R. No. 125948, December 29, 1989.

[149]Spouses Perena v. Spouses Nicolas, G.R. No. 157917, August 29, 2012.

[150]Crisostomo v. Court of Appeals, *infra.*

[151]Spouses Tedoro and Nanette Perena v. Spouses Teresita Philippine Nicolas and L. Zarate, G.R. No. 157917, August 29, 2012.

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a. A common carrier offers its service to the public; a private carrier does not.
b. A common carrier is required to observe extraordinary diligence; a private carrier is only required to exercise ordinary diligence.[152]

The other distinctions are as follows:

a. As to what governs the parties' rights and obligations –

The rights and obligations of the parties to a contract of private carriage are governed principally by their stipulations, whereas, in a contract of public carriage, the rights and obligations of the parties are governed by law and the terms of the contract of carriage.

b. As to whether or not it may refuse to enter into a contract of carriage –

A common carrier is bound to carry for all who offer such goods as he is accustomed to carry and tender reasonable compensation for carrying them. A private carrier is not bound to carry for any reason, unless bound by a contract.

c. As to exemption for negligence of employees –

A common carrier cannot stipulate that it is exempt from liability on account of the negligence of its employees. Such stipulation is void for being contrary to public policy. A private carrier may validly enter into such stipulation because the public is not involved.[153]

Much of the distinction between a "common or public carrier" and a "private or special carrier" lies in the character of the business, such that if the undertaking is an isolated transaction, not a part of the business or occupation, and the carrier does not hold itself out to carry the goods for the general public or to a limited clientele, although involving the carriage of goods for a fee, the person or corporation providing such service could very well be just a private carrier.[154]

May a common carrier be converted to private carrier by stipulation?

Yes. A common carrier may be converted to a private carrier in case of bareboat or demise charter, that is, the ship owner lets the vessel and the crew insofar as that particular voyage is concerned. A common carrier retains its status as such in case of voyage or time charter, where the charter is limited to the ship.[155]

It was held in one case that carrier was converted into a private carrier notwithstanding the existence of the Time Charter Party agreement since the said agreement was not limited to the ship only but extends even to the control of its crew. Despite the denomination as Time Charter by the parties, their agreement undoubtedly reflected that their intention was to enter into a Bareboat Charter Agreement.[156]

3. Diligence required of common carriers

What is the diligence required of common carriers?

[152] BAR 2002; Spouses Perena, *ibid.*
[153] Loadstar Shipping v. Court of Appeals, G.R. No. 131621, September 28, 1999.
[154] Philippine American General Insurance Company v. PKS Shipping Company, G.R. No. 149038, April 9, 2003.
[155] Caltex (Philippines), Inc. v. Sulpicio Lines, Inc., G.R. No. 131166, September 30, 1999.
[156] Federal Phoenix Assurance v. Fortune Sea Carrier, G.R. No. 188118, November 23, 2015.

Under Article 1733 of the Civil Code, common carriers from the nature of their business and for reasons of public policy are bound to observe extraordinary diligence in the vigilance over the goods and for the safety of passengers transported by them according to all the circumstances of each case. Thus, under Article 1735 of the same Code, in all cases other than those mentioned in Article 1734 thereof, the common carrier shall be presumed to have been at fault or to have acted negligently, in case of death or injury to passengers or loss or damage to goods, unless it proves that it has observed the extraordinary diligence required by law.[157]

In a contract of carriage, it is presumed that the common carrier is at fault or is negligent when a passenger dies or is injured. In fact, there is even no need for the court to make an express finding of fault or negligence on the part of the common carrier. This statutory presumption may only be overcome by evidence that the carrier exercised extraordinary diligence. The fact that the driver of the vehicle was acquitted in the criminal action for reckless imprudence has no bearing on the liability of the carrier arising from breach of contract of carriage.[158]

The trial court is not required to make an express finding of the common carrier's fault or negligence. The presumption of negligence applies so long as there is evidence showing that: (a) a contract exists between the passenger and the common carrier; and (b) the injury or death took place during the existence of such contract. In such event, the burden shifts to the common carrier to prove its observance of extraordinary diligence, and that an unforeseen event or *force majeure* had caused the injury. However, for a common carrier to be absolved from liability in case of *force majeure*, it is not enough that the accident was caused by a fortuitous event. The common carrier must still prove that it did not contribute to the occurrence of the incident due to its own or its employees' negligence.[159]

Cite jurisprudence where the Supreme Court ruled that the common carrier breached its obligation to exercise extraordinary diligence.

a. When the common carrier could not present evidence that it specifically installed a radar which could have allowed the vessel to navigate safely for shelter during a storm coupled with the negligence of the captain as found by the appellate court which were the proximate causes of the sinking of the vessel.[160]
b. Common carriers are deemed to warrant impliedly the seaworthiness of the ship. For a vessel to be seaworthy, it must be adequately equipped for the voyage and manned with a sufficient number of competent officers and crew. The failure of a common carrier to maintain in seaworthy condition the vessel involved in its contract of carriage is a clear breach of its duty prescribed in Article 1755 of the Civil Code.[161]
c. The testimonial evidence of respondent showed that petitioner, through its bus driver, failed to observe extraordinary diligence, and was, therefore, negligent in transporting the passengers of the bus safely, since the bus bumped a tree and a house, and caused physical injuries to respondent.[162]
d. Petitioners failed to prove that they did exercise the degree of diligence required by law over the goods they transported. Aside from their persistent disavowal of liability by conveniently posing an excuse that their extraordinary responsibility is terminated upon release of the goods to the Ports Authority, petitioners failed to

[157] American Home Assurance Company v. Court of Appeals, G.R. No. 94149, May 5, 1992.
[158] Heirs of Jose Marcia K. Ochoa v. G&S Transport Corporation, G.R. No. 170071, 170125, March 9, 2011.
[159] Sulpicio Lines, Inc. v. Napoleon Sesante, Now Substituted By Maribel Atilano, *et al.*, G.R. No. 172682, July 27, 2016.
[160] American Home Assurance Company v. Court of Appeals, G.R. No. 94149, May 5, 1992.
[161] Vector Shipping Corporation v. Adelfo Macasa, G.R. No. 160219, July 21, 2008.
[162] R. Transport Corporation v. Eduardo Pante, G.R. No. 162104, September 15, 2009.

adduce sufficient evidence they exercised extraordinary care to prevent unauthorized withdrawal of the shipments.[163]

e. Mere proof of delivery of the goods in good order to a common carrier and of their arrival in bad order at their destination constitutes a *prima facie* case of fault or negligence against the carrier. If no adequate explanation is given as to how the deterioration, loss, or destruction of the goods happened, the transporter shall be held responsible.[164]

f. The driver was clearly negligent when he was relatively driving fast on a narrow highway and approaching a similarly narrow bridge. A bus is a significantly large vehicle which would be difficult to maneuver and stop if it were travelling at a high speed. On top of this, the time of the accident was on or about sunrise, when visibility on the road was compromised. The driver should have been more prudent and careful in his driving the bus, especially considering that the transportation company is a common carrier.[165]

g. Part of the extraordinary responsibility of common carriers is the duty to ensure that shipments are received by none but the person who has a right to receive them. Common carriers must ascertain the identity of the recipient. Failing to deliver the shipment to the designated recipient amounts to a failure to deliver. The shipment shall then be considered lost, and liability for this loss ensues.[166]

h. At the time the customs broker turned over the custody of the cargoes to a common carrier for inland transportation, it is still required to observe extraordinary diligence in the vigilance of the goods. Failure to successfully establish this carries with it the presumption of fault or negligence, thus, rendering the customs broker liable to the shipper it contracted with, subject to right of reimbursement against the carrier in whose possession, the goods where hijacked.[167]

i. When the loss of the goods was not attended by grave or irresistible threat, violence, or force but was brought about by the carrier's failure to exercise extraordinary diligence when she neglected vetting her driver (who absconded with the goods) or providing security for the cargo and failing to take out insurance on the shipment's value.[168]

j. Petitioner was extremely remiss before and during the time of the vessel's sinking. Petitioner did not endeavor to dispute the Court of Appeals' finding that the vessel's captain erroneously navigated the ship, and failed to reduce its speed considering the ship's size and the weather conditions. The crew members were also negligent when they did not make any stability calculations, and prepare a detailed report of the vessel's cargo stowage plan. The radio officer failed to send an SOS message in the internationally accepted communication network but instead used the Single Side Band informing the company about the emergency situation.[169]

B. Obligations and Liabilities

Who is liable in case of breach of contract of carriage? The operator or the driver or both?

If the cause of action is based on a breach of a contract of carriage, the liability of the owner/operator is direct as the contract is between him and the passenger. The driver cannot be made liable as he is not a party to the contract of carriage. The obligation to carry

[163] Nedlloyd Lijnen B.V. Rotterdam v. Glow Laks Enterprises, G.R. No. 156330, November 19, 2014.
[164] Eastern Shipping Lines v. BPI MS Insurance, G. R. No. 182864, January 12, 2015.
[165] Linda Cacho v. Universal Robina Corporation, G.R. No. 203081, January 17, 2018.
[166] Federal Express Corporation v. Luwalhati Antonino, G.R. No. 199455, June 27, 2018.
[167] Keihin-Everett Forwarding Co. v. Marine Malayan, *et al.*, G.R. No. 212107, January 28, 2019.
[168] Annie Tan v. Great Harvest, *supra*.
[169] Sulpicio Lines v. Major Victorio Karaan, G.R. No. 208590, October 3, 2018.

the passenger safely to his destination was with the operator and the elements of a contract of carriage exist between the operator and the passenger. Thus, a complaint for breach of a contract of carriage is dismissible as against the employee who was driving the bus because the parties to the contract of carriage are only the passenger, the bus owner, and the operator.[170]

The driver, however, may be sued based on quasi-delict and/or criminally if his negligence can be established.

Are common carriers liable for injuries to passengers even if they have observed ordinary diligence and care? Explain.

Yes, common carriers are liable to injuries to passengers even if the they observed ordinary diligence and care because the obligation imposed upon them by law is to exercise extraordinary diligence. Common carriers are bound to carry passengers safely as far as human care and foresight can provide, using the utmost diligence of very cautious persons with a due regard for all the circumstances.[171]

X Company loaded six (6) metric tons of Soybean Meal on board the vessel M/V "Sea Dream" at the Port of U.S.A., for delivery to the Port of Manila to Simon Enterprises, Inc., as consignee. When the vessel arrived in Manila, the shipment was discharged to the receiving barges of the arrastre operator. Consignee later received the shipment but claimed having received only five (5) metric tons of Soybean Meal. Are the common carrier and arrastre operator liable for the shortage?

No. Though it is true that common carriers are presumed to have been at fault or to have acted negligently if the goods transported by them are lost, destroyed, or deteriorated, and that the common carrier must prove that it exercised extraordinary diligence in order to overcome the presumption, the plaintiff must still, before the burden is shifted to the defendant, prove that the subject shipment suffered actual shortage. This can only be done if the weight of the shipment at the port of origin and its subsequent weight at the port of arrival are proven by a preponderance of evidence, and it can be seen that the former weight is considerably greater than the latter weight, taking into consideration the exceptions provided in Article 1734 of the Civil Code.[172]

1. VIGILANCE OVER GOODS

1. Exempting causes

What are the defenses available to the common carrier in case of loss, destruction, or deterioration of the goods?[173]

As a rule, the common carrier is liable for the loss, destruction, or deterioration of the goods, except in the following cases:

a. Flood, storm, earthquake, lightning, or other natural disaster or calamity;
b. Acts of public enemy in war, whether international or civil;
c. Act or omission of the shipper or passenger;
d. Character of the goods or defects in the packing or container;
e. Order or act of competent public authority;[174]

[170]Jose Sanico and Vicente Castro v. Werherlina P. Colipano, G.R. No. 209969, September 27, 2017.
[171]Article 1755 of the Civil Code; Bar 2015.
[172]Asian Terminals, Inc. v. Simon Enterprises, Inc., G.R. No. 177116, February 27, 2013.
[173]BAR 2001.
[174]Article 1734, Civil Code.

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f. Exercise of extraordinary diligence.

Force majeure

What are the requisites for natural disaster to be considered an exempting circumstance in case of loss or damage to goods?

a. The natural disaster is the proximate and only cause of the loss;
b. The common carrier should have exercised due diligence to prevent or minimize the loss before, during and after the occurrence of the natural disaster;
c. The common carrier should not incur in delay.[175]

It should be noted that fire is not one of those enumerated under the above provision which exempts a carrier from liability for loss or destruction of the goods. Since the peril of fire is not comprehended within the exceptions in Article 1734, then the common carrier shall be presumed to have been at fault or to have acted negligently, unless it proves that it has observed the extraordinary diligence required by law.[176]

In one case, it was held that monsoons, during which strong winds were not unusual, would not be sufficient to categorize the weather condition as a storm. When the loss of the vessel was caused not only by the southwestern monsoon but also by the shifting of the logs in the hold due to improper stowage, the defense of *force majeure* is unavailing.[177]

Hijacking of goods is likewise not considered a force majeure. Nevertheless, a common carrier may absolve itself of liability for a resulting loss caused by robbery or hijacking if it is proven that the robbery or hijacking was attended by grave or irresistible threat, violence or force.[178]

A shipment of electronic goods arrived at the Port of Manila for Sony Philippines, Inc. (Sony). Previous to the arrival, Sony had engaged the services of TMBI to facilitate, process, withdraw, and deliver the shipment from the port to its warehouse in Biñan. TMBI – who did not own any delivery trucks – subcontracted the services of BMT Trucking Services (BMT), to transport the shipment from the port to the Biñan warehouse. Four (4) BMT trucks picked up the shipment from the port. However, only three (3) trucks arrived at Sony's Biñan warehouse. The fourth truck driven by Rufo Reynaldo Lapesura was found abandoned.

Mitsui, the insurer, paid the claims and ran after TMBI. TMBI, however, denied being a common carrier because it does not own a single truck to transport its shipment and it does not offer transport services to the public for compensation and hence, it is not bound to observe extraordinary diligence. Furthermore, TMBI insists that the hijacking of the truck was a fortuitous event which should exonerate its liability.

a. Is TMBI is a common carrier?

Yes, TMBI is a common carrier. The delivery of the goods is an integral, albeit ancillary, part of its brokerage services. TMBI admitted that it was contracted to facilitate, process, and clear the shipments from the customs authorities, withdraw them from the pier, then

[175] Central Shipping Company v. Insurance Company of North America, G.R. No. 150751, September 20, 2004; Articles 1739 and 1740, Civil Code.

[176] DSR-Senator Lines v. Federal Phoenix Assurance Co., G.R. No. 135377, October 7, 2003; Eastern Shipping Lines v. Intermediate Appellate Court, G.R. Nos. L-69044 and L-71478, May 29, 1987.

[177] *Ibid.*

[178] Keihin-Everett Forwarding Co. v. Marine Malayan Insurance Corporation, *et al.,* G.R. No. 212107, January 28, 2019.

transport and deliver them to Sony's warehouse in Laguna. That TMBI does not own trucks and has to subcontract the delivery of its clients' goods, is immaterial. As long as an entity holds itself to the public for the transport of goods as a business, it is considered a common carrier regardless of whether it owns the vehicle used or has to actually hire one. Lastly, TMBI's customs brokerage services – including the transport/delivery of the cargo – are available to anyone willing to pay its fees.

b. Should TMBI be held liable for the hijacking of the truck?

TMBI is liable for the hijacking of the truck. Theft or the robbery of the goods is not considered a fortuitous event or a *force majeure*. Nevertheless, a common carrier may absolve itself of liability for a resulting loss: (1) if it proves that it exercised extraordinary diligence in transporting and safekeeping the goods; or (2) if it stipulated with the shipper/owner of the goods to limit its liability for the loss, destruction, or deterioration of the goods to a degree less than extraordinary diligence.

Instead of showing that it had acted with extraordinary diligence, TMBI simply argued that it was not a common carrier bound to observe extraordinary diligence. Its failure to successfully establish this premise carries with it the presumption of fault or negligence, thus rendering it liable to Sony/Mitsui for breach of contract.

c. Is BMT liable solidarily with TMBI to Mitsui?

No, BMT and TMBI are not solidarily liable to Mitsui. While the responsibility of two or more persons who are liable for quasi-delict is solidary under Article 2194 of the Civil Code, TMBI's liability to Mitsui does not stem from a quasi-delict but from its breach of contract. The tie that binds TMBI with Mitsui is contractual, albeit one that passed on to Mitsui as a result of TMBI's contract of carriage with Sony to which Mitsui had been subrogated as an insurer who had paid Sony's insurance claim.

BMT is not directly liable to Sony/Mitsui for the loss of the cargo. While it is undisputed that the cargo was lost under the actual custody of BMT (whose employee is the primary suspect in the hijacking or robbery of the shipment), no direct contractual relationship existed between Sony/Mitsui and BMT. If at all, Sony/Mitsui's cause of action against BMT could only arise from quasi-delict, as a third party suffering damage from the action of another due to the latter's fault or negligence.

However, TMBI must not absorb the loss. By subcontracting the cargo delivery to BMT, TMBI entered into its own contract of carriage with a fellow common carrier. Since BMT failed to prove that it observed extraordinary diligence in the performance of its obligation to TMBI, it is liable to TMBI for breach of their contract of carriage.[179]

In sum, TMBI is liable to Sony (subrogated by Mitsui) for breaching the contract of carriage. In turn, TMBI is entitled to reimbursement from BMT due to the latter's own breach of its contract of carriage with TMBI. The proverbial buck stops with BMT who may either: (a) absorb the loss, or (b) proceed after its missing driver, the suspected culprit.

Acts of public enemy

Who is a public enemy?

A public enemy is a citizen of another country against which the Philippine government is at war.

[179] Torres-Madrid Brokerage, Inc. v. Feb Mitsui Marine Insurance Co., Inc. and Benjamin P. Manalastas, doing business under the Name of BMT Trucking Services, G.R. No. 194121, July 11, 2016.

Acts or omission of shipper

Character of the goods or defect in packing

Because of spillage of the rice during the trip from Davao to Manila due to the bad condition of the sacks, there was a shortage in the rice delivered by the Provident Lines Inc. to the consignee XYZ Import and Export Corporation. The carrier accepted the shipment, knowing that the sacks had holes and some had broken strings. When sued, Provident Lines, Inc. alleged that the loss was caused by the spillage of the rice on account of the defective condition of the sacks, at the time it received the shipment, and therefore, it cannot be held liable. Decide. Give reasons.

The maritime carrier is liable. Where the fact of improper packing is known to the carrier or its servants, or apparent upon ordinary observations, but the carrier accepts the goods notwithstanding such conditions, it is not relieved of liability for loss or injury resulting therefrom.[180]

The rule is that if the improper packing or, in this case, the defect/s in the container, is/are known to the carrier or his employees or apparent upon ordinary observation, but he nevertheless accepts the same without protest or exception notwithstanding such condition, he is not relieved of liability for damage resulting therefrom. In this case Provident Lines, Inc. accepted the cargo without exception despite the apparent defects in some of the container vans. Hence, for a failure of Provident Lines, Inc. to prove that it exercised extraordinary diligence in the carriage of goods in this case or that it is exempt from liability, the presumption of negligence as provided under Article 1735 holds.[181]

Order of competent public authority

Y contracted the services of X to haul tons of scrap iron from Bataan to the port of Manila on board the lighter "Batman." Z sent his lighter to dock at Mariveles, where Y delivered the scrap irons for loading which also began on the same day. The Acting Mayor, together with three (3) policemen, ordered the dumping of the scrap iron where the lighter was docked and the rest to be brought to NASSCO compound. Is the intervention of the municipal officials considered a *force majeure* as to exempt the carrier from any liability?

No. The intervention of municipal officials was not in any case, of a character that would render impossible the fulfillment by the carrier of its obligation. The carrier was not duty bound to obey the illegal order to dump into the sea the scrap iron. Moreover, there is absence of sufficient proof that the issuance of the same order was attended with such force and intimidation as to completely overpower the will of the carrier's employees. The mere difficulty in the fulfillment of the obligation is not considered *force majeure*.[182]

In a contract of carriage for goods, when does the obligation to exercise extraordinary diligence commence and when does it end?

The extraordinary responsibility of the common carrier lasts from the time the goods are unconditionally placed in the possession of, and received by the carrier for transportation until the same are delivered, actually or constructively, by the carrier to the consignee, or to the person who has a right to receive them.[183]

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[180]Southern Lines, Inc. v. Court of Appeals, 4 SCRA 259; BAR 1978 and 1984.
[181]Virgines Calvo v. UCPB General Insurance, G.R. No. 148496, March 19, 2002.
[182]Mauro Ganzon v. Court of Appeals, G.R. No. L-48757, May 30, 1988.
[183]Article 1736, Civil Code.

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The carrier's liability as a common carrier begins with the actual delivery of the goods for transportation and not with the mere formal execution of a receipt or bill of lading because the issuance of such is not necessary to complete delivery and acceptance. Even where it is provided by statute that liability commences with the issuance of the bill of lading, actual delivery and acceptance are sufficient to bind the carrier.[184]

The fact that part of the shipment had not been loaded on board the lighter does not impair the contract of transportation as the goods remained in the custody and control of the carrier, albeit still unloaded.[185]

In one case, it was held that the receipt of the goods by the lighters (even if free of charge) is already deemed to be a receipt by the vessel even though the goods are not yet actually shipped. The receipt of goods by the carrier has been said to lie at the foundation of the contract to carry and deliver, and if actually no goods are received there can be no such contract. The liability and responsibility of the carrier under a contract for the carriage of goods commence on their actual delivery to, or receipt by, the carrier or an authorized agent. The delivery to a lighter in charge of a vessel for shipment on the vessel, where it is the custom to deliver in that way, is a good delivery and binds the vessel receiving the freight. The liability commences at the time of delivery to the lighter. Similarly, where there is a contract to carry goods from one port to another, and they cannot be loaded directly on the vessel and lighters are sent by the vessel to bring the goods to it, the lighters are for the time its substitutes, so that the bill of lading is applicable to the goods as soon as they are placed on the lighters.

In another case, it was held that the liability of a common carrier does not cease by mere transfer of custody of the cargo to the arrastre operator. Like the duty of seaworthiness, the duty of care of the cargo is non-delegable and the carrier is accordingly responsible for the acts of the master, the crew, the stevedore, and his other agents. The fact that a consignee is required to furnish persons to assist in unloading a shipment may not relieve the carrier of its duty as to such unloading. It is settled in maritime law jurisprudence that cargoes while being unloaded generally remain under the custody of the carrier. Since the damage to the cargo was incurred during the discharge of the shipment and while under the supervision of the carrier, the latter is liable for the damage caused to the cargo.[186]

The Supreme Court also ruled that when there is no dispute that the custody of the goods was never turned over to the consignee or his agents but was lost into the hands of unauthorized persons who secured possession thereof on the strength of falsified documents, the common carrier is liable.[187]

Does the obligation of a common carrier to exercise extraordinary diligence cease when the goods are turned over to the customs authorities?

The delivery to the customs authorities is not the delivery contemplated by Article 1736 because the owner cannot exercise dominion over them, it believes that the parties may agree to limit the liability of the carrier in connection therewith considering that the goods have still to go through the inspection of the customs authorities. The carrier losses control of the goods because of a custom regulation and it is unfair that it be made responsible for what may happen during the interregnum.

[184]Compania Maritima v. Insurance Company of North America, G.R. No. L-18965, October 30, 1964.

[185]Mauro Ganzon v. Court of Appeals, G.R. No. L-48757, May 30, 1988.

[186]Westwind Shipping Corporation v. UCPB General Insurance Co., G.R. No. 2002289, November 25, 2013.

[187]Nedlloyd Lijnen B.V. Rotterdam And The East Asiatic Co., Ltd. v. Glow Laks Enterprises, Ltd., G.R. No. 156330, November 19, 2014.

In the corresponding bill of lading, both the carrier and the consignee have stipulated to limit the responsibility of the former for the loss or damage that may occur to the goods before they are actually delivered. It appears that the carrier does not assume liability for any loss or damage once they have been taken into the custody of customs or other authorities or when they have been delivered at ship's tackle. These stipulations have been adopted precisely to mitigate the responsibility of the carrier considering the present law on the matter and the Court found nothing therein that is contrary to morals or public policy that may justify their nullification.[188]

X took the Benguet Bus from Baguio going to Manila. He deposited his *maleta* in the baggage compartment of the bus common to all passengers. He did not declare his baggage nor pay its charges contrary to the regulations of the bus company. When X got off, he could not find his *maleta* which obviously was taken by another passenger. Determine the liability of the bus company.

The bus company is liable for the loss of the *maleta*. The duty of extraordinary diligence in the vigilance over the goods is due on such goods as are deposited or surrendered to the common carrier for transportation. The fact that the *maleta* was not declared nor the charges paid thereon would not be consequential so long as it was received by the carrier for transportation.[189]

X delivered 10 boxes of goods in good order to the carrier. Y, the consignee, however, received the same in bad condition. No proof of negligence was offered by X or Y. Is the common carrier liable for damages?

Yes, mere proof delivery of the goods in good order to a common carrier and of their arrival in bad order at their destination constitutes a *prima facie* case of fault or negligence against the carrier. If no adequate explanation is given as to how the deterioration, loss, or destruction of the goods happened, the transporter shall be held responsible.[190]

South east Asia Container Line(SEACOL), a foreign company, received shipment of musical instruments from Australia for transportation to the port of Manila. The aforesaid shipment was insured with Insurance Company of North America(ICNA) against all risk in favor of the consignee, San Miguel Foundation (San Miguel).

Upon arriving in Manila, the container van was discharged from the vessel, and was received by Unitrans International Forwarders,Inc (Unitrans) which delivered the same to the consignee where it was found that two(2) units of musical instruments were damaged and could no longer be used. As cargo-insurer of the subject shipment, ICNA paid consignee and by reason thereof was subrogated to consignee's rights of recovery against SEACOL and Unitrans.

ICNA filed a complaint for collection of sum of money arising from marine insurance coverage on the two(2) musical instruments, against SEACOL and the unknown owner/charterer of the vessel M/S Buxcrown, both doing business in the Philippines through its local ship agent Unitrans.

Unitrans, denied being a ship agent of SEACOL, alleging that BTI Logistics PTY LTD. (BTI Logistics), a foreign freight forwarder, engaged its services as receiving agent in connection to the subject shipment. As such agent, Unitrans' obligations

[188]Lu Do & Lu Ym Corporation v. L.V. Binamira, G.R. No. L-9840, April 22, 1957.
[189]BAR 1989.
[190]Eastern Shipping Lines, Inc. v. BPI/MS Insurance Corporation and Mitsui Insurance Co., Ltd., G.R. No. 182864, January 12, 2015.

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were limited to receiving and handling the bill of lading sent to it by BTI Logistics, prepare an inward cargo manifest, notify the party indicated of the arrival of the subject shipment, and release the bill of lading upon order of the consignee so that the subject shipment could be withdrawn from the pier/customs. It further alleged that San Miguel engaged its services as customs broker for the subject shipment. As such, Unitrans' obligation was limited to paying on behalf of San Miguel the necessary duties and kindred fees, file with the Bureau of Customs (BOC) the Import Entry Internal Revenue Declaration together with other pertinent documents, as well as to pick up the shipment and then transport and deliver the said shipment to the consignee's premises in good condition.

Is Unitrans liable for the damaged shipment?

YES. Unitrans, as a common carrier, cannot escape liability

Unitrans had expressly admitted that San Miguel also engaged its services as customs broker for the subject shipment; one of its obligations was to pick up the shipment and then transport and deliver the same to the consignee's premises in good condition.

Emphasis must be placed on the fact that Unitrans itself admitted that in handling the subject shipment and making sure that it was delivered to the consignee's premises in good condition as the delivery/forwarding agent, Unitrans was acting as a freight forwarding entity and an accredited non-vessel operating common carrier.

Jurisprudence holds that a common carrier is presumed to have been negligent if it fails to prove that it exercised extraordinary vigilance over the goods it transported. When the goods shipped are either lost or arrived in damaged condition, a presumption arises against the carrier of its failure to observe that diligence, and there need not be an express finding of negligence to hold it liable. To overcome the presumption of negligence, the common carrier must establish by adequate proof that it exercised extraordinary diligence over the goods. It must do more than merely show that some other party could be responsible for the damage.

In the instant case, considering that it is undisputed that the subject goods were severely damaged, the presumption of negligence on the part of the common carrier, i.e., Unitrans, arose. Hence, it had to discharge the burden, by way of adequate proof, that it exercised extraordinary diligence over the goods; it is not enough to show that some other party might have been responsible for the damage. Unitrans failed to discharge this burden. Hence, it cannot escape liability.[191]

Pasahero, a paying passenger, boarded a Victory Liner bus bound for Olongapo. He chose a seat at the front near the bus driver. Pasahero told the bus driver that he had valuable items in his bag which was placed near his feet. Since he had not slept 24 hours, he requested the driver to keep an eye on the bag should he doze off during the trip.

a) **While Pasahero was asleep, another passenger took the bag away and alighted at Guagua, Pampanga. Is Victory Liner liable to Pasahero? Explain.**
b) **Supposing two (2) armed men staged a hold-up while the bus was speeding along the North Expressway. One of them pointed a gun at Pasahero and stole not only his bag but also his wallet as well. Is Victory Liner liable to Pasahero? Explain.**

[191] Unitrans International Forwarders, Inc. v. Insurance Company of North America, G.R. No. 203865, March 13, 2019. J. Caguioa

a) The responsibility of common carriers in the case of loss or damage to hand-carried baggage is governed by the rule on necessary deposits. The common carrier is thus liable for the loss of the personal property caused by its employees or by strangers.
b) The use of arms (in the staging of the holdup) is *force majeure* under the rule on necessary deposits. Accordingly, Pasahero may not hold Victory Liner liable.[192]

2. SAFETY OF PASSENGERS

What is the diligence required for common carriers in the carriage of its passengers?

A common carrier is bound to carry its passengers safely as far as human care and foresight can provide, using the utmost diligence of very cautious persons, with due regard to all the circumstances. In a contract of carriage, it is presumed that the common carrier was at fault or was negligent when a passenger dies or is injured. Unless the presumption is rebutted, the court need not even make an express finding of fault or negligence on the part of the common carrier. This statutory presumption may only be overcome by evidence that the carrier exercised extraordinary diligence.[193]

In the carriage of passengers, when does the obligation to exercise extraordinary diligence commence and when does it end?

Utmost diligence starts once the passenger places himself to, and is accepted by, and while he remains under the proper care and charge of the carrier. It lasts until such time that the passenger safely alights from and is given reasonable opportunity to leave the premises of the common carrier, including such time that he looks for and claims his luggage.

For the light rail transit system of transportation, it was held that a contract of carriage was created from the moment the passenger paid the fare at the LRT station and entered the premises of the latter, entitling him/her to all the rights and protection under a contractual relation.[194]

A and her child boarded the train of Manila Railroad Company. Upon approaching Barrio Lagalag, the train slowed down and the conductor shouted "Lusacan, Lusacan!", despite the fact that the next stop was still three (3) minutes away. A walked towards the train exit carrying her child with one hand and holding her baggage with the other. When they were near the door, the train suddenly picked up speed. A and her child stumbled from the train causing them to fall down the tracks and were hit by an oncoming train, causing their instant death. Is Manila Railroad Company liable?

Yes. It is a matter of common knowledge and experience about common carriers like trains and buses that before reaching a station or flagstop they slow down and the conductor announces the name of the place. It is also a matter of common experience that as the train or bus slackens its speed, some passengers usually stand and proceed to the nearest exit, ready to disembark as the train or bus comes to a full stop. This is especially true of a train because passengers feel that if the train resumes its run before they are able to disembark, there is no way to stop it as a bus may be stopped.

It was negligence on the conductor's part to announce the next flag stop when said stop was still a full three (3) minutes ahead. That the announcement was premature and erroneous is shown by the fact that immediately after the train slowed down, it unexpectedly

[192] BAR 1986.
[193] Victory Liner, Inc. v. Rosalito Gammad, G.R. No. 159636, November 25, 2004; Articles 1755 and 1756, NCC.
[194] Light Rail Transit Authority v. Marjorie Navidad, G.R. No. 145804, February 6, 2003.

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accelerated to full speed. Manila Railroad Company failed to show any reason why the train suddenly resumed its regular speed. The announcement was made while the train was still in Barrio Lagalag. This announcement prompted the victims to stand and proceed to the nearest exit. Without said announcement, the victims would have been safely seated in their respective seats when the train jerked as it picked up speed.[195]

A bus of GL Transit on its way to Davao stopped to enable a passenger to alight. At that moment, Santiago, who had been waiting for a ride, boarded the bus. However, the bus driver failed to notice Santiago who was still standing on the bus platform, and stepped on the accelerator. Because of the sudden motion, Santiago slipped and fell down, suffering serious injuries.

May Santiago hold GL Transit liable for breach of contract of carriage? Explain.

Santiago may hold GL liable for breach of contract of carriage. It was the duty of the driver, when he stopped the bus, to do no act that would have the effect of increasing the peril to a passenger such as Santiago while he was attempting to board the same. When a bus is not in motion there is no necessity for a person who wants to ride the same to signal his intention to board. A public utility bus, once it stops, is in effect making a continuous offer to bus riders. It is the duty of common carriers of passengers to stop their conveyances for a reasonable length of time in order to afford passengers an opportunity to board and enter, and they are liable for injuries suffered by boarding passengers resulting from the sudden starting up or jerking of their conveyances while they are doing so. Santiago, by stepping and standing on the platform of the bus, was already considered a passenger and was entitled to all the rights and protection pertaining to a contract of carriage.[196]

The father returned to the bus to get one of his baggages which was not unloaded when they alighted from the bus. Racquel, his child, followed him. However, although the father was still on the running board of the bus waiting for the conductor to hand him the bag or *bayong*, the bus started to run. Raquel was run over and killed. Is the bus operator still liable as a common carrier?

Yes. The relation of carrier and passenger does not cease at the moment the passenger alights from the carrier's vehicle at a place selected by the carrier at the point of destination, but continues until the passenger has had a reasonable time or a reasonable opportunity to leave the carrier's premises. And, what is a reasonable time or a reasonable delay within this rule is to be determined from all the circumstances. It cannot be claimed that the carrier's agent had exercised the "utmost diligence" of a "very cautious person" required by Article 1755 of the Civil Code to be observed by a common carrier in the discharge of its obligation to transport safely its passengers. The presence of said passengers near the bus was not unreasonable and they are, therefore, to be considered still as passengers of the carrier, entitled to the protection under their contract of carriage.[197]

An hour after the passengers and Viana had disembarked the vessel, the crane operator began its unloading operation. While the crane was being operated, Viana who had already disembarked the vessel remembered that some of his cargoes were still loaded there. He went back and while he was pointing to the crew where his cargoes were, the crane hit him resulting in his death. A complaint for damages was filed against Aboitiz Shipping Lines (Aboitiz) for breach of contract of carriage. Aboitiz contends that Viana ceased to be a passenger when he disembarked the

[195]Clemente Brinas v. People of the Philippines, G.R. No. L-30309, November 25, 1983.
[196]BAR 1996.
[197]La Mallorca v. Court of Appeals, G.R. No. L-20761, July 27, 1966.

vessel and that consequently his presence there was no longer reasonable. Is Aboitiz still liable as a common carrier?

Yes. The rule is that the relation of carrier and passenger continues until the passenger has been landed at the port of destination and has left the vessel owner's dock or premises. Once created, the relationship will not ordinarily terminate until the passenger has, after reaching his destination, safely alighted from the carrier's conveyance or had a reasonable opportunity to leave the carrier's premises. All persons who remain on the premises within a reasonable time after leaving the conveyance are to be deemed passengers, and what is a reasonable time or a reasonable delay within this rule is to be determined from all the circumstances, and includes a reasonable time to see after his baggage and prepare for his departure. It is of common knowledge that, by the very nature of the business of a shipper, the passengers of vessels are allotted a longer period of time to disembark from the ship than the passengers of other common carriers considering the bulk of cargoes and the number of passengers it can load. Consequently, such passenger will need at least an hour to disembark from the vessel and claim his baggage. In the case at bar, when the accident occurred, the victim was in the act of unloading his cargoes which he had every right to do. As such, even if he had already disembarked an hour earlier, his presence in the carrier's premises was not without cause.

While the victim was admittedly contributorily negligent, still Aboitiz's aforesaid failure to exercise extraordinary diligence was the proximate and direct cause of, because it could definitely have prevented, the former's death.[198]

Is a common carrier liable for the death of or injuries to passengers through the acts of its employees?

Yes, common carriers are liable for the death of or injuries to passengers through the negligence or willful acts of the former's employees, although such employees may have acted beyond the scope of their authority or in violation of the orders of the common carriers.[199]

What is the basis of liability of a common carrier for injuries of passengers committed by its employees?

As can be gleaned from Article 1759, the Civil Code of the Philippines evidently follows the rule based on the principle that it is the carrier's implied duty to transport the passenger safely. At least three (3) very cogent reasons underlie this rule: (1) the special undertaking of the carrier requires that it furnish its passenger that full measure of protection afforded by the exercise of the high degree of care prescribed by the law, *inter alia*, from violence and insults at the hands of strangers and other passengers, but above all, from the acts of the carrier's own servants charged with the passenger's safety; (2) said liability of the carrier for the servant's violation of duty to passengers, is the result of the formers confiding in the servant's hands the performance of his contract to safely transport the passenger, delegating therewith the duty of protecting the passenger with the utmost care prescribed by law; and (3) as between the carrier and the passenger, the former must bear the risk of wrongful acts or negligence of the carrier's employees against passengers, since it, and not the passengers, has power to select and remove them.

Accordingly, it is the carrier's strict obligation to select its drivers and similar employees with due regard not only to their technical competence and physical ability, but also, no less

[198]Aboitiz Shipping Corporation v. Court of Appeals, G.R. No. 84458, November 6, 1989.
[199]Article 1759, NCC.

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important, to their total personality, including their patterns of behavior, moral fibers, and social attitude.[200]

The carrier was made liable in the foregoing case after his driver stabbed and killed the passenger despite the assertion that the driver acted in self-defense against the passenger who made the assault first.

City Railways, Inc. (CRI) provides train services, for a fee, to commuters from Manila to Calamba, Laguna. Commuters are required to purchase tickets and then proceed to designated loading and unloading facilities to board the train. Ricardo Santos purchased a ticket for Calamba and entered the station. While waiting, he had an altercation with the security guard of CRI leading to a fistfight. Ricardo Santos fell on the railway just as the train was entering the station. Ricardo Santos was run over by the train. He died. In the action for damages filed by the heirs of Ricardo Santos, CRI interposed lack of cause of action, contending that the mishap occurred before Ricardo Santos boarded the train and that it was not guilty of negligence. Decide.

CRI is liable. A contract of carriage was created from the moment Ricardo paid the fare at the train station and entered the premises of the latter, entitling Ricardo to all the rights and protection under a contractual relation. CRI is liable for the death of Ricardo in failing to exercise extraordinary diligence imposed upon a common carrier. The law requires common carriers to carry passengers safely using the utmost diligence of very cautious persons with due regard for all circumstances. Such duty of a common carrier to provide safety to its passengers obligates it not only during the course of the trip but for so long as the passengers are within its premises and where they ought to be in pursuance to the contract of carriage. Furthermore, a common carrier is liable for the death of or injuries to passengers through the negligence or willful act of its employees or agents that it contracted with.[201]

What is the liability of the common carrier for death or injuries to passengers caused by other passengers and/or strangers?

A common carrier is responsible for injuries suffered by a passenger on account of the willful acts or negligence of other passengers or of strangers, if the common carrier's employees through the exercise of the diligence of a good father of a family could have prevented or stopped the act or omission.[202]

The contributory negligence of the passenger does not bar recovery of damages for his death or injuries, if the proximate cause thereof is the negligence of the common carrier, but the amount of damages shall be equitably reduced.[203]

Battung boarded a bus in Isabela bound for Manila. He was seated at the first row behind the driver and slept during the ride. When the bus reached Nueva Ecija, the bus driver stopped the bus and alighted to check the tires. At this point, a man who was seated at the fourth row of the bus stood up, shot Battung at his head resulting in his death. Should the common carrier be liable for the death of the victim?

No. The law requires the highest degree of diligence from common carriers in the safe transport of their passengers and creates a presumption of negligence against them.

[200]Maranan v. Perez, *et al.*, G.R. No. L-22272, June 26, 1967; BAR 2011.
[201]Light Rail Transit Authority and Rodolfo Roman v. Marjorie Navidad, *supra.* BAR 2008.
[202]Article 1763, NCC.
[203]Article 1762, NCC.

It does not, however, make the carrier an insurer of the absolute safety of its passengers. Further, during the ride, the driver and the conductor observed nothing which would rouse their suspicion that the men were armed or were about to carry out an unlawful activity. With no such indication, there was no need for them to conduct a more stringent search (*i.e.*, bodily search) on the aforesaid men. By all accounts, therefore, it cannot be concluded that the common carrier or any of its employees failed to employ the diligence of a good father of a family.[204]

Mariter, a paying bus passenger, was hit above her left eye by a stone hurled at the bus by an unidentified bystander as the bus was speeding through the National Highway. The bus owner's personnel lost no time in bringing Mariter to the provincial hospital where she was confined and treated.

Mariter wants to sue the bus company for damages and seeks your advice whether she can legally hold the bus company liable?

Mariter cannot legally hold the bus company liable. There is no showing that any such incident previously happened so as to impose an obligation on the part of the personnel of the bus company to warn the passengers and to take the necessary precautions. Such hurling of a stone constitutes a fortuitous event in this case. The bus company is not an insurer of the absolute safety of its passengers.[205]

Similarly, a tort committed by a stranger which causes injury to a passenger does not accord the latter a cause of action against the carrier. The negligence for which a common carrier is held responsible is the negligent omission by the carrier's employees to prevent the tort from being committed when the same could have been foreseen and prevented by them.[206]

In one case, the passenger argued that the carrier could have prevented the injury if something like mesh-work grills had covered the windows of its bus but the Court found the same untenable. Although the suggested precaution could have prevented the injury, the rule of ordinary care and prudence is not so exacting as to require one charged with its exercise to take doubtful or unreasonable precautions to guard against unlawful acts of strangers. Where the carrier uses cars of the most approved type used generally by others engaged in the same occupation, and exercises a high degree of care in maintaining them in suitable condition, the carrier cannot be charged with negligence in this respect.[207]

A bus of Fortune Express, Inc. (FEI) figured in an accident with a jeepney which resulted in the death of several passengers including two (2) Maranaos. It was found out that a Maranao owns said jeepney and certain Maranaos planned to take revenge by burning some of FEI's buses. The operations manager of FEI was advised by an agent of the Philippine Constabulary to take precautionary measures, however, three (3) armed Maranaos were able to seize a bus of FEI and set it on fire, causing the death of its passenger. Is FEI exempt from liability?

No. Despite the report of the Philippine Constabulary agent that the Maranaos were going to attack its buses, FEI took no steps to safeguard the lives and properties of its passengers. The seizure of the bus of FEI was foreseeable and, therefore, was not a fortuitous event which would exempt petitioner from liability.[208]

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[204]G.V. Florida Transport, Inc. v. Heirs of Romeo L. Battung, Jr., Represented By Romeo Battung, Sr., G.R. No. 208802, October 14, 2015.

[205]BAR 1994.

[206]Jose Pilapil v. Court of Appeals, G.R. No. 52159, December 22, 1989.

[207]*Ibid.*

[208]Fortune Express, Inc. v. Court of Appeals, G.R. No. 119756, March 18, 1999.

A passenger at the rear portion of the bus owned by Bachelor Express, Inc. suddenly stabbed a Philippine Constabulary soldier. Because of the commotion and panic inside the bus, passengers Beter and Rautraut jumped off the bus causing their death. Bachelor Express, Inc. denies liability arguing that the death of the said passengers was caused by a third person who was beyond its control and supervision. Is Bachelor Express, Inc. correct?

No. Considering that the bus driver did not immediately stop the bus at the height of the commotion; the bus was speeding from a full stop; the victims fell from the bus door when it was opened or gave way while the bus was still running; the conductor panicked and blew his whistle after people had already fallen off the bus; and the bus was not properly equipped with doors in accordance with law, it is clear that Bachelor Express, Inc. failed to overcome the presumption of fault and negligence found in the law governing common carriers. It failed to prove that the deaths of the two (2) passengers were exclusively due to *force majeure* and not to the failure to observe extraordinary diligence in transporting safely the passengers to their destinations as warranted by law.[209]

C. Defenses available to a common carrier

1. Proof of negligence

In a court case involving claims for damages arising from death and injury of bus passengers, counsel for the bus operator filed a demurrer to evidence arguing that the complaint should be dismissed because the plaintiffs did not submit any evidence that the operator or its employees were negligent. If you were the judge, would you dismiss the complaint?

No. In the carriage of passengers, the failure of the common carrier to bring the passengers safely to their destination immediately raises the presumption that such failure is due to the carrier's fault or negligence. It is not the burden of the aggrieved passenger to establish such fault or negligence. The carrier instead must rebut such presumption. Otherwise, the conclusion can be properly made that the carrier failed to exercise extraordinary diligence as required by law.[210]

What is the effect of a stipulation regarding the exercise of diligence to less than extraordinary?

In the carriage of goods, the carrier and shipper may agree on the observance of diligence to a degree less than extraordinary (but not total exemption nor diligence less than ordinary) provided the stipulation is: (1) in writing; (2) supported by a valuable consideration other than the service rendered by the carrier; and (3) reasonable, just, and not contrary to public policy.[211]

When is the obligation of the common carrier to observe extraordinary diligence in the carriage of goods reduced to ordinary diligence?

The obligation of the common carrier to observe extraordinary diligence in the carriage of goods is reduced to ordinary diligence in the following cases:

a) When the seller exercised his right of stoppage in transit;[212]

[209]Bachelor Express, Incorporated, and Cresencio Rivera v. Court of Appeals, G.R. No. 85691, July 31, 1990.
[210]BAR 1997.
[211]Articles 1744-1745[3], NCC.
[212]Article 1737, NCC.

b) If there is stipulation between the shipper and the carrier, subject to the conditions stated above;
c) For hand-carried baggage.[213]
d) If the loss, destruction, or deterioration of the goods should be caused by the character of the goods, or the faulty nature of the packing or of the containers, the common carrier is only required to exercise due diligence to forestall or lessen the loss.[214]

What is the liability of a common carrier for baggage of passengers?

If the baggage is in the custody of the common carrier (checked-in), the latter is obliged to observe extraordinary diligence. The presumption of negligence applies against the common carrier. Articles 1733 to 1753 of the Civil Code apply.[215]

But if the baggage is in the custody of the passenger (hand-carried), the carrier is liable as a depositary provided that (a) notice was given to him or his employees; and (b) the passenger took the necessary precautions which the carrier had advised relative to the care and vigilance of the baggage. The baggage in transit is deemed as a necessary deposit. The diligence required of the carrier/depositary is merely ordinary diligence. In case of loss owing to the fault of the passenger, the carrier will not be held liable.[216]

2. Due diligence in the selection and supervision of employees
3. Fortuitous event

Spouses Tumboy and their minor children boarded Yobido Liner bus. While on the trip, the left front tire of the bus exploded. The bus fell into a ravine and got stuck to a tree. The incident resulted in the death of Spouses Tumboy and injuries to other passengers. Yobido Liner argued that it was not liable for the tire blow-out because the tire was new and was installed onto the bus just five (5) days before the incident. Thus, its blow-out was unforeseeable. Is the tire blow-out a fortuitous event?

No. A fortuitous event is possessed of the following characteristics:

a. The cause of the unforeseen and unexpected occurrence, or the failure of the debtor to comply with his obligations, must be independent of human will;
b. It must be impossible to foresee the event which constitutes the *caso fortuito*, or if it can be foreseen, it must be impossible to avoid;
c. The occurrence must be such as to render it impossible for the debtor to fulfill his obligation in a normal manner; and
d. The obligor must be free from any participation in the aggravation of the injury resulting to the obligee.

Under the circumstances of this case, the explosion of the new tire may not be considered a fortuitous event. There are human factors involved in the situation. The fact that the tire was new did not imply that it was entirely free from manufacturing defects or that it was properly mounted on the vehicle. Neither may the fact that the tire bought and used in the vehicle is of a brand name noted for quality, resulting in the conclusion that it could not explode within five (5) days use. Be that as it may, it is settled that an accident caused either by defects in the automobile or through the negligence of its driver is not a *caso fortuito* that would exempt the carrier from liability for damages.

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[213]Article 1754, NCC.
[214]Article 1742, Civil Code.
[215]Article 1754, NCC.
[216]*Supra.*

Moreover, a common carrier may not be absolved from liability in case of *force majeure* or fortuitous event alone. The common carrier must still prove that it was not negligent in causing the death or injury resulting from an accident. While it may be true that the tire that blew-up was still good condition because the grooves of the tire were still visible, this fact alone does not make the explosion of the tire a fortuitous event. No evidence was presented to show that the accident was due to adverse road conditions or that precautions were taken by the jeepney driver to compensate for any conditions liable to cause accidents.[217]

4. **Contributory negligence**

What is the effect of contributory negligence on the part of the shipper in case of loss or damage to his goods?

If the shipper or owner merely contributed to the loss, destruction, or deterioration of the goods, the proximate cause thereof being the negligence of the common carrier, the latter shall be liable in damages, which however, shall be equitably reduced.[218]

On the other hand, even if the loss, destruction, or deterioration of the goods should be caused by the character of the goods, or the faulty nature of the packing or of the containers, the common carrier must exercise due diligence to forestall or lessen the loss.[219]

Tupang boarded a train as a paying passenger bound for Manila. Unfortunately, upon passing Iyam Bridge at Lucena, Quezon, Tupang fell off the train resulting in his death. The train did not stop despite the alarm raised by the other passengers that somebody fell from the train. Instead, the train conductor called the station agent and requested for verification of the information. Police authorities of Lucena City were dispatched to the Iyam Bridge where they found the lifeless body of Tupang. The train company denied liability and argued that it was the passenger who opted to sit in the open platform which led to his falling off from the train. Is the train company correct?

No. The train company has the obligation to transport its passengers to their destinations and to observe extraordinary diligence in doing so. Death or any injury suffered by any of its passengers gives rise to the presumption that it was negligent in the performance of its obligation under the contract of carriage. Thus, it failed to overthrow such presumption of negligence with clear and convincing evidence.

But while the train company failed to exercise extraordinary diligence as required by law, it appears that the deceased was chargeable with contributory negligence. Since he opted to sit on the open platform between the coaches of the train, he should have held tightly and tenaciously on the upright metal bar found at the side of said platform to avoid falling off from the speeding train. Such contributory negligence, while not exempting the PNR from liability, nevertheless justified the deletion of the amount adjudicated as moral damages.[220]

5. **Doctrine of last clear chance**

X is a passenger of RJT Bus Company who suffered injuries due to the collision of the bus he was riding with a jeepney. X sued RJT Bus Company for damages. RJT Bus

[217]Alberta Yobido v. Court of Appeals, G.R. No. 113003, October 17, 1997.
[218]Article 1741, Civil Code.
[219]Article 1742, Civil Code.
[220]Philippine National Railways v. Court of Appeals, G.R. No. L-55347, October 4, 1987.

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Company invokes as a defense that it was the jeepney that had the last clear chance to avoid the injury. Hence, the bus company cannot be held liable. Is the principle of last clear chance applicable?

No. The principle of last clear chance applies only in a suit between owners and drivers of two colliding vehicles. It does not arise where a passenger demands responsibility from the carrier to enforce its contractual obligations, for it would be inequitable to exempt the negligent driver and its owner on the ground that the other driver was likewise guilty of negligence.[221]

Both the tortfeasor and the common carrier are jointly and severally liable for damages of the injuries caused to X.[222]

D. Extent of liability for damages

1. Recoverable damages

What is the extent of damages awarded in case of death or injury among the passengers?

Article 1764 in relation to Article 2206 of the Civil Code, holds the common carrier in breach of its contract of carriage for the death of a passenger, and it is liable to pay the following: (1) indemnity for death, (2) indemnity for loss of earning capacity, and (3) moral damages.[223]

In determining the reasonableness of the damages awarded under Article 1764 in conjunction with Article 2206 of the Civil Code, the factors to be considered are: (1) life expectancy (considering the health of the victim and the mortality table which is deemed conclusive) and loss of earning capacity; (b) pecuniary loss, loss of support and service; and (c) moral and mental sufferings. The loss of earning capacity is based mainly on the number of years remaining in the person's expected life span. In turn, this number is the basis of the damages that shall be computed and the rate at which the loss sustained by the heirs shall be fixed.

The formula for the computation of loss of earning capacity is as follows:

Net earning capacity = Life expectancy × [Gross Annual Income – Living Expenses (50% of gross annual income)], where life expectancy = 2/3 (80 – the age of the deceased).[224]

Thus, if prior to his death at the age of 60 years old, he was earning P10 million gross income, his loss of earning capacity is computed as follows:

Life expectancy = 2/3 × 80 – 60 = 13.33 × (P10 million – P5 million or P5 million) = P66,666,666.70 million.

Although as a general rule, documentary evidence is required to prove loss of earning capacity, there are two exceptions to this general rule and the injured passenger's testimonial evidence falls under the second exception, viz.:

[221] William Tiu v. Pedro Arriesgado, G.R. No. 138060, September 1, 2004.
[222] *Ibid.*
[223] Victory Liner, Inc. v. Rosalito Gammad, G.R. No. 159636, November 25, 2004.
[224] Smith Bell Dodwell Shipping Agency Corp. v. Borja, G.R. No. 143008, June 10, 2002.

By way of exception, damages for loss of earning capacity may be awarded despite the absence of documentary evidence when (1) the deceased is self-employed earning less than the minimum wage under current labor laws, and judicial notice may be taken of the fact that in the deceased's line of work no documentary evidence is available; or (2) the deceased is employed as a daily wage worker earning less than the minimum wage under current labor laws.

Loss of earning capacity should be computed not at the time the injured passenger testified about his injury but at the time he sustained it. [225]

2. **Stipulations limiting liability**

Carriage of goods

Cite stipulations in a contract of carriage which are considered unreasonable, unjust, and contrary to public policy.

Any of the following or similar stipulations shall be considered unreasonable, unjust, and contrary to public policy:

a. That the goods are transported at the risk of the owner or shipper;
b. That the common carrier will not be liable for any loss, destruction, or deterioration of the goods;
c. That the common carrier need not observe any diligence in the custody of the goods;
d. That the common carrier shall exercise a degree of diligence less than that of a good father of a family, or of a man of ordinary prudence in the vigilance over the movables transported;
e. That the common carrier shall not be responsible for the acts or omission of his or its employees;
f. That the common carrier's liability for acts committed by thieves, or of robbers who do not act with grave or irresistible threat, violence, or force, is dispensed with or diminished;
g. That the common carrier is not responsible for the loss, destruction, or deterioration of goods on account of the defective condition of the car, vehicle, ship, airplane, or other equipment used in the contract of carriage.[226]

May a common carrier limit its liability to a fixed amount in case of loss or damage to goods?

A contract fixing the sum that may be recovered by the owner or shipper for the loss, destruction, or deterioration of the goods is valid, if it is reasonable and just under the circumstances, and has been fairly and freely agreed upon.[227]

The fact that the common carrier has no competitor along the line or route, or a part thereof, to which the contract refers shall be taken into consideration on the question of whether or not a stipulation limiting the common carrier's liability is reasonable, just, and in consonance with public policy.[228]

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[225] Jose Sanico v. Werhelina Colipano, G.R. No. 209969, September 27, 2017
[226] Article 1745, NCC.
[227] Article 1750, NCC.
[228] Article 1751, NCC.

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May a common carrier limit its liability to the value of the goods?

Yes, a stipulation that the common carrier's liability is limited to the value of the goods appearing in the bill of lading, unless the shipper or owner declares a greater value, is binding.[229]

Pursuant to such provision, where the shipper is silent as to the value of his goods, the carrier's liability for loss or damage thereto is limited to the amount specified in the contract of carriage and where the shipper states the value of his goods, the carrier's liability for loss or damage thereto is limited to that amount. A stipulation in a contract of carriage that the carrier will not be liable beyond a specified amount unless the shipper declares the goods to have a greater value is generally deemed to be valid and will operate to limit the carrier's liability, even if the loss or damage results from the carrier's negligence. It is the duty of the shipper to disclose, rather than the carrier's to demand the true value of the goods and silence on the part of the shipper will be sufficient to limit recovery in case of loss to the amount stated in the contract of carriage.[230]

What are the usual stipulations often made in a bill of lading regarding the liability of the common carrier?

Three (3) kinds of stipulations have often been made in a bill of lading. The first is one exempting the carrier from any and all liability for loss or damage occasioned by its own negligence. The second is one providing for an unqualified limitation of such liability to an agreed valuation. And the third is one limiting the liability of the carrier to an agreed valuation unless the shipper declares a higher value and pays a higher rate of freight. According to an almost uniform weight of authority, the first and second kinds of stipulations are invalid as being contrary to public policy, but the third is valid and enforceable.[231]

A stipulation limiting the sum that may be recovered by the shipper or owner to 90% of the value of the goods in case of loss due to theft is void. Such stipulation is considered unreasonable, unjust, and contrary to public policy under Article 1745 of the Civil Code.[232]

Martin Nove shipped an expensive video equipment to a friend in Cebu. Martin had bought the equipment from Hong Kong for U.S. $5,000.00. The equipment was shipped through M/S Lapu-Lapu under a bill of lading which contained the following provision in big bold letters:

"The limit of the carrier's liability for any loss or damage to cargo shall be P200 regardless of the actual value of such cargo, whether declared by shipper or otherwise."

The cargo was totally damaged before reaching Cebu. Martin Nove claimed for the value of his cargo ($5,000.00 or about P100,000.00) instead of just P200.00 as per the limitation on the bill of lading.

Is there any legal basis for Nove's claim?

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[229]Article 1749, NCC.

[230]Eastern and Australian Steamship Co., Ltd. v. Great American Insurance Co., G.R. No. L-37604, October 23, 1981.

[231]Loadstar Shipping Co. v. Court of Appeals, G.R. No. 131621, September 28, 1999.

[232]BAR 2002.

There is legal basis for the claim of Martin Nove. The stipulation limiting the carrier's liability up to a certain amount "regardless of the actual value of such cargo, whether declared by its shipper or otherwise," is violative of the requirement of the Civil Code that such limiting stipulations should be fairly and freely agreed upon.[233] A stipulation that denies to the shipper the right to declare the actual value of his cargoes and to recover, in case of loss or damage, on that basis would be invalid.[234]

Sylvex Purchasing Corporation delivered to Unsworth Transport International (UTI) a shipment of 27 drums of various raw materials for pharmaceutical manufacturing. UTI issued a Bill of Lading covering the aforesaid shipment. The shipment arrived at the port of Manila wherein it was later found to be damaged.

The rejected UTI's claim that its liability should be limited to $500.00 per package pursuant to the Carriage of Goods by Sea Act (COGSA) considering that the value of the shipment was declared pursuant to the letter of credit and the *pro forma* invoice.

Is UTI liable for the value of the goods not stated in the bill of lading?

No, UTI is liable only for $500.00 per package. Sylvex did not declare a higher valuation of the goods to be shipped. The insertion of an invoice number in the bill of lading does not in itself sufficiently and convincingly show that the common carrier had knowledge of the value of the cargo.[235]

In a similar case, it was held that the insertion of the words "L/C No. 90/02447," cannot be the basis for the carriers' liability. First, a notation in the Bill of Lading which indicated the amount of the Letter of Credit obtained by the shipper for the importation of steel sheets did not effect a declaration of the value of the goods as required by the bill.[236]

However, in another case, it was ruled that the declaration requirement does not require that all the details must be written down on the very bill of lading itself. Compliance can be attained by incorporating the invoice, by way of reference, to the bill of lading provided that the former containing the description of the nature, value and/or payment of freight charges is duly admitted as evidence.[237]

To summarize, the insertion of an invoice number or reference to a letter of credit does not in itself sufficiently and convincingly show that the common carrier had knowledge of the value of the cargo. As such, it does not amount to a higher declaration of the value of the goods. However, the same interpretation does not apply if the bill of lading incorporates the invoice value of the goods with appropriate description thereof and payment of corresponding freight charges.[238]

X took a plane from Manila bound for Davao via Cebu where there was a change of planes. X arrived in Davao safely but to his dismay, his two (2) suitcases were left behind in Cebu. The airline company assured X that the suitcases would come in the next flight, but they never did.

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[233]Articles 1749-1750, Civil Code.

[234]BAR 1987.

[235]Unsworth Transport International v. Court of Appeals, G.R. No. 166250, July 26, 2010.

[236]Philam Insurance Company v. Heung Ah Shipping Corporation and Wallem Shipping Inc., G.R. No. 18771 and G.R. No. 187812, July 23, 2014

[237]Eastern Shipping Lines, Inc. v. BPI/MS Insurance Corp., & Mitsui Sumitomo Insurance Co., Ltd., G.R. No. 182864, January 12, 2015.

[238]Bar 1998.

X claimed P2,000.00 for the loss of both suitcases, but the airline was willing to pay only P500.00 because the airline ticket stipulated that unless a higher value was declared, any claim for the loss cannot exceed P250.00 for each piece of luggage. X however reasoned out that he did not sign the stipulation and in fact had not even read it.

X did not declare a greater value despite the fact that the clerk had called his attention to the stipulation in the ticket. Decide the case.

Even if he did not sign the ticket, X is bound by the stipulation that any claim for loss cannot exceed P250.00 for each luggage. He did not declare a higher value. Thus, X is only entitled to P500.00 for the two (2) luggage lost.[239]

Carriage of passengers

Cite stipulations that are considered void in a contract of carriage for passengers.

a. Stipulation where the responsibility of the common carrier for the safety of its passengers is dispensed with or lessened by stipulation, by the posting of notices, by statements on the ticket, or otherwise.[240]
b. Stipulation limiting the liability for willful acts or gross negligence.[241]

When a passenger is carried gratuitously, a stipulation limiting the common carrier's liability for negligence is valid, but not for willful acts or gross negligence.[242]

The reduction of fare does not justify any limitation of the common carrier's liability.[243]

Suppose "A" was riding on an airplane of a common carrier when the accident happened and "A" suffered serious injuries. In an action by "A" against the common carrier, the latter claimed that (1) there was a stipulation in the ticket issued to "A" absolutely exempting the carrier from liability from the passenger's death or injuries and notices were posted by the common carrier dispensing with the extraordinary diligence of the carrier, and (2) "A" was given a discount on his plane fare thereby reducing the liability of the common carrier with respect to "A" in particular.

Are those valid defenses?

No. These are not valid defenses because they are contrary to law as they are in violation of the extraordinary diligence required of common carriers.

In the carriage of passengers, the responsibility of common carriers cannot be dispensed with or lessened by stipulation. This rule applies notwithstanding the reduction of fare. But, when the passenger is carried gratuitously, a stipulation limiting liability for negligence is valid, except for willful acts or gross negligence.[244]

A and his classmates take a bus from UP to Quiapo. On the way, another Quiapo-bound bus tries to overtake them. A and his classmates dare the bus driver to run faster and race with the other bus. The driver takes their dare, to the delight of A and his friends who cheered him. On rounding the curve, the bus driver fails to slow

[239]BAR 1998; 1985.
[240]Article 1757, NCC.
[241]Article 1758, NCC.
[242]*Ibid.*
[243]*Ibid.*
[244]Articles 1757-1758, NCC.

down and the bus turns turtle, resulting in the death of A and injuries to the other passengers. The bus carried the following sign: "Do not talk to driver while bus is on motion, otherwise the company will not assume liability for any accident." Explain briefly the extent of the liability, if any, of the bus company, giving the legal provisions and principles involved.

The bus company is liable for damages to A's heirs and to all the injured passengers. Under the Civil Code, a common carrier is duty bound to exercise extraordinary diligence in carrying its passengers. This liability cannot be eliminated or limited by stipulation or by posting notices.[245]

Juan, a paying passenger, noted the stipulation at the back of the bus ticket stating that the liability of the bus company is limited to P1,000.00 in case of injuries to its passengers and P500.00 in case of loss or damage to baggage caused by the negligence or willful acts of its employees.

Upon arrival at his destination, Juan got into an altercation with the ticket conductor, who pulled out a knife and inflicted several wounds on Juan. The bus driver intervened, heaping abusive language on Juan and completely destroying Juan's baggage which contained expensive goods worth P3,000.00. The hospital expenses for Juan would probably amount to at least P6,000.00.

Give the extent of liability of the bus company, with reasons.

The bus company's liability for the injuries inflicted upon Juan is at least P6,000.00, notwithstanding the stipulation limiting its liability, and only P500.00, the amount stipulated in the bus ticket, for the damage and destruction to Juan's baggage.

With respect to the injuries inflicted upon Juan, common carriers are liable for the death or injuries to passengers through the negligence or willful acts of the former's employees, although such employees may have acted beyond the scope of their authority or in violation of the orders of the common carriers. The common carrier's responsibility for these acts cannot be eliminated or limited by stipulation by the posting of notices, by statements on the tickets or otherwise.

The rule is different with respect to a stipulation limiting the carrier's liability for the loss, destruction, or deterioration of goods shipped. Under Article 1750 of the Civil Code, a contract fixing the sum that may be recovered by the owner or shipper for the loss, destruction, or deterioration of the goods is valid, if it is reasonable and just under the circumstances and has been fairly and freely agreed upon.[246]

3. Limitations under the Warsaw Convention[247]

When is the Warsaw Convention applicable?

The Warsaw Convention applies to all international carriage of persons, luggage or goods performed by aircraft for hire. It applies equally to gratuitous carriage by aircraft performed by an air transport undertaking.

The expression "international carriage" means any carriage in which, according to the contract made by the parties, the place of departure and the place of destination, whether

[245] BAR 1983.

[246] BAR 1984.

[247] The Warsaw Convention has been supplanted by the Montreal Convention. It is included in this book because it is in the 2020 Bar Exam Syllabus in Commercial law and for purposes of comparison with the Montreal Convention.

or not there be a break in the carriage or a transshipment, are situated either within the territories of two High Contracting Parties, or within the territory of a single High Contracting Party, if there is an agreed stopping place within a territory subject to the sovereignty, suzerainty, mandate or authority of another Power, even though that Power is not a party to this Convention. A carriage without such an agreed stopping place between territories subject to the sovereignty, suzerainty, mandate or authority of the same High Contracting Party is not deemed to be international for the purposes of the Convention.[248]

Thus, when the place of departure and the place of destination in a contract of carriage are situated within the territories of two High Contracting Parties, said carriage is deemed an "international carriage." The High Contracting Parties referred to are the signatories to the Warsaw Convention and those which subsequently adhered to it.

The Montreal Convention retained this provision.

What are the liabilities of the air carrier under the Warsaw Convention?

Under the Warsaw Convention, the air carrier is liable in any of the following cases:

a. Death or injury to the passenger while on board, embarking and disembarking.
b. Loss, destruction and damage to baggage during the carriage.
   This means simple loss of luggage without any improper conduct on the part of carrier's officials and employees.[249]
   The period of responsibilities includes the period during which the baggage is in the charge, of the carrier whether in an airport or any place whatsoever.
c. Delay in the flight.
   Getting bumped off, however, is not delay.[250]

It was held that Section 2, Article 30 of the Warsaw Convention does not contemplate the instance of "bumping-off" but merely of simple delay. In its ordinary sense, "delay" means to prolong the time of or before; to stop, detain or hinder for a time, or cause someone or something to be behind in schedule or usual rate of movement in progress. "Bumping-off," which is the refusal to transport passengers with confirmed reservation to their planned and contracted destinations, totally forecloses said passengers' right to be transported, whereas delay merely postpones for a time being the enforcement of such right. Consequently, Section 2, Article 30 of the Warsaw Convention cannot provide a handy excuse for the air carrier as to exculpate it from any liability to its passenger.[251]

What are the legal effects of the Warsaw Convention on the liabilities of air carrier engaged in international transportation?

They are as follows:

a. The action against the carrier will prescribe if it is not brought within two (2) years from date of arrival of the air carrier at the destination, or it should have arrived or from the date on which the transportation stopped.[252]
   The Montreal Convention retained this provision.
   The Montreal Convention, however, added time limits in case of filing claims against the carrier. In case of damage to baggage, the complainant must file his or her written complaint within seven (7) days from the date of receipt of the checked-in baggage. In case of delay of delivery, on the other hand, the complaint must be

[248] Article 1, Warsaw Convention.

[249] Pan America v. IAC.
[250] Lufthansa German Airlines v. Court of Appeals, G.R. No. 83612, November 24, 1994.
[251] *Ibid.*
[252] Article 29, Warsaw Convention.

made at the latest within 21 days from the date of receipt of the baggage.[253] These time limitations are important since no action can lie against the carrier if the complaints were made beyond the period stated, save in the cases where the carrier employed fraud.

b. There is a limitation on the liability on the air carrier in case of loss or damage to goods or death or injury to passengers.

With respect to goods, the limit is US$ 20 or 9.07 pound per kilo unless the shipper declares higher valuation.[254] For unchecked baggage, it is US$400.

For death or injury to passengers, the liability does not exceed US$25,000.

Under the Montreal Convention, the liability of the air carrier has been modified, as follows:

a. Death or injury to passengers

The Montreal Convention established a two-tier liability for death or bodily injury to a passenger. The first tier is on the basis of a strict liability where an airline carrier shall be made liable for damage sustained in case of death or bodily injury of a passenger on the condition that the accident which caused the death or injury took place on board the aircraft or in the course of any of the operations of embarking or disembarking.[255] Under this first tier of liability, the carrier cannot limit or exclude its liability provided the damages sustained does not exceed 113,100 Special Drawing Rights ("SDRs"). An SDR is a type of foreign exchange reserve asset created by the International Monetary Fund. Its value is based on an artificial basket of currencies consisting of the US dollar, the euro, the pound and the Japanese yen. The liability limits are reviewed every five (5) years.

In this regard, the carrier may be held liable even if it is not negligent or at fault.[256] The carrier is thus presumptively liable up to the amount of 113,100 SDRs. The carrier's liability may be reduced or exonerated only in case where damage was caused by contributory or sole negligence of the passenger or person claiming compensation.[257]

Under the second tier of liability, or for all damages higher than 113,100 SDRs (or approximately up to US$170,000 based on current IMF valuation), the carrier shall be liable unless it can show that the damage was not due to its negligence or wrongful act or omission, or that the damage was solely due to the negligence or wrongful act or omission of a third party.[258] Otherwise stated, for those claims above 113,100 SDRs, the carrier shall not be liable under this tier only if it shall prove that it was not negligent or at fault. To emphasize, the burden of proof is on the carrier.

This two-tier liability is a departure from the liability regime under the Warsaw Convention (and its subsequent amendments) where the carrier's liability was limited to $25,000.00 (or its equivalent) regardless of whether the airline was at fault or not. Also, the full defense that the carrier or its agents has taken all reasonable measures to avoid damage is not already availing under the Montreal Convention.

In 2019, the limits of liability were revised, as follows :

[253]Article 31, Montreal Convention.
[254]Article 22(1), Warsaw Convention.
[255]Article 17, Montreal Convention.
[256]Article 21, *ibid.*
[257]Article 20, *ibid.*
[258]Article 21, *ibid.*

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- There are no financial limits for passenger death or bodily injury, however, the carrier shall not be liable for damages exceeding 128,821 Special Drawing Rights (Approximately EUR160,240) if it proves that it was not negligent or at fault or such damages is solely attributable to the negligence or fault of third parties.
- In the case of damage caused by delay in the carriage by air of passengers, 5,346 Special Drawing Rights (approximately EUR 6,650)
- In the case of destruction, loss of, or damage or delay to baggage, 1,288 Special Drawing Rights (approximately EUR 1,602) per passenger.
- In the case of destruction, loss of, damage or delay to cargo, 22 Special Drawing Rights per kilogram (approximately EUR27 per kilogram)

b. Destruction, loss damage or delay in carrying baggage.

In the case of destruction, or loss of, or of damage to, checked baggage, the carrier shall be liable for damages as long as the destruction, loss or damage took place on board the aircraft or during any period within which the checked baggage was under the carrier's custody. The carrier may be held not liable if and to the extent that the damage resulted from the inherent defect, quality or vice of the baggage. In case of unchecked baggage, including personal items, the carrier shall be liable if the damage resulted from its faults or that of its agents.[259]

In those cases where the carrier is held liable, the carrier's liability shall be up to 1,131 SDRs for each passenger, or approximately US$70 per kg luggage (per current valuation). This is an apparent increase from the previous limit under the Warsaw Convention of only up to US$20 per kg luggage. The passenger may only claim above the limit of 1,131 SDR if he has made a special declaration of interest at the time of check-in and has paid a supplementary sum if the case so requires. In such case, the carrier will be liable to pay a sum not exceeding the declared sum.

May the passenger recover an amount greater than the amount set forth in the Convention?

The passenger may recover a greater amount in the following cases:

a. If at the time the packages were handed over to the carrier, the passenger made a special declaration of the value at delivery and has paid a supplementary sum;[260] and
b. When the air carrier failed to raise timely objections during the trial when questions and answers regarding the actual claims and damages sustained by the passenger were asked.[261]

Where should the action be filed?

Under Article 28(1) of the Warsaw Convention, the plaintiff may bring the action for damages before: 1.) the court where the carrier is domiciled; 2.) the court where the carrier has its principal place of business; 3.) the court where the carrier has an establishment by which the contract has been made; or 4.) the court of the place of destination.[262]

The Montreal Convention retained the jurisdictional rules under the Warsaw Convention but as a supplement, the MC99 also allows, in respect of damage resulting from death or injury of a passenger, the filing of action in the territory of a State Party in which at

[259]Article 17, *ibid.*
[260]Article 22(1), Warsaw Convention.
[261]British Airways v. Court of Appeals, G.R. No. 121824, January 29, 1998.
[262]Edna Diego Lhuillier v. British Airways, G.R. No. 171092, March 15, 2010.

the time of the accident the passenger has his principal and permanent residence and to and from which the carrier operates services for the carriage of passengers by air.[263]

If a claim is covered by the Warsaw Convention, may the passenger bring the legal action under local laws?

Article 24 of the Warsaw Convention excludes other remedies by further providing that "(1) in the cases covered by Articles 18 and 19 (of the Convention), any action for damages, however founded, can only be brought subject to the conditions and limits set out in this convention." Therefore, a claim covered by the Warsaw Convention can no longer be recovered under local law if the statute of limitations of two (2) years has already lapsed.

The same principle applies under the Montreal Convention.

Cite jurisprudence where the Supreme Court ruled that the Warsaw Convention does not apply.

Jurisprudence recognizes that the Warsaw Convention does not "exclusively regulate" the relationship between passenger and carrier on an international flight. For instance, the Supreme Court distinguished between the (1) damage to the passenger's baggage and (2) humiliation he suffered at the hands of the airline's employees. The first cause of action was covered by the Warsaw Convention which prescribes in two (2) years, while the second was covered by the provisions of the Civil Code on torts, which prescribes in four (4) years. Had the case merely consisted of claims incidental to the airlines' delay in transporting their passengers, the passenger's complaint would have been time-barred under Article 29 of the Warsaw Convention.[264]

The Warsaw Convention does not apply if there is bad faith, misconduct or tortious act on the part of the air carrier and its employees or agents; and, some special species of injury were caused to the passenger arising from the act or omission of the air carrier.

The principles enunciated in the foregoing cases are still applicable under the Montreal Convention.

[263]Article 33, Montreal Convention.

[264]Philippine Airlines, Inc. v. Hon. Adriano Savillo, *et al.*, G.R. No. 149547, July 4, 2008.

III. CORPORATION LAW

A. General principles

1. Nationality of corporations

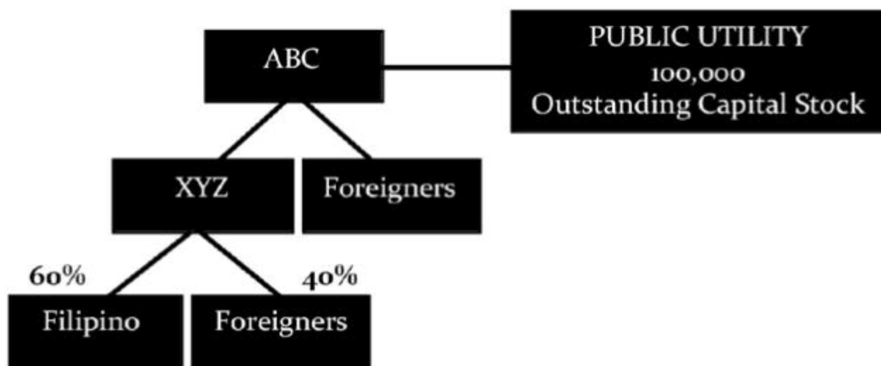
a. *Control test* – It is a mode of determining the nationality of a corporation engaged in nationalized areas of activities, provided for under the Constitution and other applicable laws, where corporate shareholders with foreign shareholdings are present, by ascertaining the nationality of the controlling stockholder of the corporation.

b. *Grandfather rule* – This is "the method by which the percentage of Filipino equity in a corporation engaged in nationalized and/or partly nationalized areas of activities, provided for under the Constitution and other applicable laws, is accurately computed, in cases where corporate shareholders with foreign shareholdings are present, by attributing the nationality of the second or even subsequent tier of ownership to determine the nationality of the corporate shareholder." Thus, to arrive at the actual Filipino ownership and control in a corporation, both the direct and indirect shareholdings in the corporation are determined. In the case of a multi-tiered corporation, the stock attribution rule must be allowed to run continuously along the chain of ownership until it finally reaches the individual stockholders.

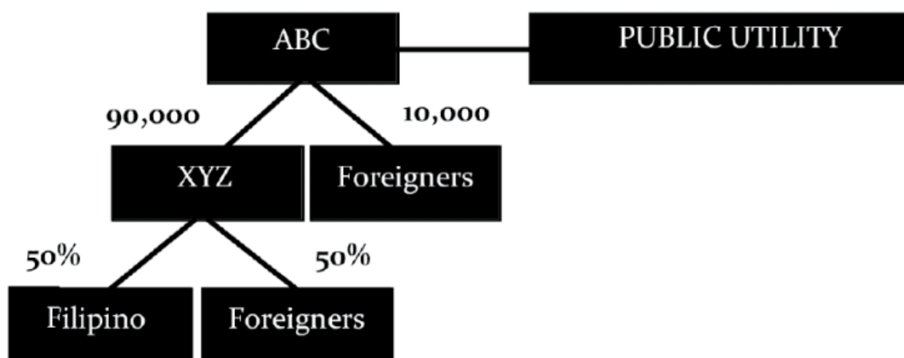
The purpose of this rule is to trace the nationality of the stockholder of investor corporations to ascertain the nationality of the corporation where the investment is made.[265]

Application of the control test and grandfather rule.

Rule I:

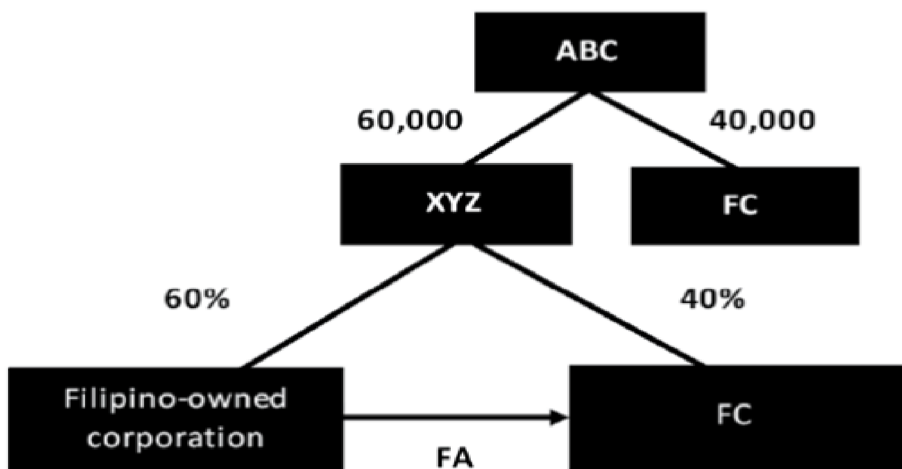


Rule II:

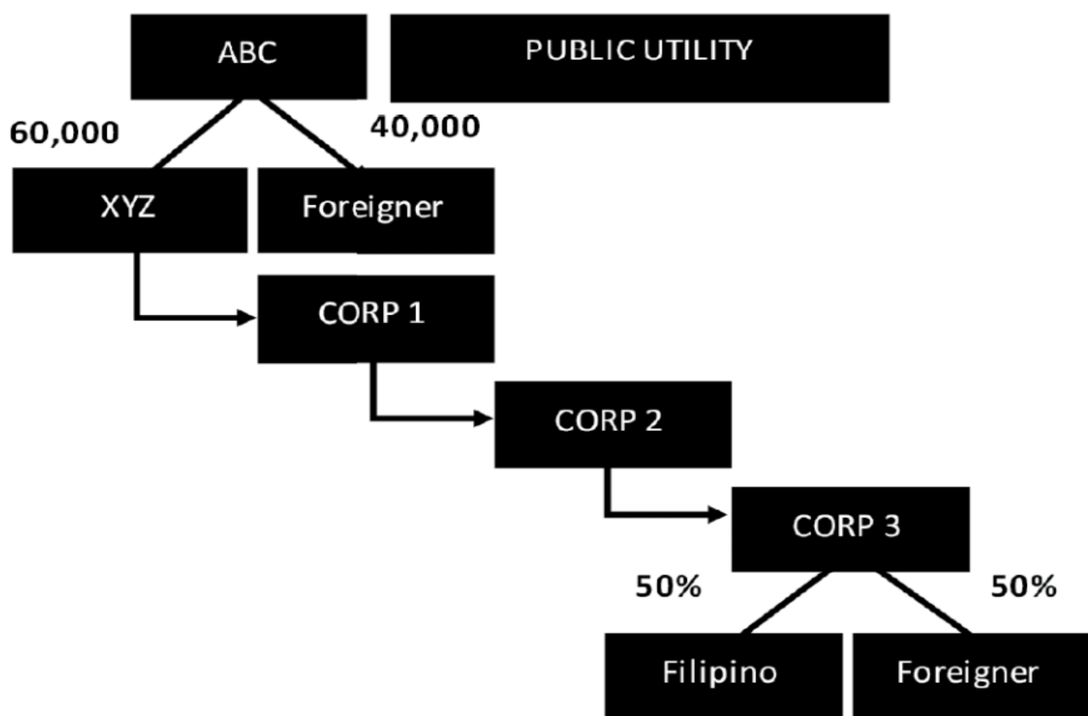


[265] SEC Opinion, May 4, 1987.

Rule III



Rule IV:



In an *en banc* decision, the Supreme Court clarified that the term "capital" in Section 11, Article XII of the 1987 Constitution refers to *shares with voting rights, as well as with full beneficial ownership*. This is precisely because the right to vote in the election of directors, coupled with full beneficial ownership of stocks, translates to effective control of a corporation.[266]

Thus, for purposes of determining compliance with the constitutional or statutory ownership, the required percentage of Filipino ownership shall be applied to BOTH (a) the total number of outstanding shares of stock entitled to vote in the election of directors; AND (b) the total number of outstanding shares of stock, whether or not entitled to vote." What the Constitution requires is the full and legal beneficial ownership of 60% of the outstanding capital stock, coupled with 60% of the voting rights which must rest in the hands of Filipino nationals.[267]

[266]Jose M. Roy III v. Teresita Herbosa, et al., G.R. No. 207246, November 22, 2016, J. Caguioa
[267]Jose M. Roy III v. Teresita Herbosa, et al., G.R. No. 207246, April 18, 2017.

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By way of example, ABC is a public utility corporation with 300,000,000 outstanding capital stock divided into 100,000 common shares, 100,000 voting preferred shares, and 100,000 non-voting preferred shares all with par value of P100 per share. In terms of Filipino and foreign share ownership, the outstanding shares are broken down as follows:

- 100,000 common shares
  - 100% – Filipino-owned
- 100,000 voting preferred shares
  - 60,000 – Filipino-owned
  - 40,000 – Foreign-owned
- 100,000 non-voting preferred shares
  - 80,000 – Foreign-owned
  - 20,000 – Filipino-owned

If we follow the pronouncement in *Gamboa v. Teves*, the share ownership structure will not be compliant with the Constitution because the 60-40 Filipino-foreign ownership is not reflected in each class or kind of shares but based on *Roy v. Herbosa*, this will be compliant because Filipinos own at least 60% of the voting shares (100,000 common shares and 60,000 voting preferred shares or 160,000/200,000 shares) and at least 60% of the outstanding capital stock (100,000 common shares + 60,000 voting preferred shares + 20,000 non-voting preferred shares or 180,000/300,000 shares).

To require Filipino shareholders to acquire preferred shares that are substantially debts, in order to meet the " restrictive " Filipino ownership requirement may not bode well for the Philippine corporation and its Filipino shareholders. That stock corporations are allowed to create shares of different classes with varying features is a flexibility that is granted, among others, for the corporation to attract and generate capital (funds) from both local and foreign capital markets. This access to capital-which a stock corporation may need for expansion, debt relief/repayment, working capital requirement, and other corporate pursuits-will be greatly eroded with unwarranted limitations that are not articulated in the Constitution.

2. Doctrine of separate juridical personality

The subsidiary is not liable to absorb the employees of its parent company when the latter closed its business, particularly, if the subsidiary was set up long before the termination of employment such that it could not be said that the subsidiary was set up to evade the parent company's liabilities. This is true even if the parent company transferred its assets to the subsidiary because settled is the rule that generally, where one corporation sells or otherwise transfers all its assets to another corporation for value, the latter is not, by that fact alone, liable for the debts and liabilities of the transferor.[268]

A subsidiary company's separate corporate personality may be disregarded only when the evidence shows that such separate personality was being used by its parent or holding corporation to perpetrate a fraud or evade an existing obligation. Concomitantly, employees of a corporation have no cause of action for labor-related claims against another unaffiliated corporation, which does not exercise control over them.[269]

Legal consequences of the doctrine of separate legal entity.

[268] Rommel M. Zambrano, et. al v. Philippine Carpet Manufacturing Corporation, et. al, G.R. No. 224099, June 21, 2017.
[269] Maricalum Mining Corporation vs Ely Florentino, GR No. 221813, July 23, 2018.

a. Properties registered in the name of the corporation are owned by it as an entity separate and distinct from its stockholders. Stockholders are not entitled to possession of any definite portion of its property or assets. The stockholder is not a co-owner or tenant in common of the corporate property. Thus-

   i. Where stockholders granted a loan to the corporation to finance the acquisition of property which was eventually mortgaged to a bank to secure a corporate loan, the right of the stockholders is subordinate to the mortgagee. The stockholder have the right to be paid the loan but not to the property of the corporation.[270]
   ii. The probate court hearing the settlement of estate of the deceased stockholder cannot order the lessees of the corporation to remit rentals to the estate's administrator. The decedent was not the owner of the rented property but only of the shares of the corporation that owns the property.[271]

b. As a general rule, directors, officers, or agents of a corporation cannot be held personally liable for the obligations incurred by the corporation, unless it can be shown that such director/officer/agent is guilty of gross negligence or bad faith or committed an unlawful act, and that the same was clearly and convincingly proven. Thus-

   The President should not be held solidarily liable with the Corporation for the unpaid commissions due to a marketing agent because no commission of unlawful act, gross negligence or bad faith was alleged in the complaint, much less proven in the course of trial.[272]

An officer may not be held liable for the corporation's labor obligations unless he acted with evident malice and/or bad faith in dismissing an employee.[273] In this case, certain workers (employed as security guards) filed a claim for monetary benefits before the labor arbiter; were thereafter asked by the manager of the company to withdraw their complaint, otherwise, they would not be given duty assignment; and were eventually terminated after they refused to do so. It was held that the Chairman and President is not liable with the corporation for the payment of monetary awards in favor of the terminated employees since there is no showing that he acted in bad faith or with gross negligence in conducting the affairs of the corporation, or knowingly voted for or assented to the unlawful acts of the company. To disregard the separate juridical personality of a corporation, the wrongdoing must be established clearly and convincingly. It cannot be presumed.[274]

Although the pieces of evidence show that respondent signed the Trust Receipt Agreements, they do not show that he signed them in his personal capacity. Without any evidence that respondent personally bound himself to the debts of the company he represented, he cannot be held civilly liable under the Trust Receipt Agreements.[275]

c. The cause of action available to the corporation cannot be generally enforced by its director, officer or stockholder and vice-versa. Thus-

   i. The stockholders are not themselves the real parties in interest to claim and recover compensation for the damages arising from the wrongful attachment of

[270] Philippine National Bank vs. Merelo B. Aznar, G.R. No. 171805, May 30, 2011
[271] Manuela Azucena Mayor, Petitioner, - Versus - Edwin Tiu; G.R. No. 203770, Second Division, November 23, 2016
[272] Mactan Rock Industries vs Germo, GR No. 228799, January 10, 2018.
[273] Symex Security Services, Inc. V. Magdalino O. Rivera, Jr. G.R. No. 202613, November 08, 2017, Second Division (Caguioa, J.)
[274] ibid
[275] BDO Unibank, Inc. V. Antonio Choa G.R. No. 237553, 10 July 2019, THIRD DIVISION.

corporate assets. Only the corporation is the real party in interest for that purpose.[276]

Doctrine of piercing the corporate veil

In one case, the owner of a business terminated the employment of his workers on the pretext that there will be an impending permanent closure of the business as a result of an intended sale of the assets to an undisclosed corporation, and that there will be a change in the management. Subsequent events, however, revealed that the buyer of the assets was a corporation owned by the same employer and members of his family. Furthermore, the business re-opened in less than a month under the same management. Admittedly, mere ownership by a single stockholder of all or nearly all of the capital stock of the corporation does not by itself justify piercing the corporate veil. Nonetheless, in this case, other circumstances show that the buyer of the assets of the proprietor employer is none other than his alter ego.[277]

Doctrine of piercing the corporate veil applies to a nonstock non-profit corporation and natural persons.

The equitable character of the remedy permits a court to look to the substance of the organization and its decision is not controlled by the statutory framework under which the corporation was formed and operated. While it may appear to be impossible for a person to exercise ownership control over a nonstock non-profit corporation, a person can be held personally liable under the alter ego theory if the evidence shows that the person controlling the corporation did in fact exercise control even though there was no stock ownership.[278]

Reverse piercing of the corporate veil.

In a traditional veil-piercing action, the court disregards the existence of the corporate entity so a claimant can reach the assets of a corporate insider (meaning, the directors, stockholders, and officers). In reverse piercing action, however, the plaintiff seeks to reach the assets of the corporation to satisfy claims against corporate insider. Reverse piercing flows in the opposite direction (of traditional corporate veil-piercing) and makes the corporation liable for the debt of the shareholders or members.

In *International Academy of Management and Economics (I/AME) Litton and Company, Inc. v. Litton and Company, Inc.*,[279] however, the Supreme Court applied the reverse piercing doctrine and made a nonstock corporation liable for the debts of its member.

In this case, a lawyer-lessee failed to pay his rentals. The lessor filed a complaint for unlawful detainer and secured a favorable judgment. Judgment was not immediately executed but it was eventually revived. The sheriff levied a piece of real property in the name of International Academy of Management and Economics Incorporated (I/AME), a nonstock corporation, in order to execute the judgment against the lessee, who is a member of I/AME. The Supreme Court agreed with the Court of Appeals and sustained the levy, ruling that the corporation is an alter ego of the lessee and the lessee – the natural person is the alter ego of the corporation. The lessee falsely represented himself as president of the corporation in the Deed of Sale when he bought the property at a time when the corporation had not yet existed. Uncontroverted facts also revealed that the lessee and the corporation are one and

[276] Stronghold Insurance Company, Inc. vs. Tomas Cuenca, et. al., G.R. No. 173297, March 6, 2013.

[277] Leo R. Rosales, et al. v. New A.N.J.H. Enterprises & N.H. Oil Mill Corporation, et al., G.R. No. 203355, August 18, 2015.

[278] Ibid.

[279] International Academy of Management and Economics (I/AME) v. Litton and Company, Inc., G.R. No. 191525, December 13, 2017.

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the same person: The lessee is the conceptualizer and implementor of the corporation and the majority contributor of the corporation. I/AME is basically the corporate entity used by the lessee as his alter ego for the purpose of shielding his assets from the reach of his creditors.

Effects of piercing the corporate veil

The piercing of the corporate veil does not dissolve the corporation. It simply means that the stockholder and/or director and/or officer, whose action/s became the basis for the application of the doctrine, and the corporation shall be treated as one and the same entity. In traditional piercing the corporate veil, the concerned stockholders, directors/trustees, and officers become liable for the obligation of the corporation. In reverse piercing the corporate veil, the corporation becomes liable for the debts of the concerned stockholders/members, directors/trustees, and officers of the corporation.

In case the corporation is just an alter ego of another corporation, both corporations become one and the same entity.

B. De facto corporations versus corporations by estoppel

Elements of a *de facto* corporation

The requisites of a *de facto* corporation are as follows:

a. Existence of a valid law under which it may be incorporated;
b. Attempt in good faith to incorporate; and
c. Actual use or exercise in good faith of corporate powers.

As such, if the law under which it is incorporated is declared unconstitutional, there is neither *de jure* nor *de facto* existence.

For instance, if Congress enacts a law to create a private corporation, such corporation cannot be considered *de facto* because the law creating it is unconstitutional.[280] Congress can enact a law to create a corporation only if it is owned and controlled by the government.[281]

With regard to the second element, attempt in good faith to incorporate, at the very least, means obtaining a certificate of incorporation from the SEC. The execution of the articles of incorporation and adoption of bylaws, *per se*, are not enough to warrant *de facto* existence. In other words, there is no *bona fide* attempt to incorporate until the SEC at the very least issues the certificate of incorporation.

The filing of articles of incorporation and the issuance of the certificate of incorporation are essential for the existence of a *de facto* corporation. In fine, it is the act of registration with the SEC through the issuance of a certificate of incorporation that marks the beginning of an entity's corporate existence.[282]

Corporation by estoppel.

Who cannot invoke the doctrine of corporation by estoppel?

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[280]BAR 1994.
[281]Feliciano v. Commission on Audit, G.R. No. 147402, January 14, 2004.
[282]Missionary Sisters of Our Lady of Fatima v. Alzona, et al., G.R. No. 224307, August 6, 2018.

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The doctrine of corporation by estoppel is founded on principles of equity and is designed to prevent injustice and unfairness. It applies when a non-existent corporation enters into contracts or dealings with third persons. In which case, the person who has contracted or otherwise dealt with the non-existent corporation is estopped to deny the latter's legal existence in any action leading out of or involving such contract or dealing. While the doctrine is generally applied to protect the sanctity of dealings with the public, nothing prevents its application in the reverse, in fact, the very wording of the law which sets forth the doctrine of corporation by estoppel permits such interpretation. Such that a person who has assumed an obligation in favor of a non-existent corporation, having transacted with the latter as if it was duly incorporated, is prevented from denying the existence of the latter to avoid the enforcement of the contract. In this case, while the donation was accepted at the time the donee was not yet incorporated, the subsequent incorporation of the donee-corporation and its affirmation of the recipient's authority to accept on its behalf cured whatever defect that may have attended the acceptance of the donat ion, applying the doctrine of corporation by estoppel under the Corporation Code.[283]

C. Corporate Powers

Different corporate powers and their respective voting requirements.

Powers of Corporation	**Board of Directors**	**Outstanding Capital Stock (or members, for nonstock corporations)**
Sec. 15 – Amendment of Articles of Incorporation	At least majority of the board	At least 2/3 of the outstanding capital stock
Sec. 23 – Election of Directors		At least majority of the outstanding capital stock
Sec. 24 – Appointment of Corporate Officers	At least majority of the board	
Removal of Corporate Officers	At least majority of the board	
Sec. 27 – Removal of Directors/Trustees		At least 2/3 of the outstanding capital stock
Sec. 28 – Filling Vacancy in the Board	If the ground is not expiration of the term, removal, increase in number of board seats and the remaining directors constitute a quorum – Majority of the remaining directors/trustees	If the ground is expiration, removal, increase in number of directors; or If the ground is not expiration, removal, increase in number of board seats but the remaining directors do not constitute a quorum – at least majority of the outstanding capital stock
Sec. 29 – Payment of Compensation to Directors		At least majority of the outstanding capital stock

[283] Missionary Sisters of Our Lady of Fatima v. Alzona, et al., G.R. No. 224307, August 6, 2018.

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Powers of Corporation	Board of Directors	Outstanding Capital Stock (or members, for nonstock corporations)
Sec. 34 – Appointment of the members of the Executive Committee	Majority of the quorum	
Sec. 34 – Creation of Special Committees	Majority of the quorum	
Sec. 36 – Extension/Shortening of the Term	At least majority of the board	At least 2/3 of the outstanding capital stock
Sec. 37 – Incurring, Creating or Increasing Bonded Indebtedness; Increasing or Decreasing Capital Stock	At least majority of the board	At least 2/3 of the outstanding capital stock
Incurring Debt in the Ordinary Course of Business	Majority of the quorum	
Sec. 39 – Sale or other Disposition of Assets	In the ordinary course of business – Majority of the quorum	
	All or substantially all of corporate assets – At least majority of the board	At least 2/3 of the outstanding capital stock
Sec. 41 – Invest Funds in the Primary Purpose	Majority of the quorum	
Invest Funds to Incidental Purpose for which Corporation is Created	Majority of the quorum	
Invest the Funds in a Secondary Purpose or another business	At least majority of the board	At least 2/3 of the outstanding capital stock
Sec. 42 – Declaration of Cash Dividends	Majority of the quorum	
Cash Dividends		
Sec. 42 – Declaration of Stock Dividends	Majority of the quorum	At least 2/3 of the outstanding capital stock
Sec. 43 – Enter into Management Contract	Majority of the quorum for both managed and managing corporation	At least majority of the outstanding capital stock of each managed and managing corporation (but at least 2/3 of the

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Powers of Corporation	Board of Directors	Outstanding Capital Stock (or members, for nonstock corporations)
		outstanding capital stock is required from the managed corporation in case interlocking directors and stockholders)
Sec. 45 – Adoption of By-laws		Majority of the outstanding capital stock
Sec. 46 – Amendment of Bylaws	At least majority of the board	At least majority of the outstanding capital stock. If authority to amend will be delegated by stockholders to the board at least 2/3 of the outstanding capital stock. Revocation of the delegation made to the Board – At least majority of the outstanding capital stock.
Sec. 61 – Fixing the Issued Value of No Par Value Shares (if not fixed in the Articles of Incorporation)	Majority of the quorum (pursuant to authority conferred by the Articles of Incorporation or the Bylaws)	or At least majority of the outstanding capital stock
Sec. 75 – Merger or Consolidation	At least majority of the board	At least 2/3 of the outstanding capital stock
Sec. 102 – Amendment of articles of incorporation of a close corporation		At least 2/3 of the outstanding capital stock
Sec. 134 – Voluntary Dissolution Where No Creditors are Affected	At least majority of the board	At least majority of the outstanding capital stock
Sec. 135 – Voluntary Dissolution Where Creditors are Affected	At least majority of the board	At least 2/3 of the outstanding capital stock

Doctrine of apparent authority.

The doctrine of apparent authority provides that a corporation will be estopped from denying the agent's authority if it knowingly permits one of its officers or any other agent to act within the scope of apparent authority, and it holds him out to the public as possessing the power to do those acts.

Although an officer or agent acts without, or in excess of, his actual authority if he acts within the scope of an apparent authority with which the corporation has clothed him, by holding him out or permitting him to appear as having such authority, the corporation is bound thereby in favor of a person who deals with him in good faith in reliance on such apparent

authority, as where an officer is allowed to exercise a particular authority with respect to the business, or a particular branch of its continuously and publicly, for a considerable time.[284]

The Doctrine of Apparent Authority is determined by the acts of the principal and not by the acts of the agent. As applied to corporations, the doctrine of apparent authority provides that "a corporation is estopped from denying the officer's authority if it knowingly permits such officer to act within the scope of an apparent authority, and it holds him out to the public as possessing the power to do those acts."[285] In a case involving a Toll Agreement (under which Agro agreed to dress the chickens supplied by Vitarich for a toll fee), amendments to the toll fee agreements approved and carried out by the officer of Agro were considered binding on the latter, despite the lack of board authority, under this doctrine of apparent authority. Evaluating the evidence presented by Vitarich, the conduct by which Agro clothed its officer with authority is evident on the following: *first,* in over a span of two (2) years, with over eighty nine (89) billings and three (3) instances of amendments, Agro never contested the amended toll fees; *second,* even after receipt of several demand letters from Vitarich, Agro never made an issue of the amended toll fees, and only raised the same in its Answer; and *third,* Agro accepted the benefits arising from the amendments through the extension of the period for its payment of the P20 million deposit (brought about by the decrease in the percentage of billings to be deducted from the P20 million deposit of Vitarich)

k. Limitations

i. *Ultra vires* acts

There are three (3) types of *ultra vires* acts:

a. Acts done beyond the powers of the corporation as provided in the law or its articles of incorporation.
b. Acts entered into on behalf of the corporation by persons who have no corporate authority or exceeded the scope of their authority.
c. Acts or contracts, which are *per se* illegal as being contrary to law.

Jurisprudence on *ultra vires* acts for being outside or beyond the powers of the corporation.

a. Petitioner, an educational institution does not have the power to mortgage its properties in order to secure loans of a savings and loan association ("SLA") even though they have common stockholders. Securing SLA's loans by mortgaging the school's properties does not appear to have even the remotest connection to its operations as an educational institution. Further, not having the proper board resolution to authorize the signatory to execute the mortgage contracts for the school, the contracts he executed are unenforceable against the petitioner. While the lender's mortgage is annotated on the certificates of titles of petitioner's properties, the annotations are merely claims of interest or claims of the legal nature and incidents of the relationship between the person whose name appears on the document and the person who caused the annotation. It does not say anything about the validity of the claim nor convert a defective claim or document into a valid one.

[284] TERP Construction Corporation v. Banco Filipino Savings and Mortgage Bank, G.R. No. 221771, September 18, 2019.
[285] AGRO FOOD PROCESSING CORP. vs. VITARICH CORPORATION G.R. No. 217454. January 11, 2021, (Caguioa, J.)

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b. While Section 13 of DBP's charter, exempts it from existing laws on compensation and position classification, it concludes by expressly stating that DBP's system of compensation shall nonetheless conform to the principles under the Salary Standardization Law (SSL). From this, there is no basis to conclude that the DBP's Board of Directors was conferred unbridled authority to fix the salaries and allowances of its officers and employees. The authority granted DBP to freely fix its compensation structure under which it may grant allowances and monetary awards remains circumscribed by the SSL; it may not entirely depart from the spirit of the guidelines therein.

The grant of a wider latitude to DBP's Board of Directors in fixing remunerations and emoluments does not include an abrogation of the principle that employees in the civil service "cannot use the same weapons employed by the workers in the private sector to secure concessions from their employees." While employees of chartered GFIs enjoy the constitutional right to bargain collectively, they may only do so for non-economic benefits and those not fixed by law, and may not resort to acts amounting to work stoppages or interruptions. There is no other way to view the Governance Forum Productivity Award (GFPA) other than as a monetary benefit collectively wrung by DBP's employees under threat of disruption to the bank's smooth operations.

All told, the grant of GFPA was indeed an *ultra vires* act or beyond the authority of DBP's Board of Directors.[286]

b. Trust fund doctrine

Definition of trust fund doctrine.

The trust fund doctrine provides that subscriptions to the capital stock of a corporation constitute a fund to which the creditors have a right to look for the satisfaction of their claims.[287] In a sense, they have to be unimpaired for the protection of creditors. These cover the entire consideration received for the issuance of no par value shares or the aggregate amount for the par value shares issued by the corporation.

It must be noted, however, that the trust fund doctrine is not limited to the stockholders' subscriptions. The scope of the doctrine encompasses not only the capital stock but also other property and assets generally regarded in equity as a trust fund for the payment of corporate debts.[288]

The Trust Fund Doctrine is violated in the following cases:

a. The corporation has distributed its capital among the stockholders without providing for the payment of creditors.
b. It released the subscribers to the capital stock from their unpaid subscriptions.
c. It transferred corporate property in fraud of its creditors.
d. It distributed properties to stockholders except by way of dissolution and liquidation, the redemption of redeemable shares, and reduction of capital stock.[289]
e. When it declared dividends without unrestricted retained earnings.[290]
f. When it acquired its shares without unrestricted retained earnings.[291]

[286] Development Bank of the Philippines v. Commission on Audit, G.R. No. 210838, July 3, 2018.
[287] Ong v. Tiu, G.R. Nos. 144476 and 144629, April 8, 2003.
[288] Halley v. Printwell, Inc., G.R. No. 157549, May 30, 2011; 2015 and 2019 Bar Exams.
[289] Ong v. Tiu, G.R. Nos. 144476 and 144629, April 8, 2003; 2007 and 2015 Bar Exams.
[290] Section 42, RCC.
[291] Section 41, RCC.

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g. When it pays dissenting stockholders exercising appraisal right without unrestricted retained earnings.

APIC forms part of the equity emanating from the original subscription agreement. APIC, as a premium, forms part of the capital of the corporation and therefore, falls within the purview of the trust fund doctrine.[292]

ABC Corporation ("ABC") obtained a loan from XYZ Bank secured by a mortgage on its real property. ABC defaulted. To stave off foreclosure, A, the controlling stockholder of ABC invited investor X to invest in ABC. X subscribed to shares of stock of ABC and became a significant stockholder. In further consideration of his investment, X and A agreed on how to manage the corporation. Unfortunately, the two (2) stockholders had a disagreement, with each one claiming a breach of the subscription agreement. May A rescind the subscription of X?

No, the rescission of the Subscription Agreement will effectively result in the unauthorized distribution of the capital assets and property of the corporation, thereby violating the Trust Fund Doctrine. Rescission of a subscription agreement is not one of the instances when the distribution of capital assets and property of the corporation is allowed. The Trust Fund Doctrine provides that subscriptions to the capital stock of a corporation constitute a fund to which the creditors have a right to look for the satisfaction of their claims.[293]

Upon the acceptance of a stock subscription by a corporation, the subscription becomes a binding contract to which the subscriber cannot withdraw. Neither does the corporation have the power to release an original subscriber from its subscription, and as against the creditors, a reduction of the capital stock can only take place in the manner and under the conditions prescribed by law or the charter of the corporation. To do so would be violative of the Trust Fund Doctrine since it does not fall under any of the allowable instances where a corporation may distribute its assets to its creditors and stockholders. As such, subscription contracts cannot be cancelled by the board of directors without justifiable cause. This is tantamount to relieving an original subscriber from the subscription, a contractual obligation, which a corporation has no power to do so.[294]

A creditor is allowed to maintain an action upon any unpaid subscriptions (in the same collection suit against the corporation) and thereby step into the shoes of the corporation for the satisfaction of the debt. To make out a *prima facie* case in a suit against stockholders of an insolvent corporation to compel them to contribute to the payment of its debts by making good the balances upon their subscriptions, it is only necessary to establish that the stockholders have not in good faith paid the par value of the stocks of the corporation. Subscriptions to the capital stock of a corporation constitute a fund to which creditors have the right to look for the satisfaction of their claims.[295]

In *Halley v. Printwell, Inc.*,[296] there was no insolvency proceeding and yet the Supreme Court affirmed the right of the creditor to enforce the payment of the unpaid subscription in the same collection suit against the corporation. It is submitted that the appropriate remedy is to enforce the judgment against the corporation first and it is only when the writ of execution is returned unsatisfied for lack of leviable assets sufficient to satisfy the judgment debt that the judgment against the unpaid subscriber may be enforced. Otherwise, the

[292]SEC-OGC Opinion No. 50-2019.
[293]Ong Yong, et al. v. David S. Tiu, et al., G.R. No. 144476 and G.R. No. 144629, April 8, 2003.
[294]Re: Condonation of Subscriptions Receivables or Cancellation of Subscriptions, SEC-OGC Opinion No. 50-19, October 2019.
[295]Halley v. Printwell, Inc., G.R. No. 157549, May 30, 2011.
[296]G.R. No. 157549, May 30, 2011.

unpaid subscriber effectively becomes solidarily liable with the corporation. Such solidary liability has no basis in law.

In another case though (penned by Justice Caguioa), the Court, citing Halley v Printwell, recognized three instances when the creditor is allowed to maintain an action upon any unpaid subscriptions based on the trust fund doctrine: (1) where the debtor corporation released the subscriber to its capital stock from the obligation of paying for their shares, in whole or in part, without a valuable consideration, or fraudulently, to the prejudice of creditors; and (2) where the debtor corporation is insolvent or has been dissolved without providing for the payment of its creditors. [297]. In this case, the Supreme Court ruled that the trust fund doctrine can not be invoked to justify a collection suit against both the corporation-lessee and its stockholders since the lessor did not plead the insolvency or dissolution of the corporation.

D. Board of Directors and trustees

a. Doctrine of centralized management.

It means that corporate powers are vested in a body, called board of directors for a stock corporation and board of trustees for a nonstock corporation. Except in those instances where stockholders' or members' approval is required for certain acts under the RCC or the corporation's bylaws, it is the board which exercises corporate powers. The stockholders or members, regardless of number, will have to delegate the power to manage the corporation to the board.

Stockholders or members periodically elect the board of directors or trustees, who are charged with the management of the corporation. The board, in turn, periodically elects officers to carry out management function on a day-to-day basis. As owners though, the stockholders or members have residual powers over fundamental and major corporate changes. Acts of management pertain to the board; and those of ownership, to the stockholders or members.[298]

b. Business judgment rule

Questions of policy and management are left to the sound discretion and honest decision of the officers and directors of a corporation, and the courts are without authority to substitute their judgment for the judgment of the board of directors. The board is the business manager of the corporation, and so long as it acts in good faith, its orders are not reviewable by the courts.[299] Courts are barred from intruding into the business judgments of the corporation when the same are made in good faith.[300]

The business judgment rule is not absolute. Corporate acts cannot be justified under the business judgment rule if they are contrary to law. For instance, the board cannot invoke this rule to declare dividends when there is no surplus profit or declare dividends out of re-appraisal surplus,[301] or to pay compensation to directors, as this power is lodged with the stockholders. It cannot be relied upon to support a request for a new stock and transfer book

[297] Jennifer M. Enano-Bote, et al v. Jose Ch Alvarez and SBMA G.R. No 223572. November 10, 2020, (J. Caguioa)

[298] Paul Lee Tan v. Paul Sycip, et al., G.R. No. 153468, August 17, 2006.

[299] Cua, Jr. v. Tan, G.R. Nos. 181455-56 and 182008, December 4, 2009; Sales v. Securities and Exchange Commission, G.R. No. 54330, January 13, 1989.

[300] Balinghasay v. Castillo, G.R. No. 185664, April 8, 2015.

[301] 1985 Bar Exam.

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on the pretext that the original is lost (when in fact it is not) and declare entries in the supposed lost stock and transfer book as invalid.[302]

1. ***Tenure, qualifications, and disqualifications of directors***

Distinction between term and tenure.

Term is the time during which the officer may claim to hold the office as a right and fixes the interval after which the several incumbents shall succeed one another. The term is fixed by statute and it does not change simply because the office may have become vacant, nor because the incumbent holds over in office beyond the end of the term due to the fact that a successor has not been elected and has failed to qualify.

Term is distinguished from tenure in that an officer's "tenure" represents his actual incumbency. The tenure may be shorter (or, in case of holdover, longer) than the term for reasons within or beyond the power of the incumbent.

The former is fixed while the latter extends until his successor is duly elected and qualified.[303]

If a hold-over director resigns, the vacancy is due to the expiration of term and not resignation. Accordingly, the vacancy can only be filled by the stockholders in a meeting called for the purpose and not by the board of directors even though the remaining directors may still constitute a quorum.[304]

The election of the new members of the Board of Directors of the Condominium Corporation ("CondoCor") has been nullified due to a.) lack of quorum and b.) disqualification of the nominee-directors of the developer for the position. Consequently, it caused the nullification of the subsequent organizational meeting and election of officers. Under the circumstances, may the incumbent Board of Directors continuously function in a "hold-over" capacity until a new set of members of the Board of Directors are elected and qualified? If the answer is in the affirmative, is the authority of the Board of Directors limited only to handle the corporation's daily operations such as payment of utilities, salaries, the management of personnel, and other issues/problems that requires immediate attention?

The old or incumbent Board of Directors can act as a legitimate managing body pending the election of the successor directors. Pursuant to the hold-over principle as provided in Section 22 of the RCC the incumbent Board of Directors shall serve as directors until their successors are elected and qualified in accordance with the RCC or the Bylaws.

On the other hand, the position that the hold-over Board's authority is limited only to "handling the corporation's daily operation such as payment of utilities, salaries, the management of personnel and other issues/problems that requires immediate attention" is mistaken. The RCC expressly states that the "corporate powers of all corporations formed under the Code shall be exercised, all business conducted and all property of such corporations controlled and held by the board of directors or trustees." Thus, the Board of Directors has the authority to: (1) exercise all powers provided for under the RCC; (2) conduct all business of the corporation; and (3) control and hold all property of the corporation.

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[302] Provident International Resources v. Joaquin Venus, et al., G.R. No. 167041, June 17, 2008.

[303] Valle Verde Country Club, Inc., et al. v. Victor Africa, G.R. No. 151969, September 4, 2009; Re-Election of The Members of The Board of Directors, SEC-OGC Opinion No. 48-11, December 2, 2011.

[304] Valle Verde, ibid., see discussion on "Vacancies in the Office of Director or Trustee".

Qualifications of directors or trustees.

The bylaws may enlarge the share ownership requirement provided that it is not intended to deprive minority representation.

As provided under Section 46 of the RCC, additional qualifications of directors and trustees may also be prescribed under the bylaws of the corporation.

In the absence of a provision in the bylaws, a corporation cannot require additional qualifications for directors other than the mandatory requirement under the RCC.[305]

Bohol Mining Corporation is 60% Filipino-owned and 40% Canadian-owned. As provided in its Articles of Incorporation and Bylaws, its Board of Directors is composed of nine (9) members. During the last annual stockholders meeting held on May 31, three (3) of the nine (9) elected directors were Canadian citizens. Juan de la Cruz together with two (2) other Filipino stockholders petitioned the SEC to disqualify the said three (3) Canadians and to enjoin them from discharging their functions as directors, on the grounds that: (1) aliens cannot participate in any capacity in a nationalized industry, like mining; and (2) the exploitation of natural resources is reserved under the Constitution to Filipino citizens.

a. Will the petition prosper?

The petition will not prosper. The elections of aliens as members of the board of directors or governing body of corporations or associations, engaging in partially nationalized-activities, are allowed by law, in proportion to their allowable participation or share in the capital of such entities, like mining or development of natural resources, in which the foreigners may even own 40% of the capital.[306]

b. Supposing that Bohol Mining Corporation is 70% Filipino-owned while the 30% remaining stocks are owned by foreigners, how many foreigners can be elected to the board?

Since 70% of the capital is owned by Filipinos and 30% by aliens, only 30% of its directors may be foreigners. Since three (3) out of nine (9) is more than 30% only two (2) aliens may sit in X's board. Rounding off to the nearest number is obviously not allowed for the election of directors.[307]

Definition of independent director.

An independent director is a person who, apart from shareholdings and fees received from the corporation, is independent of management and free from any business or other relationship which could or could reasonably be perceived to materially interfere with the exercise of independent judgment in carrying out the responsibilities as a director.

What corporations are required to have independent directors in their Boards?

Independent directors are now explicitly required by RCC to constitute at least twenty percent (20%) of the Board of corporations vested with public interest.

[305] SEC-OGC Opinion No. 51-19, October 11, 2019.
[306] 1985 Bar Exam.
[307] 1983 Bar Exam.

Below are the corporations vested with public interest specified in the RCC:

a. Public companies as described under the Securities Regulation Code ("SRC");
b. Banks and quasi-banks, NSSLAs, pawnshops, corporations engaged in money service business, pre-need, trust and insurance companies, and other financial intermediaries; and
c. Other corporations engaged in businesses vested with public interest similar to the above, as may be determined by the SEC.

A public company is any corporation with class of equity securities listed for trading on an Exchange, or with assets in excess of Fifty Million Pesos (Php50,000,000.00) and has 200 or more holders, at least 200 of which hold at least 100 shares each.[308] This is also the definition of a public company for the purpose of electing independent directors.[309]

CMCI is required by the Securities and Regulation Code ("SRC") to have two (2) independent directors in its Board. Thus, the Bylaws of CMCI provides for the segregation of casting of votes for the election of their regular and independent directors, as follows:

"1. That the segregation of the votes for regular and independent directors is acceptable, such that one vote cast per independent director (since there are only two nominees for independent director) would already be sufficient to elect them. On the other hand, for the regular directors, the nominees with the highest votes cast in their favor would be elected. Under this procedure, the losing nominee for regular director, even if he/she gets a higher number of votes than the independent directors, would still not be elected."

Is the segregate casting of votes for regular and independent directors sanctioned by the Corporation Code?

The segregate casting of votes for regular and independent directors is not contrary to the Corporation Code. The segregation of the voting for regular directors and independent ones is a practical device in order to ensure that at least two (2) independent directors are elected to the CMCI's member Board of Directors in accordance with SRC Rule 38.[310]

2. **Election and removal of directors**

EPCC is a nonstock corporation. Article 6 of EPCC Articles of Incorporation states: "That the number of trustees of the association shall be 15."

Based on the foregoing:

a. Should there be 11 nominees to the Board of Trustees, which is below the required number of trustees to be elected [15] as provided by the Corporation's Articles of Incorporation, are all 11 considered automatically elected regardless of the number of votes received by each?

While the Corporation Code requires the presence of at least a majority of the members of a nonstock corporation for the election of its Board, it does not require such number of votes for one to be declared elected. Under the aforecited provision, the candidates receiving the highest number of votes shall be declared elected.

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[308]Rule 3 (O) of the Revised Implementing Rules and Regulations of the Securities Regulation Code.
[309]Section 38 of the SRC.
[310]Procedure for Election of Directors, SEC-OGC Opinion No. 19-11, March 23, 2011.

Thus, for a candidate to be elected as trustee, said candidate must be among the group of candidates who received the highest number of votes. In case the number of candidates does not exceed the number of seats in the board, said candidates, provided they received votes, can be said to have received the highest number of votes, as the law requires only plurality of the votes cast at the election.

b. What is the minimum number of trustees/nominees in order for the election to be valid?

SEC has previously opined that an election of less number of directors than the number which the meeting was called to elect is valid as to those actually elected.

Thus, the stockholders or members of a corporation may opt to elect a number of directors/trustees less than the number of directors/trustees as fixed in the articles of incorporation. Such a situation would merely give rise to a vacancy in the board, which may be later filled up. The power of the board is not suspended by vacancies in the board unless the number is reduced below a quorum.

The number of candidates elected, however, is not without importance.

The grant of corporate power is to the Board as a body, and not to the individual members thereof, and that the corporation can be bound only by the collective act of the Board. In relation to this, the Board can only transact business if it reaches a quorum.

Votes of the stockholders entitled to cast.

For stock corporations, the stockholders may cast such number of votes based on the shares registered in their names in the books of the corporation, at the time specified in the bylaws, or by the board of directors or trustees, multiplied by the total number of directors to be elected.

To illustrate, if a stockholder owns one thousand (1,000) shares and there are 15 directors to be elected, said stockholder is entitled to cast a total of fifteen thousand (15,000) votes.

Votes of the members of nonstock corporations entitled to cast.

For nonstock corporations, unless cumulative voting is allowed in their articles of incorporation or bylaws, members may cast as many votes as there are trustees to be elected but may not cast more than one (1) vote for one (1) candidate.

Hence, if there are six (6) trustees to be elected, a member has six (6) votes but he cannot cast more than one (1) vote for one (1) candidate. However, if cumulative voting is allowed by the articles or bylaws, he can cast all the six (6) votes in favor of any nominee or spread out the six (6) votes among the nominees as he deems fit.[311]

Emergency quorum

What happens if no election is held, or the owners of majority of the outstanding capital stock or majority of the members entitled to vote are not present in person, by proxy, or through remote communication or not voting *in absentia* at the meeting?

[311] BAR 2011.

The meeting may be adjourned and the outgoing directors or trustee shall serve in a hold-over capacity.[312]

The non-holding of elections and the reasons therefor shall be reported to the SEC within 30 days from the date of the scheduled election. The report shall specify a new date for the election, which shall not be later than 60 days from the scheduled date.

If no new date has been designated, or if the rescheduled election is likewise not held, the SEC may, upon the application of a stockholder, member, director or trustee, and after verification of the unjustified non-holding of the election, summarily order that an election be held. The SEC shall have the power to issue such orders as may be appropriate, including orders directing the issuance of a notice stating the time and place of the election, designated presiding officer, and the record date or dates for the determination of stockholders or members entitled to vote.

Notwithstanding any provision of the articles of incorporation or bylaws to the contrary, the shares of stock or membership represented at such meeting and entitled to vote shall constitute a quorum for purposes of conducting an election under this section.[313]

May a director or trustee be removed from office? If yes, under what conditions?

Yes, a director or trustee may be removed from office. The removal may be carried out by the stockholders or the SEC.

Within the corporation, only stockholders or members have the power to remove the directors of trustees elected by them. The board of directors or trustees may remove an officer but not a director or trustee.[314]

The removal of a director or trustee in a meeting called by a committee not authorized to call a meeting is void even if the removal was approved by the required number of stockholders or members.[315]

Note, however, that only a majority of the outstanding capital stock of the corporation must be present to have a quorum on the election to be held to fill the aforesaid vacancy.

The SEC may order the removal, after due notice and hearing, of a director or trustee who has been elected despite his disqualification, or whose disqualification arose or is discovered subsequent to an election.[316]

The power to remove a director or trustee may be exercised by SEC *motu proprio* or upon receiving a verified complaint. The removal, however, cannot be carried out without due notice and hearing,[317] consistent with due process requirement.

Who may fill the vacancy?

The stockholders or the board of directors, depending on the circumstances may fill the vacancy.

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[312]Section 23, RCC.

[313]Section 25, RCC.

[314]Nectarina Raniel v. Paul Jochico, G.R. No. 153413, March 1, 2007.

[315] Jose Bernas, et al v. Jovencio Cinco, G.R. Nos. 163356-57, July 1, 2015

[316]Ibid.

[317]Ibid.

a. The stockholders have the sole power to fill the vacancy in the following cases:
b. The cause of the vacancy is the expiration of term, removal of a director or increase in the number of board seats;
c. The cause of the vacancy is not any of the three (3) grounds referred to above but the remaining directors do not constitute a quorum;[318] and
d. The cause of the vacancy is not any of the three (3) grounds referred to above, the remaining directors constitute a quorum but the board of directors referred the authority to fill the vacancy to the stockholders.

The filling of vacancy by the stockholders is subject to the notice and quorum requirements under Section 24 of the RCC. Nonvoting shares are not included in the computation of quorum because the election of directors is outside the eight (8) cases where nonvoting shares are vested the right to vote.[319]

The board of directors may fill the vacancy if the following requisites are present:

a. The cause of the vacancy is due to any ground other than expiration of term, removal of a director or increase in the number of board seats; and,
b. The remaining directors constitute a quorum.[320]

Requisites to create an Emergency Board.

The requisites are:

a. The vacancy prevents the remaining directors from constituting a quorum;
b. Emergency action is required to prevent grave, substantial, and irreparable loss or damage to the corporation;
c. The vacancy may be temporarily filled from among the officers of the corporation;
d. The appointment must be made by the unanimous vote of the remaining directors or trustees; and
e. The action by the designated director or trustee shall be limited to the emergency action necessary, and the term shall cease within a reasonable time from the termination of the emergency or upon the election of the replacement director or trustee, whichever comes earlier.

The corporation must notify the SEC within three (3) days from the creation of the emergency board, stating therein the reason for its creation.

3. Duties, responsibilities and liabilities for unlawful acts

Are directors, trustees, and officers liable for action they have taken on behalf of the corporation?

A corporation, as a juridical entity, may act only through its directors, officers, and agents. Obligations incurred as a result of the directors' and officers' acts as corporate agents are not their personal liability but the direct responsibility of the corporation they represent.[321]

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[318] Section 28.
[319] Section 6, RCC.
[320] Section 28, ibid.
[321] Girly G. Ico v. Systems Technology Institute Inc., et al., G.R. No. 185100, July 9, 2014.

As such, as a general rule, directors, or officers are not liable for any action taken on behalf of the corporation.

Instances when personal liability may attach to directors, trustees, or officers of the corporation.

A director, officer, or trustee may be held personally liable in the following cases:

a. Knowingly voting for or assenting to patently unlawful acts of the corporation;
b. Gross negligence or bad faith in directing the affairs of the corporation;
c. Acquiring any personal or pecuniary interest in conflict with his duty as director or trustee or officer resulting in damage to the corporation;[322]
d. He consents to the issuance of watered stocks or who, having knowledge thereof, does not forthwith file with the corporate secretary his written objection thereto;
e. He agrees to hold himself personally liable with the corporation; and
f. He is made, by a specific provision of law, to personally answer for his corporate action.[323]

There is no hard and fast rule as to when an act amounts to ordinary or gross negligence or bad faith. It depends on the surrounding circumstances.

However, before a director or officer of a corporation can be held personally liable for corporate obligations, the following requisites must concur:

i. The complainant must allege in the complaint that the director or officer assented to patently unlawful acts of the corporation, or that the officer was guilty of gross negligence or bad faith; and
ii. The complainant must clearly and convincingly prove such unlawful acts, negligence, or bad faith.[324]

It should be noted that the stockholders are not included in the enumeration of persons who may be held personally liable. Stockholders are liable only to the extent of their subscription[325] unless they also act as directors, officers, or agents of the corporation.

On whether payment of bonuses to officers despite knowledge of substantial losses of the company is a criminal offense under Section 144 of the Corporation Code (now Section 170 of the RCC), it was held that the lack of specific language imposing criminal liability in Sections 31 (gross negligence and bad faith in conducting the affairs of the corporation) and 34 (doctrine of corporate opportunity) shows legislative intent to limit the consequences of their violation to the civil liabilities mentioned therein. Had it been the intention of the drafters of the law to define Sections 31 and 34 as offenses, they could have easily included similar language as that found in Section 74 (violation of right of inspection).

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[322]Section 30, RCC.

[323]Pioneer Insurance Surety Corporation v. Morning Star Travel & Tours Inc., G.R. No. 198436, July 8, 2015; Carag v. NLRC, G.R. No. 147590, April 2, 2007; Atrium Management v. Court of Appeals, et al., G.R. No. 109491, February 28, 2001; John F. McLeod v. National Labor Relations Commission First Division, et al., G.R. No. 146667, January 23, 2007; Philex Gold Philippines v. Philex Bulawan Supervisors Union, G.R. No. 149758, April 25, 2005.

[324]Heirs of Fe Tan Uy v. International Exchange Bank, G.R. No. 166282, February 13, 2013; See also Bank of Commerce v. Marilyn P. Nite, G.R. No. 211535, July 22, 2015 and Polymer Rubber Corporation v. Ang, G.R. No. 185160, July 24, 2013.

[325]Donnina Halley v. Printwell, Inc., G.R. No. 157549, May 30, 2011.

The Corporation Code was intended as a regulatory measure, not primarily as a penal statute. Sections 31 and 34 in particular were intended to impose exacting standards of fidelity on corporate officers and directors but without unduly impeding them in the discharge of their work with concerns of litigation. Considering the object and policy of the Corporation Code to encourage the use of the corporate entity as a vehicle for economic growth, we cannot espouse a strict construction of Sections 31 and 34 as penal offenses in relation to Section 144 in the absence of unambiguous statutory language and legislative intent to that effect. [326]

The liability of the erring director, trustee or officer under Section 31 of the Corporation Code (for gross negligence and bad faith in conducting the affairs of the corporation) being purely civil, i.e., "all damages resulting [from its violation] suffered by the corporation, its stockholders or members and other persons," the Civil Code is the controlling law to determine prescription of action, particularly, Article 1146 of the Civil Code which provides for a four year period for an action upon an injury to the rights of the plaintiff, and quasi-delict. [327]

Statutory liability for corporate act or omission

There are cases when the law makes the directors and officers liable for the corporate act or omission. The general rule is that directors, trustees, and officers can be held criminally liable for acts or omission done on behalf of the corporation only when they are made by specific provision of law to personally answer for their corporate act or omission.[328] If the offender is a corporation, certain laws impose criminal liability on the directors, officers, or even agents responsible for the violation or offense. An example is Presidential Decree 115 (“**P.D. No. 115**”) or Trust Receipts Law.

In *Ching v. Secretary of Justice*,[329] the director/officer, who signed the trust receipt agreement, did not receive the goods under the trust receipt. He did not get the loan himself nor derived any personal benefit under the trust receipt transaction. The Supreme Court said that these are not valid justifications to negate his criminal liability because it is the law that makes him liable for the corporate act of violating the trust receipt.

The director or officer who signed the trust receipts cannot, thus, hide behind the cloak of the separate corporate personality of the corporation. In the words of Chief Justice Earl Warren, a corporate officer, cannot protect himself behind a corporation where he is the actual, present, and efficient actor.

In *Edward C. Ong v. the Court of Appeals and the People of the Philippines*,[330] criminal liability was imposed against the person who signed the trust receipt agreement on behalf of the corporation even though he is not a director or officer of the corporation. It is because under P.D. No. 115, or the Trust Receipts Law, if the offender is a corporation the penalty shall be imposed upon the director, officer, or any person responsible for the violation.

Although the pieces of evidence show that respondent signed the Trust Receipt Agreements, they do not show that he signed them in his personal capacity. Without any evidence that respondent personally bound himself to the debts of the company he represented, he cannot be held civilly liable under the Trust Receipt Agreements.[331]

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[326] United Coconut Planters Bank v. Secretary of Justice, et al., G.R. No. 209601, January 12, 2021 (J. Caguioa)

[327] United Coconut Planters Bank v. Secretary of Justice, ibid

[328] Sia v. People of the Philippines, G.R. No. L-30896, April 28, 1983.

[329] Ching v. Secretary of Justice, G.R. No. 164317, February 6, 2006.

[330] Edward Ong v. Court of Appeals and People of the Philippines, G.R. No. 119858, April 29, 2003.

[331] BDO Unibank, Inc. V. Antonio Choa G.R. No. 237553, 10 July 2019, THIRD DIVISION.

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E. Stockholders and members

1. **Rights and obligations of stockholders and members**

Rights of a stockholder

In exchange for his equity investment in a corporation, a stockholder is entitled to the following rights:

a. Proprietary Rights – these rights pertain to certain economic benefits that accrue to his shares, such as:

   i. Right to receive dividends; and
   ii. Right to participate in the assets of the corporation upon dissolution and liquidation.

b. Management Rights – these refer to participation in the conduct of the business of the corporation exercised through the following:

   i. Right to vote on all corporate acts requiring stockholder's approval; and
   ii. Right to elect the directors of the corporation.

c. Remedial Rights – these refer to remedies the stockholder may pursue depending on the issues involved, such as:

   i. Appraisal right;
   ii. Pre-emptive right;
   iii. Right to inspect;
   iv. Right to copy of the financial statements of the company; and
   v. Right to file a derivative suit.

Obligations of a stockholder

A stockholder has the following obligations:

1. To pay to the corporation unpaid subscription;
2. To pay to the corporation interest on unpaid subscription if so required by the bylaws or in case of default;
3. He is liable to the creditors of the corporation for unpaid subscription based on the trust fund doctrine;
4. He is liable for watered stocks;
5. He is liable to return dividends unlawfully paid; and
6. He is liable for claims against the corporation in cases where the corporate veil is pierced.

a. **Doctrine of equality of shares**

This means that shares have the same rights and privileges unless otherwise classified by the articles of incorporation.

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2. *Participation in management*

A distressed company ("Company") executed a voting trust agreement for a period of three (3) years over 60% of its outstanding paid-up shares in favor of a bank to whom it was indebted, with the Bank named as trustee. Additionally, the Company mortgaged all its properties to the Bank.

Because of the insolvency of the Company, the Bank foreclosed the mortgaged properties, and as the highest bidder, acquired said properties and assets of the Company.

The three-year period prescribed in the Voting Trust Agreement having expired, the Company demanded the turnover and transfer of all its assets and properties, including the management and operation of the Company, claiming that under the Voting Trust Agreement, the bank was constituted as trustee of the management and operations of the Company.

Does the demand of the Company tally with the concept of a Voting Trust Agreement? Explain briefly.

No. The demand of the Company does not tally with the concept of a Voting Trust Agreement. Under a voting trust agreement, the transferring stockholder merely conveys to the trustee the right to vote and other rights of a stockholder over the transferred shares except for proprietary rights.

The consequence of the foreclosure of the mortgaged properties is distinct and separate from the Voting Trust Agreement and its effects.[332]

Distinguish proxy from voting trust agreement.

	Proxy	**Voting Trust Agreement**
As to form	It must be in writing, signed by the stockholder and filed with the corporate secretary on the date fixed in the bylaws but not later than a reasonable time before the meeting. The RCC clarified that proxy may be in any form as long as the same is authorized by the bylaws.	It must be in writing, signed by the stockholder and notarized. A copy of the voting trust agreement must be submitted to the SEC, otherwise, it is not enforceable.
As to the rights conferred	A proxy is vested the right to vote. No right to inspect is granted, unless separately authorized for that purpose. A proxy cannot be voted and cannot qualify as director of a corporation unless he is a stockholder in his own right.	A trustee is vested legal title to the shares and as such, may exercise not only voting right but the right of inspection as well. A trustee is qualified to be elected as director or trustee. All rights of a stockholder may be exercised by trustee EXCEPT proprietary rights (*e.g.*, right to receive dividends and to receive the assets upon

[332] 1992 Bar Exam.

	Proxy	Voting Trust Agreement
		dissolution and liquidation of the corporation).
As to term	Valid only for the meeting intended, unless general and continuing in nature but not to exceed five (5) years. The presence of stockholder or principal revokes the authority of the proxy holder.	Valid for a period not exceeding five (5) years. The voting trust can be longer than five (5) years if executed pursuant to a loan agreement, but expires upon full payment of a loan. The voting trust can be extended if it is co-terminus with the loan agreement. The presence of trustor does not revoke the authority of the trustee.

3. *Proprietary rights*

a. Right to dividends

The total subscriptions are deducted from the assets to determine the availability of retained earnings because, under the trust fund doctrine, subscriptions to the capital stock constitute a fund to which creditors have a right to look for the satisfaction of their claims and which the corporation is not allowed to impair to their prejudice.

It is not necessary for the corporation to seek prior approval/advice from the SEC to declare cash and stock dividend. However, if the stock dividend declaration requires an increase of authorized capital stock, an application therefor is mandated to be filed with the SEC pursuant to Section 37 of the RCC.[333]

Palmavera Corporation has an authorized capital stock of P500,000,000 all subscribed and outstanding as of December 31, 2019. The corporation also has unrestricted retained earnings in its book amounting to P375,000,000. Since the corporation needed the cash surplus to carry out its expansion projects, the board of directors, in its meeting held on January 5, 2020, approved a resolution declaring and ordering the issuance of 50% stock dividends in lieu of cash dividends.

a. Was the resolution declaring the issuance of stock dividends valid? Explain your answer.

Yes, the resolution of the Board of Directors declaring the issuance of stock dividends was valid, but still insufficient for purposes of stock dividend.[334]

b. What is/are the step/s needed to be taken so that the decision of the board could be implemented? State the required vote.

The aforesaid approval of the Board of Directors for the declaration of stock dividends should still be concurred in by the stockholders representing not less than 2/3 of the outstanding capital stock, at a regular or special meeting called for the purpose. In addition, the authorized capital stock must be increased to accommodate the stock dividends since the authorized capital stock of Palmavera Corporation is fully subscribed. The increase in capital stock is subject to SEC approval.[335]

[333] Re: SEC Approval of Issuance of Cash and Stock Dividends, SEC-OGC Opinion No. 23-19, June 17, 2019.
[334] Section 42, RCC.
[335] Answered based Sections 37 & 42, RCC; 1982 Bar Exam.

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ABC Management, Inc. presented to DEF Mining Corp. the draft of its proposed Management Contract. As an incentive, ABC included in the terms of compensation that ABC would be entitled to 10% of any stock dividend which DEF may declare during the lifetime of the Management Contract. Would you approve of such provision? If not, what would you suggest as an alternative?

I would not approve of a proposed stipulation in the management contract that the managing corporation, as additional compensation to it, should be entitled to 10% of any stock dividend that may be declared. Stockholders are the only ones entitled to receive stock dividends. I would add that the unsubscribed capital stock of a corporation may only be issued for cash or property or for services already rendered constituting a demandable debt. As an alternative, I would suggest that the managing corporation should instead be given net profit participation and, if later so desires, to then convert the amount that may be due thereby to equity or shares of stock at no less than the par value thereof.[336]

b. Right to inspect

The Corporation Code has granted to all stockholders the right to inspect the corporate books and records, and in so doing has not required any specific amount of interest for the exercise of the right to inspect. The right cannot be denied on the basis that the inspection is for a doubtful or dubious reason. The right of the shareholder to inspect the books and records should not be made subject to the condition of a showing of any particular dispute or of proving any mismanagement or other occasion rendering an examination proper, but if the right is to be denied, the burden of proof is upon the corporation to show that the purpose of the shareholder is improper, by way of defense.[337]

The burden of proof is on the corporation to show that the stockholder's action in seeking examination of the corporate records was moved by unlawful or ill-motivated design.[338]

Extent or scope of the right of inspection.

The right of inspection extends to all corporate records, regardless of the form in which they are stored.[339] It covers the stock and transfer book because it is part of corporate records.[340]

It also extends to books and records of the corporation's wholly-owned subsidiary which are in the corporation's possession and control as it is more in accord with equity, good faith and fair dealing to construe the statutory right of a stockholder to cover such books and records.[341]

Persons allowed to inspect corporate records.

Corporate records, regardless of the form in which they are stored, shall be open to inspection by any director, trustee, stockholder, or member of the corporation in person or by a representative at reasonable hours on business days, and a demand in writing may be made by such director, trustee, or stockholder at their expense, for copies of such records or excerpts from said records.

[336] 1991 Bar Exam.
[337] Terelay Investment and Development Corporation v. Cecilia Teresita J. Yulo, G.R. No. 160924, August 5, 2015.
[338] Republic v. Sandiganbayan, G.R. Nos. 88809 and 88858 (Resolution), July 10, 1991.
[339] Section 73, RCC.
[340] Aderito Z. Yujuico v. Cezar T. Quiambao, et al., G.R. No. 180416, June 2, 2014; Section 73, RCC.
[341] John Gokongwei, Jr. v. Securities and Exchange Commission, et al., G.R. No. L-45911, April 11, 1979.

A requesting party who is not a stockholder or member of record, or is a competitor, director, officer, controlling stockholder or otherwise represents the interests of a competitor shall have no right to inspect or demand reproduction of corporate records.[342]

Did the RCC de-criminalize violation of stockholder's right of inspection?

The RCC did not de-criminalize the violation of stockholder's right of inspection. It only removed the penalty of imprisonment and limited the penalty to monetary fines.

Remedies of a stockholder if the corporation denies or does not act on his demand for inspection.

The remedies are as follows:

a. If the corporation denies or does not act on a demand for inspection and/or reproduction, the aggrieved party may report such denial or inaction to the SEC. Within five (5) days from receipt of such report, the SEC shall conduct a summary investigation and issue an order directing the inspection or reproduction of the requested records;[343]
b. He may file with a criminal complaint for violation of his right of inspection;[344] and
c. He may file a petition for inspection of corporate records (Rule 7 of the Rules of Procedure for Intra-Corporate Controversies).

Is an action to recover possession of a stock transfer from the former secretary of the corporation enforceable by criminal prosecution based on violation of the stockholders' right of inspection?

No, a criminal action based on the violation of a stockholder's right to examine or inspect the corporate records and the stock and transfer book of a corporation can only be maintained against corporate officers or any other persons acting on behalf of such corporation. A violation of Section 74 of the OCC (now, Section 73 of the RCC) contemplates a situation wherein a corporation, acting through one of its officers or agents, denies the right of any of its stockholders to inspect the records, minutes and the stock and transfer book of such corporation.

The proprietary right of the corporation to be in possession of such records and book, though certainly legally enforceable by other means, cannot be enforced by a criminal prosecution based on a violation of the Corporation Code.[345]

Defenses available to the corporation against a person demanding to examine and copy excerpts from the corporation's records.

a. The stockholder demanding to examine and copy excerpts from the corporation's records and minutes has improperly used any information secured through any prior examination of the records or minutes of such corporation or of any other corporation.
b. The stockholder was not acting in good faith or for a legitimate purpose in making the demand to examine or reproduce corporate records.

[342]Section 73, RCC.
[343]Ibid.
[344]Sections 73 and 161, RCC.
[345]Aderito Z. Yujuico v. Cezar T. Quiambao, et al., G.R. No. 180416, June 2, 2014.

c. The person demanding inspection or is a competitor, director, officer, controlling stockholder or otherwise represents the interests of a competitor.[346]
d. The purpose of inspection is not germane to his interest as a stockholder.[347]
e. The right is not being exercised during reasonable hours on a business day.
f. The subject matter of the inspection is a protected information under other applicable laws R.A. No. 8293, otherwise known as the Intellectual Property Code of the Philippines, as amended, and R.A. No. 10173, otherwise known as the Data Privacy Act of 2012 and R.A. No. 1405, otherwise known as Law on Secrecy of Philippine Currency Bank Deposits.

Examples of legitimate purposes to warrant the exercise of the right of inspection.

Among the purposes held to justify a demand for inspection are the following: (1) to ascertain the financial condition of the company or the propriety of dividends; (2) to determine the value of the shares of stock for sale or investment; (3) to determine whether there has been mismanagement; (4) in anticipation of shareholders' meetings, to obtain a mailing list of shareholders to solicit proxies or influence voting; (5) to obtain information in aid of litigation with the corporation or its officers as to corporate transactions.[348]

Examples of improper purposes which may justify denial of the right of inspection.

Among the improper purposes which may justify denial of the right of inspection are: (1) obtaining of information as to business secrets or to aid a competitor; (2) to secure business "prospects" or investment or advertising lists; (3) to find technical defects in corporate transactions in order to bring "strike suits" for purposes of blackmail or extortion.[349]

Right of inspection not extinguished by the dissolution of the corporation.

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 nor those of its owners and creditors. Thus, the revocation of the corporation's registration does not automatically strip off the stockholder of his right to examine pertinent documents and records of the corporation.[350]

The rights and remedies against, or liabilities of, the officers shall not be removed or impaired by reason of the dissolution of the corporation. Corollary then, a stockholder's right to inspect corporate records subsists during the period of liquidation. Accordingly, if the stockholder was deprived of the exercise of an effective right of inspection, offenses had in fact been committed, regardless of lack of criminal intent.[351]

c. Pre-emptive right

Definition of pre-emptive right.

It is the right of stockholders to subscribe to all issues or disposition of shares of any class by the corporation, in proportion to their respective shareholdings.[1] In practical terms, this

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[346]Section 73, RCC.
[347]Gonzales v. Philippine National Bank, supra.
[348]Terelay Investment and Development Corporation v. Cecilia Teresita J. Yulo, G.R. No. 160924, August 5, 2015.
[349]Ibid.
[350]Alejandro· D.C. Roque v. People of the Philippines, G.R. No. 211108, June 7, 2017.
[351]Alfredo L. Chua v. People of the Philippines, G.R. No. 216146, August 24, 2016.

means that the shares of stock of the corporation should first be offered proportionately to the stockholders before they can be issued or sold to non-stockholders.[352]

The right may be exercised whether the issued shares are taken from the unsubscribed portion of the authorized capital stock or in case of increase of capital stock.

Rationale of pre-emptive right.

The foundation or underlying basis of this right is to maintain the proportionate voting strength and control of existing stockholders, that is, the existing ratio of their interest and voting power in the corporation. This right prevents the dilution and impairment of the stockholders' interest in the corporation.

Exceptions to pre-emptive right

The pre-emptive right of stockholders is not an absolute right. It is subject to the following exceptions:

a. Denial of pre-emptive right in the articles of incorporation or amendment thereto.

   Take note that the denial of pre-emptive right must be contained in the articles of incorporation or amendment thereto. The denial cannot be by mere board resolution or as an amendment to the bylaws of the corporation.[353]

b. Waiver of such right by the stockholder, whether express or implied.

   If the board resolution approving the issuance of shares prescribes certain number of days to exercise the pre-emptive right and the stockholder fails to exercise such right within the fixed period, the stockholder is deemed to have impliedly waived his right.

c. Shares issued in compliance with the laws requiring minimum stock ownership by the public.

   Public companies are required to have a portion of their outstanding capital stock owned by the public. The current minimum public ownership set by law is 10% of the corporation's outstanding capital stock. Failure to comply with this requirement will result to the delisting of the shares in the Stock Exchange. Thus, the issuance of shares to comply with the minimum public ownership requirement is not subject to pre-emptive right.

d. Issuance of shares in exchange for property given for a corporate purpose, if approved by the stockholders representing at least 2/3 of the outstanding capital stock.

e. Issuance of share in payment of debt made in good faith, if approved by the stockholders representing 2/3 of the outstanding capital stock.

Philippine Stock Exchange, Inc. ("PSE") has two prospective strategic investors which manifested its intent to subscribe to the unsubscribed shares of the PSE. The legal counsel of the PSE posits that the pre-emptive right of the existing shareholders does not apply to the intended subscription based on the following grounds: (1) the shares to be offered to the strategic investors are not new shares but are sourced from the PSE's unsubscribed capital stock; and/or, (2) the sale to the

[352] 2019 Bar Exam.
[353] 2011 Bar Exam.

strategic investors is in furtherance of the ownership limits prescribed by Section 33.2 (c) of the Securities and Regulation Code ("SRC") which provides for the maximum ownership of the stockholders of the PSE, and thus falls under the exceptions recognized by Section 38 of the RCC. Is the position of legal counsel of PSE tenable?

Section 38 of the RCC explicitly states that unless denied in the articles of incorporation or the issuance falls under any of the enumerated exceptions, all existing stockholders of record are entitled to exercise pre-emptive right to subscribe to "**all issues or disposition of shares of any class**" of a stock corporation.

Since Section 38 of the RCC uses the phrase "all issues or disposition of shares of any class," pre-emptive right extends not only to the issuance of new shares resulting from an increase in capital stock but also to the issuance of previously unsubscribed shares which form part of the existing authorized capital stock, as well as to the disposition of treasury shares.

Considering that Section 38 of the RCC does not distinguish between newly issued shares and previously unsubscribed shares, the pre-emptive right is available to existing shareholders of PSE upon its issuance of unsubscribed authorized capital stock to potential strategic investors.

Neither does the issuance of shares to potential strategic investors fall under the exceptions enumerated in Section 38 of the RCC. It is apparent from Section 38 of the RCC that pre-emptive right does not extend to the issue of shares made in compliance with laws requiring stock offerings or minimum stock ownership by the public. However, PSE's issuance of shares to potential strategic investors to comply with Section 33.2 (c) of the SRC cannot be considered as one in compliance with laws requiring stock offerings or minimum stock ownership. Section 33.2 (c) of the SRC clearly provides a maximum, not the minimum, limit on stock ownership, and does not necessarily require the issuance of shares to comply with the legal requirements provided therein.[354]

Remedies available to stockholders in case of an amendment to the corporation's articles of incorporation to create preferred redeemable shares.

The remedies of the stockholders in case of an amendment to the corporation's articles of incorporation to create redeemable shares are as follows:

a. Vote in favor of the amendment but pass up to the opportunity to subscribe to the preferred redeemable shares since this type of shares is non-voting and as such, will not dilute the stockholder's voting rights, save for the eight (8) cases under Section 6 of the RCC;
b. Subscribe to the new preferred shares since the stockholders' pre-emptive right covers shares of any class; or
c. Exercise their appraisal right.[355]

"X" Realty, Inc., a corporation engaged in the subdivision business, has an authorized capital of P8, 000,000, all of which has been fully subscribed. At a special meeting of the board of directors, the majority vote decided, on the basis of the recommendation of its Executive Committee, that the corporation purchase a 5-hectare property offered to it because it was ideal for its subdivision business, the price offered was lower than the prevailing market price, and John Roque, the owner of the property, was willing to accept P2,000,000 worth of shares of the corporation

[354]Availability of Pre-Emptive Rights; Ownership Restrictions in the PSE, SEC-OGC Opinion No. 41-11, October 5, 2011.

[355] Section 80, RCC.

in exchange of, or as payment for, his property. No cash was involved in the transaction. Thus, the board approved a resolution increasing the authorized capital stock from P8,000,000 to P10,000,000, stipulating that the additional P2,000,000 worth of shares shall be issued in exchange for the 5-hectare property and that the existing stockholders shall have no pre-emptive right to subscribe to the additional shares as the same were being issued to pay for the property.

Was the action of the Board correct and sufficient?

The action of the Board of Directors was correct, but not sufficient. Under Sections 38 and 61 of the RCC, shares may be issued for property needed for corporate purposes but subject to SEC approval to ensure that the real property is fairly valued, to prevent the issuance of watered stocks. The increase of capital stock is also subject to the approval of the stockholders representing at least 2/3s of the outstanding capital stock. No SEC and stockholders approvals were indicated in the problem.[356]

Remedy of the stockholder not in favor of an amendment to the articles of incorporation to deny pre-emptive right.

He can exercise his appraisal right. One of the instances where appraisal right is available is in case of an amendment to the articles of incorporation that has the effect of changing or restricting the rights of the stockholder or any shares.[357] Denial of pre-emptive right restricts his right to subscribe to the issuance of shares by the corporation.[358]

d. Right of first refusal

Distinction of right of first refusal from pre-emptive right.

Right of first refusal is the option granted to the corporation and/or its stockholders to purchase the shares of a transferring stockholder upon reasonable terms and conditions while pre-emptive right refers to the right of the stockholder to subscribe to any and all issuances and disposition of shares by the corporation.

The corporation and its stockholders have no right of first refusal unless such restriction on transfer is embodied in the articles of incorporation, bylaws of the corporation and stock certificate of the corporation. This means that a stockholder may freely convey his shares to any person without having to offer the shares to the corporation and/or the stockholders first, unless a right of first refusal is granted to the latter.

Pre-emptive right is available to all stockholders unless such right is denied in the articles of incorporation or amendment thereto.

Pre-emptive right pertains to stockholders by law and does not require any statutory enabling provision, the right of first refusal, if not provided for by law or by the articles of incorporation, does not exist at all.[359]

4.Remedial rights

[356] 1982 Bar Exam but answered under the RCC.
[357] Section 80, RCC.
[358] See Turner vs. Lorenzo Shipping Corporation, G.R. No. 157479, November 24, 2010.
[359]SEC-OGC Opinion 51-19.

Appraisal right

It is the right of the stockholder to demand the payment of the fair value of his shares after dissenting against a proposed corporate act in the cases specified by law.[360] In practical terms, it means the right to get out of the corporation and get back his equity investment.

Instances when appraisal right is available.

The appraisal right can be exercised by a dissenting stockholder in the following cases:

a. In case an amendment to the articles of incorporation has the effect of changing or restricting the rights of any stockholder or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, or of extending or shortening the term of corporate existence.
b. In case of sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets.[361]
c. In case of merger or consolidation.
d. In case of investment of corporate funds for any purpose other than the primary purpose of the corporation.[362]
e. In a close corporation, a stockholder may, for any reason, compel the said corporation to purchase his shares at their fair value, which shall not be less than their par or issued value, when the corporation has sufficient assets in its books to cover its debts and liabilities exclusive of capital stock.[363]

Cite examples of the amendment to the articles of incorporation that has the effect of changing or restricting the rights of any stockholder or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, which then warrants the exercise of appraisal right.

a. Denial of pre-emptive right.
b. Creating shares which are given preferences in payment of dividends or in the distribution of assets or other preferences as may be indicated in the amendment to the articles of incorporation provided they are not contrary to law.
c. Converting non-voting preferred shares to voting shares.
d. Making non-voting redeemable preferred shares into convertible voting shares in case of non-redemption of the redeemable shares.

4. Intra-corporate disputes (individual vs representative vs derivative suits)

What are the cases falling under the rules on intra-corporate controversy?

The following cases are governed by the Supreme Court-issued "Interim Rules of Procedure for Intra-Corporate Controversies":

a. Devices or schemes employed by, or any act of, the board of directors, business associates, officers or partners, amounting to fraud or misrepresentation which may be detrimental to the interest of the public and/or of the stockholders, partners, or members of any corporation, partnership, or association;
b. Controversies arising out of intra-corporate, partnership, or association relations, between and among stockholders, members, or associates; and between, any or all of

[360] Section 80, RCC.
[361] See discussion in Section 39, RCC.
[362] Section 80, RCC.
[363] Article 104, RCC.

them and the corporation, partnership, or association of which they are stockholders, members, or associates, respectively;
c. Controversies in the election or appointment of directors, trustees, officers, or managers of corporations, partnerships, or associations;
d. Derivative suits; and
e. Inspection of corporate books.[364]

When is a dispute considered intra-corporate in nature?

A dispute is considered intra-corporate in nature if it satisfies the relationship test and nature of the controversy test. The two tests must concur. Under the relationship test, the parties in dispute must be any one of the following: (a) between the corporation, partnership, or association and the public; (b) between the corporation, partnership, or association and its stockholders, partners, members, or officers; (c) between the corporation, partnership, or association and the State as far as its franchise, permit or license to operate is concerned; and (d) among the stockholders, partners, or associates themselves.

Under the nature of the controversy test, the disagreement must not only be rooted in the existence of an intra-corporate relationship, but must pertain to the enforcement of the parties' correlative rights and obligations under the Corporation Code and the internal and intra-corporate regulatory rules of the corporation. If the relationship and its incidents are merely incidental to the controversy or if there will still be conflict even if the relationship does not exist, then no intra-corporate controversy exists.[365]

Cite jurisprudence where the Supreme Court held that the case is intra-corporate in nature.

a. A controversy between the condominium corporation and its members-unit owners for alleged unsound business practices and violation of the master deed of restriction does not fall within the jurisdiction of the HLRUB despite its expansive jurisdiction. It is considered an intra-corporate controversy falling within the jurisdiction of the Regional Trial Court designated as special commercial court.[366]

b. The mere fact that a corporation's shares of stocks are owned by a sequestered corporation does not, by itself, automatically categorize the matter as one involving sequestered assets, or matters incidental to or related to transactions involving sequestered corporations and/or their assets.

   Based on the foregoing tests, it is clear that this case involves an intra-corporate dispute. It is a conflict between a stockholder and the corporation, which satisfies the relationship test, and it involves the enforcement of the right of a stockholder to inspect the books of PHC and the obligation of the latter to allow its stockholder to inspect its books.[367]

DC is a unit owner of Medici Condominium located in Pasig City. On September 7, 2011, Medici Condominium Corp. ("Medici") demanded from DC payment for alleged

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[364] Section 1, Interim Rules of Procedure For Intra-Corporate Controversies.
[365] Norma D. Cacho and North Star International Travel, Inc. vs. Virginia D. Balagtas, G.R. No. 202974. February 7, 2018; Gulfo vs. Ancheta, G.R. No. 175301, August 15, 2012; Medical Plaza Makati Condominium Corporation vs. Robert H. Cullen G.R. No. 181416, November 11, 2013; Philippine Overseas Telecommunications Corporation vs. Africa, Et Al. G.R. No. 184622, July 3, 2013; Philippine Communications Satellite Corporation vs. Sandiganbayan,G.R. No. 203023, 17 June 2015; San Jose vs. Ozamiz, G.R. No. 190590, July 12, 2017; Philippine Communications Satellite Corporation And Philcomsat Holdings Corporation vs. Sandiganbayan G.R. No. 203023, 17 June 2015; Roberto vs. San Jose and Delfin P. Angcao vs. Jose Ma. Ozamiz; G.R. No. 190590, July 12, 2017.
[366] Lim vs. Distinction Properties Development and Construction, GR no. 194024, April 25, 2012.
[367] Roberto vs. San Jose and Delfin P. Angcao vs. Jose Ma. Ozamiz, G.R. No. 190590, July 12, 2017.

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unpaid association dues and assessments amounting to ₱195,000.00. DC disputed the claim, saying that he paid all dues as shown by the fact that he was previously elected as Director and President of Medici. Medici, on the other hand, claimed that DC's obligation was a carry-over of his obligations to the condominium developer, Medici Construction Corporation. Consequently, DC was prevented from exercising his right to vote and be voted for during the 2011 election of Medici's Board of Directors. This prompted DC to file a complaint for damages before the Special Commercial Court of Pasig City. Medici filed a motion to dismiss on the ground that the court has no jurisdiction over the intra-corporate dispute which the Housing and Land Use Regulatory Board ("HLURB") has exclusive jurisdiction over.

Is Medici correct?[368]

No. Medici is not correct. Where a member of the condominium corporation was denied the right to vote for alleged non-payment of condominium dues and assessments, the action although denominated as one for damages is an intra-corporate controversy and therefore falling within the jurisdiction of the Regional Trial Court designated as a special commercial court.[369]

Cite jurisprudence where the Supreme Court ruled that the case is not intra-corporate in nature.

a. The determination as to who is the true owner of the disputed property entitled to the income generated therefrom is civil in nature. The conflict among the parties was outside the jurisdiction of the special commercial court.[370]

b. A complaint for damages filed by a member of the subdivision homeowners association for the harm he suffered when another member maliciously closed a portion of the plaintiff's drainage pipe which led to the overflowing of his septic tank is not an intra corporate controversy following nature of the controversy test.[371]

a. Election or appointment controversies of directors, trustees, officers or managers.

Test to determine if the removal of an officer of the corporation is a labor dispute or an intra-corporate controversy

The test to determine if the removal of an officer of the corporation is a labor dispute or an intra-corporate controversy is the nature of the office the officer is occupying in the corporation. If he is holding an office specified in the in the charter or bylaws, then he is a corporate officer. Any issue pertaining to his removal is intra-corporate in nature and therefore cognizable by the appropriate Regional Trial Court. If the officer is not holding a bylaws position, his removal is considered a labor dispute, falling within the jurisdiction of the labor arbiter.

An office is created by the charter of the corporation and the officer is elected by the directors or stockholders. On the other hand, an employee occupies no office and generally is employed not by the action of the directors or stockholders but by the managing officer of the corporation.[372]

[368] 2014 Bar Exam.
[369] Medical Plaza Makati Condominium Corporation vs. Cullen, GR No. 181416, November 11, 2013.
[370] Eustacio Atwel et al. vs. Concepcion Progressive Association, G.R. No. 169370, April 14, 2008.
[371] Gulfo vs. Ancheta, G.R. No. 175301, August 15, 2012.
[372] Easycall Communications Philippines vs. Edward King. G.R. No. 145901, December 15, 2005.

The creation of the position is under the corporation's charter or by-laws, and that the election of the officer is by the directors or stockholders must concur in order for an individual to be considered a corporate officer, as against an ordinary employee or officer. It is only when the officer claiming to have been illegally dismissed is classified as such corporate officer that the issue is deemed an intra-corporate dispute which falls within the jurisdiction of the trial courts.[373]

The following cases are illustrative.

a. Section 25 of the Corporation Code (now Section 24 of the RCC) explicitly provides for the election of the corporation's president, treasurer, secretary, and such other officers as may be provided for in the by-laws. In interpreting this provision, the Court has ruled that if the position is other than the corporate president, treasurer, or secretary, it must be expressly mentioned in the by-laws in order to be considered as a corporate office.[374]

   This means therefore that the removal of any of the statutory officers, President, Secretary and Treasurer (even compliance officer for corporations vested with public interest) is an intra-corporate dispute. It is because being statutory officers, their positions ought to be specified in the bylaws too.

   Thus, in one case, it was held that the removal of the president of a university is an intra-corporate controversy. The alleged appointment of the president instead of the election as provided under the bylaws did not convert the president of the university to a mere employee. The National Labor Relations Commission erred in taking cognizance of the case and in concluding that the president was a mere employee and subordinate official because of the manner of his appointment, his duties and responsibilities, salaries and allowances, and considering the Identification card, the Administration and Personnel Policy Manual which specified the retirement of the university president, as pieces of evidence supporting such finding.[375]

b. In another case, the bylaws provide for the position of one or more vice presidents. The respondent was the company's Executive Vice President. The complaint against her alleged misappropriations and these alleged misappropriations breached the company's trust and confidence specifically reposed in the respondent as such Executive Vice President.

   That all these incidents are adjuncts of her corporate office lead the Court to conclude that the respondent's dismissal is an intra-corporate controversy, not a mere labor dispute.[376]

In other words, an officer shall be considered a corporate officer if he is occupying a position required by law (such as president, secretary and treasurer) or specified in the bylaws, and appointed by the stockholders or the board. In which case, his removal is an intra-corporate dispute. Otherwise, it will be a labor dispute cognizable by the labor arbiter.

Petitioner Belo Medical Group (BMG) filed a Complaint for Interpleader and Supplemental Complaint for Declaratory Relief against respondents Jose Santos and Victoria Belo.

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[373] Wesleyan University-Philippines vs. Guillermo T. Maglaya, Sr., G.R. No. 212774, January 23, 2017.
[374] Norma D. Cacho and North Star International Travel, Inc. vs. Virginia D. Balagtas, G.R. No. 202974. February 7, 2018.
[375] Wesleyan University-Philippines vs. Guillermo T. Maglaya, Sr., G.R. No. 212774, January 23, 2017. supra
[376] Norma D. Cacho and North Star International Travel, Inc. vs. Virginia D. Balagtas, G.R. No. 202974. February 7, 2018. See also Garcia vs Eastern Telecommunications Philippines, Inc. Garcia vs Eastern Telecommunications Philippines, Inc., G.R. Nos. 173115 and 173163-64, April 16, 2009.

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Respondent Santos filed a request to Belo Medical Group for an inspection of corporate records. He claims that he is a registered shareholder and co-owner of Victoria Belo's shares which he acquired while they cohabited as husband and wife. His repeated attempts to inspect the corporate books were all denied.

Belo claims that she paid for the shares and Santos only held the shares in his name in trust for her. She further claims that Santos, allegedly a majority owner of Obagi Clinics, would be inspecting the BMG records in bad faith as it was to obtain a competitor's business information.

BMG thus filed a Complaint for Interpleader to protect its interest and compel respondents to litigate their conflicting claims of ownership over the shares and the right of inspection.

On the other hand, Santos filed a Motion to Dismiss the case.

The complaints were raffled to a special commercial court and thus classified as intra-corporate. The trial court recognized the case as intra-corporate controversy but granted respondent Santos' Motion to Dismiss.

Was the proceeding between the parties an intra-corporate controversy ?

The case for interpleader filed by BMG was essentially an intra-corporate controversy based on the relationship test and the nature of controversy test.

In this case, both Belo and Santos are named shareholders of BMG's Articles of Incorporation. Since the conflict involves two shareholders then it is clearly intra-corporate. Although the ownership of stocks of Santos is questioned, the court continues to recognize him as a stockholder until a decision is rendered on the true ownership of the 25 shares of stock in his name.

The intra-corporate dispute is evident in the Complaint for Interpleader wherein the goal of both BMG and Belo is not just to determine the true owner of the shares of stock but ultimately to stop Santos from inspecting the corporate books. Even if Santos is declared the owner, BMG would then base his disqualification on bad faith.

Based on the facts of this case and applying the relationship and nature of the controversy tests, the case is centered around a registered stockholder's right to inspect corporate books and is therefore an intra-corporate dispute. As such, Santos should not have been allowed to file a Motion to Dismiss. The trial court should have treated the case as an intra-corporate dispute.

The dismissal of the intra-corporate case is thus reversed. The case is remanded to the commercial court of origin for further proceedings.[377]

At the time of his alleged dismissal, petitioner Malcaba was the President of respondent corporation. As a consequence, petitioner questioned his dismissal and filed a Complaint for Illegal Dismissal before the Labor Arbiter.

When the case was elevated before the Court of Appeals, it dismissed Malcaba's complaint for lack of jurisdiction since Malcaba, being a corporate officer, should have filed his complaint with the regular court and not with the labor arbiter.

[377] Belo Medical Group Inc. V. Jose Santos And Victoria Belo G.R. No. 185894, August 30, 2017, Leonen, J.

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Did the labor arbiter have jurisdiction over petitioner Malcaba's complaint?

Under Section 25 of the Corporation Code, the President of a corporation is considered a corporate officer. The dismissal of a corporate officer is considered an intra-corporate dispute, not a labor dispute. Thus, a corporate officer's dismissal is always a corporate act, or an intracorporate controversy, and the nature is not altered by the reason or wisdom with which the Board of Directors may have in taking such action.

Finding that petitioner Malcaba is the President of respondent corporation and a corporate officer, any issue on his alleged dismissal is beyond the jurisdiction of the Labor Arbiter or the National Labor Relations Commission. Their adjudication on his money claims is void for lack of jurisdiction. As a matter of equity, petitioner Malcaba must, therefore, return all amounts received as judgment award pending final adjudication of his claims. The Court's dismissal of petitioner Malcaba's claims, however, is without prejudice to his filing of the appropriate case in the proper forum.[378]

Remedial rights available to stockholders aggrieved by certain wrongful acts of the board and corporate officers.

Certain wrongful acts on the part of the directors and corporate officers may give rise to certain rights and the corresponding types or kinds of suit, *to wit*:

i. <u>Individual Suit</u>

An individual suit is filed when the cause of action belongs to the individual stockholder personally, and not to the stockholders as a group or to the corporation (*e.g.*, denial of the right to inspection and denial of dividends to a stockholder).[379]

In one case, it was held that the suit cannot be characterized as derivative, because she was complaining only of the violation of her pre-emptive right and was merely praying that she be allowed to subscribe to the additional issuances of stocks in proportion to her shareholdings to enable her to preserve her percentage of ownership in the corporation. She was therefore not acting for the benefit of the corporation. Quite the contrary, she was suing on her own behalf, out of a desire to protect and preserve her pre-emptive rights.[380]

ii. <u>Representative Suit</u>

If the cause of action belongs to a group of stockholders, such as when the rights violated belong to preferred stockholders, or denial of the pre-emptive right to a group or class of stockholders, a representative suit may be filed to protect the stockholders similarly situated.[381]

iii. <u>Derivative Suit</u>

Definition of Derivative suit.

A derivative suit is an action filed by stockholder in the name and on behalf of the corporation to enforce a corporate right or cause of action to set aside the wrongful acts of the corporation's directors and officers.

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[378] Malcaba v. ProHealth Pharma Philippines, Inc., G.R. No. 209085, June 6, 2018, Leonen, J.

[379] Villamor v. Umale, G.R. Nos. 172843, 172881, September 24, 2014.

[380] Gilda C. Lim, et al. v. Patricia Lim-Yu, In her capacity as a Minority Stockholder of Limpan Investment Corporation, G.R. No. 138343, Third Division, February 19, 2001.

[381] Cua, Jr. v. Tan, 622 Phil. 661 (2009), e.g., denial of pre-emptive right of a group of stockholders.

It concerns a wrong to the corporation itself. The real party in interest is the corporation, not the stockholders filing the suit. The stockholders are technically nominal parties but are nonetheless the active persons who pursued the action for and on behalf of the corporation.[382]

Rationale of the derivative suit.

A derivative suit is an exception to the general rule that the corporation's power to sue is exercised only by the board of directors or trustees.

Individual stockholders may be allowed to sue on behalf of the corporation whenever the directors or officers of the corporation refuse to sue to vindicate the rights of the corporation or are the ones to be sued and are in control of the corporation.

Remedies through derivative suits are not expressly provided for in our statutes — more specifically, in the Corporation Code and the Securities Regulation Code — but they are "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. They are intended to afford reliefs to stockholders in instances where those responsible for running the affairs of a corporation would not otherwise act.[383]

However, a derivative suit cannot prosper without first complying with the legal requisites for its institution.[384]

As a general rule, corporate litigation must be commenced by the corporation itself, with the imprimatur of the board of directors, which, pursuant to the law, wields the power to sue. Therefore, since the derivative suit is a remedy of last resort, it must be shown that the board, to the detriment of the corporation and without a valid business consideration, refuses to remedy a corporate wrong. A derivative suit may only be instituted after such an omission. Simply put, derivative suits take a back seat to board-sanctioned litigation whenever the corporation is willing and able to sue in its own name.[385]

Elements of a derivative suit.

Rule 8, Section 1 of the Interim Rules of Procedure for Intra-Corporate Controversies ("Interim Rules") provides the five (5) requisites for filing derivative suits:

"SECTION 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:

a. 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;
b. He exerted all reasonable efforts, and alleges the same with particularity in the complaint, to exhaust all remedies available under the articles of incorporation, bylaws, laws or rules governing the corporation or partnership to obtain the relief he desires;
c. No appraisal rights is available for the act or acts complained of; and
d. The suit is not a nuisance or harassment suit."

[382] 2019 Bar Exam; Florete v. Florete, G.R. No. 174909, January 20, 2016.
[383] Florete v. Florete, GR. No. 174909, January 20, 2016.
[384] Nestor Ching v. Subic Bay Golf and Country Club, Inc., et al., G.R. No. 174353, September 10, 2014.
[385] AGO Realty & Development Corporation v. Dr. Angelita Go, G. R. No. 210906/G.R. No. 211203, October 16, 2019.

In case of a nuisance or harassment suit, the court shall forthwith dismiss the case.

The fifth requisite for filing derivative suits, while not included in the enumeration, is implied in the first paragraph of Rule 8, Section 1 of the Interim Rules: The action brought by the stockholder or member must be "in the name of [the] corporation or association to enforce a corporate right or cause of action."[386]

AA, a minority stockholder, filed a suit against BB, CC, DD, and EE, the holders of majority shares of MOP Corporation, for alleged misappropriation of corporate funds. The complaint averred, *inter alia*, that MOP Corporation is the corporation in whose behalf and for whose benefit the derivative suit is brought. In their capacity as members of the board of directors, the majority stockholders adopted a resolution authorizing MOP Corporation to withdraw the suit. Pursuant to said resolution, the corporate counsel filed a motion to dismiss in the name of MOP Corporation.

Should the motion be granted or denied? Reason briefly.

The motion should be denied. The complaint is in the nature of a derivative suit. In *Conmart (Phils.) Inc. v. Securities and Exchange Commission*,[387] it was held that to grant the corporation concerned the right of withdrawing or dismissing the suit, at the instance of the majority stockholders and directors who themselves are the persons alleged to have committed the breach of trust against the interest of the corporation would be to emasculate the right of the minority stockholders to seek redress for the corporation. Filing such action as a derivative suit even by a lone stockholder is one of the protections extended by law to the minority stockholders against the abuses of the majority.[388]

Cite jurisprudence where resort to derivative suit was held to be improper for failure to meet the fifth requisite for its filing – *it should be filed in the name of the corporation to enforce a corporate right or cause of action.*

a. A derivative suit filed by stockholders of a corporation against the bank that foreclosed the mortgage of the property of the corporation, but without impleading the corporation in the suit.[389]
b. A suit to enforce pre-emptive rights in a corporation is not a derivative suit because it was not filed for the benefit of the corporation.[390]
c. Whether as an individual or as a derivative suit, the RTC – sitting as special commercial court – has no jurisdiction to hear the plaintiff's complaint since what is involved is the determination and distribution of successional rights to the shareholdings of his mother as the controlling shareholder of the corporation. Plaintiff's proper remedy, under the circumstances, is to institute a special proceeding for the settlement of the estate of the deceased. The bare claim that the complaint is a derivative suit will not suffice to confer jurisdiction to the RTC (as a

[386]Oscar C. Reyes v. Hon. Regional Trial Court of Makati, Branch 142, Zenith Insurance Corporation, and Rodrigo C. Reyes, G.R. No. 165744, August 11, 2008; Anthony Yu, et al. v. Joseph Yukayguan, et al., G.R. No. 177549, January 18, 2009; Juanito Ang, for and in behalf of Sunrise Marketing (Bacolod), Inc. v. Sps. Roberto and Rachel Ang, G.R. No. 201675, June 19, 2013; Alfredo L. Villamor, Jr. v. John S. Umale, G.R. Nos. 172843 & 172881, September 24, 2014; Nestor Ching v. Subic Bay Golf And Country Club, Inc., et al., G.R. No. 174353 September 10, 2014.

[387]Commart (Phils.) Inc., et al. v. Securities and Exchange Commission and Alice Magtulac, G.R. No. 85318, June 3, 1991.

[388]2004 Bar Exam.

[389]Asset Privatization Trust v. Court of Appeals, G.R. No. 121171, December 29, 1988.

[390]Lim v. Lim-Yu, G.R. No. 138343, February 19, 2001.

special commercial court) if plaintiff cannot comply with the requisites for the existence of a derivative suit.[391]

d. Petitioners who are members of the board for 2003-2004 sought the nullification of the election where the new board of directors for 2004-2005 pushed through with the election even if petitioners had adjourned the meeting allegedly due to lack of quorum. Petitioners are the injured party whose right to vote and to be voted upon were directly affected by the election of the new set of board of directors. The party-in-interest are the petitioners as stockholders who wield such right to vote. The cause of action devolves on petitioners, not the condominium corporation, which did not have the right to vote. Hence, the complaint for nullification of the election is a direct action by the petitioners who were the members of the board of directors of the corporation before the election, against respondents, who are the newly elected board of directors. Under the circumstances, the derivative suit filed by petitioners on behalf of the condominium corporation is improper.[392]
e. The action should be a proper derivative suit even if the assailed acts do not pertain to a corporation's transactions with third persons. The pivotal consideration is whether the wrong done as well as the cause of action arising from it accrues to the corporation itself or to the whole body of its stockholders. An action "seeking to nullify and invalidate the duly constituted acts [of a corporation]" entails a cause of action that "rightfully pertains to [the corporation itself and which stockholders] cannot exercise . . . except through a derivative suit." In this case, the Marcelino Jr. Group prays for the cancellation of share transfers and subscription to the capital stock of the Rogelio Group, all intended to reconfigure the capital structure of the corporation to reflect a status *quo ante*.

Erroneously pursuing a derivative suit as a class suit not only meant that the Marcelino, Jr. Group lacked a cause of action; it also meant that they failed to implead an indispensable party. In derivative suits, the corporation concerned must be impleaded as a party. Hence, Marcelino Jr. Group's complaint must fail for failure to implead the corporation.[393]

F. Capital structure

Can treasury shares be sold for a price below par value? If yes, are they not considered watered shares?

Yes, treasury shares may be sold for a price below par value; provided that such price is reasonable under the circumstances as determined by the board of directors. They are not watered stocks because rule against watered stocks only applies to the issuance of original or primary shares and not disposition of existing shares.

Are holders of preferred shares creditors of the corporation?

The preferences granted to the holders of the preferred stockholders do not give them a lien upon the property of the corporation nor make them creditors of the corporation, the right of the former being always subordinate to the latter. Shareholders, both common and preferred, are considered risk-takers who invest capital in the business and who can look only to what is left after corporate debts and liabilities are fully paid.[394]

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[391] Oscar C. Reyes v. Hon. Regional Trial Court of Makati, Branch 142, Zenith Insurance Corporation, and Rodrigo C. Reyes, G.R. No. 165744, August 11, 2008.
[392] Legaspi Towers 300, Inc. v. Muer, G.R. No. 170783, June 18, 2012; 2014 Bar Exam.
[393] Marcelino M. Florete v. Rogelio M. Florete, et al., G.R. No. 174909, January 20, 2016; Rogelio M. Florete, Sr., et al. v. Marcelino M. Florete, Jr., et al., G.R. No. 223321, April 2, 2018, Second Division.
[394] Republic Planters Bank, ibid.

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There is also no guarantee that the shares will receive any dividends. The right to receive dividends is conditioned on the availability of the unrestricted retained earnings or surplus profit. The holders cannot compel the payment of dividends if there is no surplus profit. The preference as to dividends only applies if the corporation legally declared dividends.

Company X issued preferred shares to A. The terms and conditions of the certificate of stock entitle the holder of preferred shares to 1% quarterly interest as a quarterly dividend. After the end of the first quarter, A demanded the interest due but Company X declined to pay for lack of unrestricted retained earnings. Can A compel the payment of the quarterly interest?

No. Dividends cannot be declared for preferred shares which were guaranteed a quarterly dividend if there are no unrestricted retained earnings. "Interest-bearing stocks," on which the corporation agrees absolutely to pay interest before dividends are paid to common stockholders, is legal only when construed as requiring payment of interest as dividends from net earnings or surplus only.[395]

Note however what the Supreme Court, through Justice Caguioa, stated in Roy v. Herbosa[396].A mandatory redeemable preference shares may be issued by a corporation to augment its financing. In form, the mandatory redeemable preferred shares are equity instruments but in substance, they are debt instruments and liabilities of the issuing corporation because the fixed dividend payment and the mandatory redemption feature constitute a contractual obligation to deliver cash.

The foregoing rule should, however, be construed to mean, based on Republic Planters Bank case, that the corporation has available surplus profit to pay dividends or sufficient funds to redeem the redeemable shares.

Founder's shares

Founders' shares are shares classified as such in the articles of incorporation which may be given certain rights and privileges not enjoyed by the owners of other stocks. Where the exclusive right to vote and be voted for in the election of directors is granted, it must be for a limited period not to exceed five (5) years from the date of incorporation: *Provided,* That such exclusive right shall not be allowed if its exercise will violate Commonwealth Act No. 108, otherwise known as the "Anti-Dummy Law"; R.A. No. 7042, otherwise known as the "Foreign Investments Act of 1991"; and other pertinent laws.[397]

Note that only the exclusive right to vote and be voted for in the election of directors is subject to a limited period of five (5) years from the date of incorporation.

The Articles of Incorporation of a corporation provides for voting rights privilege of its founders' shares, as follows:

"In terms of voting rights, FOUNDERS' shares shall have a 1:10 ratio as opposed to 1:1 ratio for the COMMON shares. In the other words, one FOUNDERS' share is equivalent to ten votes. All shares regardless of whether it is FOUNDERS' or COMMON shall be allowed to vote on all matters of the holding corporation, including the right to vote and be voted for in the election of directors."

[395] Republic Planters Bank v. Agana, G.R. No. 51765, March 3, 1997.
[396] ibid
[397] Section 7, RCC.

Is the 1:10 voting rights ratio for founders' shares subject to a limited period not to exceed five (5) years provided under Section 7 of the RCC?

The 1:10 voting rights ratio for founders' shares is not subject to the limited period not to exceed five (5) years provided under Section 7 of the RCC since this provision only applies to the exclusive right to vote and be voted for in the election of directors.[398]

Treasury shares

Treasury shares are shares of stock that have been issued and fully paid for, but subsequently reacquired by the issuing corporation through purchase, redemption, donation, or some other lawful means. Such shares may again be disposed of for a reasonable price fixed by the board of directors.[399]

Treasury shares shall have no voting right as long as such shares remain in the Treasury.[400] No dividends can be declared thereon as corporations cannot declare dividends to themselves.

If treasury shares are purchased from the stockholder, the transaction in effect is a return to the stockholders of the value of their investment in the company and a reversion of the shares to the corporation.

The law clearly sets out the parameters when a corporation may reacquire its shares and convert them into treasury shares. According to Section 9 of the Corporation Code[401], "treasury shares are shares of stock which have been issued and fully paid for, but subsequently reacquired by the issuing corporation by purchase, redemption, donation or through some other lawful means." Apart from reacquiring the shares through some lawful means, the Corporation Code is also explicit that while a corporation has the power to purchase or acquire its own shares, the corporation must have unrestricted retained earnings in its books to cover the shares to be purchased or acquired. In addition, in cases where the reason for reacquiring the shares is because of the unpaid subscription, the Corporation Code is likewise explicit that the corporation must purchase the same during a delinquency sale and not to direct the reduction on the number of subscribed shares to what has been paid. Simply agreeing in a meeting for their reduction, thereby releasing the stockholder from his obligation to pay the unpaid subscriptions, cannot be the mode by which said unpaid subscriptions are settled. To allow corporations to do such an act would violate the aforementioned trust fund doctrine in corporation law.

Verily, if it were true that subscriber had unpaid subscriptions, it was invalid for the Board of Directors to waive such payment, for it would amount to a decrease in the corporation's capital stock which could not be accomplished without the formalities under Section 38 of the Corporation Code (Section 37 under the Revised Corporation Code) which includes, among others, the prior approval of the SEC.[402]

1. ***Certificate of stock***

Possession of stock certificate is not an indispensable condition for the exercise of stockholders' rights. This is because a certificate of stock shall only be issued to a subscriber

[398] Close Holding Corporation; Founder's Shares, SEC-OGC Opinion No. 02-10, January 15, 2010.
[399] Section 9, RCC.
[400] Section 56, RCC.
[401] Same as under the RCC
[402] Salido, Jr. v. Aramaywan Metals, G.R. No. 233857, March 18, 2021, as penned by J. Caguioa)

upon payment of the full amount of the subscription together with interest and expenses.[403] Any holders of unpaid shares that are not delinquent have all the rights of stockholders.[404]

b. Uncertificated shares

The SEC may require corporations whose securities are traded in trading markets and which can reasonably demonstrate their capability to do so to issue their securities or shares of stocks in uncertificated or scripless form in accordance with the rules of the SEC.

c. Negotiability

Is a stock certificate a negotiable instrument?

Although a stock certificate is sometimes regarded as quasi-negotiable, in the sense that it may be transferred by delivery, it is well-settled that the instrument is non-negotiable, because the holder thereof takes it without prejudice to such rights or defenses as the registered owner or creditor may have under the law, except insofar as such rights or defenses are subject to the limitations imposed by the principles governing estoppel. That the holder found the stock certificates endorsed in blank does not necessarily make it the owner of the shares represented therein. Their true ownership has to be ascertained in a proper proceeding.[405]

d. Issuance

May a corporation consider the portion paid by a shareholder as full payment for the corresponding number of shares and cancel the subscription as to the rest?

The SEC has consistently opined that a subscription is one, entire and indivisible whole contract. This indivisibility of subscription is absolute as Section 63 of the RCC speaks no exception.

The purpose of the doctrine is to prevent the partial disposition of a subscription, which is not fully paid, because if it is permitted and the stockholder subsequently becomes delinquent in the payment of his subscription, the corporation may not be able to sell as many of his subscribed shares as would be necessary to cover the total amount from him pursuant to Section 67 of the RCC.

Applying the aforementioned doctrine, a corporation cannot issue certificates of stock for the portion of the subscription that is paid and cancel the portion which remains unpaid as it violates the doctrine of indivisibility of subscription contracts. In effect, it is also condonation of part of the subscription of a stockholder, which is violative of the trust fund doctrine.[406]

2. **Disposition and encumbrance of shares**

   a. **Sale of shares**

When is the sale of shares perfected?

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[403]Section 63, RCC.
[404]Section 71, RCC.
[405]Republic of the Phils. (PCGG) v. Sandiganbayan, ibid.
[406]Re: Condonation of Subscriptions Receivables or Cancellation of Subscriptions, SEC-OGC Opinion No. 50-19, October 11, 2019.

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Sale of share is perfected not upon the meeting of the minds by the parties on the cause, consideration and object of the sale but upon compliance with the formalities prescribed by the RCC.

In one case, the buyer of the shares had fully paid the purchase price but the stock certificate was only delivered after close to three (3) years from the sale. The seller clearly failed to deliver the stock certificates to the buyer, representing the shares of stock purchased by the buyer, within a reasonable time from the transaction. This was a substantial breach of their contract that entitles the buyer the right to rescind the sale under Article 1191 of the Civil Code. It is not entirely correct to say that a sale had already been consummated as the buyer already enjoyed the rights a shareholder can exercise. The enjoyment of these rights cannot suffice where the law, by its express terms, requires a specific form to transfer ownership.[407]

How may partially paid shares be transferred?

Because partially paid shares are not covered yet by a stock certificate, and as such, there is no certificate which can be endorsed and delivered to the transferee as required by Section 62 of the RCC, the subscriber, as the owner of the shares, may assign his right to the contract of subscription in favor of the assignee.

The corporation, may, however, refuse the transfer of shares based on Section 62 of the RCC which provides that the corporation may refuse the transfer if it holds unpaid claim over the shares. The term "unpaid claim" means unpaid subscription.[408]

Is the consent of the corporation necessary or required in case of sale of unpaid shares?

If the subscription is fully paid, the stockholder may sell or dispose of his shares without having to secure the consent of the corporation. In fact, the corporation cannot require its consent for the transfer of the shares. It will be contrary to law and public policy. To be valid, the restriction on transfer cannot be more onerous than the option granted to a stockholder to purchase the shares of a transferring stockholder on reasonable terms and conditions, or simply, the right of first refusal. Requiring the consent of the corporation is certainly more onerous than the right of first refusal.

However, if the subscription is not fully paid, the consent of the corporation is necessary before the subscriber may assign his right to the contract of subscription. Assignment of shares with unpaid subscription basically amounts to novation as there will be a change of debtor from the subscriber to the assignee. The obligation to pay the balance of the subscription will be assumed by the assignee. To be valid, novation requires the consent of the creditor which in this case is the corporation.

b. Allowable restrictions on sale of shares

The corporation may ~~then~~ impose restrictions on the transfer of shares but subject to the following requisites:

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[407] Fil-Estate Golf and Development, Inc. v. Vertex Sales And Trading, Inc., G.R. No. 202079, June 10, 2013.

[408] China Banking Corporation v. Court of Appeals and Valley Golf and Country Club, Inc., G.R. No. 117604, March 26, 1997.

a. Restrictions on the right to transfer shares must appear in the articles of incorporation, in the bylaws, as well as in the certificate of stock; otherwise, the same shall not be binding on any purchaser in good faith.
b. Restrictions shall not be more onerous than granting the existing stockholders or the corporation the option to purchase the shares of the transferring stockholder with such reasonable terms, conditions or period stated.
c. Upon the expiration of the said period, the existing stockholders or the corporation fails to exercise the option to purchase, the transferring stockholder may sell their shares to any third person.[409]

Mr. A is a stockholder/founding member of Rural Bank of Maria Aurora Incorporated, (RBMAI for brevity). Previously, he was able to sell shares of stock of RBMAI.

However, at present, Mr. A could not sell his shares to outsiders since the new manager/majority stockholder imposed a new policy that the shares should be sold only to insiders, particularly, to the employees who are also stockholders of RBMAI. Mr. A is now questioning the new policy since these employees/stockholders buy at very low prices while there are third-party buyers willing to buy his shares at a higher price.

Is the restriction on the transfer of shares to insiders a valid restriction?

The company policy restricting the transferability of shares is not valid.

In order to be valid and enforceable, any restriction on the transfer of shares of stock must be explicitly provided for in the articles of incorporation and in the certificate of stocks.

Restrictions on the transfer of shares are essentially contractual in nature between the stockholders and the corporation. Hence, such restrictions must be embodied in their contract, i.e., the articles of incorporation.

Considering further that shares of stock burdened with restrictions on transferability may fall into the hands of innocent purchasers, the SEC, as a matter of policy, also requires that the restrictions on the transfer of shares must be printed in the stock certificates.[410]

Does "unpaid claim," which justifies the corporation to refuse the registration of the transfer, include any obligation or liability that the subscriber may owe the corporation?

No, the term "unpaid claim" only refers to "any unpaid claim arising from unpaid subscription. It does include any indebtedness which a subscriber or stockholder may owe the corporation arising from any other transaction. It does not, for instance, include monthly dues imposed by the corporation for the use of its facilities.[411]

c. Requisites of a valid transfer

For a valid transfer of stocks, there must be strict compliance with the mode of transfer prescribed by law. The requirements are:

[409]Section 97, RCC.
[410]Re: Restrictions on Transferability of Shares, SEC Opinion No. 22-05, December 12, 2005.
[411]China Banking Corporation v. Court of Appeals, and Valley Golf and Country Club, Inc., G.R. No. 117604, March 26, 1997.

a. There must be a delivery of the stock certificate;
b. The certificate must be endorsed by the owner or his attorney-in-fact or other persons legally authorized to make the transfer; and,
c. No transfer, however, shall be valid, except as between the parties, until the transfer is recorded in the books of the corporation showing the names of the parties to the transaction, the date of the transfer, the number of the certificate or certificates, and the number of shares transferred.[412]

Thus, where an incorporator organized a corporation and a certain number of shares was issued to a stockholder but the certificate of stock covering said shares was in the possession of the incorporator who refused to deliver the same to the heir of the stockholder after the latter died, the stockholder of record should be considered the owner of the shares since he did not indorse the certificate in favor of the incorporator. The allegation that it was delivered to him by the stockholder because he was the one who paid for it does not hold.[413]

The fact that the stock certificates covering the shares registered in the names of certain persons were found in the possession of another does not necessarily prove that the latter owned the shares. A stock certificate is merely a tangible evidence of ownership of shares of stock. Its presence or absence does not affect the right of the registered owner to dispose of the shares covered by the stock certificates.[414]

In another case involving the garnishment of the surety's shares of stock in a corporation that owns a real property, the third party claim filed by the alleged transferee of the shares could not be upheld even if it can be assumed that the sale of the shares of stock contained in a mere photocopy had indeed transpired, such transfer is only valid as to the parties thereto but not binding on the corporation because the same is not recorded in the books of the corporation. [415]

Besides, the right of the stockholder to corporate property is only inchoate which will only ripen to full ownership in case of dissolution and liquidation of the corporation.

Is the payment of the capital gains tax on the part of the seller, assuming there was a gain in the sale, a requirement for the validity of the sale or assignment or transfer of the shares to the buyer?

Nonpayment of capital gains tax does not affect the validity of the transfer as between the seller and the buyer. However, if the capital gains tax is not paid, the sale or the transfer of the shares shall not be registered in the books of the corporation by the transfer agent or secretary of the corporation.[416]

Is delivery or surrender of the certificate of stock a requisite before the conveyance may be recorded in the books of the corporation?

No, to compel delivery to the corporation of the certificates as a condition for the registration of the transfer would amount to a restriction on the right of a stockholder to have the stocks transferred to his name, which is not sanctioned by law. The only limitation

[412] Section 62, RCC.
[413] Razon v. Intermediate Appellate Court, G.R. No. 74306, March 16, 1992.
[414] Republic v. Estate of Hans Menzi, G.R. No. 152578, November 23, 2005.
[415] Tee Ling Kiat v. Ayala Corporation, G.R. No. 192530, March 7, 2018, J. Caguioa
[416] Transfer of Shares; Documentary Requirements, SEC-OGC Opinion No. 06-07, April 19, 2007.

imposed by Section 63 of the OCC (now Section 62 of the RCC) is when the corporation holds any unpaid claim against the shares intended to be transferred.[417]

Nevertheless, as previously pointed out, the *surrender of the original certificate of stock is necessary before the issuance of a new one so that the old certificate may be cancelled*.[418]
of the SEC.[419]

Appropriate legal remedy if the corporation refuses to register the transfer of shares.

Because it is its ministerial duty to register the transfer of shares, the corporation, if it refuses without good cause to make such transfer, may be compelled to do so by *mandamus*.[420]

Who may file the petition for *mandamus* to compel the registration of the transfer?

In *Ponce v. Alsons Cement Corporation*,[421] the Supreme Court ruled that only the transferor may file the petition for *mandamus*. The transferee cannot compel the corporate secretary to cause the registration and issuance of a stock certificate because the transferee has not acquired standing yet in the books of the corporation and that the transferee can only file such petition if he has been authorized by the transferor to cause such transfer.

Subsequently, in *Andaya v. Rural Bank of Cabadbaran,*[422] the Supreme Court held that transferees of shares of stock are real parties in interest having a cause of action for *mandamus* to compel the registration of the transfer and the corresponding issuance of stock certificates.

The Supreme Court ruled that the reliance of the RTC on the *Ponce* case in finding that petitioner had no cause of action for *mandamus* against the defendant bank was misplaced. In *Ponce,* the issue resolved by the Court was whether the petitioner therein had a cause of action for *mandamus* to compel the *issuance* of stock certificates, not the registration of the transfer. Ruling in the negative, the Court said in that case that without any record of the transfer of shares in the stock and transfer book of the corporation, there would be no clear basis to compel that corporation to issue a stock certificate.

In contrast, at the crux of this petition are the registration of the transfer *and* the issuance of the corresponding stock certificates. Requiring petitioner to register the transaction before he could institute a *mandamus* suit in supposed abidance by the ruling in *Ponce* was a palpable error. It led to an absurd, circuitous situation in which the petitioner was prevented from causing the registration of the transfer, ironically because the shares had not been registered. With the logic resorted to by the RTC, transferees of shares of stock would never be able to compel the registration of the transfer and the issuance of new stock certificates in their favor. Transferees of shares of stock are real parties in interest then having a cause of action for *mandamus* to compel the registration of the transfer and the corresponding issuance of stock certificates.

When may a corporation refuse to register the transfer of the shares in the books of the corporation?

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[417]Ibid.
[418]Ibid.
[419]Section 64, RCC.
[420]Anna Teng v. SEC, ibid.
[421]G.R. No. 139802, December 10, 2002.
[422]G.R. No. 188769, August 3, 2016.

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a. If the formalities prescribed by law for the transfer of shares, which are endorsement of the stock certificate and delivery to the transferee, are not complied with.
b. If the above-stated formalities have been complied with but the corresponding taxes for the transfer have not been paid.
c. If the corporation holds any unpaid claim on the shares.[423]

d. Involuntary dealings

Are transactions where the shares of stock are subjected to security interest or encumbrance required to be recorded in the books of the corporation in order to make the transfer effective as against the corporation and third persons?

Only the transfer of shares resulting in a change of ownership is required to be registered in the books of the corporation. These include sale, donation or succession. Encumbrances, like security interest on shares, are not required to be registered to bind the corporation and third persons. They are binding and enforceable against third persons if they are registered with the appropriate registration registry under R.A. No. 11057, otherwise known as the Personal Property Security Act.

G. Dissolution and liquidation

Dissolution is the extinguishment or cancellation of the corporate franchise and the termination of its corporate existence for business purposes.

A corporation that has already been dissolved, be it voluntarily or involuntarily, retains no juridical personality to conduct its business save for those directed towards corporate liquidation. In other words, the corporation ceases to be a body corporate for the purpose of continuing the business for which it was organized. But it 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 of enabling it gradually to settle and close its affairs, to dispose of and convey its property and to divide its assets.[424]

Thus, a real estate mortgage executed by a corporation after its dissolution is void. The redemption of the mortgaged property is likewise void for being inconsistent with liquidation. A real estate mortgage is not part of the liquidation powers that could have been extended to the corporation. It could not have been 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.

Consequently, any redemption exercised by the Corporation pursuant to this void real estate mortgage is likewise void, and could not be given any effect. If a real estate mortgage agreement was entered *prior* to its dissolution, then the redemption of the subject property, even if already after its dissolution (as long as it would not exceed three [3] years thereafter), would still be valid because of the liquidation/winding up powers accorded by the Corporation Code.[425]

A corporation whose term has expired and, *ipso facto*, dissolved can no longer exercise an option to lease a property because the same is tantamount to the continuation of the business.[426]

[423]Section 62, RCC.
[424]Philippine National Bank v. Court of First Instance of Rizal, et al., G.R. No. 63201, May 27, 1992.
[425]Dr. Gil J. Rich v. Guillermo Paloma III, G.R. No. 210538, March 7, 2018.
[426]Philippine National Bank v. Court of First Instance of Rizal, et al., G.R. No. 63201, May 27, 1992.

Barn filed an action to enjoin SN Company's board of directors from selling a parcel of land registered in the corporation's name, to compel the corporation to recognize Barn as a stockholder with 50 shares, to allow him to inspect the corporate books, and to claim damages against the corporation and its officers. Subsequently, the corporation and the individual defendants moved to dismiss the complaint since the corporation's certificate of registration was revoked by the SEC during the pendency of Barn's case on the ground of noncompliance with reportorial requirements. The special commercial court granted the motion and reasoned that only action for liquidation of assets can be maintained when a corporation has been dissolved and Barn cannot seek reliefs which in effect lead to the continuation of the corporation's business. The court also ruled that it lost jurisdiction over the intra-corporate controversy upon the dissolution of the corporation.

a. Was the court correct?

The court is not correct. An action to be recognized as a stockholder and to inspect corporate documents is an intra-corporate dispute which does not constitute a continuation of the business. The dissolution of the corporation simply prohibits it from continuing its business. Moreover, under Section 145 of the OCC (now Section 184 of the RCC), no right or remedy in favor of or against any corporation, its stockholders, members, directors and officers shall be removed or impaired by the subsequent dissolution of the corporation.

The dissolution does not automatically convert the parties into strangers or change their intra-corporate relationship. Neither does it terminate existing causes of action which arose because of the corporate ties of the parties. The cause of action involving an intra-corporate controversy remains and must be filed as an intra-corporate dispute despite the subsequent dissolution of the corporation.[427]

The foregoing bar exam question is based on the case of *Aguirre v. FQB +7, Inc.*[428] In that case, the Supreme Court said that the complaint does not show any intention to continue the corporate business of FQB+7. It does not seek to enter into contracts, issue new stocks, acquire properties, execute business transactions, etc. Its aim is not to continue the corporate business, but to determine and vindicate an alleged stockholder's right to the return of his stockholdings and to participate in the election of directors, and a corporation's right to remove usurpers and strangers from its affairs. Neither are these issues mooted by the dissolution of the corporation. A corporation's board of directors is not rendered *functus officio* by its dissolution. Since Section 122 of the OCC (now Section 139 of the RCC) allows a corporation to continue its existence for a limited purpose, necessarily there must be a board that will continue acting for and on behalf of the dissolved corporation for that purpose. Thus, the determination of which group is the *bona fide* or rightful board of the dissolved corporation will still provide practical relief to the parties involved. The same is true with regard to the shareholdings in the dissolved corporation. A party's stockholdings in a corporation, whether existing or dissolved, is a property right which he may vindicate against another party who has deprived him thereof. The corporation's dissolution does not extinguish such property right.

b. Four (4) years later, SN Company files an action against Barn to recover corporate assets allegedly held by the latter for liquidation. Will this action prosper?[429]

[427]Aguirre v. FQB +7, Inc., G.R. No. 170770, January 9, 2013.
[428]Ibid.
[429]2015 Bar Exam.

The action cannot prosper because the corporation has no more legal capacity to sue after three (3) years from its dissolution.[430]

It would have been different if the complaint was filed during the three-year liquidation period for in such case, the action may be continued even thereafter.

a. Modes of dissolution

Distinction between voluntary dissolution where creditors are not affected and creditors are affected.

The distinctions are as follows:

a. *Where creditors are not affected*, the dissolution should be adopted by at least majority of the board of directors or trustees and approved by the stockholders representing at least majority of the outstanding capital stock or majority of the members in nonstock corporation in a meeting to be called by the board of directors or trustees.

   Where creditors are affected, the dissolution should be adopted by at least majority of the board of directors and approved by the stockholders representing at least 2/3 of outstanding capital or 2/3 of the members in a meeting called for the purpose.

b. *Where creditors are not affected,* verified request for dissolution is filed with the SEC stating: (a) the reason for the dissolution; (b) the form, manner, and time when the notices were given; (c) names of the stockholders and directors or members and trustees who approved the dissolution; (d) the date, place, and time of the meeting in which the vote was made; and (e) details of publication.

   Where creditors are affected, a verified petition for dissolution is filed with the SEC. The petition should be signed by a majority of the corporation's board of directors or trustees, verified by its president or secretary or one of its directors or trustees, and shall set forth all claims and demands against it.

c. *Where creditors are not affected***,** what is given to the stockholders or members is written notice of the meeting. Notice is given at least 20 days prior to the meeting and should be published once prior to the date of the meeting in a newspaper published in the place where the principal office of said corporation is located, or if no newspaper is published in such place, in a newspaper of general circulation in the Philippines.

   Where creditors are affected, what is published is a copy of the order setting the date and time of the hearing on the petition. It shall be published at least once a week for three consecutive weeks in a newspaper of general circulation published in the municipality or city where the principal office of the corporation is situated, or if there be no such newspaper, then in a newspaper of general circulation in the Philippines, and a similar copy shall be posted for three consecutive weeks in three public places in such municipality or city.

d. *Where creditors are not affected,* the SEC should approve the request for dissolution within 15 days from receipt of the verified request for dissolution, and in the absence of any withdrawal within said period, the SEC shall approve the request and issue the certificate of dissolution.

[430] Alabang Development Corporation v. Alabang Hills Village Association, G.R. No. 187456, June 2, 2014.

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Where creditors are affected, the SEC shall render judgment dissolving the corporation only after hearing on the petition and determination that the material allegations in the petition are true.

(c) By shortening of corporate term

ii. Involuntary dissolution

Under Section 21 of the RCC, if a corporation does not formally organize and commence its business within five (5) years from the date of its incorporation, its certificate of incorporation shall be deemed revoked as of the day following the end of the five-year period.

However, if a corporation has commenced its business but subsequently becomes inoperative for a period of at least five (5) consecutive years, the SEC may, after due notice and hearing, place the corporation under delinquent status.

A delinquent corporation shall have a period of two (2) years to resume operations and comply with all requirements that the SEC shall prescribe. Upon compliance by the corporation, the SEC shall issue an order lifting the delinquent status. Failure to comply with the requirements and resume operations within the period given by the SEC shall cause the revocation of the corporation's certificate of incorporation.

The grounds under (a) and (b) will lead to the dissolution of the corporation unless the corporation files a petition to set aside its delinquency status and the SEC grants it.

Upon finding by final judgment that the corporation:

i. Was created for the purpose of committing, concealing or aiding the SEC of securities violations, smuggling, tax evasion, money laundering, or graft and corrupt practices;
ii. Committed or aided in the commission of securities violations, smuggling, tax evasion, money laundering, or graft and corrupt practices, and its stockholders knew of the same; and
iii. Repeatedly and knowingly tolerated the commission of graft and corrupt practices or other fraudulent or illegal acts by its directors, trustees, officers, or employees.

If the corporation is ordered dissolved by final judgment pursuant to the grounds set forth in subparagraph (e) hereof, its assets, after payment of its liabilities, shall, upon petition of the SEC with the appropriate court, be forfeited in favor of the national government. Such forfeiture shall be without prejudice to the rights of innocent stockholders and employees for services rendered, and to the application of other penalties or sanctions under the RCC or other laws.

The SEC shall give reasonable notice to, and coordinate with, the appropriate regulatory agency prior to the involuntary dissolution of companies under their special regulatory jurisdiction.[431]

Note that it is only on the grounds specified in paragraph (e) that the SEC may file a petition with the appropriate court that the assets be forfeited in favor of the national government but without prejudice to the rights of innocent stockholders and employees for services rendered.

[431]Section 138, RCC.

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Note further that while the three (3) grounds provided in paragraph (e) refer to commission of graft and corrupt practices, fraudulent or other illegal acts, these are distinct from one another. Under the first ground, the corporation was organized for the purpose of creating, concealing or aiding in the commission of the specified illegal acts. Obviously, in this case, there was misrepresentation too as to the purposes of the corporation because the SEC will not approve the incorporation if the articles of incorporation, on its face, indicates as the corporation's purposes the commission of illegal acts. Under the second ground, the corporation is lawfully organized and conducting business but it committed or aided in the commission of the same specified illegal acts and its stockholders knew about them. Under the third ground, the corporation is created for lawful purposes and legally conducting business but it repeatedly and knowingly tolerated the commission of graft and corrupt practices or other fraudulent or illegal acts by its directors, trustees, officers, or employees.

2. Methods of liquidation

There are four (4) methods of liquidation, namely: a) by the corporation itself; b) by the trustee duly appointed by the corporation; c) by the receiver that the SEC may appoint upon judgment dissolving the corporation after hearing the corporation's petition for voluntary dissolution; and, d) by the rehabilitation receiver or liquidator appointed by the court after judgment on a petition for liquidation involving an insolvent debtor.

a. By the corporation itself

Under Section 139 of the RCC, the corporation is granted a period of three (3) years after dissolution, whether voluntary or involuntary, to wind up it affairs. Ideally, the winding-up process should be completed in three (3) years. Otherwise, it should appoint a trustee to carry out the liquidation even beyond three (3) years. But, in the absence of an appointed trustee, the board of directors shall be deemed the trustees of the corporation.

b. By the trustee appointed by the corporation

Under Section 139 of the RCC, at any time during said three-year liquidation period, the corporation is authorized and empowered to convey all of its property to a trustee for the benefit of stockholders, members, creditors and other persons in interest. 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 trustee, and the beneficial interest in the stockholders, members, creditors or other persons-in-interest.

The trustee is not bound by the three-year period. What is important is the completion of the liquidation process so that creditors will be paid and the residual assets are distributed to the stockholders.

c. By the Receiver appointed by the SEC

Under Section 135 of the RCC, the SEC shall proceed to hear the petition (filed by a corporation where creditors are affected) and try any issue raised in the objections filed; and if no such objection is sufficient, and the material allegations of the petition are true, it shall render judgment dissolving the corporation and directing such disposition of its assets as justice requires, and may appoint a receiver to collect such assets and pay the debts of the corporation.

The receiver represents the SEC, as well as the stockholders and creditors. The receiver is not bound by the three-year liquidation period.[432]
The appointment of a receiver operates to suspend the authority of a corporation and its directors and officers over its property and effects, such authority being reposed in the receiver. Thus, a corporate officer had no authority to condone a debt.[433]

In *Bank of the Philippine Islands v. Eduardo Hong*,[434] the Supreme Court held, however, that while the SEC has jurisdiction to order the dissolution of a corporation, jurisdiction over the liquidation of the corporation now pertains to the appropriate regional trial courts. This is the correct procedure because the liquidation of a corporation requires the settlement of claims for and against the corporation, which clearly falls under the jurisdiction of the regular courts. The trial court is in the best position to convene all the creditors of the corporation, ascertain their claims, and determine their preferences.

It should be noted that the power of the SEC to appoint a receiver existed even under the OCC and retained under the RCC despite the ruling in *Bank of the Philippine Islands v. Eduardo Hong*. It is submitted that the receiver may carry out the liquidation of the corporation if the creditors and the corporation are able to agree among themselves on how the creditors' claims shall be satisfied. Otherwise, the RTC should carry out the liquidation process.

d. By the rehabilitation receiver or the liquidator appointed by the competent RTC in cases involving insolvent debtor under FRIA

The receiver who may be appointed by the SEC is different from the rehabilitation receiver that the competent Regional Trial Court may appoint in cases involving the rehabilitation of an insolvent debtor under FRIA.

In cases falling under FRIA, the liquidation of the debtor will be carried out by the rehabilitation receiver or the liquidator appointed by the court.

Under Section 25 of the FRIA, the rehabilitation court may convert a petition for rehabilitation to liquidation if there is no showing that the debtor may be rehabilitated. In which case, the rehabilitation receiver may perform the functions of the liquidator.

The insolvent debtor may also file a petition for voluntary liquidation or be the subject of a petition for involuntary liquidation by his creditors. In either case, if the petition is sufficient in form and substance, the rehabilitation court shall issue the Order of Liquidation. Such order has the effect of dissolving the corporation and title to the properties of the debtor shall be transferred to the Liquidator who will then carry out the liquidation of the corporation.[435]

How are the assets of the corporation distributed during the liquidation process?

The assets of the corporation shall be used to pay off the claims of various creditors based on the law on concurrence and preference of credit. The residual assets shall then be distributed to the holders of the preferred shares of stock, if any, then to the holders of common shares based on their agreement, if any, otherwise, in proportion to their respective shareholdings in the corporation.

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[432] Pepsi Cola Products Philippines v. Court of Appeals, G.R. No. 145855, November 24, 2004.

[433] Victor Yam & Yek Sun Lent, doing business under the name and style of Philippine Printing Works v. Court of Appeals and Manphil Investment Corporation, G.R. No. 104726, February 11, 1999.

[434] G.R. No. 161771, February 15, 2012.

[435] Section 112, FRIA.

Note that SEC approval is not required in the approval of the distribution or liquidation of the assets of the dissolved corporation. This falls within the authority of the directors and stockholders or the duly appointed trustee or receiver.

Any asset distributable to the creditor or stockholder or member who is unknown or cannot be found shall be escheated in favor of the national government.[436]

Period the liquidation of the corporation should be concluded.

Every corporation whose charter expires pursuant to its articles of incorporation, is annulled by forfeiture, or whose corporate existence is terminated in any other manner, shall nevertheless remain as a body corporate for three (3) years after the effective date of dissolution, for the purpose of prosecuting and defending suits by or against it and enabling it to settle and close its affairs, dispose of and convey its property, and distribute its assets, but not for the purpose of continuing the business for which it was established.[437]

Nevertheless, a corporation that has a pending action and which cannot be terminated within the three-year period after its dissolution is authorized under Section 139 of the RCC to convey all its property to a trustee to enable it to prosecute and defend suits by or against the corporation beyond the three-year period. The trustee may commence a suit which can proceed to final judgment even beyond the three-year period.

Even if no trustee is formally appointed, the directors of the dissolved corporation may be permitted to continue as trustees to complete the liquidation of the corporation.[438]

iv. Liquidation after three (3) years

May a corporation be allowed to dispose of its remaining assets after three (3) years from the time of its dissolution?

Yes, a corporation may still dispose of its assets despite the lapse of the three-year period for liquidation of assets provided under Section 139 of the RCC.

Based on the above provision, there is, as a general rule, no juridical personality after dissolution. If there is, it is only a juridical personality to serve but one purpose — liquidation, culminating in the disposition and distribution of the dissolved corporation's remaining assets. As pointed out, any matter entered into that is not for the purpose of liquidation will be a void transaction because of the non-existence of the corporate party.

While Section 139 of the RCC gives a dissolved corporation three (3) years to continue as a body corporate for purposes of liquidation, *the disposition of the remaining undistributed assets must necessarily continue even after such period.* This should not, however, be construed to prevent a corporation from pursuing activities which would complete the final liquidation of a dissolved corporation. Accordingly, it should be allowed to continue liquidating its remaining assets in order to complete the process of dissolving the corporation. Likewise, it should be allowed to distribute the proceeds from the said disposition to its stockholders or creditors if any. A contrary interpretation would have unjust and absurd results.

[436]Section 139, RCC.
[437]Section 139, RCC.
[438]Clemente v. Court of Appeals, G.R. No. 82407, March 27, 1995.

In *Clemente v. Court of Appeals*, the Supreme Court affirmed that 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) itself, following the rationale of the Supreme Court's decision in *Gelano v. Court of Appeals,* G.R. No. L-39050, February 24, 1981 ,maybe permitted to continue as "trustees" by legal implication to complete the corporate liquidation. Still, 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 on its behalf, might make proper representations with the SEC which has primary and sufficiently broad jurisdiction in matters of this nature, for working out a final settlement of the corporate concerns[439].

May the following legal actions involving the corporation be enforced by or against the corporation beyond the three-year liquidation period?

a. Action filed during the lifetime of the corporation?

The trustee (of a dissolved corporation) may commence a suit which can proceed to final judgment even beyond the three-year period of liquidation. No reason can be conceived why a suit already commenced by the corporation itself during its existence, not by a mere trustee who, by fiction, merely continues the legal personality of the dissolved corporation, should not be accorded similar treatment – to proceed to final judgment and execution thereof. Indeed, the rights of a corporation that has been dissolved pending litigation are accorded protection by Section 145 of the OCC (now Section 184 of the RCC) which provides "no right or remedy in favor of or against any corporation, its stockholders, members, directors, trustees, or officers, nor any liability incurred by any such corporation, stockholders, members, directors, trustees, or officers, shall be removed or impaired either by the subsequent dissolution of said corporation."[440]

A dissolved corporation may also maintain actions in court for the protection of its rights including the right to appeal from an adverse decision.[441]

b. Action filed during the three-year liquidation period?

Yes, the trustee appointed by the corporation may initiate a suit during the three-year liquidation period, which may continue even beyond the said period.[442] As pointed out, in *Gelano v. Court of Appeals*, it was held that the lawyer handling the case for the corporation is deemed a trustee with respect to that case. In *Clemente v. Court of Appeals*, it was held that in the absence of a trustee formally appointed, the board of directors shall be deemed the trustees of the corporation to carry out the liquidation of the corporation."

Moreover, it is clear under Section 184 of the RCC that "no right or remedy in favor of or against any corporation, its stockholders, members, directors, trustees, or officers, nor any liability incurred by any such corporation, stockholders, members, directors, trustees, or officers, shall be removed or impaired either by the subsequent dissolution of said corporation."

c. Action filed more than three (3) years from the dissolution of the corporation?

[439]See SEC-OGC Opinion No. 31-09, December 9, 2009.

[440]Rene Knecht and Knecht, Inc. v. United Cigarette Corp., represented by Encarnacion Gonzales Wong, and Eduardo Bolima, Sheriff, Regional Trial Court, Branch 151, Pasig City, G.R. No. 139370, July 4, 2002.

[441]Paramount Insurance Corp. v. A.C. Ordoñez Corporation and Franklin Suspine, G.R. No. 175109, August 6, 2008.

[442]Section 139, RCC.

As previously expounded, an action filed more than three (3) years from the dissolution of the corporation should be dismissed since by that time the corporation lacks the capacity to sue because it no longer possesses juridical personality by reason of its dissolution.

While there are cases that a corporation may still sue, even after it has been dissolved and despite the lapse of the three-year liquidation period, the corporations involved in those cases filed their respective complaints while they were still in existence. In other words, they already had pending actions at the time that their corporate existence was terminated.[443]

H. Other corporations

1. ***Close corporations***

Definition of close corporation.

Under Section 95 of the RCC, a close corporation is one whose articles of incorporation provides that:

a. all the corporation's issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than a specified number of persons, not exceeding 20;
b. all the issued stock of all classes shall be subject to one or more specified restrictions on transfer permitted by this Title; and
c. the corporation shall not list in any stock exchange or make any public offering of its stocks of any class.

Notwithstanding the foregoing, a corporation shall not be deemed a close corporation when at least two-thirds (2/3) of its voting stock or voting rights is owned or controlled by another corporation which is not a close corporation within the meaning of the RCC.[444]

Is the narrow distribution of share ownership the only criterion in determining the nature of a close corporation?

No, in one case,[445] the Supreme Court held that a corporation does not become a close corporation just because a man and his wife own 98.86% of its subscribed capital stock; So too, a narrow distribution of ownership does not, by itself, make a close corporation. The features of a close corporation under the Corporation Code must be embodied in the articles of incorporation to make it as one.

Main difference between a close corporation and other corporations.

The main difference between a close corporation and other corporations is the identity of stock ownership and active management, that is, all or most of the stockholders of a close corporation are active in the corporate business either as directors, officers or other key men in management. Where business associates belong to a small, closely-knit group, they usually prefer to keep the organization exclusive and would not welcome strangers. Since it is through their efforts and managerial skill that they expect the business to grow and prosper, it is quite understandable why they would not trust outsiders to come in and interfere with their management of the business, and much less share whatever fortune, big or small, that the business may bring.

[443] Alabang Corporation Development v. Alabang Hills Village Association and Rafael Tinio, G.R. No. 187456, June 2, 2014.
[444] Section 95, RCC.
[445] San Juan Structural and Steel Fabricators, Inc. v. Court of Appeals, G.R. No. 129459, September 29, 1998.

Principal characteristics of close corporations.

The principal characteristics of close corporations are the following:

a. The business of the corporation may be managed by the stockholders of the corporation rather than by a board of directors.

Stockholders who are actively involved in the management of the corporation are liable in the same manner as directors are liable. They are personally liable for corporate torts unless the corporation has obtained reasonably adequate liability insurance. An example of corporate tort is the nonpayment of separation benefits of employees who were terminated due to authorized cause.[446]

While Section 97 of the Corporation Code (now Section 96, RCC) only specifies that "the stockholders of the corporation shall be subject to all liabilities of directors," nowhere in that provision do we find any inference that stockholders of a close corporation are automatically liable for corporate debts and obligations.

It is true that the stockholders who are *actively engaged* in the management or operation of the business and affairs of a close corporation, shall be *personally liable for corporate torts* unless the corporation has obtained reasonably adequate *liability insurance.* But, as can be read in that provision, several requisites must be present for its applicability.[447]

b. If a corporation is classified as a close corporation, a board resolution authorizing the sale or mortgage of the corporate property is not necessary to bind the corporation for the action of its president.[448]
c. Quorum may be greater than a mere majority.
d. Transfers of stocks to others which would increase the number of stockholders to more than the maximum are invalid.
e. Corporate actions may be binding even without a formal board meeting, if the director had knowledge or ratified the informal action of the others, unless after having knowledge thereof, the director promptly files his written objection with the secretary of the corporation.
f. Pre-emptive right extends to all stocks issued, including re-issuance of treasury shares, whether for money or for property or personal services, or in payment of corporate debts, unless the articles of incorporation provide otherwise.
g. Deadlocks in the board may be settled by the SEC, on written petition by any stockholder.
h. A stockholder may withdraw for any reason and avail himself of his right of appraisal when the corporation has sufficient assets in its books to cover its debts and liabilities exclusive of capital stock.[449]

2. ***Nonstock corporations***

Definition of a nonstock corporation.

A nonstock corporation is one without a capital stock and/or where no part of its income is distributable as dividends to its members, trustees, or officers, subject to the provision on dissolution.[450] Any profit which a nonstock corporation may obtain incidental to its

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[446] Sergio Naguiat and Clark Field Taxi, Inc. v. NLRC, G.R. No. 116123, March 13, 1997.
[447] Joselito Hernand M. Bustos v. Millians Shoe, Inc., G.R. No. 185024, April 24, 2017.
[448] Manuel R. Dulay Enterprises, Inc. v. Court of Appeals, G.R. No. 91889, August 27, 1993.
[449] Sections 96-104, RCC.
[450] Sections 3 and 86, RCC.

operations shall, whenever necessary or proper, be used for the furtherance of the purpose or purposes for which the corporation was organized.

Most common characteristics of a nonstock corporation.

The following are the most common characteristics of a nonstock corporation:

a. Any profit derived by it from any authorized activity cannot be distributed as dividends to its members;
b. It may not lawfully engage in any business activity for profit as it would run counter to its very nature as a non-profit entity;
c. When incidental to the objects and purposes of the corporation and without the end of making profits to be distributed to the members, it may engage in certain economic activities stated in its articles of incorporation;
d. Do not issue stock and distribute dividends to their members; they are created not for profit but for public good and welfare; and
e. The mere fact that a nonstock corporation may earn profit does not make it a profit-making corporation where such profit or income is used to carry out the purposes set forth in the articles of incorporation and is not distributed to its incorporators, members, trustees or officers.[451]

ii. Purposes

Allowable purposes for a nonstock corporation.

It may be formed or organized for charitable, religious, educational, professional, cultural, fraternal, literary, scientific, social, civic service, or similar purposes, like trade, industry, agricultural and like chambers, or any combination thereof, subject to the special provisions governing particular classes of nonstock corporations.[452]

A nonstock corporation cannot be organized for profit since it is not engaged in business. Neither can it be organized for political purpose or end, otherwise, it should be registered as a party with the Commission on Elections.

BCDA is a government instrumentality vested with corporate powers. As such, it is exempt from the payment of docket fees. A government instrumentality may be endowed with corporate powers and at the same time retain its classification as a government "instrumentality" for all other purposes.

When the law vests in a government instrumentality corporate powers, the instrumentality does not become a corporation. Unless the government instrumentality is organized as a stock or non-stock corporation, it remains a government instrumentality exercising not only governmental but also corporate powers.

A stock corporation is one whose "capital stock is divided into shares and authorized to distribute to the holders of such shares dividends." BCDA has an authorized capital of Php100 Billion, however, it is not divided into shares of stock. BCDA has no voting shares. There is likewise no provision which authorizes the distribution of dividends and allotments of surplus and profits to BCDA's stockholders. Hence, BCDA is not a stock corporation. Section 8 of R.A. No. 7227 provides an enumeration of BCDA's purposes and their

[451]Nonstock Corporations; Use of Profits Derived by Nonstock Corporations. Special Corporations; Nonstock Educational Corporations; Required Number of Members of the Board of Trustees of Nonstock Educational Corporation, SEC-OGC Opinion No. 29-06, June 7, 2006.
[452]Section 87, RCC.

corresponding percentage shares in the sales proceeds of BCDA. Section 8 likewise states that after distribution of the proceeds acquired from BCDA's activities, the balance, if any, shall accrue and be remitted to the National Treasury. The National Treasury is not a stockholder of BCDA. Hence, none of the proceeds from BCDA's activities will be allotted to its stockholders. BCDA also does not quality as a non-stock corporation because it is not organized for any of the purposes mentioned under Section 88 of the Corporation Code. BCDA is organized for a specific purpose — to own, hold and/or administer the military reservations in the country and implement its conversion to other productive uses. BCDA is neither a stock nor a non-stock corporation.[453]

Are the members of the nonstock corporation entitled to the assets of the corporation upon its dissolution?

The assets of a nonstock corporation cannot be distributed to the members, trustees, or officers thereof unless their distributive rights upon dissolution are specified in the articles of incorporation or are specified in a plan of distribution duly adopted by at least majority of the board of trustees and approved by at least 2/3 of the members.[454]

Thus, during the lifetime of the corporation, there can be no distribution of assets of the corporation, unlike in a stock corporation.

3. Foreign corporations

A foreign corporation is one formed, organized or existing under laws other than those of the Philippines and whose laws allow Filipino citizens and corporations to do business in its own country or State.[455]

A corporation, composed entirely of Filipino citizens, is formed, organized and existing under the laws of the USA. Is this a foreign or domestic corporation?

It is a foreign corporation. Whether the corporation is domestic or foreign is determined by the country or State of incorporation. Thus, a corporation is foreign if it is formed, organized or existing under the laws of a foreign country regardless of the nationality of the stockholders.

a. What constitutes doing business

When is a foreign corporation deemed doing business in the Philippines?

The term "doing business" is not specifically defined by the OCC and the RCC. There are certain activities, however, which are deemed as doing business under R.A. No. 7042, otherwise known as the Foreign Investments Act of 1991 ("FIA"). Under the FIA, doing business shall include:

a. soliciting orders;
b. service contracts;
c. opening offices, whether called "liaison" offices or branches;
d. appointing representatives or distributors domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totaling 180 days or more;

[453] Bases Conversion and Development Authority v. CIR, GR. No. 205466, January 11, 2021, J. Hernando
[454] Section 93, RCC.
[455] Section 140, RCC.

e. participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines; and
f. any other act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of, commercial gain or of the purpose and object of the business organization.[456]

May one act or transaction be considered as doing business?

There is no general rule or governing principle laid down as to what constitutes "doing" or "engaging in" or "transacting" business in the Philippines. Each case must be judged in the light of its peculiar circumstances. Thus, it has often been held that a single act or transaction may be considered as "doing business" when a corporation performs acts for which it was created or exercises some of the functions for which it was organized. The amount or volume of the business is of no moment, for even a singular act cannot be merely incidental or casual if it indicates the foreign corporation's intention to do business. A foreign corporation engaged in ports operation which participated in a bidding to operate the Subic Bay ports is considered as doing business in the Philippines even though it is only one transaction because it shows the intention of the foreign corporation to attain the purpose of its incorporation.[457]

In another case, a foreign corporation engaged in the manufacture of uniforms entered into one purchase transaction but involving thousands of soccer jerseys from the Philippines was considered doing business in the Philippines since the purchase was within its ordinary course of business. The Supreme Court said that when a single act or transaction of a foreign corporation is not merely incidental or casual but is of such character as distinctly to indicate a purpose on the part of the foreign corporation to do other business in the state, such act will be considered as constituting doing business.[458]

Activities specifically excluded under FIA as doing business.

Under the FIA, the phrase "doing business" shall not be deemed to include the following activities:

a. Mere investment as a shareholder in a domestic corporation duly registered to do business and/or the exercise of rights as such investor;
b. Having a nominee director or officer to represent its interest in such corporation;
c. Appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account;
d. Publication of a general advertisement through any print or broadcast media;
e. Maintaining a stock of goods in the Philippines solely for the purpose of having the same processed by another entity in the Philippines;
f. Consignment by FC of equipment with a local company to be used in the processing of products for export;
g. Collecting information in the Philippines; and
h. Performing services auxiliary to an existing isolated contract of sale which is not on a continuing basis.[459]

[456]Section 3(d), R.A. No. 7042.
[457]Hutchison Ports Philippines Limited v. Subic Bay Metropolitan Authority, G.R. Nos. 100801-02, August 25, 2000.
[458]Litton Mill, Inc. v. Court of Appeals, G.R. No. 94980, May 15, 1996.
[459]Section 1, Implementing Rules and Regulations of R.A. No. 7402.

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Jurisprudence where the Supreme Court ruled that the foreign corporation is doing business in the Philippines.

a. When a foreign corporation engaged in the manufacture of uniforms purchased thousands of soccer jerseys from the Philippines since the purchase was within its ordinary course of business. When a single act or transaction of a foreign corporation is not merely incidental or casual but is of such character as distinctly to indicate a purpose on the part of the foreign corporation to do other business in the state, such act will be considered as constituting doing business.[460]
b. When it granted a 90-day credit term to a domestic corporation over a period of seven months for every purchase, as in the usual course of a commercial transaction, credit is extended only to customers in good standing or to those on whom there is an intention to maintain a long-term relationship.[461]
c. When as foreign corporation engaged in the port operations, it participated in a bidding process to operate the Subic Bay free ports.

The bidding for the concession contract is but an exercise of the corporation's reason for creation or existence. Participating in the bidding process constitutes "doing business" because it shows the foreign corporation's intention to engage in business here.[462]

Jurisprudence where the Supreme Court ruled that the activities of the foreign corporation are not deemed as doing business.

a. The hiring of an attorney-in-fact by a foreign corporation which owns the copyright to foreign films and exclusive distribution rights in the Philippines to file criminal cases for the protection of its property rights, if the contracts are consummated abroad, as this is merely for the protection of its property rights.[463]

b. The mere act of exporting from one's own country, without doing any specific commercial act within the territory of the importing country, cannot be deemed as doing business in the importing country. The importing country does not acquire jurisdiction over the foreign exporter who has not performed any specific commercial acts within the territory of the importing country. Without jurisdiction over the foreign exporter, the importing country cannot compel the foreign exporter to secure a license to do business in the importing country.

   Otherwise, Philippine exporters, by the mere act alone of exporting their products, could be considered by the importing countries to be doing business in those countries. This will require Philippine exporters to secure a business license in every foreign country where they usually export their products, even if they do not perform any specific commercial act within the territory of such importing countries. Such a legal concept will have a deleterious effect not only on Philippine exports, but also on global trade.[464]

c. A foreign company that merely imports goods from a Philippine exporter, without opening an office or appointing an agent in the Philippines, is not doing business in the Philippines.[465]

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[460]Litton Mill, Inc. v. Court of Appeals, G.R. No. 94980, May 15, 1996.
[461]Eriks Pte. Ltd. v. Court of Appeals, G.R. No. 118843, 1997.
[462]Hutchison Ports Philippines Limited v. Subic Bay Metropolitan Authority, G.R. Nos. 100801-02, August 25, 2000.
[463]Columbia Pictures, Inc. v. Court of Appeals, G.R. No. 110318. August 28, 1996.
[464]Van Zuiden Bros Ltd. v. GTVL Manufacturing Industries, G.R. No. 147905, May 28, 2007; 2015 Bar.
[465]Cargill, Inc. v. Intra Strata Assurance Corporation, G.R. No. 168266, March 15, 2010.

d. The appointment of a distributor in the Philippines is not sufficient to constitute doing business unless it is under the full control of the foreign corporation. If the distributor is an independent entity which buys and distributes products, other than those of the foreign corporation, doing business for its own name and account, the latter cannot be considered as doing business.[466]

e. A foreign corporation may file a petition to enforce a foreign arbitral award even though it is not licensed to do business in the Philippines. When a party enters into a contract containing a foreign arbitration clause and submits itself to arbitration, it becomes bound by the contract, by the arbitration and by the result of arbitration, conceding thereby the capacity of the other party to enter into the contract, participate in the arbitration and cause the implementation of the result.[467]

f. A foreign corporation, if it is a holder in due course of a draft, can file a suit in the Philippines to enforce the warranties of the drawer and endorser after the drawee dishonored the instrument.[468] The foreign corporation does not need a license to sue because it sued upon a singular and isolated transaction.

g. Subscribing to shares to stock of a domestic corporation, maintaining investments therein and deriving dividend income therefrom does not qualify as "doing business" contemplated under R.A. No. 7042. Hence, the foreign corporation is not required to secure a license before it can file a claim for tax refund.[469]

Mere investment as a shareholder by a foreign corporation in a duly registered domestic corporation shall not be deemed "doing business" in the Philippines. It is clear then that the IGC's act of subscribing shares of stocks from McCann, a duly registered domestic corporation, maintaining investments therein, and deriving dividend income therefrom, does not qualify as "doing business" contemplated under R.A. No. 7042. Hence, the IGC is not required to secure a license before it can file a claim for tax refund.[470]

b. Necessity of a license to do business

Legal consequence if a foreign corporation transacts business in the Philippines without the corresponding license from the SEC.

No foreign corporation transacting business in the Philippines without a license, or its successors or assigns, shall be permitted to maintain or intervene in any action, suit or proceeding in any court or administrative agency of the Philippines; but such corporation may be sued or proceeded against before Philippine courts or administrative tribunals on any valid cause of action recognized under Philippine laws.[471]

In other words, a foreign corporation doing business in the country, without a license, cannot sue but can be sued.

A foreign corporation that is not doing business in the Philippines must disclose such fact if it desires to sue in Philippine courts under the "isolated transaction rule" because without such disclosure, the court may choose to deny it the right to sue. The qualifying

[466]Steel Case v. Design International Selection, G.R. No. 171995, April 18, 2012; 2015 Bar Exam.
[467]Tuna Processing, Inc. v. Philippine Kingford, Inc., G.R. No. 185582, February 29, 2012.
[468]Llorente v. Star City Pty Limited, G.R. Nos. 212050 and 212216, January 15, 2020.
[469]Commissioner of Internal Revenue v. Interpublic Group of Companies, G.R. No. 207039, August 14, 2019.
[470] Commissioner of Internal Revenue v. Interpublic Group of Companies, G.R. No. 207039, August 14, 2019
[471]Section 150, RCC.

circumstance that if it is doing business in the Philippines, it is duly licensed or if it is not, it is suing upon a singular and isolated transaction, is an essential part of the element of the plaintiffs capacity to sue and must be affirmatively pleaded.[472]

Personality to sue and suability

What confers upon the foreign corporation the legal capacity to sue in the Philippines?

The foreign corporation has the legal capacity to sue if it has procured from the SEC a license to do business or it is suing on a casual or isolated transaction.

For purposes of acquiring jurisdiction by way of service of summons, there is no need to prove first the fact that the defendant is doing business in the Philippines. Where a complaint alleges that the defendant has an agent in the Philippines, summons can validly be served thereto even without prior evidence of the truth of such factual allegation. If in fact, a foreign corporation does not do business here, that is a matter that should be ventilated in the trial on the merits but not in a motion to dismiss.[473]

It does not follow that the insurer, as subrogee, has also no capacity to sue in this jurisdiction simply because the insured party (which is a foreign corporation) has no legal capacity to sue in the Philippines. The rights inherited by the insurer pertain only to the payment it made to the insured and which amount it now seeks to recover from the shipping company which caused the loss sustained by the insured. The capacity to sue is a right personal to its holder. It is conferred by law and not by the parties. The insurer has satisfactorily proven its capacity to sue, after having shown that it is not doing business in the Philippines, but is suing only under an isolated transaction, *i.e.*, under the one marine insurance policy issued in favor of the consignee/insured.[474]

Suability of foreign corporations

State the principles governing the right to sue and suability of foreign corporations.

The following principles governing a foreign corporation's right to sue in local courts have long been settled, *to wit*:

a. if a foreign corporation does business in the Philippines without a license, it cannot sue before the Philippine courts;
b. if a foreign corporation is not doing business in the Philippines, it needs no license to sue before Philippine courts on an isolated transaction or on a cause of action entirely independent of any business transaction; and
c. if a foreign corporation does business in the Philippines with the required license, it can sue before Philippine courts on any transaction.

It is not the absence of the prescribed license but the "doing (of) business" in the Philippines without such license which debars the foreign corporation from access to our courts.[475]

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[472] Quintin Artacho Llorente V. Star City Pty Limited, Represented By The Jimeno And Cope Law Offices As Attorney-In-Fact G.R. No. 212050, January 15, 2020, First Division (Caguioa, J.)

[473] Signetics Corp. v. Court of Appeals, G.R. No. 105141 (Resolution), August 31, 1993.

[474] Lorenzo Shipping Corp. v. Chubb and Sons, G.R. No. 147724, June 8, 2004.

[475] MR Holdings, Ltd. v. Sheriff Carlos P. Bajar, Sheriff Ferdinand M. Jandusay, Solidbank Corporation, and Marcopper Mining Corporation, G.R. No. 138104, April 11, 2002.

Tersely, the issue on whether a foreign corporation, which does not have a license to engage in business in the Philippines can seek redress in Philippine courts depends on whether it is doing business or it merely entered into an isolated transaction. A foreign corporation that is not doing business in the Philippines must disclose such fact if it desires to sue in Philippine courts under the isolated transaction rule because, without such disclosure, the court may choose to deny it the right to sue.[476]

Instances when an unlicensed foreign corporation may be allowed to sue.

The following are the instances when an unlicensed foreign corporation may be allowed to sue in the Philippines courts.

a. *If the foreign corporation is suing on a casual or isolated transaction.*[477]

An isolated transaction will not result in the enterprise being deemed as doing business in the Philippines. The phrase "isolated transaction" has a definite and fixed meaning, *i.e.*, a transaction or series of transactions set apart from the common business of a foreign enterprise in the sense that there is no intention to engage in a progressive pursuit of the purpose and object of the business organization.[478]

The ascertainment of whether a foreign corporation is merely suing on an isolated transaction or is actually doing business in the Philippines requires the elicitation of at least a preponderant set of facts. It simply cannot be answered through conjectures or acceptance of unsubstantiated allegations.[479]

b. *Action to protect the good name, goodwill and reputation of a foreign corporation.*

Foreign corporation not doing business in the Philippines may sue here even if not licensed in order to protect intellectual property rights. Under the Paris Convention for the Protection of Intellectual Property Rights, the Philippines is obligated to assure nationals of countries of the Paris Convention that they are afforded effective protection against violation of their intellectual property rights in the Philippines in the same way that their own countries are obligated to accord similar protection to Philippine nationals.[480]

Our obligation under the Paris Convention is incorporated in Section 3 of R.A. No. 8293, otherwise known as the Intellectual Property Code.

c. *Where the contract provides the Philippine court as the exclusive venue for court action, to the exclusion of other courts.*

Stipulation as to venue which is not permissive but exclusive in nature is binding to the parties.

d. *A license to engage in business granted subsequent to the transaction enables the foreign corporation to sue on contracts executed before grant of license.*

[476]Llorente v. Star City Pty Limited, G.R. Nos. 212050 and 212216, January 15, 2020.

[477]See discussions on Question No. 21 (cases where the Supreme Court held that the activities of the foreign corporation do no amount to doing business).

[478]Lorenzo Shipping Corp. v. Chubb and Sons, G.R. No. 147724, June 8, 2004.

[479]Rimbunan Hijau Group of Companies v. Oriental Wood Processing Corporation, G.R. No. 152228. September 23, 2005.

[480]Converse Rubber Corporation v. Universal Rubber Products, Inc., G.R. No. L-27906, January 8, 1987; Philip Morris, Inc. v. Court of Appeals, G.R. No. 91332, July 16, 1993; Fredco Manufacturing Corporation v. President and Fellows of Harvard College, G.R. No. 185917, June 1, 2011.

In one case, the Supreme Court ruled that a contract entered into by a foreign corporation not licensed to do business in the Philippines is not void even as against the erring foreign corporation. The lack of capacity at the time of the execution of the contracts was cured by the subsequent grant of a license to engage in business.

It was likewise held in this case that while the grant of the license retroacts to the date of the transaction, this is without prejudice to criminal prosecution against the foreign corporation for doing business without a license. The basis of criminal liability is Section 144 of the OCC (now Section 170 of the RCC) that any violation of the provisions of the Corporation Code or its amendments not otherwise specifically penalized therein shall be punished by a fine or by imprisonment. (The RCC retained the language but removed the penalty of imprisonment.)

In *IENT v. Tullett Prebon*,[481] the Supreme Court, however, ruled that its declaration in *Home Insurance Company v. Eastern Shipping Lines* that "the prohibition against doing business without first securing a license is now given a penal sanction which is also applicable to other violations of the Corporation Code under the general provisions of Section 144 of the Code" is unmistakably an *obiter dictum*. The issue in the *Home Insurance case* was whether or not a foreign corporation previously doing business here without a license has the capacity to sue in our courts when it had already acquired the necessary license at the time of the filing of the complaints. The statement regarding the supposed penal sanction was not essential to the resolution of the case as none of the parties was being made criminally liable.

e. *When the unlicensed foreign corporation has domestic corporation as a co-plaintiff/ petitioner.*

   This is necessary to prevent multiplicity of suits.

f. *Under the doctrine of estoppel when the counterparty is estopped or precluded from questioning the lack of legal capacity of the foreign corporation, as held in the following cases:*

A foreign corporation which licensed a domestic corporation to manufacture and market its products and equipment is doing business in the Philippines and cannot sue the domestic corporations if it has no license to do business in the Philippines. For being *in pari delicto*, the domestic corporation cannot ask the courts to prohibit the foreign corporation from terminating its contract and giving the license to produce and market its products to another.[482]

A foreign corporation doing business in the Philippines may sue in the Philippine courts although it has no license to do business here against a Philippine citizen who had contracted with and been benefited by said corporation where such party is aware that the foreign corporation is doing business in the Philippines without a license and received benefits from transacting business with it, under the principle of estoppel.[483]

A party is estopped from challenging the personality of a corporation after having acknowledged the same by entering into a contract with it. The principle is applied to prevent a person contracting with a foreign corporation from later taking advantage of its

[481]G.R. No. 189158, January 11, 2017.

[482]Top-Weld Manufacturing, Inc. v. Eced, S.A., G.R. No. L-44944, August 9, 1985; See also Granger Associates v. Microwave Systems, Inc., G.R. No. 79986. September 14, 1990.

[483]Merrill Lynch Futures, Inc. v. Court of Appeals, G.R. No. 97816, July 24, 1992.

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noncompliance with the statutes, chiefly in cases where such person has received the benefits of the contract.[484]

4.One person corporations

Definition of One Person Corporation ("OPC")

OPC is a corporation with a single stockholder: *Provided*, that only a natural person, trust, or an estate may form a OPC.

May a foreign natural person organize an OPC?

In case of a natural person, the only requirement under the RCC is that he/she must be of legal age. There is no provision on any nationality requirement. Thus, subject to the applicable constitutional and statutory restrictions on foreign participation in certain investment areas or activities, a foreign natural person may organize an OPC.[485]

"Trust" referred to under the RCC which can organize an OPC.

The "trust" as used by the law does not refer to a trust entity, but to the subject being managed by the trustee.[486]

Additional requirement for incorporation of an OPC if the single stockholder is a trustee, administrator, executor, guardian, conservator, custodian or any other person exercising fiduciary duties.

If the single stockholder is a trustee, administrator, executor, guardian, conservator, custodian or any other person exercising fiduciary duties, proof of authority to act on behalf of the trust or estate must be submitted at the time of incorporation.[487]

i. Excepted corporations

Which corporations are not allowed to incorporate as OPC?

Banks and quasi-banks, pre-need, trust, insurance, public and publicly-listed companies, and non-chartered government-owned and -controlled corporations may not incorporate as OPC: *Provided, further*, That a natural person who is licensed to exercise a profession may not organize as an OPC for the purpose of exercising such profession except as otherwise provided under special laws.

Characteristics of OPC

An OPC has the following characteristics:

a. It has a single stockholder.
b. It is not required to have a minimum authorized capital stock except as otherwise provided by special law. Further, no portion of the authorized capital is required to

[484] Global Business Holdings, Inc. v. Surecomp Software, B.V., G.R. No. 173463, October 13, 2010; Steelcase, Inc. v. Design International Selections, Inc., G.R. No. 171995, April 18, 2012.
[485] Section 15, SEC MC No. 7.
[486] Section 1, SEC MC No. 7.
[487] SEC MC No. 7, ibid.

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be paid up at the time of the incorporation, unless otherwise required by applicable laws or regulations.[488]

c. It is not required to submit and file corporate bylaws.[489]
d. It is required to indicate the letters "OPC" either below or at the end of its corporate name.[490]
e. The single stockholder shall be the sole director and president of the OPC.[491]
f. The single stockholder is required to designate a nominee and an alternate nominee who shall, in the event of the single stockholder's death or incapacity, take the place of the single stockholder as director and shall manage the corporation's affairs.[492]
g. The liability of the single stockholder shall be limited to his subscription to the corporation unless there is ground to pierce to pierce the veil of corporate fiction.[493]

Who are the officers of a OPC?

OPC should appoint a treasurer, corporate secretary, and other officers as it may deem necessary, within 15 days from the issuance of its certificate of incorporation and should be reported to the SEC within five days from appointment.

The single stockholder may not be appointed as the corporate secretary.

A single stockholder who is likewise the self-appointed treasurer of the corporation shall give a bond to the SEC in such a sum as may be required: *Provided*, That the said stockholder/treasurer shall undertake in writing to faithfully administer the OPC's funds to be received as treasurer, and to disburse and invest the same according to the articles of incorporation as approved by the SEC. The bond shall be renewed every two years or as often as may be required.[494]

The surety bond coverage is subject to renewal every two years or as may be required, upon review of the audited financial statements certified under oath by the company's president and treasurer. Further, the bond is a continuing requirement as long as the single stockholder is the self-appointed treasurer of the OPC. However, the bond may be cancelled upon proof of appointment of another person as the treasurer and filing of amended form for appointment of officers.

Requisites for the limited liability of the single stockholder of OPC.

The liability of the sole stockholder shall be limited to his subscription to the corporation if the following requisites are present:

a. The sole shareholder must show that the corporation was adequately financed;
b. He must prove that the property of the OPC is independent of the stockholder's personal property; and
c. There is no ground to pierce the veil of corporate fiction.

Otherwise, the sole stockholder shall be jointly and severally liable for the debts and other liabilities of the OPC.[495]

[488] Section 117, RCC and Section 8 of MC No. 7.
[489] Section 119, RCC.
[490] Section 120, RCC.
[491] Section 121, RCC.
[492] Section 124, RCC.
[493] Section 130, RCC.
[494] Section 122, RCC.
[495] Section 130, RCC.

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I. Merger and Consolidation

1. Concept

Distinguish merger from asset sale between corporations.

In merger, the constituent corporations cease to exist except the surviving corporation which retains its corporate identity but acquires all the rights and liabilities of the acquired corporation/s whereas in asset sale, both the seller corporation and buyer corporation continue to exist. The seller corporation is not dissolved even though it may not have any asset left.

In merger, the surviving corporation assumes all the liabilities of the absorbed corporation whereas in asset sale, the buyer, as a general rule, does not assume the liabilities of the seller.

Distinguish merger from consolidation.

Consolidation is the union of two (2) or more existing corporations to form a new corporation called the consolidated corporation.

Merger, on the other hand, is a union whereby one corporation absorbs one or more existing corporations, and the absorbing corporation survives and continues the combined business.

The parties to a merger or consolidation are called constituent corporations. In consolidation, all the constituents are dissolved and absorbed by the new consolidated enterprise. In merger, all constituents, except the surviving corporation, are dissolved. In both cases, however, there is no liquidation of the assets of the dissolved corporations, and the surviving or consolidated corporation acquires all their properties, rights and franchises and their stockholders usually become its stockholders.

The surviving or consolidated corporation assumes automatically the liabilities of the dissolved corporations, regardless of whether the creditors have consented or not to such merger or consolidation.[496]

In 2015, Total Bank ("Total") proposed to sell to Royal Bank ("Royal") its banking business for P10 billion consisting of specified assets and liabilities. The parties reached an eventual agreement, which they termed as "Purchase and Assumption Agreement" ("P&A") in which Royal would acquire Total's specified assets and liabilities, excluding contingent claims, with the further stipulation that it should be approved by the *Bangko Sentral ng Pilipinas* ("BSP"). BSP imposed the condition that Total should place in escrow Pl billion to cover for contingent claims against it. Total complied. After securing the approval of the BSP, the two (2) banks signed the agreement. BSP thereafter issued a circular advising all bank and non-bank intermediaries that effective January 1, 2016, "the banking activities of Total Bank and Royal Bank have been consolidated and the latter has carried out their operations since then."

a. Was there a merger and consolidation of the two (2) banks in point of the Corporation Code? Explain.

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[496] John F. McLeod v. National Labor Relations SEC First Division, et al., G.R. No. 146667, January 23, 2007.

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There was no merger or consolidation of the two (2) banks in point of the Corporation Code. The Supreme Court ruled in *Bank of Commerce v. Radio Philippine Network, Inc.*[497] that there can be no merger if the requirements and procedure for merger were not observed and no certificate of merger was issued by the SEC.

The transaction is basically a sale of all or substantially all of the assets. It is settled if one (1) corporation sells or otherwise transfers all its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor if it has acted in good faith and has paid adequate consideration for the assets, except: (1) where the purchaser expressly or impliedly agrees to assume such debts; (2) where the transaction amounts to a consolidation or merger of the corporations; (3) where the purchasing corporation is merely a continuation of the selling corporation; and (4) where the transaction is entered into fraudulently in order to escape liability for such debts.

The evidence fails to show that BOC was a mere continuation of TRB. TRB retained its separate and distinct identity after the purchase. Although it subsequently changed its name to Traders Royal Holding's, Inc., such change did not result in its dissolution. As such, BOC and TRB remained separate corporations.

b. What is meant by a *de facto* merger? Discuss.[498]

De facto merger means that a corporation called the Acquiring Corporation acquired the assets and liabilities of another corporation in exchange for an equivalent value of shares of stock of the Acquiring Corporation making the other corporation a stockholder of the Acquiring Corporation.[499]

In the present case, there is no *de facto* merger because the Acquiring Corporation acquired the assets and liabilities of the other corporation but not in exchange for stocks. The assets were acquired in exchange for the assumption of liabilities.

2. Effects and limitations

Effects of merger or consolidation.

The following are the effects of merger or consolidation:

a. The constituent corporations shall become a single corporation which, in case of merger, shall be the surviving corporation designated in the plan of merger; and, in case of consolidation, shall be the consolidated corporation designated in the plan of consolidation.
b. The separate existence of the constituent corporations shall cease, except that of the surviving or the consolidated corporation.
c. The surviving or the consolidated corporation shall possess all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under the RCC.
d. The surviving or the consolidated corporation shall possess all the rights, privileges, immunities and franchises of each constituent corporation; and all real or personal property, all receivables due on whatever account, including subscriptions to shares and other choses in action, and every other interest of, belonging to, or due to each constituent corporation, shall be deemed transferred to and vested in such surviving or consolidated corporation without further act or deed.

[497] G.R. No. 195615, April 21, 2014.
[498] 2016 Bar Exam.
[499] Bank of Commerce v. Radio Philippines Network, Inc., et al., G.R. No. 195615, April 21, 2014.

e. The surviving or consolidated corporation shall be responsible for all the liabilities and obligations of each constituent corporation as though such surviving or consolidated corporation had itself incurred such liabilities or obligations; and any pending claim, action or proceeding brought by or against any constituent corporation may be prosecuted by or against the surviving or consolidated corporation. The rights of creditors or liens upon the property of such constituent corporations shall not be impaired by the merger or consolidation.[500]

Is merger a mode of dissolution?

Yes, because the absorbed corporation ceases to exist upon approval by the SEC of the merger.

Should the absorbed corporation undertake dissolution to transfer its assets to the surviving corporation?

Although there is a dissolution of the absorbed corporations, there is no winding up of their affairs or liquidation of their assets, because the surviving corporation automatically acquires all their rights, privileges and powers, as well as their liabilities.

Can the debtor of the absorbed bank invoke novation against the surviving corporation which demanded payment of the debtor's loan?

A bank which merged with another bank can sue the debtor of the absorbed bank because it acquired the rights of the latter. Novation (because of the change of creditor) is not a valid defense because it is settled that in a merger of two (2) existing corporations, one of the corporations survives and continues the business, while the other is dissolved and all its rights, properties and liabilities are acquired by the surviving corporation.[501]

The surviving or consolidated corporation shall be responsible for all the liabilities and obligations of each constituent corporation as though such surviving or consolidated corporation had itself incurred such liabilities or obligations; and any pending claim, action or proceeding brought by or against any constituent corporation may be prosecuted by or against the surviving or consolidated corporation. The rights of creditors or liens upon the property of such constituent corporations shall not be impaired by the merger or consolidation.[502]

Cite jurisprudence where the surviving corporation was made to assume the liabilities of the absorbed corporation.

a. Upon service of the writ of garnishment, the garnishee becomes a "virtual party" or "forced intervenor" to the case. Citytrust, therefore, upon service of the notice of garnishment and its acknowledgment that it was in possession of defendants' deposit accounts, became a "virtual party" to or a "forced intervenor" in the civil case.

   As such, it became bound by the orders and processes issued by the trial court despite not having been properly impleaded therein. Consequently, by virtue of its merger with BPI, BPI, as the surviving corporation, effectively became the garnishee, thus the "virtual party" to the civil case. BPI cannot avoid the obligation attached to the writ of garnishment by claiming that the fund was not transferred to it, in light of the rule on merger that all liabilities and obligations of the absorbed corporation (Citytrust) shall

[500]Section 79, RCC.
[501]Babst v. Court of Appeals, G.R. Nos. 99398 and 104625, January 26, 2001.
[502]Section 79, RCC.

be transferred to and become the liabilities and obligations of the surviving corporation (BPI) in the same manner as if the BPI had itself incurred such liabilities or obligations.[503]

b. In a case where an employee obtained judgment against two corporations holding them solidarily liable for money claim and damages, the surviving corporation, which absorbed one of the judgment debtor-corporations, assumes the same solidary liability and not only for the money claim corresponding to the period the employee was employed with the absorbed corporation. One of the effects of a merger is that the surviving company shall inherit not only the assets, but also the liabilities of the corporation it merged with.[504]

c. The merger of a corporation with another does not operate to dismiss the employees of the corporation absorbed by the surviving corporation. This is in keeping with the nature and effects of a merger as provided under law and the constitutional policy protecting the rights of labor. The employment of the absorbed employees subsists. Necessarily, these absorbed employees are not entitled to separation pay on account of such merger in the absence of any other ground for its award.[505] The surviving corporation, however, may terminate employment for redundancies resulting from the merger.

d. Since BSA incurred delay in the performance of its obligations and subsequently cancelled the omnibus line without the mortgagor's consent, its successor BPI cannot be permitted to foreclose the mortgage for the reason that its predecessor BSA violated the terms of the contract even prior to the mortgagor's justified refusal to continue paying the amortizations. As such, BPI is liable for BSA, its predecessor. BPI did not only acquire all the rights, privileges and assets of BSA but likewise acquired the liabilities and obligations of the latter as if BPI itself incurred it.[506]

[503]Bank of Philippine Islands v. Lee, G.R. No. 190144, August 1, 2012.

[504]Sumifru (Philippines) Corporation (Surviving Entity In A Merger With Davao Fruits Corporation and Other Companies) v. Bernabe Baya, G.R. No. 188269, April 17, 2017.

[505]The Philippine Geothermal, Geothermal, Inc. v. Unocal Philippines, Inc. (now known as Chevron Geothermal Philippines Holdings, Inc.), G.R. No. 190187, September 28, 2016.

[506]Spouses Ong v. BPI Family Savings Bank, G.R. No. 208638, January 14, 2018.

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IV. INTELLECTUAL PROPERTY CODE
(R.A. No. 8293; exclude implementing rules and regulations)

A. Patents

What is a patent?

It is an exclusive right granted to an inventor over an invention or a utility model or industrial design to sell, use, and make the same for commerce and industry.

What are the various types of patents?

The following are the types of Patents: a) patentable inventions; b) industrial designs; and c) utility models.

1. Patentable vs. non-patentable invention

What may be patented?

Any technical solution of a problem in any field of human activity which is new, involves an inventive step and is industrially applicable shall be patentable. It may be, or may relate to, a product, or process, or an improvement of any of the foregoing.[507]

What are the requisites for the patentability of an invention?

The requisites are derived from the definition of a patentable invention itself. They are: a) novelty or newness; b) an inventive step; and c) industrial applicability.

Define novelty as an element of patentability.

It is best defined in the negative: an invention shall not be considered new if it forms part of a prior art. Prior art, on the other hand, shall consist of:

a. Everything which has been made available to the public anywhere in the world, before the filing date or the priority date of the application claiming the invention; and,
b. The whole contents of a published application for a patent, utility model, or industrial design registration, filed or effective in the Philippines, with a filing or priority date that is earlier than the filing or priority date of the application.[508]

Thus, if the inventor makes his invention available to the public but without obtaining a patent, he cannot restrain others from using his invention. The use of the invention does not constitute patent infringement. The rule is, no patent no protection. Neither can anyone, however, from the public apply for and obtain a patent over same invention because the application for patent will no longer satisfy the element of novelty.

It was held that a utility model shall not be considered "new" if before the application for a patent it has been publicly known or publicly used in this country or has been described in a printed publication or publications circulated within the country, or if it is substantially similar to any other utility model so known, used or described within the country.[509]

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[507] Section 21, IPC, as amended.

[508] Section 23, IPC, as amended.
[509] Angelita Manzano v. Court of Appeals, G.R. No. 113388, September 5, 1997.

An invention must possess the essential elements of novelty, originality, and precedence; and for the patentee to be entitled to protection, the invention must be new to the world. When it was established by evidence that the powder puffs identical with that of petitioner's patents existed and were publicly known and used as early as 1963 long before petitioner was issued the patent in question, then the presumption of correctness and validity of the patent should be set aside.[510]

What is the doctrine of prejudicial disclosure?

Under the doctrine of non-prejudicial disclosure, the disclosure of information contained in the application during the 12 months preceding the filing date or priority date of the application shall not prejudice the applicant on the ground of lack of novelty if such disclosure was made by the inventor himself.[511]

Yosha was able to put together a mechanical water pump in his garage consisting of suction systems capable of drawing water from the earth using less human effort than what was then required by existing models. The water pump system provides for a new system which has the elements of novelty and inventive steps. Yosha, while preparing to have his invention registered with the IPO, had several models of his new system fabricated and sold in his province.

Is Yosha's invention no longer patentable by virtue of the fact that he had sold several models to the public before the formal application for registration of patent was filed with the IPO?[512]

Yosha's invention is still patentable despite the fact he had sold several models to the public before the formal application for registration of the patent was filed with the IPO. It is true that an invention shall not be considered new if it forms part of a prior art and that prior art shall consist of everything which has been made available to the public anywhere in the world, before the filing date or the priority date of the application claiming the invention.This, however, presupposes that the one who has made available the patentable invention to the public is a person other than the applicant for patent.

Under the doctrine of non-prejudical disclosure, the disclosure of information contained in the application during the 12 months preceding the filing date or priority date of the application shall not prejudice the applicant on the ground of lack of novelty if such disclosure was made by the inventor himself.[513]

What is "inventive step" as an element of patentability?

An invention involves an inventive step if, having regard to prior art, it is not obvious to a person skilled in the art at the time of the filing date or priority date of the application claiming the invention.[514]

Only prior art made available to the public before the filing date or priority date is considered in assessing inventive step. Thus, subsequent development in technologies or invention cannot be used to discard the element of inventive step.

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[510]Rosario Maguan v. Court of Appeals, G.R. L-45101, November 28, 1986.
[511]Section 25, IPC, as amended.
[512]BAR 2018.
[513]Section 25, IPC, as amended.
[514]Section 26.1, IPC, as amended.

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The phrase "skilled in the art" means the criterion is only limited to a person with an average level of skill in the concerned field. It excludes the best expert available.[515]

In the case of drugs and medicines, there is no inventive step if the invention results from the mere discovery of a new form or new property of a known substance which does not result in the enhancement of the known efficacy of that substance, or the mere discovery of any new property or new use for a known substance, or the mere use of a known process unless such known process results in a new product that employs at least one new reactant.[516]

What is industrial applicability as an element of patentability?

An invention that can be produced and used in any industry shall be industrially applicable.[517]

What are the non-patentable inventions?

These are inventions that are excluded from patent protection, to wit:

a. Discoveries, scientific theories and mathematical methods, and in the case of drugs and medicines, the mere discovery of a new form or new property of a known substance which does not result in the enhancement of the known efficacy of that substance, or the mere discovery of any new property or new use for a known substance, or the mere use of a known process unless such known process results in a new product that employs at least one new reactant;
b. Schemes, rules and methods of performing mental acts, playing games or doing business, and programs for computers;
c. Methods for treatment of the human or animal body by surgery or therapy and diagnostic methods practiced on the human or animal body;
d. Plant varieties or animal breeds or essentially biological process for the production of plants or animals;
e. Aesthetic creations; and
f. Anything which is contrary to public order or morality.[518]

2. Ownership of a patent

Who has a right to a patent?

The right to a patent belongs to the inventor, his heirs, or assigns. When two (2) or more persons have jointly made an invention, the right to a patent shall belong to them jointly.[519]

What happens if the inventor never secured a patent on a patentable product but a copyright was secured instead?

In one case, a corporation was engaged in the manufacture of advertising display units simply referred to as light boxes. These units utilize specially printed posters sandwiched between plastic sheets and illumined by back lights. The manufacturer was able to secure a certificate of copyright registration over these illuminated display units. On the issue of whether there is a patent infringement if another person manufactures the same light boxes,

[515]Gepty, *ibid*., p. 258.
[516]Section 26.2, IPC, as amended.
[517]Secton 27, IPC, as amended.
[518]Section 22, IPC, as amended.
[519]Section 28, IPC, as amended.

it was held that (assuming these light boxes are patentable)when an inventor never secured a patent for the light boxes, it therefore acquired no patent rights which could have protected its invention. The ultimate goal of a patent system is to bring new designs and technologies into the public through disclosure; hence, ideas, once disclosed to the public without protection of a valid patent, are subject to appropriation without significant restraint.[520]

And so, in that case, the Court ruled that the copyright protection extended only to the technical drawings and not to the light box itself as the latter does not fall under the category of "prints, pictorial illustrations, advertising copies, labels, tags and box wraps." The light box was not a literary or artistic piece which could be copyrighted under the copyright law; and no less clearly, neither could the lack of statutory authority to make the light box copyrightable be remedied by the simplistic act of entitling the copyright certificate issued by the National Library as "Advertising Display Units."

What is the "First to File Rule" under the law on patent?

If two (2) or more persons have made the invention separately and independently of each other, the right to the patent shall belong to the person who filed an application for such invention, or where two or more applications are filed for the same invention, it shall belong to the applicant who has the earliest filing date or, the earliest priority date.[521]

Who owns inventions created pursuant to a commission but not under an employer-employee relationship?

The person who commissions the work shall own the patent, unless otherwise provided in the contract.[522]

This is different from copyright where the work is owned by the one who commissioned it but the copyright belongs to the author or creator.

How about those inventions created by an employee?

In case the employee made the invention in the course of his employment contract, the patent shall belong to: a) the **employee**, if the inventive activity is not a part of his regular duties even if the employee uses the time, facilities and materials of the employer; b) the **employer**, if the invention is the result of the performance of his regularly-assigned duties, unless there is an agreement, express or implied, to the contrary.[523]

Cezar works in a car manufacturing company owned by Joab. Cezar is quite innovative and loves to tinker with things. With the materials and parts of the car, he was able to invent a gas-saving device that will enable cars to consume less gas. Francis, a co-worker, saw how Cezar created the device and likewise came up with a similar gadget, also using scrap materials and spare parts of the company. Thereafter, Francis filed an application for registration of his device with the Bureau of Patents. Eighteen months later, Cezar filed his application for the registration of his device with the Bureau of Patents. Assuming that it is patentable, who is entitled to the patent? What, if any, is the remedy of the losing party?[524]

[520]Pearl & Dean (Phil.) v. Shoemart, Inc., G.R. No. 148222, August 15, 2003.

[521]Section 29, IPC, as amended.
[522]Section 30.1, IPC, as amended.
[523]Section 30.2, IPC, as amended.
[524]BAR 2005.

Francis is entitled to the Patent, because he had the earlier filing date under the "First to File Rule."[525] The remedy of Cezar is to file a petition in court for the cancellation of the patent of Francis on the ground that he is the true and actual inventor, and ask for his substitution as patentee.[526]

Supposing in the same question above, Joab got wind of the inventions of his employees and also laid claim to the patents, asserting that Cezar and Francis were using his materials and company time in making the devices, will his claim prevail over those of his employees? Explain.

No. The claim of Joab will not prevail over those of his employees, even if they used his materials and company time in making the gas-saving device. The invention of the gas-saving device is not part of their regular duties as employees of a car manufacturing company.[527]

What is the "Right of Priority"?

An application for patent filed by any person who has previously applied for the same invention in another country which by treaty, convention or law affords similar privileges to Filipino citizens, shall be considered as filed as of the date of the filing of the foreign application; provided, that: a) the local application expressly claims priority; b) it is filed within 12 months from the date of the earliest foreign application was filed; and c) certified copy of the foreign application together with an English translation is filed within six (6) months from the date of filing in the Philippines.[528]

A patent applicant with the right of priority is given preference in the grant of a patent when there are two or more applicants for the same invention. Since both the United States and the Philippines are signatories to the Paris Convention for the Protection of Industrial Property, an applicant who has filed a patent application in the United States may have a right of priority over the same invention in a patent application in the Philippines. However, this right of priority does not immediately entitle a patent applicant the grant of a patent. A right of priority is not equivalent to a patent. Otherwise, a patent holder of any member-state of the Paris Convention need not apply for patents in other countries where it wishes to exercise its patent. It was, therefore, inaccurate for petitioner to argue that its prior patent application in the United States removed the invention from the public domain in the Philippines. It should have complied with the other requirements of the actual grant of the patent. In this case, the applicant for patent was declared abandoned by the Intellectual Property Office for failure to comply with strict procedural rules. The right of priority of the patent applicant was therefore lost.[529]

3. Grounds for cancellation of a patent

What are the grounds for cancellation of patents?

The following are the grounds for the cancellation of a patent: a) the invention is not new or patentable; b) the patent does not disclose the invention in a manner sufficiently clear and complete for it to be carried out by any person skilled in the art; or c) the patent is contrary to public order or morality,[530] or granted when the product or the process is non-patentable.

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[525]Section 29, IPC, as amended.

[526]Sections 67 and 68, IPC, as amended.

[527]Section 30.2, IPC, as amended.

[528]Section 31, IPC, as amended.

[529]E.I. Dupont De Nemours and Co. v. Director Emma C. Francisco, *et al.*, G.R. No. 174379, August 31, 2016.

[530]Section 61.1, IPC.

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Once cancelled, the rights conferred by the patent shall terminate.

That the patent is granted not in favor of the true and actual inventor is not a ground for cancellation of patent.

What are the remedies of a person declared by final court order as having the right to the patent?

If a person referred to in Section 29 [First to File Rule] other than the applicant, is declared by final court order or decision as having the right to the patent, such person may, within three (3) months after the decision has become final: a) prosecute the application as his own application in place of the applicant; b) file a new patent application in respect of the same invention; c) request that the application be refused; or d) seek cancellation of the patent, if one has already been issued.[531]

What are the remedies of the true and actual inventor deprived of the patent?

If a person, who was deprived of the patent without his consent or through fraud, is declared by final court order or decision to be the true and actual inventor, the court shall order for his substitution as patentee, or at the option of the true inventor, cancel the patent, and award actual and other damages in his favor if warranted by the circumstances.[532]

Even the true and actual inventor, who is not a patent holder, cannot file an action for patent infringement. Such remedy is available only to the patentee or his successors-in-interest.[533]

The remedy available to the inventor who is not issued the patent is not to file a petition for cancellation of patent with the IPO but institute the appropriate court action to be declared the patentee and only after he has obtained judgment that he can ask the IPO to cancel the patent of the holder. If the inventor was deprived of patent through fraud or without his consent, he can ask for the cancellation of patent of the holder upon finality of the favorable court decision; whereas, if the patent is issued not to the first filer but no fraud attended the patent issuance, the inventor must wait for three (3) months from finality of the favorable court decision before he can seek for the cancellation of patent.

What are the rights conferred by a patent?

A patent shall confer on its owner the following exclusive rights: a) where the subject matter of a patent is a product, to restrain, prohibit and prevent any unauthorized person or entity from making, using, offering for sale, selling or importing that product; b) where the subject matter of a patent is a process, to restrain, prevent or prohibit any unauthorized person or entity from using the process, and from manufacturing, dealing in, using, selling or offering for sale, or importing any product obtained directly or indirectly from such process.[534]

Patent owners shall also have the right to assign, or transfer by succession the patent, and to conclude licensing contracts for the same.[535]

[531]Section 67, IPC.

[532]Section 68, IPC, as amended.

[533]Creser Precision Systems, Inc. v. Court of Appeals and Floro International Group, G.R. No. 118708, February 2, 1998.

[534]Section 71.1, IPC, as amended.

[535]Section 71.2 IPC, as amended.

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4. Patent infringement

What constitutes civil action for patent infringement?

Intellectual property infringement basically means performing any act in violation of the rights granted by law to the owner or holder of the intellectual property right.

The making, using, offering for sale, selling, or importing a patented product or a product obtained directly or indirectly from a patented process, or the use of a patented process without the authorization of the patentee constitutes patent infringement: provided, that, this shall not apply to instances covered by Sections 72.1 and 72.4 (Limitations of Patent Rights)Section 74 (Use of Invention by Government); Section 93.6 (Compulsory Licensing); and Section 93-A (Procedures on Issuance of a Special Compulsory License under the TRIPS Agreement) of the IPC.[536]

There can be no infringement of a patent until a patent has been issued, since whatever right one has to the invention covered by the patent arises alone from the grant of patent. An inventor has no common law right to a monopoly of his invention. He has the right to make use of and vend his invention, but if he voluntarily discloses it, such as by offering it for sale, the world is free to copy and use it with impunity. A patent, however, gives the inventor the right to exclude all others. To be able to effectively and legally preclude others from copying and profiting from the invention, a patent is a primordial requirement. No patent, no protection.[537]

When will importation of the patented product not amount to patent infringement?

Generally, importation of the patented product without the patentee's authorization amounts to infringement. However, with regard to drugs and medicines, the law allows importation by the government or any private third party once the drug or medicine has been introduced in the Philippines or anywhere else in the world by the patent owner, or by any party authorized to use the invention in the Philippines.[538]

What is the term of patent?

The term of a patent shall be 20 years from the filing date of the application. The term is not subject to extension.

What is the significance of the term of patent?

A patentee shall have the exclusive right to make, use and sell the patented machine, article or product, and to use the patented process for the purpose of industry or commerce, throughout the territory of the Philippines for the term of the patent; and such making, using, or selling by any person without the authorization of the patentee constitutes infringement of the patent.[539] The patentee's exclusive rights exist only during the term of the patent, hence, after the cut-off date, the exclusive rights no longer exist.[540]

Who may file an action for patent infringement?

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[536] Section 76.1, IPC, as amended.

[537] Creser Precision Systems, Inc. v. Court of Appeals, G.R, No. 118708, February 2, 1998; Pearl & Dean (Phil.) Incorporated v. Shoemart Incorporated, G.R. No. 148222, August 15, 2003.

[538] Section 72.1, IPC, as amended.

[539] Roberto del Rosario v. Court of Appeals, G.R. No. 115106, March 15, 1996.

[540] Philippine Pharmawealth, Inc. v. Pfizer, Inc., G.R. No. 167715, November 17, 2010.

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Any patentee, or anyone possessing any right, title or interest in and to the patented invention, whose rights have been infringed, may bring an action for patent infringement before a court of competent jurisdiction.[541]

Only the patent holder can file an action for infringement. The inventor, who was not issued the patent, cannot file such action nor even apply for injunction to enjoin the use or making or sale of the patented product.[542]

The Supreme Court further ruled that the phrase "anyone possessing any right, title or interest in and to the patented invention, whose rights have been infringed" may bring an action for infringement does not refer to the inventor not issued the patent but to the patentee's successors-in-interest and assignee.[543]

The remedy of the inventor but who was deprived of the patent is to file an action in court that he be declared the patentee and not to file an action for infringement.[544]

Who has the burden of proof in an action for infringement?

The burden of proof to substantiate a charge of infringement is with the plaintiff. But where the plaintiff introduces the patent in evidence, and the same is in due form, there is created a *prima facie* presumption of its correctness and validity. The decision of the Director of Patent (now, of the IPO) in granting the patent is presumed to be correct. The burden of going forward with the evidence (burden of evidence) then shifts to the defendant to overcome by competent evidence this legal presumption.[545]

What are the tests to determine infringement of patent?

The tests to determine infringement of patent are: a) literal infringement; and b) the doctrine of equivalents.

How is the literal infringement test used *vis-à-vis* the doctrine of equivalents?

In using literal infringement as a test, resort must be had, in the first instance, to the words of the claim. If accused matter clearly falls within the claim, infringement is made out and that is the end of it. The Court must juxtapose the claims of the patent and the accused product within the context of the claims and specifications to determine whether there is exact identity of all material elements. Under the doctrine of equivalents, infringement also occurs when a device appropriates a prior invention by incorporating its innovative concept and albeit with some modifications and change, performs substantially the same function in substantially the same way to achieve substantially the same result. It requires satisfaction of the function-means-and-result test.[546]

Applying both tests, the Supreme Court held in one case that viewed from any perspective or angle, the floating power tiller of petitioner is identical and similar to that of the turtle power tiller of defendant in form, configuration, design and appearance. In operation, the floating power tiller operates also in similar manner as the turtle power tiller. The patent issued by the Patent Office referred to a "farm implement but more particularly to a turtle hand tractor having a vacuumatic housing float on which the engine drive is held

[541]Section 76, IPC, as amended.
[542]Creser, *supra*.
[543]Creser, *supra*.
[544]*Supra*.
[545]Rosario Maguan v. Court of Appeals, G.R. No. L-45101, November 28, 1986.
[546]Pascua Godines v. Court of Appeals and SV-Agro Enterprises, Inc., G.R. No. 97343, September 13, 1993; BAR 2015.

in place, the operating handle, the harrow housing with its operating handle and the paddy wheel protective covering." It appears from the foregoing observation of the trial court that these claims of the patent and the features of the patented utility model were copied by petitioner. The Supreme Court is compelled to arrive at no other conclusion but that there was infringement.[547]

In applying this test in another case, the Supreme Court ruled that while both compounds have the effect of neutralizing parasites in animals, identity of result does not amount to infringement of patent unless the accused product operates in substantially the same way or by substantially the same means as the patented compound, even though it performs the same function and achieves the same result. In other words, the principle or mode of operation must be the same or substantially the same. The doctrine of equivalents thus requires satisfaction of the function-means-and result test. In the case at bar, apart from the fact the Albendozole is an anthelmintic agent like methyl5propylthio-2-benzimidazole carbamate, nothing is more asserted regarding the method or means by which Albendozole weeds out parasites in animals, thus giving no information on whether that method is substantially the same as the manner by which the accused's compound works.[548]

In *Del Rosario v. Court of Appeals,*[549] a case involving patent for utility model covering an audio equipment, commonly known as the sing along system or karaoke, the Supreme Court, in ruling that there was patent infringement under the doctrine of equivalents, observed: (a) both are used by a singer to sing a amplify his voice; (b) both are used to sing with a minus-one or multiplex tapes, or that both are used to play minus-one or standard cassette tapes for singing or for listening to; (c) both are used to sing a minus-one tape and multiplex tape and to record the singing and the accompaniment; (d) both are used to sing with live accompaniment; (d) both are used to sing with live accompaniment and to record the same; (e) both are used to enhance the voice of the singer using echo effect, treble, bass and other controls; (g) both are equipped with cassette tape decks which are installed with one being used for playback and the other, for recording the singer and the accompaniment, and both may also be used to record a speaker's voice or instrumental playing, like the guitar and other instruments; (h) both are encased in box-like cabinets; and (i) both can be used with one or more microphones.

Clearly, therefore, both models involve substantially the same modes of operation and produce substantially the same if not identical results when used.

What's the rationale of the doctrine of equivalents?

The reason for the doctrine of equivalents is that to permit the imitation of a patented invention which does not copy any literal detail would be to convert the protection of the patent grant into a hollow and useless thing. Such imitation would leave room for, and indeed encourage, the unscrupulous copyist to make unimportant and insubstantial changes and substitutions in the patent which, though adding nothing, would be enough to take the copied matter outside the claim, and hence outside the reach of the law.[550]

What are the remedies of the patent owner in case of patent infringement?

The remedies of the patentee in case of patent infringement are as follows:

[547]Godines, *supra.*
[548]Smith Kline Beckman Corporation v. Court of Appeals, G.R. No. 126627, August 14, 2003.
[549]*Supra.*
[550]Godines, *supra.*

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a. Civil action

Any patentee, or anyone possessing any right, title or interest in and to the patented invention, whose rights have been infringed, may bring a civil action before a court of competent jurisdiction, to recover from the infringer such damages sustained thereby, plus attorney's fees and other expenses of litigation, and to secure an injunction for the protection of his rights.[551]

If the damages are inadequate or cannot be readily ascertained with reasonable certainty, the court may award by way of damages a sum equivalent to reasonable royalty.[552]

The court may, according to the circumstances of the case, award damages in a sum above the amount found as actual damages sustained: *provided,* that the award does not exceed three (3) times the amount of such actual damages.[553]

Anyone who actively induces the infringement of a patent or provides the infringer with a component of a patented product or of a product produced because of a patented process knowing it to be especially adopted for infringing the patented invention and not suitable for substantial non-infringing use shall be liable as a contributory infringer and shall be jointly and severally liable with the infringer.[554]

b. Criminal action

If infringement is repeated by the infringer or by anyone in connivance with him after finality of the judgment of the court against the infringer, the offender shall, without prejudice to the institution of a civil action for damages, be criminally liable.[555]

Unlike trademark and copyright infringement, the first act of patent infringement does not give rise to criminal liability. A person can only be held criminally liable if he repeats the commission of the same infringing acts after finality of the court judgment (in a civil action for infringement) against him. The repeated acts of infringement will then give rise to both criminal and civil liabilities.

c. Provisional remedies

The patent holder may secure a preliminary injunction to restrain acts of infringement during the pendency of the action for patent infringement.[556]

Relevantly, under the 2020 Rules of Procedure for Intellectual Property Cases, at any time after the filing of the complaint, a motion for the disposal and/or destruction of the seized infringing goods, or materials and implements predominantly used in the infringement, may be filed by the right-holder before the court.[557]

There is destruction when the infringing goods are completely destroyed and are put beyond further use. There is disposal when the infringing goods are effectively prohibited from re-entry into the channels of commerce but may be reused for some other lawful purpose.[558]

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[551]Section 76.2, IPC, as amended.
[552]Section 76.3, *ibid.*
[553]Section 76.4, *ibid.*
[554]Section 76.6, IPC, as amended.
[555]Section 84,IPC, as amended.
[556]Section 76.2, IPC, as amended.
[557]Rule 20, Section 1.

[558]*Ibid.*

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The court may, in its discretion, order that the infringing goods, materials and implements predominantly used in the infringement be disposed of outside the channels of commerce or destroyed, without compensation.[559]

Generally, unless restrained by the Supreme Court or the Court of Appeals, any order issued by the court in cases involving intellectual property rights is immediately executory except, among others, an order of destruction where a motion for reconsideration is filed.[560]

Nestor Dionisio invented a space age revolutionary mini room air-conditioner and was able to secure the registration patent and issuance of patent certificate for said invention by the Philippines' Patent Office. He immediately went into commercial production and sale of his invention. Later, Carlos Asistio, who used to be Nestor's plant manager, organized his own company, and engaged in the manufacture of exactly the same mini-room air-conditioners for his own outfit and which he sold for his own benefit.

As counsel of Dionisio, what legal steps would you take to protect his rights and interests? Discuss.[561]

As counsel for Dionisio, I will take the following legal steps: Within four (4) years from the commission of acts of infringement, I will bring a civil action for infringement of patent before the proper court to recover from the infringer damages sustained by reason of the infringement. The amount of damages is based on the profits which he would have made without the infringement and if the same cannot be determined, reasonable royalty. If the circumstances warrant, I will also ask for other damages but not to exceed three times (3x) the amount of actual damages.

In the same civil action, I will also pray for attorney's fees, costs of suit and the issuance of writ of preliminary injunction to restrain further acts of infringement during the pendency of the case. An order to seize and impound tools, equipment and paraphernalia used in connection with the infringement may also be prayed for.

If after a final judgment is rendered by the Court against the infringer, he repeated the infringement, I will again institute a civil action for damages with the same above stated provisional remedies, as well as criminal action for the repetition of infringement.

After finality of the court judgment, the preliminary injunction shall be converted into a final injunction and the seized tools, equipment and paraphernalia used to commit the acts of infringement may be destroyed and declared outside the channels of commerce.

If the infringer commits the same acts of infringement, I will file criminal and civil actions for the repeated acts of infringement.

What is the prescriptive period of a patent infringement suit?

No damages can be recovered for acts of infringement committed more than four (4) years before the institution of the action for infringement.[562]

The IPC, as amended, provides: Damages cannot be recovered for acts of infringement committed before the infringer had known, or had reasonable grounds to know of the

[559]Section 76.5, *ibid.*
[560]Rule 1, Section 4 of the 2020 Rules of Procedure for Intellectual Property Cases.
[561]BAR 1985; 1977; 1993.
[562]Section 79, IPC, as amended.

patent. It is presumed that the infringer had known of the patent if on the patented product, or on the container or package in which the article is supplied to the public, or on the advertising material relating to the patented product or process, are placed the words "Philippine Patent" with the number of the patent.[563]

What are the defenses that can be asserted in a patent infringement suit?[564]

The following are defenses that can be asserted in a patent infringement suit:

a. The patent or any claim thereof is invalid;
b. Any of the grounds on which petition for cancellation can be brought;
c. The patent is not new or patentable;[565]
d. Specification of the invention does not comply with the law;
e. The patent was issued not to the true and actual inventor, or the plaintiff did not derive his rights from the true and actual inventor; and
f. Prescription.

In one case, when a patent is sought to be enforced, the questions of invention, novelty or prior use, and each of them, are open to judicial examination; in cases of infringement of patent no preliminary injunction will be granted unless the patent is valid and infringed beyond question and the record conclusively proves the defense is sham. In other words, the competent court has jurisdiction to declare a patent invalid. Upon certification that the judgment has become final, it is the ministerial duty of the Patent Office (now the IPO) to execute the judgment.[566]

In fact, under the IPC, in an action for infringement, if the court shall find the patent or any claim to be invalid, it shall cancel the same, and the Director of Legal Affairs upon receipt of the final judgment of cancellation by the court, shall record that fact in the register of the Office and shall publish a notice to that effect in the IPO Gazette.[567]

In an action for infringement of patent, the alleged infringer defended himself by stating (1) that the patent issued by the Patent Office was not really an invention which was patentable; (2) that he had no intent to infringe so that there was no actionable case for infringement; and (3) that there was no exact duplication of the patentee's existing patent but only a minor improvement.

With those defenses, would you exempt the alleged violator from liability? Why?[568]

I would not exempt the alleged violator from liability for the following reasons:

a. A patent once issued by the Patent Office raises a presumption that the article is patentable. The validity of the patent and the question over the inventiveness, novelty and usefulness of the product are matters which are better determined by the Patent Office. There is a presumption that the Philippine Patent Office has correctly determined the patentability of the model and such action must not be interfered with in the absence of competent evidence to the contrary.[569] A mere statement or allegation is not enough to destroy that presumption;

[563]Section 80, IPC, as amended.
[564]BAR 1993.
[565]Section 81 in relation to Section 161, IPC, as amended.
[566]Rosario Maguan v. Court of Appeals, G.R. L-45101, November 28, 1986.
[567]Section 82, IPC, as amended.
[568]BAR 1992.
[569]Manzano v. Court of Appeals, G.R. No. 113388, September 5, 1997.

b. An intention to infringe is not necessary nor an element in a case for infringement of a patent;

c. There is no need of exact duplication of the patentee's existing patent such as when the improvement made by another is merely minor. Under the doctrine of equivalents, infringement is committed if the accused product introduced only minor innovations or improvement but performs the same function in the same way to accomplish the same result. Exact duplication of the patentee's existing patent is not necessary for infringement to lie.

B. Trademarks

1. Marks, Collective Marks, Trade Names

What is a trademark?

A "trademark" is any word, name, symbol, emblem, sign or device or any combination thereof adopted and used by a manufacturer or merchant to identify his goods and distinguish them from those manufactured, sold or dealt in by others; it is any visible sign capable of distinguishing goods.[570]

What is a collective mark?

"Collective Mark" means any visible sign designated as such in the application for registration and capable of distinguishing the origin or any other common characteristic, including the quality of goods or services of different enterprises which use the sign under the control of the registered owner of the collective mark.[571]

Differentiate a trademark from a service mark.

"Mark" means any visible sign capable of distinguishing the goods (trademark) or services (service mark) of an enterprise and shall include a stamped or marked container of goods.[572] Thus, the name and container of a beauty cream product and LPG cylinder tank bearing a stamp or mark are proper subjects of a trademark.

What is a trade name?

A trade name means the name or designation identifying or distinguishing an enterprise.[573]

A name or designation may not be used as a trade name if by its nature or the use to which such name or designation may be put, it is contrary to public order or morals and if, in particular, it is liable to deceive trade circles or the public as to the nature of the enterprise identified by that name.[574]

In one case, it was ruled that while "San Francisco" is just a proper name referring to the famous city in California and that "coffee" is simply a generic term, the respondent in that case has acquired an exclusive right to the use of the trade name "SAN FRANCISCO

[570]Pribhdas J. Marpuri v. Court of Appeals, G.R. No. 114508, November 19, 1999.
[571]Section 121.2, IPC, as amended.
[572]Section 121.1, IPC, as amended
[573]Section 121.3, IPC, as amended.
[574]Section 165.1 , IPC, as amended.

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COFFEE & ROASTERY, INC." since the registration of the business name with the Department of Trade and Industry. Thus, respondent's use of its trade name from then on must be free from any infringement by similarity.[575]

Is registration with the IPO a prerequisite in an infringement suit of a trade name?

No. A trade name previously used in trade or commerce in the Philippines need not be registered with the IPO before an infringement suit may be filed by its owner against the owner of an infringing trademark. The IPC eliminated such requirement.[576]

2. Acquisition of ownership of mark

How is trademark acquired?

The rights in a mark shall be acquired through registration made validly in accordance with the provisions of the law. The applicant or the registrant shall file a declaration of actual use of the mark with evidence to that effect, within three (3) years from the filing date of the application. Otherwise, the application shall be refused or the mark shall be removed from the Register by the Director unless non-use is caused by circumstances arising independently of the will of the trademark owner. Lack of funds shall not excuse non-use of a mark.[577]

In *Zuneca Pharmaceutical v. Natrapharm, Inc.,*[578] the Supreme Court abandoned its previous rulings[579] that registration does not confer ownership of the trademark and that the first user in good faith defeats the right of the first filer in good faith. Instead, it was held that trademarks are acquired solely through registration.

In this case, the two competing marks involved were "ZYNAPS" and "ZYNAPSE." They were admitted by both parties to be confusingly similar with each other. "ZYNAPS" (without an E) is owned by Zuneca. It is a drug for the treatment of seizures like epilepsy. On the other hand, Natrapharm owns "ZYNAPSE" (with an E), which is also a medicine, but for stroke.

Zuneca never registered its trademark "ZYNAPS" with the Intellectual Property (IP) Office, but it has been using it since 2004. Meanwhile, Natrapharm has registered its trademark "ZYNAPSE" on September 24, 2007.

With that, Natrapharm sued Zuneca for trademark infringement for using a confusingly similar trademark in the same field of drugs or medicine. Zuneca counter-sued and alleged that Natrapharm was the one in bad faith since it (Natrapharm) knows Zuneca's usage of "ZYNAPS" as a mark since 2004 considering that they both presented their products in the same pharmaceutical convention years prior.

The trial court found Zuneca liable for trademark infringement, essentially saying that Natrapharm was the first one to register the trademark in good faith. The trial court found no bad faith on the part of Natrapharm either since Zuneca failed to prove that Natrapharm

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[575] Coffee Partners v. San Francisco Coffee and Roastery, Inc., G.R. No. 169504, March 3, 2010.

[576] Coffee Partners v. San Francisco Coffee and Roastery, Inc., G.R. No. 169504, March 3, 2010.

[577] Section 152.1, IPC, as amended.

[578] *Ibid.*

[579] These are the cases of: Mattel, Inc. v. Emma Francisco, *et al.*, G.R. No. 166886, July 30, 2008; E.Y. Industrial Sales v. Shien Dar Electricity and Machinery Co., G.R. No. 184850, October 20, 2010; Berris Agricultural Co., Inc v. Norvy Abyadang, G.R. No. 183404, October 13, 2010; Birkenstock Orthopaedia GMBH v. Philippine Shoe Expo Marketing Corporation, G.R. No. 194307, November 20, 2013; Ecole de Cuisine Manille v. Renaud Cointreau, G.R. No. 185830, June 5, 2013.

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actually knew the existence of Zuneca's "ZYNAPS." The Court of Appeals affirmed this decision.

The Supreme Court partly affirmed the lower courts' decision. It definitively ruled that the only mode of acquiring ownership of a trademark is through registration (and not use). According to the Supreme Court: "(i) the language of the IP Code provisions clearly conveys the rule that ownership of a mark is acquired through registration; (ii) the intention of the lawmakers was to abandon the rule that ownership of a mark is acquired through use; and (iii) the rule on ownership used in *Berris* and *E.Y. Industrial Sales, Inc.* [cases] is inconsistent with the IP Code regime of acquiring ownership though registration."

Indeed, Section 122 of the IP Code states *"[t]he rights in a mark shall be acquired through registration made validly in accordance with the provisions of this law."*

In short, the Supreme Court held that Natrapharm's "ZYNAPSE" must prevail over Zuneca's "ZYNAPS" since the former was first registered. The Supreme Court, however, absolved Zuneca from being liable for trademark infringement because it found Zuneca to be a prior user in good faith. Accordingly, the IP Code contemplates that a prior user in good faith may continue to use its mark even after the registration of the mark by the first to file registrant in good faith.

In another case, however, the registrant's certificate of trademark registration was cancelled when the BLA-IPO concluded that the registrant copied the first user's mark It compared the two and found that petitioner's mark is identical with respondent's. It noted that the word "Mr. Gulaman" in both of their marks are "exactly the same in all aspects" This conclusion was bolstered by its finding that in petitioner's Declaration of Actual Use, she submitted photographs of a packaging showing respondent's "Mr. Gulaman" and its logo design.

The Supreme Court ruled that by reason of its special knowledge and expertise over matters falling within its jurisdiction, the Intellectual Property Office is in a better position to determine whether there was bad faith. Its finding on this matter "are generally accorded great respect, if not finality by the courts, as long as they are supported by substantial evidence, even if such evidence might not be overwhelming or even preponderant."

While the rule admits of exceptions, the Supreme Court did not find any reason to depart and overturn the factual determination of the BLA-IPO as affirmed by both the Office of the Director General and the Court of Appeals.[580]

Did the Supreme Court abandon the first-to-file rule?

By ruling that trademark is acquired solely through registration, the Supreme Court did not, nevertheless, abandon the first the file rule. While it is the fact of registration which confers ownership of the mark and enables the owner thereof to exercise the rights expressed in the IP Code, the first to file rule nevertheless prioritizes the first filer of the trademark application and operates to prevent any subsequent applicant from registering the mark.[581]

a. concept of actual use

Is the registrant still required to declare actual use of the trademark?

[580] Ma Shairmaine Medina/Rackey Crystal Top Corporation v. Global Quest Ventures, G.R. No. 213815, February 8, 2021

[581] Zuneca Pharmaceuticals, *supra.*

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Yes, the applicant or registrant must declare actual use of the trademark. The applicant or the registrant shall file a declaration of actual use of the mark with evidence to that effect within three (3) years from the filing date of the application. Otherwise, the application shall be refused or the mark shall be removed from the Register by the Director.[582]

In *Mattel v. Francisco*,[583] it was held that an admission in a pleading (Comment and Memorandum) that the party has not filed declaration of actual use within three (3) years from application may be construed as an abandonment or withdrawal of any right or interest in his trademark.

The registrant is also required to file a declaration of actual use and evidence to that effect within one (1) year from the fifth anniversary of the date of the registration of the mark.[584]

The Supreme Court, however, held that while the registrant should declare actual use, this does not imply that actual use is the recognized mode of acquisition of ownership. Rather, it must be understood as provision requiring actual use of the mark in order for the registered owner of a mark to maintain his ownership.[585]

b. Effect of registration

What is the significance of the certificate of registration of a trademark?

A certificate of registration of a mark shall be *prima facie* evidence of the validity of the registration, the registrant's ownership of the mark, and of the registrant's exclusive right to use the same in connection with the goods or services and those that are related thereto specified in the certificate.[586]

The rule on the *prima facie* validity of a certificate of registration is merely meant to recognize the instances when such certificate is not reflective of ownership such as when the registration was done contrary to the IP Code.[587]

c. Acquisition of ownership of trade name

Trade name is acquired by use.

Notwithstanding any laws or regulations providing for any obligation to register trade names, such names shall be protected, even prior to or without registration, against any unlawful act committed by third parties.[588] In particular, any subsequent use of the trade name by a third party, whether as a trade name or a mark or collective mark, or any such use of a similar trade name or mark, likely to mislead the public, shall be deemed unlawful.[589]

The remedies provided for infringement of trademark in shall apply *mutatis mutandis* in case of trade name infringement.[590]

3. Well-known marks

[582]Section 124.2, IPC, as amended.
[583]G.R. No. 166886, July 30, 2008.
[584]Section 145, IPC, as amended.
[585]Zuneca Pharmaceuticals, *supra*.
[586]Section 138, IPC, as amended.
[587]Zuneca Pharmaceuticals, *supra*.
[588]Section 165.2, (a) IPC, as amended.

[589]Section 165.2 (b), IPC, as amended.
[590]Section 165.3, IPC, as amended.

What is a well-known mark?

A well-known mark is a mark which is considered by the competent authority of the Philippines to be well-known internationally and in the Philippines, whether or not it is registered here, as being already the mark of a person other than the applicant for registration.

If the well-known mark is registered in the Philippines, any mark identical with, confusingly similar to, or constitutes a translation of such well-known mark, cannot be used for identical goods or services or be registered in the Philippines with respect to goods or services which are not similar to those with respect to which registration is applied for: *provided,* that use of the mark in relation to those goods or services would indicate a connection between those goods or services, and the owner of the registered mark: provided further, that the interests of the owner of the registered mark are likely to be damaged by such use.[591]

If the well-known mark is not registered in the Philippines, the scope of protection only extends to marks used for identical goods or services.[592]

What are the remedies of the owner of a well-known mark that is not registered in the Philippines?

Without prejudice to other remedies under the law, the owner of the well-known mark may:

a. Oppose the application for registration of a mark which is identical with or confusingly similar or constitutes a translation of such well-known mark;
b. Petition for cancellation of the registration, if one has been granted; and,
c. Unfair competition if the goods are being passed off by another as the goods of the owner of the well-known mark.

Is the knowledge of the general public of the mark taken into account in determining whether it is a well-known mark?

No, in determining whether a mark is well-known, account shall be taken of the knowledge of the relevant sector of the public, rather than of the public at large, including knowledge in the Philippines which has been obtained as a result of the promotion of the mark.

The power to determine whether a trademark is well-known lies in the "competent authority of the country of registration or use." This competent authority would be either the registering authority if it has the power to decide this, or the courts of the country in question if the issue comes before a court.[593]

What is the role of the Paris Convention on the protection of trademarks?

Under the IPC and the Paris Convention, any foreign national or juridical person has the legal capacity to sue for the protection of its trademarks, albeit he or it is not doing business in the Philippines. Article 6 of the Paris Convention which governs the protection of well-known trademarks, is a self-executing provision and does not require legislative

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[591]Section 123.1(e), IPC.
[592]*Supra.*

[593]Sehwani Incorporated v. In-N-Out Burger, Inc., G.R. No. 171053, October 15, 2007; Fredco Manufacturing Corporation v. President and Fellows of Harvard College, G.R. No. 185917, June 1, 2011.

enactment to give it effect in the member country. It may be applied directly by the tribunals and officials of each member country by the mere publication or proclamation of the Convention, after its ratification according to the public law of each state and the order for its execution. The essential requirement under this Article is that the trademark to be protected must be "well-known" in the country where protection is sought.[594]

Applying this principle in one case, the Court ruled that in upholding the right of the petitioner to maintain a suit for unfair competition or infringement of trademarks of a foreign corporation before the Philippine courts, the duties and rights of foreign states under the Paris Convention for the Protection of Industrial Property to which the Philippines and France are parties are upheld.[595]

Cite examples of cases involving well-known marks.

a. The word "Barbizon" cannot be registered as a trademark for ladies' underwear, since it is an internationally well-known trademark for lingerie.[596]
b. In the case of *Sehwani v. In-N-Out Burger*, the Supreme Court held that "In-N-Out Burger" is a well-known mark, given its registration in various countries around the world and comprehensive advertisements. As such, the mark is entitled to protection even though there is no actual use of such mark in the Philippines.[597]
c. "Harvard" is the trade name of the world-famous Harvard University, and it is also a trademark of Harvard University. Under the Paris Convention, Harvard University is entitled to protection in the Philippines of its trade name "Harvard" even without registration of such trade name in the Philippines. This means that no educational entity in the Philippines can use the trade name "Harvard" without the consent of Harvard University. "Harvard" is a well-known name and mark not only in the United States but also internationally, including the Philippines. It is internationally known as one of the leading educational institutions in the world. As such, even before Harvard University applied for registration of the mark "Harvard" in the Philippines, the mark was already protected under the Paris Convention.[598]

4. Rights conferred by regisration

What is the scope of protection afforded to registered trademark owners?

The scope of protection afforded to registered trademark owners is not limited to protection from infringers with identical goods. It also extends to protection from infringers with related goods, and to market areas that are the normal expansion of business of the registered trademark owners.

This means that the registered trademark owner may use his mark on the same or similar products, in different segments of the market, and at different price levels depending on variations of the products for specific segments of the market. The Supreme Court has recognized that the registered trademark owner enjoys protection in product and market areas that are the *normal potential expansion of his business*.[599]

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[594]Sehwani Incorporated v. In-N-Out Burger, Inc., 536 SCRA 227 (2007).
[595]Melbarose R. Sasot and Allandale R. Sasot v. People of the Philippines, G.R. No. 143193, June 29, 2005.
[596]Pribhdas J. Mirpuri v. Court of Appeals, G.R. No. 114508, November 19, 1999.
[597]*Ibid.*
[598]Fredco Manufacturing Corporation v. President and Fellows of Harvard College, G.R. No. 185917, June 1, 2011.
[599]Sketchers USA, Inc. v. Inter Pacific Industrial Trading, G.R. No. 164321, March 23, 2011; Societe Des Produits Nestlé, SA v. Dy, G.R. No. 172276, August 8, 2010.

In *Societe Des Produits Nestlé, S.A. v Martin Dy, Jr.,*[600] the Supreme Court held that while there are differences between NAN and NANNY, (1) NAN is intended for infants while NANNY is intended for children past their infancy and for adults; and (2) NAN is more expensive than NANNY, the registered owner of the "NAN" mark, Nestlé should be free to use its mark on similar products, in different segments of the market, and at different price levels.

The same principle was applied in *Sketchers, U.S.A., Inc. v. Inter Pacific Industrial Trading Corporation.*[601] The use of the stylized "S" by the manufacturer of its Strong rubber shoes infringes on the mark of Sketchers. It is no defense that the Strong rubber shoes are cheaper and cater to different market segments. Sketchers should be free to expand its product offering in different segments of the market.

In a relevant case, it was held that "PAPA BOY& DEVICE" is confusingly similar with the previously registered mark "PAPA" even though they refer to different products, PAPA BOY is for lechon sauce while PAPA is for catsup. The Supreme Court stated that since petitioner's product, catsup, is also a household product found on the same grocery aisle, in similar packaging, the public could think that petitioner had expanded its product mix to include lechon sauce, and that the "PAPA BOY" lechon sauce is now part of the "PAPA" family of sauces. Thus, if allowed registration, confusion of business may set in, and petitioner's hard-earned goodwill may be associated to the newer product introduced by respondent.[602]

In *Mang Inasal Philippines v. IFP Manufacturing Corpora-tion*,[603] the Supreme Court ruled that the mark "Ok Hotdog Inasal Cheese Flavor" for curl snack product is confusingly similar with the mark "Mang Inasal" for marinated chicken. The Supreme Court also concluded that average buyer who comes across the curls marketed under the OK Hotdog Inasal mark is likely to be confused as to the true source of such curls. " To our mind, it is not unlikely that such buyer would be led into the assumption that the curls are of petitioner and that the latter has ventured into snack manufacturing or, if not, that the petitioner has supplied the flavorings for respondent's product. Either way, the reputation of petitioner would be taken advantage of and placed at the mercy of respondent."[604]

What is the doctrine of unrelated goods?

One who has adopted, used and registered a trademark on his goods cannot prevent the adoption, use and registration of the same trademark by others on unrelated articles of a different kind.

What is the basis of the doctrine?

The certificate of registration entitles the registrant to use the trademark only for the goods specified in the certificate or goods related thereto. Therefore, the registrant cannot preclude others from adopting and registering the trademark for totally unrelated goods.

It was also held that the prohibition under Section 123 of the Intellectual Property Code extends to goods that are related to the registered goods, not to goods that the registrant may produce *in the future*. To allow the expansion of coverage is to prevent future registrants of goods from securing a trademark on the basis of mere possibilities and conjectures that

[600] *Supra.*
[601] *Supra.*

[602] UFC Philippines, Inc. (Now Merged with Nutri-Asia, Inc., with Nutri-Asia, Inc. as the Surviving Entity) *v.* Fiesta Barrio Manufacturing Corporation, G.R. No. 198889, January 20, 2016.
[603] *Supra.*
[604] Mang Inasal Philippines, Inc. v. IFP Manufacturing Corporation, G.R. No. 221717, June 19, 2017.

may or may not occur at all. Surely, the right to a trademark should not be made to depend on mere possibilities and conjectures.[605]

Cite jurisprudence where the Supreme Court applied the doctrine of unrelated goods.

a. The registered owner of the trademark "Brut" for toilet articles cannot oppose the registration of the trademark "Brute" for briefs, since the two products are unrelated, even if the former has a pending application for the registration. A purchaser who is out in the market for the purposes of buying Brute brief would definitely be not mistaken or misled into buying BRUT after shave lotion or deodorant.[606]
b. The owner of the registered trademark "Hickok" for its diverse articles of men's wear such as wallets, belts and men's briefs which are all manufactured here in the Philippines by a licensee Quality House, Inc. but are so labeled as to give the misimpression that the said goods are of foreign (stateside) manufacture cannot preclude the registration of the same trademark exclusively for shoes.[607]
c. There is no infringement when the trademark "CANON" is used for paints, chemical products, toner and dyestuff while it is used by another for footwear (sandals).[608]
d. The trademark registration of LOTUS for soy sauce was granted and upheld, although the trademark LOTUS is already registered in favor of another for its product, edible oil.[609]
e. The GALLO trademark registration certificates in the Philippines and in other countries expressly state that they cover wines only, without any evidence or indication that registrant Gallo Winery expanded or intended to expand its business to cigarettes. Thus, Gallo Winery, as registered owner of the trademark GALLO, cannot prevent the registration of the trademark GALLO for tobacco products.[610]
f. Kolin Electronics, the registered owner of the mark "Kolin", for goods falling under Class 9 of the Nice Classification, such as amplifier, booster, converter, voltage regulator and similar electronic products, can not preclude the adoption, use and registration of the trademark "Kolin" on a combination of goods, including colored televisions, refrigerators, window-type and split-type air conditioners, electric fans and water dispensers with Taiwan Kolin even though they belong to the same Class 9, because they are unrelated products. The Supreme Court held that whether or not the products covered by the trademark sought to be registered by Taiwan Kolin, on the one hand, and those covered by the prior issued certificate of registration in favor of Kolin Electronics, on the other, fall under the same categories in the NCL is not the sole and decisive factor in determining a possible violation of Kolin Electronics' intellectual property right should Taiwan Kolin's application be granted. It is hornbook doctrine that emphasis should be on the similarity of the products involved and not on the arbitrary classification or general description of their properties or characteristics.

[605] Kensonic, Inc. v. Uni-Line Multi Resources, Inc., G.R. Nos. 211820-21 and 211834-35, June 6, 2018.
[606] Faberge, Inc. v. Intermediate Appellate Court, 215 SCRA 316 (1992); BAR 1994.

[607] Hickok Manufacturing, Co., Inc. v. Court of Appeals, G.R. No. L-44707, August 31, 1982.
[608] Canon Kabushiki Kaisha v. Court of Appeals, G.R. No. 120900, July 20, 2004.

[609] Acoje Mining Co., Inc. v. Director of Patents, 38 SCRA 480; BAR 1978.

[610] Mighty Corporation v. E.& J Gallo Winery, G.R. No. 154342, July 14, 2004.

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Reiterating the doctrine in *Mighty Corporation v. E & J Gallo Winery,*[611] the Supreme Court ruled that the goods should be tested against several factors before arriving at a sound conclusion on the question of relatedness. Among these are: (a) the business (and its location) to which the goods belong; (b) the class of product to which the goods belong; (c) the product's quality, quantity, or size, including the nature of the package, wrapper or container; (d) the nature and cost of the articles; (e) the descriptive properties, physical attributes or essential characteristics with reference to their form, composition, texture or quality; (f) the purpose of the goods; (g) whether the article is bought for immediate consumption, that is, day-to-day household items; (h) the fields of manufacture; (i) the conditions under which the article is usually purchased; and (j) the channels of trade through which the goods flow, how they are distributed, marketed, displayed and sold.

The Supreme Court then gave credence to the arguments of Taiwan Kolin that —

Taiwan Kolin's goods are classified as home appliances as opposed to Kolin Electronics' goods which are power supply and audio equipment accessories;

Taiwan Kolin's television sets and DVD players perform a distinct function and purpose from Kolin Electronics' power supply and audio equipment; and

Taiwan Kolin sells and distributes its various home appliance products on wholesale and to accredited dealers, whereas Kolin Electronics' goods are sold and flow through electrical and hardware stores.[612]

NB.

In the en banc decision of Kolin Electronics Co. v Kolin Philippines International[613], the Supreme Court abandoned the use of product or service classification as a factor in determining relatedness or non-relatedness. The NICE classification (NCL) serves purely administrative purposes - merely a way for trademark offices worldwide to organize the thousands of applications that are filed - and the classification of products/services should not have been included as one of the factors in determining relatedness because there was no legal basis for its inclusion. In fact, it even contradicts specific provisions of the Trademark Law and the IP Code. The use of classification of products/services in determining relatedness also conflicts with a provision of the 2020 Revised Rules of Procedure for Intellectual Property Rights Case.

In this case, after it was ruled that Kolin Electronics Corporation, Inc. (KECI)owns the trademark " **KOLIN** " for voltage regulators, converter, recharger, stereo booster and step-down transformer, Kolin Philippines, Inc. (KPI), a subsidiary of Taiwan Kolin Corporation, applied for the registration of the stylized mark **kol*in*** for "Television and DVD players".

The Supreme Court held that the application of KPI for the registration of the trademark **kol*in*** should be rejected because it would cause likelihood of confusion and KECI's trademark rights would be damaged. Accordingly, there is resemblance between KECI's **KOLIN** and KPII's marks; (2) the goods covered by KECI's *KOLIN* are related to the goods covered by KPII's kolin; (3) there is evidence of actual confusion between the two marks; (4) the goods covered by KPII's kolin fall within the normal potential expansion of business of KECI; (5) sophistication of buyers is not enough to eliminate confusion; (6) KPII's adoption of KECI's coined and fanciful mark would greatly contribute to likelihood of confusion; and (7) KPII applied for kolin in bad faith.

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[611] G.R. No. 154342, July 14, 2004.

[612] Taiwan Kolin Corporation, LTD. v. Kolin Electronics Co., Inc., G.R. No. 209843, March 15, 2015.

[613] G.R. No. 228165, February 09, 2021, J. Caguioa

It should also be stated that in addition to the factors in Mighty Corporation, another ground for finding relatedness of goods/services is their complementarity. The goods covered by KECI's *KOLIN* are complementary to the goods covered by KPII's kolin and could thus be considered as related. This increases the likelihood that consumers will at least think that the goods come from the same source. In other words, confusion of business will likely arise.

g. Television sets, stereo components, DVD and VCD players as against voltage regulators, portable generators, switch breakers and fuses because the latter's registration only covered electronic audio-video products, not electrical home appliances. The two classifications of goods are unrelated. For one, the first pertained to goods which belong to the information technology and audiovisual equipment subclass while the latter pertained to the apparatus and devices for controlling the distribution of electricity sub-class. Also, the goods of the first registrant were final products but the latter's products were spare parts.[614]

Author's note. When does one apply the doctrine of unrelated goods and doctrine of normal or potential expansion of business? For sure, jurisprudence which applied the doctrine of unrelated goods could have been arguably ruled as falling under the opposite doctrine of normal expansion of business, and *vice-versa*. For academic discussion, your answer to any such bar question will depend on the similarity of facts to the foregoing jurisprudence.

Puregold filed an application for the registration of the trademark "*COFFEE MATCH*" for use on coffee, tea, cocoa, sugar, artificial coffee, flour and preparations made from cereals, bread, pastry and confectionery, and honey. However, Nestlé opposed the same alleging that it is the exclusive owner of the "*COFFEE-MATE*" trademark and that there is confusing similarity between its "*COFFEE-MATE*" trademark and Puregold's "*COFFEE MATCH*" application. Nestlé alleged that "*COFFEE-MATE*" has been declared an internationally well-known mark and Puregold's use of "*COFFEE MATCH*" would indicate a connection with the goods covered in Nestlé's "*COFFEE-MATE*" mark because of its distinct similarity. Is there confusing similarity between *COFFEE MATCH* and *COFFEE-MATE?*

No. The word "COFFEE" is the common dominant feature between Nestlé's mark "COFFEE-MATE" and Puregold's mark "COFFEE MATCH." However, following the IPC's prohibition of registration of generic marks, the word "COFFEE" cannot be exclusively appropriated by either Nestlé or Puregold since it is generic or descriptive of the goods they seek to identify. The distinctive features of both marks are sufficient to warn the purchasing public which are Nestlé's products and which are Puregold's products. While both "-MATE" and "MATCH" contain the same first three letters, the last two letters in Puregold's mark, "C" and "H," rendered a visual and aural character that made it easily distinguishable from Nestlé's mark. Also, the distinctiveness of Puregold's mark with two separate words with capital letters "C" and "M" made it distinguishable from Nestlé's mark which is one word with a hyphenated small letter "-m" in its mark. In addition, there is a phonetic difference in pronunciation between Nestlé's "-MATE" and Puregold's "MATCH." As a result, the eyes and ears of the consumer would not mistake Nestlé's product for Puregold's product. Hence, likelihood of confusion between Nestlé's product and Puregold's product does not exist.[615]

What rights are conferred by the registration of trademark?

Except in cases of importation of drugs and medicines which has been introduced in the Philippines or anywhere else in the world by the patent owner, or by any party

[614]Kensonic, *supra.*
[615]Societe Des Produits, Nestlé, S.A. v. Puregold Price Club, Inc., G.R. No. 217194, September 6, 2017.

authorized to use the invention and of off-patent drugs and medicines, the owner of a registered mark shall have the exclusive right to prevent all third parties not having the owner's consent from using in the course of trade identical or similar signs or containers for goods or services which are identical or similar to those in respect of which the trademark is registered, where such use would result in a likelihood of confusion. In case of the use of an identical sign for identical goods or services, a likelihood of confusion shall be presumed.

There shall be no infringement of trademarks or trade names of imported or sold patented drugs and medicines allowed under the IPC, as well as imported or sold off-patent drugs and medicines: provided, that, said drugs and medicines bear the registered marks that have not been tampered, unlawfully modified, or infringed upon.[616]

When do these rights terminate?

The rights conferred by trademark registration end upon cancellation of the certificate of registration by the IPO in the cases allowed by law.

5. Cancellation of trademark

When may the IPO cancel the certificate of trademark registration?

The certificate of registration may be cancelled in the following cases:

a. Failure to file declaration of actual use within one (1) year from the fifth anniversary of the trademark registration;[617]
b. Failure to file declaration of actual use within three (3) years from filing of the application for trademark registration;[618]
   A petition to cancel a registration of a mark may also be filed with the Bureau of Legal Affairs of the IPO by any person who believes that he is or will be damaged by the registration of a mark under the IPC as follows:
   i. Within five (5) years from the date of the registration of the mark;
   ii. At any time, if the registered mark becomes the generic name for the goods or services, or a portion thereof, for which it is registered, or has been abandoned, or its registration was obtained fraudulently or contrary to the provisions of the IPC, or if the registered mark is being used by, or with the permission of, the registrant so as to misrepresent the source of the goods or services on or in connection with which the mark is used.
c. At any time, if the registered owner of the mark without legitimate reason fails to use the mark within the Philippines, or to cause it to be used in the Philippines by virtue of a license during an uninterrupted period of three (3) years or longer.[619]

In 2005, W Hotels, Inc., a multinational corporation engaged in the hospitality business, applied for and was able to register its trademark "W" with the Intellectual Property Office of the Philippines (IPO) in connection with its hotels found in different parts of the world.

In 2009, a Filipino corporation, RST Corp., filed before the IPO a Petition for cancellation of W Hotels, Inc.'s "W" trademark on the ground of non-use, claiming that W Hotels, Inc. failed to use its mark in the Philippines because it is not operating any hotel in the country which bears the "W" trademark.

[616]Section 147, in relation to Section 72.1, IPC, as amended.
[617]*Supra.*
[618]*Supra.*
[619]Section 151.1, IPC.

In its defense, W Hotels, Inc. maintained that it has used its "W" trademark in the Philippine commerce, pointing out that while it did not have any hotel establishment in the Philippines, it should still be considered as conducting its business herein because its hotel reservation services, albeit for its hotels abroad, are made accessible to Philippine residents through its interactive websites prominently displaying the "W" trademark. W Hotels, Inc also presented proof of actual booking transactions made by the Philippine residents through such websites.

Is W Hotels, Inc.'s defense against the petition for cancellation of trademark tenable? Explain.[620]

The defense of W Hotel is tenable. Having a hotel establishment in the Philippines with the trademark W is not the only way to prove actual use of the trademark. In one case, the Supreme Court ruled that the use of the mark on an interactive website sufficiently showing an intent towards realizing a within-State commercial activity or interaction is considered actual use to keep the trademark registration in force. That W Hotel was able to present proof of actual booking transactions made by the Philippine residents though such website proves that the use of its "W" mark through its interactive website is intended to produce a discernible commercial effect or activity within the Philippines, or at the very least, seeks to establish commercial interaction with local consumers. This is enough to keep it trademark registration in force.[621]

In the *W Land Holdings* case, Starwood filed before the IPO an application for registration of the trademark "W" for use in its hotel business which was eventually granted. However, W Land applied for the registration of its own "W" mark which thereby prompted Starwood to oppose the same. The BLA ruled that W Land's "W" mark is confusingly similar with Starwood's mark, which had an earlier filing date. Unperturbed, on May 29, 2009, W Land filed a Petition for Cancellation of Starwood's mark for non-use under Section 151.1 of the Intellectual Property Code of the Philippines, claiming that Starwood has failed to use its mark in the Philippines because it has no hotel or establishment in the Philippines rendering the services covered by its registration.

In this case, Starwood has proven that it owns Philippine registered domain names, provides a phone number for Philippine consumers, the prices for its hotel accommodations and/or services can be converted into the local currency or the Philippine Peso, among others. Taken together, these facts and circumstances show that Starwood's use of its "W" mark through its interactive website is intended to produce a discernable commercial effect or activity within the Philippines, or at the very least, seeks to establish commercial interaction with local consumers. Accordingly, Starwood's use of the "W" mark in its reservation services through its website constitutes use of the mark sufficient to keep its registration in force.

6. Trademark Infringement

What is and when is there trademark infringement?

Any person who shall, without the consent of the owner of the registered mark:[622]

1. Use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark or the same container or a dominant feature thereof in connection

[620] BAR 2019.

[621] W Land Holdings, Inc. v. Starwood Hotels and Resorts Worldwide, Inc., G.R. No. 222366, December 4, 2017.

[622] Section 155, IPC, as amended.

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with the sale, offering for sale, distribution, advertising of any goods or services including other preparatory steps necessary to carry out the sale of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive;[623] or

2. Reproduce, counterfeit, copy or colorably imitate a registered mark or a dominant feature thereof and apply such reproduction, counterfeit, copy or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive, shall be liable in a civil action for infringement by the registrant for the remedies hereinafter set forth: *provided,* that the infringement takes place at the moment any of the acts stated in Subsection 155.1 or this subsection are committed regardless of whether there is actual sale of goods or services using the infringing material.[624]

What are the elements of trademark infringement?

There are five (5) elements, *to wit:*

a. The trademark being infringed is registered in the Intellectual Property Office;
b. The trademark is reproduced, counterfeited, copied, or colorably imitated by the infringer;
c. The infringing mark is used in connection with the sale, offering for sale, or advertising of any goods, business or services; or the infringing mark is applied to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used upon or in connection with such goods, business or services;
d. The use or application of the infringing mark is likely to cause confusion or mistake or to deceive purchasers or others as to the goods or services themselves or as to the source or origin of such goods or services or the identity of such business; and
e. The use or application of the infringing mark is without the consent of the trademark owner or the assignee thereof.[625]

In the case of *Pearl & Dean*,[626] it was held that assuming *arguendo* that "Poster Ads" could validly qualify as a trademark, the failure of Pearl & Dean to secure a trademark registration for specific use on the light boxes meant that there could not have been any trademark infringement since registration was an essential element thereof.[627]

What are the remedies of the owner of the registered trademark if his rights to the trademark are infringed?

He may file a civil action for trademark infringement to recover damages from any person who infringes his rights, and the measure of the damages suffered shall be either the reasonable profit which the complaining party would have made, had the defendant not infringed his rights, or the profit which the defendant actually made out of the infringement, or in the event such measure of damages cannot be readily ascertained with reasonable certainty, then the court may award as damages a reasonable percentage based upon the amount of gross sales of the defendant or the value of the services in connection with which the mark or trade name was used in the infringement of the rights of the complaining party.[628]

[623] Section 155.1, *ibid*.
[624] Section 155.2, *ibid*.
[625] Diaz v. People of the Philippines and Levi Strauss (Phil.), G.R. No. 180677, February 18, 2013.
[626] *Supra.*
[627] Pearl & Dean (Phil.), Inc. v. Shoemart, Inc., G.R. No. 148222, August 15, 2003.
[628] Section 156.1, IPC, as amended.

In cases where actual intent to mislead the public or to defraud the complainant is shown, in the discretion of the court, the damages may be doubled.[629]

He may also recover attorney's fees and the costs of suit.

The civil action for trademark infringement may include an application with the court for the issuance of an order to impound during the pendency of the action, sales invoices and other documents evidencing sales[630] and to grant a preliminary injunction to restrain acts of infringement while the action is pending.[631]

He may also ask the court to issue an order that goods found to be infringing be, without compensation of any sort, disposed of outside the channels of commerce in such a manner as to avoid any harm caused to the right holder, or destroyed; and all labels, signs, prints, packages, wrappers, receptacles and advertisements in the possession of the defendant, bearing the registered mark or trade name or any reproduction, counterfeit, copy or colorable imitation thereof, all plates, molds, matrices and other means of making the same, shall be delivered up and destroyed.[632]

He may also file a criminal action for trademark infringement.

What are the other remedies available the owner of the registered mark to protect his rights to the trademark?

He may oppose any other application for registration of the same trademark, or a dominant feature thereof, for the same goods and services or good and services related thereto.

In case of issuance of a certificate of trademark registration in favor of another, he may file a petition for cancellation of trademark with the IPO.

Does the application for administrative cancellation of a registered trademark preclude the registrant from filing an action for trademark infringement?

The application for administrative cancellation of a registered trademark does not preclude the first registrant from filing an action for trademark infringement. Such application cannot *per se* have the effect of restraining or preventing the courts from the exercise of their lawfully conferred jurisdiction. A contrary rule would unduly expand the doctrine of primary jurisdiction which, simply expressed, would merely behoove regular courts, in controversies involving specialized disputes, to defer to the findings of resolutions of administrative tribunals on certain technical matters.[633]

However, if the IPO cancels the registered trademark and such resolution has attained finality, the action for trademark infringement will have no more legal stand on. The cancellation of registration of a trademark has the effect of depriving the registrant of protection from infringement from the moment the judgment or order of cancellation has become final.[634]

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[629]Section 156.3, IPC, as amended.

[630]Section 156.2, IPC, as amended.

[631]Section 156.4, IPC, as amended.

[632]Section 157.1., IPC, as amended.

[633]Conrad and Company v. Court of Appeals, G.R. No. 115115, July 10, 1995; Shangri-La International Hotel Management v. Court of Appeals, G.R. No. 111580, June 21, 2001.

[634]Superior Commercial Enterprises, Inc. v. Kunnan Enterprises Ltd. and Sports Concept & Distributor, Inc., G.R. No. 169974, April 20, 2010.

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The first trademark registrant may however file an action for trademark infringement independently of any application for the administrative cancellation of the trademark of the second registrant.

May the defendant in an action for trademark infringement file a petition for administrative cancellation of the registrant's trademark?

No, his remedy is to file an answer and invoke as a defense that the plaintiff is not entitled to the trademark registration. This is consistent with Section 151.2 of the IPC that the court or the administrative agency vested with jurisdiction to hear and adjudicate any action to enforce the rights to a registered mark shall likewise exercise jurisdiction to determine whether the registration of said mark may be cancelled in accordance with the Act. The filing of a suit to enforce the registered mark with the proper court or agency shall exclude any other court or agency from assuming jurisdiction over a subsequently filed petition to cancel the same mark. On the other hand, the earlier filing of petition to cancel the mark with the Bureau of Legal Affairs shall not constitute a prejudicial question that must be resolved before an action to enforce the rights to same registered mark may be decided.

What are the limitations to an action for infringement?

a. The owner shall not be entitled to recover profits or damages unless the acts were committed with knowledge that such imitation is likely to cause confusion. Knowledge is presumed when the registrant gives notice that his mark is registered by displaying with the mark the word "registered mark" or the letter "R" with a circle. Note that good faith is not a defense in a criminal suit for trademark infringement;
b. The registered mark shall have no effect against any person who, in good faith before filing or priority date, was using the mark for the purpose of his business;
c. Where the infringer who is engaged solely in the business of printing the mark or other infringing materials for others is an innocent infringer, the owner of the right infringed shall only be entitled to injunction against future printing;
d. Where the infringement is part of a paid advertisement in a newspaper or magazine or similar periodical or in an electronic communication, the remedy of the owner of the right infringed as against the publishers or distributor shall be limited to injunction against the presentation of such advertising matter in future issues of such papers. Such injunctive relief is not available where restraining the dissemination would delay the delivery of such issue or transmission of such electronic communication, if customarily conduced in accordance with sound business practice.[635]

What test is applied to determine confusing similarity between marks?

Only the dominancy test is incorporated in the IP Code in determining the semblance of similar marks. This is found in Section 155.1 of the IPC which defines trademark infringement as the colorable imitation of a registered mark or a dominant feature thereof. Based on the legislative deliberations leading to the enactment of the IPC, the exclusion of the Holistic test was intentional and the dominancy test should be adopted. Considering the adoption of the Dominancy Test and the abandonment of the Holistic Test, as confirmed by the provisions of the IP Code and the legislative deliberations, the Court hereby makes it crystal

[635]Section 159, IPC, as amended.

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clear that the use of the Holistic Test in determining the resemblance of marks has been abandoned.[636]

The Holistic Test in determining trademark resemblance has been abandoned hence the Dominancy Test must be used in determining the existence of confusing similarity between the "LEVI'S" and "LIVE'S" marks. This test relies not only on the visual but also on the aural and connotative comparisons and overall impressions between the two trademarks. Here, respondents' "LIVE'S" mark is but a mere anagram of petitioner's "LEVI'S" marks. It would not be farfetched to imagine that a buyer, when confronted with such striking similarity would be led to confuse one over the other. Thus, by simply applying the Dominancy Test, it can already be concluded that there is a likelihood of confusion between petitioner's "LEVI'S" marks and respondents' "LIVE'S" mark.[637]

h. Petitioner's marks "ELARZ LECHON" and "ELAR LECHON" bear an indubitable likeness with respondent's "ELARS LECHON." As can easily be seen, both marks use the essential and dominant word "ELAR". The only difference between the petitioner's mark from that of respondent's are the last letters Z and S, respectively. However, the letters Z and S sound similar when pronounced. Thus, both marks are not only visually similar, but are phonetically and aurally similar as well. To top it all off, both marks are used in selling lechon products. Verily, there exists a high likelihood that the consumers may conclude an association or relation between the products. Likewise, the uncanny resemblance between the marks may even lead purchasers to believe that the petitioner and respondent are the same entity[638].

7. Unfair Competition

Define unfair competition.

Unfair competition has been defined as the passing off (or palming off) or attempting to pass off upon the public of the goods or business of one person as the goods or business of another with the end and probable effect of deceiving the public. Passing off (or palming off) takes place where the defendant, by imitative devices on the general appearance of the goods, misleads prospective purchasers into buying his merchandise under the impression that they are buying that of his competitors. Thus, the defendant gives his goods the general appearance of the goods of his competitor with the intention of deceiving the public that the goods are those of his competitor.[639]

The essential elements of an action for unfair competition are: (1) confusing similarity in the general appearance of the goods, and (2) intent to deceive the public and defraud a competitor. The confusing similarity may or may not result from similarity in the marks but may result from other external factors in the packaging or presentation of the goods. Likelihood of confusion of goods or business is a relative concept, to be determined only according to peculiar circumstances of each case. The element of intent to deceive and to defraud may be inferred from the similarity of the appearance of the goods as offered for sale to the public.

Here, Elidad and Violeta's product which is a medicated facial cream sold to the public is contained in the same pink oval-shaped container which had the mark "Chin Chun Su," as that of respondent. While they indicated in their product the manufacturer's name, the same

[636] Kolin Electronics Co. INC. V. Kolin Philippines International, Inc., G.R. No. 228165, February 9, 2021 J. Caguioa
[637] Levi Strauss & Co. v. Sevilla, G.R. No. 219744, March 1, 2021
[638] Emzee Foods, Inc. v. Elarfoods, Inc., G.R. No. 220558, February 17, 2021
[639] Republic Gas Corporation v. Petron Corporation, G.R. No. 194062, June 17, 2013; BAR 2019.

does not change the fact that it is confusingly similar to respondent's product in the eyes of the public. An ordinary purchaser would not normally inquire about the manufacturer of the product. Their product and that solely distributed by Summerville are similar in the following respects "1. both are medicated facial creams; 2. both are contained in pink, oval-shaped containers; and 3. both contain the trademark "Chin Chun Su". The similarities far outweigh the differences. The general appearance of Elidad's product is confusingly similar to Summerville's. Verily, the acts complained of against Elidad and Violeta constituted the offense of Unfair Competition.[640]

When is a person liable for unfair competition?

Any person who shall employ deception or any other means contrary to good faith by which he shall pass off the goods manufactured by him or in which he deals, or his business, or services for those of the one having established such goodwill, or who shall commit any acts calculated to produce said result, shall be guilty of unfair competition, and shall be subject to an action therefor.[641]

In particular, and without in any way limiting the scope of protection against unfair competition, the following shall be deemed guilty of unfair competition:

a. Any person, who is selling his goods and gives them the general appearance of goods of another manufacturer or dealer, either as to the goods themselves or in the wrapping of the packages in which they are contained, or the devices or words thereon, or in any other feature of their appearance, which would be likely to influence purchasers to believe that the goods offered are those of a manufacturer or dealer, other than the actual manufacturer or dealer, or who otherwise clothes the goods with such appearance as shall deceive the public and defraud another of his legitimate trade, or any subsequent vendor of such goods or any agent of any vendor engaged in selling such goods with a like purpose;
b. Any person who by any artifice, or device, or who employs any other means calculated to induce the false belief that such person is offering the services of another who has identified such services in the mind of the public; or
c. Any person who shall make any false statement in the course of trade or who shall commit any other act contrary to good faith of a nature calculated to discredit the goods, business or services of another.[642]

It was held that unfair competition is a transitory or continuing offense. Search warrant may be applied for in any court where any element of the alleged offense was committed.[643]

St. Francis Development Corporation (SFDC), a domestic corporation engaged in the real estate business and the developer of St. Francis Square Commercial Center in Ortigas Center, filed complaint for unfair competition against Shang Properties Realty Corporation (Shang) before the IPO - Bureau of Legal Affairs due to Shang's use and filing of applications for the registration of the marks "THE ST. FRANCIS TOWER" and "THE ST. FRANCIS SHANGRILA PLACE" for use relative to Shang's business, particularly the construction of permanent buildings or structures for residential and office purposes.
Is Shang Properties guilty of unfair competition?

[640] Elidad Kho and Violate Kho V. Summerville General Merchandising & Co., Inc., G.R. No. 213400, August 04, 2021
[641] Section 168.2, IPC, as amended.
[642] Section 168.3, IPC, as amended.
[643] Sony Computer Entertainment, Inc. v. Supergreen, Inc., 518 SCRA 750 (2007).

Shang Properties is not guilty of unfair competition in using the marks "THE ST. FRANCIS TOWERS" and "THE ST. FRANCIS SHANGRI-LA PLACE." The "true test" of unfair competition has thus been "whether the acts of the defendant have the intent of deceiving or are calculated to deceive the ordinary buyer making his purchases under the ordinary conditions of the particular trade to which the controversy relates." It is therefore essential to prove the existence of fraud, or the intent to deceive, actual or probable, determined through a judicious scrutiny of the factual circumstances attendant to a particular case. Here, the element of fraud is wanting; hence, there can be no unfair competition.[644]

Distinguish trademark infringement from unfair competition.

There are four basic distinctions, as follows:

a. Infringement of trademark is the unauthorized use of a trademark whereas unfair competition is the passing off one's goods as those of another;
b. In infringement of trademark, fraudulent intent in unnecessary, whereas in unfair competition fraudulent intent is essential;[645]
c. In infringement of trademark, prior registration of the trademark is a prerequisite to the action whereas in unfair competition, registration is not necessary;[646]
d. There is no trademark infringement if the registered trademark is used for totally unrelated to the goods specified in the certificate of trademark registration but there can be unfair competition even if two products are not related if there is passing off of one's product as that of another manufacturer.

Does the act of refilling empty LPG gas cylinder tank bearing a registered trademark amount to infringement or unfair competition or BOTH?

The act of refilling empty LPG gas cylinder tank bearing a registered trademark amounts to both trademark infringement and unfair competition.

The mere unauthorized use of a container bearing a registered trademark in connection with the sale, distribution or advertising of goods or services which is likely to cause confusion, mistake or deception among the buyers or consumers can be considered as trademark infringement. The petitioners in this case actually committed trademark infringement when they refilled, without the respondents' consent, the LPG containers bearing the registered marks of the respondents.

There is likewise unfair competition. Petitioners' acts will inevitably confuse the consuming public, since they have no way of knowing that the gas contained in the LPG tanks bearing respondents' marks is in reality not the latter's LPG product after the same had been illegally refilled. The public will then be led to believe that petitioners are authorized refillers and distributors of respondents' LPG products, considering that they are accepting empty containers of respondents and refilling them for resale.

Unfair competition has been defined as the passing off (or palming off) or attempting to pass off upon the public of the goods or business of one person as the goods or business of another with the end and probable effect of deceiving the public. Passing off (or palming off) takes place where the defendant, by imitative devices on the general appearance of the goods, misleads prospective purchasers into buying his merchandise under the impression that they are buying that of his competitors. Thus, the defendant gives his goods the general

[644] Shang Properties Realty Corporation v. St. Francis Development Corporation, G.R. No. 190706, July 21, 2014.
[645] BAR 2014.
[646] Del Monte Corporation v. Court of Appeals, 181 SCRA 410 (1990); BAR 1996; BAR 2015.

appearance of the goods of his competitor with the intention of deceiving the public that the goods are those of his competitor.

In the present case, respondents pertinently observed that by refilling and selling LPG cylinders bearing their registered marks, petitioners are selling goods by giving them the general appearance of goods of another manufacturer. Obviously, the mere use of those LPG cylinders bearing the trademarks "GASUL" and "SHELLANE" will give the LPGs sold by REGASCO the general appearance of the products of the petitioners.[647]

In another case, it has been established that the parties conspired in the sale/distribution of counterfeit Greenstone products to the public, which were even packaged in bottles identical to that of the original, thereby giving rise to the presumption of fraudulent intent. Although there is unfair competition, there can be no trademark infringement considering that the registration of the trademark "Greenstone" – essential as it is in a trademark infringement case – was not proven to have existed during the time the acts complained of were committed.[648]

Note that in another case, the sale of counterfeit Fundador products had been held to constitute trademark infringement.[649]

Is an action for cancellation of trademark a prejudicial question in a criminal action for unfair competition?

It is not. An action for the cancellation of trademark is a remedy available to a person who believes that he is or will be damaged by the registration of a mark. On the other hand, the criminal actions for unfair competition involved the determination of whether or not the respondent had given his goods the general appearance of the goods of the petitioner, with the intent to deceive the public or defraud the petitioner as his competitor. In the suit for the cancellation of trademark, the issue of lawful registration should necessarily be determined, but registration is not a consideration necessary in unfair competition. Indeed, unfair competition is committed if the effect of the act is to pass off to the public the goods of one man as the goods of another; it is independent of registration. One may be declared an unfair competitor even if his competing trademark is registered.[650]

D. Copyright

What is a copyright?

Copyright is an incorporeal and intangible property granted by law to the originator or creator of certain literary, artistic, scientific and scholarly works whereby he or she is invested for a specific period of time a collection of economic and moral rights on the terms specified by statute.

1. Copyrightable Works

When is the starting point of protection of a Copyright?

Works are protected by the sole fact of their creation, irrespective of their mode or form of expression, as well as of their content, quality and purpose.[651]

What are the classifications of protected works?

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[647] Republic Gas Corporation v. Petron Corporation, G.R. No. 194062, June 17, 2013.
[648] Roberto Co v. Keng Huan, Jerry Yeung and Emma Yeung, G.R. No. 212705, September 10, 2014.
[649] Juno Batistis v. People of the Philippines, G.R. No. 181571, December 16, 2009.
[650] Caterpillar, Inc. v. Manolo P. Samson, G.R. No. 205972 and G.R. No. 164352, November 9, 2016.
[651] Section 172.2, IPC, as amended.

There are two:

a. Original and literary works; and
b. Derivative works.

What are considered original literary and artistic works?

Literary and artistic works are original intellectual creations in the literary and artistic domain protected from the moment of their creation and shall include in particular:

a. Books, pamphlets, articles and other writings;
b. Periodicals and newspapers;
c. Lectures, sermons, addresses, dissertations prepared for oral delivery, whether or not reduced in writing or other material form;[652]
d. Letters;
e. Dramatic or dramatico-musical compositions; choreographic works or entertainment in dumb shows;
f. Musical compositions, with or without words;
g. Works of drawing, painting, architecture, sculpture, engraving, lithography or other works of art; models or designs for works of art;
h. Original ornamental designs or models for articles of manufacture, whether or not registrable as an industrial design, and other works of applied art;
i. Illustrations, maps, plans, sketches, charts and three-dimensional works relative to geography, topography, architecture or science;
j. Drawings or plastic works of a scientific or technical character;
k. Photographic works including works produced by a process analogous to photography; lantern slides;
l. Audiovisual works and cinematographic works and works produced by a process analogous to cinematography or any process for making audio-visual recordings;
m. Pictorial illustrations and advertisements;
n. Computer programs; and
o. Other literary, scholarly, scientific, and artistic works.[653]

Is a hatch door, which is defined as a small door, small gate or an opening that resembles a window equipped with an escape for use in case of fire or emergency, copyrightable?

Hatch door is not copyrightable. It is by nature, functional and utilitarian serving as egress access during emergency. It is not primarily an artistic creation but rather an object of utility designed to have aesthetic appeal. It is intrinsically a useful article, which, as a whole, is not eligible for copyright.

Thus, the first fabricator of the hatch door cannot sue for copyright infringement all other fabricators of the same article. What is copyrightable is the drawing or the sketch of the hatch door itself. Reproduction of the drawing or sketch without the consent of the creator constitutes copyright infringement.[654]

There is also no copyright infringement even if the hatch door is fabricated based on the copyrighted drawing or sketch. Unlike a patent, a copyright gives no exclusive right to the art disclosed; protection is given only to the expression of the idea not the idea itself.[655]

[652]BAR 2011.
[653]Section 172.1, IPC, as amended.
[654]Sison Olaño, *et al. v.* Lim Eng Co., G.R. No. 195835, March 14, 2016.
[655]*Ibid.*

Is a useful article copyrightable?

A "useful article" defined as an article "having an intrinsic utilitarian function that is not merely to portray the appearance of the article or to convey information" is excluded from copyright eligibility.

The only instance when a useful article may be the subject of copyright protection is when it incorporates a design element that is physically or conceptually separable from the underlying product. This means that the utilitarian article can function without the design element. In such an instance, the design element is eligible for copyright protection.

The design of a useful article shall be considered a pictorial, graphic, or sculptural work only if, and only to the extent that, such design incorporates pictorial, graphic, or sculptural features that can be identified separately from, and are capable of existing independently of, the utilitarian aspects of the article.

A belt, being an object utility with the function of preventing one's pants from falling down, is in itself not copyrightable. However, an ornately designed belt buckle which is irrelevant to or did not enhance the belt's function hence, conceptually separable from the belt, is eligible for copyright. It is copyrightable as a sculptural work with independent aesthetic value, and not as an integral element of the belt's functionality.

A table lamp is not copyrightable because it is a functional object intended for the purpose of providing illumination in a room. The general shape of a table lamp is likewise not copyrightable because it contributes to the lamp's ability to illuminate the reaches of a room. But, a lamp base in the form of a statue of male and female dancing figures made of semi vitreous china is copyrightable as a work of art because it is unrelated to the lamp's utilitarian function as a device used to combat darkness.[656]

Based on this test, hatch doors may become copyrightable if they bear design elements that are physically and conceptually separable, independent and distinguishable from the hatch door itself.

What are derivative works?

The following are considered derivative works and shall also be protected by copyright:

a. Dramatizations, translations, adaptations, abridgments, arrangements, and other alterations of literary or artistic works; and
b. Collections of literary, scholarly or artistic works, and compilations of data and other materials which are original by reason of the selection or coordination or arrangement of their contents.[657]

What is the treatment over derivative works?

They shall be protected as new works: provided however, that such new work shall not affect the force of any subsisting copyright upon the original works employed or any part thereof, or be construed to imply any right to such use of the original works, or to secure or extend copyright in such original works.[658]

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[656] *Ibid.*
[657] Section 173.1, IPC, as amended.
[658] Section 173.2, IPC, as amended.

One of the economic rights of the author is to carry out, prevent or authorize derivative work.[659] Thus, no one carry out a work derived from the original work except the author or without his authorization.

Does a publisher have a right over the published edition of the copyrighted work?

Yes. In addition to the right to publish granted by the author, his heirs, or assigns, the publisher shall have a copyright consisting merely of the right of reproduction of the typographical arrangement of the published edition of the work.[660]

Typographical arrangement covers the layout, composition, style and general appearance of a page of a published work.[661] In other words, the visual appearance of the printed page is independently copyrightable from the contents of the published work.

2. Non-copyrightable works

What are considered as unprotected subject matter or non-copyrightable work?

a. Idea, procedure, system, method or operation, concept, principle, discovery or mere data as such, even if they are expressed, explained, illustrated or embodied in a work;
b. News of the day and other miscellaneous facts having the character of mere items of press information;
c. Any official text of a legislative, administrative or legal nature, as well as any official translation thereof;[662]
d. Any work of the Government of the Philippines. However, prior approval of the government agency or office wherein the work is created shall be necessary for exploitation of such work for profit. Such agency or office may, among other things, impose as a condition the payment of royalties;
e. Statutes, rules and regulations, and speeches, lectures, sermons, addresses, and dissertations, pronounced, read or rendered in courts of justice, before administrative agencies, in deliberative assemblies and in meetings of public character.[663]

However, the author of speeches, lectures, sermons, addresses, and dissertations of these works shall have the exclusive right of making a collection of his works.[664]

a. Idea, procedure, system, method or operation, concept, principle, discovery or mere data as such, even if they are expressed, explained, illustrated or embodied in such work.

The format or mechanics of a television show is not included in the list of protected works in Section 2 of P.D. No. 49, which is substantially the same as Section 172 of the Intellectual Property Code (R.A. No. 8293). The subject of copyright refers to finished works and not to concepts. For this reason, the protection afforded by the law cannot be extended to cover format or mechanics of a television show. The audio-visual recording of the show, however, is copyrightable.[665]

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[659]Section 177, IPC, as amended.
[660]Section 174, IPC, as amended.
[661]Gepty, *ibid.*, p. 155 *citing* Carol Tullo, Controller, HMSO Queen's Printer, Guidance-Copyright in Typographical Arrangement.
[662]Section 175, IPC, as amended.
[663]Section 176.1, IPC, as amended.
[664]Section 176.2, IPC, as amended.
[665]Francisco Joaquin, Jr. v. Franklin Drilon, *et al.*, G.R. No. 108946, January 28, 1999.

While an idea is not copyrightable, the expression of an idea is protected by copyright. Thus, there can be a copyright of a book which expounded on a new accounting system the author had developed but the system itself is not copyrightable.

b. News of the day

Overseas Filipino worker Angelo dela Cruz was kidnapped by Iraqi militants and as a condition for his release, a demand was made for the withdrawal of Filipino troops in Iraq. After negotiations, he was released by his captors and was scheduled to return to the country. Occasioned by said homecoming and the public interest it generated, both GMA Network, Inc. and ABS-CBN made their respective broadcasts and coverage of the live event.

ABS-CBN conducted live audio-video coverage of and broadcasted the event. ABS-CBN allowed Reuters Television Service (Reuters) to air the footages it had taken earlier under a special embargo agreement.

ABS-CBN alleged that under the special embargo agreement, no other Philippine subscriber of Reuters would be allowed to use ABS-CBN footage without the latter's consent.

GMA-7 subscribes to Reuters. It received a live video feed of the coverage of Angelo dela Cruz's arrival from Reuters.

GMA-7 immediately carried the live newsfeed in its program "Flash Report," together with its live broadcast. Allegedly, GMA-7 did not receive any notice or was not aware that Reuters was airing footages of ABS-CBN.

ABS-CBN filed the Complaint for copyright infringement under Sections 177and 211 of the Intellectual Property Code against Felipe Gozon and other officers of GMA 7. Is the news footage of ABS CBN copyrightable?

The event itself is not copyrightable because that is the newsworthy event. However, any footage created from the event itself is an intellectual creation which is copyrightable. While news of the day and other miscellaneous facts having the character of "mere items of press information" are considered unprotected subject matter, the Code does not state that *expression* of the news of the day, particularly when it underwent a creative process, is not entitled to protection[666].

Stated otherwise, copyright protection does not extend to news "events" or the facts or ideas which are the subject of news reports. But it is equally well-settled that copyright protection does extend to the reports themselves, as distinguished from the substance of the information contained in the reports. Copyright protects the manner of expression of news reports, "the particular form or collocation of words in which the writer has communicated it."[667]

3. Rights conferred by copyright

What is the scope of protection of a copyright?

[666]ABS-CBN Corporation v. Felipe Gozon, *et al.*, G.R. No. 195956, March 11, 2015.
[667]*Ibid.*

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It is immediate. The aforementioned literary and artistic works are protected from the moment of their creation. Works are protected by the sole fact of their creation, irrespective of their mode or form of expression, as well as of their content, quality and purpose.[668]

Ownership of copyrighted material is shown by proof of originality and copyrightability.[669]

What then is the effect of registration and deposit with the National Library?

The certificates of registration and deposit issued by the National Library serve merely as a notice of recording and registration of the work but do not confer any right or title upon the registered copyright owner or automatically put his work under the protective mantle of the copyright law; it is not a conclusive proof of copyright ownership. Hence, it was held that when there is sufficient proof that the copyrighted products are not original creations but are readily available in the market under various brands, as in one case, validity and originality will not be presumed.[670]

It was held that the Intellectual Property Code does not require registration of the work to fully recover in an infringement suit.[671]

A copyright certificate nevertheless creates a presumption of the validity and ownership of the copyright and as such, is useful in support of the claim of infringement. This presumption, however, is rebuttable and it cannot be sustained where other evidence in the record casts doubt on the question of ownership.[672]

Moreover, the presumption of validity to a certificate of copyright registration merely orders the burden of proof. The applicant should not ordinarily be forced, in the first instance, to prove all the multiple facts that underline the validity of the copyright unless the respondent, effectively challenging them, shifts the burden of doing so to the applicant.[673]

What rights are derived from a Copyright?

There are two classifications of rights derived from a copyright:

a. Economic rights; and
b. Moral rights.

What are economic rights?

Copyright or economic rights shall consist of the exclusive right to carry out, authorize or prevent the following acts:[674]

a. Reproduction of the work or substantial portion of the work;
b. Dramatization, translation, adaptation, abridgment, arrangement or other transformation of the work;

[668] Section 172.1, IPC, as amended.
[669] Sison Olano, *ibid.*
[670] Manly Sportwear Manufacturing, Inc. v. Dadodette Enterprises and/or Hermes Sports Center, G.R. No. 165306, September 20, 2005.
[671] ABS-CBN v. Gozon, March 11, 2015.
[672] Sison Olano, *ibid.*
[673] *Supra.*
[674] Section 177, IPC, as amended.

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c. The first public distribution of the original and each copy of the work by sale or other forms of transfer of ownership;
d. Rental of the original or a copy of an (i) audiovisual, or (ii) cinematographic work, (iii) a work embodied in a sound recording, (iv) a computer program, (v) a compilation of data and other materials, or (vi) a musical work in graphic form, irrespective of the ownership of the original or the copy which is the subject of the rental;
e. Public display of the original or a copy of the work;
f. Public performance of the work; and
g. Other communication to the public of the work.

Reproduction

What is the test of substantiality?

To constitute infringement, it is not necessary that the whole or even a large portion of the work shall have been copied. If so much is taken that the value of the original is sensibly diminished, or the labors of the original author are substantially and to an injurious extent appropriated by another, that is sufficient in point of law to constitute piracy. In cases of infringement, copying alone is not what is prohibited. The copying must produce an injurious effect.[675]

Derivative right

How many works are protected if the author, or another person with the consent of the author, makes a transformation of the original work?

There are two works protected and covered by copyright, the original and the derivative work. However, if the transformation of the original work was done after the term of the copyright, then, only one copyright subsists—that of the derivative work.

Who can carry out derivative work on the original work of the author?

The author has the exclusive privilege to carry out derivative work of his original work. During the term of the copyright, the author may authorize person to carry out the derivative work.

First public distribution

What is the first sale doctrine?

The first sale doctrine provides that an individual who knowingly purchases a copy of a copyrighted work from the copyright holder receives the right to sell, display or otherwise dispose of that particular copy, notwithstanding the interests of the copyright owner.

The copyright holder's right to control the distribution of his work goes away after the "first sale" of the work. The "First Sale Doctrine" is codified in U.S. copyright law at 17 U.S.C. Section 109. The doctrine is mirrored in our own copyright laws.

This principle is also called the "exhaustion" principle. It also applies to patent.

KK is from Bangkok, Thailand. She studies medicine in the Pontifical University of Santo Tomas (UST). She learned that the same foreign books prescribed in UST

[675]Pacita, *et al.* v. Felicidad Robles and Goodwill Trading Co., Inc., G.R. No. 131522, July 19, 1999.

are 40-50% cheaper in Bangkok. So she ordered 50 copies of each book for herself and her classmates and sold the books at 20% less than the price in the Philippines. XX, the exclusive licensed publisher of the books in the Philippines, sued KK for copyright infringement. Decide.

KK did not commit copyright infringement. Under the "first sale" doctrine, the economic rights of the author relevant to the question extend only to the first public distribution of each original copy. After the first sale of the original copies, the owner may use and re-sell the same. Hence, there is no infringement by KK since the said doctrine permitted resale without the publisher's further permission.[676]

What is the right of *Droite de Suite*?

Droite de Suite means right to follow. This means that in every sale or lease of an original work of painting or sculpture or of the original manuscript of a writer or composer, subsequent to the first disposition thereof by the author, the author or his heirs shall have an inalienable right to participate in the gross proceeds of the sale or lease to the extent of five percent (5%). This right shall exist during the lifetime of the author and for 50 years after his death.

May the purchaser of a copyrighted book reproduce it or create a derivative work out of it?

No, the purchaser may only distribute the work, without incurring liability, but cannot reproduce or carry out derivative work out of it. The rights of reproduction and transformation are distinct from the right of first public distribution.

Rental right

May the buyer or assignee of an audiovisual or cinematographic work, work embodied in a sound recording, a computer program, or musical work lease or rent such work without the consent of its creator following the first sale doctrine?

No, the above-enumerated works cannot be rented out to others without the consent of the copyright holder. The right of rental is a distinct economic right which is not covered by the first sale doctrine.

However, works not covered by the foregoing enumeration, like books, may be leased out for profit by the buyer, without the consent of the copyright owner.

Right of public display

Raphael is an internationally well-known and award-winning painter. Alvaro is the President of world-wide organization devoted to works of charity and the spread of the norms of hope, fortitude, and serenity in the face of a global pandemic that has brought desolation to humanity. Alvaro's mother Maricor is the Chairperson. Alvaro commissioned Raphael to do a painting with a theme of inspiring mankind to be filled with faith and hope amid difficulties. After eight (8) months, he finished the work of art. Despite the painstaking effort that went with it, he is not proud of his *opus*. He showed it to his friends, Javier, Gabriel

[676] BAR 2014; Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S 319, 213 WL 1104736 (U.S Mar. 19, 2013), *cited in* Gepty, *ibid.*, p. 179.

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and Michael who were all in tremendous awe and considered it a *magnum opus*-comparable to, if not better than, the works of the Masters.

May Alvaro organize an open for all exhibit to display the great work of Raphael?

Under Section 178.4 of the IPC, as amended, the person who commissioned the work shall have ownership of the work but the copyright thereto pertains to the creator unless there is stipulation to the contrary. Therefore, while Alvaro owns the painting, the copyright belongs to Raphael. The right to display is one of the economic rights of the creator. Thus, unless Raphael allows it, Alvaro cannot publicly display the painting of Raphael.

If Raphael did not transfer the copyright to Alvaro, may Alvaro organize an exhibit among his close friends and display the painting of Raphael?

Yes, Alvaro may display the painting to his close friends. What is prohibited is the public display of the copyrighted work.

A public display is generally accepted to mean a display at a place open to the public or where a substantial number of persons outside of a normal circle of family or its social acquaintances are gathered.[677]

Right of public performance

What is public performance?

"Public performance", in the case of a work other than an audiovisual work, is the recitation, playing, dancing, acting or otherwise performing the work, either directly or by means of any device or process; in the case of an audiovisual work, the showing of its images in sequence and the making of the sounds accompanying it audible; and, in the case of a sound recording, making the recorded sounds audible at a place or at places where persons outside the normal circle of a family and that family's closest social acquaintances are or can be present, irrespective of whether they are or can be present at the same place and at the same time, or at different places and/or at different times, and where the performance can be perceived without the need for communication within the meaning of Subsection 171.3 of the Intellectual Property Code.[678]

Right of communication to the public

What does communication to the public, as an economic right, mean?

"Communication to the public" or "communicate to the public" means the making of a work available to the public by wire or wireless means in such a way that members of the public may access these works from a place and time individually chosen by them.[679]

What are the so-called moral rights of a copyright holder?

The author of a work shall, independently of the economic rights or the grant of an assignment or license with respect to such right, have the following moral rights:[680]

[677]Gepty, *ibid.*, p.181 *citing* Nimmer on Copyright and Amador, Copyright under the Intellectual Property Code.

[678]Section 171.6, IPC, as amended.

[679]Section 171.3, IPC, as amended.

[680]Section 193, IPC, as amended.

a. To require that the authorship of the works be attributed to him, in particular, the right that his name, as far as practicable, be indicated in a prominent way on the copies, and in connection with the public use of his work; ("Right of attribution")
b. To make any alterations of his work prior to, or to withhold it from publication;
c. To object to any distortion, mutilation or other modification of, or other derogatory action in relation to, his work which would be prejudicial to his honor or reputation; ("Right of integrity") and
d. To restrain the use of his name with respect to any work not of his own creation or in a distorted version of his work.[681] ("Right against false attribution")

SJ, a computer genius, commissioned WI, former managing editor of the largest publishing company in the world, to write about SJ's biography . SJ, preoccupied by his overwhelming ambition to grow his company to be able to offer technological products that will benefit mankind, did not get to spend much time with his children. His intention in having the biography is for his children to get to know the real SJ—his virtues and frailties. WI accepted the engagement on one condition—it will be a no holds barred account of SJ's life. SJ agreed. But after the finishing the book, WI is not happy with it and refuses to publish it.

May SJ compel WI to publish the book?

The copyright to the book belongs to WI unless otherwise stipulated. Therefore, it is within his moral rights to withhold the book from publication.

Also, an author cannot be compelled to perform his contract to create a work or for the publication of his work already in existence. However, he may be held liable for damages for breach of such contract.[682]

What is the term of moral right?

All moral rights shall be coterminous with the economic rights of the author or creator of the work except the right of attribution, which is in perpetuity.[683]

4. Ownership of Copyright

What rules govern copyright ownership?

Copyright ownership shall be governed by the following rules:

a. In the case of original literary and artistic works, copyright shall belong to the author of the work;[684]
b. In the case of works of joint authorship, the co-authors shall be the original owners of the copyright and in the absence of agreement, their rights shall be governed by the rules on co-ownership. If, however, a work of joint authorship consists of parts that can be used separately and the author of each part can be identified, the author of each part shall be the original owner of the copyright in the part that he has created;[685]
c. In the case of work created by an author during and in the course of his employment, the copyright shall belong to:

[681]Section 34, P.D. No. 49; BAR 1995.
[682]Section 194, IPC, as amended.
[683]Section 198.1 as amended by R.A. No. 10372.
[684]Section 178.1, IPC, as amended.
[685]Section 178.2, *ibid.*

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i. The employee, if the creation of the object of copyright is not a part of his regular duties even if the employee uses the time, facilities and materials of the employer.
ii. The employer, if the work is the result of the performance of his regularly-assigned duties, unless there is an agreement, express or implied, to the contrary.[686]

d. In the case of a work commissioned by a person other than an employer of the author, and who pays for it, and the work is made in pursuance of the commission, the person who so commissioned the work shall have ownership of the work, but the copyright thereto shall remain with the creator, unless there is a written stipulation to the contrary;[687]
e. In the case of audiovisual work, the copyright shall belong to the producer, the author of the scenario, the composer of the music, the film director, and the author of the work so adapted. However, subject to contrary or other stipulations among the creators, the producer shall exercise the copyright to an extent required for the exhibition of the work in any manner, except for the right to collect performing license fees for the performance of musical compositions, with or without words, which are incorporated into the work;[688]
f. In respect of letters, the copyright shall belong to the writer subject to the provisions of Article 723 of the Civil Code.[689] The publishers shall be deemed to represent the authors of articles and other writings published without the names of the authors or under pseudonyms, unless the contrary appears, or the pseudonyms or adopted name leaves no doubt as to the author's identity, or if the author of the anonymous works discloses his identity.[690]

5. Limitations on copyright

What is the general term of copyright protection?

Subject to the other rules below, the copyright of both original and derivative works shall be protected during the life of the author and for 50 years after his death. This rule also applies to posthumous works.[691]

How about in cases of joint authorship?

In case of works of joint authorship, the economic rights shall be protected during the life of the last surviving author and for 50 years after his death.[692]

If today a person is granted a copyright for a book, for how long will the copyright be valid? If said person uses a pseudonym, how would this affect the length of the copyright?

A copyright endures during the lifetime of the creator and for 50 years after his death. In case he uses a pseudonym, the copyright shall last until the end of 50 years following the date of the first publication of the work, unless the author is identified, in which case, the copyright subsists during his lifetime and for 50 years after his death.[693]

Are there other kinds of works with different terms of protection?

[686]Section 178.3, *ibid.*
[687]Section 178.4, *ibid.*
[688]Section 178.5, *ibid.*
[689]Section 178.6, *ibid.*
[690]Section 179, IPC, as amended.
[691]Section 213.1, IPC, as amended.
[692]Section 213.2, IPC, as amended.
[693]BAR 1975.

Yes. In case of works of applied art, the protection shall be for a period of 25 years from the date of making.[694]

In case of photographic works, the protection shall be for 50 years from publication of the work and, if unpublished, 50 years from the making.[695]
In case of audio-visual works including those produced by process analogous to photography or any process for making audio-visual recordings, the term shall be 50 years from date of publication and, if unpublished, from the date of making.[696]

The rights granted to performers and producers of sound recordings under this law shall expire:

a. For performances not incorporated in recordings, 50 years from the end of the year in which the performance took place; and
b. For sound or image and sound recordings and for performances incorporated therein, 50 years from the end of the year in which the recording took place.[697]

For example, Juan dela Cruz composed a song. He asked Pedro to sing the musical composition. Because of his excellent rendition of the song, it became a hit. Juan has a copyright to the musical composition. It subsists during his lifetime and 50years after his death. Pedro has the copyright to his performance. This is an example of a neighboring right to copyright. It has a term of 50 years following the end of the year in which the performance took place.

In case of broadcasts, the term shall be 20 years from the date the broadcast took place. The extended term shall be applied only to old works with subsisting protection under the prior law.

What are the limitations on copyright?

Notwithstanding the provisions of Chapter V of the IPC, the following acts shall not constitute infringement of copyright:[698]

a. The recitation or performance of a work, once it has been lawfully made accessible to the public, (i) if done privately and free of charge or (ii) if made strictly for a charitable or religious institution or society;
   Example: Students singing popular songs to entertain a professor celebrating his birthday.
b. The making of quotations from a published work if they are compatible with fair use and only to the extent justified for the purpose, including quotations from newspaper articles and periodicals in the form of press summaries: *provided,* that the source and the name of the author, if appearing on the work, are mentioned;
   Example: Lifting an insignificant portion of a book and incorporating it in another book, with proper attribution.
c. The reproduction or communication to the public by mass media of (i) articles on current political, social, economic, scientific or religious topic, (ii) lectures, addresses and other works of the same nature, which are delivered in public if such

[694]Section 213.4, IPC, as amended.
[695]Section 213.5, IPC, as amended.
[696]Section 213.6, IPC, as amended.
[697]Section 215, IPC, as amended.
[698]Section 184.1, IPC, as amended.

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use is for information purposes and has not been expressly reserved: provided, that the source is clearly indicated;
Example: News story printing a substantial part of the speech of a public official.

d. The reproduction and communication to the public of literary, scientific or artistic works as part of reports of current events by means of photography, cinematography or broadcasting to the extent necessary for the purpose;
Example: Taking a photo of paintings in art gallery exhibit as part of report of current events.

e. The inclusion of a work in a publication, broadcast, or other communication to the public, sound recording or film, if such inclusion is made by way of illustration for teaching purposes and is compatible with fair use: *provided,* that the source and of the name of the author, if appearing in the work, are mentioned;
Example: Slides presentation of comparative works of architecture as illustration for teaching purposes of the different types of architecture throughout the decades.

f. The recording made in schools, universities, or educational institutions of a work included in a broadcast for the use of such schools, universities or educational institutions; *provided,* that such recording must be deleted within a reasonable period after they were first broadcast: *provided, further,* that such recording may not be made from audiovisual works which are part of the general cinema repertoire of feature films except for brief excerpts of the work;
Example: The recording made in a university of UAAP basketball games for the viewing of the university students.

g. The making of ephemeral recordings by a broadcasting organization by means of its own facilities and for use in its own broadcast;
Example: The recording by a broadcasting organization of current events as part of a newscast.

h. The use made of a work by or under the direction or control of the Government, by the National Library or by educational, scientific or professional institutions where such use is in the public interest and is compatible with fair use;
Example: The application of the must-carry rule of the National Telecommunications Commission which obligates cable provides to carry the signals and shows of free TV stations to afford the public wider viewing options.

i. The public performance or the communication to the public of a work, in a place where no admission fee is charged in respect of such public performance or communication, by a club or institution for charitable or educational purpose only, whose aim is not profit making, subject to such other limitations as may be provided in the Regulations;
Example: Poetry reading competition among students where no admission fee is charged in respect of such public performance.

j. Public display of the original or a copy of the work not made by means of a film, slide, television image or otherwise on screen or by means of any other device or process: *provided,* that either the work has been published, or, that the original or the copy displayed has been sold, given away or otherwise transferred to another person by the author or his successor in title;
Example: Public display of a painting after its purchase from the owner.

k. Any use made of a work for the purpose of any judicial proceedings or for the giving of professional advice by a legal practitioner.
Example: Copying portions of a book for inclusion in a pleadings to be filed with the court or in an opinion to be given to a client.

l. The reproduction or distribution of published articles or materials in a specialized format exclusively for the use of the blind, visually- and reading-impaired persons: *Provided,* That such copies and distribution shall be made on a nonprofit basis and shall indicate the copyright owner and the date of the original publication; and,[699]

[699]Section 184, IPC, as amended.

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Example: The non-commercial reproduction of books under the Braille system for the use of the blind.

m. In case of fair use of the copyrighted work.[700]

Private Performance of a work

The Filipino Society of Composers (FCT) is a non-profit association of authors, composers and publishers. Said association is the owner of certain musical compositions among which are the songs entitled: "Dahil Sa Iyo," "Sapagkat Ikaw Ay Akin," "Sapagkat Kami Ay Tao Lamang" and "The Nearness Of You."

BT is the operator of a restaurant known as "Alex Soda Foundation and Restaurant" where a combo with professional singers, hired to play and sing musical compositions to entertain and amuse customers therein, were playing and singing the above-mentioned compositions without any license or permission from FCT to play or sing the same. It is admitted that the patrons of the restaurant in question pay only for the food and drinks and apparently not for listening to the music.

Was the playing and singing of the musical compositions of FCT inside the establishment of BT constitute a public performance for profit within the meaning and contemplation of the Copyright Law?

The music provided is for the purpose of entertaining and amusing the customers in order to make the establishment more attractive and desirable. It will be noted that for the playing and singing the musical compositions involved, the combo was paid as independent contractors. It is therefore obvious that the expenses entailed thereby are added to the overhead of the restaurant which are either eventually charged in the price of the food and drinks or to the overall total of additional income produced by the bigger volume of business which the entertainment was programmed to attract. Consequently, it is beyond question that the playing and singing of the combo in BT's restaurant constituted performance for profit contemplated by the Copyright Law.[701]

Incidentally, in a similar case, it was ruled that "(t)he Performance in a restaurant or hotel dining room, by persons employed by the proprietor, of a copyrighted musical composition, for the entertainment of patrons, without charge for admission to hear it, infringes the exclusive right of the owner of the copyright."[702]

Making of quotations

What are the criteria to be observed such that making quotation from a published work does not amount to copyright infringement?

The criteria are as follows:

a) It is compatible with fair use;
b) The extent of the use is justifiable for the purpose intended; and,
c) The source and author of the work are mentioned

Johnny Cruz is a staunch conservative and a loyal member of the Republican Party. He is pro-life, believes in the second amendment that protects the right to keep and bear arms and advocates former POTUS Trump's basic philosophy—America First.

[700]Section 185, IPC, as amended.
[701]Filipino Society of Composers v Benjamin Tan, G.R. No. L-36402, Second Division, March 16, 1987.
[702]*Ibid.*

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He wrote an 88-page thought-provoking article about the second impeachment of Trump. Echoing many legal scholars, he argued that the impeachment is unconstitutional because the impeachment process only applies to a sitting President; the objective of impeachment is to remove an incumbent President and since Trump has left the POTUS office, the impeachment has no legal leg to stand on. He concluded that the impeachment is nothing but a hoax and part of the continuing prosecution of Trump by the left and the media mob.

Pearly Ivory is an avid fan of the Democratic Party. She believes in all its liberal ideas and progressive policies. Anti-abortion for her is really not against life but simply means pro-choice. She gushes with admiration on the prominent Democrats—Bill Clinton, Barack Obama, and the like. She wrote a critique on the work of Johnny Cruz which literally copied 90% of Johnny's article but made the proper attribution. Ten percent (10%) of the article is in support of her conclusion that Trump is a threat to society and democracy and should be permanently barred from seeking elective office.[703]

Is Pearly Ivory liable for copyright infringement?

Yes, Pearly Ivory is liable for copyright infringement. Making quotations from a published work is permissible. However, to constitute as a valid limitation on copyright, the quotation must be compatible with fair use. One of the factors to be considered in determining whether the use made of a work in any particular case is fair use is the amount and substantiality of the portion used in relation to the copyrighted work as a whole. Copying 90% of the work, even though with proper attribution, is not compatible with fair use.

Does the lifting of a portion of a book by another author constitute copyright infringement?

The lifting of substantial portions of a book by the author constitutes infringement of the copyright of the authors of the first book. If so much is taken that the value of the original works is substantially diminished, there is an infringement of copyright and to an injurious extent, the work is appropriated.[704]

In cases of infringement, copying alone is not what is prohibited. The copying must produce an injurious effect. In the *Habana* case, the Supreme Court held that the injury consists in that the second author lifted from the first author's book materials that were the result of the latter's research work and compilation and misrepresented them as her own. The infringer circulated the book for commercial use and did not acknowledge the first author as her source.[705]

It should be noted that in the *Habana* case, the number of pages copied did not even account for more than 50% of the book. It seems that had the second author made the proper author attribution, there would have been no infringement.

Information purposes

Cite example of "addresses and other works of the same nature" which can be reproduced to the public by mass media without infringement.

[703]Patterned after a 1989 Bar Exams but based on contemporary news as of the date of writing.
[704]Pacita Habana, *et al.* v. Felicidad Robles and Goodwill Trading Co., Inc., G.R. No. 131522, July 19, 1999.
[705]*Supra.*

In *Rappler, Inc. v. Andres Bautista*,[706] it was held that presidential and vice presidential debates fall under "addresses and other works of the same nature." Thus, the copyright conditions for the debates are: (1) the reproduction or communication to the public by mass media of the debates is for information purposes; (2) the debates have not been expressly reserved by the copyright holders); and (3) the source is clearly indicated.

The Supreme Court allowed the debates to be shown or live streamed unaltered on Rappler's and other websites subject to the foregoing copyright conditions.

Under the direction and control of the government

What do you understand by the must-carry rule?

The must-carry rule is a regulation of the National Telecommunications Commission which obligates cable TV networks to carry the signals of local TV stations and show in full the free-local TV programs.

The improved broadcast signals offered by a cable TV may infringe or encroach upon the audience or viewer market of the free-signal TV. This is so because the latter's signal may not reach the remote areas or reach them with poor signal quality. To foreclose this possibility and protect the free-TV market (audience market), the must-carry rule was adopted to level the playing field. This, in turn, benefits the public who would have a wide-range of choices of programs or broadcast to watch. This also benefits the free-TV signal as their broadcasts are carried under cable TV's much-improved broadcast signals thus expanding their viewer's share.[707]

Hence, it was ruled that the carriage by cable TV providers of ABS-CBN's signals and the showing in full of the local TV programs do not constitute copyright infringement.[708] This is based on Section184.1 (h) of the IPC, as amended, the use made of a work by or under the direction or control of the Government, by the National Library or by educational, scientific or professional institutions where such use is in the public interest and is compatible with fair use will not constitute copyright infringement.

It was further held that while the Memorandum Circular of the NTC on the must-carry rule refers to cable television, it should be understood as to include direct-to-home via satellite TV (DTH) which provides essentially the same services.

In *GMA Network v. Central CATV,*[709] the Supreme Court further ruled that under the must-carry rule, the cable TV networks are required to carry and show in full the free-local TV's programs, including advertisements, without alteration or deletion. The act of showing advertisements does not constitute an infringement of the "television and broadcast markets" under Section 2 of E.O. No. 205.

Is carrying the signals of the local TV station as form of re-broadcasting?

No, the cable TV provider is not the origin nor does it claim to be the origin of the programs broadcasted by the ABS-CBN; the former did not make and transmit on its own but merely carried the existing signals of the latter and when the cable provider subscribers

[706]G.R. No. 222702, April 5, 2016.

[707]GMA Network, Inc. v. Central CATV, Inc., G.R. No. 176694, July 18, 2014.

[708]ABS-CBN Broadcasting Corporation v. Philippine Multi-Media System, Inc., G.R. Nos. 175769-70, January 19, 2009.

[709]GMA Network, *supra*.

view ABS-CBN's programs in Channels 2 and 23, they know that the origin thereof was the latter.[710]

Judicial proceedings or professional advice

May a person have photocopies of some pages of the book of Professor Rosario made without violating the copyright law?

No, the private reproduction of a published work in a single copy, where the reproduction is made by a natural person exclusively for research and private study, is permitted, without the authorization of the owner of the copyright in the work does not apply to a book. Reproduction of a book is covered by a separate provision. If the pages copied amount to a substantial portion, there is infringement of copyright.

In a written legal opinion for a client on the difference between apprenticeship and learnership, Liza quoted without permission a labor law expert's comment appearing in his book entitled "Annotations on the Labor Code." Can the labor law expert hold Liza liable for infringement of copyright for quoting a portion of his book without his permission?

No. The labor law expert cannot hold Liza liable for infringement of copyright. Under Section 184.1(k) of the IPC, as amended, "Any use made of a work for the purpose of any judicial proceeding or for giving of professional advice by a legal practitioner" shall not constitute infringement of a copyright.[711] The use made of a work for the purpose of giving professional advice is a limitation on copyright and does not require the consent of the author.

May Liza be held criminally liable if she did not attribute the portion of the work she quoted in her opinion to the labor law author?

The law does not require attribution when it comes to the use of the work for judicial proceeding or giving professional advice and as such, Liza cannot be sued for copyright infringement despite lack of attribution. However, Liza may be held liable for plagiarism which is broader in scope than copyright. To plagiarize means to steal and pass off the ideas or words of another as one's own. It is basically a literary theft.[712]

Doctrine of fair use

What is fair use?

Fair use is "a privilege to use the copyrighted material in a reasonable manner without the consent of the copyright owner or as copying the theme or ideas rather than their expression."[713] Fair use is an exception to the copyright owner‹s monopoly of the use of the work to avoid stifling "the very creativity which that law is designed to foster".[714]

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[710]ABS-CBN Broadcasting Corporation v. Philippine Multi-Media System, Inc., G.R. Nos. 175769-70, January 19, 2009.

[711]BAR 2006.

[712]Webster's online dictionary.

[713]ABS CBN case *citing* Habana v. Robles, 369 Phil. 764 (1999) [Per J. Pardo, First Division], *citing* 18 AM JUR2D ,109§ in turn *citing* Toksvig v. Bruce Pub. Co., (CA7Wis) 181 F2d 664 [1950]; Bradbury v. Columbia Broadcasting System, Inc., (CA9 Cal) 287 F2d 478, cert den 368 US 801, 7 L ed 2d 15, 82 S Ct 19 [1961]; Shipman v. R.K.O. Radio Pictures, Inc., (CA2 NY) 100 F2d 533 [1938].

[714]ABS CBN case *citing* Matthew D. Bunker, TRANSFORMING THE NEWS: COPYRIGHT AND FAIR USE IN NEWS-RELATED CONTEXTS, 52 J. COPYRIGHT SOC'Y U.S.A. 309, 311 (2004-2005), *citing* Iowa St. Univ. Research Found., Inc. v. Am. Broad. Cos., 621 F.2d 57, 60 (2d Cir. 1980). The four factors are similarly codified under the United States Copyright Act of 1976, Section 107.

Under this doctrine, the fair use of a copyrighted work for: (1) criticism and comment; (2) news reporting; (3) teaching, including multiple copies for classroom use; and (4) scholarship, research, and similar purposes is not an infringement of copyright.

What are the factors to be considered in determining fair use?

Determining fair use requires application of the four-factor test. Section 185 of the Intellectual Property Code lists four (4) factors to determine if there was fair use of a copyrighted work:

a. The purpose and character of the use, including whether such use is of a commercial nature or is for non-profit educational purposes;
b. The nature of the copyrighted work;
c. The amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
d. The effect of the use upon the potential market for or value of the copyrighted work.

First, the purpose and character of the use of the copyrighted material must fall under those listed in Section 185, thus: “criticism, comment, news reporting, teaching including multiple copies for classroom use, scholarship, research, and similar purposes.” The purpose and character requirement is important in view of copyright’s goal to promote creativity and encourage creation of works. Hence, commercial use of the copyrighted work can be weighed against fair use.

The “transformative test” is generally used in reviewing the purpose and character of the usage of the copyrighted work. The court must look into whether the copy of the work adds “new expression, meaning or message” to transform it into something else. “Meta-use” can also occur without necessarily transforming the copyrighted work used.

Second, the nature of the copyrighted work is significant in deciding whether its use was fair. If the nature of the work is more factual than creative, then fair use will be weighed in favor of the user.

Third, the amount and substantiality of the portion used is important to determine whether usage falls under fair use. An exact reproduction of a copyrighted work, compared to a small portion of it, can result in the conclusion that its use is not fair. There may also be cases where, though the entirety of the copyrighted work is used without consent, its purpose determines that the usage is still fair. For example, a parody using a substantial amount of copyrighted work may be permissible as fair use as opposed to a copy of a work produced purely for economic gain.

Lastly, the effect of the use on the copyrighted work’s market is also weighed for or against the user. If this court finds that the use had or will have a negative impact on the copyrighted work’s market, then the use is deemed unfair.[715]

Interestingly, in the ABS-CBN case, the respondents from GMA-7 invoked as of one of their defenses the doctrine of fair use since footage was only aired for five (5) seconds. It was held that whether the alleged five-second footage may be considered fair use is a matter of defense as the case involves determination of probable cause at the preliminary investigation stage only.

[715] ABS-CBN, *ibid.*

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GMA-7's rebroadcast of ABS-CBN's news footage without the latter's consent is not an issue. The mere act of rebroadcasting without authority from the owner of the broadcast gives rise to the probability that a crime was committed under the Intellectual Property Code.

Copyright Infringement

What is copyright infringement?

Infringement of a copyright is a trespass on a private domain owned and occupied by the owner of the copyright, and, therefore, protected by law, and infringement of copyright, or piracy, which is a synonymous term in this connection, consists in the doing by any person, without the consent of the owner of the copyright, of anything the sole right to do which is conferred by statute on the owner of the copyright.[716]

The gravamen of copyright infringement is not merely the unauthorized "manufacturing" of intellectual works but rather the unauthorized performance of any of the rights exclusively granted to the copyright owner. Hence, any person who performs any of such acts without obtaining the copyright owner's prior consent renders himself civilly and criminally liable for copyright infringement. It was held that the copying of the genuine Microsoft software to produce computer system hard disk or read-only memory (CD-ROMs) containing fake Microsoft software and their distribution are illegal even if the copier or distributor is a Microsoft licensee.[717]

Absolute similarity of the purported pirated works to the copyrighted works is not required. The essence of a copyright infringement is the similarity or at least substantial similarity of the purported pirated works to the copyrighted work.[718]

When is copyright infringement committed?

Copyright infringement is committed by any person who shall use original literary or artistic works, or derivative works, without the copyright owner's consent in such a manner as to violate the foregoing economic and moral rights of the author.

A person infringes a right protected under the IPC when one:

a. Directly commits an infringement;
b. Benefits from the infringing activity of another person who commits an infringement if the person benefiting has been given notice of the infringing activity and has the right and ability to control the activities of the other person;
c. With knowledge of infringing activity, induces, causes or materially contributes to the infringing conduct of another.[719]

May the author or creator of the work sue for copyright infringement if he fails to deposit a copy of his work to the National Library (or the IPO as deputized by the National Library)?

Yes, he may sue for copyright infringement notwithstanding the lack of deposit and registration with the National Library. Artistic and Literary works are now protected by its mere creation under the new Copyright Law.

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[716]ABS-CBN, *supra.*

[717]NBI-Microsoft Corporation v. Judy Hwang, *et al.,* G.R. No. 147043, June 21, 2005.

[718]Francisco G. Joaquin, Jr., and BJ Productions, Inc. v. Honorable Franklin Drilon, *et al.,* G.R. No. 108946, January 28, 1999.

[719]Section 216, IPC, as amended.

Under P.D, No. 49, failure to comply with registration and deposit does not deprive the copyright owner of the right to sue for infringement but merely limits the remedies available to him because the copyright for a work is granted from the moment of creation. This means that the author whose work was infringed can only secure an injunction against infringement but cannot sue for damages.[720]

However, under the IPC, the copyright owner may not only obtain an injunction but may also ask for damages and exercise other remedies provided by the law even though his work is not deposited and registered with the IPO.

What are the elements of copyright infringement?

For a claim of copyright infringement to prevail, the evidence on record must demonstrate:

a. Ownership of a validly copyrighted material by the complainant; and
b. Infringement of the copyright by the respondent.[721]

In an action for damages on account of an infringement of a copyright, the defendant (the alleged pirate) raised the defense that he was unaware that what he had copied was a copyright material. Would this defense be valid?

No. An intention to pirate is not an element of infringement. Infringement under the Intellectual Property Code is *malum prohibitum.* The Intellectual Property Code is a special law. Copyright is a statutory creation: Malice or criminal intent is completely immaterial. Hence, an honest intention is no defense to an action for infringement.[722]

A copy of a piracy is an infringement of the original, and it is no defense that the pirate, in such cases, did not know whether or not he was infringing any copyright; he at least knew that what he was copying was not his, and he copied at his peril.

Thus, unless clearly provided in the law, offenses involving infringement of copyright protections should be considered *malum prohibitum.* It is the act of infringement, not the intent, which causes the damage. To require or assume the need to prove intent defeats the purpose of intellectual property protection.

Nevertheless, proof beyond reasonable doubt is still the standard for criminal prosecutions under the Intellectual Property Code.[723]

In one case, however, the Supreme Court found no grave abuse of discretion on the part of the Department of Justice when it dismissed the complaint against the respondent who had possession of a product after purchase from legitimate sources but which turned out to be a counterfeit, without the knowledge of the purchaser/possessor.[724]

What are the remedies of the copyright owner against an infringer?

The copyright owner may exercise the following remedies in case of infringement:

[720] Columbia Pictures, Inc., *et al.* v. Court of Appeals, G.R. No. 110318, August 28, 1996.
[721] Ching v. Salinas, Sr., 500 Phil. 628, 639 (2005).
[722] BAR 1988 and 1997.
[723] ABS-CBN *supra*, *citing* Habana v. Robles.
[724] Sanrio Company Ltd. v. Lim, G.R. No. 168662, February 19, 2008.

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a. He may file a civil action for copyright infringement to obtain any or all of the following reliefs:
   i. Damages. The court can order the defendant to pay to the copyright proprietor or his assigns or heirs such actual damages, including legal costs and other expenses, as he may have incurred due to the infringement as well as the profits the infringer may have made due to such infringement, and in proving profits the plaintiff shall be required to prove sales only and the defendant shall be required to prove every element of cost which he claims, or, in lieu of actual damages and profits, such damages which to the court shall appear to be just and shall not be regarded as penalty.[725]

The amount of damages to be awarded shall be doubled against any person who:
(i) Circumvents effective technological measures; or
(ii) Having reasonable grounds to know that it will induce, enable, facilitate or conceal the infringement, remove or alter any electronic rights management information from a copy of a work, sound recording, or fixation of a performance, or distribute, import for distribution, broadcast, or communicate to the public works or copies of works without authority, knowing that electronic rights management information has been removed or altered without authority.[726]

'Technological measure' means any technology, device or component that, in the normal course of its operation, restricts acts in respect of a work, performance or sound recording, which are not authorized by the authors, performers or producers of sound recordings concerned or permitted by law.[727]

'Rights management information' means information which identifies the work, sound recording or performance; the author of the work, producer of the sound recording or performer of the performance; the owner of any right in the work, sound recording or performance; or information about the terms and conditions of the use of the work, sound recording or performance; and any number or code that represent such information, when any of these items is attached to a copy of the work, sound recording or fixation of performance or appears in conjunction with the communication to the public of a work, sound recording or performance.[728]

Moral and exemplary damages may likewise be awarded as court may deem proper, wise and equitable.[729]

However, no damages may be recovered after the lapse of four years from the time the cause of action arose.[730]

   ii. Preliminary injunction. The court may also order the defendant to desist from committing any infringement and/or to prevent the entry into the channels of commerce of imported goods that involve an infringement, immediately after customs clearance of such goods.[731]
   iii. Search and seizure order. This may include the seizure and impounding of sales invoices and other documents evidencing sales, all articles and their packaging alleged to infringe a copyright and implements for making them which may serve as evidence in court proceedings in accordance with the rules

[725]Section 216.1(b), IPC, as amended.
[726]Section 216.1(b), IPC, as amended.
[727]Section 171.12, IPC, as amended.
[728]Section 171.13, IPC, as amended.
[729]Section 216.1(e), IPC, as amended.
[730]Section 226, IPC, as amended.
[731]Section 216.1(a), as amended.

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on search and seizure involving violations of intellectual property rights issued by the Supreme Court.[732]

iv. Order of Destruction. The court can also order the destruction without any compensation all infringing copies or devices, as well as all plates, molds, or other means for making such infringing copies as the court may order.[733]

The destruction of infringing copies of the work may be ordered even in the event of acquittal in a criminal case.[734]

The order of destruction is however not executory if defendant files a motion for reconsideration.[735]

The foregoing remedies shall not preclude an independent suit for relief by the injured party by way of damages, injunction, accounts or otherwise.[736]

v. He may also file a criminal action for copyright infringement.[737]

The copyright owner may elect, at any time before final judgment is rendered, to recover instead of actual damages and profits, an award of statutory damages for all infringements involved in an action in a sum equivalent to the filing fee of the infringement action but not less than fifty thousand pesos (P50,000.00). In awarding statutory damages, the court may consider the following factors:

(1) The nature and purpose of the infringing act;
(2) The flagrancy of the infringement;
(3) Whether the defendant acted in bad faith;
(4) The need for deterrence;
(5) Any loss that the plaintiff has suffered or is likely to suffer by reason of the infringement; and
(6) Any benefit shown to have accrued to the defendant by reason of the infringement.

In case the infringer was not aware and had no reason to believe that his acts constitute an infringement of copyright, the court in its discretion may reduce the award of statutory damages to a sum of not more than P10,000.00.[738]

The amount of damages to be awarded shall be doubled against any person who circumvents effective technological measures and/or alters or removes electronic rights management information.[739]

Jose Santos has written many poems, some of which have been published in Panorama Magazine but never registered with the Copyright Office. Among his published works was the poem entitled "In a Rose Garden." About a year from its publication, Jose was surprised to hear over the radio a song whose lyrics were copied from his poem. It appears that music sheets of the song have been published and sold under the name of the composer, without any acknowledgment in favor of Jose. Jose wants to know what his rights are and whether he can secure an injunction against the composer and/or the publisher, perhaps with damages. How will you advise him? Explain.

I would tell Santos that he has a right to file an injunction proceeding to restrain the composer and/or his publisher from further committing any act of infringement of his copyright. Under the present law, copyright is acquired from the moment of creation of the

[732]Section 216.2, and 216.1(c), IPC, as amended.
[733]Section 216.1(d), IPC, as amended.
[734]Section 216.1, IPC, as amended.
[735]2020 Rules, *supra*.
[736]Section 216.2, IPC, as amended.
[737]Section 217.1, IPC, as amended.
[738]*Supra*.
[739]Section 216.1, IPC

work. Registration and deposit of the work are no longer necessary for its acquisition. The moment Santos wrote his poem, he acquired the right to restrain any infringement on his copyright, as well as the right to have the infringing copies and devices impounded.

He may recover actual damages, including legal costs and other expenses, as he may have incurred due to the infringement as well as the profits the infringer may have made due to such infringement, and in proving profits the plaintiff shall be required to prove sales only and the defendant shall be required to prove every element of cost which he claims, or, in lieu of actual damages and profits, such damages which to the court shall appear to be just and shall not be regarded as penalty.

He may also recover moral and exemplary damages, which the court may deem proper, wise and equitable.[740]

What are the defenses available against an action for copyright infringement?

The defenses are as follows:

a. The work is not copyrightable;
b. The term of the copyright has expired;
c. The use of the work falls within the limitations on copyright;
d. The plaintiff/complainant is not the owner of the copyright;
e. Non-participation in the commission of the infringing activities;
f. If the basis of the complaint is the benefit derived from the infringing activity, lack of notice thereof and/or did not have the ability to control the infringement;
g. Prescription; and
h. Lack of evidence to support the allegations of the complaint.

[740]BAR 1981 but answered under the IPC.

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V. ANTI-MONEY LAUNDERING ACT (R.A. No. 9160, as amended)

A. Covered institutions/persons and their obligations

Who are the covered institutions/persons under the Anti-Money Laundering law?

"Covered institutions" refer to:

(1) Banks, non-banks, quasi-banks, trust entities, and all other institutions and their subsidiaries and affiliates supervised or regulated by the Bangko Sentral ng Pilipinas (BSP);
(2) Insurance companies and all other institutions supervised or regulated by the Insurance Commission; and
(3) (i) Securities dealers, brokers, salesmen, investment houses and other similar entities managing securities or rendering services as investment agent, advisor, or consultant; (ii) mutual funds, closed-end investment companies, common trust funds, pre-need companies and other similar entities; (iii) foreign exchange corporations, money changers, money payment, remittance, and transfer companies and other similar entities; and (iv) other entities administering or otherwise dealing in currency, commodities or financial derivatives based thereon, valuable objects, cash substitutes and other similar monetary instruments or property supervised or regulated by Securities and Exchange Commission.
(4) Jewelry dealers in precious metals, who, as a business, trade in precious metals, for transactions in excess of one million pesos (P1,000,000.00);
(5) Jewelry dealers in precious stones, who, as a business, trade in precious stones, for transactions in excess of one million pesos (P1,000,000.00);
(6) Company service providers which, as a business, provide any of the following services to third parties: (i) acting as a formation agent of juridical persons; (ii) acting as (or arranging for another person to act as) a director or corporate secretary of a company, a partner of a partnership, or a similar position in relation to other juridical persons; (iii) providing a registered office, business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement; and (iv) acting as (or arranging for another person to act as) a nominee shareholder for another person; and
(7) Persons who provide any of the following services:
  (i) managing of client money, securities or other assets;
  (ii) management of bank, savings or securities accounts;
  (iii) organization of contributions for the creation, operation or management of companies; and
  (iv) creation, operation or management of juridical persons or arrangements, and buying and selling business entities.[741]

Notwithstanding the foregoing, the term 'covered persons' shall exclude lawyers and accountants acting as independent legal professionals in relation to information concerning their clients or where disclosure of information would compromise client confidences or the attorney-client relationship: *Provided,* that these lawyers and accountants are authorized to practice in the Philippines and shall continue to be subject to the provisions of their respective codes of conduct and/or professional responsibility or any of its amendments.[742]

[741] Section 3(a), R.A. No. 9160, as amended.
[742] *Supra.*

(8) **Casinos, including internet and ship-based casinos, with respect to their casino cash transactions related to their gaming operations;**[743]
(9) Real estate developers and brokers;
(10) Offshore gaming operators, as well as their: service providers, supervised, accredited or regulated by the Philippine Amusement and Gaming Corporation (PAGCOR) or any government agency.[744]

What are the obligations of covered institutions/persons?

The obligations of covered institutions/persons under AMLA are as follows:

a. Customer identification

Covered institutions shall establish and record the true identity of its clients based on official documents. They shall maintain a system of verifying the true identity of their clients and, in case of corporate clients, require a system of verifying their legal existence and organizational structure, as well as the authority and identification of all persons purporting to act on their behalf.

The provisions of existing laws to the contrary notwithstanding, anonymous accounts, accounts under fictitious names, and all other similar accounts shall be absolutely prohibited. Peso and foreign currency non-checking numbered accounts shall be allowed.[745]

b. Record keeping

All records of all transactions of covered institutions shall be maintained and safely stored for five (5) years from the dates of transactions. With respect to closed accounts, the records on customer identification, account files and business correspondence, shall be preserved and safely stored for at least five (5) years from the dates when they were closed.[746]

c. Reporting of covered and suspicious transactions

Covered institutions shall report to the AMLC all covered transactions within five (5) working days from occurrence thereof, unless the Supervising Authority concerned prescribes a longer period not exceeding ten (10) working days.[747]

B. Covered and suspicious transactions

What is a Covered Transaction?

"Covered Transaction" is a transaction in cash or other equivalent monetary instrument involving a total amount in excess of five hundred thousand pesos (P500,000.00) within one (1) banking day; for covered persons under Section 3(a)(8), a single casino cash transaction involving an amount in excess of five million pesos (P5,000,000.00) or its equivalent in any other currency.[748]

[743]Section 1(a)(8), R.A. No. 9160, as amended by R.A. No. 10927.
[744]Section 3(a), R.A. No. 9160, as further amended by R.A. No. 11521.
[745]Section 9(a), R.A. No. 9160.
[746]Section 9(b), *ibid.*
[747]Section 9(c), *ibid.*
[748]Section 23 (b), R.A. No. 9160, as amended by R.A. No. 10927.

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For covered persons under Section 3(a)(9),[749] a single cash transaction involving an amount in excess of seven million five hundred thousand pesos (P7,500,000.00) or its equivalent in any other currency.[750]

What are Suspicious Transactions?

"Suspicious transactions" are transactions with covered persons, regardless of the amounts involved, where any of the following circumstances exist:

a. There is no underlying legal or trade obligation, purpose or economic justification;
b. The client is not properly identified;
c. The amount involved is not commensurate with the business or financial capacity of the client;
d. Taking into account all known circumstances, it may be perceived that the client's transaction is structured in order to avoid being the subject of reporting requirements under the Act;
e. Any circumstance relating to the transaction which is observed to deviate from the profile of the client and/or the client's past transactions with the covered person;
f. The transaction is in any way related to an unlawful activity or offense under the Act that is about to be, is being or has been committed; or
g. Any transaction that is similar or analogous to any of the foregoing.[751]

What is the distinction between a "covered transaction report" and a "suspicious transaction report"?[752]

A covered transaction report involves transaction/s in cash or other equivalent monetary instrument involving generally a total amount in excess of P500,000.00 within one (1) banking day, while suspicion transaction report involves transactions with covered institutions regardless of the amounts involved made under any of the suspicious circumstances enumerated by law.

d. Money laundering-how committed and unlawful activities

When is money laundering committed?

Money laundering is a crime whereby the proceeds of an unlawful activity are transacted thereby making them appear to have originated from legitimate sources. It is committed by the following:

Money laundering is committed by any person who, knowing that any monetary instrument or property represents, involves, or relates to the proceeds of any unlawful activity:

a. Transacts said monetary instrument or property;
b. Converts, transfers, disposes of, moves, acquires, possesses or uses said monetary instrument or property;
c. Conceals or disguises the true nature, source, location, disposition, movement or ownership of or rights with respect to said monetary instrument or property;
d. Attempts or conspires to commit money laundering offenses referred to in paragraphs (a), (b) or (c);

[749]Real estate developers and brokers.
[750]Section 3(b), R.A. No. 9160, as amended further by R.A. No. 11521.
[751]Section 3(b.1), R.A. No. 9160, as amended by R.A. No. 11521.
[752]BAR 2015.

e. Aids, abets, assists in or counsels the commission of the money laundering offenses referred to in paragraphs (a), (b) or (c) above; and
f. Performs or fails to perform any act as a result of which he facilitates the offense of money laundering referred to in paragraphs (a), (b) or (c) above.

Money laundering is also committed by any covered person who, knowing that a covered or suspicious transaction is required under this Act to be reported to the Anti-Money Laundering Council (AMLC), fails to do so.[753]

What are the predicate crimes under the Anti-Money Laundering law?

Save for the omission to report covered and suspicious transactions, a money laundering offense, by definition, assumes the commission of an unlawful activity. For instance, kidnapping is an unlawful activity. If the kidnapper deposits the ransom money with a bank, another offense is committed—money laundering. There is money laundering because the proceeds of the unlawful activity were transacted to make it appear that they originated from lawful sources. To constitute money laundering, however, the predicate crime must be based on any of the unlawful activities enumerated by law.

Unlawful activity, as defined by AMLA, refers to any act or omission or series or combination thereof involving or having direct relation to the following:

1. Kidnapping for ransom under Article 267 of Act No. 3815, otherwise known as the Revised Penal Code, as amended;
2. Sections 4, 5, 6, 8, 9, 10, 11, 12, 13, 14, 15, and 16 of R.A. No. 9165, otherwise known as the Comprehensive Dangerous Drugs Act of 2002;
3. Section 3 paragraphs B, C, E, G, H and I of R.A. No. 3019, as amended, otherwise known as the Anti-Graft and Corrupt Practices Act;
4. Plunder under R.A. No. 7080, as amended;
5. Robbery and extortion under Articles 294, 295, 296, 299, 300, 301 and 302 of the Revised Penal Code, as amended;
6. *Jueteng* and *masiao* punished as illegal gambling under P.D. No. 1602;
7. Piracy on the high seas under the Revised Penal Code, as amended and P.D. No. 532;
8. Qualified theft under Article 310 of the Revised Penal Code, as amended;
9. Swindling under Article 315 and Other Forms of Swindling under Article 316 of the Revised Penal Code, as amended;
10. Smuggling under R.A. Nos. 455 and 1937;
11. Violations of R.A. No. 8792, otherwise known as the Electronic Commerce Act of 2000;
12. Hijacking and other violations under R.A. No. 6235; destructive arson and murder, as defined under the Revised Penal Code, as amended;
13. Terrorism and conspiracy to commit terrorism as defined and penalized under Sections 3 and 4 of R.A. No. 9372;
14. Financing of terrorism under Section 4 and offenses punishable under Sections 5, 6, 7 and 8 of R.A. No. 10168, otherwise known as the Terrorism Financing Prevention and Suppression Act of 2012;
15. Bribery under Articles 210, 211 and 211-A of the Revised Penal Code, as amended, and Corruption of Public Officers under Article 212 of the Revised Penal Code, as amended;
16. Frauds and Illegal Exactions and Transactions under Articles 213, 214, 215 and 216 of the Revised Penal Code, as amended;

[753]Section 4, R.A. No. 9160, as amended by R.A. No. 10365.

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17. Malversation of Public Funds and Property under Articles 217 and 222 of the Revised Penal Code, as amended;
18. Forgeries and Counterfeiting under Articles 163, 166, 167, 168, 169 and 176 of the Revised Penal Code, as amended;
19. Violations of Sections 4 to 6 of Republic Act No. 9208, otherwise known as the Anti-Trafficking in Persons Act of 2003;
20. Violations of Sections 78 to 79 of Chapter IV, of P.D. No. 705, otherwise known as the Revised Forestry Code of the Philippines, as amended;
21. Violations of Sections 86 to 106 of Chapter VI, of R.A. No. 8550, otherwise known as the Philippine Fisheries Code of 1998;
22. Violations of Sections 101 to 107, and 110 of R.A. No. 7942, otherwise known as the Philippine Mining Act of 1995;
23. Violations of Section 27(c), (e), (f), (g) and (i), of R.A. No. 9147, otherwise known as the Wildlife Resources Conservation and Protection Act;
24. Violation of Section 7(b) of R.A. No. 9072, otherwise known as the National Caves and Cave Resources Management Protection Act;
25. Violation of R.A. No. 6539, otherwise known as the Anti-Carnapping Act of 2002, as amended;
26. Violations of Sections 1, 3 and 5 of P.D. No. 1866, as amended, otherwise known as the decree Codifying the Laws on Illegal/Unlawful Possession, Manufacture, Dealing In, Acquisition or Disposition of Firearms, Ammunition or Explosives;
27. Violation of P.D. No. 1612, otherwise known as the Anti-Fencing Law;
28. Violation of Section 6 of R.A. No. 8042, otherwise known as the Migrant Workers and Overseas Filipinos Act of 1995, as amended by R.A. No. 10022;
29. Violation of R.A. No. 8293, otherwise known as the Intellectual Property Code of the Philippines;
30. Violation of Section 4 of R.A. No. 9995, otherwise known as the Anti-Photo and Video Voyeurism Act of 2009;
31. Violation of Section 4 of R.A. No. 9775, otherwise known as the Anti-Child Pornography Act of 2009;
32. Violations of Sections 5, 7, 8, 9, 10(c), (d) and (e), 11, 12 and 14 of R.A. No. 7610, otherwise known as the Special Protection of Children Against Abuse, Exploitation and Discrimination;
33. Fraudulent practices and other violations under R.A. No. 8799, otherwise known as 'The Securities Regulation Code of 2000';
34. Violation of Section 19 (a)(3) of R.A. No. 10697, otherwise known as the 'Strategic Trade Management Act', in relation to the proliferation of weapons of mass destruction and its financing pursuant to United Nations Security Council Resolution Numbers 1718 of 2006 and 2231 of 2015";
35. Violations of Section 254 of Chapter II, Title X of the National Internal Revenue Code of 1997, as amended, where the deficiency basic tax due in the final assessment is in excess of twenty-five million pesos (P25,000,000.00) per taxable year, for each tax type covered and there has been a finding of probable cause by the competent authority: *Provided, further,* that there must be a finding of fraud, willful misrepresentation or malicious intent on the part of the taxpayer*: Provided, finally*, that in no case shall the AMLC institute forfeiture proceedings to recover monetary instruments, property or proceeds representing, involving, or relating to a tax crime, if the same has already been recovered or collected by the Bureau of Internal Revenue (BIR) in a separate proceeding; and
36. Felonies and offenses of a similar nature that are punishable under the penal laws of other countries.[754]

Flora, a frequent traveler, found a purse concealed between the cushions of a large sofa inside the VIP lounge in NAIA while she was waiting for her flight to be

[754]Section 7(I), R.A. No. 9160, as amended by R.A. No. 10365 and R.A. No. 11521.

called. Inside the purse was a very valuable diamond-studded necklace. She decided not to turn over the purse to the airport management, and instead to keep it. On her return from her travels, she had a dependable jeweler appraise the necklace, and the latter told her that the necklace was easily worth at least P5,000,000.00 in the open market. To test the appraisal, she pawned the necklace for P2,000,000.00. She then deposited the entire amount in her checking account with Metro Bank. Promptly, Metro Bank reported the transaction to the Anti-Money Laundering Council (AMLC).

Given that her appropriation of the necklace was theft, may Flora be successfully prosecuted for money laundering? Explain briefly your answer.[755]

Flora may not be prosecuted for money laundering. Money laundering is a crime whereby the proceeds of an unlawful activity are transacted making it appear that they originated from legitimate sources. One of the ways of committing money laundering is if a person knows the cash relates to unlawful activity and transacts it. Under the rules implementing the Anti-Money Laundering law, however, only qualified theft (not simple theft) is considered an unlawful activity. In the case presented, the theft committed by Flora did not become qualified because it was not committed with grave abuse of discretion.

e. Authority to inquire into bank deposits

May the AMLC examine the bank accounts of the accused-public officials even without seeking a prior court order? Explain.[756]

The AMLC cannot examine the bank accounts of the accused-public officials without seeking a prior court order. Under the Anti-Money Laundering law, the AMLC needs to obtain a bank inquiry order from the Court of Appeals to inquire into funds and deposits if there is probable cause they relate to unlawful activity under AMLA. Bank inquiry order is not necessary only if the predicate crime is any of hijacking, kidnapping, terrorism, murder, arson and violation of the Dangerous Drugs Law.[757] Violation of the Anti-Graft and Corrupt Practices Act does not fall within the exception.

From his first term in 2007, Congressman Abner has been endorsing his pork barrel allocations to Twin Rivers in exchange for a commission of 40% of the face value of the allocation. Twin Rivers is a non-governmental organization whose supporting papers, after audit, were found by the Commission on Audit to be fictitious. Other than to prepare and submit falsified papers to support the encashment of the pork barrel checks, Twin Rivers does not appear to have done anything on the endorsed projects and Congressman Abner likewise does not appear to have bothered to monitor the progress of the projects he endorsed. The congressman converted most of the commissions he generated into US dollars, and deposited these in a foreign currency account with Banco de Plata (BDP).

Based on amply-supported tips given by a congressman from another political party, the Anti-Money Laundering Council (AMLC) sent BDP an order: (1) to confirm Cong. Abner's deposits with the bank and to provide details of these deposits; and (2) to hold all withdrawals and other transactions involving the congressman's bank accounts.

[755]BAR 2017.
[756]BAR 2019.

[757]Section 11, R.A. No. 9160, as amended.

As counsel for BDP, would you advise the bank to comply with the order?[758]

I shall advise BDP not to comply with the order of the AMLC. Without a bank inquiry order from a competent court, AMLC cannot inquire bank deposits, regardless of currency, unless there is probable cause that the predicate crime involved is hijacking, kidnapping for ransom, violations of the Dangerous Drugs act, hijacking or other violations of R.A. No. 6235, destructive arson, murder, or terrorism.

Further, the AMLC cannot order BDP to hold all withdrawals and other transactions involving the accounts of Congressman Abner. The power to issue freeze order is lodged with the Court of Appeals which may issue it upon after AMLC establishes and the Court of Appeals independently determines that the account relates to unlawful activities under the AMLA.

Prosperous Bank is a domestic bank with head office in Makati. It handles the banking requirements of thousands of clients.

The AMLC initiated a discreet investigation of the financial transactions of Lorenzo, a suspected drug trafficker based in Naga City. The intelligence group of the AMLC, in coordination with the counterpart group from the PDEA and the NBI, gathered ample evidence establishing Lorenzo's unlawful drug activities. The AMLC had probable cause that his deposits and investments in various banks, including Prosperous Bank, were related to money laundering.

Accordingly, the AMLC now transmits to Prosperous Bank a formal demand to allow its agents to examine the banking transactions of Lorenzo, but Prosperous Bank refuses the demand.

Is Prosperous Bank's refusal justified? Explain your answer.[759]

Prospero's refusal is not justified. Notwithstanding the provisions of R.A. No. 1405, R.A. No. 6426 and R.A. No. 8791, the AMLC may inquire into or examine any particular deposit or investment with any bank or non-bank financial institution if there is a probable cause that the deposits are related to unlawful activity under the Anti-Money Laundering Law, as in this case. Bank inquiry order from the court is not necessary since the predicate crime is a violation of the Dangerous Drugs Law.[760]

Through various acts of graft and bribery, Mayor Ycasiano accumulated a large amount of wealth which he converted into U.S. dollars and deposited in a Foreign Currency Deposit Unit (FCDU) account with the Yuen Bank (YB). On a tip given by the secretary of the mayor, the Anti-Money Laundering Council (AMLC) sent an order to YB to confirm the amount of U.S. dollars that Mayor Ycasiano had in his FCDU account. YB claims that, under the Foreign Currency Deposit Act (R.A. No. 6426, as amended), a written permission from the depositor is the only instance allowed for the examination of FCDU accounts. YB alleges that AMLC on its own cannot order a banking institution to reveal matters relating to bank accounts.

Is the legal position of YB, in requiring written permission from the depositor, correct?

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[758]BAR 2013.
[759]BAR 2017.
[760]Section 11, R.A. No. 9160, as amended.

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Yes, the legal position of YB in requiring written permission from the depositor is correct. The AMLC cannot order the bank to inquire into the bank account of any depositor on mere suspicions of acts of graft and bribery without his written consent or a bank inquiry order issued by the competent court.

Is the authority of the AMLC to undertake an inquiry into certain bank accounts or deposits arbitrary and as such, unconstitutional?

Taking into account Section 11 of the AMLA, the Court found nothing arbitrary in the allowance and authorization to AMLC to undertake an inquiry into certain bank accounts or deposits. Instead, the Court found that it provides safeguards before a bank inquiry order is issued, ensuring adherence to the general state policy of preserving the absolutely confidential nature of Philippine bank accounts:

a. The AMLC is required to establish probable cause as basis for its *ex-parte* application for bank inquiry order;
b. The CA, independent of the AMLC's demonstration of probable cause, itself makes a finding of probable cause that the deposits or investments are related to an unlawful activity under Section 3(i) or a money laundering offense under Section 4 of the AMLA;
c. A bank inquiry court order *ex-parte* for related accounts is preceded by a bank inquiry court order *ex-parte* for the principal account which court order *ex-parte* for related accounts is separately based on probable cause that such related account is materially linked to the principal account inquired into; and the authority to inquire into or examine the main or principal account and the related accounts shall comply with the requirements of Article III, Sections 2 and 3 of the Constitution.[761]

f. Application for a freeze order

Does the Anti-Money Laundering Council have the authority to freeze deposits? Explain.[762]

No. The authority to freeze deposits is lodged with and based upon the order of the Court of Appeals.[763]

Similarly, the bank does not have the unilateral right to freeze the accounts of its clients on mere suspicion that the depositor does not have a right over them.[764]

However, a bank has the authority to temporarily freeze the bank account of a deceased depositor under Section 97, R.A. No. 8424 or the Tax Reform Act of 1997. The second paragraph of Section 97 provides that, "If a bank has knowledge of the death of a person, who maintained a bank deposit account alone, or jointly with another, it shall not allow any withdrawal from the said deposit account."

The purpose of Section 97 is to ensure the payment of the estate taxes due on the transfer of the decedent's bank deposits before they could be exhausted or withdrawn by his heirs or by any person who may have access to the said deposits. For the authority under the above-cited provision to take effect, the bank needs only two things: (1) a person is

[761] Subido Pagente Certeza Mendoza and Binay Law Offices v. The Court of Appeals, G.R. No. 216914, *En Banc*, December 6, 2016.
[762] BAR 2015.
[763] Section 10, R.A. No. 9160, as amended.
[764] Philippine Commercial Bank v. Balmaceda, September 12, 2011.

maintaining a bank deposit account; and (2) the bank has knowledge of the said person's death. The authority applies with equal force to joint accounts even to a joint "and/or" account as the law did not make any distinction.[765]

It should be pointed out, however, that the TRAIN law has amended Section 97 of the Tax Code to allow any withdrawal from the deposit account of a deceased depositor but subject to a final withholding tax of 6%. For this purpose, all withdrawal slips shall contain a statement to the effect that all of the joint depositors are still living at the time of withdrawal by any one of the joint depositors and such statement shall be under oath by the said depositors.

Under what conditions may a freeze order be issued?

Upon a verified *ex parte* petition by the AMLC and after determination that probable cause exists that any monetary instrument or property is in any way related to an unlawful activity as defined in Section 3(i) of the AMLA, the Court of Appeals may issue a freeze order.

What is the period of effectivity of the freeze order?

The freeze order shall be effective immediately for a period of 20 days. Within the 20-day period, the Court of Appeals shall conduct a summary hearing, with notice to the parties, to determine whether or not to modify or lift the freeze order, or extend its effectivity. The total period of the freeze order issued by the Court of Appeals under this provision shall not exceed six (6) months. This is without prejudice to an asset preservation order that the Regional Trial Court having jurisdiction over the appropriate anti-money laundering case or civil forfeiture case may issue on the same account depending upon the circumstances of the case, where the Court of Appeals will remand the case and its records: *Provided,* that if there is no case filed against a person whose account has been frozen within the period determined by the Court of Appeals, not exceeding six (6) months, the freeze order shall be deemed *ipso facto* lifted; *Provided further,* that this new rule shaii not apply to pending cases in the courts. In any case, the court should act on the petition to freeze within 24 hours from filing of the petition. If the application is filed a day before a non-working day, the computation of the 24-hour period shall exclude the non-working days.

The freeze order or asset preservation order issued under the law shall be limited only to the amount of cash or monetary instrument or value of property that the court finds there is probable cause to be considered as proceeds of a predicate offense and the freeze order or asset preservation order shall not apply to amounts in the same account in excess of the amount or value of the proceeds of the predicate offense.[766]

g. Safe harbor provision

What is the meaning of the safe harbor provision under AMLA?

No administrative, criminal, or civil proceedings shall lie against any person for having made a covered transaction or suspicious transaction report in the regular performance of his duties and in good faith, whether or not such reporting results in any criminal prosecution under the AMLA or any other Philippine law.[767]

h. Forfeiture provisions

[765] Allied Banking Corporation v. Elizabeth Sia, G.R. No. 195341, August 28, 2019.
[766] Section 10, R.A. No. 9160, as amended by R.A. No. 10927.
[767] Section 9(c), R.A. No. 9160.

Other than obtaining bank inquiry order and freeze orders, what other remedy should the AMLC pursue if probable cause exists that any monetary instrument or property is related to an unlawful activity?

Upon determination by the AMLC that probable cause exists that any monetary instrument or property is in any way related to an unlawful activity as defined in Section 3(i) or a money laundering offense under Section 4 hereof, the AMLC shall file with the appropriate court through the Office of the Solicitor General, a verified *ex parte* petition for forfeiture, and the Rules of Court on Civil Forfeiture shall apply.

The forfeiture shall include those other monetary instrument or property having an equivalent value to that of the monetary instrument or property found to be related in any way to an unlawful activity or a money laundering offense, when with due diligence, the former cannot be located, or it has been substantially altered, destroyed, diminished in value or otherwise rendered worthless by any act or omission, or it has been concealed, removed, converted, or otherwise transferred, or it is located outside the Philippines or has been placed or brought outside the jurisdiction of the court, or it has been commingled with other monetary instrument or property belonging to either the offender himself or a third person or entity, thereby rendering the same difficult to identify or be segregated for purposes of forfeiture.[768]

The AMLC, if circumstances warrant, may initiate civil forfeiture proceedings to preserve the assets and to protect it from dissipation. No court shall issue a temporary restraining order or a writ of injunction against the freeze order, except the Court of Appeals or the Supreme Court.[769]

In the conduct of its investigation, the AMLC may also apply for the issuance of search and seizure order with any competent court.[770]

[768]Section 12, R.A. No. 9160, as amended.
[769]Section 10, R.A. No. 9160, as amended by R.A. No. 11521.
[770]Section 7(13), *ibid*.

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VI. ELECTRONIC COMMERCE ACT (R.A. No. 8792)

What is an Electronic Data Message?

Refers to information generated, sent, received or stored by electronic, optical or similar means.[771]

What is an Electronic Document?

Refers to information or the representation of information, data, figures, symbols or other modes of written expression, described or however represented, by which a right is established or an obligation extinguished, or by which a fact may be proved and affirmed, which is received, recorded, transmitted, stored, processed, retrieved, or produced electronically.[772]

NOTE: Under the Rules on Electronic Evidence, the term "electronic document" may be used interchangeably with "electronic data message".[773]

What is the legal effect of an Electronic Document?

1. Electronic documents shall have the legal effect, validity or enforceability as any other document or legal writing.
2. Equivalent Compliance
   a. Any legal requirement that a document be in writing is complied by an electronic document if:
      i. It maintains its integrity and reliability; and
      ii. It can be authenticated, so as to be usable for subsequent reference, in that —
         1. The electronic document has remained complete and unaltered, apart from the addition of any endorsement and any authorized change, or any change which arises in the normal course of communication, storage, and display; and
         2. The electronic document is reliable in the light of the purpose for which it was generated and in the light of all relevant circumstances.
   b. Any legal requirement that a document be presented or retained in its original form is met by an electronic document if:
      i. There exists a reliable assurance as to the integrity of the document from the time when it was first generated in its final form; and
      ii. That document is capable of being displayed to the person to whom it is to be presented.[774]

NOTE: The Electronic Commerce Act does not vary the requirements of any existing laws on the formalities required in the execution of documents for their validity. But, for evidentiary purposes, an electronic document shall be the functional equivalent of a written document under existing laws.[775]

The Rules on Electronic Evidence regards an electronic document as admissible in evidence if it complies with the rules on admissibility prescribed by the Rules of Court and related laws, and is authenticated in the manner prescribed by the said Rules.[776] An

[771]Section 5(c), R.A. No. 8792.
[772]Section 5(f), R.A. No. 8792.
[773]Rule 2, Section 1(h), Rules on Electronic Evidence.
[774]Section 7, R.A. No. 8792.
[775]Section 7, R.A. No. 8792.
[776]Rule 3, Section 2, Rules on Electronic Evidence.

electronic document shall be regarded as the equivalent of an original document under the Original Document Rule if it is a printout or output readable by sight or other means, shown to reflect the data accurately.[777]

The Senate Committee on Accountability of Public Officers and Investigations summoned Mr. Cruz in order to be questioned in an inquiry in aid of legislation. Mr. Cruz argued that the inquiry in aid of legislation cannot be allowed to continue, as the Senate did not publish the rules of procedure, which is in clear derogation of the Constitution. The Senators justified their non-observance of the constitutionally mandated publication by arguing that the rules of procedure have never been amended since 1995 and, despite that, they are published in booklet form available to anyone for free, and accessible to the public at the Senate's internet web page. The Senators invoked the provisions of R.A. No. 8792 to support their claim of valid publication through the Internet.

Are they correct?

No, there was no valid publication through the Internet. R.A. No. 8792 considers an electronic data message or an electronic document as the functional equivalent of a written document only for evidentiary purposes, that is, the law merely recognizes the admissibility in evidence (for their being the original) of electronic data messages and/or electronic documents. BUT, it does not regard the Internet as a valid medium for publishing laws, rules and regulations.[778]

What is an Electronic Signature?

Refers to any distinctive mark, characteristic and/or sound in electronic form, representing the identity of a person and attached to or logically associated with the electronic data message or electronic document or any methodology or procedures employed or adopted by a person and executed or adopted by such person with the intention of authenticating or approving an electronic data message or electronic document.[779]

NOTE: Under the Rules on Electronic Evidence, an electronic signature includes digital signatures.[780]

What is the legal effect of an Electronic Signature?

An electronic signature on the electronic document shall be equivalent to the signature of a person on a written document if that signature is proved by showing that a prescribed procedure, not alterable by the parties interested in the electronic document, exists and conforms with Section 8 of the law.[781]

What are the presumptions relating to an Electronic Signature?

In any proceedings involving an electronic signature, it shall be presumed that:

1. The electronic signature is the signature of the person to whom it correlates; and
2. The electronic signature was affixed by that person with the intention of signing or approving the electronic document unless the person relying on the electronically

[777]Rule 4, Section 1, Rules on Electronic Evidence.
[778]Garcillano v. House of Representatives, G.R. No. 170338, December 23, 2008.
[779]Section 5(e), R.A. No. 8792.
[780]Rule 2, Section 1(j), Rules on Electronic Evidence.
[781]Section 8, R.A. No. 8792.

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signed electronic document knows or has noticed of defects in or unreliability of the signature or reliance on the electronic signature is not reasonable under the circumstances.[782]

What are the rules on the admissibility and evidentiary weight of an Electronic Data Message or Electronic Document?

In any legal proceedings, the admissibility of an electronic data message or electronic document in evidence cannot be denied:

a. On the sole ground that it is in electronic form; or
b. On the ground that it is not in the standard written form and electronic data message or electronic document meeting and complying with the requirements under Section 6 or 7 hereof shall be the best evidence of the agreement and transaction contained therein.

In assessing the evidential weight of an electronic data message or electronic document, the reliability of the manner in which it was generated, stored or communicated, the reliability of the manner in which its originator was identified, and other relevant factors shall be given due regard.[783]

Perdue Corporation is engaged in the business of importing and trading construction equipment. One of its suppliers is Cardin Company, a manufacturer located in Japan. The two corporations conducted business through telephone calls and facsimile or telecopy transmissions. Cardin Company would send *pro forma* invoices containing product details to Perdue Corporation; if the latter conforms thereto, their representatives would affix their signatures on the facsimile and send it back by fax. Are the original facsimile transmissions of the *pro forma* invoices considered as electronic documents/electronic date messages?

No, these are paper-based documents. While Congress adopted the term "data message" under the UNCITRAL Model Law, it modified the definition to *exclude telexes or faxes, except computer-generated faxes*. This congressional interpretation is in harmony with the Electronic Commerce Law's focus on "paperless" communications and the "functional equivalent approach" and facsimile transmissions are not, in this sense, "paperless," but verily are paper-based.

Accordingly, a *facsimile transmission* cannot be considered as electronic evidence. It is not the functional equivalent of an original under the Best Evidence Rule and is not admissible as *electronic evidence*.[784]

Jean and Annie are opposing candidates for the 1st District of Palawan. Annie lost to Jean by a thin margin of 800 votes. Annie filed an electoral protest before the House of Representatives Electoral Tribunal (HRET), assailing the results in several precincts. Annie moved for printing of the picture images of the ballots of the questioned precincts stored in the PCOS machines, as there were irregularities in the condition of the ballot boxes. The HRET directed the copying of the picture image files relative to the protest. Jean argues that the picture images of the ballots cannot be considered as the "official ballots" or the equivalent of the original paper ballots which the voters filled out. Jean maintains that, since the automated election

[782] Section 9, R.A. No. 8792.

[783] Section 12, R.A. No. 8792.
[784] MCC Industrial Sales Corp. v. Ssangyong Corp., G.R. No. 170633, October 17, 2007.

system used was paper-based, the "official ballot" is only the paper ballot. Is Jean correct?

No, the picture image of the paper ballot scanned is considered an electronic document. The rule is different in elections. Hence, even if the type of automated election system that our country used is "paper-based," the picture images of the paper ballots, as scanned and recorded by the PCOS machines, are considered "official ballots" that faithfully captures in electronic form the votes cast by the voter, as defined by Section 2 (3) of R.A. No. 9369. As such, the printouts thereof are the functional equivalent of the paper ballots filled out by the voters and, thus, may be used for purposes of revision of votes in an electoral protest.[785]

However, despite the equal probative weight accorded to the paper ballots and the printouts of their picture images, before the latter may be utilized, it must be first shown that the official ballots are lost or their integrity has been compromised if the other party does not agree that the printouts should be used.[786]

Are electronic contracts valid?

Yes. Except as otherwise agreed by the parties, an offer, the acceptance of an offer and such other elements required under existing laws for the formation of contracts may be expressed in, demonstrated and proved by means of electronic data messages or electronic documents.[787]

Electronic transactions made through networking among banks, or linkages thereof with other entities or networks, and vice versa, shall be deemed consummated upon the actual dispensing of cash or the debit of one account and the corresponding credit to another, whether such transaction is initiated by the depositor or by an authorized collecting party: Provided, that the obligation of one bank, entity, or person similarly situated to another arising therefrom shall be considered absolute and shall not be subjected to the process of preference of credits.[788]

Liberty Bank performs custodial services on behalf of its investor-clients, with respect to their passive investments in the Philippines. Liberty Bank's investor-clients maintain Philippine peso and/or foreign currency accounts, which are managed by Liberty Bank through instructions given through electronic messages. The said instructions are standard forms known in the banking industry as SWIFT, or "Society for Worldwide Interbank Financial Telecommunication." In purchasing shares of stock and other investment in securities, the investor-clients would send electronic messages from abroad instructing Liberty Bank to debit their local or foreign currency accounts and to pay the purchase price therefor upon receipt of the securities. Under the tax code, a documentary stamp tax (DST) shall be levied on the instrument, *i.e.,* a bill of exchange or order for the payment of money, which purports to draw money from a foreign country but payable in the Philippines. The BIR asserts that Liberty Bank is required to pay DST based on its acceptance of these electronic messages. Is the BIR correct?

No. An electronic message sent by an investor-client from abroad (via SWIFT) to his local bank here in the Philippines, containing instructions to debit his local or foreign currency accounts in the Philippines and pay a certain named recipient also residing in the Philippines, is not the transaction contemplated under Section 181 of the Tax Code as such

[785]Chato v. House of Representatives Electoral Tribunal, G.R. No. 199149, January 22, 2013.
[786]Maliksi v. COMELEC, G.R. No. 203302, April 11, 2013.
[787]Section 16, R.A. No. 8792.
[788]*Id*.

instructions are "parallel to an automatic bank transfer of local funds from a savings account to a checking account maintained by a depositor in one bank." Said electronic messages "cannot be considered negotiable instruments as they lack the feature of negotiability" and are "mere memoranda" of the transaction consisting of the "actual debiting of the [investor-client-payor's] local or foreign currency account in the Philippines" and "entered as such in the books of account of the local bank.[789]

The electronic messages are not bills of exchange. The electronic messages are not signed by the investor-clients as supposed drawers of a bill of exchange; they do not contain an unconditional order to pay a sum certain in money as the payment is supposed to come from a specific fund or account of the investor-clients; and, they are not payable to order or bearer but to a specifically designated third party. As there was no bill of exchange or order for the payment drawn abroad and made payable here in the Philippines, there could have been no acceptance or payment that will trigger the imposition of the DST under Section 181 of the Tax Code.[790]

What is the obligation of confidentiality?

It provides that unless authorized by law, any person who obtained access to any electronic key, electronic data message or electronic document, book, register, correspondence, information, or other material pursuant to any powers conferred under this Act, shall not convey to or share the same with any other person.[791]

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[789]Hongkong and Shanghai Banking Corp. v. Commissioner on Internal Revenue, G.R. No. 166018, June 4, 2014.

[790]*Id*.

[791]Section 32, R.A. No. 8792.

VII. FINANCIAL REHABILITATION, INSOLVENCY, LIQUIDATION and SUSPENSION OF PAYMENTS (R.A. No. 10142, FR Rules [A.M. No. 12-12-11-SC], and FLSP Rules [A.M. No.15-04-06-SC])

A. Basic concepts

What are the remedies available to or against an insolvent debtor under FRIA?

An individual insolvent debtor may file a petition for suspension of payments and/or may also file, or be the subject of, petition for liquidation.

A juridical insolvent debtor may file, or be the subject of, a petition for rehabilitation or liquidation. A juridical insolvent debtor refers to, unless specifically excluded by a provision under FRIA, a sole proprietorship duly registered with the Department of Trade and Industry ("**DTI**"), a partnership duly registered with the Securities and Exchange Commission ("**SEC**"), a corporation duly organized and existing under Philippine laws.[792]

An individual debtor refers to a natural person who is a resident and citizen of the Philippines who has become insolvent as defined under FRIA.[793]

1. Rehabilitation

What is rehabilitation in the context of FRIA?

Rehabilitation shall refer to the restoration of the debtor to a condition of successful operation and solvency, if it is shown that its continuance of operation is economically feasible and its creditors can recover by way of the present value of payments projected in the plan, more if the debtor continues as a going concern than if it is immediately liquidated.[794]

What is the objective of rehabilitation?

Corporate rehabilitation contemplates a continuance of corporate life and activities in an effort to restore and reinstate the corporation to its former position of successful operation and solvency, the purpose being to enable the company to gain a new lease on life and allow its creditors to be paid their claims out of its earnings. Thus, the basic issues in rehabilitation proceedings concern the viability and desirability of continuing the business operations of the distressed corporation, all with a view of effectively restoring it to a state of solvency or to its former healthy financial condition through the adoption of a Rehabilitation Plan.[795]

The purpose of rehabilitation proceedings is to enable the company to gain a new lease on life and thereby allow creditors to be paid their claims from its earnings.[796]

Rehabilitation assumes that the corporation has been operational but for some reasons like economic crisis or mismanagement had become distressed or insolvent. The petition for rehabilitation should be denied if the debtor had not been in the position of successful operation and solvency prior to the filing of the petition. Thus, while the debtor had indeed commenced business through the preparatory act of opening a credit line with the bank to finance the construction of a new hospital building for its future operations, but the debtor

[792]Section 4(k).
[793]Section m(o).
[794]Section 4(gg).
[795]Philippine Asset Growth Two, Inc. and Planters Development Bank v. Fastech Synergy Philippines, Inc., *et al.,* G.R. No. 206528, June 28, 2016.
[796]Philippine Bank of Communications v. Basic Polyprinters and Packaging Corporation, G.R. No. 187581, October 20, 2014.

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corporation itself admitted that it has not formally operated nor earned any income since its incorporation, this simply means that there exists no viable business concern to be restored and the petition for rehabilitation should be dismissed.[797]

How may the objective of restoring the debtor to its/his former state of successful operations be attained?

The objective of restoring the debtor to its/his former state of successful operation and solvency may be attained through the following:

a. Adoption of an economically feasible Rehabilitation Plan;
b. During the pendency of the rehabilitation, the enforcement of claims against the debtor are generally suspended – to give time to the debtor and the Rehabilitation Receiver to rehabilitate the debtor undistracted by court suits;
c. The Rehabilitation Plan is binding on the debtor and all creditors affected by the proceedings even to those who did not take part or opposed the Rehabilitation Plan under the cram down effect of the Rehabilitation Plan; and
d. National and local taxes are likewise waived until approval of the Rehabilitation Plan or termination of the rehabilitation proceedings.

2. Insolvent

What does insolvent mean to describe a debtor under FRIA?

Insolvent shall refer to the financial condition of a debtor that is generally unable to pay its or his liabilities as they fall due in the ordinary course of business or has liabilities that are greater than its or his assets.[798]

Technical insolvency means that the debtor has more assets than liabilities but generally unable to pay its or his liabilities as they fall due. Actual insolvency means that the debtor's assets are less than liabilities.

Prior to FRIA, only a technically insolvent debtor may file a petition for rehabilitation. An actually insolvent debtor could not file a petition for rehabilitation but should file a petition for insolvency, instead.

FRIA covers both technical and actual insolvency. An actually insolvent debtor may file a petition for rehabilitation and the court will give it due course if the court believes that there is substantial likelihood that the debtor may be rehabilitated through a viable Rehabilitation Plan.[799] Otherwise, the court may convert the rehabilitation proceedings into one of liquidation.[800]

In one case,[801] the Supreme Court ruled that a corporation left without assets could not file a petition for rehabilitation, and the fact that there are pending actions to nullify the foreclosure of its assets does not change such conclusion. Given the expanded concept of insolvency under FRIA, it appears that such debtor without assets can now file a petition for rehabilitation under FRIA.

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[797]BPI Family Savings Bank v. St Michael Medical Center, G.R. No. 205469, March 25, 2015.

[798]Section 4(p), R.A. No. 10142.

[799]*See* Philippine Bank of Communications v. Basic Polyprinters and Packaging Corporation, G.R. No. 187581, October 20, 2014 where the Supreme Court stated that a debtor whose assets are less than liabilities may file a petition for rehabilitation under FRIA. The petition for rehabilitation, however, was dismissed.

[800]Section 92.

[801]New Frontier Sugar Corporation v. Regional Trial Court, Branch 39, Iloilo City, G.R. No. 165001, January 31, 2007.

The term debtor does not include banks, insurance companies, pre-need companies, and national and local government agencies or units. The rehabilitation of distressed banks and insurance companies are governed by other special laws.[802]

Government financial institutions other than banks and government-owned or -controlled corporations are covered by FRIA unless their specific charter provides otherwise.[803]

3.Liquidation

What is the objective of liquidation of juridical debtors?

To resolve and adjust competing claims and property rights of the creditors and the debtor, maximize asset recovery of the debtor and equitably distribute the debtor's properties to the creditors based on the rules on concurrence and preference of credit.

What is the objective of voluntary liquidation of an individual debtor?

The objective is to be discharged from his obligations and to start afresh.

What are the types of liquidation proceedings?

Liquidation proceedings may be voluntary or involuntary.

Voluntary liquidation is initiated by the insolvent debtor whereas involuntary liquidation is commenced by the creditor/s of the insolvent debtor.

Distinguish voluntary from involuntary liquidation of individual debtors.

In voluntary liquidation, it is the debtor himself who files the petition for insolvency, while in involuntary liquidation, a creditor or group of creditors are the ones who file the petition for liquidation against the insolvent debtor.

In voluntary liquidation, the filing of the petition is by itself the act of insolvency whereas in involuntary liquidation filed by creditor/s against the individual, the latter must have committed an act of insolvency.

The required amount of debt for the debtor to file the petition for voluntary liquidation should exceed P500,000 whereas in involuntary liquidation, the creditor/s claims should be at least P500,000.

Distinguish Petition for Liquidation from Suspension of Payments.

The distinctions are as follows:

In Liquidation, the liabilities of the debtor are more than his assets, while in Suspension of Payments, assets of the debtor are more than his liabilities but that the debtor foresees the impossibility of paying his debts as they fall due.

In Liquidation, the assets of the debtor are to be converted into cash for distribution among his creditors, while in Suspension of Payments, the debtor is only asking for time within which to convert his frozen assets into liquid cash with which to pay his obligations when the latter fall due.

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[802]R.A. No. 7653, as amended; (The New Central Bank Act) P.D. No. 612, as amended (Insurance Code of the Philippines) and R.A. No. 9829 (Pre-need Code of the Philippines).

[803]Section 5.

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There is discharge in Voluntary Liquidation of individual debtor but there is no discharge in Suspension of Payments.

The court order in Petition for Suspension of Payments does not include secured creditors whereas in Petition for Liquidation, foreclosure proceedings shall not be allowed for a period of 180 days from issuance of the Liquidation Order.

4.Suspension of Payments

Who may file a petition for suspension of payments?

An individual debtor who, possessing sufficient property to cover all his debts but foreseeing the impossibility of meeting them when they respectively fall due, may file a verified petition that he be declared in the state of suspension of payments by the court of the province or city in which he has resided for six (6) months prior to the filing of his petition. He shall attach to his petition, as a minimum: (a) a schedule of debts and liabilities; (b) an inventory of assess; and (c) a proposed agreement with his creditors.[804]

Suspension of payments, as a remedy under FRIA, is not available to a juridical insolvent debtor. For juridical insolvent debtors, suspension of payments is part of the commencement order which the court may issue through the filing of a petition for rehabilitation.

B. Modes of Rehabilitation

What are the types of rehabilitation proceedings?

The types of rehabilitation proceedings are as follows:

a. Court-supervised rehabilitation
   i. Voluntary
   ii. Involuntary
b. Pre-negotiated rehabilitation
c. Out-of-court or informal restructuring agreement or Rehabilitation Plan

1. Court-supervised rehabilitation

a. Voluntary vs. involuntary

Who may initiate voluntary rehabilitation proceedings?

When approved by the owner in case of a sole proprietorship, or by a majority of the partners in case of a partnership, or, in case of a corporation, by a majority vote of the board of directors or trustees and authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or in case of non-stock corporation, by the vote of at least two-thirds (2/3) of the members, in a stockholder's or member's meeting duly called for the purpose, an insolvent debtor may initiate voluntary proceedings under the FRIA by filing a petition for rehabilitation with the court and on the grounds hereinafter specifically provided. The petition shall be verified to establish the insolvency of the debtor and the viability of its rehabilitation, and include, whether as an attachment or as part of the body of the petition, as a minimum, the following:

a. Identification of the debtor, its principal activities and its addresses;

[804] Section 94.

b. Statement of the fact of and the cause of the debtor's insolvency or inability to pay its obligations as they become due;
c. The specific relief sought pursuant to FRIA;
d. The grounds upon which the petition is based;
e. Other information that may be required under this Act depending on the form of relief requested;
f. Schedule of the debtor's debts and liabilities including a list of creditors with their addresses, amounts of claims and collaterals, or securities, if any;
g. An inventory of all its assets including receivables and claims against third parties;
h. A Rehabilitation Plan;
i. The names of at least three (3) nominees to the position of Rehabilitation Receiver; and
j. Other documents required to be filed with the petition pursuant to the Act and the rules of procedure as may be promulgated by the Supreme Court.

A group of debtors may jointly file a petition for rehabilitation under FRIA when one or more of its members foresee the impossibility of meeting debts when they respectively fall due, and the financial distress would likely adversely affect the financial condition and/or operations of the other members of the group and/or the participation of the other members of the group is essential under the terms and conditions of the proposed Rehabilitation Plan.[805]

Under what conditions may involuntary rehabilitation proceedings be initiated against an insolvent juridical debtor?

Any creditor or group of creditors with a claim of, or the aggregate of whose claims is, at least P1,000,000.00 or at least 25% of the subscribed capital stock or partners' contributions, whichever is higher, may initiate involuntary proceedings against the debtor by filing a petition for rehabilitation with the court if:

a. there is no genuine issue of fact or law on the claim/s of the petitioner/s, and that the due and demandable payments thereon have not been made for at least 60 days or that the debtor has failed generally to meet its liabilities as they fall due; or
b. a creditor, other than the petitioner/s, has initiated foreclosure proceedings against the debtor that will prevent the debtor from paying its debts as they become due or will render it insolvent.[806]

The creditor/s' petition for rehabilitation shall be verified to establish the substantial likelihood that the debtor may be rehabilitated, and include:

a. identification of the debtor, its principal activities and its address;
b. the circumstances sufficient to support a petition to initiate involuntary rehabilitation proceedings under Section 13 of FRIA;
c. the specific relief sought under FRIA;
d. a Rehabilitation Plan;
e. the names of at least three (3) nominees to the position of Rehabilitation Receiver;
f. other information that may be required under this Act depending on the form of relief requested; and
g. other documents required to be filed with the petition pursuant to FRIA and the rules of procedure as may be promulgated by the Supreme Court.[807]

[805]Section 12.

[806]Section 13.
[807]Section 14.

When may creditor/s commence involuntary proceedings?

Any creditor or group of creditors with a claim of, or the aggregate of whose claims is, at least P1,000,000.00 or at least 25% of the subscribed capital stock or partners' contributions, whichever is higher, may initiate involuntary proceedings against the debtor by filing a petition for rehabilitation with the court if: (a) there is no genuine issue of fact on law on the claim/s of the petitioner/s, and that the due and demandable payments thereon have not been made for at least 60 days or that the debtor has failed generally to meet its liabilities as they fall due; or (b) a creditor, other than the petitioner/s, has initiated foreclosure proceedings against the debtor that will prevent the debtor from paying its debts as they become due or will render it insolvent.

b. Commencement order (including stay order)

What is a Commencement Order?

It is the order that commences the rehabilitation proceedings which is issued by the Rehabilitation Court after it finds the petition for rehabilitation as sufficient in form and substance.

The rehabilitation proceedings shall be deemed to have commenced from the date of filing of the petition, which is also termed the commencement date.[808]

The commencement order shall:

a. identify the debtor, its principal business or activity/ies and its principal place of business;
b. summarize the ground/s for initiating the proceedings;
c. state the relief sought under FRIA and any requirement or procedure particular to the relief sought;
d. state the legal effects of the Commencement Order, including those mentioned in Section 17 hereof;
e. declare that the debtor is under rehabilitation;
f. direct the publication of the Commencement Order in a newspaper of general circulation in the Philippines once a week for at least two (2) consecutive weeks, with the first publication to be made within seven (7) days from the time of its issuance;
g. if the petitioner is the debtor, direct the service by personal delivery of a copy of the petition on each creditor holding at least ten percent (10%) of the total liabilities of the debtor as determined from the schedule attached to the petition within five (5) days; if the petitioner/s is/are creditor/s, direct the service by personal delivery of a copy of the petition on the debtor within five (5) days;
h. appoint a Rehabilitation Receiver who may or may not be from among the nominees of the petitioner/s, and who shall exercise such powers and duties defined in FRIA as well as the procedural rules that the Supreme Court will promulgate;
i. summarize the requirements and deadlines for creditors to establish their claims against the debtor and direct all creditors to file their claims with the court at least five (5) days before the initial hearing;
j. direct the Bureau of Internal Revenue ("**BIR**") to file and serve on the debtor its comment on or opposition to the petition or its claim/s against the debtor under such procedures as the Supreme Court may hereafter provide;
k. prohibit the debtor's suppliers of goods or services from withholding the supply of goods and services in the ordinary course of business for as long as the debtor

[808] Allied Banking Corporation v. In the Matter of the Petition to Have Steel Corporation of the Philippines Placed under Corporate Rehabilitation, G.R. No. 191939, March 14, 2018.

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makes payments for the services or goods supplied after the issuance of the Commencement Order;

l. authorize the payment of administrative expenses as they become due;
m. set the case for initial hearing, which shall not be more than 40 days from the date of filing of the petition for the purpose of determining whether there is substantial likelihood for the debtor to be rehabilitated;
n. make available copies of the petition and Rehabilitation Plan for examination and copying by any interested party;
o. indicate the location or locations at which documents regarding the debtor and the proceedings under FRIA may be reviewed and copied;
p. state that any creditor or debtor, who is not the petitioner, may submit the name or nominate any other qualified person to the position of Rehabilitation Receiver at least five (5) days before the initial hearing;
q. include a Stay or Suspension Order.[809]

Should the Commencement Order be served to the creditors of the insolvent debtor to bind them to the rehabilitation proceedings?

No, jurisdiction over all persons affected by the rehabilitation proceedings shall be considered as acquired upon publication of the notice of the commencement of the proceedings in any newspaper of general circulation in the Philippines in the manner prescribed by the rules of procedure promulgated by the Supreme Court.[810]

What are the effects of a Commencement Order?

Unless otherwise provided for by law, the court's issuance of a Commencement Order shall, in addition to the effects of a Stay or Suspension Order:

a. vest the Rehabilitation Receiver with all the powers and functions provided for in FRIA, such as the right to review and obtain all records to which the debtor's management and directors have access, including bank accounts of whatever nature of the debtor, subject to the approval by the court of the performance bond filed by the Rehabilitation Receiver;
b. prohibit, or otherwise serve as the legal basis for rendering null and void the results of any extrajudicial activity or process to seize property, sell encumbered property, or otherwise attempt to collect on or enforce a claim against the debtor after the commencement date unless otherwise allowed in FRIA, subject to the provisions of Section 50 hereof;
c. serve as the legal basis for rendering null and void any set-off after the commencement date of any debt owed to the debtor by any of the debtor's creditors;
d. serve as the legal basis for rendering null and void the perfection of any lien against the debtor's property after the commencement date; and
e. consolidate the resolution of all legal proceedings by and against the debtor to the court: *Provided, however,* that the court may allow the continuation of cases in other courts where the debtor had initiated the suit.

Attempts to seek legal or other recourse against the debtor outside these proceedings shall be sufficient to support a finding of indirect contempt of court.[811]

Similarly, upon issuance of the Commencement Order, and until the approval of the Rehabilitation Plan or dismissal of the petition, whichever is earlier, the imposition of all

[809]Section 16.

[810]Section 3.

[811]Section 17.

taxes and fees, including penalties, interests and charges thereof, due to the national government or to LGUs shall be considered waived, in furtherance of the objectives of rehabilitation.[812]

What is the effectivity and duration of the Commencement Order?

Unless lifted by the court, the Commencement Order shall be effective for the duration of the rehabilitation proceedings for as long as there is a substantial likelihood that the debtor will be successfully rehabilitated.[813]

The effects of such commencement order shall retroact to the date that the petition was filed, and renders void any attempt to collect on or enforce a claim against the debtor or to set off any debt by the debtor's creditors, after the commencement date.[814]

It was held, however, that the retroactive effect of a Commencement Order only applies to petitions filed after the effectivity of FRIA. Section 146 of the FRIA, which makes it applicable to "all further proceedings in insolvency, suspension of payments and rehabilitation cases x x x except to the extent that in the opinion of the court their application would not be feasible or would work injustice," still presupposes a prospective application. Thus, the rule that a third-party or accommodation mortgage may be enjoined if the mortgaged property is needed to rehabilitate the debtor only applies to mortgage foreclosed during the effectivity of FRIA.[815]

Is court hearing required prior to the issuance of a Stay Order?

The Interim Rules do not require a hearing before the issuance of a Stay Order. What it requires is an initial hearing before it can give due course to or dismiss a petition. Nevertheless, while the Interim Rules do not require the holding of a hearing before the issuance of a Stay Order, neither does it prohibit the holding of one. Thus, the trial court has ample discretion to call a hearing when it is not confident that the allegations in the petition are sufficient in form and substance, for so long as this hearing is held within the five (5)-day period from the filing of the petition — the period within which a Stay Order may issue as provided in the Interim Rules.[816]

On February 20, 2021, ABC, an insolvent debtor, filed a petition for rehabilitation. On February 22, 2021, upon learning of ABC's filing of the petition, XYZ Bank, of the creditors of ABC, declared the loan of ABC with XYZ due and demandable based on the terms of the relevant loan agreement. Right after such declaration, XYZ applied the bank deposit of ABC with the Bank against ABC's outstanding loan obligation. On February 24, 2021, the court found the petition for rehabilitation sufficient in form and substance, consequently, issued on the same day a commencement order. The commencement order, among others, appointed a Rehabilitation Receiver and included a stay order which enjoined the enforcement of claims against ABC. Upon learning of the set-off, the Rehabilitation Receiver demanded that the set-off should be set-aside arguing that XYZ cannot collect the loan because of the stay order. XYZ Bank, in turn, countered that there is no more claim when the stay order was issued because such claim had been extinguished on February 22, 2021 and legal set-off took effect by operation of law.

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[812]Section 19.

[813]Section 21.

[814]Allied Banking Corporation v. In the Matter of the Petition to Have Steel Corporation of the Philippines Placed under Corporate Rehabilitation, *ibid.;* Section 4(d), FRIA.

[815]Situs Dev. Corporation, *et al.* v. AsiaTrust Bank, *et al.*, G.R. No. 180036, January 16, 2013.

[816]Pryce Corporation v. China Banking Corporation, G.R. No. 172302, February 18, 2014. Although this was decided under the Interim Rules on Corporate Rehabilitation, the same principle may be applied under FRIA.

Should the set-off be nullified?

Yes, the set-off should be nullified. This is because while the Commencement Order was issued two (2) days after the set-off of deposit, it retroacted to the date of the filing of the petition for rehabilitation on February 20, 2021. Thus, the set-off in between should set aside.

What are the effects of a Stay or Suspension Order?

The Stay or Suspension Order shall:

a. suspend all actions or proceedings, in court or otherwise, for the enforcement of claims against the debtor;
b. suspend all actions to enforce any judgment, attachment or other provisional remedies against the debtor;
c. prohibit the debtor from selling, encumbering, transferring or disposing in any manner any of its properties except in the ordinary course of business; and
d. prohibit the debtor from making any payment of its liabilities outstanding as of the commencement date except as may be provided herein.[817]

What is the rationale of a Stay Order?

A Stay Order is a recognition that all assets of a corporation under rehabilitation are held in trust for the equal benefit of all creditors under the doctrine of "equality is equity." As all the creditors, secured or unsecured, ought to stand on equal footing, not any one of them should be paid ahead of others. No creditor should obtain an advantage or preference over another by the expediency of foreclosure, attachment, execution or otherwise.[818] Furthermore, the stay order will enable the Rehabilitation Receiver to effectively exercise its or his powers free from judicial or extrajudicial interference that might unduly hinder or prevent the "rescue" of the distressed company, rather than to waste its/his time, effort and resources in defending claims against the corporation. This is precisely the reason for suspending all pending claims against the corporation under receivership. This is also called the "*pari passu* principle."[819]

Under FRIA, a Stay Order is included in the Commencement Order.

What claims are suspended by the Stay Order?

Claim shall refer to all claims or demands of whatever nature or character against the debtor or its property, whether for money or otherwise, liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, including, but not limited to: (1) all claims of the government, whether national or local, including taxes, tariffs and customs duties; and (2) claims against directors and officers of the debtor arising from acts done in the discharge of their functions falling within the scope of their authority: *Provided,* that, this inclusion does not prohibit the creditors or third parties from filing cases against the directors and officers acting in their personal capacities.[820]

PA Assurance (PA) was incorporated in 1980 to engage in the sale of pre-need educational plans. It sold open-ended educational plans which guaranteed the

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[817]Section 16.

[818]Negros Navigation Company v. Court of Appeals, G.R. Nos. 163156 and 166845, December 10, 2008, reiterated in Abrera v. Hon. Barza, *supra*.

[819]BAR 2006; 2008.

[820]Section 4(c).

payment of tuition and other fees to planholders irrespective of the cost at the time of availment. It also engaged in the sale of fixed value plans which guaranteed the payment of a pre-determined amount to planholders. In 1982, PA was among the country's top corporations. However, it subsequently suffered financial difficulties.

On September 8, 2005, PA filed a Petition for Corporate Rehabilitation before the RTC of Makati City. On October 17, 2005, 10 plan holders filed an Opposition and Motion to Exclude Planholders from Stay Order on the ground that planholders are not creditors as they (planholders) have a trust relationship with PA. Are the planholders correct?

No. The planholders are not correct. On November 21, 2000, the Court approved the Interim Rules of Procedure on Corporate Rehabilitation of 2000 (Interim Rules), which took effect on December 15, 2000. The Interim Rules apply to petitions for rehabilitation filed by corporations, partnerships, and associations pursuant to P.D. No. 902-A, as amended. Under the Interim Rules, "claim" shall include "all claims or demands of whatever nature or character against the debtor or its property, whether for money or otherwise." "Creditor" shall mean "any holder of a claim." Hence, the claim of the planholders from PA is included in the definition of "claims" under the Interim Rules.[821]

Cite examples of claims that were enjoined as a result of the issuance of a Stay Order.

a. The claim of a passenger against an airline company for missing luggage is a money claim or a financial demand that the law requires to be suspended upon issuance of a Stay Order.[822]
b. Unpaid security services.[823]
c. Claim under a pre-need educational plan.[824]
d. Claims against the distressed corporation whether for damages founded on a breach of contract of carriage, collection suits or any other claims of a pecuniary nature.[825]
e. Labor claims of employees[826] except when filed with the NLRC, which is a quasi-judicial agency, which upon determination by the court, is capable of resolving the claim more quickly, fairly and efficiently than the court: *Provided,* that any final and executory judgment of such agency shall be referred to the court and shall be treated as a non-disputed claim;[827]
f. Loan secured by mortgages.

Does the suspension of actions and/or claims cover only cases pending in court?

No, the suspension of all actions and/or claims against a corporation under rehabilitation does not only cover cases which are pending in court. The automatic suspension of an action for claims embraces all phases of the suit, that is, the entire proceedings of an action or suit and not just the payment of the claims.[828] This Supreme Court ruling should now be qualified to exclude appeals pending with the Supreme Court as of commencement date.[829]

The return of the car subject of the writ of replevin is correct notwithstanding the pendency of the rehabilitation proceedings. This is the necessary consequence of the

[821]BAR 2014.
[822]Philippine Airlines v. Court of Appeals, 389 SCRA 589.
[823]Veterans Philippine Scout Security Agency, Inc. v. First Dominion Prime Holdings, Inc., G.R. No. 190907, August 23, 2012.
[824]Abrera v. Hon. Romeo Barza, G.R. No. 171881, September 11, 2009.
[825]Molina v. Pacific Plans, G.R. No. 165476, August 15, 2011.
[826]Rubberworld v. NLRC, 336 SCRA 433.
[827]Section 18(b).
[828]*Ibid.*
[829]Section 18(a).

dismissal of the replevin case for failure to prosecute without prejudice. Upon the dismissal of the replevin case, the writ of seizure, which is merely ancillary in nature, became *functus officio* and should have been lifted. There was no adjudication on the merits, which means that there was no determination of the issue who has the better right to possess the subject car. Returning the seized vehicle is not an enforcement of a claim against the distressed corporation which must be suspended by virtue of the Stay Order issued by the Rehabilitation Court. The issue in a replevin case is who has a better right of possession. So long as the respondent is not interposing a MONETARY CLAIM, respondent's prayer for the return of the car subject of the replevin suit is not in any way violative of the Rules on Corporate Rehabilitation.[830]

Rehabilitation proceedings are summary and non-adversarial in nature, and do not contemplate adjudication of claims that must be threshed out in ordinary court proceedings.

The jurisdiction of the Rehabilitation Court is over claims against the debtor that is under rehabilitation, not over claims by the debtor against its own debtors or against third parties.

The corporation under rehabilitation must file a separate action against its debtors/insurers to recover whatever claim it may have against them.[831]

ABC Bank extra-judicially foreclosed the real estate mortgage on the property of XYZ Corporation for non-payment of the loan secured by the mortgage. The certificate of sale was thereafter issued. Thereafter, XYZ filed a petition for rehabilitation and obtained a Stay Order. Will the Stay Order have the effect of suspending the consolidation of title to the property after expiration of the redemption period?

Since the foreclosure of the mortgage and the issuance of the certificate of sale in favor of the mortgagee were done prior to the appointment of a Rehabilitation Receiver and the issuance of the Stay Order, all the actions taken with respect to the foreclosed mortgage property which were subsequent to the issuance of the Stay Order were not affected by the Stay Order. Thus, after the redemption period expired without the mortgagor redeeming the foreclosed property, the mortgagee becomes the absolute owner of the property and it was within its right to ask for the consolidation of title and the issuance of new title in its favor. The writ of possession procured by the mortgagee despite the subsequent issuance of a stay order in the rehabilitation proceedings instituted is also valid.[832]

However, if the foreclosure of the mortgage or attachment of the property of the debtor or any enforcement of claim is done between the filing of the petition and the issuance of the commencement order, such action on the part of the creditors will be set aside, in view of the retroactive effect of the commencement order.[833]

Does the issuance of the Commencement Order and the Stay Order diminish or impair the security or lien of a secured creditor?

The issuance of the Commencement Order and the Suspension or Stay Order, and any other provision of this Act, shall not be deemed in any way to diminish or impair the security or lien of a secured creditor, or the value of his lien or security, except that his right to enforce said security or lien may be suspended during the term of the Stay Order.[834]

The court, upon motion or recommendation of the Rehabilitation Receiver, may allow a secured creditor to enforce his security or lien, or foreclose upon property of the debtor

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[830] Advent Capital and Medical Corporation v. Young, G.R. No. 183018, August 3, 2011.

[831] Steel Corporation v. Mapfre Insular Insurance Corporation, G.R. No. 201199, October 16, 2013.

[832] Equitable PCI Bank v. DNG Realty and Development Corporation, 627 SCRA 125; reiterated in Town and Country Enterprises, Inc. v. Quisumbing, G.R. No. 173610, October 1, 2012.

[833] *Supra.*

[834] Section 18(b).

securing his/its claim, if the said property is not necessary for the rehabilitation of the debtor. The secured creditor and/or the other lien holders shall be admitted to the rehabilitation proceedings only for the balance of his claim, if any.[835]

Are the effects of the commencement order and the stay order on the suspension of rights to foreclose or otherwise pursue legal remedies applicable to government financial institutions?

Yes, notwithstanding the provisions in their charters or other laws to the contrary.[836]

What cases/instances are not covered by the Stay or Suspension Order?

The Stay or Suspension Order shall not apply:

a. to cases already pending appeal in the Supreme Court as of commencement date: *Provided,* that any final and executory judgment arising from such appeal shall be referred to the court for appropriate action;[837]
b. subject to the discretion of the court, to cases pending or filed at a specialized court or quasi-judicial agency which, upon determination by the court, is capable of resolving the claim more quickly, fairly and efficiently than the court: *Provided,* that any final and executory judgment of such court or agency shall be referred to the court and shall be treated as a non-disputed claim;[838]
c. to the enforcement of claims against sureties and other persons solidarily liable with the debtor, and third party or accommodation mortgagors as well as issuers of letters of credit, unless the property subject of the third party or accommodation mortgage is necessary for the rehabilitation of the debtor as determined by the court upon recommendation by the Rehabilitation Receiver;[839]
   It was held that the issuance of a stay order did not prevent a Regional Trial Court from acquiring jurisdiction over a guarantor who has waived the benefit of excussion;[840]
d. to any form of action of customers or clients of a securities market participant to recover or otherwise claim moneys and securities entrusted to the latter in the ordinary course of the latter's business as well as any action of such securities market participant or the appropriate regulatory agency or self-regulatory organization to pay or settle such claims or liabilities;[841]
e. to the actions of a licensed broker or dealer to sell pledged securities of a debtor pursuant to a securities pledge or margin agreement for the settlement of securities transactions in accordance with the provisions of the Securities Regulation Code and its implementing rules and regulations;[842]
f. the clearing and settlement of financial transactions through the facilities of a clearing agency or similar entities duly authorized, registered and/or recognized by the appropriate regulatory agency like the Bangko Sentral ng Pilipinas (BSP) and the SEC as well as any form of actions of such agencies or entities to reimburse themselves for any transactions settled for the debtor;[843] and

[835]Section 60.
[836]Section 20.
[837]Section 18(a).
[838]Section 18(b).
[839]Section 18(c).
[840]Trade and Investment Development Corporation v. Philippine Veterans Bank, G.R. No. 233850, July 1, 2019.
[841]Section 18(d).
[842]Section 18(e).
[843]Section 18(f).

g. any criminal action against the individual debtor or owner, partner, director or officer of a debtor shall not be affected by any proceeding commenced under FRIA.[844]

It was held that the suspension of claims in corporate rehabilitation does not extend to criminal actions against the distressed corporations or its directors and officers. It would be absurd for one who has engaged in criminal conduct to escape punishment simply because the corporation of which he is director or officer filed a petition for rehabilitation. The prosecution of the officers of the corporation has no bearing on the pending rehabilitation of the corporation.[845]

The stay order shall likewise not cover the payment of administrative expenses as they become due.[846]

Similarly, the property of the surety cannot be taken into custody by the Rehabilitation Receiver.[847]

ABC Company filed a Petition for Rehabilitation with the Court. An Order was issued by the Court, (1) staying enforcement of all claims, whether money or otherwise against ABC Company, its guarantors and sureties not solidarily liable with the company; and (2) prohibiting ABC Company from making payments of its liabilities, outstanding as of the date of the filing of the Petition. XYC Company is a holder of an irrevocable Standby Letter of Credit which was previously procured by ABC Company in favor of XYC Company to secure performance of certain obligations. In the light of the Order issued by the Court, can XYC Company still be able to draw on their irrevocable Standby Letter of Credit when due? Explain your answer.

Yes, as an exception to a Stay or Suspension Order included in a Commencement Order issued pursuant to the FRIA". Under Section 18(c) of FRIA, a Stay or Suspension Order shall not apply "to the enforcement of claims against sureties and other persons solidarily liable with the debtor, and third party or accommodation mortgagors as well as issuers of letters of credit x x x." Similarly, assuming that it has not been superseded by the FRIA, Section 7(b) of the Supreme Court Rules of Procedure on Corporate Rehabilitation provides that a stay order shall not cover claims against letters of credit and similar security arrangements issued by a third party to secure the payment of the debtor's obligations.

What are the administrative expenses not covered by the Stay Order?

Administrative expenses shall refer to those reasonable and necessary expenses:

a. incurred or arising from the filing of a petition under the provisions of FRIA;
b. arising from, or in connection with, the conduct of the proceedings under FRIA, including those incurred for the rehabilitation or liquidation of the debtor;
c. incurred in the ordinary course of business of the debtor after the commencement date;
d. for the payment of new obligations obtained after the commencement date to finance the rehabilitation of the debtor;
e. incurred for the fees of the Rehabilitation Receiver or liquidator and of the professionals engaged by them; and
f. that are otherwise authorized or mandated under this Act or such other expenses as may be allowed by the Supreme Court in its rules.[848]

[844]Section 18(g).
[845]Panlilio v. Regional Trial Court, Branch 51, City of Manila, G.R. No. 173846, February 2, 2011.
[846]Section 16(l).
[847]MWSS v. Hon. Daway, 432 SCRA 559.
[848]Section 4(a).

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Debtor Corporation and its principal stockholders filed with the Regional Trial Court a petition for rehabilitation. The objective was for the RTC to take control of the corporation and all its assets and liabilities, earnings and operations and rehabilitating the company for the benefit of investors and creditors.

Generally, the unsecured creditors had manifested willingness to cooperate with Debtor Corporation. The secured creditors, however, expressed serious objections and reservations.

First Bank had already initiated judicial foreclosure proceedings on the mortgage constituted on the factory of Debtor Corporation.

Second Bank had already initiated foreclosure proceedings on a third-party mortgage constituted on certain assets of the principal stockholders.

Third Bank had already filed a suit against the principal stockholders who had held themselves liable jointly and severally for the loans of Debtor Corporation with said Bank.

After examining the petition, the Rehabilitation Court directed the appointment of a Rehabilitation Receiver and issued a Commencement Order which included a Stay Order. The Stay Order directed the suspension of all actions and claims against the Debtor Corporation as well as against the principal stockholders.

a. Discuss the validity of the RTC order of suspension.
b. Discuss the effects of the RTC order of suspension on the judicial foreclosure proceedings initiated by First Bank.
c. Would the order of suspension have any legal effect on the foreclosure proceedings initiated by Second Bank? Explain.
d. Would the order of suspension have any effect on the suit filed by Third Bank? Explain.
e. What measures may the receiver take to preserve the assets of Debtor Corporation?

Answers:

a. The RTC Order of Suspension of Payments is valid with respect to the debtor corporation, but not with respect to the principal stockholders. Group filing of petition for rehabilitation is allowed only if the debtors refer to: (1) corporations that are financially related to one another as parent corporations, subsidiaries or affiliates; (2) partnerships that are owned more than 50% by the same person; and (3) single proprietorships that are owned by the same person.[849]
b. The RTC Order of Suspension of Payments suspended the judicial proceedings initiated by First Bank. Under the principle of equality is equity, all creditors, secured or unsecured, stand in equal footing. Thus, the Suspension Order applies to secured creditors and to the action to enforce the security against the corporation regardless of the stage thereof.
c. Under Section 18 of FRIA, the Suspension Order shall not apply to the enforcement of claims against sureties and other persons solidarily liable with the debtor, and third party or accommodation mortgagors as well as issuers of letter of credit, unless the property subject of the third party or accommodation mortgage is necessary for the rehabilitation of the debtor as determined by the court upon the recommendation of the Rehabilitation Receiver.

[849]Section 4(n).

Whether or not the suspension order then will stay the foreclosure of the Second Bank will depend on whether the mortgaged properties are needed for the rehabilitation of the Debtor Corporation.

d. For the same reason as in (c), the Order of Suspension of Payments does not cover the suit filed by Third Bank against the principal stockholders.
e. To preserve the assets of the Debtor Corporation, the receiver may take custody of, and control over, all the existing assets and property of the corporation; evaluate existing assets and liabilities, earnings and operations of the corporation; and determine the best way to salvage and protect the interest of the investors and creditors.[850]

Is the issuance of a Stay Order (as part of the Commencement Order) appealable?

No, the effectivity period of a Stay Order is only "from the date of its issuance until dismissal of the petition or termination of the rehabilitation proceedings." It is not a final disposition of the case. It is an interlocutory order defined as one that» does not finally dispose of the case, and does not end the Court's task of adjudicating the parties' contentions and determining their rights and liabilities as regards each other, but obviously indicates that other things remain to be done by the Court."[851]

As such, the order is not appealable.

c. Rehabilitation Receiver and Management Committee

Who is a Rehabilitation Receiver?

Rehabilitation Receiver shall refer to the person or persons, natural or juridical, appointed as such by the court pursuant to the provisions of FRIA and which shall be entrusted with such powers and duties as set forth in the law.[852]

Who may serve as a Rehabilitation Receiver?

Any qualified natural or juridical person may serve as a Rehabilitation Receiver: *Provided,* that if the Rehabilitation Receiver is a juridical entity, it must designate a natural person/s who possess/es all the qualifications and none of the disqualifications as its representative, it being understood that the juridical entity and the representative/s are solidarily liable for all obligations and responsibilities of the Rehabilitation Receiver.[853]

What are the powers, duties and responsibilities of the Rehabilitation Receiver?

The Rehabilitation Receiver shall be deemed an officer of the court with the principal duty of preserving and maximizing the value of the assets of the debtor during the rehabilitation proceedings, determining the viability of the rehabilitation of the debtor, preparing and recommending a Rehabilitation Plan to the court, and implementing the approved Rehabilitation Plan. To this end, and without limiting the generality of the foregoing, the Rehabilitation Receiver shall have the following powers, duties and responsibilities:

a. To verify the accuracy of the factual allegations in the petition and its annexes;
b. To verify and correct, if necessary, the inventory of all of the assets of the debtor, and their valuation;

[850] 1999 Bar Exam but modified and answered based on FRIA.
[851] Pryce Corporation, *supra.*
[852] Section 4(hh).
[853] Section 28.

c. To verify and correct, if necessary, the schedule of debts and liabilities of the debtor;
d. To evaluate the validity, genuineness and true amount of all the claims against the debtor;
e. To take possession, custody and control, and to preserve the value of all the property of the debtor;
f. To sue and recover, with the approval of the court, all amounts owed to, and all properties pertaining to the debtor;
g. To have access to all information necessary, proper or relevant to the operations and business of the debtor and for its rehabilitation;
h. To sue and recover, with the approval of the court, all property or money of the debtor paid, transferred or disbursed in fraud of the debtor or its creditors, or which constitute undue preference of creditor/s;
i. To monitor the operations and the business of the debtor to ensure that no payments or transfers of property are made other than in the ordinary course of business;
j. With the court's approval, to engage the services of or to employ persons or entities to assist him in the discharge of his functions;
k. To determine the manner by which the debtor may be best rehabilitated, to review, revise and/or recommend action on the Rehabilitation Plan and submit the same or a new one to the court for approval;
l. To implement the Rehabilitation Plan as approved by the court, if so provided under the Rehabilitation Plan;
m. To assume and exercise the powers of management of the debtor, if directed by the court pursuant to Section 36 hereof;
n. To exercise such other powers as may, from time to time, be conferred upon him by the court; and
o. To submit a status report on the rehabilitation proceedings every quarter or as may be required by the court *motu proprio*, or upon motion of any creditor, or as may be provided, in the Rehabilitation Plan.

Unless appointed by the court, pursuant to Section 36 hereof, the Rehabilitation Receiver shall not take over the management and control of the debtor but may recommend the appointment of a management committee over the debtor in the cases provided by law.[854]

Is the court bound by the report of the Rehabilitation Receiver?

No. The determination of the validity and the approval of the rehabilitation plan is not the responsibility of the Rehabilitation Receiver, but remains the function of the court. The Rehabilitation Receiver's duty prior to the court's approval of the plan is to study the best way to rehabilitate the debtor, and to ensure that the value of the debtor's properties is reasonably maintained; and after approval, to implement the Rehabilitation Plan. Notwithstanding the credentials of the court-appointed Rehabilitation Receiver, the duty to determine the feasibility of the rehabilitation of the debtor rests with the court. While the court may consider the receiver's report favorably recommending the debtor's rehabilitation, it is not bound thereby if, in its judgment, the debtor's rehabilitation is not feasible.[855]

When may the court appoint a Management Committee?

[854]Section 31.

[855]Philippine Asset Growth Two, Inc. and Planters Development Bank v. Fastech Synergy Philippines, Inc., *et al.*, G.R. No. 206528, June 28, 2016.

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Upon motion of any interested party, the court may appoint a Management Committee that will undertake the management of the debtor, upon clear and convincing evidence of any of the following circumstances:

a. Actual or imminent danger of dissipation, loss, wastage or destruction of the debtor's assets or other properties;
b. Paralyzation of the business operations of the debtor; or
c. Gross mismanagement of the debtor, or fraud or other wrongful conduct on the part of, or gross or willful violation of FRIA by, existing management of the debtor or the owner, partner, director, officer or representative/s in management of the debtor.[856]

What is the role of the Management Committee?

When appointed pursuant to the foregoing section, the management committee shall take the place of the management and the governing body of the debtor and assume their rights and responsibilities.

The specific powers and duties of the management committee, whose members shall be considered as officers of the court, shall be prescribed by the procedural rules.[857]

Does the act of the corporation in waiving its option to lease a property without receiving any consideration therefor resulting in lost income constitute a valid ground for the appointment of a Receiver or a Management Committee?

Applicants for the appointment of a Receiver or Management Committee need to establish the confluence of these two requisites. This is because appointed Receivers and Management Committees will immediately take over the management of the corporation and will have the management powers specified in law. This may have a negative effect on the operations and affairs of the corporation with third parties, as persons who are more familiar with its operations are necessarily dislodged from their positions in favor of appointees who are strangers to the corporation's operations and affairs.

The act of the corporation in waiving its option to lease a property without receiving any consideration therefor resulting in lost income in the form of goodwill money and rental payments is enough to constitute loss or dissipation of assets.

Respondent, however, failed to show that there was an imminent danger of paralysis of the corporation's business operations. He, therefore, failed to show at least one of the requisites for appointment of a Receiver or Management Committee.[858]

d.Determination of claims

State the obligation of the Rehabilitation Receiver on the determination of claims.

Registry of Claims. — Within twenty (20) days from his assumption into office, the rehabilitation receiver shall establish a preliminary registry of claims. The rehabilitation receiver shall make the registry available for public inspection and provide publication notice to the debtor, creditors and stakeholders on where and when they may inspect it. All claims included in the registry of claims must be duly supported by sufficient evidence.

[856]Section 36.
[857]Section 37.
[858]Alfredo Villamor, Jr. v. John Umale, G.R. Nos. 172834 and 172881, September 24, 2014.

Opposition or Challenge of Claims. — Within thirty (30) days from the expiration of the period stated in the immediately preceding section, the debtor, creditors, stakeholders and other interested parties may submit a challenge to claim/s to the court, serving a certified copy on the rehabilitation receiver and the creditor holding the challenged claim/s. Upon the expiration of the thirty (30)-day period, the rehabilitation receiver shall submit to the court the registry of claims which shall include undisputed claims that have not been subject to challenge.

Any decision of the rehabilitation receiver regarding a claim may be appealed to the court.

e. Rehabilitation Plan

What is a Rehabilitation Plan?

Rehabilitation Plan shall refer to a plan by which the financial well-being and viability of an insolvent debtor can be restored using various means including, but not limited to, debt forgiveness, debt rescheduling, reorganization or quasi-reorganization, *dacion en pago*, debt-equity conversion and sale of the business (or parts of it) as a going concern, or setting-up of new business entity as prescribed in Section 62 of FRIA, or other similar arrangements as may be approved by the court or creditors.[859]

What are the contents of a Rehabilitation Plan?

The Rehabilitation Plan shall, as a minimum:

a. specify the underlying assumptions, the financial goals and the procedures proposed to accomplish such goals;
b. compare the amounts expected to be received by the creditors under the Rehabilitation Plan with those that they will receive if liquidation ensues within the next 120 days;
c. contain information sufficient to give the various classes of creditors a reasonable basis for determining whether supporting the Plan is in their financial interest when compared to the immediate liquidation of the debtor, including any reduction of principal interest and penalties payable to the creditors;
d. establish classes of voting creditors;
e. establish subclasses of voting creditors if prior approval has been granted by the court;
f. indicate how the insolvent debtor will be rehabilitated including, but not limited to, debt forgiveness, debt rescheduling, reorganization or quasi-reorganization, *dacion en pago*, debt-equity conversion and sale of the business (or parts of it) as a going concern, or setting-up of a new business entity or other similar arrangements as may be necessary to restore the financial well-being and viability of the insolvent debtor;
g. specify the treatment of each class or subclass described in subsections (d) and (e);
h. provide for equal treatment of all claims within the same class or subclass, unless a particular creditor voluntarily agrees to less favorable treatment;
i. ensure that the payments made under the plan follow the priority established under the provisions of the Civil Code on concurrence and preference of credits and other applicable laws;
j. maintain the security interest of secured creditors and preserve the liquidation value of the security unless such has been waived or modified voluntarily;
k. disclose all payments to creditors for pre-commencement debts made during the proceedings and the justifications thereof;
l. describe the disputed claims and the provisioning of funds to account for appropriate payments should the claim be ruled valid or its amount adjusted;

[859]Section 4(ii).

m. identify the debtor's role in the implementation of the Plan;
n. state any rehabilitation covenants of the debtor, the breach of which shall be considered a material breach of the Plan;
o. identify those responsible for the future management of the debtor and the supervision and implementation of the Plan, their affiliation with the debtor and their remuneration;
p. address the treatment of claims arising after the confirmation of the Rehabilitation Plan;
q. require the debtor and its counter-parties to adhere to the terms of all contracts that the debtor has chosen to confirm;
r. arrange for the payment of all outstanding administrative expenses as a condition to the Plan's approval unless such condition has been waived in writing by the creditors concerned;
s. arrange for the payment of all outstanding taxes and assessments, or an adjusted amount pursuant to a compromise settlement with the BIR or other applicable tax authorities;
t. include a certified copy of a certificate of tax clearance or evidence of a compromise settlement with the BIR;
u. include a valid and binding resolution of a meeting of the debtor's stockholders to increase the shares by the required amount in cases where the Plan contemplates an additional issuance of shares by the debtor;
v. state the compensation and status, if any, of the Rehabilitation Receiver after the approval of the Plan; and
w. contain provisions for conciliation and/or mediation as a prerequisite to court assistance or intervention in the event of any disagreement in the interpretation or implementation of the Rehabilitation Plan.[860]

What are the characteristics of an economically feasible Rehabilitation Plan?

In the case of *Viva Shipping Lines, Inc. v. Keppel Philippines Mining, Inc*., the Court took note of the characteristics of an economically feasible Rehabilitation Plan.

a. The debtor has assets that can generate more cash if used in its daily operations than if sold.
b. Liquidity issues can be addressed by a practicable business plan that will generate enough cash to sustain daily operations.
c. The debtor has a definite source of financing for the proper and full implementation of a Rehabilitation Plan that is anchored on realistic assumptions and goals.

The Court upheld the dismissal of petitioner's Rehabilitation Plan because its assets are non-performing; its vessels were no longer serviceable which reduces the probability that rehabilitation may restore and reinstate petitioner to its former position of successful operation and solvency; and, the plan of selling properties of petitioner's sister company to generate cash flow cannot be a basis for the approval of the Rehabilitation Plan because the plan still requires the conformity from the sister company and even if the two companies have the same directorship and ownership, they are still two separate juridical entities.[861]

The Court also enumerated the characteristics of a Rehabilitation Plan that is infeasible:

a. the absence of a sound and workable business plan;
b. baseless and unexplained assumptions, targets and goals;
c. speculative capital infusion or complete lack thereof for the execution of the business plan;

[860]Section 62.
[861]Viva Shipping Lines, Inc. *v.* Keppel Philippines Mining, Inc., G.R. No. 177382, February 17, 2016.

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d. cash flow cannot sustain daily operations; and
e. negative net worth and the assets are near full depreciation or fully depreciated.[862]

What does liquidation analysis, as an integral part of the Rehabilitation, mean?

It means that the Rehabilitation Plan should contain any analysis showing that given the various stakeholders of the insolvent debtor-shareholders, creditors, the state, it is better to rehabilitate the debtor than to carry out its liquidation and that the present value recovery is better if the debtor continues as a going concern than if the debtor is to go under liquidation within 120 days from filing of the petition.

Present value recovery acknowledges that, in order to pave way for rehabilitation, the creditor will not be paid by the debtor when the credit falls due. The court may order a Suspension of Payments to set a Rehabilitation Plan in motion; in the meantime, the creditor remains unpaid. By the time the creditor is paid, the financial and economic conditions will have been changed. Money paid in the past has a different value in the future. It is unfair if the creditor merely receives the face value of the debt. Present value of the credit takes into account the interest that the amount of money would have earned if the creditor were paid on time.[863]

What does material financial commitment mean as a condition for the approval of the Rehabilitation Plan?

The failure of the Rehabilitation Plan to state any material financial commitment to support rehabilitation, as well as to include a liquidation analysis, translates to the conclusion that the RTC's stated considerations for approval, are actually unsubstantiated, and hence, insufficient to decree the debtor's rehabilitation.

A material financial commitment gauges the resolve, determination, earnestness and good faith of the distressed corporation in financing the proposed Rehabilitation Plan. The commitment may include the voluntary undertakings of the stockholders or the would-be investors of the debtor indicating their readiness, willingness and ability to contribute funds or property to guarantee the continued successful operation of the debtor during the period of rehabilitation. As case law intimates, nothing short of legally binding investment commitment/s from third parties is required to qualify as a material financial commitment.[864]

The following cases are illustrative.

a. The Rehabilitation Plan should be denied if the debtor avers that it will not require the infusion of additional capital but only proposes to have all accrued penalties, charges and interest waived and reduced interest rate prospectively applied to all its obligations without any concrete plan to build on debtor's beleaguered financial position through substantial investment. Anathema to the true purpose of rehabilitation, a distressed corporation cannot be restored to its former position of successful operation and regain solvency by the sole strategy of delaying payments/waiving accrued interests and penalties at the expense of the creditors.[865]
b. The Rehabilitation Plan should be dismissed if the only proposed source of revenue the plan suggests is the capital which would come from the company's potential investors, which negotiations are merely pending.[866]

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[862]Philippine Asset Growth Two v. Fastech Synergy Philippines, *ibid.*
[863]*Ibid.*
[864]BPI Family Savings Bank v. St. Michael Medical Center, Inc., G.R. No. 205469, March 25, 2015.
[865]Philippine Asset Growth Two v. Fastech Synergy Philippines, G.R. No. 206528, June 28, 2016.
[866]BPI Family Savings Bank v. St. Michael Medical Center, G.R. No. 205469, March 25, 2015.

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c. A commitment to add working capital appeared to be doubtful considering that the insurance claim from which said working capital would be sourced had already been written-off and a claim that has been written-off is considered a bad debt or a worthless asset, and cannot be deemed a material financial commitment for purposes of rehabilitation.[867]

d. A proposal to enter into the *dacion en pago* to create a source of" fresh capital "is also not feasible because the object thereof would not be its own property but one belonging to its affiliate, a corporation also undergoing rehabilitation.[868]

e. At Rehabilitation Plan which is heavily, if not completely predicated on speculative business proposals as well as the contingent entry of the potential foreign investor lacks the requirement of material financial commitment.[869]

f. Creditor approval and confirmation

What is the procedure to obtain creditors' approval of the Rehabilitation Plan ?

Contents of a Rehabilitation Plan. — The Rehabilitation Plan shall, as a minimum:

(a) specify the underlying assumptions, the financial goals and the procedures proposed to accomplish such goals;

(b) compare the amounts expected to be received by the creditors under the Rehabilitation Plan with those that they will receive if liquidation ensues within the next one hundred twenty (120) days;

(c) contain information sufficient to give the various classes of creditors a reasonable basis for determining whether supporting the Plan is in their financial interest when compared to the immediate liquidation of the debtor, including any reduction of principal interest and penalties payable to the creditors;

(d) establish classes of voting creditors;

(e) establish subclasses of voting creditors if prior approval has been granted by the court;

(f) indicate how the insolvent debtor will be rehabilitated including, but not limited to, debt forgiveness, debt rescheduling, reorganization or quasi-reorganization, *dacion en pago*, debt-equity conversion and sale of the business (or parts of it) as a going concern, or setting-up of a new business entity or other similar arrangements as may be necessary to restore the financial well-being and viability of the insolvent debtor;

(g) specify the treatment of each class or subclass described in subsections (d) and (e);

(h) provide for equal treatment of all claims within the same class or subclass, unless a particular creditor voluntarily agrees to less favorable treatment;

(i) ensure that the payments made under the plan follow the priority established under the provisions of the Civil Code on concurrence and preference of credits and other applicable laws;

(j) maintain the security interest of secured creditors and preserve the liquidation value of the security unless such has been waived or modified voluntarily;

[867]Philippine Bank of Communication v. Basic Polyprinters, *supra.*
[868]*Ibid.*
[869]Metropolitan Bank and Trust Co. v. Fortuna Paper Mill & Packaging Corporation, G.R. No. 190800, November 7, 2018.

(k) disclose all payments to creditors for pre-commencement debts made during the proceedings and the justifications thereof;

(l) describe the disputed claims and the provisioning of funds to account for appropriate payments should the claim be ruled valid or its amount adjusted;

(m) identify the debtor's role in the implementation of the Plan;

(n) state any rehabilitation covenants of the debtor, the breach of which shall be considered a material breach of the Plan;

(o) identify those responsible for the future management of the debtor and the supervision and implementation of the Plan, their affiliation with the debtor and their remuneration;

(p) address the treatment of claims arising after the confirmation of the Rehabilitation Plan;

(q) require the debtor and its counter-parties to adhere to the terms of all contracts that the debtor has chosen to confirm;

(r) arrange for the payment of all outstanding administrative expenses as a condition to the Plan's approval unless such condition has been waived in writing by the creditors concerned;

(s) arrange for the payment of all outstanding taxes and assessments, or an adjusted amount pursuant to a compromise settlement with the BIR or other applicable tax authorities;

(t) include a certified copy of a certificate of tax clearance or evidence of a compromise settlement with the BIR;

(u) include a valid and binding resolution of a meeting of the debtor's stockholders to increase the shares by the required amount in cases where the Plan contemplates an additional issuance of shares by the debtor;

(v) state the compensation and status, if any, of the rehabilitation receiver after the approval of the Plan; and

(w) contain provisions for conciliation and/or mediation as a prerequisite to court assistance or intervention in the event of any disagreement in the interpretation or implementation of the Rehabilitation Plan.

When may the rehabilitation court issue the order confirming the Rehabilitation Plan?

Filing of Objections to Rehabilitation Plan. — A creditor may file an objection to the Rehabilitation Plan within twenty (20) days from receipt of notice from the court that the Rehabilitation Plan has been submitted for confirmation. Objections to a Rehabilitation Plan shall be limited to the following:

(a) The creditors' support was induced by fraud;

(b) The documents or data relied upon in the Rehabilitation Plan are materially false or misleading; or

(c) The Rehabilitation Plan is in fact not supported by the voting creditors.

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What are the effects of the confirmation by the court of the Rehabilitation Plan?

The confirmation of the Rehabilitation Plan by the court shall result in the following:

a. The Rehabilitation Plan and its provisions shall be binding upon the debtor and all persons who may be affected by it, including the creditors, whether or not such persons have participated in the proceedings or opposed the Rehabilitation Plan or whether or not their claims have been scheduled;
b. The debtor shall comply with the provisions of the Rehabilitation Plan and shall take all actions necessary to carry out the Plan;
c. Payments shall be made to the creditors in accordance with the provisions of the Rehabilitation Plan;
d. Contracts and other arrangements between the debtor and its creditors shall be interpreted as continuing to apply to the extent that they do not conflict with the provisions of the Rehabilitation Plan;
e. Any compromises on amounts or rescheduling of timing of payments by the debtor shall be binding on creditors regardless of whether or not the Plan is successfully implemented; and
f. Claims arising after approval of the Plan that are otherwise not treated by the Plan are not subject to any Suspension Order.

The Order confirming the Plan shall comply with Rule 36 of the Rules of Court: *Provided, however,* that the court may maintain jurisdiction over the case in order to resolve claims against the debtor that remain contested and allegations that the debtor has breached the Plan.[870]

g. Failure of rehabilitation

When may the rehabilitation proceedings be terminated?

The rehabilitation proceedings under Chapter II shall, upon motion by any stakeholder or the rehabilitation receiver, be terminated by order of the court either declaring a successful implementation of the Rehabilitation Plan or a failure of rehabilitation.

There is failure of rehabilitation in the following cases:

a. Dismissal of the petition by the court;
b. The debtor fails to submit a Rehabilitation Plan;
c. Under the Rehabilitation Plan submitted by the debtor, there is no substantial likelihood that the debtor can be rehabilitated within a reasonable period;
d. The Rehabilitation Plan or its amendment is approved by the court but in the implementation thereof, the debtor fails to perform its obligations thereunder, or there is a failure to realize the objectives, targets or goals set forth therein, including the timelines and conditions for the settlement of the obligations due to the creditors and other claimants;
e. The commission of fraud in securing the approval of the Rehabilitation Plan or its amendment; and
f. Other analogous circumstances as may be defined by the rules of procedure.[871]

What are the results of the termination of the rehabilitation proceedings?

Termination of the proceedings shall result in the following:

a. The discharge of the Rehabilitation Receiver, subject to his submission of a final accounting; and
b. The lifting of the Stay Order and any other court order holding in abeyance any action for the enforcement of a claim against the debtor.

[870]Section 69.
[871]Section 74.

Provided, however, that if the termination of proceedings is due to failure of rehabilitation or dismissal of the petition for reasons other than technical grounds, the proceedings shall be immediately converted to liquidation.[872]

2. Pre-negotiated rehabilitation

a. How initiated

Under what conditions may the Rehabilitation Court approve a pre-negotiated Rehabilitation Plan?

An insolvent debtor, by itself or jointly with any of its creditors, may file a verified petition with the court for the approval of a pre-negotiated Rehabilitation Plan which has been endorsed or approved by creditors holding at least two-thirds (2/3) of the total liabilities of the debtor, including secured creditors holding more than 50% of the total secured claims of the debtor and unsecured creditors holding more than 50% of the total unsecured claims of the debtor. The petition shall include, as a minimum:

a. a schedule of the debtor's debts and liabilities;
b. an inventory of the debtor's assets;
c. the pre-negotiated Rehabilitation Plan, including the names of at least three (3) qualified nominees for Rehabilitation Receiver; and
d. a summary of disputed claims against the debtor and a report on the provisioning of funds to account for appropriate payments should any such claims be ruled valid or their amounts adjusted.[873]

b. Period and effect of approval

What is the effect of the approval of the pre-negotiated Rehabilitation Plan?

The approval of a pre-negotiated Rehabilitation Plan shall have the same legal effect as confirmation of a Rehabilitation Plan in a voluntary rehabilitation proceedings.[874]

3. Out-of -Court or Informal Restructuring Agreement or Rehabilitation Plan

a. Minimum requirements

What are the requirements for an Out-of-Court or Informal restructuring agreement or Rehabilitation Plan?

a. The debtor must agree to the out-of-court or informal restructuring/workout agreement or Rehabilitation Plan;
b. It must be approved by creditors representing at least 67% of the secured obligations of the debtor;
c. It must be approved by creditors representing at least 75% of the unsecured obligations of the debtor; and
d. It must be approved by creditors holding at least 85% of the total liabilities, secured and unsecured, of the debtor.[875]

[872]Section 75.
[873]Section 76.

[874]Section 82.
[875]Section 84.

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It means that among the secured and unsecured creditors and total number of creditors, there is a threshold percentage of liabilities. The approval is based on the amount of liabilities and not based on number of creditors.

b. Standstill period

What is a standstill agreement?

It is an agreement by the debtor and the creditors providing for a standstill period pending negotiation and finalization of the out-of-court or informal restructuring agreement which is effective and enforceable not only against the contracting parties but also against other creditors. *Provided,* that such agreement is approved by creditors representing more than 50% of the total liabilities of the debtor; notice thereof is published in a newspaper of general circulation in the Philippines once a week for two consecutive weeks; and the standstill period does not exceed 120 days from the date of effectivity. The notice must invite creditors to participate in the negotiation for out-of-court rehabilitation or restructuring agreement and notify them that said agreement will be binding on all creditors if the required majority votes are met.[876]

What is the effect of duly approved informal or restructuring/workout agreement or Rehabilitation Plan?

A restructuring/workout agreement or Rehabilitation Plan that is approved pursuant to an informal workout framework referred to above shall have the same legal effect as confirmation of a Rehabilitation Plan in a court-supervised rehabilitation proceedings. The notice of the Rehabilitation Plan or restructuring agreement or Plan shall be published once a week for at least three (3) consecutive weeks in a newspaper of general circulation in the Philippines. The Rehabilitation Plan or restructuring agreement shall take effect upon the lapse of 15 days from the date of the last publication of the notice thereof.[877]

C. Cram down effect

What is the Cram-down clause of a Rehabilitation Plan?

This means that a Rehabilitation Plan may be approved by the Court even over the opposition of the creditors holding a majority of the corporation's total liabilities if there is a showing that rehabilitation is feasible and the opposition of the creditors is manifestly unreasonable. Also known as the "cram-down" clause, this provision, which is currently incorporated in the FRIA, is necessary to curb the majority creditors' natural tendency to dictate their own terms and conditions to the rehabilitation, absent due regard to the greater long-term benefit of all stakeholders. Otherwise stated, it forces the creditors to accept the terms and conditions of the Rehabilitation Plan, preferring long-term viability over immediate but incomplete recovery.[878]

Sarabia is a corporation engaged in the business of owning, leasing, managing and/or operating hotels. It obtained loans from Far East Bank and Trust Company (FEBTC) in order to finance the construction of a five (5)-storey hotel building (New Building) for the purpose of expanding its hotel business. The foregoing debts were secured by real estate mortgages over several parcels of land owned by Sarabia and a comprehensive surety agreement signed by its stockholders. By virtue of a merger, Bank of the Philippine Islands (BPI) assumed all of FEBTC's rights against Sarabia.

[876]Section 85.
[877]Section 86.
[878]Bank of the Philippine Islands v. Sarabia Manor Hotel Corporation, G.R. No. 175844, July 29, 2013.

Largely because of the delayed completion of the New Building, Sarabia incurred various cash flow problems. Thus, despite the fact that it had more assets than liabilities at that time, it, nevertheless, filed a Petition] for corporate rehabilitation.

After hearing, the RTC rendered judgment approving the Rehabilitation Plan which was affirmed by the Court of Appeals. BPI filed the petition with the Supreme Court. BPI mainly argues that the approved Rehabilitation Plan did not give due regard to its interests as a secured creditor in view of the imposition of a fixed interest rate of 6.75% p.a. and the extended loan repayment period.

May the Rehabilitation Plan be approved and implemented despite the objection of BPI?

Yes, based on the Rehabilitation Receiver's report, Sarabia has the financial capability to undergo rehabilitation; it has the ability to have sustainable profits over a long period of time and the interests of its creditors are well-protected. Therefore, based on the above-stated reasons, the Court finds Sarabia's rehabilitation to be feasible.

While the Rehabilitation Court shall consider certain incidents in determining whether the opposition is manifestly unreasonable, BPI neither proposes Sarabia's liquidation over its rehabilitation nor questions the controlling interest of Sarabia's shareholders or owners. It only takes exception to: (a) the imposition of the fixed interest rate of 6.75% p.a. as recommended by the Receiver and as approved by the courts *a quo*, proposing that the original escalating interest rates of 7%, 8%, 10%, 12%, and 14%, over 17 years be applied instead. It must be pointed out that oppositions which push for high interest rates are generally frowned upon in rehabilitation proceedings given that the inherent purpose of a rehabilitation is to find ways and means to minimize the expenses of the distressed corporation during the rehabilitation period. It is the objective of a rehabilitation proceeding to provide the best possible framework for the corporation to gradually regain or achieve a sustainable operating form. Hence, if a creditor, whose interests remain well-preserved under the existing Rehabilitation Plan, still declines to accept interests pegged at reasonable rates during the period of rehabilitation, and, in turn, proposes rates which are largely counter-productive to the rehabilitation, then it may be said that the creditor's opposition is manifestly unreasonable.

In this case, the Court finds BPI's opposition on the approved interest rate to be manifestly unreasonable considering that: (a) the 6.75% p.a. interest rate already constitutes a reasonable rate of interest which is concordant with Sarabia's projected rehabilitation; and (b) on the contrary, BPI's proposed escalating interest rates remain hinged on the theoretical assumption of future fluctuations in the market, this notwithstanding the fact that its interests as a secured creditor remain well-preserved.

In another case, the Court upheld a Rehabilitation Plan, including those terms which its creditors had found objectionable, namely, the 50% "haircut" reduction of the principal obligations and the condonation of accrued interests and penalty charges. There is nothing unreasonable or onerous about the 50% reduction of the principal amount when, as found by the court *a quo*, a Special Purpose Vehicle (SPV) acquired the credits of the debtor from its creditors at deep discounts of as much as 85%. Meaning, the debtor's creditors accepted only 15% of their credit's value. Stated otherwise, if the debtor's creditors are in a position to accept 15% of their credit's value, with more reason that they should be able to accept 50% thereof as full settlement by their debtor.[879]

[879]Puerto Azul Land v. Pacific Wide Realty Development Corporation, G.R. No. 184000, September 17, 2014.

While the voice and participation of the creditors is crucial in the determination of the viability of the Rehabilitation Plan, as they stand to benefit or suffer in the implementation thereof, the interest of all stakeholders is the ultimate and prime consideration.[880]

C. Liquidation

1. Voluntary liquidation vs. involuntary liquidation vs. conversion

Under what conditions may an insolvent juridical debtor file a petition for Voluntary Liquidation?

A juridical insolvent debtor may apply for liquidation by filing a Petition for Liquidation with the court. The petition shall be verified, shall establish the insolvency of the debtor and shall contain, whether as an attachment or as part of the body of the petition:

a. a schedule of the debtor's debts and liabilities including a list of creditors with their addresses, amounts of claims and collaterals, or securities, if any;
b. an inventory of all its assets including receivables and claims against third parties; and
c. the names of at least three (3) nominees to the position of liquidator.

At any time during the pendency of court-supervised or pre-negotiated rehabilitation proceedings, the debtor may also initiate liquidation proceedings by filing a motion in the same court where the rehabilitation proceedings are pending to convert the rehabilitation proceedings into liquidation proceedings. The motion shall be verified, shall contain or set forth the same matters required in the preceding paragraph, and state that the debtor is seeking immediate dissolution and termination of its corporate existence.

If the petition or the motion, as the case may be, is sufficient in form and substance, the court shall issue a Liquidation Order.[881]

Under what conditions may the creditors of a juridical insolvent debtor file a Petition for Involuntary Liquidation?

Three (3) or more creditors the aggregate of whose claims is at least either P1,000,000.00 or at least 25% of the subscribed capital stock or partner's contributions of the debtor, whichever is higher, may apply for and seek the liquidation of an insolvent debtor by filing a petition for liquidation of the debtor with the court. The petition shall show that:

a. there is no genuine issue of fact or law on the claim/s of the petitioner/s, and that the due and demandable payments thereon have not been made for at least 180 days or that the debtor has failed generally to meet its liabilities as they fall due; and
b. there is no substantial likelihood that the debtor may be rehabilitated.

At any time during the pendency of or after a Rehabilitation Court supervised or pre-negotiated rehabilitation proceedings, three (3) or more creditors whose claims is at least either P1,000,000.00 or at least 25% of the subscribed capital or partner's contributions of the debtor, whichever is higher, may also initiate liquidation proceedings by filing a motion in the same court where the rehabilitation proceedings are pending to convert the rehabilitation proceedings into liquidation proceedings. The motion shall be verified, shall contain or set forth the same matters required in the preceding paragraph, and state that the movants are seeking the immediate liquidation of the debtor.

[880] Marilyn Victorio-Aquino v. Pacific Plans, Inc. and Mamerto A. Marcelo, Jr. (Court-Appointed Rehabilitation Receiver of Pacific Plans, Inc.), G.R. No. 193108, December 10, 2014.
[881] Section 90.

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If the petition or motion is sufficient in form and substance, the court shall issue an Order:

a. directing the publication of the petition or motion in a newspaper of general circulation once a week for two (2) consecutive weeks; and
b. directing the debtor and all creditors who are not the petitioners to file their comment on the petition or motion within 15 days from the date of last publication.

If, after considering the comments filed, the court determines that the petition or motion is meritorious, it shall issue the Liquidation Order.[882]

Is the issuance of an order, declaring a petitioner in a Voluntary liquidation proceeding insolvent, mandatory upon the court?

Assuming that the petition was in due form and substance and that the assets of the petitioner are less than his liabilities, the court must adjudicate the insolvency.[883]

When may the court convert Rehabilitation proceedings to Liquidation proceedings?

During the pendency of court-supervised or pre-negotiated rehabilitation proceedings, the court may order the conversion of rehabilitation proceedings to liquidation proceedings pursuant to: (a) Section 25(c) of the Act; or (b) Section 72 of the Act; or (c) Section 75 of the Act; or (d) Section 90 of the Act; or at any other time upon the recommendation of the Rehabilitation Receiver that the rehabilitation of the debtor is not feasible. Thereupon, the court shall issue the Liquidation Order.[884]

Specifically, the court may convert the rehabilitation proceedings to liquidation proceedings in the following cases:

a. Within ten (10) days from receipt of the report of the Rehabilitation Receiver, the court may convert the proceedings into one for the liquidation of the debtor upon a finding that:
    i. the debtor is insolvent; and
    ii. there is no substantial likelihood for the debtor to be successfully rehabilitated as determined in accordance with the rules promulgated by the Supreme Court.[885]
b. If no Rehabilitation Plan is confirmed within a maximum period of one year from date of filing of the petition, the proceedings may, upon motion or *motu proprio*, be converted into one for the liquidation of the debtor.[886]
c. Termination of proceedings due to failure of rehabilitation or dismissal of the petition for reasons other than technical grounds, in which case the rehabilitation proceedings shall be immediately converted to liquidation.[887]
d. At any time during the pendency of court-supervised or pre-negotiated rehabilitation proceedings, the debtor may also initiate liquidation proceedings by filing a motion in the same court where the rehabilitation proceedings are pending to convert the rehabilitation proceedings into liquidation proceedings. The motion shall be verified, shall contain or set forth the same matters required in the preceding paragraph, and state that the debtor is seeking immediate dissolution and termination of its corporate existence.

[882]Section 91.
[883]BAR 1991.
[884]Section 92.
[885]Section 25.
[886]Section 72.
[887]Section 75.

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If the petition or the motion, as the case may be, is sufficient in form and substance, the court shall issue a Liquidation Order.

e. A any other time upon the recommendation of the Rehabilitation Receiver that the rehabilitation of the debtor is not feasible.

It was held that the remedy of rehabilitation should be denied to corporations whose insolvency appears to be irreversible and whose sole purpose is to delay the enforcement of any of the rights of the creditors, which is rendered obvious by: (a) the absence of a sound and workable business plan; (b) baseless and unexplained assumptions, targets, and goals; and (c) speculative capital infusion or complete lack thereof for the execution of the business plan.[888]

When may an individual debtor file a petition for Voluntary Liquidation?

An individual debtor whose properties are not sufficient to cover his liabilities, and owing debts exceeding P500,000.00, may apply to be discharged from his debts and liabilities by filing a verified petition with the court of the province or city in which he has resided for six (6) months prior to the filing of such petition. He shall attach to his petition a schedule of debts and liabilities and an inventory of assets. The filing of such petition shall be an act of insolvency.[889]

If the court finds the petition sufficient in form and substance, it shall, within five (5) working days, issue the Liquidation Order.[890]

A debtor who has been adjudged insolvent is given his discharge by the court after his properties have been applied to his debts. A year later, with those debts still not fully paid, he wins in the sweepstakes and comes into a large fortune. His creditors sue him for the balance.

Would the suit prosper? Reasons.

The suit will not prosper on debts that are properly discharged in insolvency. Those that are not discharged, assuming that a discharge can be obtained, include:

a. Taxes and assessments due the government, national or local;
b. Obligation arising from embezzlement or fraud;
c. Obligations of any person liable to the insolvent debtor for the same debt;
d. Alimony or claim for support;
e. In general, debts that are not provable against the estate of the insolvent or not listed in the schedule submitted by the insolvent debtor.[891]

When may a creditor or group of creditors file a Petition for Liquidation?

Any creditor or group of creditors with a claim of, or with claims aggregating, at least P500,000.00 may file a verified petition for liquidation with the court of the province or city in which the individual debtor resides.

The following shall be considered acts of insolvency, and the Petition for Liquidation shall set forth or allege at least one of such acts:

a. That such person is about to depart or has departed from the Republic of the Philippines, with intent to defraud his creditors;

[888] Philippine Asset Growth Two v. Fastech Synergy, *supra.*
[889] Section 103.
[890] Section 104.
[891] BAR 1988.

b. That being absent from the Republic of the Philippines, with intent to defraud his creditors, he remains absent;
c. That he conceals himself to avoid the service of legal process for the purpose of hindering or delaying the liquidation or of defrauding his creditors;
d. That he conceals, or is removing, any of his property to avoid its being attached or taken on legal process;
e. That he has suffered his property to remain under attachment or legal process for three (3) days for the purpose of hindering or delaying the liquidation or of defrauding his creditors;
f. That he has confessed or offered to allow judgment in favor of any creditor or claimant for the purpose of hindering or delaying the liquidation or of defrauding any creditor or claimant;
g. That he has willfully suffered judgment to be taken against him by default for the purpose of hindering or delaying the liquidation or of defrauding his creditors;
h. That he has suffered or procured his property to be taken on legal process with intent to give a preference to one or more of his creditors and thereby hinder or delay the liquidation or defraud any one of his creditors;
i. That he has made any assignment, gift, sale, conveyance or transfer of his estate, property, rights or credits with intent to hinder or delay the liquidation or defraud his creditors;
j. That he has, in contemplation of insolvency, made any payment, gift, grant, sale, conveyance or transfer of his estate, property, rights or credits;
k. That being a merchant or tradesman, he has generally defaulted in the payment of his current obligations for a period of 30 days;
l. That for a period of 30 days, he has failed, after demand, to pay any moneys deposited with him or received by him in a fiduciary capacity; and
m. That an execution having been issued against him on final judgment for money, he shall have been found to be without sufficient property subject to execution to satisfy the judgment.[892]

"X," owner of a general merchandise store, departed from the Philippines with intent to defraud her creditors and has remained absent from the country. While she has liabilities totaling P100,000, her assets, however, are worth P120,000.

May "X" be declared an insolvent? Reason.

Yes, X may be declared insolvent. Under FRIA, although the debtor has more than sufficient property to pay all his creditors, yet if she would commit any act of insolvency, she should be declared insolvent through a petition for involuntary liquidation. One of the acts of insolvency out of the 13 enumerated by the Insolvency Law, is: that being absent from the Philippines, with intent to defraud his/her creditors, he/she remains absent.

Juan opened a coffee shop using money borrowed from financial institutions. After three (3) months, Juan left for the USA with the intent of defrauding his creditors. While his liabilities are P1.2 M, his assets, however are worth P1.5 M. May Juan be declared insolvent?

No. Juan may not be declared insolvent if he was the one who filed the Petition for Liquidation because his assets worth P1.5 M are more than his liabilities worth P1.2 M. However, his creditors may file a petition for involuntary liquidation since he committed an act of insolvency.[893]

2. Procedure

[892] Section 105.
[893] BAR 1998.

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a. Liquidation Order; effects

What are the contents of a Liquidation Order?

The Liquidation Order shall:

a. declare the debtor insolvent;
b. order the liquidation of the debtor and, in the case of a juridical debtor, declare it as dissolved;
c. order the sheriff to take possession and control of all the property of the debtor, except those that may be exempt from execution;
d. order the publication of the petition or motion in a newspaper of general circulation once a week for two (2) consecutive weeks;
e. direct payments of any claims and conveyance of any property due the debtor to the liquidator;
f. prohibit payments by the debtor and the transfer of any property by the debtor;
g. direct all creditors to file their claims with the liquidator within the period set by the rules of procedure;
h. authorize the payment of administrative expenses as they become due;
i. state that the debtor and creditors who are not petitioner/s may submit the names of other nominees to the position of liquidator; and
j. set the case for hearing for the election and appointment of the liquidator, which date shall not be less than 30 days nor more than 45 days from the date of the last publication.[894]

What are the effects of the issuance of the Liquidation Order?

Upon the issuance of the Liquidation Order:

a. the juridical debtor shall be deemed dissolved and its corporate or juridical existence terminated;
b. legal title to and control of all the assets of the debtor, except those that may be exempt from execution, shall be deemed vested in the liquidator or, pending his election or appointment, with the court;
c. all contracts of the debtor shall be deemed terminated and/or breached, unless the liquidator, within 90 days from the date of his assumption of office, declares otherwise and the contracting party agrees;
d. no separate action for the collection of an unsecured claim shall be allowed. Such actions already pending will be transferred to the Liquidator for him to accept and settle or contest. If the liquidator contests or disputes the claim, the court shall allow, hear and resolve such contest except when the case is already on appeal. In such a case, the suit may proceed to judgment, and any final and executory judgment therein for a claim against the debtor shall be filed and allowed in court; and
e. no foreclosure proceeding shall be allowed for a period of 180 days.[895]

Does a Liquidation Order affect the right of a secured creditor?

The Liquidation Order shall not affect the right of a secured creditor to enforce his lien in accordance with the applicable contract or law. A secured creditor may:

[894]Section 112.
[895]Section 113.

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a. waive his rights under the security or lien, prove his claim in the liquidation proceedings and share in the distribution of the assets of the debtor; or
b. maintain his rights under his security or lien.

If the secured creditor maintains his rights under the security or lien:

a. the value of the property may be fixed in a manner agreed upon by the creditor and the liquidator. When the value of the property is less than the claim it secures, the liquidator may convey the property to the secured creditor and the latter will be admitted in the liquidation proceedings as a creditor for the balance; if its value exceeds the claim secured, the liquidator may convey the property to the creditor and waive the debtor's right of redemption upon receiving the excess from the creditor;
b. the liquidator may sell the property and satisfy the secured creditor's entire claim from the proceeds of the sale; or
c. the secured creditor may enforce the lien or foreclose on the property pursuant to applicable laws.[896]

It is worth mentioning that under FRIA, the right of a secured creditor to enforce his lien during liquidation proceedings is retained. A secured creditor, however, is subject to the temporary stay of foreclosure proceedings for a period of 180 days, upon the issuance by the court of the Liquidation Order.[897]

The creditor-mortgagee may exercise his right to foreclose the mortgage upon the termination of the rehabilitation proceedings or upon the lifting of the stay order.[898]

It was also held that in the event that the rehabilitation is no longer feasible and claims against the distressed corporation would have to be settled, the secured creditors shall enjoy preference over unsecured creditors subject only to the provisions of the Civil Code on concurrence and preference of credit.[899]

Distinguish the remedies of the secured creditors in Rehabilitation proceedings, Suspension of Payments and Liquidation proceedings.

In Rehabilitation, the Stay Order suspends enforcement of the mortgage lien until termination of the Rehabilitation proceedings. The order of the court in Suspension of Payments does not cover secured creditors while in liquidation, the secured creditor can only enforce his lien after 180 days from issuance of the Liquidation Order.

3.Determination of claims

How does the Liquidator determine the claims against the insolvent debtor?

Within 20 days from his assumption into office, the liquidator shall prepare a preliminary registry of claims of secured and unsecured creditors. Secured creditors who have waived their security or lien, or have fixed the value of the property subject of their security or lien by agreement with the Liquidator and is admitted as a creditor for the balance, shall be considered as unsecured creditors. The Liquidator shall make the registry available for public inspection and provide publication notice to creditors, individual debtors, owner/s of the sole proprietorship-debtor, the partners of the partnership-debtor

[896]Section 114.
[897]Metropolitan Bank and Trust Company v. S.F. Naguiat Enterprises, G.R. No. 178407, March 18, 2015.
[898]Yngson, Jr. (in his capacity as Liquidator of Arcam & Company, Inc.) v. Philippine National Bank, G.R. No. 171132, August 15, 2012.
[899]RCBC v. IAC, 320 SCRA 279.

and shareholders or members of the corporation-debtor, on where and when they may inspect it. All claims must be duly proven before being paid.[900]

Within 30 days from the expiration of the period for filing of applications for recognition of claims, creditors, individual debtors, owner/s of the sole proprietorship-debtor, partners of the partnership-debtor and shareholders or members of the corporation-debtor and other interested parties may submit a challenge to a claim or claims to the court, serving a certified copy on the liquidator and the creditor holding the challenged claim. Upon the expiration of the 30-day period, the Rehabilitation Receiver shall submit to the court the registry of claims containing the undisputed claims that have not been subject to challenge. Such claims shall become final upon the filing of the register and may be subsequently set aside only on grounds of fraud, accident, mistake or inexcusable neglect.[901]

If the debtor and a creditor are mutually debtor and creditor of each other, one debt shall be set off against the other, and only the balance, if any, shall be allowed in the liquidation proceedings.[902]

The Liquidator shall resolve disputed claims and submit his findings thereon to the court for final approval. The liquidator may disallow claims.[903]

What will guide the Liquidator in settling the claims against the insolvent debtor?

Within three (3) months from his assumption into office, the Liquidator shall submit a Liquidation Plan to the court. The Liquidation Plan shall, as a minimum, enumerate all the assets of the debtor, all the claims against the debtor and a schedule of liquidation of the assets and payment of the claims.[904]

The Liquidator shall implement the Liquidation Plan as approved by the court. Payments shall be made to the creditors only in accordance with the provisions of the Plan.[905]

The Liquidation Plan and its implementation shall ensure that the concurrence and preference of credits as enumerated in the Civil Code of the Philippines and other relevant laws shall be observed, unless a preferred creditor voluntarily waives his preferred right. For purposes of this chapter, credits for services rendered by employees or laborers to the debtor shall enjoy first preference under Article 2244 of the Civil Code, unless the claims constitute legal liens under Articles 2241 and 2242 thereof.[906]

D. Suspension of Payments; suspension of payment order

What order will the court issue if it finds the petition for suspension of payments to be sufficient in form and substance?

If the court finds the petition sufficient in form and substance, it shall, within five (5) working days from the filing of the petition, issue an Order:

[900]Section 123.
[901]Section 125.
[902]Section 124.
[903]Section 126.
[904]Section 129.
[905]Section 132.
[906]Section 133.

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a. calling a meeting of all the creditors named in the schedule of debts and liabilities at such time not less than 15 days nor more than 40 days from the date of such Order and designating the date, time and place of the meeting;
b. directing such creditors to prepare and present written evidence of their claims before the scheduled creditors' meeting;
c. directing the publication of the said order in a newspaper of general circulation published in the province or city in which the petition is filed once a week for two (2) consecutive weeks, with the first publication to be made within seven (7) days from the time of the issuance of the Order;
d. directing the clerk of court to cause the sending of a copy of the Order by registered mail, postage prepaid, to all creditors named in the schedule of debts and liabilities;
e. forbidding the individual debtor from selling, transferring, encumbering or disposing in any manner of his property, except those used in the ordinary operations of commerce, or of industry in which the petitioning individual debtor is engaged, so long as the proceedings relative to the suspension of payments are pending;
f. prohibiting the individual debtor from making any payment outside of the necessary or legitimate expenses of his business or industry, so long as the proceedings relative to the suspension of payments are pending; and
g. appointing a commissioner to preside over the creditors' meeting.[907]

May the court suspend any pending execution against the debtor who filed the petition?

Upon motion filed by the individual debtor, the court may issue an order suspending any pending execution against the individual debtor: *provided,* that properties held as security by secured creditors shall not be the subject of such suspension order. The suspension order shall lapse when three (3) months shall have passed without the proposed agreement being accepted by the creditors or as soon as such agreement is denied[908].

What is the effect of the filing of the petition for suspension of payments?

No creditor shall sue or institute proceedings to collect his claim from the debtor from the time of the filing of the petition for suspension of payments and for as long as proceedings remain pending except: (a) those creditors having claims for personal labor, maintenance, expense of last illness and funeral of the wife or children of the debtor incurred in the 60 days immediately prior to the filing of the petition; and (b) secured creditors.[909]

In other words, the mere filing of a petition for suspension of payments suspends the enforcement of claims against the individual debtor except the excluded claims above-mentioned.

What are the conditions for the approval of the petition for suspension of payments?

The presence of creditors holding claims amounting to at least three-fifths (3/5) of the liabilities shall be necessary for holding a meeting. The commissioner appointed by the court shall preside over the meeting and the clerk of court shall act as the secretary thereof, subject to the following rules:

a. The clerk shall record the creditors present and amount of their respective claims;
b. The commissioner shall examine the written evidence of the claims. If the creditors present hold at least three-fifths (3/5) of the liabilities of the individual debtor, the commissioner shall declare the meeting open for business;

[907]Section 95.
[908]Section 96.
[909]Section 96.

c. The creditors and individual debtor shall discuss the propositions in the proposed agreement and put them to a vote;
d. To form a majority, it is necessary:
    i. that two-thirds (2/3) of the creditors voting unite upon the same proposition; and
    ii. that the claims represented by said majority vote amount to at least three-fifths (3/5) of the total liabilities of the debtor mentioned in the petition; and
e. After the result of the voting has been announced, all protests made against the majority vote shall be drawn up, and the commissioner and the individual debtor together with all creditors taking part in the voting shall sign the affirmed propositions.
    No creditor who incurred his credit within 90 days prior to the filing of the petition shall be entitled to vote.[910]

What is the double majority rule in petition for suspension of payments?

It means that the proposed agreement for suspension of payments should be approved by 2/3 of number of creditors and such number of creditors must represent at least 3/5 of total liabilities. Otherwise, the court should deny the petition.

ABC Corporation has outstanding money obligations to six (6) creditors, namely A, B, C, D, E, and F, in the aggregate amount of P250 million. The amount due to A, B, and C collectively is P150 million. In the creditors meeting, the three (3) agreed to the petition but not the remaining creditors. Should the court approve the petition for suspension of payments?

No, the petition cannot be approved by the court because while A, B, and C are representing at least 3/5 of total liabilities, they do not represent at least 2/3 of total number of creditors.

What are the effects of the approval of the proposed Suspension of Payments agreement?

If the decision of the majority of the creditors to approve the proposed agreement or any amendment thereof made during the creditors' meeting is upheld by the court, or when no opposition or objection to said decision has been presented, the court shall order that the agreement be carried out and all parties bound thereby to comply with its terms.

The court may also issue all orders which may be necessary or proper to enforce the agreement on motion of any affected party. The Order confirming the approval of the proposed agreement on any amendment thereof made during the creditors' meeting shall be binding upon all creditors whose claims are included in the schedule of debts and liabilities submitted by the individual debtor and who were properly summoned, but not upon: (a) those creditors having claims for personal labor, maintenance, expenses of last illness and funeral of the wife or children of the debtor incurred in the 60 days immediately prior to the filing of the petition, and (b) secured creditors who failed to attend the meeting o[r] refrained from voting therein.[911]

What claims are not covered by the filing of the petition for suspension of payments and/or the court order approving the petition for suspension of payments?

a. Those whose claims are not included in the schedule of debts and liabilities submitted by the individual debtor to the court;

[910]Section 97.
[911]Section 101.

b. Those creditors having claims for personal labor, maintenance, expenses of last illness and funeral of the wife or children of the debtor incurred in the 60 days immediately prior to the filing of the petition; and,
c. Secured creditors. (like mortgagee of real property and holders of security interest on personal property)

When is the proposed agreement deemed rejected?

The proposed agreement shall be deemed rejected if the number of creditors required for holding a meeting do not attend thereat, or if the two (2) majorities mentioned in Section 97 hereof are not in favor thereof. In such instances, the proceeding shall be terminated without recourse and the parties concerned shall be at liberty to enforce the rights which may correspond to them.[912]

When may the creditors enforce their claims against the debtor who filed the petition for suspension of payment?

The creditors may enforce their claims against the debtor in the following cases:

a. If the proposed agreement is rejected for lack of quorum or failure to obtain the approval of the double majorities required by law.
b. If the individual debtor fails, wholly or in part, to perform the agreement decided upon at the meeting of the creditors, all the rights which the creditors had against the individual debtor before the agreement shall revest in them.[913] In this particular case, the individual debtor may be made subject to the insolvency proceedings in the manner established by FRIA.
c. If their claims are those not covered by the rules on suspension of payments.

Hortencio owned a modest grocery business in Laguna. Because of the economic downturn, he incurred huge financial liabilities. He remained afloat only because of the properties inherited from his parents who had both come from landed families in Laguna. His main creditor was Puresilver Company (Puresilver), the principal supplier of the merchandise sold in his store. To secure his credit with Puresilver, he executed a real estate mortgage with a dragnet clause involving his family's assets worth several millions of pesos.

Nonetheless, Hortencio, while generally in the black, now faces a situation where he is unable to pay his liabilities as they fall due in the ordinary course of business.

What will you advise him to do to resolve his dire financial condition? Explain your answer.

If Hortencio is doing business as a registered sole proprietorship, he can file a petition for rehabilitation. Under the FRIA, a sole proprietorship can now file a petition for rehabilitation. The remedy may be availed of in case of actual or technical insolvency. In the petition, he can pray for the issuance of a commencement order which includes a stay order. The stay order, once issued, has the effect of enjoining the enforcement of claims against Hortencio.

If Hortencio is not registered as a sole proprietorship, he can file a petition for suspension of payments in the city or province in which he has resided for six (6) months prior to the filing of the petition, a remedy available for an individual debtor who has more assets than liabilities but foresees the impossibility of paying his debts when they respectively fall due.[914]

[912]Section 99.
[913]Section 102.
[914]Section 94 of FRIA.

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What are the procedural remedies under FRIA?

a. Decisions of the Regional Trial Court on rehabilitation are immediately executory and shall be appealable to the Court of Appeals through a petition for review under Rule 43 of the Rules of Court.[915] Motion for reconsideration of the decision is not allowed.
b. A party may file a motion for reconsideration of a suspension of payment order or any order issued by the court prior to its order confirming or disapproving the proposed agreement to suspend payment, as well as any order of issued by the court prior to the issuance of the liquidation order.[916]
   No relief can be extended to the party aggrieved by the court's order on the motion through a special civil action for *certiorari* under Rule 65 of the Rules of Court.[917]
c. The court's dismissal of the Petition for Suspension of Payments on the ground of insufficiency in form and substance resulting in the non-issuance of the Suspension Order and its order confirming or disapproving the proposed suspension of payment agreement, as well as the Liquidation Order and the order approving or disapproving the liquidation plan can only be reviewed through a petition for *certiorari* to the Court of Appeals under Rule 65 of the Rules of Court within 15 days from notice of the decision or order.[918]

Thank you for listening/reading. You are now ready for the Bar Exams in Commercial Law. Congratulations in advance. God bless you.

[915]Marilyn Victorio-Aquino v. Pacific Plans, *supra*.
[916]Sections 1 and 3 of Rule 5 of the FRIA Implementing Rules (A.M. No. 15-04-06-SC).
[917]*Ibid.*
[918]Sections 2 and 4, Rule 5.