

TITLE VI

SALES

Chapter 1

NATURE AND FORM OF THE CONTRACT

Article 1458. By the contract of sale one of the contracting parties obligates himself to transfer the ownership of and to deliver a determinate thing, and the other to pay therefor a price certain in money or its equivalent.

A contract of sale may be absolute or conditional.

COMMENT:

(1) 'Sale' Defined

Sale is a contract where one party (seller or vendor) obligates himself to *transfer the ownership of* and to *deliver a determinate thing*, while the other party (buyer or vendee) obligates himself to *pay for said thing a price certain in money or its equivalent*. (See Art. 1458, Civil Code).

(2) Historical Notes

Under Roman Law, a sale was termed *avenditio*. Today, the French refer to the contract as *a venta*, while the Spaniards call it *a venta*. The definition of the contract of sale in Art. 1458 is taken from Art. 1445 of the Spanish Civil Code, except that under said Spanish Code, the obligation of the vendor was merely to "deliver" the thing sold, so that even if the seller was *not* the owner, he might still validly sell, subject to the warranty to maintain the buyer in the legal and peaceful possession of the thing sold. The Civil Code requires

not only delivery but also the transfer of the ownership of the thing sold. (*Report of the Code Commission, p. 141*). However, the vendor need not be the owner at the time the sale is perfected. It is sufficient that he is the owner at the time the thing sold is delivered. (*See Art. 1459, Civil Code*).

Query: Suppose Art. 1458 did *not* specify that the seller must transfer the ownership of the object, does he still have this obligation?

Answer: Yes, for after all, this transfer of ownership is clearly the fundamental aim of the contract. A buyer is not interested in a mere physical transfer: he is after ownership. (*See 3 Castan 12-13*).

(3) Essential Characteristics of the Contract of Sale

- (a) *Consensual* (as distinguished from *real*), because the contract is perfected by mere consent.

(NOTE: A real contract is one perfected by delivery, *e.g.*, the contract of deposit or *commodatum*.)

- (b) *Bilateral reciprocal*, because both parties are bound by obligations dependent upon each other.
- (c) *Onerous*, because to acquire the rights, valuable consideration must be given.
- (d) *Commutative*, as a rule, because the values exchanged are almost equivalent to each other.

(NOTE: By way of *exception*, some contracts of sale are aleatory, *i.e.*, what one receives may in time be greater or smaller than what he has given. *Example:* The sale of a genuine sweepstakes ticket.)

- (e) *Principal* (as distinguished from an *accessory* contract), because for the contract of sale to validly exist, there is no necessity for it to depend upon the existence of another valid contract. (Examples of accessory contracts are those of pledge and mortgage.)
- (f) *Nominate* (as distinguished from an innominate contract) because the Code refers to it by a special designation or name, *i.e.*, the contract of *sale*.

(4) Elements of the Contract of Sale

- (a) *Essential* elements (those without which there can be no valid sale):
- 1) *Consent or meeting of the minds, i.e.*, consent to transfer ownership in exchange for the price.
 - 2) *Determinate subject matter* (generally, there is no sale of generic thing; moreover, if the parties differ as to the object, there can be no meeting of the minds).
 - 3) *Price certain in money or its equivalent* (this is the cause or consideration). (The price need not be in money.) (*Republic v. Phil. Resources Dev. Corp., L-10414, Jan. 31, 1958*).

Aguinaldo v. Esteban
GR 27289, Apr. 15, 1985

A contract of sale of property, without consideration, and executed by a person who is of low intelligence, illiterate, and who could not sign his name or affix his thumbmark, is void.

Leabres v. CA
GR 41837, Dec. 12, 1986

A receipt which merely acknowledges the sum of P1,000, without any agreement as to the total purchase price of the land supposedly purchased, nor to the monthly installment to be paid by the buyer lacks the requisites of a valid contract sale, namely: (a) consent or meeting of the minds of the parties; (b) determinate subject matter; (c) price certain in money or its equivalent, and, therefore, the "sale" is not valid nor enforceable.

- (b) *Natural* elements (those which are inherent in the contract, and which in the absence of any contrary provision, are deemed to exist in the contract).

- 1) warranty against *eviction* (deprivation of the property bought)
- 2) warranty against *hidden defects*
- (c) *Accidental* elements (those which may be present or absent in the stipulation, such as the *place* or *time* of payment, or the presence of conditions).

(5) Stages in the Contract of Sale

- (a) generation or negotiation
- (b) perfection — meeting of the minds
- (c) consummation — when the object is delivered and the price is paid

(6) Kinds of Sales

- (a) As to the nature of the subject matter:
 - 1) sale of real property
 - 2) sale of personal property
- (b) As to the value of the things exchanged:
 - 1) commutative sale
 - 2) aleatory sale
- (c) As to whether the object is tangible or intangible:
 - 1) sale of property (tangible or corporeal)
 - 2) sale of a right (*assignment of a right* or a credit, or some other intangibles such as a copyright, a trademark, or goodwill)

(NOTE: If the object is tangible, it is called a *chose in possession*; if the object is intangible, as the case of a *right*, it is a *chose in action*.)

[NOTE: The term “goods” as used in the Uniform Sales Act does not ordinarily include *choses in action* (*things in action*). Neither does the term include *money*. (See *Comment of the Code Commission*).]

[**NOTE:** There can be a sale of “foreign exchange,” and sale is *consummated* upon payment to the creditor by the bank concerned of the amount in foreign currency authorized to be paid under the letter of credit. The *exchange tax* is, therefore, determined as of the date of such payment or delivery. (*Marsman and Co., Inc. v. Central Bank, et al.*, L-13945, May 31, 1960). However, the sale of said foreign exchange is *perfected* as of the moment the Bangko Sentral authorizes the purchase, even if the foreign bank has *not* yet honored the letter of credit. The margin fee — at the time this was still enforced — accrues as of this moment of perfection. (*Pacific Oxygen and Acetylene Co. v. Central Bank*, L-21881, Mar. 1, 1968, cited in the comments under Art. 1475).]

- (d) As to the validity or defect of the transaction:
 - 1) valid sale
 - 2) rescissible sale
 - 3) voidable sale
 - 4) unenforceable sale
 - 5) void sale
- (e) As to the legality of the object:
 - 1) sale of a *licit* object
 - 2) sale of an *illicit* object
- (f) As to the presence or absence of conditions:
 - 1) absolute sale (no condition)
 - 2) conditional sale (as when there is a sale with a *pacto de retro*, a right to repurchase or redeem; or when there are suspensive conditions, or when the things sold merely possess a potential existence, such as the sale of the *future harvest* of a designated parcel of land; or when, for example, all the personal properties in an army depot would be sold “except all combat materials” that may be found therein.

Such a stipulation is necessarily valid and, therefore, such combat materials should be *excluded* from sale. (*Celestino v. Aud. Gen.*, L-12183, May 29, 1959).

People's Homesite v. Court of Appeals
L-61623, Dec. 26, 1984

If subdivision lot is sold to a buyer on condition that higher authorities would approve the same, there is as yet no perfected sale.

Zambales v. Court of Appeals
GR 54070, Feb. 28, 1983

If during the 5-year period when a homestead cannot be sold, it is promised to be sold (in a compromise agreement), will this promise be regarded as valid?

HELD: The promise will be void even if the sale is actually made after the 5-year period, and even if the Minister (now Secretary) of Agriculture approves the same after the lapse of said 5-year period.

Almendra v. IAC
GR 76111, Nov. 21, 1991

FACTS: Petitioners contend principally that the appellate court erred in having sanctioned the sale of particular portions of yet undivided real properties.

HELD: While petitioners' contention is basically correct, there is, however, no valid, legal and convincing reason for nullifying the questioned deeds of sale. Petitioner had not presented any strong proof to override the evidentiary value of the duly notarized deed of sale. Moreover, the testimony of the lawyer who notarized the deeds of sale that he saw not only Aleja (the mother) signing and affixing her thumbmark on the questioned deeds but also Angeles (one of the children) and Aleja "counting

the money between them,” deserves more credence that the self-serving allegations of the petitioners. Such testimony is admissible as evidence without further proof of the due execution of the deeds in question and is conclusive as to the truthfulness of their contents in the absence of clear and convincing evidence to the contrary. The petitioners’ allegation that the deeds of sale were obtained thru fraud, undue influence and misrepresentation and that there was a defect in the consent of Aleja in the execution of the documents because she was then residing with Angeles, had not been fully substantiated. They failed to show that the uniform price of P2,000 in all the sales was grossly inadequate. The sales were effected between a mother and two of her children in which case filial more must be taken into account. The unquestionability of the due execution of the deeds of sale notwithstanding, the Court may not put an imprimatur on the intrinsic validity of all the cases. The Aug. 10, 1973 sale to Angeles of one-half portion of the conjugal property may only be considered valid as a sale of Aleja’s one-half interest therein. Aleja could not have sold the particular hilly portion specified in the deed of sale in the absence of proof that the conjugal partnership property had been partitioned after the death of Santiago (the husband of Aleja). Before such partition, Aleja could not claim title to any definite portion of the property for all she had was an ideal or abstract quota or proportionate share in the entire property. The sale of the one-half portion of land covered by Tax Declaration 27190 is valid because said property is paraphernal. As regards the sale of property covered by Tax Declaration 115009, Aleja could not have intended the sale of the whole property, since said property had been subdivided. She could exercise her right of ownership only over Lot 6366 which was unconditionally adjudicated to her in said case. Lot 6325 was given to Aleja subject to whatever may be the rights of her son Magdaleno Ceno. The sale is subject to the

condition stated above. Hence, the rights of Ceno are amply protected. The rule on *caveat emptor* applies.

**Sps. Vivencio Babasa and Elena Cantos
Babasa v. CA, et al.
GR 124045, May 21, 1993**

A deed of sale is absolute in nature although denominated a “conditional sale” absent such stipulations. In such cases, ownership of the thing sold passes to the vendee upon the constructive or actual delivery thereof.

**Heirs of Romana Ingjughtiro, et al. v.
Spouses Leon V. Casals & Lilia
C. Casals, et al.
GR 134718, Aug. 20, 2001**

It is essential that the vendors be the owners of the property sold, otherwise they cannot dispose that which does not belong to them. *Nemo dat quod non habet* (“No one can give more than what he has”).

- (g) As to whether wholesale or retail:
 - 1) *Wholesale*, if to be resold for a profit the goods being unaltered when resold, the quantity being large.
 - 2) *Retail*, if otherwise (also if sold to tailors). (*Sy Kiong v. Sarmiento, L-2934, Nov. 29, 1951*).
- (h) As to the proximate inducement for the sale:
 - 1) sale by description
 - 2) sale by sample
 - 3) sale by description and sample (*Art. 1481, Civil Code*).
- (i) As to when the price is tendered:
 - 1) cash sale
 - 2) sale on the installment plan

Ortigas and Co. v. Herrera
GR 36098, Jan. 21, 1983

If a lot owner in a subdivision sues for a refund of a certain sum for having complied with *certain conditions* imposed upon him, the action is one for specific performance incapable of pecuniary estimation (and, therefore, within the jurisdiction of the Regional Trial Court). The suit cannot be regarded as merely one for a sum of money. If no conditions had been imposed, the action would have been merely for a sum of money and, therefore, capable of pecuniary estimation, there being no specific fact or fulfillment of a condition to be proved.

(7) ‘Sale’ Distinguished from ‘Dation in Payment’ (*Adjudicacion en Pago, or Dacion en Pago or Dacion en Solutum*)

<i>SALE</i>	<i>DATION IN PAYMENT</i>
1. There is no pre-existing credit.	1. There is a pre-existing credit.
2. Gives rise to obligations.	2. Extinguishes obligations.
3. The cause or consideration here is the price, from the viewpoint of the seller; or the obtaining of the object, from the viewpoint of the buyer.	3. The cause or consideration here, from the viewpoint of the person offering the dation in payment, is the extinguishing of his debt; from the viewpoint of the creditor, it is the acquisition of the object offered in lieu of the original credit.
4. There is greater freedom in the determination of the price.	4. There is less freedom in determining the price.
5. The giving of the price may generally end the obligation of the buyer.	5. The giving of the object in lieu of the credit may extinguish <i>completely</i> or <i>partially</i> the credit (depending on the agreement).

(**NOTE:** Example of *dacion en pago*: I owe Maria P1 million. But I ask her if she is willing to accept my solid gold Rolex watch, instead of the money. If Maria agrees, my debt will be extinguished. Please observe that in this example, although what has happened is a *dation in payment*, it is as if I sold my watch for P1 million. Hence, we have to distinguish between the two kinds of transactions.)

(8) Bar Question

A has sold a baby grand piano to B, by private instrument for P500,000. In that contract of sale, which is the object, and which is the cause?

ANS.: There are at least two viewpoints here, the latter of which appears preferable. *First view* — The object (subject matter) of the sale is the piano, while the cause (consideration) is P500,000 (or, as one authority puts it, the giving of the P500,000, at least insofar as the seller A is concerned).

Insofar as the buyer B is concerned, the object is the P500,000, while the cause (the consideration for which he parted with his money) is the piano (or, as the same authority puts it, the giving of the piano).

Second view — Insofar as both the seller and the buyer are concerned, there is only one subject matter, namely, the piano. The cause or consideration for the seller is the *price paid*; for the buyer, it is the delivery to him of the piano.

(9) ‘Contract of Sale’ Distinguished from ‘Contract to Sell’

- (a) In a Contract of Sale, the non-payment of price is a *resolutory* condition, *i.e.*, the contract of sale may by such occurrence put an end to a transaction that once upon a time existed; in a Contract to Sell, the payment in full of the price is a positive *suspensive* condition. Hence, if the price is not paid, it is as if the obligation of the seller to deliver and to transfer ownership never became effective and binding.
- (b) In the *first*, title over the property generally passes to the buyer upon delivery; in the *second*, ownership is

retained by the seller, regardless of delivery and is not to pass until full payment of the price.

- (c) In the *first*, after delivery has been made, the seller has lost ownership and cannot recover it unless the contract is resolved or rescinded; in the *second*, since the seller retains ownership, despite delivery, he is enforcing and not rescinding the contract if he seeks to oust the buyer for failure to pay. (See *Santos v. Santos*, C.A. 47 O.G. 6372 and *Manuel v. Rodriguez*, L-13435, Jul. 27, 1960).

(10) ‘Sale’ Distinguished from ‘Assignment of Property in Favor of Creditors’ (Cession or Cesion de Bienes)

Sale differs from *cession* in much the same way as sale, differs from dation in payment. Moreover, in cession the assignee (creditor) does not acquire ownership over the things assigned, but only the *right to sell said things*. From the proceeds of such sale, the creditors are to be paid what is due them.

(NOTE: The concept of *cession* is found in Art. 1255 of the Civil Code, which provides that “the debtor may cede or assign his property to his creditors in payment of his debts. This cession, unless there is a stipulation to the contrary, shall only release the debtor from responsibility of the net proceeds of the thing assigned. The agreements which, on the effect of the cession, are made between the debtor and his creditors shall be governed by special laws.”)

[NOTE: Manresa defines *cession* as that which “consists in the abandonment of all the property of the debtor for the benefit of his creditors in order that the latter may apply the proceeds thereof to the satisfaction of their credits.” (8 *Manresa* 321).]

[NOTE: *Dation in payment* distinguished from *Cession*.]

<i>DATION IN PAYMENT</i>	<i>CESSION</i>
(1) One creditor is sufficient.	(1) There must be two or more creditors.

(2) Not all properties of the debtor are conveyed.	(2) All the debtor's properties are conveyed.
(3) Debtor may be <i>solvent</i> or <i>insolvent</i> .	(3) Cession takes place only if the debtor is insolvent.
(4) The creditor becomes the owner of the thing conveyed.	(4) The creditors do not become owners of the thing conveyed.

(11) 'Sale' Distinguished from a 'Loan'

In a loan, the amount is substantially smaller than the value of the security given. (*Facundo, et al., CA-GR 833-R, Nov. 13, 1947*). If a person, however, borrows a sum of money, and with it purchases *in his own name* a car, said purchaser would really be considered the *buyer*, and not the person who lent the money to him. (*Collector of Int. Rev. v. Favis, L-11651, May 30, 1960*).

(12) 'Sale' Distinguished from 'Lease'

In a sale, the seller transfers *ownership*; in a lease, the lessor or landlord transfers merely the temporary possession and use of the property.

(13) Kinds of Extrajudicial Foreclosure Sale

These are:

1. an *ordinary execution sale* is governed by the pertinent provisions of Rule 39 of the Rules of Court;
2. a *judicial foreclosure sale* is governed by Rule 68 of the Rules of Court;
3. an *extrajudicial foreclosure sale* is governed by Act 3135, as amended by Act 4118, otherwise known as "An Act to Regulate the Sale of Property Under Special Powers Inserted In or Annexed to Real Estate Mortgages."

A different set of law applies to each class of sale aforementioned. (*DBP v. CA & Emerald Resort Hotel Corp., GR 125838, Jun. 10, 2003*).

Art. 1459. The thing must be licit and the vendor must have a right to transfer the ownership thereof at the time it is delivered.

COMMENT:

(1) Lawfulness of the Object and Right to Transfer Ownership

Two rules are given here:

- (a) The object must be LICIT.
- (b) The vendor must have the RIGHT to transfer OWNERSHIP at the time the object is *delivered*.

(2) Licit Object

- (a) The word *licit* means *lawful*, i.e., within the commerce of man.
- (b) Things may be *illicit*:
 - 1) *per se* (of its nature)

Example: Sale of human flesh for human pleasure.
 - 2) *per accidens* (made illegal by provision of the law)

Examples: Sale of land to an alien after the effective date of the Constitution; sale of illegal lottery tickets.
- (c) If the object of the sale is illicit, the contract is *null and void* (Art. 1409), and *cannot*, therefore, be ratified.
- (d) The right of redemption may be sold. (*Lichauco v. Olegario & Olegario*, 43 Phil. 540). So also may literary, artistic, and scientific works. (10 *Manresa* 38). A usufruct may also be sold. (10 *Manresa* 25).

**Artates and Pojas v. Urbi, et al.
L-29421, Jan. 30, 1971**

FACTS: A homestead patent was issued to a married couple (Lino Artates and Manuela Pojas) *Sept. 23,*

1952. Because of a crime (physical injuries) Artates had committed and for which he was found guilty (Mar. 14, 1956), the homestead was SOLD at a public auction to satisfy Artates' civil liability. Note that the sale was made *less than four years* after the acquisition by the couple of the land. Now then, under Sec. 118 of the Public Land Law (Com. Act 141), such homestead, generally *cannot* be sold, *cannot* be encumbered, and *cannot* be held liable for the satisfaction "of any debt CONTRACTED" prior to the expiration of the period of *five years* from and after the date of the issuance of the patent or grant. *Issue:* Is the sale valid?

HELD: No, the sale is NOT VALID, for the following reasons:

- (a) the provision applies both to *voluntary* sales and *involuntary* sales such as in this case, because the purpose of the law is to make the homesteader a property owner, a contented and useful member of society;
- (b) the term "contracted" must be understood to have been used in the term INCURRED (see Webster's Dictionary), thus, applicable to *both contractual* and *extra contractual* debts considering the *protective policy* of the law.

(NOTE: Justice Antonio Barredo dissented on the ground that one who commits a *crime*, as in this case, FORFEITS the privilege granted him under the Public Land Act.)

(3) Transfer of Ownership

- (a) It is essential for a seller to transfer ownership (*Art. 1458*) and, therefore, the seller must be the owner of the subject sold. This stems from the principle that nobody can dispose of that which does not belong to him — *nemo dat quod non habet*. (*See Azcona v. Reyes & Larracas, 59 Phil. 446; see Coronel v. Ona, 33 Phil. 456*).
- (b) But although the seller must be the owner, he need not be the owner at the time of the perfection of the contract.

It is sufficient that he is the owner at the time the object is delivered; otherwise, he may be held liable for breach of warranty against eviction. Be it noted that the contract of sale by itself, is *not* a mode of acquiring ownership. (See Art. 712, *Civil Code*). The contract transfers no real rights; it merely causes certain obligations to arise. Hence, it would seem that A can sell to B property belonging to C at the time of the meeting of the minds. (*TS, Jan. 31, 1921*). Of course, if at the time A is supposed to deliver, he cannot do so, he has to answer for damages. Having assumed the risk of acquiring ownership from C, it is clear he must be liable in case of failure. (See *Martin v. Reyes, et al., 91 Phil. 666*).

- (c) Indeed, the seller need not be the owner at the time of perfection because, after all, “future things or goods,” *inter alia*, may be sold.

[NOTE: While there can be a sale of future property, there can generally be no donation of future property. (Art. 751, *Civil Code*).]

- (d) A person who has a right over a thing (although he is not the owner of the thing itself) may sell such right. (*10 Manresa, p. 25*). Hence, a usufructuary may generally sell his usufructuary right.
- (e) Of course, if the buyer was already the owner of the thing sold at the time of sale, there can be no valid contract for then how can ownership be transferred to one who already has it?

(4) Comment of the Code Commission

“It is required in the Proposed Code that the seller transfer the ownership over the thing sold. In the old Code his obligation is merely to deliver the thing, so that even if the seller is not the owner, he may validly sell, subject to the warranty to maintain the buyer in the legal and peaceful possession of the thing sold. The Commission considers the theory of the present law (old Code) unsatisfactory from the moral point of view.” (*Report, p. 141*).

(5) Illustrative Cases**Santos v. Macapinlac and Pinlac
51 Phil. 224**

FACTS: A mortgaged his land to B, but sold the land to C. Give the effect of the transaction.

HELD: A, being the owner, could sell the property to C who after delivery became the owner, subject to B's right to foreclose the mortgage upon non-payment of the mortgage credit. B does not have to give C anything, even if the mortgage is foreclosed, for the simple reason that B did not sell the property to him. Neither did B receive the purchase price.

**Lichauco v. Olegario and Olegario
43 Phil. 540**

FACTS: A owed B, and was declared a judgment debtor. To pay the debt, A's properties were attached. At the auction sale, B was the highest bidder. Now then, under the law, the debtor, A, has the right to redeem the property sold within a certain period. A, however, sold his right of redemption to C. B now seeks a court declaration to the effect that the sale of the right of redemption to C be considered fraudulent and void.

HELD: The sale of the right of redemption to C is perfectly valid, since A, the seller, was the owner the right.

**Uy Piaco v. McMicking, et al.
10 Phil. 286**

FACTS: A corporate stockholder sold his share to another, but the sale has not yet been recorded in the books of the corporation. Is the sale valid?

HELD: As between the seller and the buyer, the sale is perfectly valid since the seller was the owner of the corporate shares. However, as between the corporation and the buyer, the latter has acquired only an *equitable* title which may eventually ripen into a legal title after he presents himself to

the corporation and performs the acts required by its charter or by-laws, and which are needed to effectuate the transfer.

Martin v. Reyes, et al.
91 Phil. 666

FACTS: A sold to B land, which at the time of sale did not belong to A. Is the sale valid?

HELD: Yes, for the vendor need not own the property at the time of the perfection, it being sufficient that he be the owner at the time he is to deliver the object. The contention that there is no sale is rather too technical a viewpoint. The deed of sale may be placed in the same category as a promise to convey land not yet owned by the vendor — an obligation which nevertheless may be enforced. The court cited *American Jurisprudence* to the effect that “it is not unusual for persons to agree to convey by a certain time, notwithstanding they have no title to the land at the time of the contract, and the validity of such agreements is *upheld*. In such cases, the vendor assumes the risk of acquiring the title, and making the conveyance, or responding in damages for the vendee’s loss of his bargain.” (55 *Am. Jur.* 480).

Delpher Trades Corp. v. IAC
GR 69259, Jan. 26, 1989

FACTS: A and B were owners of a parcel of land. They leased the land to CCI, Inc. The lease contract provided that during the existence or after the term of the lease, the lessors (A and B) should first offer the same to the lessee and the latter has priority to buy under similar conditions. Later, CCI, Inc. assigned its rights in favor of Hydro, Inc., with the consent of A and B. Thereafter, a deed of exchange was executed by A and B, on the one hand and Delpher Corp., upon the other, whereby A and B conveyed to Delpher Corp. the leased property for 2,500 shares of stock of Delpher. On the ground that it was not given the first option to buy the leased property pursuant to the provision in the lease agreement, Hydro filed a complaint for reconveyance in its favor under conditions similar to those whereby Delpher acquired the property from A and B.

The trial court declared valid Hydro's preferential right to acquire the property (right of first refusal), and ordered *A* and *B* and Delpher to convey the property to Hydro. The Court of Appeals affirmed the decision. The Supreme Court reversed the judgment.

HELD: In the exchange for their properties whereby *A* and *B* acquired 2,500 original unissued no par value shares of stocks of Delpher, the former became stockholders of the latter by subscription, and by their ownership of the 2,500 shares, *A* and *B* acquired control of the corporation. In effect, Delpher is a business conduit of *A* and *B*. What they did was to invest their properties and change the nature of their ownership from unincorporated to incorporated form by organizing Delpher to take control of their properties and at the same time save on inheritance taxes.

The deed of exchange of property between *A* and *B* and Delpher cannot be considered a contract of sale. There was no transfer of actual ownership interests by *A* and *B* to a third party. *A* and *B* merely changed their ownership from one form to another. The ownership remained in the same hands. Hence, Hydro has no basis for its claim of a right of first refusal.

Art. 1460. A thing is determinate when it is particularly designated or physically segregated from all others of the same class.

The requisite that a thing be determinate is satisfied if at the time the contract is entered into, the thing is capable of being made determinate without the necessity of a new or further agreement between the parties.

COMMENT:

(1) Meaning of Determinate

- (a) The object of the sale must be determinate, *i.e.*, specific, but it is not essential really that at the time of perfection, the object be already specific. It is sufficient that it be capable of being determinate without need of any new agreement. Thus, there can be a sale of 20 kilos of sugar of a named quality.

- (b) However, from the viewpoint of risk or loss, not until the object has really been made determinate can we say that the object has been lost, for as is well known, “generic things cannot be lost.”

Yu Tek v. Gonzales
29 Phil. 384

FACTS: Seller sold 600 piculs of sugar to buyer. Because seller was not able to produce 600 piculs on his sugar plantation he was not able to deliver. Is he liable?

HELD: Yes, because no specific lot of sugar can be pointed out as having been lost. Sugar here was still generic. (*See De Leon v. Soriano*, 47 O.G. Supp. to No. 12, p. 377).

[*NOTE:* Understood correctly, however, there can sometimes be the sale of a *generic* thing but the obligations till specific designation is made are naturally different. (*See No. 19*).]

(2) Rule if New Agreement is Needed

If there is a necessity of making a new agreement to determine the amount and the quality of the object sold, this necessarily constitutes an obstacle to the perfection of the contract. (*Gonzales v. Davis*, 43 Phil. 468).

Art. 1461. Things having a potential existence may be the object of the contract of sale.

The efficacy of the sale of a mere hope or expectancy is deemed subject to the condition that the thing will come into existence.

The sale of a vain hope or expectancy is void.

COMMENT:

(1) Things With a Potential Existence

Sale of a thing having a potential existence:

This is a *future* thing that may be sold.

Example: “all my rice harvest next year.”

[**NOTE:** Future inheritance cannot be sold, however. (Art. 1347, par. 2, Civil Code).]

Other examples of thing possessed of a potential existence:

- (a) young animals not yet in existence or still ungrown fruits
- (b) the wine that a particular vineyard is expected to produce
- (c) the wool that shall, thereafter, grow upon a sheep
- (d) the expected goodwill of a business enterprise. (*Sibal v. Valdez*, 50 Phil. 512).

[**NOTE:** The second paragraph speaks of the sale of “a mere hope or expectancy.” It is believed that this cannot be what the Code Commission or Congress meant in view of the word “subject to the condition that the thing will come into existence.” The hope or expectancy *already exists*; what does *not* yet exist is the expected thing. Therefore, for the second paragraph to have some sense, it should refer to a sale of “an expected thing,” not to the “hope or expectancy” itself.]

(2) Emptio Rei Sperati and Emptio Spei

There is a difference between:

- (a) the *sale of an expected thing (emptio rei sperati)*
- (b) and the *sale of the hope itself (emptio spei)*.

If the expected thing in (a) does not materialize, the sale is not effective. In the second, it does not matter whether the expected thing materialized or not; what is important is that the hope itself validly existed. The first deals with a *future* thing — that which is expected; the second deals with a *present* thing — for certainly the hope or expectancy *already exists*.

Example of *emptio spei*: Sale of a valid sweepstakes ticket. Whether the ticket wins or not, the sale itself is valid.

(**NOTE:** The presumption is in favor of an *emptio rei sperati*.)

(3) Vain Hope or Expectancy

If the hope or expectancy itself is vain, the sale is itself void. Be it noted that this is NOT an aleatory contract for while in an aleatory contract there is an element of chance, here, there is completely NO CHANCE.

Example: Sale of a losing ticket for a sweepstakes already run.

(*Exception:* If the ticket be a *collector's item*.)

Art. 1462. The goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or goods to be manufactured, raised, or acquired by the seller after the perfection of the contract of sale, in this Title called "future goods."

There may be a contract of sale of goods, whose acquisition by the seller depends upon a contingency which may or may not happen.

COMMENT:

(1) Sale of Goods

Goods may be *future or existing* goods.

(2) Future Goods

Future goods are those still to be:

- (a) manufactured (like a future airplane) (*Hughes v. Judd*, 254 Ill. App. 14) or printed (like a subscription to a newspaper) (*Leonard v. Pennypacker*, 85 N.J.L. 333);
- (b) raised (like the young of animals, whether already conceived or not at the time of perfection of the contract) (46 Am. Jur. Sales, Sec. 31, p. 224), or future agricultural products (*Lutero v. Siulong and Co.*, 54 Phil. 272) like copra still to be manufactured (*Esguerra v. People*, L-14313, Jul. 26, 1960);

(**NOTE:** In *Esguerra v. People*, *supra*, the accused obtained P2,400 for future copra still to be delivered at some future date. The Court held that the transaction is a sale of future goods, and if the copra is not given, the liability arising therefrom is of a civil, and NOT of a criminal nature.)

- (c) acquired by seller after the perfection of the contract (like land which the seller expects to buy) (*Martin v. Reyes*, 91 Phil. 666);

(**NOTE:** This is also referred to as the sale of “hereafter-acquired” property.)

- (d) things whose acquisition depends upon a contingency which may or may not happen.

(*Example:* I can sell you now a specific car which my father promised to give me, should I pass the bar next year.) (**NOTE:** The moment I get the car, however, in accordance with my father’s promise you do *not* necessarily become its owner, for before title can pass to you, I must first *deliver* the car to you, actually or constructively.)

Art. 1463. The sole owner of a thing may sell an undivided interest therein.

COMMENT:

(1) Sale of an Undivided Interest

Examples:

- (a) If I own a house, I may sell an aliquot part thereof (say 1/2 or 1/3) to somebody, in which case he and I will become co-owners. (*See Ferguson v. Northern Bank of Ky.*, 14 Buck [Ky] 555, 29 Am. Rep. 418).
- (b) A full owner may sell the usufruct of his land leaving the naked ownership to himself.

(2) Source of Article

This was taken from Sec. 1 of the Uniform Sales Act.

Art. 1464. In the case of fungible goods, there may be a sale of an undivided share of a specific mass, though the seller purports to sell and the buyer to buy a definite number, weight or measure of the goods in the mass, and though the number, weight or measure of the goods in the mass is undetermined. By such a sale the buyer becomes owner in common of such a share of the mass as the number, weight or measure bought bears to the number, weight or measure of the mass. If the mass contains less than the number, weight or measure bought, the buyer becomes the owner of the whole mass and the seller is bound to make good the deficiency from goods of the same kind and quality, unless a contrary intent appears.

COMMENT:

Sale of Share in a Specific Mass

Example:

In a stock of rice, the exact number of cavans of which is still unknown, Jose buys 100 cavans. If there are really 150, Jose becomes the co-owner of the whole lot, his own share being $\frac{2}{3}$ thereof.

[**NOTE:** The sale is of a specific object since the mass is specific. (*Cassinelli v. Humphrey Supply Co.*, 183 *Poc.* 523).]

Art. 1465. Things subject to a resolutory condition may be the object of the contract of sale.

COMMENT:

Sale of Things Subject to a Resolutory Condition

Examples:

- (a) A property subject to *reserva troncal* may be sold.
- (b) A usufruct that may end when the naked owner becomes a lawyer may be sold.
- (c) A sold *B* the former's land *a retro*. After delivery to *B*, *B* becomes an absolute owner subject to the right of re-

demption. This land may be sold by *B* to *C*, a stranger, subject to the right of redemption; *i.e.*, *C* must respect the right of *A* to redeem the property within the stipulated period if:

- 1) *A*'s right is registered;
- 2) Or even if not, if *C* had actual knowledge of the right of redemption. (It has been held that actual knowledge is equivalent to registration.)

Art. 1466. In construing a contract containing provisions characteristic of both the contract of sale and of the contract of agency to sell, the essential clauses of the whole instrument shall be considered.

COMMENT:

(1) Distinctions Between a 'Contract of Sale' and an 'Agency to Sell' (like a Consignment for Sale)

- (a) In sale, the buyer pays the price; the agent delivers the price which in turn he got from his buyer.
- (b) In sale, the buyer after delivery becomes the *owner*; the agent who is supposed to sell does not become the owner, even if the property has already been delivered to him.
- (c) In sale, the seller warrants; the agent who sells assumes no personal liability as long as he acts *within his authority* and in the *name of the principal*.

(2) Bar Question

X acquired a booklet of 10 sweepstakes tickets directly from the office of the Philippine Charity Sweepstakes. *X* paid P1,800 for the booklet, less the customary discount. What was the legal nature of *X*'s act in acquiring the tickets? Did he enter into a contract of purchase and sale? Briefly explain your answer.

ANS.: Yes, *X* entered into a contract of purchase and sale, notwithstanding the fact that he may be referred to as an "agent" of the Sweepstakes Office, and the fact that he

may be entitled to an “agent’s prize” should one of the tickets purchased win a principal prize. The truth is that he is not really required to re-sell the tickets, and even if he were to do so, still failure on the part of his purchasers to pay will not allow him to recover what he himself has paid to the office. Moreover, the delivery of the tickets to him transferred their ownership to him; this is not true in the case of an agency to sell. Furthermore, it has been said that in a contract of sale, the *buyer pays* the price; while in an agency to sell, the agent *delivers* the price. The mere fact that a “discount” or so-called commission has been given is immaterial. (*See Quiroga v. Parsons Hardware Co.*, 38 Phil. 501).

**Quiroga v. Parsons Hardware Co.
38 Phil. 501**

FACTS: Plaintiff granted defendant the right to sell as an “agent” Quiroga beds in the Visayas. The defendant was obliged under the contract to *pay for* the beds, at a discount of 25% as commission on the sales. The payment had to be made whether or not the defendant was able to sell the beds. Is this a contract of sale, or an agency to sell?

HELD: This is clearly a contract of sale. There was an obligation to supply the beds, and a reciprocal obligation to *pay* their price. An agent does not pay the price, he merely delivers it. If he is not able to sell, he returns the goods. This is not true in the present contract, for a price was fixed and there was a duty to pay the same regardless as to whether or not the defendant had sold the beds. The phrase “commission on sales” means nothing more than a mere discount on the invoice price. The word “agent” simply means that the defendant was the only one who could sell the plaintiff’s beds in the Visayas. At any rate, a contract is what the law defines it to be, and not what it is called by the contracting parties.

[NOTE: In one case, the “sales tax” was paid by the supposed buyer; no “commission” was paid; and the contract stipulated that in case payment was not made, the property would be “resold.” These [acts] indicate a sale, and not an agency to sell. (*Chua Ngo v. Universal Trading Co.*, L-2870, Sept. 19, 1950).]

Ker and Co., Ltd. v. Jose B. Lingad
L-20871, Apr. 30, 1971

FACTS: In a contract between the U.S. Rubber International Company and Ker and Co. (Distributor), the former *consigned* to the latter certain goods *to be sold* by the Distributor. Prior to such sale, the Rubber Company would *remain the owner*. The contract, however, stated expressly that *Ker and Co.* was not being made an agent, and could not bind the company. *Issue:* Between the two entities here, was there a contract of SALE or one of AGENCY TO SELL?

HELD: This was an AGENCY TO SELL despite the disclaimer in the contract referring to the non-representation. What is important is that the U.S. Rubber International Company *retained ownership* over the goods, *and price was subject to its control*, despite the delivery. (*See Commissioner of Int. Rev. v. Constantino, L-25926, Feb. 27, 1970, 31 SCRA 779*).

Art. 1467. A contract for the delivery at a certain price of an article which the vendor in the ordinary course of his business manufactures or procures for the general market, whether the same is on hand at the time or not, is a contract of sale, but if the goods are to be manufactured specially for the customer and upon his special order, and not for the general market, it is a contract for a piece of work.

COMMENT:

(1) Rules to Determine if the Contract is One of Sale or a Piece of Work

- (a) If ordered in the ordinary course of business — SALE
- (b) If manufactured specially and not for the market piece of work contract

Example:

If I need a particular size (Size 9 1/2) of Bally Shoes, and the same is not available (for the present), but I place an order for one, the transaction would be one of sale. If upon the other hand, I place an order for Size 13, colored violet

(something not ordinarily made by the company), the resultant transaction is a contract for a piece of work.

Inchausti v. Cromwell
20 Phil. 435

FACTS: Hemp which was to be sold had to be *baled*. Is the cost of baling compensation for *work* or is it part of the selling price? (The distinction is important for if it be part of the selling price, it is subject to the sales tax under Sec. 139 of Act 1189.)

HELD: Since it was proved that it was customary to sell hemp which is already *baled*, it follows that the cost of baling is part of the selling price, and should be subject to the sales tax.

(2) Schools of Thought

- (a) *Massachusetts Rule:* If specially done at the order of another, this is a contract for a piece of work.

(NOTE: In the Philippines, we follow this Massachusetts Rule.)

- (b) *New York Rule:* If the thing already exists, it is a SALE; if not, WORK.
- (c) *English Rule:* If material is more valuable, *sale*; if skill is more valuable, *work*.

(3) Query

If I ask someone to construct a house for me, is this a contract of sale or for a piece of work?

ANS.: If he will construct on his own land, and I will get both the land and the house it would seem that this can be very well treated of as a sale. (This practice is very common nowadays.)

Art. 1468. If the consideration of the contract consists partly in money, and partly in another thing, the transaction shall be characterized by the manifest intention of the parties. If such intention does not clearly appear, it shall

be considered a barter if the value of the thing given as a part of the consideration exceeds the amount of the money or its equivalent; otherwise, it is a sale.

COMMENT:

Rules to Determine Whether Contract is One of Sale or Barter

- (a) First Rule — Intent.
- (b) If intent does not clearly appear —
 - 1) if thing is more valuable than money — BARTER
 - 2) if 50-50 — SALE
 - 3) if thing is less valuable than the money — SALE

Example:

If I give my car worth P900,000 to Jose in consideration of Jose's giving to me P300,000 cash, and a diamond ring worth P600,000, is the transaction a sale or a barter?

ANS.: It depends on our mutual intent. If the intent is not clear, the transaction is a BARTER because the ring is more valuable than the P300,000.

[NOTE: In order to judge the intention, we must consider the contemporaneous and consequent acts of the parties. (*Art. 1371; Atl. Gulf Co. v. Insular Gov't., 10 Phil. 166*). The name given by the parties is presumptive, of course, of their intention, but this may be rebutted. (*10 Manresa 16*).]

(NOTE: If I exchange at the Bangko Sentral my Philippine pesos for U.S. dollars at the rate of exchange, plus the marginal fee, if any, this should be regarded as a sale, not as a barter.)

Art. 1469. In order that the price may be considered certain, it shall be sufficient that it be so with reference to another thing certain, or that the determination thereof be left to the judgment of a specified person or persons.

Should such person or persons be unable or unwilling to fix it, the contract shall be inefficacious, unless the parties subsequently agree upon the price.

If the third person or persons acted in bad faith or by mistake, the courts may fix the price.

Where such third person or persons are prevented from fixing the price or terms by fault of the seller or the buyer, the party not in fault may have such remedies against the party in fault as are allowed the seller or the buyer, as the case may be.

COMMENT:

(1) Certainty of the Price

The price must be *certain*; otherwise, there is no true consent between the parties. (*See 10 Manresa 45-46*). There can be no sale without a price. (*Sherman*). If the price is fixed but is later on remitted or condoned, this is perfectly all right, for then the price would *not* be *fictitious*. The failure to pay the agreed price does not cancel a sale for lack of consideration, for the consideration is still there, namely, the price. (*Eusebio de la Cruz v. Apolonio Legaspi, L-8024, Nov. 29, 1955*). If the money paid is counterfeit, would the sale be still valid? Yes, for we cannot say that the consideration or cause of the contract is the illegal currency. The real consideration or cause is still the VALUE or price agreed upon.

**Reparations Commission v. Judge Morfe
GR 35796, Jan. 31, 1983**

If a contract for the acquisition of reparation goods does not specify the conversion rate of the dollar value of the goods, the conversion rate shall be the rate of exchange prevailing in the free market at the time the goods are *delivered*.

(2) When No Specific Amount is Stipulated

If no specific amount has been agreed upon, the price is still *considered certain*:

- (a) if it be certain with reference to another thing certain;

(Example: the price is the tuition fee charged at the Ateneo for the pre-bar review course). (NOTE: If the price fixed is a certain amount to be given annually or monthly to a seller — as long as said seller lives — a life pension — said price cannot be considered certain for the duration of one's life is certainly never certain.)

- (b) if the determination of the price is left to the judgment of a specified person or persons;
- (c) in the cases provided for under Art. 1472, Civil Code.

(3) Illustrative Cases

- (a) *Reference to another thing certain:*

McCullough v. Aenille and Co. 3 Phil. 285

FACTS: Furniture and tobacco were sold, the furniture at 90% of the price shown in a subsequent inventory, and the tobacco at the invoice price. Is the price here already considered certain?

HELD: Yes, in view of the reference to certain amounts.

- (b) *Determination by specified persons:*

Barretto v. Santa Maria 26 Phil. 200

FACTS: Barretto's right in the "La Insular" Company was sold for 4/173 of the entire net value of the business. Said value was, in turn, to be fixed by a specified board of assessors. Is the price certain?

HELD: Yes, for there was no need of any further meeting of the minds on the price. This is a perfect example of a perfected sale.

(4) Refusal of One Party to Go Ahead with an Agreed Appraisal

If the buyer and seller agreed on a sale and on determining the price by a *joint* appraisal, the sale is still valid even if the buyer later on refuses to join the appraisal. The bad faith of the buyer holds him liable for the true value of the object. The true value can be established by competent evidence. (*Robles v. Lizarraga Hermanos*, 50 Phil. 387).

Art. 1470. Gross inadequacy of price does not affect a contract of sale, except as it may indicate a defect in the consent, or that the parties really intended a donation or some other act or contract.

COMMENT:

(1) Effect of Gross Inadequacy of Price

- (a) In ordinary sale, the sale remains valid even if the price is very low. Of course, if there was vitiated consent (such as when fraud or undue influence is present) the contract may be *annulled* but only due to such vitiated consent.

Example: If an Igorot sells a mining claim for a ridiculously low sum, admits the fact of sale, does nothing about it for a number of years, he should not be allowed now to claim that the contract was invalid. The fact that the bargain was a hard one is not important, the sale having been made freely and voluntarily. (*Askay v. Cosolan*, 46 Phil. 179). The rule holds true even if the price seems too inadequate as to shock the conscience of man. (*Alarcon v. Kasilag*, 40 O.G. Sup. No. 16, p. 203).

- (b) In execution of judicial sales — While mere inadequacy of price will not set aside a judicial sale of real property (*Warner, Barnes and Co. v. Santos*, 14 Phil. 446), still if the price is so *inadequate* as to shock the conscience of the Court, it will be set aside. (*National Bank v. Gonzales*, 46 Phil. 693). Thus, if land worth P60,000 is sold judicially for P867, this shocks the conscience of the Court and will be set aside. (*Director of Lands v.*

Abarca, 61 Phil. 70). The same is true if the properties are sold for only around 10% of their values, as when a radio-phono worth P1,000 is sold for P100, or when a matrimonial bed worth P500 is sold for only P50. (*The Prov. Sheriff of Rizal v. CA, L-23114, Dec. 12, 1975*).

As a matter of fact, it may be that the extremely low price was the result not of a sale but of a contract of loan, with the price paid as the *principal* and the object, given merely as security. In a case like this, the contract will be interpreted to be one of loan with an equitable mortgage. (*Aguilar v. Rubiato, 40 Phil. 570*). The remedy would then be the *reformation* of the instrument. (*Arts. 1603, 1604, 1605, 1365, Civil Code*).

However, the price of around P31,000 is *not inadequate* for the foreclosure sale of a house and lot appraised by the Government Service Insurance System at P32,000 and by a realtor at P60,000. (*Pingol, et al. v. Tigno, et al., L-14749, May 31, 1960*).

[NOTE: A buyer at a judicial sale is allowed to resell to others what he has acquired. The mere fact that he demands a very high price is of no consequence. (*Vda. de Syquia v. Jacinto, 60 Phil. 861*).]

(2) In Case Contract Was Really a Donation

It is possible that a donation, not a sale, was really intended. In such a case, the parties may prove that the low price is sufficiently explained by the consideration of liberality. (*See Art. 1470, last part, Civil Code*).

Art. 1471. If the price is simulated, the sale is void, but the act may be shown to have been in reality a donation, or some other act or contract.

COMMENT:

(1) Simulated Price

- (a) The price must not be fictitious. Therefore if the price is merely simulated, the contract as a *sale* is void. It may,

however, be valid as a donation or some other agreement, provided the requirements of donations or other agreements have been complied with. If these requirements do not exist, then, as a sale, the contract is absolutely void, not merely voidable. (*Cruzado v. Bustos*, 34 Phil. 17). An action for annulment is therefore not essential. (*De Belen v. Collector of Customs*, 46 Phil. 241).

- (b) A simulated price is fictitious. There being no price, there is no cause or consideration; hence, the contract is void as a sale. However, it is enough that the price be agreed on at the time of perfection. A *rescission* of the price will not invalidate the sale. (*See 10 Manresa 39-45*).

(2) Fictitious Sale

If the sale of conjugal property is FICTITIOUS and therefore non-existent, the widow who has an interest in the property subject of the sale may be allowed to contest the sale, even BEFORE the liquidation of the conjugal partnership, making the executor a party-defendant if he refuses to do so. (*Borromeo v. Borromeo*, 98 Phil. 432).

Castillo v. Castillo **L-18238, Jan. 22, 1980**

If a mother sells to her child property at a price very much lower than what she had paid for it only three months before, it is an indication that the sale is fictitious.

Ida C. Labagala v. Nicolasa T. Santiago, **Amanda T. Santiago & Court of Appeals** **GR 132305, Dec. 4, 2001**

FACTS: Petitioner admittedly did not pay any centavo for the property. *Issue:* Did this make the sale void?

HELD: Yes. If the price is simulated, the sale is void, but the act may be shown to have been in reality a donation, or some other act or contract.

Art. 1472. The price of securities, grain, liquids, and other things shall also be considered certain, when the price fixed is that which the thing sold would have on

a definite day, or in a particular exchange or market, or when an amount is fixed above or below the price on such day, or in such exchange or market, provided said amount be certain.

COMMENT:

(1) Certainty of Price of Securities

Example: I can sell to you today my *Mont Blanc* fountain pen at the price equivalent to the stock quotation two days from today of 100 shares of PLDT.

(2) If Stock Market Price Cannot Be Ascertained

If the stock quotation price two days later cannot really be ascertained at that time (2 days later), the sale is inef-ficacious. Note the last clause in the article — “provided said amount be certain.”

Art. 1473. The fixing of the price can never be left to the discretion of one of the contracting parties. However, if the price fixed by one of the parties is accepted by the other, the sale is perfected.

COMMENT:

(1) Price Cannot Be Left to One Party’s Discretion

Reason why price fixing cannot be left to the discretion of one of them: the other could not have consented to the price, for he did not know what it was. (*See 10 Manresa 58*).

(2) Problem

S sold to *B* his piano. It was agreed that *B* would fix the price a week later. At the appointed time *B* named the price — P900,000. *S* agreed. Is the sale perfected?

ANS.: Yes, for here there is a true meeting of the minds. (*See 10 Manresa 59*).

Art. 1474. Where the price cannot be determined in accordance with the preceding articles, or in any other manner, the contract is inefficacious. However, if the thing or any part thereof has been delivered to and appropriated by the buyer, he must pay a reasonable price therefor. What is a reasonable price is a question of fact dependent on the circumstances of each particular case.

COMMENT:

Effect if the Price Cannot Be Determined

- (a) If the price cannot really be determined, the sale is void for the buyer cannot fulfill his duty to pay.
- (b) Of course, if the buyer has made use of it, he should not be allowed to enrich himself unjustly at another's expense. So he must pay a "reasonable price." The seller's price, however, must be the one paid if the buyer *knew* how much the seller was charging and there was an acceptance of the goods delivered. Here, there is an implied assent to the price fixed.

Art. 1475. The contract of sale is perfected at the moment there is a meeting of minds upon the thing which is the object of the contract and upon the price.

From that moment, the parties may reciprocally demand performance, subject to the provisions of the law governing the form of contracts.

COMMENT:

(1) Nature of Contract

Sale is a *consensual* contract (perfected by mere consent). Therefore, delivery or payment is not essential for perfection. (*Warner, Barnes v. Inza*, 43 Phil. 404).

[**NOTE:** The contract of sale is *consummated* upon delivery and payment. (*Naval v. Enriquez*, 3 Phil. 669).]

**Pacific Oxygen and Acetylene Co. v.
Central Bank
L-21881, Mar. 1, 1968**

FACTS: On Jan. 17, 1962, the Philippine Trust Company purchased foreign exchange from the Central Bank (now Bangko Sentral) for use in the United States with the Continental Illinois National Bank and Trust Co. The Illinois Bank honored the negotiable instrument only in Feb. 1962. Under the law at the time of purchase (Jan. 17, 1962) from the Central Bank (Bangko Sentral), the said Bank could impose a certain fee (called margin fee). Later, however, the law was changed.

ISSUE: As of what date was the sale of the foreign exchange perfected?

HELD: The sale was made by the Central Bank (Bangko Sentral), and was therefore perfected on Jan. 17, 1962. As of said date, there was a meeting of the minds upon the thing which is the object of the contract, and upon the price. The fact that the negotiable instrument was honored only the following month is not important — since the law speaks only of the *sale* of the foreign exchange. The margin fee was, therefore, lawfully imposed.

**Pacific Oxygen and Acetylene
Co. v. Central Bank
L-23391, Feb. 27, 1971**

The sale of foreign exchange or foreign currency is *perfected* from the moment the contract of such sale is EXECUTED, not from the moment of payment or delivery of the amount of foreign currency to the creditor.

**Obana v. CA
GR 36249, Mar. 29, 1985**

FACTS: A rice miller accepted the offer of a person to buy 170 cavans of clean rice at P37.26 per cavan. They agreed that the rice will be delivered the following day at the buyer's store, where the buyer will pay the purchase price to the

millers' representative. As agreed upon, the miller did deliver the 170 cavans of rice to the buyer's store, but the buyer was nowhere to be found when the miller's representative tried to collect the purchase price.

HELD: There was a perfected sale. Ownership of the rice, too, was transferred to the buyer when the miller's representative delivered it to the buyer's store. At the very least, the buyer had a rescissible title to the goods, since he did not pay the purchase price when the rice was delivered to him.

**Lu v. IAC, Heirs of Santiago
Bustos and Josefina Alberto
GR 70149, Jan. 30, 1989**

If the condition precedent for the sale of the property fails to materialize, there can be no perfected sale.

The decisive legal circumstance is not whether the private receipts bore the elements of a sale. The real controversy is on whether the contract arising from said receipts can be enforced in the light of the priority right of petitioner under the registered contract. It is well-settled in this jurisdiction that prior registration of a lien creates a preference, since the act of registration shall be the operative act to convey and affect the land.

(2) Requirements for Perfection

- (a) When parties *are face to face*, when an offer is accepted without conditions and without qualifications. (A conditional acceptance is a counter-offer.)

(NOTE: If negotiated thru a phone, it is as if the parties are face to face.)

- (b) When contract is thru *correspondence* or thru *telegram*, there is perfection when the offeror receives or has *knowledge* of the acceptance by the *offeree*.

[NOTE: If the buyer has already accepted, but the seller does not know yet of the acceptance, the seller may still withdraw. (*Laudico v. Arias*, 43 Phil. 270).]

- (c) When a sale is made subject to a suspensive condition, *perfection* is had from the moment the condition is fulfilled. (2 *Castan* 26).

Atkins, Kroll and Co., Inc. v. B. Cua Hian Tek
L-9871, Jan. 31, 1958

FACTS: On Sept. 13, 1951, Atkins, Kroll and Co. offered to the respondent 1,000 cartons of sardines, subject to reply by Sept. 23, 1951. The respondent accepted the offer unconditionally, and delivered his letter of acceptance on Sept. 21, 1951. However, in view of a shortage in the catch of sardines by the packers in California, petitioner failed to deliver the commodities it had offered for sale. Respondent now sues for damages. Among the defenses alleged was that there was a mere offer to sell, and that therefore the contract of sale had not yet been perfected.

HELD: The sale was perfected in view of the acceptance of the offer. The acceptance of an offer to sell by promising to pay creates a bilateral binding contract, so much so that if the buyer had backed out after accepting by either refusing to get the thing sold or refusing to pay the price, he could be sued.

Roque v. Lapuz
L-32811, Mar. 31, 1980

In a *contract to sell* where ownership is retained by the seller and is not to pass until the full payment of the price, such payment is a *positive suspensive condition*, the failure of which is not a breach, casual or serious, but simply an event that prevented the obligation of the vendor to convey title from acquiring binding force. To argue that there was only a casual breach (and therefore rescission should not be allowed) is to proceed from the wrong assumption that the contract is one of absolute sale, where non-payment is a *resolatory condition*, which is not the case. (See *Manuel v. Rodriguez*, 109 *Phil. 1*, p. 10 and *Brokerage Co., Inc. v. Maritime Building*, Nov. 16, 1978).

Republic v. Court of Appeals
L-52774, Nov. 29, 1984

Since NEDA kept the check proceeds of a sale for seven months without any comment, it cannot now express its objections to the sale.

(3) Before Perfection

Before perfection of the contract of sale, no mutual rights and obligations exist between the would-be buyer and the would-be seller. The same thing is true when perfection is conditioned upon something, and that thing is not performed. (*Roman v. Grimalt*, 6 Phil. 96).

Roman v. Grimalt
6 Phil. 96

FACTS: A person wanted to buy for P1,500 a schooner called "Santa Maria." The parties agreed, but on condition that the seller's title papers should be perfected. Before the seller's title could be perfected, the ship was lost. The would-be seller now sues for the price.

HELD: The would-be buyer was not yet a buyer. The condition not having been fulfilled, there was no perfected sale. Therefore, the defendant would-be buyer is not liable.

(4) Accepted Bilateral Promise to Buy and Sell

It has been held that in our country, an accepted bilateral promise to buy and sell is in a sense similar to, but not exactly the same as, a perfected contract of sale. (*El Banco Nacional Filipino v. Ah Sing*, 40 O.G. Supp. No. 11, p. 5, Sept. 13, 1941; see *Comment No. 9 under Art. 1458*; see *Manuel v. Rodriguez*, L-13436, July 27, 1960). This is expressly permitted under the Civil Code, Art. 1479, first paragraph, which reads: "A promise to buy and sell a determinate thing for a price certain is reciprocally demandable." (See also *Borromeo v. Franco, et al.*, 5 Phil. 49).

[*NOTE:* From the moment the parties have agreed upon the kind of rice and the price thereof, they are deemed to have

entered into a perfected contract of purchase and sale, the terms and conditions of which may not be held to depend on subsequent events or acts of the parties unless the contrary is stipulated. The mere fact that the seller thereafter sells an object of the same kind to another at a *lesser* price is no ground for the previous buyer to be entitled to claim the excess, his contract being independent of the other. (*Naric v. Fojas, et al., L-11517, Apr. 30, 1958*).]

(5) Formalities for Perfection

Under the Statute of Frauds, the sale of:

- (a) *real property* (regardless of the amount)
- (b) *personal property* — *if P500 or more* must be in writing to be *enforceable*. (*Art. 1403, No. 2, Civil Code*).

If *orally made*, it cannot be enforced by a judicial action, except if it has been completely or partially executed, or except if the defense of the Statute of Frauds is *waived*. (*Art. 1405, Civil Code; see Facturan, et al. v. Sabanal, et al., 81 Phil. 512*). [**NOTE:** Also in writing should be sales which are to be performed *only after more than one year* (from the time the agreement was entered into) — *regardless* as to whether the property is real or personal, and *regardless* of the price involved.]

Cirilo Paredes v. Jose L. Espino L-23351, Mar. 13, 1968

FACTS: Cirilo Paredes filed an action against Jose L. Espino to execute a deed of sale and to pay damages. In his complaint Paredes alleged that Espino had sold to him Lot No. 62 of the Puerto Princesa Cadastre at P4.00 a square meter; that the deal had been closed by “letter and telegram”; but that the actual execution of the deed of sale and payment of the price were deferred to the arrival of Espino at Puerto Princesa, Palawan; that Espino upon arrival had refused to execute the deed of sale although Paredes was able and willing to pay the price; that Espino continued to refuse, despite written demands by Paredes; that as a result, Paredes had lost expected profits from a resale of the property. As proof

of the sale, Paredes annexed the following letter signed by Espino —

...please be informed that after consulting with my wife, we both decided to accept your last offer of P4.00 per square meter of the lot which contains 1,826 square meters and on cash basis.

“In order that we can facilitate the transaction of the sale in question, we (Mrs. Espino and I) are going there (Puerto Princesa, Palawan) to be there during the last week of May.”

Paredes also attached both a previous letter from Espino (*re* the offer) and a telegram from Espino advising Paredes of Espino’s arrival by boat. Espino’s *defense* was that there was no *written contract of sale*, and that therefore the contract is unenforceable under the Statute of Frauds.

HELD: The contract is enforceable. The Statute of Frauds does not require that the contract itself be in writing. A written note or memorandum signed by the party charged (Espino) is enough to make the oral agreement enforceable. *The letters* written by Espino together constitute a sufficient memorandum of the transaction; they are signed by Espino, refer to the property sold, give its area, and the purchase price — the essential terms of the contract. A “sufficient memorandum” does not have to be a single instrument — it may be found in two or more documents.

(6) Some Problems

- (a) *A* sold to *B* orally a particular parcel of land for P5 million. Delivery and payment were to be made four months later. When the date arrived, *A* refused to deliver. So *B* sued to enforce the contract. If you were *A*’s attorney, what would you do?

ANS.: I would file a motion to dismiss on the ground that there is no cause of action in view of the violation of the Statute of Frauds. If I do not file said motion, I still have another remedy. In my *answer*, I would allege

as a *defense* the fact that there is no written contract. If I still do not do this, I have one more chance: I can object to the presentation of evidence — oral testimony — on the point — but only if it does *not* appear on the face of the complaint that the contract was ORAL.

- (b) Give the effect of failure to do any of the things enumerated in the preceding paragraph.

ANS.: The defense of the Statute of Frauds is deemed waived, and my client would be now compelled to pay, if the judge believes the testimony of the witnesses.

- (c) A sold to *B orally* a particular parcel of land for P5,000. Delivery was made of the land. The payment of the price was to be made three months later. At the end of the period, *B* refused to pay, and claimed in his defense the Statute of Frauds. Is *B* correct?

ANS.: *B* is wrong because the contract in this case has already been executed. It is well-known that the Statute of Frauds refers only to executory contracts. (See *Facturan, et al. v. Sabanal, et al.*, 81 Phil. 512). This is why Art. 1405 of the Civil Code provides that contracts infringing the Statute of Frauds are ratified, among other ways, by the *acceptance of the benefits under them*. It is clear in the problem that the delivery of the land had been made and that there had been due acceptance thereof. Indeed, to allow *B* to refuse to pay would amount to some sort of fraud. As has been well said by the Supreme Court, the Statute of Frauds was designed to *prevent*, and not to protect fraud. (See *Shoemaker v. La Tondeña, Inc.*, 68 Phil. 24).

- (d) A sold to *B* in a *private* instrument a parcel of land for P5,000. *B* now wants *A* to place the contract in a public instrument so that *B* could have the same registered in the Registry of Property. Is *B* given the right to demand the execution of the public instrument?

ANS.: Yes. Under Art. 1357: "If the law requires a document or other special form, as in the acts and contracts enumerated in Art. 1358, the contracting parties may compel each other to observe that form, once the

contract has been perfected. This right may be exercised simultaneously with the action upon the contract.”

[NOTE:

- 1) Art. 1357 can be availed of provided:
 - a) the contract is VALID (*Solis v. Barraso*, 53 Phil. 912); and
 - b) the contract is ENFORCEABLE, that is, it does not violate the Statute of Frauds.
- 2) Therefore, in the problem given, it is clear that *B* may compel *A* to execute the *needed public instrument*.
- 3) If the contract is *oral* but already *executed completely* or *partially*, Art. 1357 can be availed of, for in this case the Statute of Frauds is not deemed violated.
- 4) If the contract is *oral* and still completely executory, Art. 1357 cannot be used, for this time the Statute of Frauds has clearly been violated.
- 5) If a parcel of land is given by way of *donation inter vivos*, to be *valid* it must be in *public* instrument. Now then, if land is donated *orally*, Art. 1357 *cannot* be used *whether or not* the land has already been delivered. This is because the donation is VOID. Before Art. 1357 is availed of, the contract must first of all be *valid and perfected*.

EXEMPTED from the rule just given is the case of a *donation propter nuptias* of land, because here the law expressly provides that as to formalities, such a donation must merely comply with the Statute of Frauds. (*Art. 127, Civil Code*). Therefore, even if made orally, a donation *propter nuptias* of land, if *already delivered*, is enforceable and valid and Art. 1357 applies. Of course, if there has been no delivery yet, the oral wedding gift of land is still unenforceable and Art. 1357 cannot apply.

- (e) *A* sold to *B* a particular gold pen worth exactly P5,000. To be enforceable, does the sale have to be in writing?

ANS.: Yes, because under the law, if the price is P500 or more, the Statute of Frauds applies (*Art. 1403, No. 2, Civil Code*).

- (f) A sold to B a particular pen worth only P250. The sale was oral. It was agreed that delivery and payment were to be made *after 2 years*. At the stipulated period, A refused to deliver, alleging the Statute of Frauds as a defense. Is A correct?

ANS.: Yes, although the amount is only P250 and therefore less than the minimum of P500, still the contract must be in *writing* in view of the fact that under the *first agreement* referred to under the Statute of Frauds, “an agreement that by its terms is not to be performed within a year from the making thereof” the same must be in writing to be enforceable. (*See Atienza v. Castillo, et al., 72 Phil. 589*).

- (g) A bought *two pens* from B each worth P300. To be enforceable does the contract have to be in writing?

ANS.: It depends:

- 1) If the sale is *indivisible* (as when A would not have bought one pen without the other), the sale must be in writing for the total sum is P600.
- 2) If the sale is *divisible*, the important amount is P300 and, therefore, need *not* be in writing in order to be enforceable.

(7) Perfection in the Case of Advertisements

Advertisements are mere invitations to make an offer (*Art. 1325, Civil Code*) and, therefore, one cannot compel the advertiser to sell.

(8) Transfer of Ownership

- (a) Mere perfection of the contract does not transfer ownership. Ownership of the object sold is transferred only after delivery (tradition), *actual, legal or constructive*.

The rule is, therefore, this: After delivery of the object, ownership is transferred.

- (b) How about a stipulation that even with delivery there will be no change or transfer of ownership till the purchase price has been fully paid, is this valid?

ANS.: Yes, but the stipulation is not binding on innocent third persons such as customers at a store. The customers must not be prejudiced. (*TS, Dec. 1, 1919*).

(9) The Sales Tax

Even if the object sold has not yet been delivered, once there has been a meeting of the minds, the sale is perfected and, therefore, the sales tax (15% on the gross) is already due. It accrues on perfection, not on the consummation of the sale. (*Earnshaw Docks & H.I. Works v. Coll. of Int. Rev.*, 54 Phil. 696; Sec. 186, Com. Act 466 as amended). Retail sales of flour to bakeries to be manufactured into bread are subject to tax; if *wholesale*, they are not subject to tax. To determine if a sale is wholesale or retail, we must not consider the quantity sold, but the character of the purchase. If the buyer buys the commodity for his *own consumption*, the sale is retail and is subject to tax; if for *resale*, the sale is deemed wholesale, regardless of the quantity, and is not subject to the particular tax referred to. (*Kiong v. Sarmiento*, 90 Phil. 434). The same rule applies practically to sales of textiles. If the textile be bought for resale at a profit, the goods being unaltered when resold, the original sale is wholesale. If he resells the goods only after altering them by using his skill (as when he transforms them to shirts), the original sale is retail. Indeed, he is considered a consumer in legal contemplation because he used the goods purchased by him. The same rule applies in the case of the retail sale of the following:

- (a) copra for the manufacture of soap or oleomargarine
- (b) hemp used to make twine or rope
- (c) in general, raw materials that are used in or that entered into the manufacture of finished products. (*Tan v. De la Fuente, et al.*, 90 Phil. 519).

(10) Effect of Perfection

After perfection the parties must now comply with their mutual obligations. Thus, for example, the buyer can now compel the seller to deliver to him the object purchased. In the meantime, the buyer has only the personal, not a real right. Hence, if the seller sells again a parcel of land to a stranger who is in good faith, the proper remedy of the buyer would be to sue for damages. May he successfully bring an *accion reivindicatoria* against the stranger? NO, for he cannot recover ownership over something he had never owned before.

**Bucton, et al. v. Gabar, et al.
L-36359, Jan. 31, 1974**

FACTS: Villarin sold in 1946 to Gabar a parcel of land on the installment plan. Gabar, in turn, had an oral agreement with Bucton that the latter would pay half of the price, and thus own half of the land. Bucton paid her share to Gabar, and was given in 1946 receipts acknowledging the payment. In 1947, Villarin executed a formal deed of sale in favor of Gabar, who immediately built a house on half of the lot. Bucton took possession of the other half, and built improvements thereon. When Bucton asked for a separate title, she was refused, and so in 1968, she filed a complaint to compel Gabar to execute a formal deed of sale in her favor. The Court of Appeals ruled that the action had already prescribed because this was an action to enforce a written contract, and should have been brought within 10 years from 1946 under Art. 1144 of the Civil Code. *Issue:* Has the action really prescribed?

HELD: No, the action has not really prescribed. The error of the Court of Appeals is that it considered the execution of the receipt (1946) as the basis of the action. The real basis of the action is Bucton's *ownership* (and possession of the property). No enforcement of the contract of sale is needed because the property has already been delivered to Bucton, and ownership thereof has already been transferred by operation of law under Art. 1434, referring to property sold by a person (Gabar), who subsequently becomes the owner thereof. The action here, therefore, is *one to quiet title*, and as Bucton is in possession, the action is imprescriptible.

Art. 1476. In the case of a sale by auction:

(1) Where goods are put up for sale by auction in lots, each lot is the subject of a separate contract of sale.

(2) A sale by auction is perfected when the auctioneer announces its perfection by the fall of the hammer, or in other customary manner. Until such announcement is made, any bidder may retract his bid; and the auctioneer may withdraw the goods from the sale unless the auction has been announced to be without reserve.

(3) A right to bid may be reserved expressly by on behalf of the seller, unless otherwise provided by law or by stipulation.

(4) Where notice has not been given that a sale by auction is subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ or induce any person to bid at such sale on his behalf or for the auctioneer, to employ or induce any person to bid at such sale on behalf of the seller or knowingly to take any bid from the seller or any person employed by him. Any sale contravening this rule may be treated as fraudulent by the buyer.

COMMENT:**(1) When Sale by Auction is Perfected**

The sale is perfected when the auctioneer announces its perfection by the fall of the hammer or in other customary manner.

(2) Before the Fall of the Hammer

Before the hammer falls,

- (a) may the *bidder retract* his bid?

ANS.: Yes. (Art. 1476[2]). Reason: Every bidding is merely an offer and, therefore, before it is accepted, it may be withdrawn. The assent is signified on the part of the seller by knocking down the hammer. (Warlow v. Harrison, 1 El. & El. 295).

- (b) may the *auctioneer withdraw* the goods from the sale?

ANS.: Yes, unless the auction has been announced to be without reserve. (*Art. 1476[2]*). *Reason*: This bid is merely an offer, not an acceptance of an offer to sell. Therefore it can be rejected. What the auctioneer does in withdrawing is merely reject the offer. (*Freeman v. People, 37 Anno. L.R.A. 1917 A. 74*). (See also Art. 1326 of the Civil Code which says that “advertisements for bidders are simply invitations to make proposals, and the advertiser is not bound to accept the highest or lowest bidder, unless the contrary appears.”)

(3) When Seller Can Bid

May the seller bid? If so, under what conditions, if any?

ANS.: Yes, provided:

- (a) such a right to bid was reserved;
- (b) and notice was given that the sale by auction is subject to a right to bid on behalf of the seller. (*Art. 1476, pars. 3 and 4*).

(4) When Seller May Employ Others to Bid for Him

May the seller employ others to bid for him?

ANS.: Yes, provided he has notified the public that the auction is subject to the right to bid on *behalf* of the seller. (*Art. 1476, par. 4*). People who bid for the seller, but are not themselves bound, are called “by-bidders” or “puffers.” (*Story on Sales, Sec. 482*). In view of the *notice*, there would *not* be any fraud, and the transaction with the rest should be considered as valid. (*See Crowder v. Austin, 3 Bing. 368*). *Without* the notice, any sale contravening the rule may be treated by the buyer as *fraudulent*. (*Art. 1476, No. 4*). In other words, the purchaser could be relieved from his bid. (*Fisher v. Hersey, 17 Hun. [N.Y.] 370*).

[**NOTE**: It may happen that the owner is *not* himself the auctioneer. Now then if the auctioneer employs puffers and gives no notice to the public, the sale would still be fraudulent,

whether or not the owner of the goods knew what the auctioneer had done. (See *Carreta v. Castillo*, 209 N.Y.S. 257).]

Illustrative Case:

Veazie v. Williams, et al.
12 L. Ed. 1081

FACTS: Owner of the two mills told auctioneer to sell them for at least \$14,500. Unknown to the owner and to the public, the auctioneer employed puffers and because of this someone bid \$40,000. The *real* bidding had stopped at \$20,000 but the buyer did not know this. The buyer now seeks the annulment of the sale.

HELD: The sale can be annulled in view of the fraud. Had the public been informed of the puffers, this would have been different. To escape censure, notice of by-bids is essential. (*Ross on Sales*, 311; *Howard v. Castle*, 6 D. and E. 642). By-bidding, if secret, deceives and involves a falsehood and is, therefore, bad. It is not enough to apologize and say that by-bidding is after all common. It does not matter that the owner did not know of auctioneer's fraud. After all, the auctioneer was merely the agent.

(5) Right of Owner to Fix Conditions for the Sale by Auction

Leoquinco v. Postal Savings Bank
47 Phil. 772

FACTS: The Board of Directors of the Postal Savings Bank authorized the sale by public auction of a parcel of land it owned in Navotas, Rizal. The Board expressly reserved "the right to reject any and all bids." The auction notice also contained such reservation. Leoquinco offered the highest bid (P27,000) but this was rejected by the Board. Leoquinco then sued to compel the Bank to execute and deliver the deed of sale, with damages.

HELD: Action will *not* prosper for there was really *no sale*. By participating in the auction and offering his bid, he

voluntarily submitted to the terms and conditions of the auction sale announced in the notice and he, therefore, clearly acknowledged the right of the Board to reject any or all bids. The owner of property offered for sale either at public or private auction has the right to prescribe the *manner, conditions, and terms* of such sale. He may even provide that *all* of the purchase price shall be paid at the time of the sale, or any portion thereof, or that time will be given for the payment. (*Blossom v. Milwaukee and Chicago Railroad Co.*, 3 Wallace U.S. 196). The conditions are binding upon the *purchaser, whether he knew them or not.*

(6) Rule in Case of a Private Sale

**CFI of Rizal and Elena Ong Escutin
v. CA and Felix Ong
Jul. 25, 1981**

A private sale authorized by a probate court (and without objection on the part of the heirs or creditors) cannot be assailed by a person who is not an “interested party” (such as an heir or creditor). One who merely offered a higher price (without actually buying the property) is not “an interested party.” It would have been different had there been a public auction.

Art. 1477. The ownership of the thing sold shall be transferred to the vendee upon the actual or constructive delivery thereof.

COMMENT:

(1) When Ownership is Transferred

Ownership is not transferred by perfection but by delivery.

[This is true even if the sale has been made on credit; payment of the purchase price is NOT essential to the transfer of ownership, as long as the property sold has been delivered. (*Gabriel, et al. v. Encarnacion,*

et al., C.A. L-11877-R, Jul. 8, 1955). A contrary stipulation is, however, VALID. (Art. 1478).]

(2) Kinds of Delivery

Delivery may be:

- (a) *actual* (Art. 1497, Civil Code).
- (b) *constructive* (Arts. 1498-1601, Civil Code), including “any other manner signifying an agreement that the possession is transferred.” (Art. 1496, Civil Code).

C.N. Hodges, et al. v. Jose Manuel Lezema, et al. L-20630, Aug. 31, 1965

FACTS: A stockholder (Hodges) sold his shares of stock (evidenced by Stock Certificate 17) to Borja on credit, the latter executing a chattel mortgage on said shares to guarantee the indebtedness. Meanwhile, Hodges retained Stock Certificate 17 as agreed upon between them. Without Hodges surrendering the certificate, the corporation, upon Borja’s request, issued to Borja Stock Certificate 18, covering the shares which he (Borja) had purchased. In view of Borja’s failure to pay certain installments due, Hodges foreclosed the chattel mortgage, and eventually reacquired the shares of stock. Later, Hodges sold the shares to a certain Gurrea. Just before a particular stockholders’ meeting, Hodges and Gurrea sued to prevent Borja from exercising rights as a stockholder. *Issue:* Who owns the shares of stock?

HELD: If upon the sale by Hodges to Borja, Borja became the owner thereof, then, upon Hodges’ purchase of the shares at the foreclosure proceedings, Hodges reacquired ownership over the same. Stock Certificate 18 must be cancelled; a new one must be given to Hodges; and eventually, a new one also issued to Gurrea after the deal between Hodges and Gurrea is finally settled.

Art. 1478. The parties may stipulate that ownership in the thing shall not pass to the purchaser until he has fully paid the price.

COMMENT:**When Ownership is Not Transferred Despite Delivery**

Generally, ownership is transferred upon delivery, but even if delivered, the ownership may still be with the seller till full payment of the price is made, *if there is a stipulation to this effect*. But, of course, innocent third parties cannot be prejudiced. (*See TS, Dec. 1, 1919*). The stipulation is usually known as *pactum reservati dominii* and is common in sales on the installment plan. (*Perez v. Erlanger and Galinger, Inc., [C.A.] 54 O.G. 6088*). In one case, the buyer paid a down-payment. The rest of the price was stipulated to be paid for after a loan which had been applied for by the purchaser with some other entity had been approved and released. The Court held that the stipulation regarding the payment of the balance is NOT the same as the stipulation that “ownership in the thing shall *not* pass to the purchaser until he has fully paid the price.” Hence, the purchaser in this case still becomes the owner of the object sold upon its actual or constructive delivery to him, in accordance with the general rule. Indeed, the exception to the rule (*re* the stipulation) must be strictly construed. (*Tan Boon Diok v. Aparri Farmer’s Cooperative Marketing Asso., Inc., L-14154, Jun. 30, 1960*). Usually, if such a stipulation is present the sale is technically referred to not as a contract of sale, but a contract to sell, the payment of the price being a condition precedent. If no payment is made, the buyer can naturally be ejected. And here, the seller is truly *enforcing*, not rescinding the contractual agreement. (*Santos, et al. v. Santos, [C.A.] 47 O.G. 6372*).

**Sun Brothers’ Appliances v. Perez
L-17527, Apr. 30, 1963**

FACTS: The defendant bought from Sun Brothers’ Appliances one air conditioner, under a conditional sale agreement. The air conditioner was delivered and installed in the office of the defendant, but before full payment had been effected, it was totally destroyed by fire. This action was brought to recover the balance of the purchase price. The conditional sale agreement contained a stipulation that title to the air

conditioner would vest in the buyer only upon full payment of the entire account and that should said property be lost, damaged, or destroyed, the buyer would suffer the loss. *Issue*: Is such a stipulation valid, and should the buyer pay the balance?

HELD: To both questions, the answer is YES, for the stipulation is based on a sound policy in commercial conditional sales and is not contrary to law or to morals or to public order, good customs, or public policy.

[*NOTE*: Although generally delivery should not be made till after payment, still if it is stipulated that payment will be made only after a certain period, delivery must be made, even before payment. (*Warner, Barnes & Co. v. Inza*, 43 Phil. 505).]

Art. 1479. A promise to buy and sell a determinate thing for a price certain is reciprocally demandable.

An accepted unilateral promise to buy or to sell a determinate thing for a price certain is binding upon the promissor if the promise is supported by a consideration distinct from the price.

COMMENT:

(1) Distinction Between the First (Mutual Promise) and the Second Paragraphs (Accepted Unilateral Promise)

First Paragraph: A promises to buy something and B promises to sell it at an agreed price. (This is a promise to *buy and sell*, clearly a bilateral reciprocal contract.)

[*NOTE*: This is as good as a perfected sale. (*P.N.B. v. Ah Sing*, 69 Phil. 611). Of course, no title of dominion is transferred as yet, the parties, being given the right only to demand *fulfillment* or *damages*. (*Ramos v. Salcedo*, {C.A.} 48 O.G. 729; *Barretto v. Santa Marina*, 26 Phil. 200; and *Guerero v. Yñigo*, 50 O.G. 5281).]

Second Paragraph: Only one makes the promise. This promise is accepted by the other. *Hence*, A promises to sell to B accepts the promise, *but does not* in turn promise to buy.

(**NOTE:** This is an accepted unilateral promise to sell. It is binding on the promissor only if the promise is supported by a consideration distinct from the price.)

Example:

B, interested in a particular car at a car exchange, asked *A* for the price. *A* said “P500,000.” *B*, however, could not make up his mind whether to buy or not. So *A* told him, “*B*, I’ll give you a week to make up your mind.” *B* accepted, and gave *A* P10,000 for the *option* — the opportunity to make up his mind. The contract of option here is valid, because it was supported by a consideration distinct from the selling price. If *A* reneges on his word and disposes of the property in favor of another before the end of the week, *B* can sue him for damages. Upon the other hand, *B* is *not* obliged to buy the car at the end of the week. He may or he may not. After all, he did not promise to buy. He merely accepted a unilateral promise of *A* to sell. (See *Filipinas College, Inc. v. Timbang, et al.*, [C.A.] 52 O.G. 3624).

[**NOTE:** In the example given, if there had been no cause or consideration for the option, the option would *not* be a valid contract and therefore, *A* cannot be blamed for selling the car to another before the end of the stipulated week. (See *Cavada v. Diaz*, 37 Phil. 982). (Of course, had the option been given out of liberality or generosity, there would be a valid consideration, the option having been given as a *donation*).]

[**NOTE:** Under the law of obligations and contracts, we have Art. 1324 which says: “When the offeror has allowed the offeree a certain period to accept, the offer may be *withdrawn at anytime before acceptance* by communicating such withdrawal, except when the option is founded upon a consideration, as something paid or promised.”

Now then, what is meant here by “acceptance?” “Acceptance” here means acceptance of the *offer to sell*, i.e., the offeree now signifies his intention to buy. In such a case, it is as if there already is a perfected sale or contract. The word “acceptance” indeed, does not refer to acceptance of the *option*. This is evident when it is considered that as worded, the article envisages an instance when the *option is accepted, but since*

there is no consideration for the option, the offeror may still withdraw the offer before *acceptance of the contract of sale*. This is because an option without consideration is void, and it is as if there was *no option*. There being a mere offer to sell, there is no meeting of the minds yet and this is why the offer may be withdrawn. As the Supreme Court has stated — “An accepted unilateral promise can only have a binding effect if supported by a consideration which means that the option can *still be withdrawn, even if accepted*, if the same is *not* supported by any consideration.” (*Southwestern Sugar and Molasses Co. v. Atlantic Gulf and Pacific Co.*, 97 Phil. 249). Of course, once the offeree signifies his willingness to buy, there is already a meeting of the minds and there can be no withdrawal of the offer.]

Atkins, Kroll & Co., Inc. v. B. Cua Hian Tek
L-9871, Jan. 31, 1958
(also cited under Art. 1476)

FACTS: On Sept. 13, 1951, Atkins, Kroll and Co., Incorporated offered to B. Cua Hian Tek 1,000 cartons of sardines subject to reply by Sept. 23, 1951. The respondent offeree *accepted* the offer unconditionally and delivered his letter of acceptance on Sep. 21, 1951. In view, however, of the shortage of catch of sardines by the California packers, Atkins, Kroll and Co. failed to deliver the commodities it had offered for sale. Offeree now sues offeror. Offeror Atkins, Kroll and Co. argues that acceptance of the offer only created an option to buy, which, lacking consideration distinct from the price, had no obligatory force.

HELD: The argument is untenable, because acceptance of the offer to sell by showing the intention to buy for a price certain creates a bilateral contract to sell and to buy. The offeree, upon acceptance *ipso facto*, assumes the obligations of a buyer, so much so that he can be sued should he back out after acceptance, by either refusing to get the thing sold or refusing to pay the price agreed upon. Upon the other hand, the offeror would be liable for damages, if he fails to deliver the thing he had offered for sale.

Even granting that an option is granted which is not binding for lack of consideration, the authorities hold that

“If the option is given without a consideration, it is a mere offer of a contract of sale, which is not binding until accepted. If, however, acceptance (of the sale) is made before a withdrawal, it constitutes a binding contract of sale, even though the option was not supported by a sufficient consideration.” (7 *Corpus Juris Secundum*, p. 652).

[**NOTE:** It is evident here that the case was considered as one governed by the provision “A promise to buy and sell a determinate thing for a price certain is *reciprocally demandable*,” (bilateral) instead of by the provision “an accepted unilateral promise to buy or to sell a determinate thing for a price certain is binding upon the promissor if the promise is supported by a consideration distinct from the price.” (See the 2nd paragraph of Art. 1479).]

[**NOTE:** The rule enunciated in the case of *Atkins*, *supra*, apparently *contradicts* the decision of the Supreme Court in the case of *Southwestern Sugar and Molasses Co. v. Atlantic Gulf and Pacific Co.*, 97 *Phil.* 249, where the Court (erroneously, I think) held:

“It is true that under Art. 1324 of the new Civil Code, the general rule regarding offer and acceptance is that, when the offeror gives to the offeree a certain period to accept, ‘the offer may be withdrawn at any time before acceptance’ except when the option is founded upon consideration, but this general rule must be interpreted as *modified* by the provision of Art. 1479 above referred to which applies to ‘a promise to buy and sell’ *specifically*. As already stated, this rule requires that a promise to sell to be valid must be supported by a consideration distinct from the price.”]

[**NOTE:** There is no real inconsistency between the two *Articles* if correctly understood, as already discussed in the preceding paragraphs, for a “bilateral promise to buy and sell” requires NO consideration distinct from the selling price; it is only the “accepted unilateral promise to BUY or SELL” that needs such distinct consideration; moreover, we have to distinguish acceptance of an offer to sell (without promising to buy) from an acceptance that impliedly promise to buy.]

The Court in the *Southwestern Sugar and Molasses Co.* case further continued: “We are not oblivious of the existence

of American authorities which hold that an offer once accepted, cannot be withdrawn, regardless of whether it is supported or not by a consideration. (*12 Am. Jur. 528*). These authorities, we note, uphold the general rule applicable to offer and acceptance, as contained in our new Civil Code. But we are prevented from applying them in view of the specific provision embodied in Art. 1479. While under the offer of option in question, appellant has assumed a clear obligation to sell its barge to appellee and the option has been exercised in accordance with its terms, and there appears to be no valid or justifiable reason for appellant to withdraw its offer, this court cannot adopt a different attitude because the law on the matter is clear. Our imperative duty is to apply it unless modified by Congress.”]

(**NOTE:** As has been said, the Court’s error here consisted in not considering the case as a bilateral promise to buy and sell. It was not merely the option that was accepted. The whole SALE ITSELF was accepted.)

(**NOTE:** Notice how the authorities REJECTED in one case were UPHELD in the other case.)

(2) Meaning of ‘Policitacion’

This is a unilateral promise to buy or to sell which is not accepted. This produces no juridical effect, and creates no legal bond. This is a mere offer, and has not yet been converted into a contract. (*Raroque v. Maiquez, et al., [C.A.] 37 O.G. 1911*).

(3) Bilateral Promise

A bilateral promise to buy and sell a certain thing for a price certain gives to the contracting parties personal rights in that each has the right to demand from the other the fulfillment of the obligation. (*Borromeo v. Franco, et al., 5 Phil. 49*).

Borromeo v. Franco **5 Phil. 49**

FACTS: *S* agreed to sell to *B*, and *B* agreed to buy. One stipulation in the contract stated that *B* should have 6

months within which to complete and arrange the documents and papers relating to said property. At the end of 6 months, *B* wanted to get the property although the papers were not yet completed. *S* refused on the ground that said papers were not yet complete. So *B* brought this action for specific performance and damages.

HELD: The action will prosper. The agreement on *B*'s part to complete the title papers is not a condition precedent of the sale, but a mere incidental stipulation. This is so because the duty to deliver depends on the payment of the price, and vice versa, but not on the perfection of the title papers. It may be assumed that *B* is willing to buy the property even with a defective title.

[*NOTE:* A mere executory sale, one where the seller merely promises to transfer the property at some future date, or where some conditions have to be fulfilled before the contract is converted from an executory to an executed one, does not pass ownership over the real estate that may have been sold. (*McCullough and Co. v. Berger*, 43 *Phil.* 823). The parties can, however, demand specific performance or damages for the breach. (See *Mas v. Lanuza, et al.*, 5 *Phil.* 457 and *Ramos v. Salcedo*, {C.A.} 48 O.G. 729).]

Palay, Inc. v. Clave
GR 56076, Sep. 21, 1983

The seller of a subdivision lot unilaterally rescinded the contract to sell (by virtue of a contractual provision on the matter) but failed to give notice to the buyer of said rescission. The judge declared the rescission illegal for want of the necessary notice and ordered the seller to return the lot (or an adequate substitute) to the buyer. If the property has been sold to a third person, and no other lot is available, the buyer is entitled to a refund of installments paid plus 12% interest from date suit was filed.

(4) Unilateral Promise

- (a) The acceptance of a unilateral promise to sell must be plain, clear, and unconditional. Therefore, if there is a

qualified acceptance with terms different from the offer, there is no acceptance, that is, there is no promise to buy and there is no perfected sale. (*Beaumont v. Prieto*, 41 Phil. 670).

- (b) If an option is granted, how long is the offer bound by his promise?

ANS.: If no period has been stipulated, the court will fix the term.

- (c) Is the right to buy, a right that may be transmitted to others?

ANS.: Yes, unless it was granted for purely personal considerations. (*See 10 Manresa 65-70*).

- (d) *What is an Option?*

ANS.: It is a contract granting a person the privilege to buy or not to buy certain objects at any time within the agreed period at a fixed price. The contract of option is a separate and distinct contract from the contract which the parties may enter into upon the consummation of the contract; therefore, an option must have its own cause or consideration. (*Enriquez de la Cavada v. Diaz*, 37 Phil. 1982). After the period of conventional redemption has expired, there is no more right to repurchase. Should the period later on be extended, this would really be an offer to sell, or any option, and, therefore, there must be a consideration distinct from the repurchase price. (*See Miller v. Nadres*, 74 Phil. 307).

Bar

A offered to sell for P10 million his house and lot to B who was interested in buying the same. In his letter to B, A stated that he was giving B a period of one month within which to raise the amount and that as soon as B is ready, they will sign the deed of sale. One week before the expiration of the one-month period, A went to B and told him that he is no longer willing to sell the property unless the price is increased to P15 million. May B compel A to accept the P10 million first offered, and execute the sale?

ANS.: No, for *B* never signified his acceptance of *A*'s offer, and assuming that he did accept, still this would be merely an accepted unilateral promise to sell — not binding on the offeror for there was no consideration distinct from the price. (*See Mendoza v. Comple, L-19311, Oct. 29, 1965*).

**Filemon H. Mendoza, et al. v. Aquilina Comple
L-19311, Oct. 29, 1965**

FACTS: Comple agreed to sell to Mendoza a parcel of land for P4,500. Mendoza was given up to May 6, 1961 within which to raise the necessary funds. It was further agreed that if Mendoza could not produce the money on or before said date, no liability could attach to him. Mendoza paid nothing for the privilege of making up his mind. Before May 6, 1961, Comple backed out of the agreement. Mendoza now sues to compel Comple to sell. *Issue:* Is Comple required to sell the property to Mendoza?

HELD: No, for this was merely a unilateral promise on the part of Comple to sell, without a corresponding promise on the part of Mendoza to buy. Comple's promise is not binding on him since there was NO CONSIDERATION DISTINCT from the price. (*See Art. 1479*). Hence, even if Comple's promise had already been accepted by the would-be buyer, Comple could still legally withdraw from the agreement.

(*NOTE:* The answer would have been different, if Mendoza had himself promised to buy.)

(5) Contract to SELL is NOT an Absolute Sale

A *contract or promise to sell*, a parcel of land for example, is *not a contract of sale*. Such a *contract to sell* would exist when for instance, land is promised to be sold, and title given only after the down payment and the monthly installment therefor shall have all been paid. Failure to make the needed payment is failure to comply with the needed *suspensive* condition. Hence, promissor was never really obliged to convey title. Hence also, there would be nothing wrong if he sells the property to another, after an unsuccessful demand

for said price. (*Manuel v. Rodriguez, Sr.*, L-13435, Jul. 27, 1960). Therefore also, a clause in such a contract allowing *unilateral automatic rescission* by the seller in the event the buyer fails to pay any installment due is VALID, Art. 1592 not being applicable. (*Jocson v. Capitol Subdivision, Inc., et al.*, L-6573, Feb. 28, 1955; *Claridad Estates v. Santero*, 71 Phil. 114; and *Manila Racing Club v. Manila Jockey Club*, 40 O.G. 3rd Supp. No. 7, p. 88).

Roque v. Lapuz
L-32811, Mar. 31, 1980

In *contracts to sell* where ownership is retained by the seller and is not to pass until the full payment of the price, such payment is a *positive suspensive condition*, the failure of which is not a breach, casual or serious, but simply an event that prevented the obligation of the vendor to convey title from acquiring binding force. To argue that there was only a casual breach (and therefore rescission should not be allowed) is to proceed from the wrong assumption that the contract is one of absolute sale, where non-payment is a *resolutory condition*, which is not the case. (See *Manuel v. Rodriguez*, 109 Phil. 1, p. 10 and *Luzon Brokerage Co., Inc. v. Maritime Building*, Nov. 16, 1978).

Palay, Inc. v. Clave
GR 56076, Sep. 21, 1983

There is no need to judicially rescind a contract if in the contract, there is a proviso that it may be revoked in case there is a violation of its terms. However, he must send *notice* of the rescission to the other party. If the aggrieved party believes the rescission or revocation is improper, he can always go to court to ask for the cancellation of the rescission, that is, if said cancellation is justified.

Sps. Lorenzo V. Lagandaon,
Cecilia T. Lagandaon & Overseas Agricultural
Development Corp. v. CA, et al.
GR 102526-31, May 21, 1998

FACTS: Taking the place of Pacweld, petitioner seeks to collect the unpaid accounts of private respondents under the

original contracts to sell, but they want exemption from the concomitant obligation of Pacweld under the same contracts. Hence, they insist on a modification of these contracts.

HELD: That the contracts to sell had indeed been rendered stale because of the foreclosure sale does not necessarily imply that orally modified contracts to sell were subsequently entered into between petitioners as buyers of the foreclosed property, on the one hand, and private respondents as purchasers from Pacweld Corp., upon the other.

Art. 1480. Any injury to or benefit from the thing sold, after the contract has been perfected, from the moment of the perfection of the contract to the time of delivery, shall be governed by Articles 1163 to 1166, and 1262.

This rule shall apply to the sale of fungible things, made independently and for a single price, or without consideration of their weight, number, or measure.

Should fungible things be sold for a price fixed according to weight, number, or measure, the risk shall not be imputed to the vendee until they have been weighed, counted, or measured, and delivered, unless the latter has incurred in delay.

COMMENT:

(1) Who Bears the Risk of Loss?

- (a) If the object has been lost before perfection, the seller bears the loss. *Reason:* There was no contract, for there was no cause or consideration. Being the owner, the seller bears the loss. This means that he cannot demand payment of the price.

Example:

**Roman v. Grimalt
6 Phil. 96**

FACTS: B bought a vessel from S on condition that S could prove he (S) was the owner thereof by pertinent

documents. Before the condition was complied with, the vessel sank in a storm. *S* now demands the price.

HELD: *S* cannot demand the price. The condition was never fulfilled; therefore, the contract of sale was never perfected. Therefore also, *S* bears the loss.

(NOTE: Observe the implication in this case: If the condition had been fulfilled, the sale would have been perfected, and *B* would have to pay the price even if it had not yet been delivered to him.)

- (b) If the object was lost after delivery to the buyer, clearly the buyer bears the loss. (*Res perit domino* – the owner bears the loss.)

Song Fo & Co. v. Oria **33 Phil. 3**

FACTS: A launch was sold on credit. Shortly after its delivery, it was destroyed by a fortuitous event. Is the buyer still liable for the price?

HELD: Yes, because after its delivery to him, he became the owner, and therefore it is he who must bear the loss.

- (c) If the object is lost *after perfection but before delivery*.

Here the buyer bears the loss, as *exception* to the rule of *res perit domino*.

Reasons:

- 1) The implication in the case of *Roman v. Grimalt, supra*, is clear. Had the sale been perfected, the buyer would have borne the loss, that is, he would still have had to pay for the object even if no delivery had been made.
- 2) *Art. 1480 (pars. 1 and 2)* clearly, states that injuries between perfection and delivery shall be governed by Art. 1262, among others. And Art. 1262 in turn says that “an obligation which consists in the delivery of a determinate thing shall be *extinguished* if it should be lost or destroyed without the fault of

the debtor, and before he has incurred in delay.” (This means that the obligation of the seller to deliver is extinguished, but the obligation to pay is not extinguished.)

Queries:

- a) But is not the contract of sale reciprocal, and therefore if one does not comply, the other need not pay?

ANS.: True, but this happens only when the seller is able to deliver but does not. In such a case, the buyer is not required to pay, for lack of reciprocity. It is different if the law excuses the seller, but not the buyer. (Thus, in class, if a student does not take an examination, the teacher is not compelled to give him a grade; but if the student is exempted from the examination by, let us say, the authorities, the professor is not exempted from the duty of giving the grade.)

- b) Why should a buyer pay if he does not receive the object; is this not a case where there is no cause or consideration?

ANS.: There was really a cause or consideration because at the time the contract was perfected, the thing purchased *still existed*.

- 3) Art. 1583 says: “In case of *loss*, deterioration, or improvement of the thing before its delivery, the rule in Art. 1189 shall be observed, the vendor being considered the debtor.” Art. 1189, in turn, says in part:

“If the thing is lost without the fault of the debtor, the obligation shall be *extinguished*.”

- 4) Art. 1269 (on LOSS) states: “The obligation having been extinguished by the loss of the thing, the creditor shall have all the rights of action which the debtor may have against third persons by reason of the loss.” Thus, the buyer, who is the creditor as to the object, has the right to proceed against

the wrongdoer for damages. He is given this right, instead of the vendor, only because he is still being made liable for the price. It would be absurd to grant him this right against wrongdoers unless he has been prejudiced in some way. Clearly then, it is he (the vendee or buyer) who bears the loss.

- 5) Historically, the buyer has always borne the loss. Under Roman Law, “the risk of the thing sold passes to the buyer, even though he has not received the thing.” For the seller is not liable for any thing which happens without his fraud or negligence. But if after the sale, any alluvium has accrued to the land, this benefit ought to belong to him who has the risk. (*Inst 2, 23, Sec. 3; Sherman, Roman Jurisprudence, Sec. 6*).
- 6) Since the buyer gets the benefits during the intervening period, it is clear that he must also shoulder the loss.

(**NOTE:** The opinion expressed above conforms with Manresa’s view.)

(**NOTE:** *Exceptions* to the rule that between perfection and delivery, the buyer bears the loss:

- (a) If the object sold consists of fungibles sold for a price fixed according to weight, number, or measure.

(Here, if there has been no delivery yet, the seller bears the loss, unless the buyer is in *mora accipiendi*.) (*Last par., Art. 1480, Civil Code*).

- (b) If the seller is guilty of fraud, negligence, default, or violation of contractual term. (*Arts. 1165, 1262, 1170, Civil Code*).
- (c) When the object sold is generic because “genus does not perish” (*genus nunquam perit*).

(**NOTE:** The unfortunate effect of Art. 1504 on the question of the risk of loss is discussed under said article.)

(2) Examples

- (a) Eugene sold *today* to Ricardo in Manila his (Eugene's) car, located in Zamboanga. Unknown to both parties, however, the car had already been destroyed *yesterday* by a fortuitous event in Zamboanga. Does Ricardo still have to pay for the car? Reason.

ANS.: No, Ricardo does not have to pay for the car. There is in fact no valid contract of sale for at the moment of presumed perfection (*today*), there was no more subject matter (the car having been destroyed yesterday). Eugene, as owner, bears the loss of the car.

- (b) Marita on Mar. 1, 2004 sold for P20 million to Editra her (Marita's) house and lot. It was agreed that delivery of the house and lot, and the payment therefor, would be made on Apr. 3, 2004. Unfortunately, Jose, a stranger, negligently set the house on fire on Mar. 4, 2004, and house was completely destroyed. On Apr. 3, 2004, does Marita still have to deliver anything, and does Editra have to pay for anything? Reasons.

ANS.: Marita must still deliver the lot but is excused from delivering the house (since this has been completely destroyed without her fault). Upon the other hand, Editra must still pay the entire P20 million for the following reasons:

- 1) Although she was not yet the owner of the house, she must bear the loss, just as she would have been the one to profit if the house, instead of being destroyed, increased in value or had improved. As Manresa has so aptly stated—since the buyer gets the benefits during the intervening period, it is clear that she must also bear the loss. (*See Sherman, Roman Jurisprudence, Sec. 296*).
- 2) While sale is a reciprocal contract, and while it is true that in a reciprocal contract, if one does not want to comply, the other is excused from compliance, still in this case, Marita did not refuse to comply; she wanted to comply, but the unforeseen destruction prevented her from complying. Her

obligation to deliver the house was therefore extinguished. (*Art. 1583 says that in case of loss, Art. 1189 shall be observed, the seller being considered the debtor. Art. 1189 in turn says that writ the thing is lost without the fault of the debtor, the obligation shall be extinguished.*) In the case, however, of Edita, there is nothing that would prevent her from complying with the duty to pay.

- 3) We cannot say that this contract had no subject matter, for indeed it had—since the house was still existing at the time the contract was entered into (perfection). The subsequent loss is completely immaterial. (*See Villaruel v. Manila Motor Co. Colmenares, L-10394, Dec. 13, 1958.*)
 - 4) Edita, the buyer, has a right to proceed against Jose, the negligent stranger, for damages under Art. 1269 [*Art. 1269 (on LOSS) states: “The obligation having been extinguished by the loss of the thing, the creditor (Edita, the buyer, is the creditor, with respect the house) shall have all the rights of action which the debtor (Marita is the debtor, with respect to the obligation to deliver the house) may have against third persons by reason of the loss.”*]
- (c) Carole sold and delivered to Clarita on Feb. 8, 2004 a watch for P100,000. It was agreed that Clarita would pay the P100,000 at the end of said month of Feb. If before the end of the month, the watch is destroyed by a fortuitous event while in Clarita’s possession, does she still have to pay for it at the end of the month? Reason.

ANS.: Yes, for upon delivery to her of the watch on Feb. 8, 2000, Clarita became the owner thereof; and as such, she should bear the loss. *Res perit domino.*

(3) Meaning of “Fungibles”

Fungibles are personal property which may be replaced with equivalent things.

Example: I borrowed a bottle of vinegar from a friend. If I am required to return the identical bottle of vinegar, the

vinegar is non-fungible; if I can return the same quality and quantity, the vinegar is fungible. Therefore, fungibles are almost the same as consumable goods with this difference: that while the distinction between consumables and non-consumables is based on the nature of the thing, the difference between fungibles and non-fungibles is based on the intention. Thus, rice is ordinarily consumable, but if I borrowed a sack of rice for display purposes only, and I promised to return the identical sack of rice, the rice here is *non-fungible*.

(**NOTE:** As used however in Art. 1480, “fungibles” mean apparently the same thing as “consumables.”)

Art. 1481. In the contract of goods by description or by sample, the contract may be rescinded if the bulk of the goods delivered do not correspond with the description or the sample, and if the contract be by sample as well as by description, it is not sufficient that the bulk of goods correspond with the sample if they do not also correspond with the description.

The buyer shall have a reasonable opportunity of comparing the bulk with the description or the sample.

COMMENT:

(1) Definitions of Sale By Description or By Sample

- (a) *Sale by description* — where seller sells things as being of a certain kind, the buyer merely relying on the seller’s representations or descriptions. Generally, the buyer has not previously seen the goods, or even if he has seen them, he believes (sometimes erroneously) that the description tallies with the goods he has seen. (56 C.J. 738).
- (b) *Sale by sample* — that where the seller warrants that the bulk (not the major part or the majority of the goods but the goods themselves) of the goods shall correspond with the sample in kind, quality, and character. (55 C.J. 733-734). Only the sample is exhibited. The bulk is not present, and so there is no opportunity to examine or inspect it. (70 L.R.A. 654).

- (c) *Sale by description and sample* — must satisfy the requirements in both, and not in only one. (55 C.J. 7437 and *Studer v. Bleistein*, 5 L.R.A. 702).

(2) Effect of Mere Exhibition of Sample

The mere exhibition of the sample does not necessarily make it a sale by sample. (*L.A. Lockwood, Jr. v. Gross*, 99 Conn. 296). This exhibition must have been the sole basis or inducement of the sale. (55 C.J. 416). A sale by sample may still be had even if the sample was shown only in connection with a sale to the first purchaser. (*Wilhoff Schultze Grocer Co. v. Gross*, 206 App. Div. 67). There can be sale by sample even if the sale is “as is.” (*Schwartz v. Kolin*, 155 N. U.S.)

(3) Problem

Bella purchased a quantity of bed sheets which were wrapped up in bales. The sale was done in a warehouse. Some bed sheets were pulled out, displayed, and found to be all right. Bella then purchased 100 bales, which she later discovered to be bug-eaten. What, if any, are Bella’s rights?

ANS.: This is a sale by sample. Bella is allowed:

- 1) to return the bed sheets and recover the money paid; or
- 2) she may retain said sheets and still sue for the breach of warranty.

(4) Cases

Pacific Com. Co. v. Ermita Market & Cold Stores 56 Phil. 617

FACTS: A refrigerator was sold by description, but although the description was completely correct (as described), the machine would not work properly in the cold store for which it had been purchased. The buyer refused to pay the balance of the purchase price, hence this action.

HELD: The buyer must pay since the sale was by description, and the description is correct. The buyer cannot honestly say that there was any deception by the seller.

Cho Chit v. Hanson, Orth & Stevenson, et al.
L-8439, May 30, 1958

FACTS: A buyer bought a hemp press that could *not* accomplish the purpose he intended (the baling of hemp of regulation size for exportation purposes), but which nevertheless was perfectly in accordance with the *description* in the contract. *Issue:* Can he have the sale cancelled?

HELD: No, for after all, the hemp press was in accordance with the description. It is unfair to cancel the contract simply because the property was not suitable for the precise purpose intended by the customer.

(*NOTE:* Note that the remedy afforded by Art. 1481 is rescission. Technically, it should be annulment.)

Art. 1482. Whenever earnest money is given in a contract of sale, it shall be considered as part of the price and as proof of the perfection of the contract.

COMMENT:

(1) ‘Earnest Money’ Defined

Earnest money, called “*arras*,” is something of value to show that the buyer was really in earnest, and given to the seller to bind the bargain. (*See 14 Words and Phrases*, p. 23).

(2) Significance of Earnest Money

Under the Civil Code, earnest money is considered:

- (a) part of the purchase price (Hence, from the total price must be deducted the *arras*; the balance is all that has to be paid.)
- (b) as proof of the *perfection* of the contract.

(3) Example

B purchased *S*’s car for P900,000, payable after one month. To show his earnestness, *B*, at the time of perfection,

gave *S* the sum of P50,000. At the end of one month, *B* has to pay only the balance of P850,000. (*Note:* The earnest money here of P50,000 must *not* be confused with the money given as *consideration for an option*. *Earnest money* applies to a *perfected* sale; the money is *part* of the purchase price; the buyer is *required* to pay the balance. Upon the other hand, *option money* applies to a sale *not yet perfected*; the money is not part of the purchase price; the would-be buyer is *not required* to buy.)

**San Miguel Properties Phils., Inc. v.
Sps. Alfredo Huang & Grace Huang
GR 137290, Jul. 31, 2000**

FACTS: Petitioner offered certain real properties for sale to respondents, who counter-offered to pay earnest money and the payment of the balance in eight equal monthly installments. Petitioner refused the counter-offer. Respondents then made another proposal to buy the properties, and petitioners accepted the “earnest-deposit” in the amount of P1 Million. However, the parties failed to agree on the manner of payment of the purchase price, and petitioner thereafter refunded the performance, but the same was dismissed by the trial court upon motion of petitioner. The Court of Appeals (CA), however, reversed the judgment of the trial court on the ground that there existed a perfected contract of sale between petitioner and respondents. On appeal, the Supreme Court reversed the CA.

HELD: The “earnest-deposit” money of respondents was not given as the earnest money contemplated under Art. 1482. It was given not as part of the purchase price and as proof of the perfection of the sale but only as a guarantee that respondents would not renege on the sale. Thus, such “earnest-deposit” did not give rise to a perfected sale but merely to an *option* or an accepted unilateral promise on the part of respondents to buy the subject properties within 30 days from the date of acceptance of the offer. For a contract of sale to exist, all the essential elements thereof, including the mode of payment of the purchase price, should be present.

Vicente & Michael Lim v. CA & Liberty H. Luna
GR 118347, Oct. 24, 1996

FACTS: In a contract of sale of a parcel of land, Liberty Luna, as seller, received earnest money from buyers Vicente and Michael Lim, with the agreement that the balance shall be paid in full after the squatters thereon have totally vacated the premises. Luna tried to return the earnest money, claiming that the contract of sale ceased as a result of her failure to evict the squatters. The Lims refused to accept the money, which prompted Luna to deposit the money in court by way of consignment.

In the complaint for consignment, the trial court ruled that there was a perfected contract of sale between the parties and ordered Luna to comply with the agreement. The Court of Appeals (CA) reversed the trial court and allowed the complaint for consignment. On appeal, the Supreme Court reversed the CA's decisions and reinstated with modification the lower court's ruling.

HELD: The agreement Luna and the Lims amounted to a perfected contract of sale, with the earnest money being proof of the perfection of the contract. Failure of Luna to comply with the condition imposed on the performance of the obligation gave the Lims the right to chose whether to demand the return of the earnest money paid or to proceed with the sale. When the Lims chose to proceed with the sale, private respondent could not refuse to do so.

(4) When Arras Must Be Returned

If merchandise cannot be delivered, the *arras* must be returned. (2 *Benito* 312). Of course, this right may be renounced since neither the law nor public policy is violated. (See 10 *Manresa* 85).

Art. 1483. Subject to the provisions of the Statute of Frauds and of any other applicable statute, a contract of sale may be made in writing, or by word of mouth, or partly in writing and partly by word of mouth, or may be inferred from the conduct of the parties.

COMMENT:**(1) Statute of Frauds**

For a complete discussion of the pertinent parts of the Statute of Frauds, see comments under Art. 1475. (*See Vol. IV and the comments under Art. 1403[2]*).

(2) If Sale Is Made Thru an Agent

The sale of a piece of *land* or *interest therein* when made thru an agent is *void* (not merely unenforceable) unless the agent's authority is in writing. (*Art. 1874, Civil Code*). This is true even if the sale itself is in a public instrument, or even registered.

(**NOTE:** "Interest therein" refers to easement or usufruct, for example.)

(3) Effect if Notary Public is Not Authorized

If the deed of sale of land is notarized by a notary public whose authority had expired, the sale would still be valid, since for validity of the sale, a public instrument is not even essential. (*Sorfano v. Latono, L-3408, Dec. 23, 1950*).

Art. 1484. In a contract of sale of personal property the price of which is payable in installments, the vendor may exercise any of the following remedies:

(1) Exact fulfillment of the obligation, should the vendee fail to pay;

(2) Cancel the sale, should the vendee's failure to pay cover two or more installments;

(3) Foreclose the chattel mortgage on the thing sold, if one has been constituted, should the vendee's failure to pay cover two or more installments. In this case, he shall have no further action against the purchaser to recover any unpaid balance of the price. Any agreement to the contrary shall be void.

COMMENT:**(1) Requisites Before Art. 1484 May Be Applied**

- (a) there must be a *contract*
- (b) the contract must be one of *sale* (absolute sale, *not a pacto de retro* transaction, where redemption is effected in installments)
- (c) what is sold is *personal* property (sale of *real* property in installments is governed by RA 6552 — the Maceda Law — which took effect on the date of its approval, Sept. 14, 1972). (*See infra.*)
- (d) the sale must be on the *installment* plan (an installment — is any part or portion of the buying price, including the down payment)

NOTE — If the sale is for cash or on *straight terms* (here after an initial payment, the balance is paid in its *totality* at the time specified, say, two months or three months later — this is also considered a *cash* sale), Art. 1484 does *not* apply. (*See Levy Hermanos, Inc. v. Gervacio, 69 Phil. 62.*)

(2) Purpose of the Rules For Sale of Personal Property on the Installment Plan

To prevent abuse in the foreclosure of chattel mortgages by selling at a *low price* and then suing for the *deficiency*, is the precise purpose of the article. Otherwise, the buyer would find himself without the property, and still indebted. (*Bachrach Motor v. Millan, 61 Phil. 405.*) Parenthetically, the increase in price in a sale on installments (or a conditional sale) over the cash price *cannot* be considered interest, much less usurious interest. A conditional sale based on the installment plan is *not* a loan, if the sale is made in good faith, and not a mere pretext to cover a usurious loan. (*Sun Brothers v. Caluntad, L-21440, Apr. 30, 1966.*)

Parenthetically, the proviso on non-recovery of the deficiency (also referred to as the Recto Law) is constitutional in view of the public policy involved. Moreover, it does not

unduly impair the obligation of contracts (*Manila Trading and Supply Co. v. Reyes*, 62 Phil. 461), inasmuch as it is not retroactive. (*Int. Harvester v. Mahinay*, 39 O.G. 1874).

(3) Alternative Remedies

The remedies enumerated are not cumulative. They are *alternative*, and if one is exercised, the others cannot be made use of. Indeed, the election of one is a waiver of the right to resort to others (*Pacific Commercial Co. v. De la Rama*, 72 Phil. 380). But for this doctrine to apply, the remedy must already have been fully exercised. If after retaking possession of the chattel, the seller *desists* from foreclosure, he can still avail himself of another remedy. (See *Radiowearth v. Lavin*, L-18563, Apr. 27, 1967).

(4) Examples of the Remedies

- (a) *B* bought a particular automobile on the installment plan. *B* defaulted in the payment of *one* of the installments. Has the seller, *S*, the right to exact fulfillment of the obligation to pay?

ANS.: Yes. Remedy 1 does not require default in two or more installments, unlike in remedies Nos. 2 and 3. [Art. 1484(1)]. How much can be successfully demanded? Generally, only the installments defaulted can be recovered, *unless* there is an acceleration clause or if the debtor loses the benefit of the term. (See Art. 1198, Civil Code). should there be a DEFICIENCY in the amount collected at the levy on execution, said deficiency can still be collected. Here, there is no foreclosure of any chattel mortgage. (See *Tajanlangit, et al. v. Southern Motors, Inc.*, L-10789, May 23, 1957).

- (b) *B* bought a particular automobile but defaulted in the payment of two installments. May the seller ask for the cancellation (resolution) of the sale?

ANS.: Yes, because two installments are already in default. (Art. 1484[2]).

- (c) *B* bought a car on the installment plan, and as security, executed a chattel mortgage on it. *B* failed to pay *two*

installments. The seller foreclosed the mortgage, but the sum he obtained was *less* than what *B* still owed him. It had been previously agreed in the deed of sale that *B* would be liable for any deficiency in this matter. May the seller still sue for the deficiency?

ANS.: No, for the law says that after foreclosure, the seller-mortgagee shall have no further action against the purchaser to recover any unpaid balance of the price. The contrary stipulation in their contract is VOID. (*Art. 1484, par. 3*).

[*NOTE:* “Foreclosure” here means foreclosure by the usual methods including the sale of the goods at a public auction. (*P.C.C. v. De la Rama*, 72 *Phil.* 380 and *Macon-dray and Co., Inc. v. Tan*, 38 *O.G.* 2606).]

**Zayco v. Luneta Motor Co.
L-30583, Oct. 23, 1982**

If the unpaid vendor of a vehicle sold on the installment plan forecloses the chattel mortgage executed on the property, but is not able to collect fully the debt, there is no right to recover the deficiency, and a stipulation to the contrary is void. (*Art. 1484, CC*). If the vendor assigns its right to a financing company, the latter may be regarded as a mere collecting agency of the vendor and cannot, therefore, recover any deficiency. And even if the financing company is a “distinct and separate entity” from the seller, the same result obtains, for an assignee cannot exercise any right not given to the assignor itself.

**Ridad v. Filipinas Investment
and Finance Corporation
GR 39806, Jan. 28, 1983**

If a foreclosure of the mortgage is resorted to, there can be recovery in case of a deficiency. Other chattels given as security *cannot* be foreclosed upon if they are *not* subject of the installment sale.

[*NOTE:* If the seller selects remedy (foreclosure), but the mortgage is not actually foreclosed, he can still

avail himself of the *other* remedies, such as the fulfillment of the obligation to pay. (*Pac. Com. Co. v. Alvarez*, {C.A.} 38 O.G. 756).]

[**NOTE:** Where there has been no foreclosure of the chattel mortgage or a foreclosure sale, the prohibition against further collection of the balance of the price does not apply. Thus, in one case the seller elected to sue on the promissory note issued for the purchase price, he wanted to exact fulfillment of the obligation to pay.

When the buyer could not pay, the mortgaged goods were sold on *execution* (not foreclosure proceedings). The issue was: Could the sheriff validly levy upon other property of the buyer for the balance of the judgment debt?

HELD: Yes, for the remedy resorted to was *not* foreclosure of the chattel mortgage, but specific performance of the obligation to pay. The levy on the property is indeed *not a* foreclosure of the mortgage but a levy on execution. (*Tajanlangit, et al. v. Southern Motors, Inc.*, L-10789, May 28, 1957 and *Southern Motors v. Moscoso*, 2 SCRA 168).]

[**NOTE:** The law says that any of the aforementioned remedies “may” be exercised by the seller. Therefore, he is not obliged to foreclose the chattel mortgage even if there be one. He may still sue for fulfillment or for cancellation (if he does not want to foreclose). (*Bachrach Motor Co. v. Millan*, 61 Phil. 409). As a matter of fact, he may, in availing himself of remedy (*specific performance*), ask that a *real estate mortgage* be executed to secure the payment of such price. In such a case, in the event of foreclosure, there can be recovery of the deficiency. (*Manila Trading v. Jalandoni*, {C.A.} O.G. Aug. 31, 1941, p. 1698).]

Pascual v. Universal Motors Corporation
L-27862, Nov. 20, 1974

FACTS: For the purchase on installment of five trucks, the buyer executed a chattel mortgage thereon, and a third person executed a real estate mortgage.

Because the buyer was unable to pay, the seller filed a petition for replevin, repossessed the five trucks, and foreclosed on the chattel mortgage. The real estate mortgagor then filed an action to have the real estate mortgage cancelled, alleging that since the chattel mortgage had already been foreclosed upon, there was no more need for the real estate mortgage. Will the action prosper?

HELD: Yes, for after all, there would be no more need for the real estate mortgage, in view of the foreclosure of the chattel mortgage. Even if there should be a deficiency, recovery thereof is barred under Art. 1484.

Borbon II v. Servicewide Specialists, Inc.
72 SCAD 111
1996

The remedies under Art. 1484 of the Civil Code are not commutative but alternative and exclusive. When the assignee forecloses on the mortgage, there can be no further recovery of the deficiency, and the seller-mortgagee is deemed to have renounced any right thereto.

There is in an ordinary alternative obligation, a mere choice categorically and unequivocally made and then communicated by the person entitled to exercise the option. The creditor may not thereafter exercise any other option, unless the chosen alternative proves to be ineffectual or unavailing due to no fault on his part.

In alternative remedies, the choice generally becomes conclusive only upon the exercise of the remedy. For instance, in one of the remedies expressed in Art. 1484 of the Civil Code, it is only when there has been a foreclosure of the chattel mortgage that the vendee-mortgagor would be permitted to escape from a deficiency liability.

(5) Cancellation Requires Mutual Restitution

It is clear that when the remedy of cancellation is availed of, there must be a mutual restitution of whatever

had been received by either party, *e.g.*, when the seller of a car on installment asks for cancellation of the sale, the car must be returned to him, and he in turn must give back all installment he has received, including the downpayment. Now then, the question may be asked — suppose the car has so deteriorated, *i.e.*, been so “cannibalized” that the value at which it may be resold is much less than the balance of the purchase price (*e.g.*, while the unpaid balance may still be P20,000, the value of the returned car, in view of its sorry state, may be only P80,000), may the seller still recover the difference? It is believed that the answer is “yes.” After all, the rule against the recovery of the deficiency comes into play only if the remedy of “foreclosure” is used; in the instant problem, the remedy is that of “cancellation.” Besides under Art. 1191 of the Civil Code, in case of resolution, the aggrieved party may resort to either “Special Performance PLUS damages,” or “rescission PLUS damages.” The argument that Art. 1191 (a general proviso) cannot prevail over Art. 1484 (a specific proviso) is futile, for there is absolutely no inconsistency between the two articles. Besides, since mutual restitution is generally imperative, what the buyer must return is the equivalent of what he had received, namely, the car in its damaged condition PLUS the amount of damages (it is wrong to say that he received a damaged or deteriorated car; what he received was a brand new car). On his part, the vendor must, as already stated, return all the installments (including the downpayment) that had been received by him (in view of the rule on mutual restitution), except when in the contract there is a proviso that installments already paid shall be forfeited, that is, no longer returned. Such a stipulation is valid, provided it is not unconscionable under the circumstances. Of course what is unconscionable is a question of fact. (*See Art. 1486, Civil Code*).

(6) Instances When Art. 1484 Cannot Be Applied

- (a) Art. 1484 does *not* apply to a real estate mortgage. The reason is that the real estate mortgage may be foreclosed only in conformity with special provisions. Moreover, while in Art. 1484 the creditor is given the option to seize the

object of the transaction, this is not so in the case of a real estate mortgage. (*Pac. Com. Co. v. Jocson*, [C.A.] 39 O.G. 1859; See *Macondray and Co. v. De Santos*, 61 Phil. 370; See also express wording of Art. 1484).

- (b) Art. 1484 does not apply to the sale of personal property on straight terms, a sale on straight terms being one in which the balance, after the payment of the initial sum should be paid in its totality at the time specified. Therefore in a sale on straight terms, the mortgagee-seller will still be entitled to recover the unpaid balance. (*Levy Hermanos, Inc. v. Gervasio*, 40 O.G. 3rd S. No. 7, p. 85; 69 Phil. 52).

(7) Compounding of a Criminal Prosecution

**United General Industries, Inc. v.
Jose Paler and Jose de la Rama
L-30205, Mar. 15, 1982**

FACTS: Paler and his wife bought a TV set on installment, executed a promissory note, and as security, constituted a chattel mortgage on said TV set. Because they violated the terms of the mortgage, the buyers were accused of estafa. To prevent prosecution and to settle the matter extrajudicially, Paler and a friend Jose de la Rama (who acted as accommodation party) executed a second promissory note in favor of the seller. They were unable to pay, and the seller sued them. They contend however, that the case should be dismissed because the obligation sought to be enforced was incurred in consideration of the compounding of a crime. Are they liable?

HELD: The agreement to stifle a criminal prosecution is contrary to public policy, is VOID, and cannot be enforced in court of law. However, Paler has not yet paid for the TV set he had purchased, and he is still liable for the payment thereof. This is *independent* of the execution of the subsequent promissory note. If Paler will not pay, he will be unjustly enriched at the expense of the seller. De la Rama, being a mere accommodation party, cannot be held liable.

(8) Foreclosure and Actual Sale of Mortgage Chattel

**Sps. Romulo de la Cruz & Delia de la
Cruz, et al. v.
ASIAN Consumer of Industrial Finance
Corp. & the CA
GR 94828, Sep. 20, 1992**

FACTS: The records show that on Sep. 14, 1984, ASIAN initiated a petition for extra-judicial foreclosure of the chattel mortgage. But the sheriff failed to recover the motor vehicle from petitioners due to the refusal of the son of petitioners Romulo and Delia de la Cruz to surrender it. It was not until Oct. 10, 1984, or almost a month later, that petitioners delivered the unit to ASIAN. The action to recover the balance of the purchase price was instituted on Nov. 27, 1984. *Issue:* May a chattel mortgagee, after opting to foreclose the mortgage but failing afterwards to sell the property at public auction, still sue to recover the unpaid balance of the purchase price?

HELD: It is clear that while ASIAN eventually succeeded in taking possession of the mortgaged vehicle, it did not pursue the foreclosure of the mortgage as shown by the fact that no auction sale of the vehicle was ever conducted. Thus, under the law, the delivery of possession of the mortgaged property to the mortgagee, the herein appellee, can only operate to extinguish appellant's liability if the appellee had actually caused the foreclosure sale of the mortgaged property when it recovered possession thereof. It is the fact of foreclosure and actual sale of the mortgaged chattel that bar recovery by the vendor of any balance of the purchaser's outstanding obligation not satisfied by the sale. (*Art. 1484, par. 3, Civil Code*). If the vendor desisted, on his own initiative, from consummating the auction sale, such desistance was a timely disavowal of the remedy of foreclosure, and the vendor can still sue for specific performance. Consequently, in the case at bar, there being no actual foreclosure of the mortgaged property, ASIAN is correct in resorting to an ordinary action for collection of the unpaid balance of the purchase price.

Art. 1485. The preceding article shall be applied to contracts purporting to be leases of personal property with option to buy, when the lessor has deprived the lessee of the possession or enjoyment of the thing.

COMMENT:

(1) Reason for Rule on Leases of Personal Property With Option to Buy

This may really be considered a sale of personal property in installments. Therefore, the purpose of Art. 1485 is to prevent an indirect violation of Art. 1484.

(2) Meaning of the Clause “when the lessor has deprived the lessee of the possession or enjoyment of the thing”

This means that for failure to pay, the “lessor” is apparently exercising the right of an unpaid seller, and has taken possession of the property. This is so even if the property had been given up in obedience to the “lessor’s” extrajudicial demand, such surrender not really being voluntary. (*U.S. Com. Co. v. Halili, L-5535, May 29, 1953*).

(3) When “Lease” Construed as “Sale”

Even if the word “lease” is employed, when a sale on installment is evidently intended, it must be construed as a sale. (*Abello v. Gonzaga, 56 Phil. 132 and Heacock v. Buntal Mfg. Co., 38 O.G. 2382*).

Art. 1486. In the cases referred to in the two preceding articles, a stipulation that the installments or rents paid shall not be returned to the vendee or lessee shall be valid insofar as the same may not be unconscionable under the circumstances.

COMMENT:

(1) Non-Return of Installments Paid

- (a) As a *general rule*, it is required that a case of rescission or cancellation of the sale requires mutual restitution,

that is, all partial payments of price or “rents” must be returned.

- (b) However, by way of *exception*, it is *valid to stipulate* that there should be NO returning of the price that has been partially paid or of the “rents” given, provided the stipulation is not unconscionable.

(2) Example

B bought a car from *S* on installment. It was agreed that installments already paid should not be returned even if the sale be cancelled. This is a valid stipulation unless unconscionable. If there is no such stipulation, the installments should be returned minus reasonable rent.

SALE OF REAL PROPERTY IN INSTALLMENT

REPUBLIC ACT 6552 (The Maceda Law)

AN ACT TO PROVIDE PROTECTION TO BUYERS OF REAL ESTATE ON INSTALLMENT PAYMENTS.

Be it enacted by the Senate and House of Representatives of the Philippines in Congress assembled:

Section 1. This Act shall be known as the “*Realty Installment Buyer Protection Act*.”

Sec. 2. It is hereby declared a public policy to protect buyers of real estate on installment payments against onerous and oppressive conditions.

Sec. 3. In all transactions or contracts involving the sale or financing of real estate on installment payments, including residential condominium apartments but excluding industrial lots, commercial buildings and sales to tenants under Republic Act Numbered Thirty-eight hundred forty-four as amended by Republic Act Numbered Sixty-three hundred eighty-nine, where the buyer has paid at least two years of installments, the buyer is entitled to the following rights in case he defaults in the payment of succeeding installments:

(a) To pay, without additional interest, the unpaid installments due within the total grace period earned by him, which is hereby fixed at the rate of one-month grace period for every one year of installment payments made: *Provided*, That this right shall be exercised by the buyer only once in every five years of the life of the contract and its extensions, if any.

(b) If the contract is cancelled, the seller shall refund to the buyer the cash surrender value of the payments on the property equivalent to fifty percent of the total payments made and, after five years of installments, an additional five percent every year but not to exceed ninety per cent of the total payments made: *Provided*, That the actual cancellation of the contract shall take place after thirty days from receipt by the buyer of the notice of cancellation or the demand for rescission of the contract by a notarial act and upon full payment of the cash surrender value to the buyer.

Downpayments, deposits or options on the contract shall be included in the computation of the total number of installments made.

Sec. 4. In case where less than two years of installments were paid, the seller shall give the buyer a grace period of not less than sixty days from the date the installment became due. If the buyer fails to pay the installments due at the expiration of the grace period, the seller may cancel the contract after thirty days from receipt by the buyer of the notice of cancellation or the demand for rescission of the contract by a notarial act.

Sec. 5. Under Sections 3 and 4, the buyer shall have the right to sell his rights or assign the same to another person or to reinstate the contract by updating the account during the grace period and before actual cancellation of the contract. The deed of sale or assignment shall be done by notarial act.

Sec. 6. The buyer shall have the right to pay in advance any installment or the full unpaid balance of the purchase price any time without interest and to have such full payment of the purchase price annotated in the certificate of title covering the property.

Sec. 7. Any stipulation in any contract hereafter entered into contrary to the provisions of Sections 3, 4, 5 and 6, shall be null and void.

Sec. 8. If any provisions of this Act is held invalid or unconstitutional, no other provision shall be affected thereby.

Sec. 9. This Act shall take effect upon its approval.

Approved, Sept. 14, 1972.

(3) ‘Raison d’ Etre’ of The Maceda Law

To help especially the low income lot buyers, the legislature enacted RA 6552 — “The Realty Installment Buyer Protection Act,” or more popularly known as the Maceda Law — which came into effect on Sept. 1972, delineating the rights and remedies of lot buyers and protect them from one-sided and pernicious contract stipulations. The Act’s declared public policy is to protect buyers or real estate or installment basis against onerous and oppressive conditions. More specifically, the Act provided for the rights of the buyer in case of default in the payment of succeeding installments, where he has already paid at least two years of installment. (*Sec. 3, RA 6552*).

The Act seeks to address the acute housing shortage problem in our country that has prompted thousands of middle and lower class buyers of houses, lots, and condominium units to enter into all sorts of contracts with private housing developers involving installment schemes. Lot buyers, mostly low income earners eager to acquire a lot upon which to build their homes, readily affix their signatures on these contracts, without an opportunity to question the onerous provisions therein as the contract is offered to them on a “take it or leave it” basis. (*Angeles v. Calasanz, 135 SCRA 323 [1985]*).

Most of these contracts of adhesion, drawn exclusively by the developers, entrap innocent buyers by requiring cash deposits for reservation agreements which oftentimes include, in fine print, onerous default clauses where all the installment payments made will be forfeited upon failure to pay any installment due even if the buyers had made payments for several years. (*Realty Exchange Venture Corp. v. Sendino, 233 SCRA 665 [1994]*). Real estate developers, thus, enjoy an unnecessary advantage over lot buyers who they often exploit with iniquitous results. They get to forfeit all the installment payments of defaulting buyers and resell the same lot to another buyer with the same exigent conditions. (*Ac-*

tive Realty & Development Corp. v. Necita G. Daroya, GR 141205, May 9, 2002).

(4) Case

**Delta Motor Sales Corp. v. Niu
Kim Duan & Chan Fue Eng
GR 61043, Sep. 2, 1992**

A stipulation in a contract that the installments paid shall not be returned to the vendee is valid insofar as the same may not be unconscionable under the circumstances is sanctioned by Art. 1486 of the Civil Code.

In the case at bar, the monthly installment payable by defendants-appellants was P774 (based on the balance of P18,576 divided by 24 monthly installments). The P5,665.92 installment payments correspond only to 7 monthly installments. Since they admit having used the air-conditioners for 22 months, this means that they did not pay 15 monthly installments on the said air-conditioners and were thus using the same free for said period — to the prejudice of plaintiff-appellee. Under the circumstances, the treatment of the installment payments as rentals cannot be said to be unconscionable.

Art. 1487. The expenses for the execution and registration of the sale shall be borne by the vendor, unless there is a stipulation to the contrary.

COMMENT:

Who Pays for Expenses in Execution and Registration

Observe that as a rule the seller pays for the expenses of:

- (a) the *execution* (of the deed) of sale;
- (b) its *registration*.

(NOTE: There can, however, be a contrary stipulation.)

Art. 1488. The expropriation of property for public use is governed by special laws.

COMMENT:

(1) Nature of Expropriation

Expropriation is *involuntary* in nature, that is, the owner may be compelled to surrender the property after all the essential requisites have been complied with. Therefore, *generally* expropriation does not result in a sale. There is, however, one exception to this rule. In the case of *Gutierrez v. Court of Tax Appeal (L-9738, May 31, 1957)*, the Supreme Court held that the acquisition by the government of private properties thru the exercise of eminent domain, said properties being *justly compensated*, is a *sale or exchange within the meaning of the income tax laws and profits derived therefrom are taxable as capital gain*; and this is so although the acquisition was against the will of the owner of the property and there was no meeting of the minds between the parties.

(2) When Transaction is One of Sale

If the property owner voluntarily sells the property to the government, this would be a *sale*, and not an example of expropriation.

(3) ‘Eminent Domain’ Distinguished From ‘Expropriation’

Eminent domain refers to the right given to the state, whereas *expropriation* usually refers to the process.

(4) Essential Requisites for Expropriation

- (a) taking by competent authority
- (b) observance of due process of law
- (c) taking for public use
- (d) payment of just compensation

(5) ‘Just Compensation’ Defined

The “*just compensation*” is the market value (the price which the property will bring when it is offered for sale by one who desires but is not obliged to sell it, and is bought by one who is under no necessity of having it) PLUS the consequential *damages*, if any, MINUS the consequential *benefits*, if any. (*City of Manila v. Corrales*, 32 Phil. 85). BUT the benefits may be set off only against the consequential damages, and not against the basic value of the property taken. (*See Rule 67, Sec. 6, Revised Rules of Court*).

**Pedro Arce and Carmen Barrica de
Arce v. Genato
L-40587, Feb. 27, 1976**

FACTS: A CFI (RTC) judge, in an expropriation case, allowed the condemnor (the Municipality of Baliangao of Misamis Oriental) to take (upon deposit with the PNB of an amount equivalent to the assessed value of the property) immediate possession of a parcel of land sought to be condemned, for the beautification of its town plaza. This was done *without a prior hearing* to determine the necessity for the exercise of eminent domain. Is the Judge allowed to do so?

HELD: Yes, the Court is allowed to do so in view of President Decree 42, issued Nov. 9, 1972. PD 42 is entitled “Authorizing the Plaintiff in Eminent Domain Proceedings to Take Possession of the Property Involved Upon Depositing the Assessed Value for Purposes of Taxation.” Under said P.D. the deposit should be with the Philippine National Bank (in its main office or any of its branches or agencies). The bank will hold the deposit, subject to the orders and final disposition by the court. Under the Decree, there is no need of prior showing of necessity for the condemnation. The *City of Manila v. Arellano Law Colleges* case (886 Phil. 663) which enunciated the contrary doctrine is no longer controlling. The old doctrine requiring prior showing of necessity was the antiquarian view of Blackstone with its sanctification of the right to one’s estate. The Constitution pays little heed to the claims of property.

Province of Camarines Sur v. CA
41 SCAD 388
1993

The fixing of just compensation in expropriation proceedings shall be made in accordance with Rule 67 of the Rules of Court and not on the basis of the valuation declared in the tax declaration of the subject property by the owner or assessor which has been declared unconstitutional.

Chapter 2

CAPACITY TO BUY OR SELL

Art. 1489. All persons who are authorized in this Code to obligate themselves, may enter into a contract of sale, saving the modifications contained in the following articles.

Where necessities are sold and delivered to a minor or other person without capacity to act, he must pay a reasonable price therefor. Necessaries are those referred to in Article 290.

COMMENT:

(1) Incapacity to Buy May Be Absolute or Relative

- (a) *Absolute incapacity* —when party cannot bind himself in any case.
- (b) *Relative incapacity* —when certain persons, under certain circumstances, cannot buy certain property. (*Wolfson v. Estate of Martinez*, 20 Phil. 304 and 10 Manresa 87).

(**NOTE:** Among people relatively incapacitated are those mentioned in Arts. 1490 and 1491, Civil Code.)

(2) Purchase By Minors

When minors buy, the contract is generally *voidable*, but in the case of necessities, “where necessities are sold and delivered to a minor or other person without capacity to act, he must pay a *reasonable* price therefor. Necessaries are those referred to in Art. 290.” (*Art. 1489, par. 2*).

Felipe v. Aldon
GR 60174, Feb. 16, 1983

If a wife sells conjugal land *without* the needed consent of her husband, the sale is *voidable* (not at her instance, in view

of her guilt, but at the instance of the husband, or in case of her death, at the instance of the husband and her other heirs). It would seem that the contract should be regarded void because the transaction has been done contrary to law. It is likewise not proper to refer to the contract as unenforceable (or unauthorized) because here there is no pretense that the wife was selling the property with her husband's authorization.

[**NOTE:** Necessaries include "everything that is indispensable for *sustenance, dwelling, clothing, and medical attendance, according to the social position of the family.* Support also includes the *education* of the person entitled to be supported until he completes his education or training for some profession, trade, or vocation, even beyond the age of majority." (Art. 290, Civil Code).]

(3) Husbands

Bar

On Aug. 3, 1949, the husband bought a house and lot with money he received as bonus from his employer. On Mar. 20, 1966, without the knowledge of his wife, the husband *sold* the same house and lot to raise money for a business venture. May the wife annul the sale on the ground that it was made without her knowledge and consent? Reason.

ANS.: Regardless of whether the bonus received by the husband was his capital or conjugal property, and regardless also of whether the immovable property acquired with said bonus was capital or conjugal, the fact remains that the said immovable property (house and lot) was acquired by the husband on Aug. 3, 1949 or more than a year before the effectivity of the Civil Code on Aug. 30, 1950. Under this Code, the husband may sell, alienate, or encumber, even *without the consent of his wife*, his exclusive property and also conjugal immovable property acquired *before* the effectivity of the Civil Code. The wife cannot even ask for the annulment of the sale on the ground that it is in fraud of her rights because the purpose of the transaction was to benefit the family, that is, to raise money for a business venture. (See Arts. 166 and 173, Civil Code).

Castillo v. Castillo
L-18238, Jan. 22, 1980

If the deed of sale of the land lists as purchasers both the husband and the wife, the presumption is that it is paraphernal property.

Godinez v. Fong
120 SCRA 223
1983

If a Filipino sells a parcel of land to a Chinese who later sells the same to another Filipino, the second sale is VALID because the purpose of the Constitution of preserving the land in favor of Filipinos has not been frustrated.

Art. 1490. The husband and the wife cannot sell property to each other, except:

(1) When a separation of property was agreed upon in the marriage settlements; or

(2) When there has been a judicial separation of property under Article 191.

COMMENT:

(1) Reason Why Generally a Husband and Wife Cannot Sell to Each Other

To avoid prejudice to third persons; to prevent one spouse from unduly influencing the other; to avoid by indirection the violation of the prohibition against donations.

(2) Effect of Sale

Generally, a sale by one spouse to another is void. (*Uy Siu Pin v. Cantollas*, 40 O.G. No. 11 [7th S], p. 197). However, not everybody can assail the validity of the transaction. Thus, creditors who became such *after* the transaction cannot assail its validity for the reason that they cannot be said to have been prejudiced. (*Cook v. McMicking*, 27 Phil. 10). But prior creditors (creditors at the time of transfer) as well as the heirs of either spouse may invoke the nullity of the sale. (*Ibid.*)

When the proper party brings the sale should be declared void by the courts. (*Uy Siu Pin v. Cantollas*, 40 O.G. No. 11 [S], p. 197). The spouses themselves since they are parties to an illegal act, cannot avail themselves of the illegality of the sale. The law will generally leave them as they are.

[**NOTE:** Under the two (2) exceptions under Art. 1490, the sale is generally valid, but of course, should there be vitiated consent (as in the case of undue influence) the sale is *voidable*.]

[Just as a married couple cannot generally sell to each other, they also generally cannot donate to each other. (*Art. 87, Family Code*). Incidentally, this prohibition about donating to each other applies also to COMMON-LAW husband and wife on the theory that here there can be an even greater degree of undue influence; furthermore, if they will be allowed while those lawfully married will generally be prohibited, this would be giving a reward to illicit relationship. (*See Buenaventura v. Bautista*, 50 O.G. 3679, C.A.; *See also Cornelia Matabuena v. Petronila Cervantes*, L-28771, Mar. 31, 1971)].

(3) Problems

- (a) A husband and his wife were living together under the conjugal partnership system. May the husband sell his own parcel of land to his wife?

ANS.: No, because such a sale is expressly prohibited by law (*Art. 1490*) and is, therefore, considered VOID. (*Art. 1409[7]* and *Uy Siu Pin v. Cantollas*, 40 O.G. No. 11 [S], p. 197).

- (b) In the preceding problem, who can attack the validity of the sale?

ANS.: Although the sale is void, not everybody is given the right to assail the validity of the transaction. For instance, the spouses themselves, since they are parties to an illegal act, cannot avail themselves of the illegality of the sale, the law will generally leave them as they are. And then also, the *creditors* who became such *only after* the transaction cannot attack the validity of the sale for the reason that they cannot be said to have been prejudiced. (*Cook v. McMicking*, 27 Phil. 10). Thus, the only people who can question the sale

are the following: the heirs of either spouse, as well as *prior creditors* (persons who were already creditors at the time of the transfer). (*Ibid.*).

Example:

A husband sold his land to his wife. Later, he borrowed money from C. The loan matured. When C discovered that the husband did not have any cash or any other property, he decided to question the sale that had previously been made in favor of the wife. Do you think said creditor can go after such property?

ANS.: No, for he *was not* yet a creditor at the time the transaction took place. Therefore, it cannot truthfully be said that he had been prejudiced by the sale. It would have been different if at the time the sale was effected he was already a creditor. (*See Ibid.*).

- (c) A husband and his wife were living under the conjugal partnership system. Later, because of a quarrel, the wife left the husband, without judicial approval. They have thus been living apart for the last 10 years. Do you think that they can now sell the property to each other?

ANS.: They *still* cannot, for they are still husband and wife, and there has been no separation of property agreed upon before the marriage, nor a judicial separation of property elected during the marriage. (*Art. 1490, Civil Code*).

- (d) Would your answer to the preceding problem be the same if there has been a *legal separation*?

ANS.: No, the answer will not be the same. One of the effects of legal separation is the dissolution of the conjugal partnership. (*Art. 63, Family Code*). Once the conjugal partnership ends, the system that will prevail is the separation of property system, and here the sale can be validly done. (*Art. 1490, Civil Code*).

- (e) May a husband validly sell the wife's property for her?

ANS.: Yes, but only if he acts as an agent for her, with a specific or special power of attorney to effectuate the sale. (*See Art. 1878, Civil Code*).

Art. 1491. The following persons cannot acquire by purchase, even at a public or judicial auction, either in person or through the mediation of another:

(1) The guardian, the property of the person or persons who may be under his guardianship;

(2) Agents, the property whose administration or sale may have been intrusted to them, unless the consent of the principal has been given;

(3) Executors and administrators, the property of the estate under administration;

(4) Public officers and employees, the property of the State or of any subdivision thereof, or of any government-owned or controlled corporation or institution, the administration of which has been intrusted to them; this provision shall apply to judges and government experts who, in any manner whatsoever, take part in the sale;

(5) Justices, judges, prosecuting attorneys, clerks of superior and inferior courts, and other officers and employees connected with the administration of justice, the property and rights in litigation or levied upon an execution before the court within whose jurisdiction or territory they exercise their respective functions; this prohibition includes the act of acquiring by assignment and shall apply to lawyers, with respect to the property and rights which may be the object of any litigation in which they may take part by virtue of their profession;

(6) Any others specially disqualified by law.

COMMENT:

(1) Persons Relatively Incapacitated to Buy

This article refers to *relative incapacity*.

(2) Reason for the Law

Public policy prohibits the transactions in view of the fiduciary relationship involved.

(3) Purchase Thru Another

“Thru the mediation of another” — this must be proved, that is, that there was really an agreement between the intermediary and the person disqualified; otherwise, the sale cannot be set aside. (*Rodriguez v. Mactual*, 60 Phil. 13).

[Refer to Art. 1635 for exceptions.]

(4) Purchase By Agent for Himself

An agent is not allowed, without his principal's permission, to sell to himself what he has been ordered to buy; or to buy for himself what he has been ordered to sell. (*Moreno v. Villones*, 40 O.G. No. 11, p. 2322). The fiduciary relations between them estop the agent from asserting a title adverse to that of the principal. (*Severino v. Severino*, 44 Phil. 343). And therefore such a sale to himself would be ineffectual and void, because it is expressly prohibited by law. (*Barton v. Leyte Asphalt & Mineral Oil Co.*, 46 Phil. 938). The agent may, of course, buy after the termination of the agency. (*Valera v. Vela*, 51 Phil. 695).

[**NOTE:** Under Art. 1459 of the old Civil Code, an agent or administrator was disqualified from purchasing property in his hands for sale or management. However, under Art. 1491 of the new Civil Code, this prohibition was *modified* in that the agent may now buy the property placed in his hands for sale or administration, provided the principal gives his consent thereto.

In *Cui, et al. v. Cui, et al.*, L-7041, Feb. 21, 1957, the Supreme Court said that this provision of the new Civil Code can be applied *retroactively* to a contract of sale made by a father in favor of his son, whom he had appointed as attorney in fact in 1946. This is a right that is declared for the first time and the same may be given retroactive effect if no vested or acquired right is impaired. (*Art. 2253, Civil Code*). In this case, the other children of the vendor cannot buy the property subject matter of the agency. The Court held that during the lifetime of their father (who was still alive up to the time that the action to annul the sale was instituted), and particularly in 1946 when the sale was made, the plaintiffs

could not claim any vested or acquired right in the property, for as heirs, the most they had was a mere expectancy.]

[**NOTE:** While Art. 1491 prohibits generally an administrator from *buying* the property he is administering, what happens if he SELLS the property without due authority? If an administrator of a parcel of land should *register the land in his name* (and not that of the owner), and should later sell the land to third persons who are *able to register* the property in their names (despite their knowledge that the seller is *not* the owner) — the third persons can become the owners by acquisitive prescription (30 years because of their *bad faith*]; moreover, the true owner cannot *compel* a reconveyance by the administrator because the land is *no longer* under his name — and this is true even if the administrator is only a trustee. (*Joaquin v. Cojuangco*, L-18060, Jul. 25, 1967).]

(5) Purchase By Attorney

A lawyer is not allowed to purchase the property of his client which is in litigation. (*Hernandez v. Villanueva*, 40 Phil. 775). To do otherwise would be a breach of professional conduct (*Beltran v. Fernandez*, 40 O.G., p. 84), and would constitute *malpractice*. (*In re Attorney Melchor Ruste*, 40 O.G., p. 78). But assigning the amount of the judgment by the client to his attorney, who did NOT take any part in the case where said judgment was rendered, is valid. (*Mun. Council of Iloilo v. Evangelista*, 56 Phil. 290). A thing is said to be in litigation not only if there is some contest or litigation over it in court, but also from the moment that it became *subject* to the *judicial action* of the judge. (*Gan Tingco v. Pobinguit*, 35 Phil. 91). Art. 1491 does *not* prohibit a lawyer from acquiring a certain percentage of the value of the properties in litigation that may be awarded to his client. A contingent fee based on such value is allowed. (*Recto v. Harden*, L-6897, Nov. 29, 1956).

Florentino B. del Rosario v. Eugenio Millado **Adm. Case 724, Jan. 31, 1969**

FACTS: Attorney Eugenio Millado was sought to be disbarred on the ground that he had violated Art. 1491 of the Civil Code (and also Canon 10 of the Canons of Legal Ethics),

by *acquiring an interest in land involved in a litigation in which he had appeared as attorney*. It was proved, however, that said interest had been acquired PRIOR to his acting as such attorney.

HELD: The complaint for disbarment is WITHOUT MERIT, the interest having been acquired PRIOR to the attorney's intervention as counsel in the case.

[NOTE: Similarly, if the attorney participates in the sale, not as buyer but as AGENT for the buyer—there is no violation of the law. (See *Diaz v. Kapunan*, 46 Phil. 842 and *Tuason v. Tuason*, 88 Phil. 428).]

Fabillo v. IAC
GR 68838, Mar. 11, 1991

FACTS: In her will, Justina Fabillo bequeathed to her brother, Florencio, a house and lot in San Salvador and to her husband Gregorio, a piece of land in Pugahanay. After Justina's death, Florencio filed a petition for the probate of the will. The trial court approved the project of partition with the reservation that the ownership of the house and lot bequeathed to Florencio shall be litigated and determined in a separate proceeding. Two years later, Florencio sought the assistance of lawyer Murillo in recovering the property. Murillo wrote Florencio acquiescing to the rendering of his services for 40% of the money value of the house and lot as a contingent fee in case of success. Thereafter, Florencio and Murillo entered into a "contract of services" providing that Florencio promises to pay "Murillo, in case of success in any or both cases the sum equivalent to 40% of whatever benefit I may derive from such cases." The contract also stipulates that "if the house and lot or a portion thereof is just occupied by the undersigned or his heirs, Murillo shall have the option of either occupying or leasing to any interested party forty per cent of the house and lot." Pursuant to the contract, Murillo filed for Florencio a suit against Gregorio to recover the San Salvador property. The case was terminated on Oct. 29, 1964 when the Court, upon the parties' joint motion in the nature of a compromise agreement, declared Florencio as the lawful owner not only of the San Salvador property but

also the Pugahanay parcel of land. So, Murillo implemented the contract of services between him and Florencio by taking possession and exercising rights of ownership over 40% of said properties. He installed a tenant in the Pugahanay property. In 1966, Florencio claimed exclusive rights over the two properties and refused to give Murillo his share of their produce. Inasmuch as his demands for his share of the produce of the Pugahanay property were unheeded, Murillo sued Florencio. The trial court declared Murillo to be the owner of 40% of both San Salvador and Pugahanay properties and the improvements thereon. It directed Fabillo to pay Murillo P1,200 representing 40% of the net produce of the Pugahanay property from 1967 to 1973; entitled Murillo to 40% of the 1974 and 1975 income of the Pugahanay property which was on deposit with a bank, and order defendant to pay the costs of the suit. The Court of Appeals affirmed the trial court's decision.

HELD: The Supreme Court reversed and set aside the Appellate Court's decision and entered a new one (a) ordering Fabillo to pay Murillo or his heirs P3,000 as his contingent fee with legal interest from Oct. 29, 1964 when the civil case was terminated until the amount is fully paid less any and all amounts which Murillo might have received out of the produce or rentals of the Pugahanay and San Salvador properties, and (b) ordered the receiver of the properties to render a complete report and accounting of his receivership to the court below within 15 days from the finality of this decision. The Court ruled that the contract of services did not violate said provision of law. Art. 1491 of the Civil Code, specifically paragraph 5 thereof, prohibits lawyers from acquiring by purchase even at a public or judicial auction, properties and rights which are the objects of litigation in which they may take part by virtue of their profession. The said prohibition, however, applies only if the sale or assignment of the property takes place during the pendency of the litigation involving the client's property. A contract between a lawyer and his client stipulating a contingent fee is not covered by said prohibition under Art. 1491(5) of the Civil Code because the payment of said fee is not made during the pendency of the litigation but only after judgment has been rendered in the case handled by the lawyer. Under the 1988 Code of Professional Responsibil-

ity, a lawyer may have a lien over funds and property of his client and may apply so much thereof as may be necessary to satisfy his lawful fees and disbursements. As long as the lawyer does not exert "undue influence" on his client, that no fraud is committed or imposition applied, or that the compensation is clearly not excessive as to amount to extortion, a contract for contingent fee is valid and enforceable. Moreover, contingent fees are impliedly sanctioned by 13 of the Canons of Professional Ethics which governed lawyer-client relationships when the contract of services was entered into between the Fabillo spouses and Murillo.

However, this Court disagrees with the courts below that the contingent fee stipulated between Fabillo and Murillo is forty percent of the properties subject of the litigation for which Murillo appeared for the Fabillos. Under the contract, the parties intended forty percent of the value of the properties as Murillo's contingent fee. This is borne out by the stipulation that "in case of success of any or both cases" Murillo shall be paid. "The sum equivalent to forty per centum of whatever benefit" Fabillo would derive from favorable judgments. The same stipulation was earlier embodied by Murillo in his letter of Aug. 9, 1964. The provisions of the contract clearly states that in case the properties are sold, mortgaged, or leased, Murillo shall be entitled respectively to 40% of the "purchase price," "proceeds of the mortgage," or "rentals." The contract is vague, however, with respect to a situation wherein the properties are neither sold, mortgaged or leased because Murillo is allowed "to have the option of occupying or leasing to any interested party forty percent of the house and lot." Had the parties intended that Murillo should become the lawful owner of the 40% of the properties, it would have been clearly and unequivocally stipulated in the contract considering that Fabillo would part with actual portions of their properties and cede the same to Murillo. The ambiguity of said provisions, however, should be resolved against Murillo as it was he himself who drafted the contract. This is in consonance with the rule of interpretation that in construing a contract of professional services between a lawyer and his client, such construction as would be more favorable to the client should be adopted even if it would work prejudice to the lawyer. Rightly so, because of the inequality in situation

between an attorney who knows the technicalities of the law on the one hand and a client who usually is ignorant of the vagaries of the law on the other. Considering the nature of the case, the value of the properties subject matter thereof, the length of time and effort exerted on it by Murillo, the latter is entitled to P3,000 as reasonable attorney's fees for services rendered in the case which ended in a compromise agreement. A lawyer shall at all times uphold the integrity and dignity of the legal profession so that his basic ideal becomes one of rendering service and securing justice, not money-making. For the worst scenario that can ever happen to a client is to lose the litigated property to his lawyer in whom all trust and confidence were bestowed at the very inception of the legal controversy.

Valencia v. Cabanting
Adm. Case 1391, Apr. 26, 1991

FACTS: Atty. Cabanting purchased a lot after finality of judgment and while there was still a pending *certiorari* proceeding.

HELD: A thing is said to be in litigation not only if there is some contest or litigation over it in court, but also from the moment that it becomes subject to the judicial action of the judge. Logic dictates, in *certiorari* proceedings, that the appellant court may either grant or dismiss the petition. Hence, it is not safe to conclude, for purposes under Art. 1491 of the Civil Code that the litigation has terminated when the judgment of the trial court became final while a *certiorari* connected therewith is still in progress. Thus, purchase of the property by Atty. Cabanting in this case constitutes malpractice in violation of Art. 1491 and the Canons of Professional Ethics. This malpractice is a ground for suspension.

(6) Meaning of “Any others specially disqualified by law”

This refers to those prohibited by reason of the *fiduciary relationship* involved. This is so by the principle of “*ejusdem generis*” (in a series of enumerations, general words like “and others” placed at the end thereof are understood to embrace

only those situated under the same class or group of those listed down in the enumeration). While aliens cannot buy land because of the Constitution, they do not fall under the phrase “any others specially disqualified by law” under *Art. 1490 [No. 6]*.

[NOTE: Thus, while those disqualified under Arts. 1490 and 1491 may not become lessees (*Art. 1646*), still aliens may become lessees even if they cannot buy lands. (*Smith, Bell & Co., Ltd. v. Reg. of Deeds, 50 O.G. 6293*).]

[NOTE: A bishop, chief priest, or presiding elder of any religious denomination, society, or church who has constituted himself as a *corporation sole* under Act 1459, the Corporation can *purchase* and *sell real and personal property* for its church, charitable, benevolent, or educational purposes, irrespective of the *citizenship* of said bishop, chief priest, or elder. Such property is not owned by said corporation sole, but held in trust for the benefit of the faithful residing within its territorial jurisdiction. (*Roman Catholic Apostolic Adm. of Davao, Inc. v. Land Reg. Com., L-8451, Dec. 30, 1957*).]

(7) Status of the Sale

Generally, sales entered into in disregard of the prohibition under this article are *not void*. They are merely *voidable*. (*Wolfson v. Estate of Martinez, 20 Phil. 340 and Fradon, et al. v. Neyra, et al., L-4421, Jan. 31, 1951*).

Republic v. Court of Appeals L-59447, Dec. 27, 1982

The Iglesia ni Kristo, a corporation sole, is NOT a natural person and has no nationality, *cannot* acquire alienable lands of the public domain, and *cannot* therefore register the same in its name under an Original Certificate of Title. It may, however, get a Transfer Certificate of Title. It may, however, get a Transfer Certificate of Title since the land covered by this is no longer “public land.” *J. Teehankee, later to become Chief Justice (dissenting)*: The INK should be allowed because the *true* owners or beneficiaries are natural persons.

(8) Some Cases**Maharlika Publishing Corp. v. Tagle
GR 65594, Jul. 9, 1986**

The wife of the Chief of the Retirement Division of the GSIS is prohibited from bidding for the purchase of land foreclosed by the GSIS. The sale to her of such property, after a public bidding, is void.

**Fornilda, et al. v. Branch 164, RTC
of Pasig, et al.
GR 72306, Jan. 24, 1989**

By violating Art. 1491(5), one cannot be considered in the general run of a judgment creditor.

Art. 1492. The prohibitions in the two preceding articles are applicable to sales in legal redemption, compromise and renunciations.

COMMENT:**(1) Applicability of Relative Incapacity to Legal Redemption, Compromises, and Renunciation***Example:*

If a ward's property is sold, the guardian, even if he be an adjacent owner, and even if all the other requisites for *legal redemption* are present, *cannot* exercise the right of legal redemption.

(2) Cross-Reference

Refer to the following articles.

- (a) legal redemption (*Art. 1619, Civil Code*);
- (b) compromises (*Art. 2028, Civil Code*);
- (c) renunciation (*Arts. 6 and 1270, Civil Code*).

Chapter 3

EFFECTS OF THE CONTRACT WHEN THE THING SOLD HAS BEEN LOST

Art. 1493. If at the time the contract of sale is perfected, the thing which is the object of the contract has been entirely lost, the contract shall be without any effect.

But if the thing should have been lost in part only the vendee may choose between withdrawing from the contract and demanding the remaining part, paying its price in proportion to the total sum agreed upon.

COMMENT:

(1) Loss of Object Before Sale

This refers to a case of loss of the object even *before* the perfection of the contract. It is evident that there would be no cause or consideration; hence, the contract is *void*. Observe that it is the *seller* here who naturally will have to bear the *loss*.

Example:

I sold to Maria my house in Zamboanga which, unknown to both of us, had been completely destroyed *last night*. The sale is *null and void*. (See *10 Manresa 118*). There is, thus, no need of annulling the contract because there is nothing that has to be annulled. (*10 Manresa 119*).

(2) Complete Loss Distinguished from Partial Loss

Note the difference in the rules

- (a) When the object has been *COMPLETELY LOST*;

- (b) When the object has been *PARTLY* or *PARTIALLY LOST*.

[Remedies:

- 1) withdrawal (or rescission)
- 2) specific performance as to remainder by payment of *proportional price]*

Art. 1494. Where the parties purport a sale of specific goods, and the goods without the knowledge of the seller have perished in part or have wholly or in a material part so deteriorated in quality as to be substantially changed in character, the buyer may at his option treat the sale:

- (1) As avoided; or
- (2) As valid in all of the existing goods or in so much thereof as have not deteriorated, and as binding the buyer to pay the agreed price for the goods in which the ownership will pass, if the sale was divisible.

COMMENT:

Loss of Specific Goods

- (a) This article practically reiterates the principles involved in the preceding article.
- (b) Again the remedies are:
 - 1) cancellation (avoidance);
 - 2) or specific performance as to the remaining existing goods (if the sale was divisible).

Chapter 4

OBLIGATIONS OF THE VENDOR

Section 1

GENERAL PROVISIONS

Art. 1495. The vendor is bound to transfer the ownership of and deliver, as well as warrant the thing which is the object of the sale.

COMMENT:

(1) Obligations of Vendor

- (a) to transfer ownership (cannot be waived)
- (b) to deliver (cannot be waived)
- (c) to warrant the object sold (this can be waived or modified since warranty is not an essential element of the contract of sale)
- (d) to preserve the thing from perfection to delivery, otherwise he can be held liable for damages. (*See Art. 1163, Civil Code*).

(2) Case

**Hermogena G. Engreso with
Spouse Jose Engreso v.
Nestoria de la Cruz & Herminio dela Cruz
GR 148727, Apr. 9, 2003**

FACTS: Although the sale was made thru a public document and, hence, equivalent to delivery of the thing sold, petitioner Hermogena vehemently denied the fact of the sale and interposed the objection to private respondent's enjoyment of the property.

HELD: As such, fiction must yield to reality and petitioner's obligations to deliver the sold portion of Lot 10561, or lot 10561-A, to private respondent remains. Indeed, under the law on sales, the vendor is bound to transfer ownership of and deliver the thing object of the sale to the vendee. (*Art. 1495*).

(3) Failure to Deliver on Time

- (a) If the seller promised to deliver at a stipulated period, and such period is of the essence of the contract, but did not comply with his obligation on time, he has no right to demand payment of the price. As a matter of fact, the vendee-buyer may ask for the rescission or resolution of the sale. (*Sorer v. Chesley, 43 Phil. 529*).
- (b) If failure by seller to deliver on time is *not* due to his fault, as when it was the buyer who failed to supply the necessary credit for the transportation of the goods, delay on the part of the seller may be said to be sufficiently excused. (*Engel v. Mariano Velasco Company, 47 Phil. 114*).

(4) Effect of Non-Delivery

If the seller fails to deliver, and the buyer has no fault, the latter may ask for the resolution or rescission of the contract. (*Gonzales v. Haberer, 47 Phil. 380*).

(5) Duty to Deliver at Execution Sales

When the property is sold at an execution sale, the judgment debtor is *not* required to deliver the property sold right away. *Reason:* He has a period of *one year* within which to *redeem* the property. In the meantime, the buyer should not take actual physical possession of the property. If he does so, an action of forcible entry may be brought against him. The judgment debtor would be entitled to get damaged as well as possession of the property, unless the period of redemption has already expired, in which case he can get only damages. (*See Gonzales v. Calimbas, 61 Phil. 355 and Flores v. Lim, 60 Phil. 738*). The period of redemption commences to run not from the date of the auction or tax sale but from the day the sale

was registered in the office of the Register of Deeds, so that the delinquent registered *owner* or third parties interested in the redemption may know that the delinquent property has been sold. (*Techico v. Serrano*, L-12693, May 29, 1959).

Art. 1496. The ownership of the thing sold is acquired by the vendee from the moment it is delivered to him in any of the ways specified in Articles 1497 to 1501, or in any other manner signifying an agreement that the possession is transferred from the vendor to the vendee.

COMMENT:

(1) Ownership is Transferred Generally Only by Delivery

As a rule, in the absence of agreement, ownership is not transferred, even if sold, unless there has been a delivery.

Bar

A sold his piano to *B*, who immediately paid the price. Because the piano was at the repair shop at the time the contract was perfected, no delivery was made. Before delivery could be made, *C*, a creditor of *A*, who has filed a suit against him, attached the piano. *Question*: What right has *B* over the piano? May *B* oppose the attachment levied by *C*? Reasons.

ANS.: The piano not having been delivered to him by *A*, *B* has only a PERSONAL RIGHT to demand its delivery for it is generally only delivery that transfers the *real right of ownership*. Not having any right of ownership over the piano, *B* may not legally oppose the attachment levied thereon by *C*.

[*NOTE*: The parties may, of course, agree when and on what conditions the ownership will pass. (*Bean, Adm. v. Cadwallader Co.*, 10 Phil. 606).

(2) Effect of Delivery to Buyer (Who Used Another's Money)

In general, delivery of the property to a person who has purchased the property in his *own name* (although he used

the money of another) will give title to said purchaser (for it is he who appears in the deed of sale to have made the purchase in his own name), and NOT to the owner of the money used. (*See Enriquez v. Olaguer*, 25 Phil. 641 and *Collector of Internal Revenue v. Favis, et al.*, L-11651, May 30, 1960).

Section 2

DELIVERY OF THE THING SOLD

Art. 1497. The thing sold shall be understood as delivered, when it is placed in the control and possession of the vendee.

COMMENT:

(1) Real or Actual Delivery

Art. 1497 speaks of real or actual delivery (actual tradition).

Smith, Bell & Co. v. Gimenez L-17167, Jun. 29, 1963

FACTS: The Municipal Treasurer of Panique, Tarlac, thru the Bureau of Supply ordered one typewriter from Smith, Bell & Co. The typewriter was received by the *guard* of the municipal Aug. 30, 1958. Ten days later, the municipal building (as well as the typewriter) was totally burned. Shortly after, the seller sent a bill covering the cost of the typewriter. The municipal council adopted a resolution requesting the Company to condone the payment of the machine, it having been burned after delivery. Petitioner Company denied the request; thereafter, the municipal treasurer submitted to the provincial treasurer a voucher covering the payment of the typewriter to the petitioner. The Auditor General disapproved the same on the ground that there was *no delivery*, and that the typewriter was never presented for inspection and verification as previously agreed upon. **Issue:** Was there a *delivery* of the typewriter?

HELD: Yes. This was testified to by both the guard (who had personally received it and the Mayor who had seen the

delivery and ordered the taking of the machine to his office). Moreover, the request for condonation of payment shows beyond doubt actual delivery of the machine.

(2) When Ownership is Not Transferred Despite Delivery

The delivery of the sugar to the warehouse of the buyer transfers ownership provided that the sale had already been perfected (*Ocejo Perez and Co. v. Int. Bank*, 37 Phil. 631), but ownership is not transferred, although there has been perfection and *delivery*, if it was intended that no such transfer of ownership will take place until full payment of the price. [See Art. 1478, Civil Code: "The parties may stipulate (expressly or implied) that ownership in the thing shall not pass to the purchaser until he has fully paid the price."] (See *Masiclat, et al. v. Centeno*, L-8420, May 31, 1956).

Masiclat, et al. v. Centeno L-8420, May 31, 1956

FACTS: *S* was the owner of 15 sacks of rice offered for sale at her store situated on a street near the public market. A certain person approached *S* and bought it from her at P26 per sack, which the buyer promised to pay as soon as he would receive the price of his adobe stones which were then being unloaded from a truck parked at the opposite side of the street. The seller believed this, and upon request of the buyer, the seller ordered the loading of the rice on the truck, the seller continually watching the loading, waiting for the buyer to give to her the purchase price. But the buyer did not show up. So the seller ordered the rice unloaded from the truck. She was therefore surprised when the truck caretaker objected on the ground that he himself had purchased the rice from an unnamed individual at P26 a sack, and being the owner now of the rice, he was entitled to its possession. Nevertheless, the seller continued to unload the rice. The caretaker of the truck then sued her for the custody of the rice. *Issue:* Who is entitled to the rice?

HELD: The seller is entitled to the rice for the simple reason that she never lost ownership thereof. She could not have transferred the ownership to the unknown stranger

although there was delivery because she *did not* intend to transfer the ownership till after payment of the price. This intent is evident from the fact that the seller continually watched her rice and demanded its unloading as soon as the unknown purchaser was missing.

(**NOTE:** In the same case, the caretaker argued that he had a better title to the rice by virtue of the maxim that where one of two persons must suffer by a fraud admitted by a third person, he who made possible the injury and enabled the third person to do wrong must suffer the loss. The Supreme Court, however, held that the maxim cannot apply for the simple reason that the seller here was not guilty of any negligence at all in view of her continued watching of the rice.)

[**NOTE:** Another point of the caretaker was that Art. 1505 of the Civil Code must apply. Under said article, purchases made at a *market* are valid even if the seller was not yet the owner, and delivery of the same would transfer ownership because of the doctrine of *ostensible ownership*, namely, that the market seller appears to be the owner, and if he is not, the true owner is *negligent* for having allowed him to appear as the owner. The Court held that said provision cannot apply because the sale did *not* take place in the market but only on the street near it.]

(3) Meaning of Tradition

Tradition, or delivery, is a mode of acquiring ownership, as a consequence of certain contracts such as sale, by virtue of which, actually or constructively, the object is placed in the control and possession of the vendee.

Albert v. University Publishing Co. L-9300, Sep. 17, 1958

FACTS: The plaintiff, author of a text in Criminal Law, promised to deliver the manuscript of his book to the defendant, his publisher, on or before Dec. 31, 1948. On Dec. 16, 1948, plaintiff wrote a letter to the company stating that the manuscript was *already at its disposal*, and ready for printing

should the company desire to publish it the next month; that he was however keeping the manuscript in his office because of fear of loss, destruction, or copying by others, and because he desired to add new decisions of the Supreme Court that might be published from time to time before the manuscript would be actually sent to the printer. He also stated, however, that if the company insisted on having the manuscript right away, it should let him know because he would then actually deliver it immediately. *Issue*: Was there already delivery?

HELD: Yes, for the above-mentioned facts constitute a *delivery* of the manuscript. Delivery indeed does not necessarily mean physical or material delivery. It may be constructive, as when it is placed at the disposal of the other.

Roque v. Lapuz
L-32811, Mar. 31, 1980

The fact that a formal deed of conveyance was not made indicates very strongly that the parties did not intend to immediately transfer the ownership. What they intended was to transfer ownership only after full payment of the price.

(4) Kinds of Delivery or Tradition

- (a) Actual or real. (*Art. 1497, Civil Code*).
- (b) Legal or constructive
 - 1) *legal formalities*. (*Art. 1498, Civil Code*).
 - 2) *symbolical tradition or traditio simbolica* (such as the delivery of the key of the place where the movable sold is being kept). (*Art. 1498, par. 2, Civil Code*).
 - 3) *traditio longa manu* (by mere consent or agreement) if the movable sold cannot yet be transferred to the possession of the buyer at the time of the sale. (*Art. 1499, Civil Code*).
 - 4) *traditio brevi manu* (if the buyer had already the possession of the object even before the purchase, as when the tenant of a car buys the car, that is, his possession as an owner). (*Art. 1499, Civil Code*).

- 5) *traditio constitutum possessorium* (opposite of *traditio brevi manu*) possession as owner changed, for example, to possession as a lessee.

Example: I sold my car but continued to possess it as a lessee of the purchaser. (*Art. 1500, Civil Code*).

[NOTE: In the case of *Tan Boon Dick v. Aparri Farmer's Coop. Marketing Ass'n., Inc.* (L-14154, Jun. 30, 1960), the Supreme Court held that in *traditio brevi manu* (and by implication, also in *traditio constitutum possessorium*), there is not only constructive delivery, but also ACTUAL DELIVERY. In said case, the buyer was at the time of the sale already a lessee of the property. The Court also held that the possession of the buyer as lessee was converted into that of an owner from the date of the execution of the contract. The rule applies even if the price has *not* been fully paid in the absence of course of any stipulation that the ownership of the thing shall not pass to the purchaser until he has fully paid the price. (*Art. 1478, Civil Code*).]

- (c) *Quasi-tradition* — delivery of rights, credits, or incorporeal property, made by:
- 1) placing titles of ownership in the hands of a lawyer;
 - 2) or allowing the buyer to make use of the rights. (*Art. 1501, Civil Code*).

(5) Case

Victorias v. Leuenberger and CA GR 31189, Mar. 31, 1987

Where there is no express provision that title shall not pass until payment of the price and the thing sold has been delivered, title passes from the moment the thing sold is placed in the possession and control of the buyer. Delivery produces its natural effects in law, the principal and most important of which being the conveyance of ownership without prejudice to the right of the vendor to claim payment of the price.

Art. 1498. When the sale is made through a public instrument, the execution thereof shall be equivalent to the delivery of the thing which is the object of the contract, if from the deed the contrary does not appear or cannot clearly be inferred.

With regard to movable property, its delivery may also be made by the delivery of the keys of the place or depository where it is stored or kept.

COMMENT:

(1) Two Kinds of Constructive Delivery (Thru Legal Formalities and Thru Traditio Simbolica)

Art. 1498 treats of two kinds of constructive delivery:

- (a) *by legal formalities* (1st par.) applies to *real* and personal property since the law does not distinguish. (*See Puatu v. Mendoza*, 64 Phil. 457 and *Buencamino v. Viceo*, 13 Phil. 97).
- (b) *traditio simbolica*. (2nd par.)

**Power Commercial & Industrial Corp. v. CA,
Spouses Reynaldo & Angelito R. Quimbao,
and PNB**

**GR 119745, Jun. 20, 1997
84 SCAD 67**

Symbolic delivery, as species of constructive delivery, effects the transfer of ownership thru the execution of a public document. Its efficacy can, however, be prevented if the vendor does not possess control over the thing sold, in which case this legal fiction must yield to reality.

The key word is *control*, not *possession* of the land.

[**NOTE:** Constructive delivery requires three things before ownership may be transmitted:

- 1) The seller must have control over the thing; otherwise how can he put another in control? (*Addison v. Felix*, 30 Phil. 404 and *Masallo v. Cesar*, 39 Phil. 134).

- 2) The buyer must be put under control. (*Addison v. Felix, supra* and *Masallo v. Cesar, supra*).
- 3) There must be the *intention* to deliver the thing for purposes of ownership (not, for example, of merely allowing the inspection or examination of the keys, nor for the purpose of having said keys repaired). (*10 Manresa 132*).]

(2) Rules on Constructive Delivery

- (a) If a seller has no actual possession, he cannot transfer ownership by constructive delivery. (*Masallo v. Cesar, 39 Phil. 134*). The reason is that in every kind of delivery, the transferee should have control, but here control cannot be had since it is in the possession of another. (*Addison v. Felix, 38 Phil. 404* and *Vda. de Sarmiento v. Lesaca, L-15385, Jun. 30, 1960*).

CASES:

Addison v. Felix 38 Phil. 404

FACTS: *S* sold to *B* a parcel of land, 2/3 of which was in the possession of *T* who claimed to be the owner of said 2/3. The deed of sale between *S* and *B* was in a public instrument. Because *B* could not get control of the 2/3 of the land in the possession of *T*, *B* sued for the cancellation of the sale.

HELD: Cancellation is proper because the property was *not* delivered. It is true that ordinarily, the execution of a public instrument is equivalent to the delivery of the thing which is the object of the contract, but in order that this delivery may have the effect of tradition, it is essential that the vendor shall have had such *control* over the thing sold, that is, it could have been possible that at the moment of the sale its *material* delivery could have been made. It is not enough to confer upon the purchaser the ownership and the right of possession. It is also imperative that the thing sold must be

placed under his control. When there is no impediment whatever to prevent the thing sold from passing into the actual possession of the purchaser by the sole will of the vendor, symbolic delivery through the execution of a public instrument is sufficient. But if, notwithstanding the execution of the instrument, the purchaser cannot have the enjoyment and material tenancy of the thing and make use of it himself or through another in his name, because such tenancy and enjoyment are opposed by the interposition of another will, then fiction yields to reality — the delivery has not been effected. (*See also Garchitorena v. Almeda*, 48 O.G. No. 8, 3432 and *Vda. de Sarmiento v. Lesaca*, L-15386, Jun. 30, 1960).

Roque v. Lapuz
L-32811, Mar. 31, 1980

If in a purported sale, a deed of conveyance is not executed, this can mean that the parties did not intend to immediately transfer the ownership of the real property involved.

Vda. de Sarmiento v. Lesaca
L-15385, Jun. 30, 1960

FACTS: A buyer in a public instrument of two parcels of land could not take actual physical possession thereof because a certain Deloso *claimed* to be the real if owner thereof. Under the terms of the document, the buyer was being given the actual possession of the lands so that he could use them in a manner most advantageous to him. Since, however, he could not take possession, he alleged that there was NO delivery. Hence, he asked for rescission or resolution of the sale.

HELD: Considering the facts of the case, there really was NO delivery and, therefore, he can either ask for resolution with a return to him of the purchase price with interest and damages) or for specific fulfillment of the obligation. Indeed, the legal fiction that the execution of a public document is equivalent to delivery, holds true

only when there is *no* impediment that may prevent the turning over of the property.

**Asuncion, et al. v. Hon. Plan
GR 52359, Feb. 24, 1981**

In an action for partition, defendants agreed to deliver to plaintiff 24 hectares of land. Plaintiff's heirs then executed lease contracts involving said 24 hectares with certain persons, *not* parties in the partition case. When the lessees failed to pay the rent, the plaintiff's heirs moved for the issuance of an alias writ of execution in the *partition* case, asking in effect for the delivery to them of the 24 hectares. The motion *cannot* be granted, for by the execution of the lease contracts, the judgment in the partition case had already been executed. A new action is needed to oust the lessees, since they were not parties in the partition case.

- (b) There can be no constructive delivery by means of a public instrument if there is a stipulation to that effect. Hence, the Supreme Court has held that if there is a clause to the effect that the buyer "will take possession after four months," at the end of 4 months it cannot be said that there is an automatic delivery. At said time, there must still be a delivery. The same is true in a case of a sale by installment, where it is stipulated that title should not be transferred till after the payment of the last installment; or where the vendor reserves the right to use and enjoy their property until the gathering of the crops still growing. (*Aviles, et al. v. Arcega, et al.*, 44 Phil. 924, citing 10 Manresa, p. 129).
- (c) The Civil Code does not provide that the execution of the deed is a conclusive presumption of the delivery of possession. What it says is that the execution thereof shall be equivalent to delivery which means that the disputable presumption established can be rebutted by clear and convincing evidence, such as evidence of the fact that the buyer did *not* really obtain the material possession of the building. Hence, it may be said that the execution of the contract is only presumptive delivery. (*Montenegro v. Roxas de Gomez*, 58 Phil. 723).

Norkis Distributors, Inc. v. CA
GR 91029, Feb. 7, 1990

It is true that Art. 1498 declares that the execution of a public instrument is equivalent to the delivery of the thing which is the object of the contract, but, in order that this symbolic delivery may produce the effect of tradition, it is necessary that the vendor shall have had such control over the thing sold that at the moment of the sale, its material delivery could have been made. It is not enough to confer upon the purchaser the ownership and the right of possession. The thing sold must be placed in his control. When there is no impediment whatever to prevent the thing sold passing into the tenancy of the purchaser by the sole will of the vendor, symbolic delivery through the execution of a public instrument is sufficient.

But if, notwithstanding the execution of the instrument, the purchaser cannot have the enjoyment and material tenancy of the thing and make use of it himself or through another in his name, because such tenancy and enjoyment are opposed by the interposition of another will, then fiction yields to reality — the delivery has not been effected.

(3) Effect of Non-Payment of Price

Execution of the deed of sale, in the absence of any defect, transfers delivery, even if the selling price, in whole or in part has not yet been paid, for it is not payment that transfers ownership. (*Puatu v. Mendoza and David*, 64 Phil. 457).

Puatu v. Mendoza and David
64 Phil. 457

FACTS: Puatu sold a parcel of land to Mendoza for P39,000 in a public instrument. The amount of P14,200 was paid, leaving a balance of P24,800. The land was mortgaged to Puatu as security for the balance. Puatu sued for the balance. Mendoza claimed that the sale was *not absolute* since not all the purchase price has been paid and that therefore he should be refunded what he had already paid.

HELD: The sale was consummated and absolute, and the efendant must now pay the balance. The plaintiff has done all he is required to do in the contract of sale. The land has already been delivered by the execution of the public instrument. The buyer must now comply with his obligation.

(4) Delivery Thru Execution of a Quedan

If the parties in a sale intended that the copra sold should be placed then and there under the control of the buyer by the issuance of a *quedan*, delivery is effected upon the execution of the *quedan*, and the subsequent loss of the thing sold should be borne by the purchaser. (*North Negros Sugar Co. v. Cia Gen. de Tabacos, L-9277, Mar. 29, 1957*).

(5) Bar

A has sold a piano to B by private instrument for P500,000. Who had ownership of the piano at the moment next after B had paid the P500,000 to A? Explain your answer.

ANS.: At the moment next after B had paid the P500,000 to A, ownership over the piano still resided in A, the execution of the private instrument not being a mode of transferring ownership (unless of course there had been mutual agreement — *longa manu* — on the transfer of ownership). Payment of the price without tradition or delivery is not a mode of acquiring ownership over the piano. (*See Arts. 712, 1497, 1498, Civil Code*).

(6) Bar

A person bought in Iloilo a tractor for a certain price. It was agreed that delivery of the tractor should be made within a certain time at the warehouse of the purchaser in Manila, and the balance of the price should be paid at the moment of delivery. While enroute to Manila, the tractor was delivered by the vendor to a third person to secure a loan obtained by him for his personal convenience. Do you think that the purchaser can recover the tractor from the third person? Why?

ANS.: The answer is in the negative because no delivery was ever made to the buyer, hence he never became the owner

of the tractor. (*Art. 1496, Civil Code*). Not being the owner he had no real right over the property, so he cannot bring an action to recover it from an individual in lawful possession of the tractor. (*See Art. 1164, Civil Code; See also 1 Manresa 125 et seq.*).

(7) Case

**Zenaida M. Santos v. Calixto Santos, et al.
GR 133895, Oct. 2, 2001**

FACTS: Petitioner in her memorandum invokes Art. 1477 of the Civil Code which provides that ownership of the thing sold is transferred to the vendee upon its actual or constructive delivery. Art. 1498, in turn, provides that when the sale is made thru a public instrument, its execution is equivalent to the delivery of the thing subject of the contract. Petitioner avers that applying said provisions to the case, Salvador became the owner of the subject property by virtue of the two deeds of sale executed in his favor. *Issue:* Is a sale thru a public instrument tantamount to delivery of the thing sold?

HELD: Nowhere in the Civil Code, does it provide that execution of a deed of sale is a conclusive presumption of delivery of possession. The Code merely says that the execution shall be equivalent to delivery. The presumption can be rebutted by clear and convincing evidence. Presumptive deliver can be negated by failure of the vendee to take actual possession of the land sold.

Art. 1499. The delivery of movable property may likewise be made by the mere consent or agreement of the contracting parties, if the thing sold cannot be transferred to the possession of the vendee at the time of the sale, or if the latter already had it in his possession for any other reason.

COMMENT:

Traditio Longa Manu and Traditio Brevi Manu

(a) The first part deals with *traditio longa manu*.

- (b) The second part deals with *traditio brevi manu*.

(See also Comment No. 4 under Art. 1497.)

(Notice that Art. 1499 speaks of “movable” property.)

Art. 1500. There may also be tradition *constitutum possessorium*.

COMMENT:

Traditio Constitutum Possessorium

- (a) For meaning of *traditio constitutum possessorium*, see comment No. 4 under Art. 1497, *supra*.
- (b) The basis here is consent.
- (c) Where a seller continues to occupy the land as tenant, the possession, by fiction of law, is deemed to be constituted in the buyer. (*Amuo v. Teves*, 60 O.G. 5799).

Art. 1501. With respect to incorporeal property, the provisions of the first paragraph of Article 1498 shall govern. In any other case wherein said provisions are not applicable, the placing of the titles of ownership in the possession of the vendee or the use by the vendee of his rights, with the vendor’s consent, shall be understood as a delivery.

COMMENT:

Delivery of Incorporeal Property

Incorporeal properties may be delivered:

- (a) *by constructive tradition* — execution of public instrument.
- (b) *by quasi-tradition* — placing of titles of ownership in the possession of the buyer, or the use by the buyer of his rights, with the seller’s consent.

[NOTE: The delivery of land title deeds is equivalent to a delivery of the property itself. (*Guerrero v. Miguel*, 10 Phil. 52 and *Marella v. Reyes and Paterno*, 12 Phil.

1). So is the use of the vendor's right with the vendor's consent. (*Tablante v. Aquino*, 28 Phil. 35).]

**North Negros Sugar Co. v. Co. General
de Tabacos
L-9277, Mar. 29, 1957**

FACTS: The Compania General de Tabacos (Tabacalera) sold on Oct. 14, 1941 to the Luzon Industrial Corporation 600 tons of copra to be delivered at the *bodega of the buyer* in Jan. or Feb. 1942. Three days later, the parties agreed that the buyer would pay, and did pay P50,000 on account, and that the seller would issue, and did issue, a *quedan* for the copra agreed to be sold. The *quedan* issued and delivered to the buyer stated that the seller placed the 500 tons of copra at the *disposition* of the *buyer* in the *bodega of the seller* in Cebu for delivery Jan. or Feb. 1942. After the *quedan* had been delivered, the 500 tons of copra were actually segregated and expressly identified within the Cebu bodega. However, in *another* document the seller reserved the option to get the copra from its other bodegas, said option to be exercised in Jan. or Feb. 1942, but this option, was *never exercised*. The copra remained in the Cebu bodega until it was commanded by the Japanese forces in Sept. 1942. In 1948, the buyer brought an action to recover the P50,000 alleging that the seller had never delivered the copra. It claimed that the sale was not consummated because the copra had not been placed in its own bodegas as agreed upon in the contract of Oct. 14, 1941. *Issue:* Can the money be recovered? Was there delivery?

HELD: The money cannot be recovered anymore. Delivery was effected upon the execution of the *quedan* because the parties thereby intended that the copra sold was then and there placed under the control of the buyer. While it is true that in the original contract the copra was to be delivered at the bodega of the buyer, still this stipulation as to the place of delivery was modified in the sense that the delivery was effected then and there by the issuance of the *quedan* placing the copra in the Cebu bodega at the *buyer's disposition*. As a result, as owner

of the copra the buyer bears the loss of the same, since the loss occurred by reason of *force majeure* without the fault of the seller. (See Art. 1497, *Civil Code*; *Lizares v. Hernaez & Alunan*, 40 *Phil.* 98 and *Obejera v. Iga Sy*, 43 *O.G.* 1211). With reference to the apparently contradicting provision of the *quedan* regarding the option of getting the copra from the other bodegas delivery was in fact made on Oct. 18, 1941, upon the issuance and delivery of the *quedan*, but subject to the right of the seller to make the substitution. Since no substitution was made, it is clear that the original delivery stands. (See also Art. 1452, *Civil Code* and Art. 331, *Code of Commerce*).

Art. 1502. When goods are delivered to the buyer “on sale or return” to give the buyer an option to return the goods instead of paying the price, the ownership passes to the buyer on delivery, but he may revest the ownership in the seller by returning or tendering the goods within the time fixed in the contract, or, if no time has been fixed, within a reasonable time.

When goods are delivered to the buyer on approval or on trial or on satisfaction, or other similar terms, the ownership therein passes to the buyer:

(1) When he signifies his approval or acceptance to the seller or does any other act adopting the transaction;

(2) If he does not signify his approval or acceptance to the seller, but retains the goods without giving notice of rejection, then if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time. What is a reasonable time is a question of fact.

COMMENT

(1) Transaction ‘On Sale or Return’

The first paragraph refers to a transaction “on sale or return.” (This is a sale that depends on the *discretion* of the buyer; it is a sale with a resolutive condition.) (55 *C.J.* 403).

(2) Transactions ‘On Approval or On Trial or Satisfaction’

The second paragraph is a sale “on approval or on trial or satisfaction.” (Here, the buyer may *in time* become the owner under the conditions specified in the law; otherwise, the seller is still the owner.) (This is a sale really dependent on the quality of the goods; it is a sale with suspensive condition.) (*55 C.J. 43-431*).

(3) Problems on ‘On Sale or Return’

- (a) *S* delivered to *B* a videocam “on sale or return.” Did *B* become owner upon delivery.

ANS.: Yes, in view of the delivery. Of course, *B* may revest the ownership in *S* by returning or tendering the videocam to him within the time *fixed* in the contract; or if no time has been fixed, within a reasonable time. (*Art. 1501, par. 1*).

- (b) In the preceding problem, can *B* return the goods even if he finds nothing wrong with the quality of the goods?

ANS.: Yes, for discretion here is with the buyer. (*Sturn v. Baker, 150 U.S. 312*).

- (c) In letter (a), if *B* does not return the videocam in due time, what will be the consequences of his inaction?

ANS.: The sale will be considered absolute, and the price may be recovered since after all, delivery had been made. (*Balender v. Pearce, 238 Ill. App. 137*).

- (d) In letter (a), if *B* had not yet returned the goods, does he have to pay for them even if the videocam has been destroyed by a fortuitous event?

ANS.: Yes, for ownership has been transferred to him, and being the owner, he bears the loss. (*46 Am. Jur. Sales, Sec. 482, p. 649*).

[NOTE:

- (a) In a case of “on sale or return,” the buyer has no right to return if he has materially abused the condition of

the thing. The sale in this case becomes absolute. (46 *Am. Jur.*, p. 654).

- (b) In a case of “on sale or return,” if the objects deteriorate without fault of the buyer, the buyer can still return, provided the reasonable period for returning has not yet lapsed. (46 *Am. Jur.*, p. 654).
- (c) Give the difference between a contract “on sale or return” and a delivery of property with option to purchase.

ANS.: In the *first*, ownership is transferred at once; in the *second*, there is no transfer of ownership till the owner agrees to buy. (*Foley v. Felrath*, 98 *Ala.* 176).]

(4) Bar

X, the owner of a certain jewelry, entrusts them to Y for sale or return of the jewelry upon a specified period of time. Y sells the jewelry to Z, but retains the price. Can X obtain possession of the jewelry from Z? Why?

ANS.: This problem calls for a distinction in view of the use of the words “for sale or return,” a phrase which has technical signification in the law of SALES although, of course, phrase used in SALES is “on sale or return” but there’s no such technical meaning in the law of AGENCY.

- (a) Thus, if the phrase “for sale or return” refers to a trust case of sale from X to Y, it is clear that delivery to Y transferred ownership to him and the subsequent sale and delivery of the property by Y to Z also transferred ownership to Z. Hence, X cannot obtain possession of the jewelry from Z. X’s right would be merely to proceed against Y as a buyer who has *not* paid. (*See Arts. 1502, 1505; 477; see also Art. 559 and Asiatic Com. Corp. vs. Ang*, 40 *O.G. No. 15*, p. 20). Note here that there was no criminal or illegal deprivation; at most, Y would be liable civilly only. (*Asiatic Com. Corp. v. Ang*, *supra*).
- (b) If, upon the other hand, the phrase “for sale or return” merely meant that X was constituting Y as his (X’s) agent with authority to sell the jewelry in his behalf, and within a reasonable period, it follows that, as in the

foregoing paragraph, X would have no right to get the jewelry from Z (for after all, Z had already paid for it, and therefore, there can possibly be *no* rescission on the ground of non-payment of the price). But this time, X's remedy would be to proceed against Y, not as a buyer who has not paid, but as an agent who has *failed to render an account* of his transactions and who has failed to deliver to the principal whatever he may have received by virtue of the agency. (*Art. 189, Civil Code*).

(5) Some Rules on Sale 'On Approval or Trial or Satisfaction'

- (a) The risk of loss remains with seller, although there has been delivery, until the sale becomes absolute. (*46 Am. Jur.*, p. 565).
- (b) Risk of loss remains with seller although there has been delivery, if the sale has not yet become absolute.

Exceptions:

- 1) if buyer is at fault;
- 2) if buyer had expressly agreed to bear loss. (*46 Am. Jur.*, p. 657).
- (c) Buyer must give goods a trial except when it is evident that it cannot perform the work intended. (*46 Am. Jur.*, p. 658).
- (d) Period within which buyer must signify his acceptance commences to run only when all the parts essential for the operation of the object have been delivered. (*46 Am. Jur.*, pp. 658-659).
- (e) If it is stipulated that a third person must satisfy approval or satisfaction, the provision is valid, but the third person must be in good faith. If refusal to accept is not justified, seller may still sue. (*46 Am. Jur.*, pp. 663-665).
- (f) Generally, the sale and delivery to a buyer who is an expert on the object purchased is NOT obviously a sale on approval, trial, or satisfaction. (*Azcona v. Pac. Com. Co.*, 68 Phil. 269).

(6) Case

**Imperial Textile Manufacturing Co.
of the Phils., Inc. v. LPJ Enterprises, Inc.
GR 66140, Jan. 21, 1993**

The provision in the Uniform Sales Act and the Uniform Commercial Code from which Art. 1502 of the Civil Code was taken, clearly requires an express written agreement to make a sales contract either a “sale or return” or a “sale on approval.” Parol or extrinsic testimony could not be admitted for the purpose of showing that an invoice or bill of sale that was complete in every aspect and purporting to embody a sale without condition or restriction constituted a contract of sale or return. If the purchaser desired to incorporate a stipulation securing to him the right of return, he should have done so at the time the contract was made.

Upon the other hand, the buyer cannot accept a part and reject the rest of the goods since this falls outside the normal intent of the parties in the “on approval” situation. In light of these principles, the transaction between respondent and petitioner, in the case at bar, is deemed to have constituted an absolute sale.

Art. 1503. Where there is a contract of sale of specific goods, the seller may, by the terms of the contract, reserve the right of possession or ownership in the goods until certain conditions have been fulfilled. The right of possession or ownership may be thus reserved notwithstanding the delivery of the goods to the buyer or to carrier or other bailee for the purpose of transmission to the buyer.

Where goods are shipped, and by the bill of lading the goods are deliverable to the seller or his agent, or to the order of the seller or of his agent, the seller thereby reserves the ownership in the goods. But, if except for the form of the bill of lading, the ownership would have passed to the buyer on shipment of the goods, the seller’s property in the goods shall be deemed to be only for the purpose of securing performance by the buyer of his obligations under the contract.

Where goods are shipped, and by the bill of lading the goods are deliverable to order of the buyer or of his agent, but possession of the bill of lading is retained by the seller or his agent, the seller thereby reserves a right to the possession of the goods as against the buyer.

Where the seller of goods draws on the buyer for the price and transmits the bill of exchange and bill of lading together to the buyer to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading if he does not honor the bill of exchange, and if he wrongfully retains the bill of lading he acquires no added right thereby. If, however, the bill of lading provides that the goods are deliverable to the buyer or to the order of the buyer, or is indorsed in blank, or to the buyer by the consignee named therein, one who purchases in good faith, for value, the bill of lading, or goods from the buyer will obtain the ownership in the goods, although the bill of exchange has not been honored, provided that such purchaser has received delivery of the bill of lading indorsed by the consignee named therein, or of the goods, without notice of the facts making the transfer wrongful.

COMMENT:

(1) Reservation of Ownership Despite Delivery

- (a) The article applies only to the sale of "specific goods."
- (b) Although delivery has been made, seller may reserve ownership till certain conditions are fulfilled. Of course, the most important controlling element is the INTENTION. (*See Dow Chemical Co. v. Detroit Chem. Works, 208 Mich. 157.*)

Chrysler Phil. Corp. v. Court of Appeals L-55684, Dec. 19, 1984

As a general rule, the seller, as the owner, bears the risk of loss in line with the principle of "*res perit domino*" (owner bears the loss).

(2) Instances When Seller Is Still Owner Despite Delivery

- (a) Express stipulation.
- (b) If under the bill of lading the goods are deliverable to seller or agent or their order. (*Reason* — the buyer cannot get.)

[**NOTE:** This is, of course, not conclusive. Thus, although the bill of lading was in the seller's name, still if it is agreed in the contract that the buyer should receive and dispose of the goods, it is evident that the buyer generally cannot do this unless previously ownership has been transferred to him. (*See Bankick v. Chicago, 147 Minn. v. Chicago, 147 Minn. 176*).]

- (c) If bill of lading, although stating that the goods are to be delivered to buyer or his agent, is **KEPT** by the seller or his agent. (*Reason* — The buyer also cannot get.)
- (d) When the buyer although the goods are *deliverable* to order of buyer, and although the bill of lading is given to him, does *not honor* the *bill of exchange* sent along with it. But of course innocent third parties (innocent holders and purchasers for value) should not be adversely affected.

Example:

S sold *B* a laptop; the radio was shipped on board a carrier. The bill of lading stated that the laptop is deliverable to the order of *B*. The bill of lading was sent to *B*, accompanied by a bill of exchange which *B* was supposed to honor. If *B* does not honor the bill of exchange, but wrongfully retains the bill of lading, ownership remains with the seller. If *B* sells the bill of lading to *X*, *X* can obtain ownership of the goods if he is an innocent purchaser.

Art. 1504. Unless otherwise agreed, the goods remain at the seller's risk until the ownership therein is transferred to the buyer, but when the ownership therein is transferred to the buyer the goods are at the buyer's risk whether actual delivery has been made or not, except that:

(1) Where delivery of the goods has been made to the buyer or to a bailee for the buyer, in pursuance of the contract and the ownership in the goods has been retained by the seller merely to secure performance by the buyer of his obligations under the contract, the goods are at the buyer's risk from the time of such delivery.

(2) Where actual delivery has been delayed through the fault of either the buyer or seller the goods are at the risk of the party in fault.

COMMENT:

(1) Risk of Loss

Under this article, the risk of loss of *specific goods* is borne by the seller as a *general rule*, until ownership is transferred. *This apparently contradicts art. 1480 (supra).*

(NOTE: It should be noted, however, that as a rule under American law, the mere perfection of the contract of *sale*, as distinguished from a contract to *sell*, transfers ownership, delivery not being essential for such transfer of ownership.)

(2) Some Problems

- (a) *S* agreed to sell *B* his dog. Before the actual sale takes place, the dog dies thru no fault of *S*. Is *B* liable to *S* for the price?

ANS.: No. The destruction of the dog before ownership passed excuses performance. If the dog had died after ownership had passed, the loss would be *B*'s even though there was no delivery yet.

- (b) *S* sold *B* a dog for P2,000? It is arranged that *B* will pay for and get the animal the next day. Before *B* can pay the purchase price, the dog dies thru a fortuitous event. Must *B* still pay for the animal?

ANS.: Yes, since he was already the owner even if there was no delivery yet. Under American law, there is no need for delivery to transfer ownership insofar as

specific goods are concerned if the contract is one of sale, and not a contract *to sell*.

[**NOTE:** This has been the construction under the Uniform Sales Act.]

[**NOTE:** Generally, whoever has the *beneficial* interest should bear the risk. (*See Commissioner's Notes, U.L.A. 185-186*).]

Art. 1505. Subject to the provisions of this Title, where goods are sold by a person who is not the owner thereof, and who does not sell them under authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell.

Nothing in this Title, however, shall affect:

(1) The provisions of any factors' acts, recording laws, or any other provision of law enabling the apparent owner of goods to dispose of them as if he were the true owner thereof;

(2) The validity of any contract of sale under statutory power of sale or under the order of a court of competent jurisdiction;

(3) Purchases made in a merchant's store or in fairs, or markets, in accordance with the Code of Commerce and special laws.

COMMENT:

(1) Generally, Buyer Acquires Merely the Seller's Rights

The general rule is no one can give what he does not have — *nemo dat quod non habet*. Therefore, even if a person be a *bona fide purchaser*, he succeeds only to the rights of the vendor. (*U.S. v. Sotelo, 28 Phil. 147*). If the seller is not the owner, the sale is null and void. (*Arnido v. Francisco, L-6764, Jun. 30, 1954*). Thus, also, if a vendee buys a parcel of land the certificate of title to which contains an inscrip-

tion requiring his seller to execute a deed of sale of a portion of the lot in favor of another person, he merely acquires all the rights which his seller may have over the land subject to the right of such third person. He cannot claim otherwise for he cannot acquire more than what his seller can convey. (*Bacolod Murcia Milling Co., Inc. v. De Leon, et al.*, L-11587, Sept. 17, 1958). If an illegitimate mother sells her children's land to another, the buyer does not become the owner because the seller was not. (*Bustamante v. Azarcon*, L-8939, May 28, 1957).

(2) Exceptions

- (a) When the owner of the goods by his conduct precluded from denying the seller's authority.

Example: If A sells B's property to C, and B consents, B is estopped from denying A's authority to sell. (*Gutierrez Hermanos v. Orense*, 28 Phil. 571).

- (b) Second paragraph (Nos. 1, 2, 3) of Art. 1505.

(3) Illustrative Questions

- (a) A bought a pair of shoes from a shoe store and repair shop. It was later discovered, however, that the shoes did not belong to the store but to a customer who had left it there for repair. Did A acquire good title to the shoes? Reason.

ANS.: Yes, although the store was not the owner of the shoes. The reason is simple: The shoes were purchased at a merchant's store. A contrary rule would retard commerce. (*See Sun Bros. v. Velasco*, [C.A.] 54 O.G. 5143).

- (b) What is a *store*?

ANS.: It is any place where goods are kept and sold by one engaged in buying and selling. Thus, it has been held that the placing of an order for goods and the making of payment thereto at a principal office of a producer of logs does *not* transform said office into a store, for it is a necessary element that there must also be goods or wares stored therein or on display and that

the firm or person maintaining said office is actually engaged in the business of buying and selling. (*City of Manila v. Bugsuk Lumber Co.*, L-8255, Jul. 11, 1957).

(4) Some Recording Acts

- (a) *Sale of large cattle* — no transfer of large cattle shall be *valid* unless the same is *registered*, and a *certificate of transfer* obtained (*Sec. 59, Rev. Adm. Code*).
- (b) *Land registration law*. (*Act 496*).
- (c) *Sale of vessels* — record at each principal port of entry. (*Sec. 1171, Rev. Adm. Code*).

(5) Bar

B, in good faith, has purchased a diamond ring from *C*, a friend of his. *C* gave *B* a bill of sale. Later on, *O* identified the ring as one she had lost about a year ago. There is no question as to the veracity of *O*'s claim. In the meantime, *C* has disappeared. What advice would you give *B* in reference to *O*'s demand that the ring be returned or surrendered to her? Explain your answer.

ANS.: *I* would advise *B* to return the ring to *O*, and not expect to be reimbursed by *O* the amount he (*B*) had paid *C*. The law says that one who has *lost* any movable (or has been unlawfully deprived thereof) may recover it from the person in possession of the same, without such possessor being entitled to reimbursement, except if the acquisition in good faith had been at a public sale or auction [*Art. 559; Tuason and Sampedro, Inc. vs. Geminea, (C.A.) 46 O.G. 1113, Mar. 1, 1950*], or at a merchant's store, fair, or market. (*Art. 1505, No. 3*). (If acquisition was at a merchant's store, fair, or market, there can even be no recovery.) *B*'s good faith is not material insofar as *O*'s superior rights are concerned. (*Rebullida v. Bustamante, [C.A.] 45 O.G. 17, Supp. No. 5, May, 1949 and Arenas v. Raymundo, 19 Phil. 47*). Incidentally, the public sale referred to in *Art. 559* is one where after due notice to the public, bidders are allowed to bid for the objects they desire to purchase. (*U.S. v. Soriano, 12 Phil. 512*).

Art. 1506. Where the seller of goods has a voidable title thereto, but his title has not been avoided at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith, for value, and without notice of the seller's defect of title.

COMMENT:

(1) Effect if Seller Has Only a Voidable Title

Example:

A bought a car from B (an insane man), and in turn sold the car to C who is in *good faith*. After delivery of the car to C, he becomes its owner if, at the time he bought it, the contract between A and B had not yet been annulled.

(2) Reasons for the Law

- (a) Before a voidable contract is annulled it is considered valid.
- (b) Where one of two innocent parties must suffer, he who placed the offender in a position to do wrong must suffer. (*Neal, etc., Co. v. Tarley, 1917*).

(3) Purchase from a Thief

Can a buyer acquire title from a thief (a person who stole and then sold the goods to him)?

ANS.: No, because the owner has been unlawfully deprived of it. Hence, the true owner can get it back without reimbursement. (*See Tuason and Sampedro, Inc. v. Giminea, [C.A.] 46 O.G. 1113, Mar. 1, 1940 and Art. 559, Civil Code*). If the buyer had acquired the stolen automobile at a *public auction*, even if he be in good faith, the true owner can still get it from him, but this time he would be entitled to *reimbursement*. (*Art. 559, 2nd par.*).

[**NOTE:** All that has been stated in No. (3) applies to all cases of unlawful deprivation (theft, robbery, estafa). (*Art. 105, par. 2, R.P.C.*). It also applies to the case of a *depository* who sells the car to an innocent purchaser for value, because

this would be a case of estafa and the car is an object of the crime. (*See Arenas v. Raymundo*, 19 *Phil.* 47; *Art.* 105, par. 2, *R.P.C.*).]

[**NOTE:** However, when no crime is committed, and only a civil liability arises (as when a buyer who had *not yet paid* for the goods should sell them to *another* who is in *good faith*), the seller cannot recover from the third person the goods, for here there was neither a “losing” nor an “unlawful (criminal) deprivation.” (*See Asiatic Commercial Corp. v. Ang, et al.*, Vol. 40, *O.G. S. No. 15*, p. 102).]

[**NOTE:** For reference purposes, Art. 559 is hereby quoted:

“The possession of movable property acquired *in good faith* is equivalent to a title. Nevertheless, one who has *lost* any movable or has been *unlawfully deprived* thereof, may recover it from the person in possession of the same.

“If the possessor of a movable *lost* or of which the *owner* has been unlawfully deprived, has acquired it *in good faith* at a *public sale*, the *owner* cannot obtain its *return* without reimbursing *the price paid therefor.*”]

Art. 1507. A document of title in which it is stated that the goods referred to therein will be delivered to the bearer, or to the order of any person named in such document is a negotiable document of title.

COMMENT:

(1) What ‘Document of Title’ Includes

- (a) any bill of lading
- (b) dock warrant
- (c) *quedan*
- (d) warehouse receipt or order
- (e) any other document used as *proof of possession* or as *authority to transfer* the goods represented by the document.

(2) Negotiable Document of Title

The document is negotiable if:

- (a) the goods are deliverable to *bearer* (“deliver to *bearer*”);
- (b) or if the goods are deliverable to the *order of a certain person* (“deliver to the order of X”; “deliver to Mr. X or his order”).

[**NOTE:** If the document states that “the goods have *already* been delivered to the order of the buyer,” it is *not* negotiable because what is needed is *future* delivery. (*Hixson v. Ward*, 1929, 354 Ill. App. 505).]

[**NOTE:** A negotiable warehouse receipt is a document of title, but a *mere order to the warehouseman to deliver certain deposited goods to the order of a certain person*, is not a negotiable document of title; this is merely a *warehouse delivery order*. (See *Transmares Corp. v. George F. Smith, Inc.*, 1947-76 N.Y.S. 2d., 137).]

(3) Effect of Typographical or Grammatical Error

A mere typographical or grammatical error does *not* destroy the negotiability of a document of title, for what should be considered is the *intent*. Thus, if the words “*by order of X*” are placed instead of “*to the order of X*” the document can still be considered negotiable. (*Felisa Roman v. Asia Banking Corp.*, 46 Phil. 609). Moreover, a mere *incorrectness* in the *description* of the goods when there can be *no doubt* of the goods referred to will *not* destroy the negotiability of the document. Thus, if the goods were described as “Cagayan tobacco” when the depositor had only “Isabela tobacco” in the warehouse, the warehouse receipt is still good and negotiable. (*American Foreign Banking Corp. v. Herridge*, 49 Phil. 975).

Art. 1508. A negotiable document of title may be negotiated by delivery:

(1) Where by the terms of the document the carrier, warehouseman or other bailee issuing the same undertakes to deliver the goods to the bearer; or

(2) Where by the terms of the document the carrier, warehouseman or other bailee issuing the same undertakes to deliver the goods to the order of a specified person and such person or a subsequent indorsee of the document has indorsed it in blank or to the bearer.

Where by the terms of a negotiable document of title the goods are deliverable to bearer or where a negotiable document of title has been indorsed in blank or to bearer, any holder may indorse the same to himself or to any specified person, and in such case the document shall thereafter be negotiated only by the endorsement of such indorsee.

COMMENT:

(1) How Negotiable Document of Title is Negotiated

There are two forms of negotiating a negotiable document of title:

- (a) mere delivery;
- (b) indorsement PLUS delivery.

(2) When Mere Delivery is Sufficient

Mere delivery (handing over) is sufficient —

- (a) If “deliverable to bearer.”

(**NOTE:** The holder can just transfer it to a friend, and the friend will be entitled to the goods.)

- (b) If “deliverable to the order of a certain person” AND that person has indorsed it in *blank* merely (put his name at the back) or indorsed it to *bearer* (at the back, he placed “deliver to bearer” and then he signed his name). The document can now be negotiated by *mere delivery*.

[**NOTE:** Mercantile practice is followed in this article (*Commissioner's Note, 1 U.L.A. 1950 Ed.; Sec. 28, p. 397*).]

Art. 1509. A negotiable document of title may be negotiated by the indorsement of the person to whose order the goods are by the terms of the document deliverable. Such

indorsement may be in blank, to bearer or to a specified person. If indorsed to a specified person, it may be again negotiated by the indorsement of such person in blank, to bearer or to another specified person. Subsequent negotiations may be made in like manner.

COMMENT:

(1) Negotiation by Indorsement and Delivery

- (a) This refers to negotiation by indorsement *and* delivery.
- (b) *Example:* The document says “deliver to the order of Mr. X” To negotiate it, Mr. X must *sign* his name at the back and then deliver. Mere delivery without signing is not sufficient. When he signs he may:
 - 1) just sign his name (blank indorsement);
 - 2) or say “deliver to Mr. Y”;
 - 3) or say “deliver to bearer.”

(NOTE: Mr. Y can in turn indorse it in blank, to bearer, or to another specified person.)

- (c) This Article again follows mercantile practice. (*Commissioner’s Note, 1 U.L.A. 1950 Ed., Sec. 29, p. 398*).

(2) Effect of Undated Indorsement

It is *not* necessary to *date* an indorsement because no additional protection is given thereby to businessmen. As a matter of fact, to require dating would be to impede business transactions. (*Hongkong & Shanghai Bank v. Peters, 16 Phil. 284*).

(3) Effect of Indorsement and Delivery

Indorsement and delivery of a negotiable *quedan ipso facto* transfer possession and ownership of the property referred to therein. (*Philippine Trust Co. v. Nat. Bank, 42 Phil. 413*).

Art. 1510. If a document of title which contains an undertaking by a carrier, warehouseman or other bailee to deliver the goods to bearer, to a specified person or order of a specified person or which contains words of like import, has placed upon it the words “not negotiable,” “non-negotiable” or the like, such document may nevertheless be negotiated by the holder and is a negotiable document of title within the meaning of this Title. But nothing in this Title contained shall be construed as limiting or defining the effect upon the obligations of the carrier, warehouse man, or other bailee issuing a document of title or placing thereon the words “not negotiable,” “non-negotiable,” or the like.

COMMENT:

Effect of Placing the Word ‘Non-Negotiable’

Example:

A negotiable document of title was marked “non-negotiable” by the warehouseman (or carrier or depository). Is it still negotiable?

ANS.: Yes, insofar as the *various holders* of the note are concerned, the note is still negotiable. Regarding the intent or liability of the *maker*, this Article does *not* deal with the same. (*See Commissioner’s Note, 1 U.L.A., 1950 Ed., Sec. 30, p. 398*).

Art. 1511. A document of title which is not in such form that it can be negotiated by delivery may be transferred by the holder by delivery to a purchaser or donee. A non-negotiable document cannot be negotiated and the endorsement of such a document gives the transferee no additional right.

COMMENT:

(1) Effect of Delivery When Document Cannot Be Negotiated By Mere Delivery

Example of 1st sentence of Article

A document of title was *non-negotiable*. May it still be given or assigned to another?

ANS.: Yes, but this does not have the effect of a negotiation. It is a mere transfer or assignment. (*See Nixon vs. Ward, 1929, 254 Ill. App. 505*).

(2) Effect of Negotiation and Indorsement of Non-Negotiable Instrument

Example of 2nd sentence of Article

A document of title contained the words “deliver to Mr. X.” This is therefore *non-negotiable*.

- (a) May it be negotiated?

ANS.: No, but it may be transferred.

- (b) Suppose it is indorsed by Mr. X?

ANS.: The indorsement is useless and does *not* give the indorsee any additional right. There is in this case only a transfer or assignment.

Art. 1512. A negotiable document of title may be negotiated:

- (1) By the owner thereof; or**

(2) By any person to whom the possession or custody of the document has been entrusted by the owner, if, by the terms of the document the bailee issuing the document undertakes to deliver the goods to the order of the person to whom the possession or custody of the document has been entrusted, or if at the time of such entrusting the document is in such form that it may be negotiated by delivery.

COMMENT:

(1) Who May Negotiate Negotiable Document of Title

- (a) This Article speaks of the person who may negotiate a negotiable document of title.
- (b) *Example:* A document of title contained the following words: “Deliver to the order of X or to the order of the person to whom this document has been entrusted by X.”

Later, *X* entrusted the document to *Y*. May *Y* negotiate the same by indorsement?

ANS.: Yes. (*Art. 1512, No. 2, 1st part*).

(2) Who Bears Loss in Case of Unauthorized Negotiation

If the owner of a negotiable document of title (deliverable to *bearer*) entrusts the document to a friend for deposit, but the friend betrays the trust and negotiates the document by delivering it to another who is in *good faith*, the said owner cannot impugn the validity of the negotiation. As between two innocent persons, he who made the loss possible should bear the loss, without prejudice to his right to recover from the wrongdoer. (*Siy Long Bieng and Co. v. Hongkong & Shanghai Banking Corp.*, 56 *Phil.* 598).

Art. 1513. A person to whom a negotiable document of title has been duly negotiated acquires thereby:

(1) Such title to the goods as the person negotiating the document to him had or had ability to convey to a purchaser in good faith for value and also such title to the goods as the person to whose order the goods were to be delivered by the terms of the document had or had ability to convey to a purchaser in good faith for value; and

(2) The direct obligation of the bailee issuing the document to hold possession of the goods for him according to the terms of the document as fully as if such bailee had contracted directly with him.

COMMENT:

(1) Rights of Person to Whom Negotiable Document Is Negotiated

- (a) This Article speaks of some of the rights of a person to whom a negotiable document of title has been negotiated.
- (b) Note that the bailee (or carrier or depositary) *directly* holds the property in behalf of the person to whom the negotiable document was negotiated. It is as if such person had dealt *directly* with the bailee.

(2) Purpose of the article

The document should be made to really represent the depositor's right to the goods. (*See Commissioner's Note, 1 U.L.A., 1950 Ed., Sec. 33, p. 40*).

Art. 1514. A person to whom a document of title has been transferred, but not negotiated, acquires thereby, as against the transferor, the title to the goods, subject to the terms of any agreement with the transferor.

If the document is non-negotiable such person also acquires the right to notify the bailee who issued the document of the transfer thereof, and thereby to acquire the direct obligation of such bailee to hold possession of the goods for him according to the terms of the document.

Prior to the notification to such bailee by the transferor or transferee of a non-negotiable document of title, the title of the transferee to the goods and the right to acquire the obligation of such bailee may be defeated by the levy of an attachment of execution upon the goods by a creditor of the transferor, or by a notification to such bailee by the transferor or a subsequent purchaser from the transferor of a subsequent sale of the goods by the transferor.

COMMENT:**(1) Rights of Mere Transferee**

- (a) This Article deals with the rights of a *transferee*, not the rights of a person to whom the document was negotiated.
- (b) Note that the transferee does *not acquire directly* the obligation of the bailee to hold for him (*unlike that referred to in Art. 1513*). To acquire the *direct obligation* of the bailee, the transferee (or transferor) must *notify* the bailee.

(2) Who Can Defeat Rights of Transferee

The third paragraph refers to the persons who can *defeat* the right of the transferee **PRIOR** to the *notification*.

Art. 1515. Where a negotiable document of title is transferred for value by delivery, and the indorsement of the transferor is essential for negotiation, the transferee acquires a right against the transferor to compel him to indorse the document unless a contrary intention appears. The negotiation shall take effect as of the time when the indorsement is actually made.

COMMENT:

Rule if Indorsement is Needed for Negotiation

Example:

A document of title contained the words “deliver to X or his order.” X wanted to negotiate it to Y, but instead of indorsing it, he merely *delivered* it to Y. Has there been a negotiation?

ANS.: No, because of the non-indorsement. But Y acquires a right to compel X to indorse it provided that:

- (a) Y paid value for the document; and
- (b) no contrary intention appears.

Art. 1516. A person who for value negotiates or transfers a document of title by indorsement or delivery, including one who assigns for value a claim secured by a document of title unless a contrary intention appears, warrants:

- (1) That the document is genuine;
- (2) That he has a legal right to negotiate or transfer it;
- (3) That he has knowledge of no fact which would impair the validity or worth of the document; and
- (4) That he has a right to transfer the title to the goods and that the goods are merchantable or fit for a particular purpose, whenever such warranties would have been implied if the contract of the parties had been to transfer without a document of title the goods represented thereby.

COMMENT:**(1) Warranties in Negotiation or Transfer**

- (a) This refers to warranties
 - 1) by a person who negotiates;
 - 2) by a person who *assigns or transfers for value*.
- (b) Note that there are warranties
 - 1) about the *document*;
 - 2) about the *right to the document*;
 - 3) about the *goods* represented by the document.

[**NOTE:** *Merchantable goods* — fit for at least the ordinary purpose of the goods.]

(2) Effect of Indorsee's Knowledge of Forged Indorsement

If the indorsee knows that any of the former indorsements is a forgery, he does *not* acquire a valid title to the document. (*See Great Eastern Life Insurance Co. v. Hongkong & Shanghai Banking Corp.*, 43 Phil. 678).

Art. 1517. The indorsement of a document of title shall not make the indorser liable for any failure on the part of the bailee who issued the document or previous indorsers thereof to fulfill their respective obligations.

COMMENT:**(1) Non-liability of Indorser for Failure of Bailee to Comply**

Failure of the *bailee* or the *previous indorsers* to comply with their obligations does *not* make the present indorsers liable.

(2) Reason

The indorser warrants only the things mentioned in the *preceding* article.

Art. 1518. The validity of the negotiation of a negotiable document of title is not impaired by the fact that the negotiation was a breach of duty on the part of the person making the negotiation, or by the fact that the owner of the document was deprived of the possession of the same by loss, theft, fraud, accident, mistake, duress, or conversion, if the person to whom the document was negotiated or a person to whom the document was subsequently negotiated paid value therefor in good faith without notice of the breach of duty, or loss, theft, fraud, accident, mistake, duress or conversion.

COMMENT:

Effect if Owner of Document Was Deprived of It

Example:

A document of title contained the words “deliver to bearer.” The document was stolen by *T*; *T* subsequently indorsed it to *S*, a purchaser in *good faith*. Is the negotiation to *S* valid?

ANS.: Yes, notwithstanding the theft by *T*. *Reason:* *S* is a purchaser for value in good faith; that is, *S* did *not* know that the document had been stolen by *T*.

Art. 1519. If goods are delivered to a bailee by the owner or by a person whose act in conveying the title to them to a purchaser in good faith for value would bind the owner and a negotiable document of title is issued for them they cannot thereafter, while in possession of such bailee, be attached by garnishment or otherwise, or be levied under an execution unless the document be first surrendered to the bailee or its negotiation enjoined. The bailee shall in no case be compelled to deliver up the actual possession of the goods until the document is surrendered to him or impounded by the court.

COMMENT:

Generally No Attachment or Surrender

This Article speaks of two important things (if the document is negotiable):

- (a) *Generally no attachment or levy, except:*
 - 1) if the document is *surrendered* to bailee;
 - 2) or the *negotiation* of the document *enjoined*.
- (b) The bailee (or depositary or carrier) *cannot* be compelled to surrender the goods except:
 - 1) if the document is *surrendered to him*;
 - 2) or the document *is impounded by the court*. (Art. 1519).

(NOTE: A creditor of the owner of the negotiable document is protected by the next article.)

Art. 1520. A creditor whose debtor is the owner of a negotiable document of title shall be entitled to such aid from courts of appropriate jurisdiction by injunction and otherwise in attaching such document or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process.

COMMENT:

Right of Creditor

Here, special aid is to be given to the creditor because the document concerned is *negotiable*. Attachment is *not* easily made.

Art. 1521. Whether it is not for the buyer to take possession of the goods or for the seller to send them to the buyer is a question depending in each case on the contract, express or implied, between the parties. Apart from any such contract, express or implied, or usage of trade to the contrary, the place of delivery is the seller's place of business if he has one, and if not his residence; but in case of a contract of sale of specific goods, which to the knowledge of the parties when the contract or the sale was made were in some other place, then that place is the place of delivery.

Where by a contract of sale the seller is bound to send the goods to the buyer but no time for sending them is fixed, the seller is bound to send them within a reasonable time.

Where the goods at the time of sale are in the possession of a third person, the seller has not fulfilled his obligation to deliver to the buyer unless and until such third person acknowledges to the buyer that he holds the goods on the buyer's behalf.

Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact.

Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state must be borne by the seller.

COMMENT:

(1) Specifications for the Delivery

This Article provides for the:

- (a) *place* of delivery;
- (b) *time* of delivery;
- (c) *manner* of delivery.

(2) Place of Delivery

- (a) Should the seller send the goods or should the buyer get them?

ANS.: This depends on the:

- 1) agreement (express or implied);
- 2) if no agreement — get the USAGE of trade;
- 3) if no usage — the *buyer* must get them at the *seller's business place or residence*.

Exception — In the place where the *specific goods* are found.

- (b) There is sufficient delivery when a fortuitous event prevents delivery at the actual place agreed upon, forcing a delivery at a place near the original one. (*Bean, Admr. v. The Cadwallader Co., 10 Phil. 606*).
- (c) There is sufficient delivery when the original place is changed, but the buyer accepted the goods at a *different* place without complaint so long as the seller was in *good faith*. (*Sullivan v. Gird, 1921, 22 Ariz. 332*).

(3) Time of Delivery

- (a) Delivery (if to be made by seller) must be within a *reasonable time*, in the absence of express agreement. (*Art. 1521, par. 2*).
- (b) What is a reasonable time is a *question of fact*, depending upon circumstances provable even by *evidence aliunde* (*extrinsic evidence*). (*46 Am. Jur. 342*).
- (c) Among the *circumstances* that may be considered are the following:
 - 1) character of the goods;
 - 2) purpose intended;
 - 3) ability of seller to produce the goods;
 - 4) transportation facilities;
 - 5) distance thru which the goods must be carried;
 - 6) usual course of business in that particular trade. (*Smith, Bell and Co. v. Sotelo Matti, 44 Phil. 874*).
- (d) If a delivery is to be made “at once,” “promptly,” or “as soon as possible,” a reasonable time must necessarily be given. (*See De Moss v. Conart Motor Sales, 71 N.E. 2d 158*).
- (e) *Premature* delivery generally is *not* allowed because a *term* is for the benefit of both parties. (*See Winter v. Kahn, 208 N.Y.S. 74*).

(4) Manner of Delivery When Goods Are in the Hands of a Third Person

It is essential here that the third person acknowledges that he holds the goods on behalf of the buyer (otherwise,

the seller shall not yet be complied with his duty to deliver). (*Art. 1521, par. 3*).

(**NOTE:** This does not apply in case a *negotiable* document of title has been issued.)

[**NOTE:** The paragraph also does *not* apply when the goods are still to be manufactured. (*Percy Kent Co. v. Silverstein, 200 App. Div. 52*). It applies to the sale of goods already existing but in the hands of a third party.]

(5) Expenses to Be Shouldered by Seller

Who pays expenses for putting the goods in a deliverable state?

ANS.: The seller, unless otherwise agreed. (*Art. 1521, last paragraph*). This is true even if the buyer has the duty to take delivery.

(6) When Demand or Tender of Delivery Must Be Made

When must *demand or tender* of delivery be made?

ANS.: In the absence of agreement, at a *reasonable hour*. (This is a question of fact.) (*Art. 1521, par. 4*).

Art. 1522. Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts or retains the goods so delivered, knowing that the seller is not going to perform the contract in full, he must pay for them at the contract rate. If, however, the buyer has used or disposed of the goods delivered before he knows that the seller is not going to perform his contract in full, the buyer shall not be liable for more than the fair value to him of the goods so received.

Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and reject the rest. If the buyer accepts the whole of the goods so delivered he must pay for them at the contract rate.

Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest.

In the preceding two paragraphs, if the subject matter is indivisible, the buyer may reject the whole of the goods.

The provisions of this article are subject to any usage of trade, special agreement, or course of dealing between the parties.

COMMENT:

(1) Rules when the Quantity Is LESS than that Agreed Upon

- (a) Buyer may REJECT;
- (b) Or buyer may ACCEPT what have been delivered, at the contract rate.

Example: B buys from S 100 cans of tomato sauce. S delivers only 80 cans. Can B reject the goods?

ANS.: Yes. But if B accepts the goods knowing that S cannot deliver the remaining 20, he must pay for the 80 cans at the contract rate, namely, the price fixed for each multiplied by 80. He cannot return the 80 because he would be in estoppel.

**Chrysler Phil. Corp. v. Court of Appeals
L-55684, Dec. 19, 1984**

If a vendor delivers to the vendee goods of a smaller quantity than what he contracted to sell, the vendee may reject the goods delivered.

When estoppel does not apply:

B bought 100 suits, only 60 of which arrived. He sold some of them (perhaps even for a lesser price for purposes of propaganda or advertisement), thinking that the others were coming. Can he return the rest, if they are unsold? What price must he pay?

ANS.: Yes, he can return the rest. (*Kershrnan v. Crawford Plumber Co.*, 166 App. Div. 259, 1460 N.Y.S. 886). Since the buyer has used or disposed of the goods delivered *before* he knows that the seller is *not going* to perform his contract in full, the buyer shall *not* be liable for more than the *fair value* to him of the goods so received. (Art. 1622, par. 1, 2nd sentence).

(2) Rules When the Quantity Is MORE than the Agreement

- (a) Buyer may reject *ALL*. He must not be burdened with the duty of segregation, if he does not so desire. (*List and Son Co. v. Chase*, 80 Ohio St. 42, 88 N.E. 120).
- (b) Buyer may *accept* the goods agreed upon and reject the rest.
- (c) If he gets all, he must pay for them at the contract rate. (Art. 1622, par. 2).

[**NOTE:** For the rule to apply, the quantity must have been fixed by prior agreement. (*Sheetner v. Hollywood Credit Clothing Co.*, 1945, 42A, 2nd 522).]

Example of the rule:

B bought from *S* 100 cans of tomato sauce, 120 of which arrived. What is *B*'s right?

ANS.: *B* may accept 100 and return the 20. If he accepts all of the 120, he must pay for them at the contract rate, namely, the price per can multiplied by 120.

[**NOTE:** The law does not consider trifles and will not cure them (*de minimis non curat lex*). So if it was agreed that less than 500 *piculs* would be delivered, and 500 *piculs* are actually delivered, the slight discrepancy may be disregarded, and the case may be considered as one of sufficient compliance with the terms of the obligation. (*Matute v. Cheong Boo*, 37 Phil. 373). Moreover, if a buyer agrees to purchase a designated amount, but actually orders a lesser amount, the seller cannot complain if he decided to fulfill the order for the lesser quantity. This is a clear case of a waiver. (*Quiroga v. Parsons Hardware Co.*, 38 Phil. 501).]

(3) Implied Acceptance

Acceptance, even if not express, is implied when the buyer exercises acts of ownership over the excess goods. (*Huber v. Lalley Light Corp.*, 1928, 242 Mich. 171).

(4) Rule When Quality is Different

Where the seller delivers to the buyer the goods agreed upon MIXED with goods of a different description, the buyer may:

- (a) accept the goods which are in accordance with the contract, and
- (b) reject the rest.

(**NOTE:** If the sale is indivisible, the buyer may reject the whole of the goods.)

CASE:

**Adam Krockles Sons Co. v. Rockford
Oak Leather Co.
240 Mich. 524**

FACTS: *B* accepted the correct (as ordered) goods, rejected the rest (because incorrect). He then purchased the rest that he needed in the market, without first giving the seller opportunity to make proper substitution. Can he charge the seller for the consequent difference in price?

HELD: No, because he should have given the seller a chance to make the proper correction or substitution.

Art. 1523. Where, in pursuance of a contract of sale, the seller is authorized or required to send the goods to the buyer, delivery of the goods to a carrier, whether named by the buyer or not, for the purpose of transmission to the buyer is deemed to be a delivery of the goods to the buyer, except in the cases provided for in Article 1503, first, second and third paragraphs or unless a contrary intent appears.

Unless otherwise authorized by the buyer, the seller must make such contract with the carrier on behalf of the buyer as may be reasonable, having regard to the nature of the goods and the other circumstances of the case. If the seller omit so to do, and the goods are lost or damaged in course of transit, the buyer may decline to treat the delivery to the carrier as a delivery to himself, or may hold the seller responsible in damages.

Unless otherwise agreed, where goods are sent by the seller to the buyer under circumstances in which the seller knows or ought to know that it is usual to insure, the seller must give such notice to the buyer as may enable him to insure them during their transit, and, if the seller fails to do so, the goods shall be deemed to be at his risk during such transit.

COMMENT:

(1) When Delivery to Carrier is Delivery to Buyer

- (a) This article deals with “delivery to a carrier on behalf of the buyer.”
- (b) *General rule:* Delivery to carrier is delivery to buyer, if it is the duty of the seller to send the goods to the buyer. (*See Behn, Meyer & Co. Ltd. v. Yangco, 38 Phil. 602*).

(2) Kinds of Delivery to Carrier

Delivery to carrier may be:

- (a) *C.I.F. (cost, insurance, freight)* – (Since the selling price includes insurance and freight, it is understood that said insurance and freight should now be paid by the *seller*.)

[**NOTE:** So all charges up to the place of destination must be paid by the seller. (*56 C.J. 231*).]

[**NOTE:** If the goods will be transported from New York “C.I.F. Manila,” this means that delivery should be made at Manila. If the goods then are not delivered at Manila, seller should be held liable. (*Behn, Meyer and Co., Ltd. v. Yangco, 38 Phil. 602*).]

[**NOTE:** In a C.I.F. contract the place of delivery is presumptively at the BUYER'S place. (*Miller v. Sergeant Co.*, 182 N.Y.S. 382).]

(b) *F.O.B. (free on board)*

The sale may be:

- 1) *f.o.b. at the place of shipment* (here, the buyer must pay the freight).
- 2) *f.o.b. alongside (the vessel)* (here, also from the moment the goods are brought alongside the vessel, the buyer must pay for the freight or expenses).
- 3) *f.o.b. at the place of destination* (here, the seller must pay the freight, since the contract states "free on board till destination"). (55 C.J. 231; see *Behn, Meyer and Co. Ltd. v. Yangco*, 38 Phil. 602).

[**NOTE:** The general rule in "f.o.b." or "f.a.s." (free alongside) sales that the property *passes* as soon as the goods are delivered aboard the carrier or alongside the vessel, and that the buyer as the owner of the goods is to bear all expenses after they are so delivered. (2 *Welliston on Sales*, pp. 98-99, 120; 46 *Am. Jur.* 508-509; *Insular Lumber Co. v. Coll. of Int. Rev.*, L-7190, Apr. 28, 1956). But the terms "f.o.b." and "f.a.s." merely make rules of PRESUMPTION that yield to proof of contrary intent, specially if other terms of the contract indicate a contrary intention. They may, for instance, be used only in connection with the fixing of the price, and in such a case, they will *not* be construed as fixing the place of delivery; in other words, they may be used merely to fix the price up to a certain point for it is not uncommon to impose a duty on the seller to deliver goods at their *ultimate* destination for a price "f.o.b." the point of shipment. In other words, while delivery is to be made at the *farther point*, the seller pays for expenses only up to the place of shipment. (*Ibid.*).]

(3) Problem

S in Manila agrees to ship goods to *B* at Boac, "F.O.B.

Boac.” Before the goods reach Boac, they are destroyed by a fortuitous event. Who bears the loss?

ANS.: *S* bears the loss, because ownership (title) does not pass till the goods reach Boac. Hence, the seller bears the loss. If the price has been given him, he must return the same. If no payment has yet been made, he cannot successfully demand the price from the buyer.

Art. 1524. The vendor shall not be bound to deliver the thing sold, if the vendee has not paid him the price, or if no period for the payment has been fixed in the contract.

COMMENT:

(1) When Vendor is Not Bound to Deliver

The seller must deliver, and the buyer must pay. If the buyer does not pay, the seller is not required to deliver. This is because a sale is a reciprocal contract giving rise to reciprocal obligations.

(2) Effect if Period is Fixed for Payment

If a period has been fixed for the payment, the seller must deliver the thing sold even if said period has not yet arrived. (*Florendo v. Foz*, 20 *Phil.* 388). He will then have to wait for the end of the period before he can demand the price, except if the buyer has lost the benefit of the term. (*See Art. 1198, Civil Code*; see also *Warner, Barnes & Co. v. Inza*, 43 *Phil.* 505).

(3) Bar

When is the vendor not obliged to make delivery after the perfection of the contract of sale? Explain briefly.

ANS.: The vendor is not obliged to make said delivery in the following cases:

- (a) if the vendee has not paid him the price — for, after all, the delivery and the payment are reciprocal obligations. (*Art. 1524, Civil Code*).

- (b) if no period for the payment has been fixed in the contract — otherwise, the vendor might play a futile “waiting game.” (*See Art. 1524, Civil Code*).
- (c) Even if a period for such payment has been fixed in the contract — if the vendee has lost the right to make use of the period and still refuses to pay. (*See Arts. 1536 and 1198, Civil Code*).

Art. 1525. The seller of goods is deemed to be an unpaid seller within the meaning of this Title:

(1) When the whole of the price has not been paid or tendered;

(2) When a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has been broken by reason of the dishonor of the instrument, the insolvency of the buyer, or otherwise.

In Articles 1525 to 1535 the term “seller” includes an agent of the seller to whom the bill of lading has been indorsed, or a consignor or agent who has himself paid, or is directly responsible for the price, or any other person who is in the position of a seller.

COMMENT:

When Seller is Deemed an “Unpaid Seller”

- (a) If only *part* of the price has been *paid* or *tendered*, the seller is still an “unpaid seller.” Notice that the law uses “the *whole* of the price.” (*Art. 1525, par. 1, Civil Code*).
- (b) Mere delivery of a negotiable instrument does not extinguish the obligation of the buyer to pay because it may be dishonored. (*See Art. 1249, par. 2, Civil Code; See also U.S. v. Bedoua, 14 Phil. 398*). Therefore, the seller is still an unpaid seller, if say, a dishonor indeed is made. (*Bunde v. Smith, 1930 N.W. 847*).

Art. 1526. Subject to the provisions of this title, notwithstanding that the ownership in the goods may have passed to the buyer, the unpaid seller of goods, as such, has:

(1) A lien on the goods or right to retain them for the price while he is in possession of them;

(2) In case of the insolvency of the buyer, a right of stopping the goods *in transitu* after he has parted with the possession of them;

(3) A right of resale as limited by this Title;

(4) A right to rescind the sale as likewise limited by this Title.

Where the ownership in the goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage *in transitu* where the ownership has passed to the buyer.

COMMENT:

(1) Rights of an Unpaid Seller

This Article gives at least 4 rights to the unpaid seller:

- (a) *possessory lien* (in the nature of a pledge);
- (b) right of *stoppage in transitu* (available if seller has parted with the possession);
- (c) right of *resale*;
- (d) right to *rescind* the sale.

[**NOTE:** This Article does not refer to the right of the seller to ask for the purchase price, such right being granted under other articles. (*Robinson v. Kram*, 1921, 187 N.Y.S. 195).]

(2) Possessory Lien

- (a) The *possessory lien* is lost after the seller loses possession but his lien (no longer possessory) as an unpaid seller remains; hence, he is still a preferred creditor with respect to the price of the specific goods sold. His preference can only be defeated by the government's claim to the *specific tax* on the goods themselves. (*Arts. 2247 and 2241[3], Civil Code*).

(**NOTE:** This is the vendor's lien on the PRICE.)

- (b) Although the seller's possessory lien is in the nature of a legal pledge, and although the rule in legal pledges is that in case of a public auction of the thing pledged, there can be no recovery of the deficiency, notwithstanding a contrary stipulation (*Arts. 2115 and 2121, Civil Code*), still under Art. 1533, should he properly makes a *resale* of the property, he may *still recover the deficiency*, for the law says "he may recover from the buyer *damages* for any loss occasioned by the breach of the contract of sale." (*See also Muehlstein and Co., Inc. v. Hickman, C.C.A. No. 1928, 26 F 2d. 40.*)

Art. 1527. Subject to the provisions of this Title, the unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases, namely:

- (1) Where the goods have been sold without any stipulation as to credit;
- (2) Where the goods have been sold on credit, but the term of credit has expired;
- (3) Where the buyer becomes insolvent.

The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.

COMMENT:

(1) When Seller Has Possessory Lien

- (a) This article refers to the cases when the unpaid seller has a possessory lien.
- (b) *Example:*

S sold *B* a specific car. No term of credit was given.
S can possess a possessory lien until he is paid.

(2) Problem

S sold *B* a specific diamond ring to be paid 6 months later. By mutual agreement, *B* is made already the owner,

but *S* will act as the depositary of the ring in the meantime. If the term expires, and *B* has not yet paid, may *S* still continue possessing the ring even if he is no longer the owner?

ANS.: Yes, for he has NOT been paid. His no longer being the owner is not important, for the law says: "The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer." (*Art. 1627, last paragraph*).

[**NOTE:** This possessory lien, however, remains only so long as the property is still with the vendor. (*Urbansky v. Kutinsky, 1912, 86 Conn. 22*).]

Art. 1528. Where an unpaid seller has made part delivery of the goods he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an intent to waive the lien or right of retention.

COMMENT:

Possessory Lien After Partial Delivery

- (a) This refers to a possessory lien even after a *partial delivery*.
- (b) The lien however may be waived *expressly* or *impliedly*.

[**NOTE:** The partial delivery may have been made under such circumstances as to show an intent to waive:

- (a) the lien;
- (b) or right of retention.]

Art. 1529. The unpaid seller of goods loses his lien thereon:

(1) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the ownership in the goods or the right to the possession thereof;

(2) When the buyer or his agent lawfully obtains possession of the goods;

(3) By waiver thereof.

The unpaid seller of goods, having a lien thereon, does not lose his lien by reason only that he has obtained judgment or decree for the price of the goods.

COMMENT:

(1) When Possessory Lien is Lost

- (a) This refers to the instances when “the lien is lost.”
- (b) The lien lost is only the *possessory lien* and not the vendor’s lien on the price.

(2) Problems

- (a) *S* delivered the goods to the carrier for transmission to the buyer. He, however, reserved his right to the *ownership* in the goods. Does he lose his possessory lien?

ANS.: No, in view of the reservation.

[**NOTE:** The same answer should be given if the seller had reserved “the right to the possession of the goods” even after he had delivered the same to the carrier. (*Art. 1529, par. 1*).]

- (b) An unpaid seller still in possession of the goods sold brought an action to get the purchase price. Does he lose his lien?

ANS.: No, for the bringing of the action is not one of the ways of losing the possessory lien. (*Urbansky v. Kutinsky, 1912, 86 Conn. 22*). As a matter of fact, even if he has already obtained a money judgment in his favor, the possessory lien still remains with him. (*Art. 1529, last paragraph*).

- (c) An unpaid seller, who possessed the goods thru a warehouseman, delivered to the buyer a *negotiable* warehouse receipt. Does the unpaid seller still have a possessory lien?

ANS.: No more, for the negotiable warehouse receipt automatically transferred both title and right of possession to the goods in the buyer. (*See Rummel v. Blanchard, 1915, 1963 N.Y.S. 169; see also Art. 1629, par. 2, which states in part: "when the buyer or his agent lawfully obtains possession of the goods."*)

- (d) An unpaid seller actually delivered the goods to the buyer. The buyer however decided to cancel the sale, so he *returned* the goods to the seller. Is the possessory lien revived?

ANS.: Yes, because the unpaid seller is once more in possession of the goods. (*See Jones v. Lemay-Lieb Corp., 1938, 16 N.E. 2d. 634*).

Art. 1530. Subject to the provisions of this Title, when the buyer of goods is or becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them *in transitu*, that is to say, he may resume possession of the goods at any time while they are in transit, and he will then become entitled to the same rights in reyard to the goods as he would have had if he had never parted with the possession.

COMMENT:

(1) Right of Stoppage in Transitu

This refers to the right of *stoppage in transitu*, available to the unpaid seller —

- (a) if he has *parted* with the possession of the goods;
 (b) AND if the buyer is or *becomes insolvent*. (*Art. 1530, 1st part*).

[**NOTE:** In the second line, the words "is or" have been inserted to make it clear that the seller's right exists even though the buyer was already insolvent at the time of sale. (*Com. Note, A-1, U.L.A. 1950 Ed., p. 737*).]

(2) Meaning of Insolvency in the Article

The insolvency referred to need not be judicially declared. It is enough that the obligations exceed a man's assets. (*Coleman v. New York*, 102 N.E. 92).

(3) Who May Exercise the Right of Stoppage in Transitu

The right of *stoppage in transitu* may be exercised by any person who as between himself and a purchaser, may be regarded as an unpaid vendor. (See *Weyerhaeuser Timber Co. v. First Nat. Bank*, 38 P. 2d 48).

Art. 1531. Goods are in transit within the meaning of the preceding article:

(1) From the time when they are delivered to a carrier by land, water, or air, or other bailee for the purpose of transmission to the buyer, until the buyer, or his agent in that behalf, takes delivery of them from such carrier or other bailee;

(2) If the goods are rejected by the buyer, and the carrier or other bailee continues in possession of them, even if the seller has refused to receive them back.

Goods are no longer in transit within the meaning of the preceding article:

(1) If the buyer, or his agent in that behalf, obtains delivery of the goods before their arrival at the appointed destination;

(2) If, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent; and it is immaterial that further destination for the goods may have been indicated by the buyer;

(3) If the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf.

If the goods are delivered to a ship, freight train, truck, or airplane chartered by the buyer, it is a question

depending on the circumstances of the particular case, whether they are in the possession of the carrier as such or as agent of the buyer.

If part delivery of the goods has been made to the buyer, or his agent in that behalf, the remainder of the goods may be stopped *in transitu*, unless such part delivery has been under such circumstances as to show an agreement with the buyer to give up possession of the whole of the goods.

COMMENT:

(1) When Goods are in Transit or Not

- (a) This Article refers to the instances when the goods are still considered “in transit” and when “no longer in transit.”
- (b) The right to get back the goods exists only when the goods are still *in transitu*. (See *In re Arctic Store*, 258 F. 688).
- (c) Taking of the property in transit by an unauthorized agent of the buyer does not extinguish the right of stoppage *in transitu*. (*Kingman and Co. v. Denison*, 84 Mich. 608).

(2) Effect of Refusal to Receive

If upon arrival the buyer “unjustifiably refuses to receive the goods, the goods are still *in transitu* and therefore, the seller may still exercise the right of stoppage.” (*Tufts v. Sylvester*, 79 Me. 213).

Art. 1532. The unpaid seller may exercise his right of stoppage *in transitu* either by obtaining actual possession of the goods or by giving notice of his claim to the carrier or other bailee in whose possession the goods are. Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter case the notice, to be effectual, must be given at such time and under such circumstances that the principal, by the exercise of reasonable diligence, may prevent a delivery to the buyer.

When notice of stoppage *in transitu* is given by the seller to the carrier, or other bailee in possession of the

goods, he must redeliver the goods to, or according to the directions of, the seller. The expenses of such delivery must be borne by the seller. If, however, a negotiable document of title representing the goods has been issued by the carrier or other bailee, he shall not be obliged to deliver or justified in delivering the goods to the seller unless such document is first surrendered for cancellation.

COMMENT:

(1) How the Right of Stoppage in Transitu May Be Exercised

- (a) Obtaining actual possession.
- (b) Giving notice of the claim.

[**NOTE:** There must be intent to repossess the goods. (*Rucker v. Donouan*, 19 Am. Rep. 84).]

(2) To whom Notice is Given

Notice is given either:

- (a) to the person in actual possession of the goods;
- (b) or to his principal.

(3) Effects of the Exercise of the Right

After the exercise of the right of stoppage *in transitu*, the consequential effects are:

- (a) the goods are no longer *in transitu*;
- (b) the contract of carriage ends; instead, the carrier now becomes a mere bailee, and will be liable as such (*Rosenthal v. Weir*, 57 L.R.A. 527);
- (c) the carrier should not deliver anymore to the buyer or the latter's agent; otherwise, he will clearly be liable for damages (*Jones v. Earl*, 99 Am. Dec. 338);
- (d) the carrier must redeliver to, or according to the directions of, the seller. (Art. 1532, 2nd paragraph, 1st sentence).

Art. 1533. Where the goods are of perishable nature, or where the seller expressly reserves the right of resale in case the buyer should make default, or where the buyer has been in default in the payment of the price for an unreasonable time, an unpaid seller having a right of lien or having stopped the goods in transitu may resell the goods. He shall not thereafter be liable to the original buyer upon the contract of sale or for any profit made by such resale, but may recover from the buyer damages for any loss occasioned by the breach of the contract of sale.

Where a resale is made, as authorized in this article, the buyer acquires a good title as against the original buyer.

It is not essential to the validity of a resale that notice of an intention to resell the goods be given by the seller to the original buyer. But where the right to resell is not based on the perishable nature of the goods or upon an express provision of the contract of sale, the giving or failure to give such notice shall be relevant in any issue involving the question whether the buyer had been in default for an unreasonable time before the resale was made.

It is not essential to the validity of a resale that notice of the time and place of such resale should be given by the seller to the original buyer.

The seller is bound to exercise reasonable care and judgment in making a resale, and subject to this requirement may make a resale either by public or private sale. He cannot, however, directly or indirectly buy the goods.

COMMENT:

(1) Right of Resale

This article deals when the right of RESALE exists:

- (a) perishable goods
- (b) express stipulation
- (c) unreasonable default

(2) Right, Not Duty, to Resell

The article confers on the seller a right to resell (to enforce his lien after title has passed) but does not impose upon him the duty to resell. (*Higgins v. California Prune Growers*, 16 F.2d. 190).

[**NOTE:** The article does not apply where title to goods has not passed. (*Farish Co. v. Madison Distributing Co.*, C.C. A., N.Y. 1930, 37 F.2d. 455).]

(3) Meaning of Perishable

Goods are perishable if they are of a nature that they deteriorate rapidly. (*Perretta v. Vetrone*, 117 A. 534).

(4) Deficiency or Excess in the Price

Note that the deficiency in the price may be obtained as damages. This happens when the resale price is lower than the original selling price. (*See Urbansky v. Kutinsky*, 1912, 86 Conn. 22). Indeed, the resale is similar to a foreclosure of a lien held to secure the payment of the purchase price. On the other hand, any excess in the price goes to the seller.

Art. 1534. An unpaid seller having the right of lien or having stopped the goods *in transitu*, may rescind the transfer of title and resume the ownership in the goods, where he expressly reserved the right to do so in case the buyer should make default, or where the buyer has been in default in the payment of the price for an unreasonable time. The seller shall not thereafter be liable to the buyer upon the contract of sale, but may recover from the buyer damages for any loss occasioned by the breach of the contract.

The transfer of title shall not be held to have been rescinded by an unpaid seller until he has manifested by notice to the buyer or by some other overt act an intention to rescind. It is not necessary that such overt act should be communicated to the buyer, but the giving or failure to give notice to the buyer of the intention to rescind shall be

relevant in any issue involving the question whether the buyer had been in default for an unreasonable time before the right of rescission was asserted.

COMMENT:

(1) Right to Rescind the Transfer of Title

- (a) This Article refers to the *right to rescind the transfer of title and to resume the ownership in the goods.*
- (b) This applies in case there has been:
 - 1) express stipulation or reservation;
 - 2) unreasonable default.
- (c) Note *that damages* may be recovered for the breach of contract.
- (d) What should be done in order to rescind the transfer of title?

ANS.: There must be notice to the buyer or there must be an overt act showing an intention to rescind.

(2) Effect of Replevin Suit

When the seller brings a replevin suit (recovery of personal property), there is an implied rescission of the sale of the goods sought to be recovered. (*Barj State Milling Co. v. Susman, 91 Conn. 482*). If ownership is claimed over the property, and it is subsequently offered to a third person, these facts can be presented to indicate an intention to rescind. (*See J.I. Case Threshing Mach. Co. v. Bargabos, 14 Minn. 8*).

Art. 1535. Subject to the provisions of this Title, the unpaid seller's right of lien or stoppage *in transitu* is not affected by any sale, or other disposition of the goods which the buyer may have made, unless the seller has assented thereto.

If, however, a negotiable document of title has been issued for goods, no seller's lien or right of stoppage *in transitu* shall defeat the right of any purchaser for value in good faith to whom such document has been negotiated, whether such negotiation be prior or subsequent to the

notification to the carrier, or other bailee who issued such document, of the seller's claim to a lien or right of stoppage *in transitu*.

COMMENT:

Effect if Buyer Has Already Sold the Goods

- (a) Generally, the unpaid seller's right of LIEN or STOPPAGE IN TRANSITU remains even if the buyer has sold or otherwise disposed of the goods.
- (b) Exceptions:
 - 1) When the seller has given his consent thereto.
 - 2) When the purchaser or the buyer is a purchaser *for value in good faith of a negotiable document of title*. (*See Roman v. Asia Banking Corporation, 46 Phil. 705*).

Art. 1536. The vendor is not bound to deliver the thing sold in case the vendee should lose the right to make use of the term as provided in article 1198.

COMMENT:

(1) When Seller is Not Bound to Deliver Because Buyer Has Lost the Benefit of the Term

Under *Art. 1198*, the debtor shall lose every right to make use of the period:

- (a) When after the obligation has been contracted, he becomes insolvent, unless he gives a guaranty or security for the debts;
- (b) When he does not furnish to the creditor the guaranties which he has promised;
- (c) When by his own acts he has impaired said guaranties or securities after their establishment, and when through a fortuitous event they disappear, unless he immediately gives new ones equally satisfactory;
- (d) When the debtor violates any undertaking, in consideration of which the creditor agreed to the period;

- (e) When the debtor attempts to abscond.

In the cases enumerated, the vendor is not bound to deliver.

(2) Example

A purchased goods from B. A promised to give certain securities, as a result of which, A was given one year within which to pay. A failed to give the securities. Can B be compelled to deliver?

ANS.: No. (Of course, if B so desires, he may voluntarily deliver.)

Art. 1537. The vendor is bound to deliver the thing sold and its accessions and accessories in the condition in which they were upon the perfection of the contract.

All the fruits shall pertain to the vendee from the day on when the contract was perfected.

COMMENT:

(1) Accessions and accessories

- (a) *Example of accession:* Fruits
(b) *Example of accessories:* In the sale of a car, the jack is considered an accessory.

(2) Duty to Preserve

This article implicitly reiterates the duty of the seller to PRESERVE. Naturally, a fortuitous event excuses the seller. But since a fortuitous event is never presumed, the loss of the property because of such event is naturally to be proved by the seller. (*10 Manresa 143*).

(3) Right to the Fruits

Although under the second paragraph fruits shall pertain to the buyer from the date of perfection, it is evident that a

contrary stipulation may be agreed upon, or a later date may be set. (*See 10 Manresa 145*). The term “fruits” here includes *natural, industrial and civil fruits*. (*Binalbagan Estate v. Gatuslao, 74 Phil. 128*).

Art. 1538. In case of loss, deterioration or improvement of the thing before its delivery, the rules in article 1189 shall be observed, the vendor being considered the debtor.

COMMENT:

(1) Effect of Loss, Deterioration or Improvement Before Delivery

This reiterates the rule that from time of perfection to delivery, risk is borne by the buyer.

(2) Article 1189

“When the conditions have been imposed with the intention of suspending the efficacy of an obligation to give, the following rules shall be observed in case of the improvement, loss or deterioration of the thing during the pendency of the condition:

(1) If the thing is lost without the fault of the debtor, the obligation shall be extinguished;

(2) If the thing is lost through the fault of the debtor, he shall be obliged to pay damages; it is understood that the thing is lost when it perishes, or goes out of commerce, or disappears in such a way that its existence is unknown or it cannot be recovered;

(3) When the thing deteriorates without the fault of the debtor, the impairment is to be borne by the creditor;

(4) If it deteriorates through the fault of the debtor, the creditor may choose between the rescission of the obligation and its fulfillment, with indemnity for damages in either case;

(5) If the thing is improved by its nature, or by time, the improvement shall inure to the benefit of the creditor;

(6) If it is improved at the expense of the debtor, he shall have no other right than that granted to the usufructuary.”

Art. 1539. The obligation to deliver the thing sold includes that of placing in the control of the vendee all that is mentioned in the contract, in conformity with the following rules.

If the sale of real estate should be made with a statement of its area, at the rate of a certain price for a unit of measure or number, the vendor shall be obliged to deliver to the vendee, if the latter should demand it, all that may have been stated in the contract; but, should this be not possible, the vendee may choose between a proportional reduction of the price and the rescission of the contract, provided that, in the latter case, the lack in the area be not less than one-tenth of that stated.

The same shall be done, even when the area is the same, if any part of the immovable is not of the quality specified in the contract.

The rescission, in this case, shall only take place at the will of the vendee, when the inferior value of the thing sold exceeds one-tenth of the price agreed upon.

Nevertheless, if the vendee would not have bought the immovable had he known of its smaller area or inferior quality, he may rescind the sale.

COMMENT:

(1) Sale of Real Estate By the Unit

- (a) This refers to the sale of real estate by the unit. Hence, if *A* buys from *B* a piece of land supposed to contain 1,000 square meters at the rate of P10,000 per square meter, but the land has only 800 sq.m., the additional 200 must be given to *A* should *A* demand them. If this cannot be done, *A* may pay only P8 million (for the 800 sq.m.) or rescind the contract.

- (b) If in the above example, there are only 950 square meters, can A ask for rescission?

ANS.: As a rule no, because the lack is only 50 square meters. (The lack must be at least 1/10 of the area stated.) However, if A would not have bought the land had he known of its smaller area, he may rescind the sale.

[**NOTE:** The *one-tenth* part referred to in the article applies to 1/10 of the area stated in the contract, not to 1/10 of the true or actual area. This is evident because of the wording of the law — area “stated.” (See 10 *Manresa* 149).]

(2) Unit Price Contract

Virgilio Dionisio v. Hon. Vicente Paterno L-49654, Feb. 26, 1981

If a contract is a “unit price contract” (as distinguished from a “lump sum contract”) payment will be made only on the basis of contractual items actually performed, in accordance with the given plans and specifications.

In such a “unit price contract,” the amount agreed upon is generally merely an estimate, and may be reduced or increased depending upon the quantities performed multiplied by the unit prices previously agreed upon. For a “unit price” formula to be applied, there must be a stipulation to such effect. Incidentally, a contractor may not be awarded a compensation for his services, arising from a price adjustment due to inflation.

Art. 1540. If, in the case of the preceding article, there is a greater area or number in the immovable than that stated in the contract, the vendee may accept the area included in the contract and reject the rest. If he accepts the whole area, he must pay for the same at the contract rate.

COMMENT:**Rule When Actually the Area or Number is Greater***Example*

A buys from B a piece of land supposed to contain 1,000 square meters at the rate of P10,000 a square meter. But the land really contains 1,500 square meters. What can A do?

ANS.: A may accept 1,000 square meters and reject the extra 500, in which case he will pay only P10 million. However, A is also allowed to accept all of the 1,500 square meters, but he must pay P15 million. A is in no case allowed to rescind the contract, for such a remedy is not allowed him under this article.

Art. 1541. The provisions of the two preceding articles shall apply to judicial sales.

COMMENT:**The Rule in Judicial Sales**

Note that Arts. 1540 and 1541 apply to judicial sales.

Art. 1542. In the sale of real estate, made for a lump sum and not at the rate of a certain sum for a unit of measure or number, there shall be no increase or decrease of the price, although there be a greater or less area or number than that stated in the contract.

The same rule shall be applied when two or more immovables are sold for a single price; but if, besides mentioning the boundaries, which is indispensable in every conveyance of real estate, its area or number should be designated in the contract, the vendor shall be bound to deliver all that is included within said boundaries, even when it exceeds the area or number specified in the contract; and, should he not be able to do so, he shall suffer a reduction in the price, in proportion to what is lacking in the area or number, unless the contract is rescinded because the vendee does not accede to the failure to deliver what has been stipulated.

COMMENT:**(1) Sale for a Lump Sum (*A Cuerpo Cierto*)**

Here, the sale is made for a lump sum (*a cuerpo cierto* or *por precio alzado*) not at the rate per unit.

(2) Example

A buys a piece of land from B at the lump sum of P10 million. In the contract, the area is stated to be 1,000 square meters. The boundaries are of course mentioned in the contract. Now then it was discovered that the land within the boundaries really contains 1,500 square meters. Is B bound to deliver the extra 500?

ANS.: Yes. Furthermore, the price should not be increased. This is so because B should deliver *all which are included in the boundaries*. If B does not deliver the remaining 600, A has the right —

- (a) either *to rescind* the contract for the seller's failure to deliver what has been stipulated, or
- (b) to pay a *reduced proportional* price, namely 2/3 of the original price. This is so because he really gets only 2/3 of the land included within the boundaries (1,000 sq.m. out of 1,500 sq.m.).

(3) Another Example

A buys a piece of land *a cuerpo cierto* (for a lump sum). The contract states a certain number of square meters but the land included in the boundaries happen to be LESS.

- (a) Is A entitled to rescind?

ANS.: No.

- (b) Is A entitled to pay a reduced price?

ANS.: No.

The Civil Code presumes that the purchaser had in mind a *determinate piece of land* and that he ascertained

its area and quality before the contract was perfected. If he did not do so, or if having done so, he made no objection and consented to the transaction, he can blame no one but himself. (*Teron v. Villanueva Viada de Riosa*, 56 Phil. 677).

(4) Delivery of All the Land Included in the Boundaries

What is important is the delivery of all the *land included in the boundaries*:

- (a) If this is done, there is compliance with the contract and the greater or lesser area is immaterial. So apply paragraph 1 of this article.
- (b) If this is not done, there is really no faithful compliance with the contract and so paragraph 2 should be applied. (*Azarraga v. Gay*, 52 Phil. 599).

(5) Effect of Gross Mistake

Regarding paragraph 1, although ordinarily there can be no rescission or reduction or increase whether the area be greater or lesser, still there are instances in which equitable relief may be granted to the purchaser as where the deficiency is very great, for under such circumstances, GROSS MISTAKE may be inferred. (*Asiain v. Jalandoni*, 45 Phil. 296 and *Garcia v. Velasco*, 40 O.G. No. 2, p. 268).

(6) Effect if Buyer Took the Risk as to Quantity

In one case, the Court was satisfied that although the shortage amounts to practically one-fourth of the total area, the purchaser clearly intended to take risk of quantity, and that the area has been mentioned in the contract merely for the purpose of description. From the circumstances that the defendant, before her purchase of the fishpond, had been in possession and control thereof for two years as a lessee, she can rightly be presumed to have acquired a good estimate of its value and area, and her subsequent purchase thereof must have been premised on the knowledge of such value and area. Accordingly, she cannot now be heard to claim an

equitable re-auction in the purchase price on the pretext that the property is much less than she thought it was. (*Garcia v. Velasco*, 40 O.G. No. 2, p. 268).

(7) Meaning of “More or Less”

The phrase “more or less” or others of like import added to a statement of the quantity, can only be considered as covering *inconsiderable* or *small differences* one way or the other. The use of such phrases in designating the quantity covers only a reasonable excess or deficiency. (*Asiain v. Jalandoni*, 45 Phil. 296).

Art. 1543. The actions arising from Articles 1639 and 1642 shall prescribe in six months, counted from the day of delivery.

COMMENT:

Prescriptive Period

Note that 6 months is the period of prescription.

Art. 1544. If the same thing should have been sold to different vendees, the ownership shall be transferred to the person who may have first taken possession thereof in good faith, if it should be movable property.

Should it be immovable property, the ownership shall belong to the person acquiring it who in good faith first recorded it in the Registry of Property.

Should there be no inscription, the ownership shall pertain to the person who in good faith was first in the possession; and in the absence thereof, to the person who presents the oldest title, provided there is good faith.

COMMENT:

(1) Rules of Preference in Case of Double Sale

(a) *Personal* property — *possessor* in good faith.

(b) Real property —

- 1) *registrant in good faith;*
- 2) *possessor in good faith;*
- 3) *person with the oldest title in good faith.*

NOTE:

- a) *Registration* here requires actual recording: hence, if the property was never really registered as when the registrar forgot to do so although he has been handed the document, there is *no* registration. (*Po Sun Tun v. Price*, 54 Phil. 192). The rule as to registration covers all kinds of immovables, including land, and makes no distinction as to whether the immovable is registered under the Land Registration Law (with therefore a Torrens Title) or not so registered. But insofar as said registered lands are concerned, Art. 1544 is in perfect accord with the Land Registration Act, Sec. 50 of which provides that no deed, mortgage, lease, or other voluntary instrument except a will, purporting to convey or to affect registered land shall take effect as a conveyance or bind the land until the registration of such deed or instrument. (*Revilla, et al. v. Galindez*, L-9940, Mar. 30, 1960). Thus, as to lands, covered by a Torrens Certificate of Title, a deed of sale is considered registered from the moment it is entered or recorded in the entry or day book of the Register of Deeds. (*Levin v. Bass*, L-4340, May 25, 1952, reversing *Bass v. De la Rama*, 1 O.G. 889). If the land is registered under the Land Registration Act (and has therefore a Torrens Title), and it is sold but the subsequent sale is registered not under the Land Registration Act but under Act 3344, as amended, such sale is not considered REGISTERED, as the term is used under Art. 1544. (*Soriano v. Heirs of Magali*, L-15133,

Jul. 31, 1963). A mere “*anotacion preventiva*” (preventive precautionary notice) is not ejuivalent to registration, unless within 30 days thereafter there is made an actual recording. Such a preventive notice is good only against subsequent (not prior) transferees, and even here for only 30 days. (*Mendoza v. Kalaw*, 42 *Phil.* 236). The registration of a forged deed of sale cannot of course grant the preference adverted to in this Article inasmuch as among other things, there was no good faith. (See *Espiritu v. Valerio*, L-18018, Dec. 26, 1963).

- b) Possession here is either actual or constructive since the law makes no distinction. (*Sanchez v. Ramos*, 40 *Phil.* 614).
- c) Title in this Article means title because of the sale, and not any other title or mode of acquiring property. Hence, as between a buyer-possessor whose possession has ripened to ownership because of *prescription*, and a registrant in good faith, the possessor-owner is naturally preferred. (*Lichauco v. Berenguer*, 39 *Phil.* 642).
- d) Note that in all the rules there must be *good faith*; otherwise, the order of preference does not apply. (*Romeo Paylago and Rosario Dinaandal v. Ines Pastrana Jorabe and the Court of Appeals*, L-20046, Mar. 27, 1968). A purchaser in good faith is one who buys the property of another without notice that some other person has a right to, or interest in such property, and pays a full and fair price for the same, at the time of such purchase, or before he has notice of the claim or interest of some other person in the property. (*Cui and Joven v. Henson*, 51 *Phil.* 612; *Inquimboy v. Paez Vda. de la Cruz*, L-13953, May 26, 1960). A person for example who buys land which he knows has already been promised to another is a purchaser in

bad faith. (*Ramos v. Dueno*, 50 Phil. 786). Good faith, however, is presumed. (*Emus v. De Zuzuarregui*, 53 Phil. 197). In order that a purchaser of land with a Torrens Title may be considered as a purchaser in good faith, it is enough that he examines the latest certificate of title which, in this case, is that issued in the name of the immediate transferor. (*Hernandez v. Katigbak Vda. de Salas*, 69 Phil. 744; *Flores, et al. v. Plasina, et al.*, L-5727, Feb. 12, 1954; *Revilla, et al. v. Galindez*, L-9940, Mar. 30, 1960). The purchaser is not bound by the original certificate of title but only by the certificate of title of the person from whom he has purchased the property. (*Cañas, et al. v. Tan Chuan Leong, et al.*, L-14594, Nov. 29, 1960). However, where two certificates of title are issued to different persons covering the same land in whole or in part, the earlier in date must prevail as between original parties, and in case of successive registrations, where more than one certificate is issued over the land, the person holding under the *prior* certificate is entitled to the land as against the person who relies on the second certificate. The purchaser from the owner of the later certificate and his successors should resort to his vendor for redress, rather than molest the holder of the first certificate and his successors, who should be permitted to rest secure in their title. (*Felix de Villa v. Anacleto Trinidad, et al.*, L-24918, Mar. 20, 1968, citing *Legarda v. Saleeby*, 31 Phil. 590).

Remalate v. Tibe
GR 59514, Feb. 25, 1988

Where the same parcel of land was allegedly sold to two different persons, Art. 1544 will not apply, despite the fact that one deed of sale was registered ahead of the other, if the deed first registered is found to be a forgery

and, thus, the sale to the other vendee should prevail.

This Article does not apply to subsequent *judicial attachments*, or *executions* which should not prevail over prior unregistered sales where possession had already been conveyed by the execution of a public instrument (*See Fabian v. Smith, Bell and Co., 8 Phil. 496; see also Aitken v. Lao, 36 Phil. 510*), nor to instances where the double sale was not made by the same person or his authorized agent (*Carpio v. Exevea, 38 O.G. No. 65, p. 1336*), nor to one where one sale was an absolute one but the other was a *pacto de retro* transaction where the period to redeem has not yet expired (*See Teodosio v. Sabala, et al., L-11522, Jan. 31, 1957*), nor to one where one of the sales was one subject to a suspensive condition which condition was not complied with. (*Mendoza v. Kalaw, 42 Phil. 236*).

- e) The Article, however, applies to a double donation (*Cagaoan v. Cagaoan, 43 Phil. 554*) and to sales made by a principal and his agent of the same property.

[**NOTE:** In a Court of Appeals case, however, it was held that the article does not apply where property is first donated, then sold. (*Se-mana, et al. v. Goyena, {C.A.} 49 O.G. 2897*).]

- f) Reason for the rule on preference:

True, no one can sell what he does not own, but this is merely the general rule. Is Art. 1544 then an exception to the general rule? In a sense, yes, by reason of public convenience (*See Aitken v. Lao, 36 Phil. 510*); in still another sense, it really reiterates the general rule in that insofar as innocent third persons are concerned, the registered owner (in the case of real property) is still the owner, with power of disposition.

Caram, Jr. v. Laureta
L-28740, Feb. 24, 1981

The second buyer of a parcel of land alleged that his purchase had been made in good faith, because he did not know it had been previously bought by another. Is this enough to prove good faith in the purchase? No, because he had knowledge of circumstances which ought to have put him on inquiry. For instance, the first buyer was already on the land when the second buyer came along. The second buyer should have investigated the nature of the first buyer's possession. Since he failed to exercise the ordinary care expected of a buyer of real estate, he must suffer the consequences.

(2) Illustration of Rules as to Personal Property

In the case of *Tomasi v. Villa-Abrille*, L-7404, Aug. 21, 1958, the Surplus Property Commission sold to a buyer "all the movable goods" in a base area in Guiuan, Samar. The buyer then immediately took possession of all the movable properties located within the area. Subsequently, however, the Commission also sold to another the same properties in the same area.

The second buyer then filed suit to have himself declared the owner of the properties entitled to the possession of the same. The Supreme Court ruled in favor of the first buyer because it was he who had first taken possession in good faith of the properties.

(3) Illustration of Rules as to Real Property

A sold land to B. Subsequently, A sold the same land to C who in good faith registered it in his name. Who should be considered the owner?

ANS.: C in view of the registration in good faith.

(4) Cases**DBP v. Mangawan, et al.
L-18861, Jun. 30, 1964**

FACTS: A sold his land to two different parties at different times, selling it first to X under Original Torrens Certificate of Title 100. X had this title cancelled and a transfer Certificate of Title was issued in his name. Subsequently, A sold the same land under a different Certificate of Title to Y. Which of the two buyers is to be preferred?

HELD: This is a case of double sale, and clearly, X the first buyer who registered the land in his name, ought to be preferred.

**Astorga v. Court of Appeals
L-58530, Dec. 26, 1984**

The second buyer of property (real estate) is preferred over the first buyer if the second buyer was the first to register the property in *good faith* in the Registry of Deeds.

**Po Sun Tun v. Price
54 Phil. 192**

FACTS: A sold land to X who then went to the Registry of Property. X gave the deed of sale for registration, was given a receipt therefor, but unfortunately, the Registrar for one reason or another was not able to actually record the deed. Subsequently, A sold the same land to Y, a purchaser in good faith. Y had the land registered in his name. *Issue:* Who is now the owner?

HELD: Y, in view of the registration in good faith.

The sale in favor of X was never actually registered. The Court held: "Where a piece of real property is first sold to a person who only secures a receipt for the document evidencing the sale from the office of the register of deeds, and where the piece of property is later sold to another person who records his

documents in the Registry of Deeds as provided by law, and secures a Torrens Title the property belongs to the latter.”

(**NOTE:** The mere presentation to the Office of the Registry of a document on which acknowledgment of receipt is written is not equivalent to recording the property. Escriche says that registration in its juridical aspect must be understood as the entry made in the book or public registry of deeds.)

Soler and Castillo say:

“Registration in general as the law uses the word means any entry made in the books of the Registry, including both registration in its ordinary and strict sense, and cancellation, annotation, and even the marginal notes. In its strict acceptance, it is the entry made in the Registry which records solemnly and permanently the right of ownership and other real rights.” (*Diccionario de Legislacion Hipotecaria y Notarial*, Vol. II, p. 185).

**Victoriano Hernandez v.
Macaria Katigbak Viuda de Salas
69 Phil. 744**

FACTS: Leuterio sold in 1922 a parcel of registered land (with a Torrens Title) to Villanueva. The deed of sale was however *never registered*. In 1926, a creditor of Leuterio named Salas Rodriguez sued Leuterio for recovery of the debt, and a writ of execution was levied on Leuterio’s land (the same lot that had been sold to Villanueva). Salas Rodriguez did not know of this sale. Upon the other hand, the levy on execution was duly registered. One month after this registration of the levy, Villanueva filed a third-party claim. The very next day, the execution sale was made and Salas Rodriguez was the highest bidder. **Issue:** Who should be considered the owner of the land — Salas or Villanueva?

HELD: Salas Rodriguez should be considered as the owner because of the following reasons:

- (a) It is a well-settled rule that, when the property sold on execution is registered under the Torrens system, registration is the operative act that gives validity to

the transfer or creates a lien on the land, and a purchaser on execution sale, is *not* required to go behind the registry to determine the conditions of the property. Such purchaser acquires such right, title, and interest as appearing on the certificate of title issued on the property, subject to no liens, encumbrances or burdens that are noted thereon. Be it observed that Villanueva's right was never registered nor annotated on the Torrens Certificate.

- (b) The doctrine in *Lanci v. Yangco* (62 Phil. 563), which purports to give effect to all liens and encumbrances existing prior to the execution sale of a property registered under the Torrens System even if such liens and encumbrances are not noted in the certificate of title (on the theory that if, for example, a previous sale had been made by the registered owner, he can no longer convey what he does not have) has been ABANDONED by the Supreme Court. (*See Philippine National Bank v. Camus*, L-46870, Jun. 27, 1940).
- (c) The only exception to the rule enunciated in (a) is where the purchaser had knowledge, prior to or at the time of the levy, of such previous lien or encumbrance. In such case, his knowledge is equivalent to registration, and taints his purchase with bad faith. (*Gustilo v. Maravilla*, 48 Phil. 442; *La Urbana v. Bernardo*, 62 Phil. 790; 23 C.J. Sec. 812; *Parsons Hardware Co. v. Court of Appeals*, L-46141). But if knowledge of any lien or encumbrance upon the property is *acquired after* the levy, the purchaser *cannot be said to have acted in bad faith in making the purchase*, and, therefore, such lien or encumbrance cannot affect his title.
- (d) In the present case, the third-party claim was filed one month after the levy was recorded. The validity of the levy as recorded. The validity of the levy is thus *unaffected* by any subsequent knowledge which the judgment creditor might have derived from the third-party claim. The fact that this third-party claim was presented *one day before* the execution sale, is immaterial. If the levy is valid, as it was, the execution sale made in pursuance thereof is also valid, just as a mortgage lien validly

constituted may validly be foreclosed regardless of any equities that may have arisen after its constitution.

(5) Query

A sold a parcel of land with a Torrens Title to *B* on Jan. 5. A week later, *A* sold the same land to *C*. Neither sale was registered. As soon as *B* learned of the sale in favor of *C*, he (*B*) registered an adverse claim stating that he was making the claim because the second sale was in fraud of his rights as first buyer. Later, *C* registered the deed of sale that had been made in his favor. Who is now the owner — *B* or *C*?

ANS.: *C* is clearly the owner, although he was the second buyer. This is so, not because of the registration of the sale itself but because of the AUTOMATIC registration in his favor caused by *B*'s knowledge of the first sale (actual knowledge being equivalent to registration). The purpose of registration is to notify. This notification was done because of *B*'s knowledge. It is wrong to assert that *B* was only trying to protect his right for there was *no more right to be protected*. He should have registered the sale BEFORE knowledge came to him. It is now too late. It is clear from this that with respect to the principle "actual knowledge is equivalent to registration of the sale about which knowledge has been obtained" — the knowledge may be that of either the FIRST or the SECOND buyer.

**Maria Bautista Vda. de Reyes v. Martin de Leon
L-22331, Jun. 6, 1967**

ISSUE: Between an unrecorded sale of prior date of real property by virtue of a public instrument and a recorded mortgage thereof at a later date, which is preferred?

HELD: The former (the unrecorded sale) is preferred for the reason that if the original owner has parted with his ownership and free disposal of that thing so as to be able to mortgage under Act 3344 would, in such case, be of no moment, since it is understood to be without prejudice to the better right of third parties. (*NOTE:* It would seem that this ruling is not accurate because the mortgagor should really still be considered the owner insofar as innocent third

parties are concerned, the sale not having been registered. This comment, however, holds true only if somehow the land — even if not registered under the Torrens System — was in the name of the mortgagor — as when for instance he had previously registered his purchase of it from someone.)

Casica, et al. v. Villaseca, et al.
L-9590, Apr. 30, 1957

FACTS: A certain parcel of land was owned in undivided equal shares of three persons: Luis, Juana, and Jose Quimentel. On May 31, 1948, Juana and Luis sold their 2/3 share in the land to Rosa Casica and her children, but this sale was registered only on Jun. 28, 1949. On Jan. 5, 1949, Luis executed another deed of sale of a 1/3 portion of the land to the spouses Teofilo and Nicasia Villaseca, which sale was registered the following day, Jan. 6, 1949, ahead of the registration of the sale to Rosa Casica. On Aug. 29, 1949, however, Teofilo Villaseca executed a “quitclaim deed” whereby he released, quitclaimed, and renounced all his rights, interests, and participations over the share purchased by him from Luis Quimentel on Jan. 5, 1949. This quitclaim was not, however, recorded in the Registry of Property. On Aug. 15, 1949, the spouses Villaseca filed the action to annul the deed of sale in favor of Rosa Casica and the cancellation of its registration. On Jan. 26, 1950, Luis Quimentel executed an affidavit cancelling the quitclaim deed. *Issue:* Who owns the 1/3 share sold twice by Luis Quimentel?

HELD: Casica and her children should be considered as the owner thereof. Here, there was a double sale of the 1/3 portion of the lot of Luis Quimentel. Although the sale in favor of the Villasecas was registered ahead of the prior sale to Casica, said sale to the Villasecas was in effect cancelled and such preferential right as they may have acquired by virtue of the registration of the deed in their favor, necessarily disappeared and was extinguished by the execution of the quitclaim deed by Teofilo Villaseca. This quitclaim although not recorded was valid and binding upon Teofilo, as maker thereof, as well as upon Luis Quimentel. The purpose of registration is merely to notify and protect the interest of strangers to a given transaction, who may be ignorant thereof,

and the non-registration of the deed does not relieve the parties thereto and their obligations thereunder. Moreover, the quitclaim was binding on both Teofilo and Nicasia Villaseca although it was executed by Teofilo alone and not by Nicasia, because as husband of Nicasia, and administrator of their conjugal partnership, Teofilo had, under the provisions of the old Civil Code, full authority to bind said partnership, and his wife, as well as to dispose of said rights. Finally, the execution on Jan. 26, 1950 of the affidavit “cancelling” the quitclaim previously made, did not revive the preferential right of the Villasecas because the sale to Rosa Casica and her children was already registered on Jun. 28, 1949 or seven months prior to said affidavit.

(6) Problem

X orally appointed Y as his agent to sell a parcel of land. On Sept. 30, 2004, Y sold the land to A who forthwith took possession thereof. It turned out, however, that on Sept. 25, 2004, X without informing Y, had already sold the same land to B who up to now has not yet taken possession thereof. Neither A nor B has registered his purchase. Whose contract should prevail? Reason.

ANS.: The contract of X with B will prevail, for he has title while A has no title. It is true that A first took possession, but it should be noted that the sale to A was *null and void*, inasmuch as Y’s authority to sell the land was *not* in writing. (*Art. 1874, Civil Code*).

(7) Cases

Manuel Buason, et al. v. Mariano Panuyas L-11415, May 25, 1959

FACTS: Mr. and Mrs. Dayao authorized, by a special power of attorney, Mr. Bayuga to sell some parcels of land. Four years later, Mr. Dayao died and his children sold said parcels to Mr. and Mrs. Buason in a public instrument which was *not* recorded in the Registry of Property. Several years later, Mr. Bayuga, by virtue of the power of attorney in his favor, sold the same parcels in favor of Mr. and Mrs. Panuyas.

Mr. Bayuga did *not* know that Mr. Dayao had already died. The power of attorney executed by Mr. Dayao authorizing Mr. Bayuga had been annotated on the back of the Torrens Certificate of Title of the lands.

The sale in favor of Mr. and Mrs. Panuyas was similarly registered and annotated. *Issue*: Who should be considered the owner of the parcels of land?

HELD: Mr. and Mrs. Panuyas are the owners of the parcels of land for while their purchase thereof came later, still they have in their favor registration of the sale in good faith. While it is true that at the time of the sale to them by the agent, the principal, Dayao, was already dead; and while it is true that generally, the death of the principal extinguishes the agency; still under the law of agency anything done by the agent, without knowledge of the death of the principal or of any other cause which extinguishes the agency, is *valid* and shall be fully effective with respect to third persons who may have contracted with him in good faith. (*Art. 1738, old Civil Code; Art. 1931, new Civil Code*).

Sanchez v. Ramos
40 Phil. 614

FACTS: A sold land to B and C with the right to repurchase. The sale was in a public instrument which was *not* registered, and B and C *never* took physical or material possession of said land. The period for repurchase elapsed without A repurchasing the property. Later, A sold the same land to D in a private instrument. D was in good faith, and he immediately entered into the material possession of the land. Who should be preferred, B and C on the one hand, or D on the other hand?

HELD: B and C should be preferred. The question should be resolved by inquiring as to who had prior possession. B and C had this possession, although merely symbolical or constructive, for the possession referred to in this article includes not only material possession but also symbolic or constructive possession, which can be acquired by the execution of a public document.

[**NOTE:** Where there is no “double sale” of real property because one is an absolute sale while the other is one *con pacto de retro* with the stipulation that upon the expiration of the period to redeem, the buyer will *not* become the owner, but instead another document of *pacto de retro* will be executed, Art. 1644 does *not* apply. (*Teodosio v. Sabala, et al.*, L-11522, Jan. 31, 1957). It should be observed that in the case of *Sanchez v. Ramos, supra*, the sale *a retro* had already become an *absolute* one, with the expiration of the period of repurchase.]

Aviles v. Arcega
44 Phil. 924

FACTS: Land was sold to *A* in a public instrument which stated that delivery would be after 4 months. Same land was sold to *C* who took actual material possession. Who should be preferred?

HELD: *C* should be preferred because *A* did not even have symbolic or constructive possession since the contract itself stated implicitly that possession was NOT at *that* time being transferred.

Soriano, et al. v. Heirs of Magali
L-15133, Jul. 31, 1963

FACTS: A parcel of land was registered under the Land Registration Law in the name of *A* who therefore had a Torrens Title thereto. In 1939, he sold the land to *B*, which sale was never registered. In 1941, *B* sold the land to *C*, which sale was also not registered. In 1944, *C* sold the land to *A*, but instead of executing a formal deed of sale, he merely delivered to *A* the muniments of the title over the land. In accordance with said oral sale, *A* took possession of the land, continuing to do so up to the present, and paying the real tax thereon. In the meantime, *C* died. In 1946, *C*'s widow sold the land to *D*, the plaintiff in this case. This sale to *D* was registered under the provisions of Act 3344 (dealing with transactions over unregistered lands).

This is now an action filed by *D* against the heirs of *A* for the recovery of the said parcel of land. *Issue:* Who should get the land?

HELD: The heirs of *A* get the land, *A* having obtained possession of the land in good faith in 1944. *D* never did. Moreover, the registration by *D* of the sale in his favor was made under Act 3344, as amended and *not* under the Land Registration Act.

Bautista v. Sioson
39 Phil. 615

FACTS: *S* sold land to *B*. Then *S* became *B*'s tenant. Subsequently, *S* sold the same property to *C*. Neither sale was registered. Who should be the owner, *B* or *C*?

HELD: *B* is the owner. Art. 1544 does *not* apply because it applies only when one *owner* sold to two or more persons. Here, *S* had long ceased to be the owner for *B* had already acquired full dominion over the property. (*See also Lichauco v. Berenguer*, 39 Phil. 643).

Cruzado v. Bustos and Escobar
34 Phil. 17

FACTS: *A* sold his land to *B* who began to possess it. Later, *C*, a stranger, sold the same land to *D* who in good faith registered the sale. Who should be considered as the owner?

HELD: *B* should be considered the owner even if he did not register the land because *D* who registered the sale did not buy the land from *A*. Art. 1544 does not apply for here, in this case, we have two (not one) sellers.

(NOTE: Had *C* been the authorized agent of *A*, Art. 1544 would have applied, for then *C* would have been representing his principal, *A*.)

Carpio v. Exevea
(C.A.) 38 O.G. 1356

FACTS: *A* sold his land to *B*. Later, *A* sold the same land to *C*. *B* in turn sold the same land to *D*, who took possession of the land in good faith. *C*, a purchaser in good faith, registered the sale of the land in his favor. *Issue:* Who is now the owner of the land?

HELD: D is the owner. The rule in the Civil Code (Art. 1544) should be applied only when two buyers (or more) (C and D) bought the same property from the same person. In this case, there were two (2) different sellers (A and B), one of whom (A) had long before disposed of his rights as owner of the land.

Diosdado Sta. Romana v. Carlos Imperio, et al.
L-17280, Dec. 29, 1965

FACTS: A principal named Silvio Viola authorized his brother Jose Viola to act as agent for the sale, on the installment plan of certain parcels of land in a proposed subdivision for residential purposes. The agent then sold said parcels to a buyer named Pablo Ignacio. The deed of sale as well as the agent's power of attorney was duly registered with the Registry of Property. Four months later, however, the principal sold the same parcels to a buyer named Diosdado Sta. Romana, who in turn sold them to Carlos Imperio in whose name title was issued. Who should be preferred as owner over the land? If Ignacio sues for annulment of the sale to him in view of his inability to obtain the parcels of land, will Ignacio get anything?

HELD: Ordinarily, Ignacio should have been preferred in view of Art. 1544 read together with Art. 1916 in agency. However, since in this case, he sued for annulment, the annulment ought to be granted, and Ignacio must therefore be refunded the value of the property at the time of eviction. It is elementary that unless a contrary intention appears, the vendor warrants his title to the thing sold, and that, in the event of eviction, the vendee shall be entitled to the return of the value which the thing sold had at the time of the eviction, be it greater or less than the price of the sale.

Dagupan Trading Company v. Rustico Macam
L-18497, May 31, 1965

FACTS: In 1955, while Sammy Maron's unregistered land was still pending registration proceedings under the Torrens System, he sold the same to Rustico Macam, who thereafter

took possession thereof, and who then made certain improvements thereon. A month later, an original Torrens Certificate of Title, covering the land, was issued in Sammy Maron's name "free from all liens and encumbrances." A year later, the land was sold judicially in favor of the Manila Trading and Supply Co. to satisfy Sammy's debt in favor of said Company. The notice of levy and the Certificate of Sale were duly registered. The Company then sold its rights to the property to another entity — the Dagupan Trading Company. This buyer now sues Rustico Macam and prays that it (the Dagupan Trading Company) be declared owner of the property. *Issue*: Who owns the land?

HELD: Rustico Macam is the owner of the land, for the Company only acquired whatever rights Sammy Maron had over the property at the time of execution sale. Incidentally, this is an exceptional case. If *both* sales covered unregistered land, Macam would surely be the owner by virtue of his prior purchase and possession. If *both* sales had been made when the land was already registered under the Torrens System, it is clear that the company would be preferred because the unregistered sale in favor of Macam does *not* operate to transfer title. This case, however, falls under neither situation — for here the sale to Macam was made while the land was still unregistered, whereas the sale to the Company was effected at the time when the land was already registered. The Rules of Court should, therefore, govern this situation — and under the Rules, the purchaser of land sold in an execution sale "shall be *substituted* to, and acquire, all the rights, title, interest, and claim of the judgment debtor to the property — as of the time of levy." Since at the time of levy, Sammy no longer owned the land, the Company also acquired nothing, the levy being in a sense void and of no effect. (*Buson v. Licauco*, 13 Phil. 357-352; *Landig v. U.S. Commercial*, L-3597, Jul. 31, 1951). Parenthetically, the unregistered sale and consequent conveyance of the title and ownership to Rustico Macam could *not* have been cancelled and rendered of no effect simply because of the subsequent issuance of the Torrens Title over the land. Moreover, to deprive Macam now of the land and the improvements thereon by sheer force of technicality would be both unjust and inequitable. [*Query*: Would the answer

be the same if the buyer (after the Torrens Title had been issued) had been an ordinary purchaser for value, instead of a purchaser at an execution sale?]

Felix de Villa v. Anacleto Trinidad, et al.
L-24918, Mar. 20, 1968

FACTS: In the year 1920, through error, two separate original certificates of title were issued covering the same property (5,724,415 square meters land in Barrio San Agustin, Municipality of Iriga, Camarines Sur). The first was issued on Jan. 30, 1920; the second, on Nov. 25, 1920. (We shall refer to them as the Jan. Original and the Nov. Original, respectively). A certain Fabricante (holder of a duplicate Transfer Certificate) mortgaged the property to De Villa for a loan contracted during the Japanese occupation. This duplicate certificate was naturally in the possession of the creditor De Villa. After liberation (1945), Fabricante in bad faith petitioned the CFI (now RTC) of Camarines Sur for a new duplicate on the alleged ground that the duplicate *had been lost* (De Villa was never notified). The petition was granted and a new duplicate (without any annotation of the mortgage) was issued to Fabricante. This duplicate was based on the Nov. Original. Shortly thereafter, Fabricante sold the land to a certain Palma, who then mortgaged the same to the Development Bank of the Philippines. Palma was not able to pay, and eventually a certain Trinidad obtained ownership over the land. In all these transactions, transfer duplicates were naturally issued (all based on the Nov. Original).

In the meantime, De Villa, who had *really lost* the duplicate given him by Fabricante, petitioned for a reconstitution of the title (the original in the Registry having been lost). The title was reconstituted, based on the *Jan. original* (not the Nov. Original). The debt *not* having been paid, De Villa foreclosed the mortgage; purchased the property as the highest bidder; and eventually obtained his own duplicate certificate of title based on the said Jan. Original. De Villa then sued Trinidad for the *declaration of ownership* over the land.

Issue: Who should be preferred?

HELD: De Villa should be preferred. Both he and Trinidad are in good faith, but then De Villa's title is based on the *Jan. Original* while Trinidad's title is based on the *Nov. Original*. Where two certificates of title are issued to different persons covering the same land in whole or in part, the *earlier in date* must prevail as between original parties; and in case of successive registrations where more than one certificate is issued over the land, the person holding under the *prior* certificate is entitled to the land as against the person who relies on the second certificate. The purchaser from the owner of the later certificate and his successors, should resort to his vendor for redress, rather than molest the holder of the first certificate and his successors, who should be permitted to rest secure in their title. And from the viewpoint of *equity*, this is also the proper solution, considering the fact that unlike the titles of Palma and the DBP, De Villa's title was never tainted with fraud.

**Teodoro Almirol v. Register of Deeds of Agusan
L-22486, Mar. 20, 1968**

FACTS: On June 28, 1961, Teodoro Almirol purchased from Arsenio Abalo a parcel of land in Esperanza, Agusan, covered by Original Torrens Certificate of Title P-1237 in the name of "Arsenio Abalo, married to Nicolasa M. Abalo." Some-time in May, 1962, Almirol went to the office of the Register of Deeds of Agusan in Butuan City to register the deed of sale, and to obtain in his name a transfer certificate of title. Registration was refused by the Register of Deeds upon the following grounds, *inter alia*, stated in his letter of May 21, 1962:

"1. That Original Certificate of Title P-1237 is registered in the name of Arsenio Abalo, married to Nicolasa M. Abalo, and by legal presumption, is considered conjugal property;"

"2. That in the sale of conjugal property acquired after the effectivity of the new Civil Code, it is necessary that *both spouses* sign the document;" but

“3. Since, as in this case, the wife had already died when the sale was made, the surviving husband cannot dispose of the whole property without violating the existing law. (*LRC Consulta 46, dated Jun. 10, 1958*).”

“To effect the registration of the aforesaid deed of absolute sale, it is necessary that the property be first liquidated and transferred in the name of the surviving spouse and the heirs of the deceased wife by means of extrajudicial settlement or partition, and that the consent of such other heir or heirs must be procured by means of another document, ratifying this sale executed by their father.”

In view of the Register’s refusal, Almirol went to CFI (RTC) on a petition for *mandamus* (to compel the registration), but the Register answered that the remedy is to appeal to the Commissioner of Land Registration. *Issue*: Will the petition for *mandamus* prosper?

HELD:

- (a) Although the reasons relied upon by the Register evince a sincere desire on his part to maintain inviolate the law on succession and transmission of rights over real properties, these do *not* constitute legal grounds for his refusal to register the deed. Whether a document is valid or not, is *not* for the register of deeds to determine; this function belongs properly to a court of competent jurisdiction. (*Gabriel v. Register of Deeds of Rizal, et al., L-17956, Sept. 30, 1963 and Gurbox Singh Pablo and Co. v. Reyes & Tantoco, 92 Phil. 182-183*).
- (b) Nonetheless, *mandamus* cannot be granted for under Sec. 4 of RA 1151 — there is the proper administrative remedy: where any party in interest does not agree with the Register of Deeds — the question *shall be submitted* to the Commissioner of Land Registration who shall enter an order prescribing the step to be taken or memorandum to be made which shall be *conclusive* and *binding upon all Registers of Deeds*. This administrative remedy *must* be resorted to by the petitioner before he can have recourse to the courts.

Guzman v. CA
GR 40935, Dec. 21, 1987

Art. 1544 relating to double sales does not apply to a situation where the earlier transaction is *pacto de retro* sale of an unregistered land and the subsequent is a donation of the land by the vendor *a retro*.

Bernales v. IAC
GR 71491, Jun. 28, 1988

FACTS: The land in dispute was originally public land. It became private because of the long possession since 1908 of Sawadan, Elpidio and Augusto. The only heirs of Sawadan executed an agreement whereby Augusto quitclaimed his shares in favor of Elpidio. Thereafter, Elpidio applied for a free patent and original certificate of title was issued for the lot. After five years, Elpidio sold the lot to Cadium in whose favor transfer certificate of title was issued.

Upon the other hand, Bernales acquired the property by virtue of sale made by Constante, who claimed to have inherited it from his grandmother. Constante sold the land to Pasimio, who later sold it to the Catholic Bishop and who thereafter sold it to Bernales. But the authority of Constante to sell the land was wanting.

HELD: The sale made by non-owner Constante Siagan and all subsequent sales made thereunder, are null and void. It is true that Pasimio and the Bishop claimed to have registered their sales under Act 3344, but it is specifically provided under said law that such registration shall be understood to be without prejudice to a third party who has a better right. (*Sec. 194, Administrative Code, as amended by Act 3344*).

Cadium as innocent purchaser for value with a Transfer Certificate of Title under the Torrens system in his name has a better right than Bernales. In other words, the innocent purchaser for value is entitled to the protection of the law.

Jomoc v. Court of Appeals
GR 92871, Aug. 2, 1991

In view of Article 1544, which provides: "Should it be immovable property, the ownership shall belong to the person

acquiring it who in good faith recorded it in the Registry of Property,” the spouses Lim do not have a better right. They purchased the land with full knowledge of a previous sale to Maura So and without requiring from the vendors-heirs any proof of the prior vendee’s revocation of her purchase. They should have exercised extra caution in their purchase especially if at the time of the sale, the land was still covered by the TCT bearing the name of Mariano So and was not yet registered in the name of petitioners-heirs of Jomoc, although it had been reconveyed to said heirs.

Not having done this, Lim spouses cannot be said to be buyers in good faith. When they registered the sale on Apr. 27, 1983 after having been charged with notice of *lis pendens* annotated as early as Feb. 28, 1983 (the same date of their purchase), they did so in bad faith or on the belief that a registration may improve their position being subsequent buyers of the lot. Under Article 1544, mere registration is not enough to acquire new title. Good faith must concur.

**Abarguez, et al. v. CA, et al.
GR 95843, Sep. 2, 1992**

Although it is an established fact that the first sale to respondent spouses Israel was only notarized and registered after petitioners had already registered their Deed of Sale with the Registry of Deeds, respondent spouses Israel have a better right against the petitioners because the element of good faith was lacking as regards the latter since Art. 1544 of the Civil Code only grants preferential rights to the second vendee provided said vendee acted in good faith when he bought the property, which is not present in the case at bar.

If a vendee in a double sale registers the sale after he has acquired knowledge that there was a previous sale, the registration will constitute a registration in bad faith and will not confer upon him any right. It is as if there had been no registration, and the vendee who first took possession of the real property in good faith shall be preferred.

In the present case, there is no question that the Israels bought the small lot and upon making the downpayment, immediately took possession thereof. Admittedly, before they

bought the big lot, the Abarguezes already knew that there were houses erected on the small lot. The Abarguezes engaged the services of Engr. Lagsa to make a relevation survey, and this geodetic engineer showed the Abarguezes the perimeter or the extent of the big lot. In his answer to the fourth-party complaint, Engr. Lagsa admitted that he was asked by Ms. Ebarle to prepare two plans and technical descriptions, one covering the small lot and the other for the big lot. In effect, Engr. Lagsa was engaged by both Ms. Ebarle and the Abarguezes to prepare the plans for the lots. It is inconceivable that the Abarguezes did not know that Ms. Ebarle had already sold the small lot to the Israels. Thus, the registration by appellees in bad faith of the deed of sale over the big lot, which included that small lot, did not confer on them any preferential right to said small lot since there was no valid registration to speak of at all. Furthermore, respondent Engr. Lagsa testified as follows in the trial court: "Q: You said that you pointed to Mr. Abarguez the metes and bounds of the land. Do you mean to tell the Honorable Court that you brought Mr. Abarguez to the actual site of the land? A: Yes sir. Q: When was that? A: Before the sale."

Based on the foregoing, it is, therefore, correct to conclude that petitioners acted in bad faith since it is a well-settled rule that a purchaser cannot close his eyes to facts which should put a reasonable man upon his guard, and then claim that he acted in good faith under the belief that there was no defect in the title of the vendor. His mere refusal to believe that such defect exists, or his willful closing of his eye to the possibility of the existence of a defect in the vendor's title, will not make him an innocent purchaser for value, if it afterwards develops that the title was, in fact, defective, and it appears that he had such notice of the defects as would have led to its discovery had he acted with the measures of precaution which may be required of a prudent man in a likely situation.

**Agricultural & Home Extension Development
Groups v. CA & Librado Cabautan
GR 92310, Sep. 3, 1992**

A purchaser in good faith is defined as one who buys the property of another without notice that some other person

has a right to or interest in such property and pays a full and fair price for the same at the time of such purchase or before he has notice of the claim or interest of some other person in the property.

In the case at bar, an examination of TCT 287416 discloses no annotation of any sale, lien, encumbrance or adverse claim in favor of Gundran or the petitioner. Well settled is the rule that when the property sold is registered under the Torrens system, registration is the operative act to convey or affect the land insofar as third persons are concerned. Thus, a person dealing with registered land is only charged with notice of the burdens on the property which are noted on the register or certificate of title. Be it noted that the registration of the sale in favor of the second purchaser and the issuance of a new certificate of title in his favor does not in any manner vest in him any right of possession and ownership over the subject property because the seller, by reason of their prior sale, has already lost whatever right or interest she might have had in the property at the time the second sale was made.

Indeed, the language of Art. 1544 of the Civil Code is clear and unequivocal. In light of its mandate and of the facts established in this case, it is held that ownership must be recognized in the private respondent, who bought, the property in good faith and, as an innocent purchaser for value, duly and promptly registered the sale in his favor.

Rufina Bautista, et al. v. Court of Appeals, et al.
GR 106042, Feb. 28, 1994
48 SCAD 629

Where the thing sold twice is an immovable, the one who acquires it and first records it in the Registry of Property, both made in good faith, shall be deemed the owner. The requirement of the law, then, is two-fold: acquisition in good faith and registration in good faith. Mere registration of title is not enough; good faith must concur with the registration. To be entitled to priority, the second purchaser must not only establish prior recording of his deed but must have acted in good faith, without knowledge of the existence of another

alienation by the vendor to another. Being a question of intention, good faith or the lack of it can only be ascertained from the circumstances surrounding the purchase of the land.

According to the trial court, petitioners should have inquired from the actual possessors, including private respondents, “by what right did they have for having a house on the property, before purchasing the entire property” and not merely from the vendors. The absence of such an inquiry will remove them from the realm of *bona fide* acquisition. Although petitioners made inquiry regarding the rights of private respondents to possess the subject property, this case involves certain peculiarities which lead us to affirm the respondent trial and appellate courts’ finding that petitioners are not purchasers in good faith.

Vda. de Alcantara v. CA
67 SCAD 347, 252 SCRA 457
1996

Even if a Deed of Extrajudicial Partition is registered ahead of a *pacto de retro*, it does not, however, rise to the level of a valid instrument of conveyance where it only mentions of an alleged sale without the deed of sale being shown. Insofar as third persons are concerned, what could validly transfer or convey a person’s interest in a property is the registration of the deed of sale and not the Deed of Extrajudicial Partition which only mentions the former.

Art. 1544 of the Civil Code applies only when there are at least 2 deeds of sale over the same property.

Rosita Tan, et al. v. CA & Fernando Tan Kiat
GR 125861, Sep. 9, 1998

FACTS: Respondent filed an action to recover two parcels of land from petitioners claiming that in 1968, he bought the same from the original owner but that he was not able to transfer title in his favor owing to his foreign nationality at the time of the sale. As proof of good faith, the original owner turned over to him the certificate of title, and in addition thereto, executed a lease contract in his favor.

In 1958, respondent further alleged that the original owner sold the same properties in favor of the father of petitioners with the understanding that the latter would hold the property in trust for him. After their father died, petitioners transferred title to the properties in their own name. Instead of filing an answer, petitioners filed a motion to dismiss on the ground, *inter alia*, that the complaint stated no cause of action. The trial court granted the motion and dismissed the complaint. The Court of Appeals reversed the order. Hence, petitioners went to the Supreme Court on *certiorari*.

HELD: Under Art. 1544 of the Civil Code, if an immovable property like a piece of land should have been sold to different vendees, the ownership shall belong to the person acquiring it who in good faith first recorded it in the Registry of Property.

While respondent alleged that he bought the properties in 1954, he failed to allege any document evidencing the same. Upon the other hand, petitioners and their predecessor-in-interest have been in possession of the properties and had the deeds of sale registered in their names.

**Rev. Fr. Dante Martinez v. CA, et al.
GR 123547, May 21, 2001**

FACTS: Respondents De la Paz sold a parcel of land to petitioners. Subsequently, the same lot was sold by respondent De la Paz to respondents Veneracion against petitioner, but the complaint was dismissed by the Metropolitan Trial Court (MTC) of Cabanatuan City, which dismissal was affirmed by the Regional Trial Court (RTC).

Petitioner filed a separate complaint before the RTC for annulment of sale with damages against respondents Veneracion and De la Paz. The RTC found respondents Veneracion to be the owners of the land, subject to the rights of petitioner as builder in good faith. The Court of Appeals (CA) affirmed the trial court and likewise declared respondents Veneracion to be the true owners of the property, being the first registrants in good faith pursuant to Art. 1544 of the Civil Code. On appeal, the Supreme Court reversed the CA.

HELD: Certain circumstances in this case prove that respondents Veneracion were not in good faith when they acquired and registered the property in their name. *Firstly*, the building inspector of the Dept. of Public Works and Highways (DPWH) conducted an ocular inspection at the time of sale to private respondents Veneracion to monitor the progress of the construction of a building thereon. Thus, contrary to respondents Veneracion's claim, the property was occupied at the time of sale to them. *Secondly*, the first contract of sale between private respondents, it appears that respondents Veneracion had knowledge of facts that should have put a reasonable man on his guard. Respondents Veneracion knew that the property was being occupied by petitioner, and yet they did not even inquire from the latter about the nature of his right. This does not meet the standard of good faith. Accordingly, the Court declared as null and void the deed of sale between the private respondents and ordered a new certificate of title to be issued in the name of petitioner.

Castorio Alvarico v. Amelita L. Sola
GR 138953, Jun. 6, 2002

FACTS: Petitioner Castorio Alvarico is the natural father of respondent Amelita L. Sola while Fermina Lopez is petitioner's aunt, and also Amelita's adoptive mother. On Jun. 17, 1982, the Bureau of Lands approved and granted the Miscellaneous Sales Application (MSA) of Fermina over Lot 5, SGS-3451, with an area of 152 sq.m. at the Waterfront, Cebu City. On May 29, 1983, Fermina executed a Deed of Self-Adjudication and Transfer of Rights over Lot 5 in favor of Amelita, who agreed to assume all the obligations, duties, and conditions imposed upon Fermina under MSA V-81066. The document of transfer was filed with the Bureau of Lands (BOL). Amelita assumed payment of the lot to the Bureau of Lands. She paid a total amount of P282,900.

On Apr. 7, 1989, the BoL issued an order approving the transfer of rights and granting the amendment of the application from Fermina to Amelita. On May 2, 1989, Original Certificate of Title (OCT) 3439 was issued in favor of Amelita. On Jan. 24, 1993, herein petitioner filed Civil Case CEB-14191 for reconveyance against Amelita. He claimed that on Jan.

4, 1994, Fermina donated the land to him and immediately thereafter, he took possession of the same. He averred that the donation to him had the effect of withdrawing the earlier transfer to Amelita. For her part, Amelita maintained that the donation to petitioner is void because Fermina was no longer the owner of the property when it was allegedly donated to petitioner, the property having been transferred earlier to her. She added that the donation was void because of lack of approval from the BoL, and that she had validly acquired the land as Fermina's rightful heir. She also denied she is a trustee of the land for petitioner.

After trial, the RTC rendered a decision in favor of petitioner. On appeal, the Court of Appeals (CA) in its decision dated Mar. 23, 1999 reversed the RTC. Petitioner sought reconsideration, but was denied by the CA. Hence, the instant petition for *certiorari*.

ISSUE: In this action for reconveyance, who between petitioner and respondent has a better claim to the land?

HELD: Evidence on record and the applicable law indubitably favor respondent. Petitioner claims that respondent was in bad faith when she registered the land in her name and, based on Arts. 744 and 1544 of the Civil Code, she has a better right over the property having been first in material possession in good faith. However, this allegation of bad faith on the part of Amelita Sola in acquiring the title is devoid of evidentiary support, thus:

1. The execution of public documents, as in the case of Affidavits of Adjudication, is entitled to the presumption of regularity, hence convincing evidence is required to assail and controvert them. (*Cacho v. CA*, 269 SCRA 159 [1997]).

2. It is undisputed that OCT 3439 was issued in 1989 in the name of Amelita. It requires more than petitioner's bare allegation to defeat the OCT which on its face enjoys the legal presumption of regularity of issuance. (*Chan v. CA*, 298 SCRA 713 [1998]). A Torrens title, once registered, serves as notice to the whole world. All persons must take notice and no one can plead ignorance of its registration. (*Egao v. CA*, 74 SCRA 484 [1989]).

Even assuming that respondent Amelita Sola acquired title to the disputed property in bad faith, only the State can institute reversion proceedings under Sec. 101 of the Public Land Act. In other words, a private individual may not bring an action for reversion or any action which would have the effect of canceling a free patent and the corresponding certificate of title issued on the basis thereof, such that the land covered thereby will again form part of the public domain. Only the Solicitor General or the officer acting in his stead may do so. (*Egao v. CA*, 174 SCRA 484 [1989]). Since Amelita Sola's title originated from a grant by the government, its cancellation is a matter between the grantor and the grantee. (*De Ocampo v. Arlos*, 343 SCRA 716 [2000]). Clearly then, petitioner has no standing at all to question the validity of Amelita's title. It follows that he cannot "recover" the property because, to begin with, he has not shown that he is the rightful owner thereof.

Anent's petitioner's contention that it was the intention of Fermina for Amelita to hold the property in trust for him, this Court held that if this was really the intention of Fermina, then this was really the intention of Fermina, then this should have been clearly stated in the Deed of Self-Adjudication executed in 1983, in the Deed of Donation executed in 1904, or in a subsequent instrument. Absent any persuasive proof of that intention in any written instrument, this Court is not prepared to accept petitioner's bare allegation concerning the donor's state of mind.

The appealed decision of the CA is affirmed, and the complaint filed by herein petitioner against respondent in Civil Case CEB-14191 is declared properly dismissed.

Lu v. Spouses Manipon
GR 147072, May 7, 2002

FACTS: Petitioner denies being a purchaser in bad faith. He alleges that the only reason he spoke to respondents before he bought the foreclosed land was to invite them to share in the purchase price, but they turned him down. This, he argues, was not an indication of bad faith.

HELD: Petitioner's contention is untenable. He might have had good intentions at heart, but it is not the intention that makes one an innocent buyer. A purchaser in good faith or an instant purchaser for value is one who buys property and pays a full and fair price for it, at the time of purchase or before any notice of some other person's claim on or interest in it. One cannot close one's eyes to facts that should put a reasonable person on guard and still claim to have acted in good faith.

By his own allegations, petitioner admits he was not a purchaser in good faith. A buyer of real property which is in the possession of another must be wary and investigate the rights of the latter. Otherwise, without such inquiry, the buyer cannot be said to be in good faith. All told, the right of a buyer to rely upon the face of the title certificate and to dispense with the need of inquiring further is upheld only when the party concerned had actual knowledge of facts and circumstances that should impel a reasonably cautious man to conduct further inquiry.

**Naawan Community Rural Bank, Inc. v.
CA & Spouses Alfredo and Annabelle Lumo
GR 128573, Jan. 13, 2002**

FACTS: Before private respondents bought the subject property from Guillermo Comayas, inquiries were made with the Registry of Deeds and the Bureau of Lands regarding the status of the vendor's title. No liens or encumbrances were found to have been annotated on the certificate of title. Neither were private respondents aware of any adverse claim of lien on the property other than the adverse claim of a certain Geneva Galupo to whom Comayas had mortgaged the subject property. But the claim of Galupo was eventually settled and the adverse claim previously annotated on the title cancelled. *Issue:* Having made the necessary inquiries, should private respondents have gone beyond the certificate of title?

HELD: No, otherwise, the efficacy and conclusiveness of the Torrens Certificate of Title would be rendered futile and nugatory. Considering that private respondents exercised the diligence required by law in ascertaining the legal status of the Torrens title of Comayas over the subject property and

found no flaws therein, they should be considered as innocent purchasers for value and in good faith.

PROBLEM

QUESTION: At the time of the execution and deliver of the sheriff's deed of final conveyance on Sept. 5, 1986, the disputed property was already covered by the Land Registration Act. And Original Certificate of Title 0-820 pursuant to Decree IV was likewise already entered in the registration book of the Register of Deeds of Cagayan de Oro City as of Apr. 17, 1984. Could it be said that from Apr. 17, 1984, the subject property was already under the operation of the Torrens System?

ANSWER: Yes, under the said system, registration is the operative act that gives validity to the transfer or creates a lien upon the land. (*Naawan Community Rural Bank, Inc. v. CA & Spouses Alfredo and Annabelle Lumo, supra*).

ANOTHER PROBLEM

QUESTION: Can a person dealing with registered land possess the legal right to rely on the force of the Torrens Certificate of Title and to dispense with the need to inquire further, except when the party concerned has actual knowledge of facts and circumstances that would impel a reasonably cautious man to make such inquiry?

ANSWER: Yes. Under the established principles of land registration, a person dealing with registered land may generally rely on the correctness of a certificate of title and the law will in no way obliged him to go beyond it to determine the legal status of the property. (*Naawan Community Rural Bank, Inc. v. CA & Spouses Alfredo and Annabelle Lumo, supra*).

Section 3

CONDITIONS AND WARRANTIES

Art. 1545. Where the obligation of either party to a contract of sale is subject to any condition which is not

performed, such party may refuse to proceed with the contract or he may waive performance of the condition. If the other party has promised that the condition should happen or be performed, such first mentioned party may also treat the non-performance of the condition as a breach of warranty.

Where the ownership in the thing has not passed, the buyer, may treat the fulfillment by the seller of his obligation to deliver the same as described and as warranted expressly or by implication in the contract of sale as a condition of the obligation of the buyer to perform his promise to accept and pay for the thing.

COMMENT:

Presence of Conditions and Warranties

- (a) Conditions may be waived.
- (b) Conditions may be considered as warranties.

Art. 1546. Any affirmation of fact or any promise by the seller relating to the thing is an express warranty if the nature tendency of such affirmation or promise is to induce the buyer to purchase the same, and if the buyer purchases the thing relying thereon. No affirmation of the value of the thing, nor any statement purporting to be a statement of the seller's opinion only, shall be construed as a warranty, unless the seller made such affirmation or statement as an expert and it was relied upon by the buyer.

COMMENT.

(1) When is There a Warranty?

A good test:

- (a) If buyer is ignorant, there is a warranty.
- (b) If the buyer is expected to have an opinion AND the seller has no special opinion, there is no warranty. (*Spencer Heater Co. v. Abbot*, 91 N.J.L-594, 104 Atl. 91).

[**NOTE:** “*Express warranty*” defined — It is any affirmation of fact, or any promise by the seller relating to the thing if the natural tendency of such affirmation or promise is to induce the buyer to purchase the same, and if the buyer purchases the thing relying thereon. (Art. 1546, 1st sentence). It includes all warranties derived from the language of the contract, so long as the language is *express*. Thus, the warranty may take the form of an affirmation, a promise or a representation. (*Parish v. Kotthoff*, 128 Ore. 523).]

[**NOTE:** If a purchaser has ample opportunity to investigate the land before purchase, and the seller did not prevent such an investigation, and the purchaser really investigates, then the purchaser is not allowed afterwards to say that the vendor made false representations to him. (*Azarraga v. Gay*, 5 Phil. 599).]

(2) Effect of Dealer’s Talk

Dealer’s talk like “excellent,” cannot be considered as an express warranty. A little exaggeration is apparently allowed by the law as a concession to human nature. This is in accordance with the civil law maxim “*simplex commendatio non-obligat*” or the principle “*caveat emptor*” (let the buyer beware).

(3) Rule When There Is No Deliberate Lie

Where it does not appear that the seller deliberately violated the truth when he stated his belief that there were a certain number of coconut trees on the land, no action will lie against him. (*Gochangco v. Dean*, 47 Phil. 687).

Art. 1547. In a contract of sale, unless a contrary intention appears, there is:

(1) An implied warranty on the part of the seller that he has a right to sell the thing at the time when the ownership is to pass, and that the buyer shall from that time have and enjoy the legal and peaceful possession of the thing;

(2) An implied warranty that the thing shall be free

from any hidden faults or defects, or any charge or encumbrance not declared or known to the buyer.

This article shall not, however, be held to render liable a sheriff, auctioneer, mortgagee, pledgee or other person professing to sell by virtue of authority in fact or law, for the sale of a thing in which a third person has a legal or equitable interest.

COMMENT:

Implied Warranties Against Eviction and Against Hidden Defect

- (a) This Article is fundamentally important.
- (b) A buyer at a tax sale is supposed to take all the chances because there is no warranty on the part of the State (*Gov't v. Adriano*, 41 Phil. 1121) and a sheriff does not guarantee title to the property he sells. (*Mun. of Albay v. Benito, et al.*, 43 Phil. 576).
- (c) In general, the actions based on the implied warranties prescribe in 10 years since these obligations are imposed by law. (*See Phil. Nat. Bank v. Lasos*, [C.A.] 40 O.G. [Supp. 5], p. 10). Special provisions, of course, found in the succeeding articles will naturally prevail.

**Republic of the Phils. v. Hon. Umali
GR 80687, Apr. 10, 1989**

If a person purchases a piece of land on the assurance that the seller's title thereto is valid, he should not run the risk of being told later that his acquisition was ineffectual after all. The further consequence would be that land conflicts could be even more numerous and complex than they are now and possibly also more abrasive if not even violent.

Subsection 1

WARRANTY IN CASE OF EVICTION

Art. 1548. Eviction shall take place whenever by a final judgment based on a right prior to the sale or an act im-

putable to the vendor, the vendee is deprived of the whole or of a part of the thing purchased.

The vendor shall answer for the eviction even though nothing has been said in the contract on the subject.

The contracting parties, however, may increase, diminish, or suppress this legal obligation of the vendor.

COMMENT:

(1) Warranty in Case of Eviction

- (a) The warranty in case of eviction is a natural element in the contract of sale; hence, the vendor answers for eviction even if the contract be silent on this point.
- (b) The buyer and the seller are, of course, allowed to add to, subtract from, or suppress this legal obligation on the part of the seller. Thus, it has been held that the vendor's liability for warranty against eviction in a contract of sale is *generally* waivable and may be renounced by the vendee. (*See Arts. 1533-1634, Civil Code; see also Andaya v. Manansala, L-14714, Apr. 30, 1960*).
- (c) Although it is true that the government is not liable for the eviction of the purchaser at a tax sale (*Gov't. v. Adriano, supra*), still the owner of the property sold under execution at the instance of the judgment creditor is liable for eviction, unless otherwise decreed in the judgment. (*Art. 1662, Civil Code*).

**Serfino v. CA
GR 40858, Sep. 16, 1987**

Where a purchaser of real estate at the tax sale obtains such title as that held by the taxpayer, the principle of *caveat emptor* applies. Where land is sold for delinquency taxes under the provisions of the Provincial Assessment Law, rights of registered but undeclared owners of the land are not affected by the proceedings and the sale conveys only such interest as the person who has declared the property for taxation has therein.

- (d) The buyer is allowed to enforce the warranty against the seller or against the sellers of his own immediate seller. (*De la Riva v. Escobar*, 5 Phil. 243).
- (e) Even if the buyer does not appeal from a judgment ordering his eviction and the judgment subsequently becomes final, the seller is still liable for the eviction. (*Canizares v. Torrejon*, 21 Phil. 127).
- (f) Even if it was the buyer who instituted the suit against the third person, still the seller would be liable, if the buyer is defeated. What is important is that the buyer was defeated. (*Manresa*).

(2) Seller's Fault

Generally, all rights acquired prior to the sale by others can be imputed to the seller. But imputability or fault is really important: hence, seller is still liable even if the act be made after the sale.

Example: *B* bought land from *S*. *B* did not register. *C* then bought same land from *S*. *C* registers. *B* is defeated. Can *B* hold *S* liable for the eviction although *C*'s right came after the sale to him?

ANS.: Yes, because although it came after the sale yet it was attributable to *S*'s own fault and bad faith. (*Manresa*).

(3) Responsibility of Seller

The seller is responsible for:

- (a) his own acts;
- (b) those of his predecessors-in-interest. (*Manresa*).

He is *not* responsible for dispossession due to:

- (a) acts imputable to the buyer himself;
- (b) fortuitous events.

(4) Essential Elements for Eviction

- (a) There is a final judgment;

- (b) The purchaser has been deprived in whole or in part of the thing sold;
- (c) The deprivation was by virtue of a right prior to the sale (or one imputable to the seller) effected by the seller;
- (d) The vendor has been previously notified of the complaint for eviction at the instance of the purchaser. (*Bautista, et al. v. Lasam, et al.*, 40 O.G. No. 9, p. 1825 and *Canizares Tiana v. Torrejon*, 21 Phil. 127).

(5) Plaintiff in Suit

In general, it is only the buyer in good faith who may sue for the breach of warranty against eviction. If he knew of possible dangers, chances are that he assumed the risk of eviction. (*Aspiras v. Galuan*, [C.A.] 53 O.G. 8854).

(6) Defendant in Suit

In a proper case, the suit for the breach can be directed only against the *immediate* seller, not sellers of the seller unless such sellers had promised to warrant in favor of later buyers (*TS, Dec. 26, 1896*) or unless the immediate seller has expressly assigned to the buyer his own right to sue his own seller. (*De la Riva v. Escobar*, 51 Phil. 243).

Art. 1549. The vendee need not appeal from the decision in order that the vendor may become liable for eviction.

COMMENT:

Vendee Need Not Appeal

If the lower court evicts the buyer, he does not need to appeal to the appellate courts before he can sue for damages. However, the decision must of course be final.

Art. 1550. When adverse possession had been commenced before the sale but the prescriptive period is completed after the transfer, the vendor shall not be liable for eviction.

COMMENT:**Effect if Adverse Possession Began Before the Sale**

The rule applies only if there was *reasonable* opportunity to interrupt the prescription; otherwise, it would be unfair.

Art. 1551. If the property is sold for non-payment of taxes due and not made known to the vendee before the sale, the vendor is liable for eviction.

COMMENT:**Effect of Non-Payment of Taxes**

Example:

A has land, the taxes on which he has not paid. A sells it to B. Later, the land is sold at public auction for the non-payment of taxes and B is evicted. A is responsible, but only if B did not know at the time of the sale that A had not paid the taxes thereon.

Art. 1552. The judgment debtor is also responsible for eviction in judicial sales, unless it is otherwise decreed in the judgment.

COMMENT:**Eviction in Case of Judicial Sales**

It has been held universally that in case of failure of title, a purchaser in good faith at a judicial sale is entitled to recover the purchase money from the officer if the funds are still in his hands or from the judgment debtor. (*Banzon & Standard Oil Co. v. Osorio*, 27 Phil. 142).

Bobis v. Provincial Sheriff of Camarines Norte
GR 29838, Mar. 18, 1983

- (1) A buyer at an execution sale acquires nothing if the judgment debtor had already assigned or transferred the property to another before the levy on execution.

- (2) A sheriff who merely adheres to the terms of a writ of execution is not liable for damages. The same is true of the buyer at the public auction.
- (3) The buyer at an execution sale is a purchaser in bad faith (and not for value) if he had prior knowledge of a third party claim filed with the sheriff before the scheduled execution sale.

Art. 1553. Any stipulation exempting the vendor from the obligation to answer for eviction shall be void, if he acted in bad faith.

COMMENT:

Effect of Stipulation Waiving Liability for Eviction

- (a) If seller was in *good faith* — the exemption is *valid*, but without prejudice to Art. 1554.
- (b) If seller was in *good faith* — the stipulation is VOID.

Art. 1554. If the vendee has renounced the right to warranty in case of eviction, and eviction should take place, the vendor shall only pay the value which the thing sold had at the time of the eviction. Should the vendee have made the waiver with knowledge of the risks of eviction and assumed its consequences, the vendor shall not be liable.

COMMENT:

(1) Waiver By the Buyer

The waiver by the buyer may have been made:

- (a) *without* knowledge of risk of eviction (waiver *conscientie*);
- (b) *with* knowledge of risk of eviction (waiver *intencionada*).

[NOTE: The presumption is of course that the waiver was only one in *conscientie*. The waiver *intencionada* must be clearly proved. (4 *Manresa* 180-181 and *PNB v. Selo*, 72 *Phil.* 141).]

(2) Effects

- (a) In the first case, *value* at time of eviction should be returned. *Reason*: This is a case of *solutio indebiti*, “undue payment.”
- (b) In the second case, nothing need be returned. This is aleatory in nature (*Manresa*), and buyer assumes the consequences. And this is so even if there is a stipulation that the warranty against eviction exists, PROVIDED that said stipulation is understood by the parties merely *pro forma* (as a matter of form), and PROVIDED FURTHER that it is proved that the vendor never intended to be bound by said warranty. In a case such as this—where the vendee knew of the danger of eviction at the time he purchased the land from the vendor and assumed its consequences, the latter is not even obliged to restore to the former the price of the land at the time of eviction but is completely exempt from any liability whatsoever. (*Andaya, et al. v. Manansala, L-14714, Apr. 30, 1960*).

Art. 1555. When the warranty has been agreed upon or nothing has been stipulated on this point, in case eviction occurs, the vendee shall have the right to demand of the vendor:

- (1) The return of the value which the thing sold had at the time of the eviction, be it greater or less than the price of the sale;**
- (2) The income or fruits, if he has been ordered to deliver them to the party who won the suit against him;**
- (3) The costs of the suit which caused the eviction, and, in a proper case, those of the suit brought against the vendor for the warranty;**
- (4) The expenses of the contract, if the vendee has paid them;**
- (5) The damages and interests, and ornamental expenses, if the sale was made in bad faith.**

COMMENT:**(1) What Seller Must Give in Case of Eviction**

Keyword — VICED

V — value

I — income (or fruits)

C — costs

E — expenses

D — damages (and interests and ornamental expenses) if seller was in bad faith

(2) Rule as to Income or Fruits

If the court does not order the buyer to deliver the income or fruits to the winner, said buyer would be entitled to them. This is fair for after all, in the meantime, the seller was using the price money without interest. (*See Lovina v. Veloso*, [C.A.] 40 O.G. 2331.)

(3) Costs of Suit

Paragraph 3 does not include transportation and other incidental expenses. (*Orense v. Jaucian*, 18 Phil. 553).

(4) Damages

The interests in paragraph 5 refer to interests on costs, expenses, and damages. Note that in paragraph 5 the sale must have been made in BAD FAITH, which must be proved. (*Pascual v. Lesaca*, L-3636, May 30, 1952).

(5) Query: Why is Rescission Not a Remedy in Case of TOTAL Eviction?

The remedy of rescission contemplates that the one demanding it is able to return whatever he has received under the contract; and when this cannot be done, rescission cannot be carried out. It is for this reason that the law on sales does not make rescission a remedy in case the vendee is *totally* evicted from the thing sold, for he can no longer restore the subject matter of the sale to the vendor. Of course, in case of

partial eviction, rescission may still be allowed with respect to the subject matter that remains, as in the case contemplated in Art. 1556. (*Andaya, et al. v. Manansala, L-14714, Apr. 30, 1960*).

Art. 1556. Should the vendee lose, by reason of the eviction, a part of the thing sold of such importance, in relation to the whole, that he would not have bought it without said part, he may demand the rescission of the contract; but with the obligation to return the thing without other encumbrances than those which it had when he acquired it.

He may exercise this right of action, instead of enforcing the vendor's liability for eviction.

The same rule shall be observed when two or more things have been jointly sold for a lump sum, or for a separate price for each of them, if it should clearly appear that the vendee would not have purchased one without the other.

COMMENT:

(1) Rules in Case of Partial Eviction

- (a) The Article deals with a case of partial eviction.
- (b) Remedy here is either:
 - 1) rescission, or
 - 2) enforcement of warranty.

(2) Rescission

If he chooses rescission, there should be no new encumbrances, like a "mortgage." (*See Andaya, et al. v. Manansala, L-14714, Apr. 30, 1960*).

(3) When Enforcement of the Warranty Is the Proper Remedy

If the circumstances set forth in paragraph 1 are not present (as when there are new encumbrances), the only remedy is to enforce the warranty.

Art. 1557. The warranty cannot be enforced until a final judgment has been rendered whereby the vendee loses the thing acquired or part thereof.

COMMENT:

Necessity of Final Judgment

A judgment becomes final if on appeal, the decision decreeing the eviction is affirmed; or if within the period within which to appeal, no appeal was made. It should be noted that under Art. 1549, the vendee need not appeal from the decision of the lower court. Thus, it is sufficient that the judgment be FINAL as understood hereinabove, before the warranty can be enforced. (*Art. 1557*).

Art. 1558. The vendor shall not be obliged to make good the proper warranty, unless he is summoned in the suit for eviction at the instance of the vendee.

COMMENT:

(1) Necessity of Summoning the Seller in the Suit for the Eviction of the Buyer

- (a) This is the preparation for the suit — a *condition sine qua non*
- (b) It is immaterial whether or not the seller has a good defense or means of defense. The summons and notice must nevertheless be given. Once this is done, the buyer has done all that he had to do. (*Jovellano and Joyosa v. Lualhati, 47 Phil. 371*).
- (c) The notice must be the notice for the suit for eviction, NOT the notice in the suit for the breach of the warranty. (*De La Riva v. Escobar & Bank of the PI, 51 Phil. 243*). The notice need not be given in a case where the buyer is an applicant for registration in land registration proceedings. Here it is sufficient that the buyer notifies the seller of:

- 1) his application;

- 2) any opposition thereto. (*Lascano v. Gozun*, [C.A.] 40 O.G. [Supp. 11], p. 233).

(2) Reason for the Summoning

Object is to give vendor opportunity to show that the action against the buyer is unjust. (*Javier v. Rodriguez*, 40 O.G. No. 5, p. 1006).

Art. 1559. The defendant vendee shall ask, within the time fixed in the Rules of Court for answering the complaint, that the vendor be made a co-defendant.

COMMENT:

(1) Seller Must Be Made Co-Defendant With the Buyer

- (a) Seller was notified but did not appear. The buyer won in the suit filed by the third person. Can buyer recover expenses?

ANS.: No, because there really was no breach of warranty. (*Manresa*).

- (b) In an eviction suit, it is permissible for the buyer to file a cross-claim against the seller for the enforcement of the warranty should the buyer lose. This can be done in some cases to save time and to prevent inconvenience. Of course, if the buyer wins, there is no necessity for the enforcement of the warranty since there has been no breach thereof. (*De la Riva v. Escobar and BPI*, 51 Phil. 243).

The suit against the seller may be in the form of a third-party complaint (*Rule 6, Sec. 11, Revised Rules of Court*) if the vendor has not been made a co-defendant.

(2) Rule in Registration Proceedings

This Article applies only when the buyer is the *defendant*, hence, when the buyer is the petitioner in a registration proceeding and he loses, the formal notice here is not a condition precedent. It is enough that he advise the seller

of the application for registration and the opposition thereto. (*Lascano v. Gozun*, 40 O.G., p. 233 [C.A.]).

(3) Applicability of the Rules of Court

The buyer can make use of the Rules of Court in bringing the seller to the case. (*Jovellano v. Lualhati*, 47 Phil. 371).

Art. 1560. If the immovable sold should be encumbered with any non-apparent burden or servitude, not mentioned in the agreement, of such nature that it must be presumed that the vendee would not have acquired it had he been aware thereof, he may ask for the rescission of the contract, unless he should prefer the appropriate indemnity. Neither right can be exercised if the non-apparent burden or servitude is recorded in the Registry of Property, unless there is an express warranty that the thing is free from all burdens and encumbrances.

Within one year, to be computed from the execution of the deed, the vendee may bring the action for rescission, or sue for damages.

One year having elapsed, he may only bring an action for damages within an equal period, to be counted from the date on which he discovered the burden or servitude.

COMMENT:

(1) Rules in Case of Non-Apparent Servitudes

- (a) The defect contemplated in this Article is really a sort of “hidden defect” but remedy is similar to that provided in the case of eviction. The servitudes contemplated are not legal easements for these exist by virtue of the law. Therefore, it cannot be claimed that the buyer was ignorant thereof.
- (b) Remedies: If made within a year:
 - 1) rescission;
 - 2) damages;

If after one year, only damages.

(2) Effect if Burden or Easement is Registered

No remedy if the burden is registered, EXCEPT if there is an express warranty that the thing is free from all burdens and encumbrances.

(3) Effect of Form of the Sale

This article is applicable whether sale is:

- (a) in public instrument;
- (b) in private instrument;
- (c) made orally.

[NOTE: There is no need of first compelling the seller to execute a public instrument before the action is brought. (10 Manresa 223).]

Subsection 2**WARRANTY AGAINST HIDDEN DEFECTS OF OR ENCUMBRANCES UPON THE THING SOLD**

Art. 1561. The vendor shall be responsible for warranty against the hidden defects which the thing sold may have, should they render it unfit for the use for which it is intended, or should they diminish its fitness for such use to such an extent that, had the vendee been aware thereof, he would not have acquired it or would have given a lower price for it; but said vendor shall not be answerable for patent defects or those which may be visible, or for those which are not visible if the vendee is an expert who, by reason of his trade or profession, should have known them.

COMMENT:**(1) Requisites to Recover Because of Hidden Defects**

- (a) The defect must be hidden (not known and could not have been known);
- (b) The defect must exist at the time the sale was made;

- (c) The defect must ordinarily have been excluded from the contract;
- (d) The defect must be important (renders thing UNFIT or considerably *decreases* FITNESS);
- (e) The action must be instituted within the statute of limitations.

(2) Meaning of “unfit for the use intended”

Here, the use must have been stated in the contract itself, or can be inferred from the nature of the object or from the trade or occupation of the buyer. (*10 Manresa 227-229*).

(3) Note Meaning of ‘Hidden’

- (a) What may be hidden with respect to one person may not be hidden with respect to another. (*10 Manresa 22*).
- (b) Just because there is a difference in grade or quality, it does not necessarily mean that the defect is hidden.
- (c) defects are sometimes referred to as “redhibitory defects.”

(4) Effect of Long Inaction

If the buyer examines the tobacco at time of purchase, and questions only after 3 years, and the seller has not made any misrepresentation, there is no breach of the warranty. (*Chang Yong Tek v. Santos, 13 Phil. 52*). In fact, under Art. 1571, the action prescribes in six (6) months.

Art. 1562. In a sale of goods, there is an implied warranty or condition as to the quality or fitness of the goods, as follows:

(1) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are acquired, and it appears that the buyer relies on the seller’s skill or judgment (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be reasonably fit for such purpose;

(2) Where the goods are bought by description from a seller who deals in goods of that description (whether he be the grower or manufacturer or not), there is an implied warranty that the goods shall be of merchantable quality.

COMMENT:

(1) Meaning of Merchantable Quality

Fit for the *general* purpose of a thing, and not necessarily the particular purpose for which it has been *acquired*.

[NOTE:

- (a) A retailer is responsible in his sale of milk bottled by another. (*Lieberman v. Sheffield Farms*, 191 N-45593).
- (b) In general, it can be said that there is no implied warranty in the sale of second-hand automobile. (*Hysko v. Morawski*, 230 Mich. 221).
- (c) There is no warranty against contingencies of nature. (*Frederickson v. Hackney*, 159 Minn. 234).
- (d) If a foreign substance is found in a can of beans, there is a breach of the warranty. (*Ward v. Great Atlantic Tea Co.*, 120 N.E. 225).]

(2) Rule When Quantity, Not Quality, Is Involved

Where the agreement is that *all the tobacco in a certain place* would be taken, the obligation is absolute, and does not depend upon the quality of the tobacco, since here it was not the quality that counted. (*McCullough v. Aenile & Co.*, 3 Phil. 285).

Art. 1563. In the case of contract of sale of a specified article under its patent or other trade name, there is no warranty as to its fitness for any particular purpose, unless there is a stipulation to the contrary.

COMMENT:

Effect of Sale Under the Patent Name or Trade Name

Note that here there is generally no warranty as to the article's "fitness for any particular purpose."

Art. 1564. An implied warranty or condition as to the quality or fitness for a particular purpose may be annexed by the usage of trade.

COMMENT:

Effect of Usage of Trade

Reason for the Article. The parties are presumed to be acquainted with the usages of trade.

Art. 1565. In the case of a contract of sale by sample, if the seller is a dealer in goods of that kind, there is an implied warranty that the goods shall be free from any defect rendering them unmerchantable which would not be apparent on reasonable examination of the sample.

COMMENT:

Rule in Case of ‘Sale By Sample’

Example: In the sale of candies or potatoes or washing machines by sample, there is warranty of “merchantability.”

Art. 1566. The vendor is responsible to the vendee for any hidden faults or defects in the thing sold, even though he was not aware thereof.

This provision shall not apply if the contrary has been stipulated, and the vendor was not aware of the hidden faults or defects in the thing sold.

COMMENT:

Responsibility for Hidden Defects Even if Seller Was in Good Faith

- (a) Why is the seller responsible for hidden defects even if he is in good faith?

ANS.: Because he has to repair the damage done.

The object of the law is reparation, not punishment. Thus, for example, the seller of an unworthy vessel is liable for hidden defects even if he did not know of them. (*Bryan v. Hankins*, 44 Phil. 82).

- (b) Seller and buyer agreed that seller would be exempted from hidden defects. But seller knew of hidden defects. Would seller be liable?

ANS.: Yes, because of his bad faith. To hold otherwise would be to legalize fraud.

De Santos v. IAC
GR 69591, Jan. 25, 1988

A purchaser in good faith and for value is one who buys property of another, without notice that some other person has a right to or interest in such property and pays a full and fair price for the same, at the time of such purchase or before he has notice of the claim or interest of some other person in the property.

De la Cruz v. IAC
GR 72981, Jan. 29, 1988

Good faith consists in an honest intention to abstain from taking any unconscientious advantage of another. Good faith is the opposite of fraud and of bad faith, and its non-existence must be established by competent proof. One cannot be said to be a buyer in good faith if he had notices of the claim of third persons aside from the claim or right of the registered owner, especially if the claims were annotated on the title are the lots which were shown to the buyer together with the decision of the Court of Appeals, and the buyers were fully aware that the subject properties were under litigation.

A purchaser of a valued piece of property cannot just close his eyes to facts which should put a reasonable man upon his guard and then claim that he acted in good faith under the belief that there were no defect in the title of the vendors.

Art. 1567. In the cases of Articles 1561, 1562, 1564, 1565 and 1566, the vendee may elect between withdrawing from the contract and demanding a proportionate reduction of the price, with damages in either case.

COMMENT:**(1) Remedies in Case of Hidden Defects**

- (a) withdrawal or rescission (*accion redhibitoria*) plus damages;
- (b) proportionate reduction (*accion quanti minores o estimatoria*) — reduction in the price, plus damages.

(2) Applicability to Lease

This warranty in sales is applicable to lease. (*Yap v. Ticoqui*, 13 Phil. 433).

Art. 1568. If the thing sold should be lost in consequence of the hidden faults, and the vendor was aware of them, he shall bear the loss, and shall be obliged to return the price and refund the expenses of the contract, with damages. If he was not aware of them, he shall only return the price and interest thereon, and reimburse the expenses of the contract which the vendee might have paid.

COMMENT:**Effect of Loss of the Thing Because of the Hidden Defects**

Note that whether the seller knew or did not know of the defects, he is still responsible. However, in case of ignorance, there will be no liability for damages.

Art. 1569. If the thing sold had any hidden fault at the time of the sale, and should thereafter be lost by a fortuitous event or through the fault of the vendee, the latter may demand of the vendor the price which he paid, less the value which the thing had when it was lost.

If the vendor acted in bad faith, he shall pay damages to the vendee.

COMMENT:**(1) Effect if Cause of Loss Was a Fortuitous Event and Not the Hidden Defect**

- (a) Here the hidden defect was NOT the cause of the loss.

The cause was either:

- 1) a fortuitous event;
 - 2) or thru the fault of the buyer.
- (b) The *difference* (price minus value at loss) represents generally the *decrease in value* due to the *hidden defect* (hence, the amount by which the seller was enriched at the buyer's expense). (*See 3 Castan 75*). It is understood that the decrease in value due to wear and tear should not be compensated.

(2) Problem

S sold a car for P300,000 to *B*. Unknown to *B*, the car then had a cracked engine block, the replacement of which would cost P175,000. Despite his knowledge of this defect, obtained a waiver from *B* of the latter's right under the warranty against hidden defects. Subsequently, the car was wrecked due to the recklessness of *B* who only then discovered the defects. What right, and to what extent, if any, has *B* against *S*? Reason.

ANS.: *B* can recover approximately P175,000, which may represent the difference between the purchase price and the true value. (*Art. 1569*). The waiver is void because *S* knew of the defect. (*Art. 1566*).

Art. 1570. The preceding articles of this Subsection shall be applicable to judicial sales, except that the judgment debtor shall not be liable for damages.

COMMENT:

Applicability to Judicial Sales

While the preceding articles apply to judicial sales, still no liability for damages will be assessed against the judgment debtor in view of the compulsory nature of the sales.

Art. 1571. Actions arising from the provisions of the preceding ten articles shall be barred after six months, from the delivery of the thing sold.

COMMENT:

(1) Prescriptive Period

6 months from delivery.

(2) Effect of Mere Notification

The buyer notifies the seller of the existence of the hidden defect, but does not sue within 6 months, the action will of course prescribe.

Art. 1572. If two or more animals are sold together whether for a lump sum or for a separate price for each of them, the redhibitory defect of one shall only give rise to its redhibition, and not that of the others; unless it should appear that the vendee would not have purchased the sound animal or animals without the defective one.

The latter case shall be presumed when a team, yoke, pair, or set is bought, even if a separate price has been fixed for each one of the animals composing the same.

COMMENT:

Sale of Two or More Animals Together

- (a) Note that generally, a defect in one should not affect the sale of the others.
- (b) This is true whether the price was a *lump sum*, or *separate for each animal*.
- (c) Note, however, the exception (team, etc.).

Art. 1573. The provisions of the preceding article with respect to the sale of animals shall in like manner be applicable to the sale of other things.

COMMENT:**Applicability of Art. 1572 to Sale of Other Things**

Note that the rule stated in Art. 1572 (while expressly referring only to animals) has been made applicable to the sale of other things.

Art. 1574. There is no warranty against hidden defects of animals sold at fairs or at public auctions, or of livestock sold as condemned.

COMMENT:**When No Warranty Against Hidden Defects Exists**

Re “livestock sold as condemned,” the fact that the livestock is condemned must be communicated to the buyer; otherwise, the seller is still liable. (*Manresa*).

Art. 1575. The sale of animals suffering from contagious diseases shall be void. A contract of sale of animals shall also be void if the use or service for which they are acquired has been stated in the contract, and they are found to be unfit therefor.

COMMENT:**Void Sales of Animals**

The Article speaks of 2 kinds of void sales with respect to animals.

Art. 1576. If the hidden defect of animals, even in case a professional inspection has been made, should be of such a nature that expert knowledge is not sufficient to discover it, the defect shall be considered as redhibitory. But if the veterinarian, through ignorance or bad faith should fail to discover or disclose it, he shall be liable for damages.

COMMENT:**Definition of Redhibitory Defect**

The first paragraph defines “redhibitory defect.”

Art. 1577. The redhibitory action, based on the faults or defects of animals, must be brought within forty days from the date of their delivery to the vendee.

This action can only be exercised with respect to faults and defects which are determined by law or by local customs.

COMMENT:

Prescriptive Period

Bar

For what causes of action, if any, does the new Civil Code provide a period of limitation of:

- (a) 40 days?
- (b) six months?

ANS.:

- (a) *40 days* — the redhibitory action, based on the frauds or defects of animals. (*Art. 1577*).
- (b) *six months*:
 - 1) breach of warranty against hidden defects; rescission of the contract because of the same; or proportionate reduction in the price because of the same. (*Arts. 1561-1571, Civil Code*).
 - 2) rescission or proportionate reduction in the price for sales of real estate either by the unit or for a lump sum, because of failure to comply with the provisions of the contract. (*Arts. 1539-1543, Civil Code*).

Art. 1578. If the animal should die within three days after its purchase, the vendor shall be liable if the disease which cause the death existed at the time of the contract.

COMMENT:

Effect if Animal Dies Within 3 Days

The Article is self-explanatory.

Art. 1579. If the sale be rescinded, the animal shall be returned in the condition in which it was sold and delivered, the vendee being answerable for any injury due to his negligence, and not arising from the redhibitory fault or defect.

COMMENT:

Effect if the Sale of the Animal Is Rescinded

Note that the *condition* of the animal must generally be the same.

Art. 1580. In the sale of animals with redhibitory defects, the vendee shall also enjoy the right mentioned in Article 1567; but he must make use thereof within the same period which has been fixed for the exercise of the redhibitory action.

COMMENT:

(1) Remedies of Buyer of Animals With Redhibitory Defects

- (a) withdrawal or rescission (plus damages)
- (b) proportionate reduction in price (plus damages). (*See Art. 1567, Civil Code*).

(2) Prescriptive Period for Either Remedy 40 days from date of delivery to the buyer

Art. 1581. The form of sale of large cattle shall be governed by special laws.

COMMENT:

Form of Sale of Large Cattle

Special laws govern the form here.

Chapter 5

OBLIGATIONS OF THE VENDEE

Art. 1582. The vendee is bound to accept delivery and to pay the price of the thing sold at the time and place stipulated in the contract.

If the time and place should not have been stipulated, the payments must be made at the time and place of the delivery of the thing sold.

COMMENT:

(1) Principal Obligations of the Buyers

The buyers must:

- (a) accept delivery;
- (b) pay the price.

Soco v. Judge Militante GR 58961, Jan. 28, 1983

Tender of payment ought to be made in legal tender (not a check), unless another mode is accepted by the creditor.

(2) Bar

On Jan. 5, A sold and delivered his truck, together with the corresponding certificate of public convenience to *B* for the sum of P600,000, payable within 60 days. Two weeks after the sale, and while the certificate of public convenience was still in the name of A, it (the certificate) was revoked by the Public Service Commission thru no fault of A. Upon the expiration of the 60-day period, A demanded payment of the

price from *B*. *B* refused to pay, alleging that the contract of sale was VOID for the reason that the certificate of public convenience which was the main consideration of the sale no longer existed. Is the contention of *B* tenable? Reasons.

ANS.: Under the circumstances, the contention of *B* is NOT tenable.

- (a) *Firstly*, it cannot be correctly contended that the sale is void, since the consideration *actually existed at the time of the perfection* of the sale. The subsequent revocation of the certificate thru no fault of *A* is immaterial.
- (b) *Secondly*, what *B* should have done *immediately after* the sale was to take steps to have the Public Service Commission transfer the certificate to his name. (*Serrano v. Miave, et al.*, L-14678, Mar. 31, 1965).
- (c) *Thirdly*, while the Public Service Law requires that the sale or assignment of a certificate of public convenience, together with the property used in the operation of the *same*, should be *approved* by the Public Service Commission — for the protection of the public, still as between *A* and *B*, the contract is efficacious as all the essential requisites of the contract were present at the time of the perfection thereof.

[NOTE: Unless the deed of conveyance is executed, the buyer as a rule is not required to pay the price. (*Lafont v. Pascasio*, 5 Phil. 391).]

(3) Effect of Delivery When No Time Has Been Fixed for Payment of the Price

If seller has delivered but no time has been fixed for the payment of the price, the seller may require payment to be made at any time after delivery. The buyer here has the duty to pay the price immediately upon demand. (*Ocejo v. Int. Bank*, 37 Phil. 631).

(4) Effect of Deviations from the Contract

If the seller is forced to deviate from the provision of the contract, but the purchaser consents or agrees to such

deviations, the purchaser should still pay the price. (*Engel v. Velasco & Co.*, 47 *Phil.* 15).

Art. 1583. Unless otherwise agreed, the buyer of goods is not bound to accept delivery thereof by installments.

Where there is a contract of sale of goods to be delivered by stated installments, which are to be separately paid for, and the seller makes defective deliveries in respect of one or more installments, or the buyer neglects or refuses without just cause to take delivery of or pay for one or more installments, it depends to each case on the terms of the contract and the circumstances of the case, whether the breach of contract is so material as to justify the injured party in refusing to proceed further and suing for damages for breach of the entire contract, or whether the breach is severable, giving rise to a claim for compensation but not to a right to treat the whole contract as broken.

COMMENT:

(1) Generally No Delivery By Installments

Reason: performance must generally be complete.

Exception to Rule: express provisions.

(2) Rule in Case of Installment Deliveries

The second paragraph states the rules for delivery by installments, and distinguishes whether the breach is *severable or not*.

**Antipolo Realty Corp. v. National Housing
Authority
GR 50444, Aug. 31, 1987**

FACTS: For failure of the Realty Company to develop the subdivision project, the buyer paid only the averages pertaining to the period up to and including the month of Aug., 1972 and stopped all monthly payments falling due thereafter. In Oct. 1976, the Realty Company advised the buyer that the

improvements had already been completed and requested resumption of payments. In another letter, the Realty Company demanded immediate payment of the P16,000 representing installments which it said accrued during the period while the improvements were being completed. The buyer refused to pay the 1972-1976 installments, but agreed to pay the post 1976 installments.

ISSUE: What happens to the installment payments which would have accrued and fallen due during the period of suspension had no default on the part of the realty company intervened?

HELD: The original period of payment in the Contract to Sell must be deemed extended by a period of time equal to the period of suspension (*i.e.*, by 4 yrs., two [2] months) during which extended time (tacked on to the original contract period) the buyer must continue to pay the monthly installment payments until the entire original contract price shall have been paid.

To permit the Antipolo Realty to collect the disputed amount in a lump sum after it had defaulted in its obligations to its lot buyers would defeat the purpose of the authorization (under Sec. 23, PD 957) to lot buyers to suspend installment payments. Such must be the case, otherwise, there is no sense in suspending payments.

Upon the other hand, to condone the entire amount that would have become due would be excessively a harsh penalty upon the seller and would result in the unjust enrichment of the buyer at the expense of the seller. The suspension of installment payments was attributable to the realty company, not to the buyer. The tacking of the period of suspension to the end of the original period prevents default on the part of the lot buyer.

Under Sec. 23, PD 957, "no installment payment made by a buyer in a subdivision or condominium project for the lot or unit he contracted to buy shall be forfeited in favor of the owner or developer when the buyer, after due notice to the owner or developer, desists from further payment due to the failure of the owner or developer to develop the subdivision or condominium project according to the approved plans

and within the time limit for complying with the same. Such buyer may, at his option, be reimbursed the total amount paid including amortization and interests but excluding delinquency interest, with interest thereon at the legal rate.”

Art. 1584. Where goods are delivered to the buyer, which he has not previously examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract if there is no stipulation to the contrary.

Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound, on request, to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.

Where goods are delivered to a carrier by the seller, in accordance with an order from or agreement with the buyer, upon the terms that the goods shall not be delivered by the carrier to the buyer until he has paid the price, whether such terms are indicated by marking the goods with the words “collect on delivery,” or otherwise, the buyer is not entitled to examine the goods before the payment of the price, in the absence of agreement or usage of trade permitting such examination.

COMMENT:

(1) When Buyer Has Right to Examine

Generally, the buyer is entitled to examine the goods prior to delivery. And this is true even if the goods are shipped F.O.B. (free on board). (*See Decezo v. Chandler*, 206 N.Y.S.).

**Grageda v. IAC
GR 67929, Oct. 27, 1987**

FACTS: On Mar. 26, 1975, Dino ordered from Francisco 500 sets of pyrex trays. Prior to Apr. 27, 1975, Francisco deliv-

ered some of the items but Dino outrightly rejected them. After making the proper corrections, Francisco made subsequent deliveries on Apr. 27, Apr. 30, May 1, May 3, May 12, and May 27, 1975. Dino's caretaker duly received the deliveries. On several occasions, Francisco demanded payment for the total value of the deliveries but Dino asked for extension of time within which to pay. On Jun. 20, 1975, Dino sent a letter to Francisco, telling Francisco that he rejects the items delivered. Because of this, Francisco sued Dino for payment.

HELD: The delay in the advice or notice of rejection — almost two months after receipt — was rather too late.

Art. 1584 accords the buyer the right to a reasonable opportunity to examine the goods to ascertain whether they are in conformity with the contract. Such opportunity to examine, however, should be availed of within a reasonable time in order that the seller may not be subjected to undue delay or prejudice in the payment of his raw materials, workers and other damages which may be incurred due to the deterioration of his products.

The buyer is deemed to have accepted the goods when, after the lapse of a reasonable time he retains them without intimating to the seller that he has rejected them.

(2) When Buyer Has No Right to Examine

- (a) when there is a stipulation to this effect. (*Art. 1584, par. 1*).
- (b) when the goods are delivered C.O.D. — unless there is an *agreement* or a *usage of trade* PERMITTING such examination. (*Art. 1584, par. 2*).

Art. 1585. The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him, and he does any act in relation to them which is inconsistent with the ownership of the seller, or when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

COMMENT:**When There is Acceptance of the Goods**

The Article gives three ways of accepting the goods:

- (a) express acceptance
- (b) when buyer does an act which only an owner can do
- (c) failure to return after reasonable lapse of time

Kerr & Co. v. De la Rama
11 Phil. 453

FACTS: Buyer accepted goods despite delay. Buyer also promised later on to pay. Subsequently, buyer asked for damages on account of the delay.

HELD: Buyer is estopped because of the acceptance without reservation at the time of acceptance.

Art. 1586. In the absence of express or implied agreement of the parties, acceptance of the goods by the buyer shall not discharge the seller from liability in damages or other legal remedy for breach of any promise or warranty in the contract of sale. But, if, after acceptance of the goods, the buyer fails to give notice to the seller of the breach in any promise of warranty within a reasonable time after the buyer knows, or ought to know of such breach, the seller shall not be liable therefor.

COMMENT:**Even if Buyer Accepts, Seller Can Still Be Liable**

- (a) Reason for the last sentence. To prevent afterthoughts or belated claims.
- (b) The buyer is allowed to set up the breach of the warranty or promise as a set-off or counterclaim for the price. (*William v. Perrota*, 95 Conn. 629).

Art. 1587. Unless otherwise agreed, where goods are delivered to the buyer, and he refuses to accept them, having the right to do, he is not bound to return them to the

seller, but it is sufficient if he notifies the seller that he refuses to accept them. If he voluntarily constitutes himself a depositary thereof, he shall be liable as such.

COMMENT:

Effect if Buyer Justifiably Refuses to Accept the Delivery

- (a) buyer has no duty to return the goods to the seller
- (b) mere notification to seller of refusal will suffice
- (c) but buyer may make himself a *voluntary depositary* — in which case he must safely take care of them in the mean time

Art. 1588. If there is no stipulation as specified in the first paragraph of article 1523, when the buyer's refusal to accept the goods is without just cause, the title thereto passes to him from the moment they are placed at his disposal.

COMMENT:

Effect if Buyer Unjustifiably Refuses to Accept the Delivery

Generally, the buyer becomes the owner. Exception — when there is a contrary stipulation or when the seller reserves the ownership as a sort of security for the payment of the price. (*See Arts. 1523 and 1503, Civil Code*).

Art. 1589. The vendee shall owe interest for the period between the delivery of the thing and the payment of the price, in the following three cases:

- (1) Should it have been so stipulated;
- (2) Should the thing sold and delivered produce fruits or income;
- (3) Should he be in default, from the time of judicial or extrajudicial demand for the payment of the price.

COMMENT:**(1) When Buyer Has to Pay for Interest on the Price**

This Article answers the question: "In what cases is the buyer liable for interest on the price?"

[**NOTE:** If the buyer fails to give the money after the contract is notarized, although he had previously promised to do so, there is default with liability for legal interest. (*De la Cruz v. Legaspi*, L-8024, Nov. 29, 1955).]

(2) The Three Cases Contemplated

- (a) In No. (1), no demand is needed.
- (b) In No. (2), the reason for the law is that the fruits or income is sufficient to warrant the payment of interest.
- (c) In No. (3), "default" is *mora*, called "in delay" under the provisions of the Civil Code.

(3) Rule for Monetary Obligations

In a monetary obligation (like the obligation to pay the purchase price) in the absence of stipulation, legal interest takes the place of damages. This is so even if the damages are actually more or less. The possibility of gain because of an investment should be discounted; instead of a gain, there might be a loss. Therefore, the law has compromised on legal interest. (*Quiros v. Tan Guinlay*, 6 Phil. 675).

Art. 1590. Should the vendee be disturbed in the possession or ownership of the thing acquired, or should he have reasonable grounds to fear such disturbance, by a vindicatory action or a foreclosure of mortgage, he may suspend the payment of the price until the vendor has caused the disturbance or danger to cease, unless the latter gives security for the return of the price in a proper case, or it has been stipulated that, notwithstanding any such contingency, the vendee shall be bound to make the payment. A mere act of trespass shall not authorize the suspension of the payment of the price.

COMMENT:**(1) When Buyer May Suspend the Payment of the Price**

The buyer may SUSPEND the payment of the price if:

- (a) There is a well-grounded fear (*fundado temor*).
- (b) The fear is because of:
 - 1) a vindicatory action or action to recover, or
 - 2) a foreclosure of mortgage.

[NOTE:

- (a) The fear must not be the result of any other ground, like the vendor's insanity.
- (b) A mere act of trespass is made by one claiming no legal right whatsoever. Here, the buyer is not authorized to suspend the payment of the price.]

(2) Problem

S sold and delivered to *B* a parcel of land for P2 million payable within 30 days from the date of the contract. Soon after the sale, *X* claims ownership over the land by virtue of a prescriptive title. May *B* suspend the payment of price? Why?

If, in order to avoid trouble, *B* pays off *X* to settle the latter's claim to the land, may *B* recover the amount paid as against *S* upon *S*'s warranty in case of eviction? Reason.

ANS.: Yes, *B* may suspend the payment of the price because of a reasonable fear that an *accion reivindicatoria* will be brought against him. It is not necessary that the vindicatory action has already been brought: reasonable fear thereof is sufficient. (10 *Manresa* 274-276, 280-281). Should *B* and *X* come to an amicable settlement, *B* cannot recover from *S* because there really was no eviction. *B* was indeed not deprived of the thing purchased. (Art. 1548, *Civil Code*).

**Bareng v. Court of Appeals, et al.
L-12973, Apr. 25, 1960**

FACTS: Bareng bought cinematographic equipment from a certain Alegria for P15,000. He paid P11,400 down,

and executed a promissory note for the balance. On the date of maturity, he refused to pay the balance, alleging that a certain Ruiz had informed him that he (Ruiz) was a co-owner of Alegria of the properties purchased, and that he was not in conformity with the sale. Suit was brought by Alegria for the recovery of the balance. While the suit was pending, Alegria caused the disturbance over the ownership to cease by compromising with Ruiz for the latter's share. *Issue:* Aside from paying the balance, does Bareng have to pay any legal interest thereon? If so, from what time?

HELD: Bareng is liable for interest, not from the time of demand — for he was justified in suspending payment from the time he learned of Ruiz's adverse claims — but from the time Alegria had "caused the disturbance or danger to cease" by entering into compromise with Ruiz. The compromise Bareng knew about — for he was a party in the case.

Art. 1591. Should the vendor have reasonable grounds to fear the loss of immovable property sold and its price, he may immediately sue for the rescission of the sale.

Should such ground not exist, the provisions of Article 1191 shall be observed.

COMMENT:

(1) When Seller May Immediately Sue for the Rescission of the Sale

The seller must have reasonable grounds to fear:

- (a) LOSS of the immovable property sold, and
- (b) LOSS of the price.

So, if the buyer is squandering his money, but the immovable property remains untouched, this article cannot apply.

(2) Rule if Neither Ground Exists

If neither ground exists, Art. 1191 applies. Art. 1191 provides:

“The power to rescind obligations is implied in reciprocal ones, in case one of the obligors should not comply with what is incumbent upon him.

The injured party may choose between the fulfillment and the rescission of the obligation, with the payment of damages in either case. He may also seek rescission, even after he has chosen fulfillment, if the latter should become impossible.

“The court shall decree the rescission claimed, unless there be just cause authorizing the fixing of a period.

“This is understood to be without prejudice to the rights of third persons who have acquired the thing, in accordance with articles 1385 and 1388 and the Mortgage Law.”

Art. 1592. In the sale of immovable property, even though it may have been stipulated that upon failure to pay the price at the time agreed upon the rescission of the contract shall of right take place, the vendee may pay even after the expiration of the period, as long as no demand for rescission of the contract has been made upon him either judicially or by a notarial act. After the demand, the court may not grant him a new term.

COMMENT:

(1) Rescission of Sale of Real Property

- (a) This is only applicable to a sale of *real property*, not to a contract TO SELL real property or to a promise TO SELL real property, where title remains with the vendor until fulfillment of a positive suspensive condition, such as the full payment of the price. (*Manuel v. Rodriguez, L-13436, Jul. 27, 1960*). In the contract TO SELL, where ownership is retained by the seller and is not to pass until the full payment of the price, such payment is a positive suspensive condition, the failure of which is not a breach, casual or serious but an event that prevents the obligation of the vendor to convey title from acquiring binding force. To argue that in case of failure to pay there is only a casual breach is to proceed from the false assumption that the contract is one of absolute sale, where non-payment a mere resolutory condition. (*Ibid.*).

- (b) This article applies whether or not there is a stipulation for automatic rescission. The law says “even though.”
- (c) The demand may be:
 - 1) judicial
 - 2) extrajudicial (this must however be by notarial act).
- (d) The demand is *not* for the payment of the price, but for the RESCISSION of the contract. (*10 Manresa 288*). If the demand for such rescission comes only AFTER the offer to pay the balance (accompanied by a postal money order for the amount due), the automatic rescission *cannot* of course legally take place. (*Maximo, et al. v. Fabian, et al., L-8015, Dec. 23, 1955*).
- (e) The demand is not for the payment of the price BUT for the RESCISSION of the contract. (*Manresa, Vol. 10, p. 288*).

(2) Example of this Article

On Jul. 1, A sold B a piece of land, payment and delivery to be made on Jul. 15. It was stipulated that should payment not be made on Jul. 15, the contract would automatically be rescinded. On Jul. 20, can B still pay?

ANS.: Yes, as long as there has been no judicial or notarial demand for the rescission of the contract. But if, for example on Jul. 18, A had made a notarial demand for such a rescission then B will not be allowed to pay anymore, and the court may not grant him a new term.

(3) The Demand Needed

Be it noted that the demand is not for the payment of the price inasmuch as the seller precisely desires to rescind the contract. To say that it should be the demand for the price would lead to the anomalous paradoxical result of requiring payment from the buyer for the very purpose of preventing him from paying. It is, therefore, a demand for rescission; the term having expired, the seller does not want to continue with the contract. (*Villareal v. Tan King, 43 Phil. 251, citing 10 Manresa 288*).

(4) Rule in Contracts to Sell

As already stated, Art. 1592 does NOT apply to a promise to sell (*Mella v. Vismanos*, 45 O.G. 2099) nor to a contract TO SELL. (*Jocson v. Capitol Subdivision, Inc., et al.*, L-6573, Feb. 28, 1955 and *Manuel v. Rodriguez, Sr.*, L-13435, Jul. 27, 1960). Thus, in the case of *Jocson*, the legality of the following clauses in a contract TO SELL was SUSTAINED — “That it is hereby agreed and understood that in the event the BUYER should fail to pay any of the installments as and when the same falls due, the SELLER shall have the right at her option to consider this contract cancelled and rescinded and that all the amount therefor paid by the BUYER unto the SELLER shall be considered as rental for the use of said property up to the date of such default, and said BUYER shall have no right of action against the SELLER for the recovery of any portion of the amount thus paid; that in the event this contract be declared rescinded upon default of the BUYER in the payment of any installment as and when it falls due, said SELLER shall have the right not only to sell and dispose of the property covered by this sale, that is to say, the above described buildings, as well as the leasehold rights on the property upon which the buildings are constructed, but said SELLER shall have the right furthermore, to take possession of said property upon notice of such cancellation.”

[**NOTE:** Incidentally, if the installment buyer were to delay payment for several installments, and later sell the property to another buyer with the consent of the Subdivision, can the Subdivision still make use of the forfeiture clause even as against the new buyer, if said new buyer should also fail to pay the installments?

HELD: Yes. First, there was no express waiver. Mere tolerance or liberality to the first buyer does not establish an obligation to be liberal to the second buyer. Mere tolerance or liberality to the first buyer does not necessarily mean a waiver thereof. Secondly, the forfeiture here would be predicated on the second buyer's default, not on the first buyer's. For with respect to the first buyer, the consent to the assignment necessarily waives any right to forfeiture accruing before such assignment. (*Jocson v. Capital Subdivision*, L-6573, Feb. 28, 1955).]

**Legarda Hermanos and Jose Legarda v.
Felipe Saldaña and Court of Appeals
L-26578, Jan. 28, 1974**

FACTS: Saldaña bought two lots from the Legarda Hermanos Subdivision on the installment plan (120 installments). After paying for 95 installments (for each lot) he stopped payment, but five years later, wanted to resume payment. The Subdivision Company informed him that the contracts had been cancelled and the payments forfeited conformably with the terms of the contract. Saldaña was able to prove, however, that considering the total amount he had paid, the same already covered the full purchase price of one lot. Can Saldaña get one lot?

HELD: Yes. The giving by the Company of one lot to Saldana, and the cancellation of the contract pertaining to the other lot, does not deny substantial justice to the subdivision. Besides, in a sense there was substantial performance. (*See also Art. 1234, Civil Code*).

**Roque v. Lapuz
L-32811, Mar. 31, 1980**

Art. 1592 of the Civil Code, which speaks of the rescission of contracts of sale of real property, does not apply to *contracts to sell* real property on installments.

**Joseph and Sons Enterprises, Inc. v. CA
GR 46765, Aug. 29, 1986**

Art. 1592 of the Civil Code, which permits the vendee to pay, even after the expiration of the period, as long as no demand for rescission of the contract has been made upon him either judicially or by notarial act does not apply to a contract to sell or a deed of conditional sale.

**Leberman Realty Corp. & Aran Realty &
Development Corp. v. Joseph Typingco and CA
GR 126647, Jul. 29, 1998**

FACTS: Petitioners cancelled the contract before the period to pay arrived.

ISSUE: Was private respondent guilty of failure to pay the price of the land within the period agreed upon?

HELD: No. Petitioners' argument that respondent failed to exercise his option to buy within the period provided in the contract, and which period expired/lapsed during the pendency of the case, is plainly absurd. For how could private respondent have exercised the option granted him under the "Option to Buyer" clause when the contract itself was rejected/cancelled by the petitioners even before the arrival of the period for the exercise of said option?

The invocation by petitioners of Art. 1592 is misplaced. The provision contemplates of a situation where the buyer who failed to pay the price at the time agreed upon, may still pay, even after the expiration of the period, as long as no demand for rescission has been made upon him either judicially or by a notarial act.

(5) Effect of Stipulation Allowing the Taking of Possession

Incidentally, a stipulation in a contract to sell realty entitling one party to take possession of the land and building if the other party violates the contract does NOT *ex proprio vigore* (by its own force) confer upon the former the right to take possession thereof if objected to, without judicial intervention and determination. (*Nera v. Vacante, et al.*, L-16725, Nov. 29, 1961).

Art. 1593. With respect to movable property, the rescission of the sale shall of right take place in the interest of the vendor, if the vendee, upon the expiration of the period fixed for the delivery of the thing, should not have appeared to receive it, or having appeared he should not have tendered the price at the time, unless a longer period has been stipulated for its payment.

COMMENT:

(1) Rescission of Sale of Personal Property

- (a) This article should apply only if the object sold has not been delivered to the buyer.

- (b) If there has already been delivery, other articles, like Art. 1191 would be applicable. In this case automatic rescission is not allowed. An affirmative action is necessary (*Guevarra v. Pascual*, 12 Phil. 311), the action being one to rescind judicially, if the buyer refuses to come to amicable settlement. (*Escueta v. Pando*, 42 O.G., No. 11, p. 2759).

(2) Example of the Article

The seller and the buyer agreed that payment and delivery would be made on Jul. 15, at the buyer's house. If the buyer does not appear on said day, or having appeared, he should not have tendered the price at the same time, then the sale can be considered as automatically rescinded.

(3) Right, Not Obligation, to Rescind

If in a contract the seller is authorized to rescind the sale in case of breach, this does not necessarily mean that he is obliged to do so. (*Ramirez v. Court of Appeals & Muller Nease*, L-6536, Jan. 25, 1956, 52 O.G. 779).

Chapter 6

ACTIONS FOR BREACH OF CONTRACT OF SALE OF GOODS

Art. 1594. Actions for breach of the contract of sale of goods shall be governed particularly by the provisions of this Chapter, and as to matters not specifically provided for herein, by other applicable provisions of this Title.

COMMENT:

(1) Governing Law for Actions for Breach of the Contract of Sale of Goods

Note that this chapter is *not* applicable to sale of real property.

(2) Remedy of Buyer in a Contract of Sale by the NAMARCO

NAMARCO, etc. v. Cloribel L-26585, Mar. 13, 1968

FACTS: German E. Villanueva, a Manila businessman trading under the name VILTRA company bought from NAMARCO 10,000 metric tons of wire rods valued at over a million dollars. NAMARCO refused to comply with its commitments under the contract of sale. The VILTRA company brought a special civil action for MANDAMUS to compel NAMARCO to comply with the terms of the sale. *Issue:* Is mandamus the proper remedy?

HELD: *Mandamus* is *not* the proper remedy. It is a settled rule that *mandamus* never lies to enforce performance of contractual obligations. (*City of Manila v. Posadas*, 48 Phil. 309; *Florida Central, etc. v. State, etc.*, 20 LRA 419). In case of a breach of contract, the aggrieved party's remedy is an

ordinary action in the proper court for SPECIFIC PERFORMANCE.

This rule is applicable even in cases brought against municipal corporations to compel payment of the price agreed upon in a contract (*Quiogue v. Romualdez*, 46 Phil. 337 and *Jacinto v. Director of Lands*, 44 Phil. 853), the reason, being that a contractual obligation is *not* a duty specifically enjoined upon a party by law resulting from office, trust, or station. If it were such a duty, *mandamus* would be a proper remedy.

Art. 1595. Where, under a contract of sale, the ownership of the goods has passed to the buyer, and he wrongfully neglects or refuses to pay for the goods according to the terms of the contract of sale, the seller may maintain an action against him for the price of the goods.

Where, under a contract of sale, the price is payable on a certain day, irrespective of delivery or of transfer of title, and the buyer wrongfully neglects or refuses to pay such price, the seller may maintain an action for the price, although the ownership in the goods has not passed. But it shall be a defense to such an action that the seller at any time before the judgment in such action has manifested an inability to perform the contract of sale on his part or an intention not to perform it.

Although the ownership in the goods has not passed, if they cannot readily be resold for a reasonable price, and if the provisions of Article 1596, fourth paragraph, are not applicable, the seller may offer to deliver the goods to the buyer, and, if the buyer refuses to receive them, may notify the buyer that the goods are thereafter held by the seller as bailee for the buyer. Thereafter, the seller may treat the goods as the buyer's and may maintain an action for the price.

COMMENT:

Rules if Buyer Refuses to Pay

- (a) *Example of paragraph 1:* Machines having been sold and delivered to the buyer, if the buyer refuses to pay therefor, the seller may sue for the price. (*McCullough v. Lucena Elec. Light Co.*, 32 Phil. 141).

- (b) *Example of paragraph 2:* The seller and buyer agreed that payment would be made on Jul. 15, although the goods would be delivered only on Jul. 30. On Jul. 15, the seller may sue for the price. The buyer is allowed to refuse to pay if before the judgment in such action, he is able to prove that the seller has no intention anyway of delivering the goods on Jul. 30. In one case, our Supreme Court has held that the seller should, upon his election to enforce fulfillment against the buyer, indicate in his complaint his readiness to surrender the goods into the custody of the court and to request the court, if it should deem such course to be warranted, convenient, and advisable, to direct that the goods be delivered to its own officer or to a receiver to be appointed for the purpose (unless, of course, a later delivery date has been stipulated). In this way, the court would be placed in a position to act at once, if the situation should so require. Furthermore, in this case the adverse party is given a fair opportunity to protect his own interest. (*Matute v. Cheong Boo*, 37 Phil. 372).
- (c) *Example of paragraph 3:* Seller and buyer agreed that payment and delivery would be made on July 15. On said date, seller may offer to deliver the goods to the buyer, and if buyer refuses to receive the goods, the seller can tell the buyer, "I am holding the goods, no longer as the seller, but as your depository. You are now the owner of the goods." The seller can now maintain an action for the price. This can be done if:
- (1) The goods cannot readily be resold for a reasonable price, and
 - (2) If the provisions of Art. 1596, par. 4 are not applicable.

Art. 1596. Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may maintain an action against him for damages for non-acceptance.

The measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events from the buyer's breach of contract.

Where there is an available market for the goods in question, the measure of damages is, in the absence of special circumstances showing proximate damage of a different amount, the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted, or, if no time was fixed for acceptance, then at the time of the refusal to accept.

If, while labor or expense of material amount is necessary on the part of the seller to enable him to fulfill his obligations under the contract of sale, the buyer repudiates the contract or notifies the seller to proceed no further therewith, the buyer shall be liable to the seller for labor performed or expenses made before receiving notice of the buyer's repudiation or countermand. The profit the seller would have made if the contract or the sale had been fully performed shall be considered in awarding the damages.

COMMENT:

(1) Remedy of Seller if Buyer Refuses to Accept and Pay

Example of paragraph 1: S sold B a piano. If B wrongfully refuses to accept and pay for the goods, S may bring an action against him for damages for non-acceptance.

(2) Measure of Damages

The estimated loss directly and naturally resulting in the ordinary course of events from the buyer's breach of contract. (*Art. 1596, par. 2 and Suilong and Co. v. Manyo Shaji Kaisha, 42 Phil. 722*).

(3) Query

What action or actions are available to the seller of the goods in case the buyer *wrongfully refuses to accept* the goods sold?

ANS.:

- (a) Maintain an action for damages because of the non-acceptance. (*Art. 1596*).

- (b) Hold the goods as bailee for the buyer and bring an action for the price. (*See Art. 1595, 3rd paragraph*).
- (c) Ask for the resolution of the contract for failure of the buyer to fulfill his obligations.

Art. 1597. Where the goods have not been delivered to the buyer, and the buyer has repudiated the contract of sale, or has manifested his inability to perform his obligations thereunder, or has committed a breach thereof, the seller may totally rescind the contract of sale by giving notice of his election so to do to the buyer.

COMMENT:

When Seller May Totally Rescind the Contract of Sale

- (a) This Article which deals with the instances when the seller may totally rescind the contract of sale, applies only if the goods have not yet been delivered.
- (b) The automatic rescission here requires notice thereof to the buyer.

Art. 1598. Where the seller has broken a contract to deliver specific or ascertained goods, a court may, on the application of the buyer, direct that the contract shall be performed specifically, without giving the seller the option of retaining the goods on payment of damages. The judgment or decree may be unconditional, or upon such terms and conditions as to damages, payment of the price and otherwise, as the court may deem just.

COMMENT:

Rule When Seller Has Broken a Contract to Deliver Specific or Ascertained Goods

- (a) Observe that here the seller is guilty; hence, there is no right of retention on his part even if said seller is willing to pay damages.

- (b) Note that there must be an order from the court for the specific performance.
- (c) Note further that the court may make the order on the application of the buyer.

Art. 1599. Where there is a breach of warranty by the seller, the buyer may, at his election:

(1) Accept or keep the goods and set up against the seller, the breach of warranty by way of recoupment in diminution or extinction of the price;

(2) Accept or keep the goods and maintain an action against the seller for damages for the breach of warranty;

(3) Refuse to accept the goods, and maintain an action against the seller for damages for the breach of warranty;

(4) Rescind the contract of sale and refuse to receive the goods or if the goods have already been received, return them or offer to return them to the seller and recover the price or any part thereof which has been paid.

When the buyer has claimed and been granted a remedy in anyone of these ways, no other remedy can thereafter be granted, without prejudice to the provisions of the second paragraph of Article 1191.

Where the goods have been delivered to the buyer, he cannot rescind the sale if he knew of the breach of warranty when he accepted the goods without protest, or if he fails to notify the seller within a reasonable time of the election to rescind, or if he fails to return or to offer to return the goods to the seller in substantially as good condition as they were in at the time the ownership was transferred to the buyer. But if deterioration or injury of the goods is due to the breach of warranty, such deterioration or injury shall not prevent the buyer from returning or offering to return the goods of the seller and rescinding the sale.

Where the buyer is entitled to rescind the sale and elects to do so, he shall cease to be liable for the price upon returning or offering to return the goods. If the price or any part thereof has already been paid, the seller shall be liable

to repay so much thereof as has been paid, concurrently with the return of the goods, or immediately after an offer to return the goods in exchange for repayment of the price.

Where the buyer is entitled to rescind the sale and elects to do so, if the seller refuses to accept an offer of the buyer to return the goods, the buyer shall thereafter be deemed to hold the goods as bailee for the seller, but subject to a lien to secure payment of any portion of the price which has been paid, and with the remedies for the enforcement of such lien allowed to an unpaid seller by Article 1526.

(5) In the case of breach of warranty of quality, such loss, in the absence of special circumstances showing proximate damage of a greater amount, is the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had answered to the warranty.

COMMENT:

(1) Remedies of the Buyer if Seller Commits a Breach of Warranty

The first paragraph of the Article enumerates the FOUR REMEDIES of the buyer.

(2) Effect if Buyer Selects Any of the Four Remedies Given

If the buyer has selected any of the remedies, and has been GRANTED the same, no other remedy can be given. However, the second paragraph of Art. 1191 will still apply.

Article 1191 provides:

“The power to rescind obligations is implied in reciprocal ones in case one of the obligors should not comply with what is incumbent upon him.

“The injured party may choose between the fulfillment and the rescission of the obligation, with the payment of damages in either case. He may also seek rescission, even

after he has chosen fulfillment, if the latter should become impossible.

“The court shall decree the rescission claimed, unless there be just cause authorizing the fixing of a period.

“This is understood to be without prejudice to the rights of third persons who have acquired the thing, in accordance with Articles 1385 and 1388 and the Mortgage Law.”

(3) Effect if Buyer Still Accepted the Goods Despite His Knowledge of the Breach of the Warranty

The 3rd paragraph of the Article gives the effect — generally, NO RESCISSION.

Chapter 7

EXTINGUISHMENT OF SALE

Art. 1600. Sales are extinguished by the same causes as all other obligations, by those stated in the preceding articles of this Title, and by conventional or legal redemption.

COMMENT:

(1) How Sales Are Extinguished

Sales are extinguished:

- (a) by same causes as in other obligations (such as novation);
- (b) by redemption (whether *conventional* or *legal*).

Bert Osmeña v. Court of Appeals GR 36545, Jan. 28, 1983

A contract of sale cannot be regarded as having been novated in the absence of a new contract between the buyer and the seller.

(2) Applicability of the Article to Both Consummated and Perfected Contracts

This Article applies both to consummated contracts and those which are merely perfected contracts of sale, since no distinction is made in this provision. (*Asiatic Comm. Co. v. Ang*, 40 O.G. [11th S] No. 15, p. 102).

(3) Effect of a Claim for Damages

A claim for damages which results from a breach of a contract is considered a right which is inseparably annexed to every action for the fulfillment of the obligation. If, therefore,

damages are not sought in the action to compel performance, it is clear that said damages cannot be recovered in an independent action. (*Daywalt v. Corporacion de P.P. Agustinos Recoletos*, 39 Phil. 587).

Section 1

CONVENTIONAL REDEMPTION

Art. 1601. Conventional redemption shall take place when the vendor reserves right to repurchase the thing sold, with the obligation to comply with the provisions of Article 1616 and other stipulations which may have been agreed.

COMMENT:

(1) When Conventional Redemption Takes Place

- (a) Conventional redemption is also called the right to redeem.

It occurs in sales with a *pacto de retro*, and takes place as stated in the Article.

- (b) There cannot be conventional redemption unless it has been stipulated upon in the contract of sale. (*Ordonez v. Villaroman*, 44 O.G. 2226). Consider, therefore, this right merely as an *accidental* element in the contract of sale. It cannot be considered either as a *natural* or as an *essential* element in the contract of sale.
- (c) If the terms of the *pacto de retro* sale are clear and the contract is not assailed as false nor its authenticity challenged, the literal sense of its terms shall be given effect. (*Ordoñez v. Villaroman*, 44 O.G. 2226).

Hulganza v. CA GR 56196, Jan. 7, 1987

ISSUE: Is it necessary that the formal offer to redeem the land be accompanied by a *bona fide* tender of the redemption price, or the repurchase price be consigned in Court, within the period of redemption even if the right is exercised through the filing of judicial action?

HELD: The *bona fide* tender of the redemption price or its equivalent — consignment of said price in court — is not essential or necessary in an action to redeem a parcel of land under Sec. 119, Com. Act 141, since the filing of the action itself is equivalent to a formal offer to redeem. The formal offer to redeem, accompanied by a *bona fide* tender of the redemption price, within the period of redemption prescribed by law, is only essential to preserve the right of redemption for future enforcement beyond such period of redemption, and within the period prescribed for the action by the statute of limitations. Where the right to redeem is exercised thru the filing of judicial action within the period of redemption prescribed by law, the formal offer to redeem, accompanied by a *bona fide* tender of redemption price, might be proper, but this is not essential. The filing of the action itself, within the period of redemption, is equivalent to a formal offer to redeem. Any other construction, particularly with reference to redemption of homesteads conveyed to third parties, would work hardships on the poor homesteaders who cannot be expected to know the subtleties of the law and would defeat the evident purpose of the Public Land Law — “to give the homesteader or patentee every chance to preserve for himself and his family the land that the state granted him as a reward for his labor in cleaning and cultivating it.”

(2) Effect of Inadequacy of Price

In a sale with *pacto de retro*, the inadequacy of the price cannot be considered a ground for rescinding the contract. Indeed, the practice is to fix a relatively reduced price (but not a grossly inadequate one) in order to afford the vendor *a retro* every facility to redeem the land, unlike in an absolute sale where the vendor, in permanently giving away his property, tries to get, as compensation, its real value. (*Juan Claridad v. Isabel Novella*, L-12666, May 22, 1965 and *Vda. de Lacson, et al. v. Granada, et al.*, L-12035, Mar. 29, 1961).

Art. 1602. The contract shall be presumed to be an equitable mortgage, in any of the following cases:

(1) When the price of a sale with right to repurchase is usually inadequate;

(2) When the vendor remains in possession as lessee or otherwise;

(3) When upon or after the expiration of the right to repurchase another instrument extending the period of redemption or granting a new period is executed;

(4) When the purchaser retains for himself a part of the purchase price;

(5) When the vendor binds himself to pay the taxes on the thing sold;

(6) In any other case where it may be fairly inferred that the real intention of the parties is that the transaction shall secure the payment of a debt or the performance of any other obligation.

In any of the foregoing cases, any money, fruits or other benefit to be received by the vendee as rent or otherwise shall be considered as interest which shall be subject to the usury laws.

COMMENT:

(1) When a *Pacto de Retro* Sale Can Be Presumed an Equitable Mortgage

The Article speaks of six (6) cases when the sale *a retro* is presumed to be an equitable mortgage.

(2) Definition of Equitable Mortgage

One which although lacking in some formality, form or words, or other requisites demanded by a statute nevertheless reveals the intention of the parties to charge a real property as security for a debt, and contains nothing impossible or contrary to law. (*41 Corpus Juris 303*).

[**NOTE:** Before the new Civil Code, was the equitable mortgage recognized in this country?

ANS.: Yes, despite the fact that ours is a civil law ours is a Civil law country. (*Montanez v. Sheriff*, 18 Phil. 119 and *Macapinlac v. Gutierrez Repide*, 43 Phil. 770).].

(3) Effect of Stipulation Providing for a Renewal of the Pacto de Retro

In a contract of sale *con pacto de retro* it was agreed that after the period fixed for the repurchase, the buyer does not become the owner but a new *pacto de retro* document shall be issued. This, according to the Supreme Court, may be good reason to hold that the transaction is a mere mortgage. (*Teodosio v. Sabala, et al.*, L-11522, Jan. 31, 1958).

(4) Effect of Stipulation Allowing Buyer to Have the Usufruct in the Meantime

The fact that the buyer *a retro* has been given the right to enjoy the usufruct of the land during the period of redemption, far from being a factor favoring an equitable mortgage, is an argument in favor of a sale with *pacto de retro*, for usufruct is an element of ownership which is involved in a contract of sale. (*Claridad v. Novella*, L-12666, May 22, 1959).

**Angel Villarica, et al. v. Court of Appeals, et al.
L-19196, Nov. 29, 1968**

FACTS: The spouses Villarica in a public instrument of *absolute* sale sold to the spouses Consunji on May 19, 1951, a parcel of land located in Davao City for P35,000 (sufficiently adequate). On May 25, 1951, the buyers executed another public instrument granting the sellers an option to buy the same property within the period of one year. In Feb. 1953, the buyers Consunji sold the property to Jovito S. Francisco for P47,000. On Apr. 14, 1953, the spouses Villarica sued the spouses Consunji and Jovito S. Francisco for the reformation of the instrument of absolute sale into an equitable mortgage as a security for a certain loan. The spouses Villarica alleged, *inter alia*, that since the option to buy was extended for a month, Art. 1602 (No. 3) of the Civil Code, referring to a sale *a retro* (sale with the right to repurchase) should be applied

and, therefore, there is a presumption that an equitable mortgage was the true agreement arrived at. *Issue*: Should the deed of absolute sale be reformed?

HELD: No, the deed of absolute sale should not be reformed. It is true that in a sale *a retro*, an extension of the period within which to redeem gives rise to the presumption that an equitable mortgage was really intended. BUT in the instant case, there was *no sale a retro*; there was instead an option to buy. Notice that the deed of absolute sale was executed on *May 19, 1951*; the “option to buy” was executed on *May 25, 1951*. Now then, the right of repurchase is *not* a right granted the seller by the buyer in a *subsequent instrument*, but is a right reserved by the vendor in the SAME instrument of sale as one of the stipulations in the contract. Once the instrument of absolute sale is executed, the seller can *no longer* reserve the right to repurchase; and any right thereafter granted the seller by the buyer in a separate instrument cannot be a right of repurchase but some other rights like the option to buy in the instant case.

Gist of the Important Principle Involved —

If a seller has been granted merely an option to buy (and not a right to repurchase) within a certain period, and the price paid by the buyer was adequate — the sale is *absolute*, and *cannot* be construed and *presumed* as an equitable mortgage, even if the period within which to exercise the option is extended.

Magtira v. Court of Appeals
L-27547, Mar. 31, 1980

On Feb. 8, 1926, Isidoro and Zacarias executed a document denominated *mortgage* but with a statement that “*inilipat ipinagbili nang biling mabibiling muli*” (sale with the right to redeem). Several extensions were asked by Zacarias (up to Apr. 30, 1935 was the extension asked for). On Aug. 23, 1945 or more than 10 years after the extended period, Zacarias filed with the Register of Deeds an Affidavit for Consolidation of Ownership. All throughout, he paid the realty taxes and was in possession of the premises. On Jun. 18, 1956, Isidoro’s daughter

sued to cancel the “mortgage” and recover the ownership of the land.

HELD: No recovery. The contract was a *pacto de retro* transaction as evidenced by the Tagalog words cited in the contract. Besides, laches and prescription work against the claim.

**De Bayquen v. Baloro
GR 28161, Aug. 13, 1986**

A contract was held to be one of *pacto de retro* and not one of equitable mortgage, because not one of the instances enumerated in Art. 1602 regarding the presumption that the contract is one of equitable mortgage exists. Thus: The deed of conveyance says the purchase price is P2,000, which price is adequate, based on the size, productivity and accessibility of the land. The vendee admittedly took possession of the land; no extension of redemption period was made, the vendee did not retain any part of the purchase price; the vendee declared the property in his name and paid the land taxes; and there is no circumstance to show that the transaction was intended to secure a loan.

Art. 1603. In case of doubt, a contract purporting to be a sale with right to repurchase shall be construed as an equitable mortgage.

COMMENT:

Effect of Doubt

If there is doubt, an equitable mortgage is presumed.

Art. 1604. The provisions of Article 1602 shall also apply to a contract purporting to be an absolute sale.

COMMENT:

The Article explains itself.

Art. 1605. In the cases referred to in Articles 1602 and 1604, the apparent vendor may ask for the reformation of the instrument.

COMMENT:

Remedy of Reformation

To correct the instrument so as to make it express the true intent of the parties, reformation may be availed of.

**Raymundo Tolentino & Lorenzo Roño,
substituted by the Heirs, represented
by Emmanuela Roño, as Attorney-in-
Fact v. CA, etc.
GR 128759, Aug. 1, 2002**

FACTS: Spouses Pedro and Josefina de Guzman were the registered owners of a parcel of land covered by Transfer Certificate of Title (TCT) 20248 T-105 of the Register of Deed of Quezon City. They obtained a loan from the Rehabilitation Finance Corp. (RFC), now Development Bank of the Philippines (DBP), and executed a mortgage as security therefor; they failed to pay the obligation, hence the mortgage was foreclosed.

Before the redemption period expired, the De Guzman spouses obtained another loan for P18,000, this time from petitioners Raymundo Tolentino and Lorenza Roño, to redeem the property. The parties agreed that repayment would be for a period of 10 years at P150 a month commencing on Feb. 1963. On Dec. 14, 1962, the loan with RFC was paid and the mortgage was cancelled. Tolentino and Roño, on representation that they needed a security for the loan, requested the De Guzman spouses to sign a Deed of Promise to Sell. On Feb. 1, 1963, they again asked respondent spouses to sign another document, a Deed of Absolute Sale, on representation that they wanted the latter's children to answer for the loan in the event of their parent's untimely death. Armed with the Deed of Absolute Sale, petitioner's secured the cancellation of TCT 20248T-105 and TCT 69164 was issued in their name instead.

On Jun. 9, 1971, Pedro de Guzman died. His widow and their children tried to settle the remaining balance of the loan. Tolentino and Roño, feigning inability to remember the actual arrangements, agreed to reconvey the property on condition that respondent pay the actual market value obtaining in 1971. Upon verification with the Q.C. Registry of Deeds, the De Guzmans found that the title was already in the names of Tolentino and Roño. Consequently, the de Guzmans filed a complaint for declaration of sale as equitable mortgage and reconveyance of property with damages, at the Pasig City RTC.

On Mar. 21, 1988, the court decided in favor of the de Guzmans. Petitioners appealed to the Court of Appeals (CA), which sustained the trial court's decision. Petitioners' motion for reconsideration was denied. Hence, this instant petition.

ISSUES: Whether or not the CA erred in: (1) applying Art. 1602; and (2) not holding that the action for declaration of nullity of the deed of Absolute Sale is not the proper remedy or cause of action.

HELD: On the *first assigned error*, nothing in Art. 1602 indicates that the provision applies only in the absence of an express agreement between the parties. Said proviso is applicable in several cases despite the presence of an express agreement between the parties. The contract of sale with right to repurchase was in reality intended to secure the payment of a loan. (*Lapat v. Rosario*, 312 SCRA 539 [1999]). In ruling in favor of respondent and holding that in applying Art. 1602 the transaction was an equitable mortgage, the real intention of respondent in signing the document was to provide security for the loan and not to transfer ownership over the property. (*Misena v. Rongavilla*, 303 SCRA 749 [1999]).

Anent the *second assigned error*, it must be borne in mind that it is not obligatory for the aggrieved party, under Art. 1605 to file an action for reformation of instruments; he can avail of another action that he thinks is most appropriate and effective under the circumstances.

Art. 1606. The right referred to in Article 1601, in the absence of an express agreement, shall last four years from the date of the contract.

Should there be an agreement, the period cannot exceed ten years.

However, the vendor may still exercise the right to repurchase within thirty days from the time final judgment was rendered in a civil action on the basis that the contract was a true sale with right to repurchase.

COMMENT:

(1) Time Within Which to Redeem

- (a) *Meaning of express agreement:* This refers to the *time*. (*Bandong v. Austria*, 31 Phil. 479). It cannot refer to the right to redeem because this right must be agreed upon. (*Art. 1601*).
- (b) Rules:
 - 1) No time agreed upon — 4 years from date of contract.
 - 2) Time agreed upon — period cannot exceed 10 years.

(2) Reason for Limiting the Period of Redemption

The law does not favor suspended ownership. (*Yadao v. Yadao*, 20 Phil. 260). Please note, however, that if the four-year period (in case no period was fixed) has *not yet* expired, the seller cannot be considered delinquent. It would in such a case be error to vest title of the property *outright* to the buyer. (*See Pascua v. Perez, et al.*, L-19564, Jan. 31, 1964).

(3) Some Cases as to the Period Contemplated

- (a) “At anytime they have the money”: Here, there is agreement as to the time, although it is indefinite. Right should be exercised within 10 years. (*Soriano v. Abalos*, 47 O.G. 168).
- (b) “When he has the means”: Here, there is also agreement as to time, though indefinite. Within 10 years. (*Alojado v. Lim Siongco*, 51 Phil. 339).
- (c) “In Mar. of *any year*”: Here also is an agreement as to time, though indefinite. Within 10 years. (*Bandong v. Austria*, 31 Phil. 479).

- (d) “Not before 5 years nor after 8 years”: This stipulation is all right because the right to repurchase may be suspended. BUT “right cannot be exercised till after 10 years.” This stipulation cannot be given effect since this would destroy the right. But still the right in this case may be exercised within 10 years. (*Santos v. Heirs of Crisostomo*, 41 Phil. 342).
- (e) “Right can’t be exercised within 3 years from the date of the contract”: Here there is no time agreement, so only 4 years — 4 years from the time it could be exercised. This is all right because the total period is only 7 years. Right can be exercised after the 3rd year but before the expiration of the 7th year.

But if for example the contract says, “right cannot be exercised within 8 years,” the right can be exercised only within the next 2 years: after the 8th year but before the 10th year. *Reason*: To give 4 years after 8 years would be to have a total of 12 years. The excess 2 years would therefore, be invalid. (*Rosales v. Reyes*, 25 Phil. 496).

When it is stipulated in a contract of sale of real property that the vendor shall be entitled to repurchase it when he has established a certain business, such a stipulation does not express a period, but the suspension of the right of repurchase until the establishment of the business; and therefore, the period for the repurchase is that of four years fixed by law for cases wherein the parties have not fixed it, said period to be counted from the date of the contract. (*Medel v. Francisco*, 51 Phil. 367).

[**NOTE**: This appears to be inconsistent with the ruling set forth in (e).]

(4) Extension of the Period Within Which to Redeem

Can the period of redemption be extended after the original period has expired?

ANS.: In one case it was held that this is all right as long as the total period should not exceed 10 years from the time of the making of the contract, because there is nothing in the law to prohibit this. (*Umale v. Fernandez*, 28 Phil. 891).

In a subsequent case it was held that the right to redeem later must exist at the time of the sale, and not afterwards. Otherwise, this would merely be a promise to sell on the part of the purchaser. (*Ramos v. Icasiano*, 51 Phil. 343).

(5) Effect of Excess Period

The period in excess of 10 years is void (*Montiero v. Salgado*, 27 Phil. 631), but nullity of the stipulation to repurchase on account of the period fixed for its exercise exceeding that permitted by the law, certainly does not affect or vitiate the validity of the sale. *Reason*: Said stipulation is merely accidental to the sale, and may or may not be adopted at will by the parties. (*Alejado v. Lim Siongco*, 51 Phil. 339). Please note that if the period given is beyond 10 years, the right to redeem still exists during the first 10 years. It would be error to hold that the sale is an absolute one; it still is a sale, with the right of redemption. It is only the period that is considered modified. (*Dalandan v. Julio*, L-19101, Feb. 29, 1964). If there is an action pending in the court regarding the validity of a sale with *pacto de retro*, the action having been brought in good faith, this pendency tolls the term for the right of redemption. (*Ong Chua v. Carr*, 53 Phil. 975).

(6) Effect of the Last War on Period of Redemption

Did the last war suspend the period of redemption?

ANS.: No. The fundamental reason underlying statutes providing for suspension or extension of the period of limitation is the legal or physical impossibility for the interested party to enforce or exercise in time his right of action. *Ad impossibilia memo tenetur*. In this case, he could have consigned the repurchase money in court, if he could not contact the buyer *a retro*. (*Riviero v. Riviero*, L-578, prom. Apr. 30, 1948).

(7) Is Consignation Necessary?

If a seller *a retro* wants to repurchase the property, he should *tender* the proper amount. Now then, aside from tender, is *consignation* essential?

ANS.:

- (a) In the case of *Villegas v. Capistrano*, 9 Phil. 416, the Supreme Court held that the right to repurchase is NOT A DEBT (because the seller *a retro* may or may not, at his own option, repurchase). Therefore, no consignation is necessary. It must be borne in mind that Art. 1526 referring to consignation applies only to DEBTS.
- (b) The above ruling was reiterated in *Rosales v. Reyes*, 26 Phil. 495.
- (c) It is true that in a later case, *Riviero v. Riviero*, 45 O.G. (Sup. No. 9), p. 422, L-578, prom. Apr. 30, 1948, the Supreme Court required consignation “because a vendor who decides to redeem or repurchase a property sold *with pacto de retro* stands as the debtor and the vendee as the creditor of the repurchase price. And the plaintiff-appellant could and should have exercised his right to redemption against the defendant-appellee, if the latter was *absent*, by filing a suit against him and making a consignation with the court of the amount due for the redemption.” (It will be noticed, however, that in this case, the buyer *a retro* was ABSENT).
- (d) Finally, in the case of *Felisa Paez, et al. v. Francisco Magno*, L-793, prom. Apr. 27, 1949, the Supreme Court reiterated the doctrine held in the *Villegas* and *Rosales* cases, but stated a doctrine, that although tender is enough if made on time, this tender *a retro* is made to compel to resell. In other words, aside from tender, the seller *a retro* should, of course, pay the redemption price. This is but natural. *Said the Court*: “True that consignation of the redemption price is NOT NECESSARY in order that the vendor may compel vendee to allow the repurchase within the time provided by law or by contract. In such cases, a mere tender is *enough*, if made in time, as a BASIS for action against the vendee to compel him to resell. But that tender does not in itself relieve the vendor from his obligation to pay the price when redemption is allowed by the court. Tender of payment is sufficient to compel redemption but is not in itself a payment that relieves the vendor from his liability to pay the redemption price.”

[**NOTE:** In resume we may say: consignment is *not necessary to preserve the right to redeem*; but is *essential* to ACTUALLY redeem.]

(8) Right to Redeem Even After Final Judgment

The last paragraph of Art. 1606 says: “However, the vendor may still exercise the right to repurchase within thirty days from the time final judgment was rendered in a civil action on the basis that the contract was a true sale with right to repurchase.”

(a) Meaning of the provision

The provision has been construed to mean that after the courts have decided by a final or executory judgment that the contract is a *pacto de retro* and not a mortgage, the vendor (whose claim as mortgagor has definitely been rejected) may still have the privilege of repurchasing within 30 days.” (*Perez v. Zulueta*, L-10374, Sept. 30, 1959). The seller must exercise the right within the 30-day period. It is not sufficient to manifest the desire to repurchase. There must be an actual and simultaneous tender of payment, unless of course, there is a definite refusal to permit repurchase. The 30-day period must of course be counted from the time of finality of judgment. (*Pascual, et al. v. Basilia Crisostomo*, L-11261, Jun. 30, 1960).

(b) To what cases does said last paragraph refer?

ANS.: The Supreme Court has held that said paragraph refers to cases involving a transaction where one of the parties contests or denies that the true agreement is one of sale with right of repurchase; *not* to cases where the transaction is conclusively a *pacto de retro* sale but the period to redeem has expired. In other words, it applies to instances where the buyer *a retro* honestly believed that he had entered merely into an equitable mortgage (*Leonardo v. CA*, 220 SCRA 254 [1993]), not a *pacto de retro* transaction, and because of such belief, he had *not* redeemed within the proper period. Thus, in *Adorable, et al. v. Inacala, et al.* (L-10183, Apr. 18,

1968), the respondent Inacala in 1941 executed a deed of sale of a parcel of land, whereupon the buyer executed a private instrument granting Inacala the option to repurchase the lot for the same consideration within one year from the date to another who in turn sold it to the petitioners. Since the sale in 1941, Inacala, the original seller *a retro* remained in possession of the lot.

ISSUE: Can Inacala still redeem the property?

HELD: No more, for this was a clear *pacto de retro* transaction. The last paragraph of Art. 1606 does *not* apply.

(NOTE: The ruling in the *Adorable* case was reiterated in *Fernandez v. Fernandez*, L-15178, Oct. 31, 1960, where the Court said that Art. 1606 contemplates a case involving a controversy as to the true nature of the contract, and the court is called upon to decide the debatable question as to whether it is sale with *pacto de retro* or an equitable mortgage. Where the transaction is admittedly and clearly a deed of sale and the stipulated period of redemption had expired, said legal provision does *not* apply.)

**Pedro Tapas and Maria Oriña
de Tapas v. Court of Appeals, et al.
L-22202, Feb. 27, 1976**

FACTS: A contract purporting to be an absolute sale was questioned by the vendor, alleging that the same was actually merely an equitable mortgage. The court, however, rule the agreement to be actually an *absolute sale*. The vendor now seeks to repurchase the property within 30 days from the time the judgment becomes final. Is he allowed to do so?

HELD: No, the vendor is not allowed to do so because here, the sale was adjudged to be an absolute one, not a sale *with pacto de retro*. Hence, the 3rd paragraph of Art. 1606 (which speaks of the 30-day period) cannot apply.

**Ronaldo P. Abilla & Geralda A. Dizon v.
Carlos Ang Gobonseng, Jr. & Theresita
Mimie Ong
GR 146651, Aug. 6, 2002**

ISSUE: Does the applicability of Art. 1606 rest on the *bona fide* intent of the vendor *a retro*?

HELD: Yes, if he is of the honest belief that the transaction is an equitable mortgage, said article applies and he can still repurchase the property within 30 days from finality of the judgment declaring the transactions as a sale with *pacto de retro*. Parenthetically, it matters not what the vendee intended the transactions to be.

- (c) Does said last paragraph have a *retroactive* effect?

ANS.: No. In one case, the period to redeem ended *Mar. 3, 1940*. But final judgment was only on *Jul. 30, 1954*. The right to redeem within 30 days cannot be availed of, for the vendee *a retro* had irrevocably acquired absolute ownership in 1940. (*De la Cruz v. Muyot*, 102 *Phil. 318, 320*). Indeed, where the right to repurchase had expired before the effectivity of the new Civil Code, the last paragraph of Art. 1606 cannot be applied as it would be an impairment of a right that had already vested and consolidated in the vendee. His rights can no longer be impaired by allowing the vendors to sue for the exercise of the right of redemption given by the new Civil Code. (*Fernandez v. Fernandez*, L-15178, *Oct. 31, 1960*).

**Ronaldo P. Abilla & Geralda A. Dizon v.
Carlos Ang Gobonseng, Jr. & Theresita Mimie Ong
GR 146651, Jan. 17, 2002**

FACTS: Petitioner-spouses instituted against respondent an action for specific performance, recovery of sum of money, and damages — seeking reimbursement of expenses they incurred in connection with the preparation and registration of two public instruments, namely: a “Deed of Sale” and an “Option to Buy.” In their answer, respondents raised the defense that the transaction covered by the “Deed of Sale” and “Option

to Buy,” which appears to be a Deed of Sale with Right to Repurchase, was in truth, in fact, in law, and in legal construction, a mortgage.

On Oct. 29, 1990, the trial court ruled in favor of petitioners and declared that the transaction between the parties was not an equitable mortgage, ratiocinating that neither was the said transaction embodied in the “Deed of Sale” and “Option to Buy” a *pacto de retro* sale, but a sale giving respondents until Aug. 31, 1983 within which to buy back the 17 lots subject of the controversy. On appeal by respondents, the Court of Appeals (CA) ruled that the transaction between the parties was a *pacto de retro* sale, and not an equitable mortgage. On Nov. 10, 1997, the CA denied the motion for reconsideration (MR) of the foregoing decision.

Respondents filed a petition for review with the Supreme Court which was docketed as GR 131358. The same, however, was dismissed on Feb. 11, 1998, for having been filed out of time. The MR thereof was denied with finality on Jun. 17, 1998. Undaunted, respondents filed a second MR, claiming that since the transaction subject of the controversy was declared a *pacto de retro* sale by the CA, they can, therefore, repurchase the property pursuant to the third par. of Art. 1606. The issue of applicability of Art. 1606 was raised by respondents only in their motion for clarification with the CA and not before the trial court and on appeal to the CA. Thus, respondent’s second MR was denied, said denial becoming final and executory on Feb. 8, 1999. On Feb. 23, 1999, respondents filed with the trial court in Civil Case 8148 an urgent motion to repurchase the lots in question with tender of payment. The motion was, however, denied on Nov. 10, 1999 on Jan. 14, 2001, Br. 14 of RTC Dumaguete City, to which the case was reraffled, set aside the Nov. 10, 1999 order and granted respondents’ motion to repurchase. Henceforth, this instant recourse.

ISSUE: May the vendors in a sale judicially declared as a *pacto de retro* exercise the right of repurchase under Art. 1606 (3rd par.) after they have taken the position that the same was an equitable mortgage?

HELD: Both the trial court and the CA were of the view that the subject transaction was truly a *pacto de retro* sale, and that none of the circumstances under Art. 1602 exists to warrant a conclusion that the transaction subject of the “Deed of Sale” and “Option to Buy” was an equitable mortgage. The CA correctly noted that if respondents really believed that the transaction was indeed an equitable mortgage, as a sign of good faith, they should have, at the very least, consigned with the trial court the amount of P896,000, representing their alleged loan, on or before the expiration of the right to repurchase on Aug. 21, 1983.

Clearly, the declaration of the transaction as a *pacto de retro* sale will not, under the circumstances, entitle respondents to the right of repurchase set forth under the 3rd par. of Art. 1606. “The application of the 3rd par. of Art. 1606 is predicated upon the *bona fides* of the vendor *a retro*. It must appear that there was a belief on his part, founded on facts attendant upon the execution of the sale with *pacto de retro*, honestly and sincerely entertained, that the agreements was in reality a mortgage, one not intended to affect the title to the property ostensibly sold, but merely to give it as security for a loan or other obligation. In that event, if the matter of the real nature of the contract is submitted for judicial resolution, the application of the rule is proper, that the vendor *a retro* be allowed to repurchase the property sold within 30 days from rendition of final judgment declaring the contract to be a true sale with right to repurchase.” (*Vda. de Macoy v. CA*, 206 SCRA 244 [1992]).

Conversely, “if it should appear that the parties’ agreement was really one of sale — transferring ownership to the vendee, but accompanied by a reservation to the vendor of the right to repurchase the property — and there are no circumstances that may reasonably be accepted as generating some honest doubt as to the parties’ intention, the *proviso* is inapplicable. The reason is quite obvious. If the rule were otherwise, it would be within the power of every vendor *a retro* to set at naught a *pacto de retro*, as resurrect an expired right of repurchase, by simply instituting an action to reform

the contract — known to him to be in truth a sale with *pacto de retro* — into an equitable mortgage. To allow the repurchase by applying the 3rd par. of Art. 1606 would transform the rule into a tool to spawn, protect and even reward fraud and bad faith, a situation surely never contemplated or intended by the law.” (*Ibid.*)

Already, the Supreme Court has had occasion to rule on the proper interpretation of the provision in question. Thus, where the proofs established that there could be no honest doubt as to the parties’ intention, that the transaction was clearly and definitely a sale with *pacto de retro*, the Court adjudged the vendor *a retro* not to be entitled to the benefit of the 3rd par. of Art. 1606. (*Felicen, Sr. v. Orias, 156 SCRA 586 [1987]*).

The instant petition is granted and the Jan. 14, 2001 Order of RTC Dumaguete City, Br. 41, in Civil Case 8148, is reversed and set aside.

Art. 1607. In case of real property, the consolidation of ownership in the vendee by virtue of the failure of the vendor to comply with the provisions of Article 1616 shall not be recorded in the Registry of Property without a judicial order, after the vendor has been duly heard.

COMMENT:

(1) Reason for the Judicial Order Before Registration of the Consolidation of Ownership

After all, the “sale” may really be an equitable mortgage, so the vendor must be heard. The law seeks to prevent usurious transactions. (*Tacodoro v. Arcenas, L-15312, Nov. 29, 1960*).

(2) Requisite for Registration of Consolidation of Ownership

**Francisco Crisologo, et al. v. Isaac
Centeno, et al.
L-20014, Nov. 27, 1968**

FACTS: The spouses Centeno sold *a retro* to the spouses Crisologo two parcels of land in Ilocos Sur. Within the pe-

riod stipulated for redemption, the sellers *failed* to redeem. To register in the Registry of Property their consolidation of ownership, the buyer *a retro* filed a petition for consolidation, but did NOT name the sellers as respondents. Consequently, the sellers were not duly summoned and heard. Has the court acquired jurisdiction?

HELD: No, the court did not acquire jurisdiction for there was, under the premises, no jurisdiction over the persons of the sellers. A proceeding like this is a contentious one; the sellers should have been named respondents, should have been summoned, and should have been heard.

(3) Query: Is There a Necessity of a Judicial Order for the Consolidation Itself?

ANS.: No, because the ownership is consolidated by the *mere operation of the law* upon failure of the seller to fulfill what is prescribed for redemption, the vendee shall irrevocably acquire the ownership of the thing sold, and the vendor loses his rights over the property by the same token. The requirement in Art. 1607 for a judicial order is merely for purposes of REGISTERING the consolidation of title. (*Rosario v. Rosario*, L-13018, Dec. 29, 1960; see also *Dalandan v. Julio*, L-19101, Feb. 29, 1964). The decision is obviously correct. For instance, in a sale *a retro of personal property*, there is no question that no registration is ever required. On the other hand, whenever for the registration, a judicial order is needed, the proper procedure for obtaining such an order is to file an *ordinary civil action* cognizable by the CFI (now RTC), and NOT merely to make a *motion*, which is incidental to another action or special proceeding. The ordinary civil action should be governed by the rules established for *summons* found in Rule 14 of the Revised Rules of Court. Consequently, the *vendor a retro must* be made a party defendant, summons must be served upon him, and he must be given a period of 15 days from such service within which to answer or move to dismiss the petition. This is clearly inferable from the codal provision that the judicial order shall not issue unless “after the vendor has been duly heard.” (*Tacodoro v. Arcenas*, L-15312, Nov. 29, 1960). The consolidation by judicial order is not applicable if

the *sale* was executed BEFORE the effective date of the new Civil Code, for by virtue of the sale, ownership is transferred at time of delivery, subject only to the resolutory condition of the repurchase. Under Art. 2255 of the new Civil Code, the *old* law regulates acts and contracts with a condition or period even though said condition or period may still be pending on Aug. 30, 1950. (*Manalansan v. Manalansan*, L-13646, Jul. 26, 1960).

(4) Effect of Failure to Comply With a Certain Condition

If the parties agree that the redemption price would be fixed after an accounting to be made by the buyer *a retro*, then failure of such buyer to render said accounting should excuse the Seller *a retro* from effecting the repurchase within the time stipulated. Equity demands that the seller *a retro* be given an additional time within which to repurchase after a correct accounting has been made either by the buyer *a retro* or by the court. (*Basco v. Puzon*, 69 Phil. 706).

(5) Case

De Bayquen v. Baloro GR 28161, Aug. 13, 1986

If the contract between the parties is a deed of sale with right to repurchase, once the seller *a retro* fails to redeem within the stipulated period, ownership thereof becomes vested or consolidated by operation of law on the buyer. There is no need for a hearing. The judicial hearing contemplated by Art. 1607 of the Civil Code refers not to the consolidation itself but to the registration of the consolidation.

Art. 1608. The vendor may bring his action against every possessor whose right is derived from the vendee, even if in the second contract no mention should have been made of the right to repurchase, without prejudice to the provisions of the Mortgage Law and the Land Registration Law with respect to third persons.

COMMENT:**Right of Sellers *a retro* to Redeem Property from Persons Other than the Buyer *a retro*****(a) Example:**

S sold *B* with right to repurchase. *B* sold the thing to *T*. In the second contract, no mention was made of the right of repurchase. Can *S* proceed against *T*?

ANS.: Yes, without prejudice to the provisions of the Mortgage Law and the Land Registration Law with respects to third persons.

- (b) This right of the seller to exercise the right to repurchase is a real right. (*Montera v. Martinez*, 14 Phil. 541). In said case, the court held that “if the right to enforce the redemption is valid as against third persons, it is unquestionable that the right of conventional redemption from which the former arises is of a real and not mere personal character.”
- (c) If in letter (a), *T* had bought the thing from *B* knowing of the right held by *S* to repurchase the property, *T* cannot claim the rights of an innocent third person. (*Lucido v. Calupitan*, 27 Phil. 148).

Art. 1609. The vendee is subrogated to the vendor's rights and actions.**COMMENT:****(1) Subrogation of Buyer in the Seller's Rights and Action**

- (a) A sale with the right to repurchase transfers to the buyer all the elements of ownership subject to a resolatory condition. (*De Asis v. Manila Trading & Supply Co.*, 66 Phil. 213). This is true even if in the case of real property, consolidation cannot be registered without a judicial hearing. (*See Defensor v. Blanco, et al.*, L-77812, May 20, 1964).
- (b) But of course a seller can only transfer what he has, or if the seller was not really the owner but only a usufructuary, the buyer only acquires this usufructuary right.

(2) Examples of Rights of Vendor Transferred to the Vendee

- (a) Right to mortgage the property (provided seller is really the owner);
- (b) Right to continue prescription;
- (c) Right to receive fruits. Thus, the seller in making the repurchase, has no right to require the buyer to make an accounting of the products received from the land. (*Lustado v. Penol, et al.*, L-10825, Sept. 27, 1957).

(3) Effect of Registration

Proper registration of the contract of sale with *pacto de retro* is notice to all those dealing with the property of the character of the agreement entered into and duly recorded. (see *Asis v. Manila Trading & Supply Co.*, 66 Phil. 213).

(4) Limitations

Although this Article seems to give broad rights, it is subject to Arts. 1601 and 1618.

Art. 1610. The creditors of the vendor cannot make use of the right of redemption against the vendee, until after they have exhausted the property of the vendor.

COMMENT:**(1) When Seller's Creditor Can Use Seller's Right of Redemption**

- (a) *Example:*

S sold to *B* with *pacto de retro*. *S* has unpaid creditors. Can the creditors exercise *S*'s right of redemption?

ANS.: Yes, but only if *S*'s properties have first been exhausted.

- (b) The buyer *a retro* as a rule therefore possesses a better right to the property than the creditors of the seller.

- (c) This Article is a practical example of Art. 1177 which allows creditors to exercise rights of debtor after proceeding against the properties of the debtor.

(2) Reason Why There Should First Be an Exhaustion

It would be detrimental to the stability of property if we were to countenance an excessive use of the resolutive action.

[**NOTE:** Is this Article applicable to all creditors? In other words, should there ALWAYS be a prior exhaustion?

ANS.: No. For example, some preferred creditors, like prior mortgagees and creditors in antichresis of the property sold, need not exhaust first.]

(3) Creditors May of Course Exercise Other Rights

It is true that Art. 1610 grants creditors the right (after exhaustion) to exercise the right of redemption. BUT does this mean that creditors cannot exercise other rights, for example, the right to rescind contracts made in fraud of them?

ANS.: Creditors can, of course, exercise other rights, like rescission if the contracts were really made in fraud of them. (*Manresa*).

(4) Effect of Creditor's Exercise of Right of Redemption

[**NOTE:** Suppose the seller *a retro* agrees to *give* to the creditors the property repurchased, will this be allowed?

ANS.: Yes. This would merely be a case of *dacion en pago* (dation in payment). (*Manresa*).]

Note that the creditors do not acquire ownership over the property they repurchased from the buyer *a retro*. They do acquire, however, the right to *satisfy their credits* out of the proceeds. (*Manresa*).

Art. 1611. In a sale with a right to repurchase, the vendee of a part of an undivided immovable who acquires the whole thereof in the case of Article 498, may compel the vendor to redeem the whole property, if the latter wishes to make use of the right of redemption.

COMMENT:**(1) When Seller May Be Required to Redeem the Whole Property Although He Had Sold Only Part Thereof**

Example:

A and S are co-owners of a house. S sold his share to B with the right to repurchase. Later, there was partition, but since the house is essentially indivisible, and since A and S could not agree as to who should get it, the house was sold to B and the proceeds divided between A and S. It is clear that B has acquired the whole house subject only to S's right to repurchase. If S wants to make use of his right to redemption, can B compel him to redeem the WHOLE house?

ANS.: Yes.

(2) Reason for the Law

If the law were otherwise, then in the example given, should S be allowed to repurchase only half of the property, there would again be co-ownership. It should be remembered that co-ownership is NOT looked upon favorably by the law.

Art. 1612. If several persons, jointly and in the same contract, should sell an undivided immovable with a right of repurchase, none of them may exercise this right for more than his respective share.

The same rule shall apply if the person who sold an immovable alone has left several heirs, in which case each of the latter may only redeem the part which he may have acquired.

COMMENT:

Rule When Property Owned in Common is Sold by the Co-Owners Jointly and in the Same Contract

Example:

A, B, and C jointly and in the same contract sold an undivided piece of land with the right to repurchase. The

buyer *a retro* was *X*. Prior to the expiration of the period of redemption, *A* wanted to repurchase the whole land. *X* refused, alleging that *A* was entitled merely to repurchase *A*'s share. Is *X* correct?

ANS.: Yes, by express provisions of the law. None of the co-owners in this case is allowed to exercise the right to redeem for more than his respective share. (*Bar Exam. Question*). (*See Samonte v. Fernando, et al., [C.A.] 51 O.G. 6203.*)

Art. 1613. In the case of the preceding article, the vendee may demand of all the vendors or co-heirs that they come to an agreement upon the repurchase of the whole thing sold; and should they fail to do so, the vendee cannot be compelled to consent to a partial redemption.

COMMENT:

(1) When Buyer Cannot Be Compelled to Consent to a Partial Redemption

Example:

In the case given in Art. 1612, *X* has even the right to refuse to let *A* redeem *A*'s share under the conditions set in Art. 1613. In other words, *X* may ask that *A*, *B*, and *C* agree to redeem the whole thing. If they fail to do so, *X* cannot be compelled to consent to a partial redemption.

(2) Reason for the Law

The law is against co-ownership. (*10 Manresa 322*). (*NOTE:* The buyer, however, if he wants to, may allow a partial redemption, for the option is his.). (*Lagonera v. Macalalag, [C.A.] 49 O.G. 569*).

Art. 1614. Each one of the co-owners of an undivided immovable who may have sold his share separately, may independently exercise the right of repurchase as regards his own share, and the vendee cannot compel him to redeem the whole property.

COMMENT:**(1) When Co-Owners Sell Their Shares Separately**

Notice that in this Article, the selling was made *SEPARATELY*, whereas in Art. 1612 it was made “JOINTLY AND IN THE SAME CONTRACT.”

(2) Example

A, B, and C are the co-owners of an undivided house. A sold with right to repurchase his share to X. Later, X acquires B's and C's rights. Now A wants to redeem his share. X refuses and asks A to redeem the whole property. *Question:* Is A allowed to redeem only his share?

ANS.: Yes, since in this case, the selling had been made separately. (*See 10 Manresa 332*).

Art. 1615. If the vendee should leave several heirs, the action for redemption cannot be brought against each of them except for his own share, whether the thing be undivided, or it has been partitioned among them.

But if the inheritance has been divided, and the thing sold has been awarded to one of the heirs, the action for redemption may be instituted against him for the whole.

COMMENT:**Rule if Buyer Dies, Leaving Several Heirs**

Example:

A sold a piece of land to B with *pacto de retro*. B dies leaving C, D, and E as heirs. A brought an action for redemption against C. Can C be compelled to resell the whole property?

ANS.: As a rule, C can be compelled to sell his share only whether the land be still undivided or already partitioned among C, D, and E. But if the inheritance has already been divided, and the land sold has been awarded to C, then A can institute the action for redemption against C for the whole land.

Art. 1616. The vendor cannot avail himself of the right of repurchase without returning to the vendee the price of the sale, and in addition:

(1) The expenses of the contract, and any other legitimate payments made by reason of the sale;

(2) The necessary and useful expenses made on the thing sold.

COMMENT:

(1) What Seller Must Give Buyer if Redemption is Made

The seller, if he wants to redeem, must give to the buyer:

- (a) the price;
- (b) expenses of the contract;
- (c) any other legitimate payments made by reason of the sale;
- (d) the necessary expenses made on the thing sold;
- (e) the useful expenses on the thing sold.

[**NOTE:** An offer to redeem stops the running of the period of redemption on the date the offer is made. (*Panganiban v. Mendoza*, {C.A.} 46 O.G. 6116).]

(2) Price to Be Returned Not the Value

Note that the article uses the term “price,” hence, this refers to the price paid to the seller by the buyer, NOT the VALUE of the thing at the time of repurchase. There can of course be a contrary stipulation. (*10 Manresa* 339). The price tendered must be FULL; otherwise, the offer is not effective unless accepted. (*Rumboa v. Arzaga*, 84 Phil. 813; *Cayugan v. Santos*, 34 Phil. 100).

(3) The Expenses of the Contract

It must be remembered that under Art. 1478, “the expenses for the execution and registration of the sale shall be borne by the vendor, unless there is a stipulation to the

contrary.” This is the general rule. If, however, said expenses had been made by the buyer *a retro*, said expenses must be reimbursed.

[**NOTE:** The expenses for the contract of repurchase can be paid directly to the notary public. (*Lafont v. Pascasio*, 6 *Phil.* 391).]

(4) The Necessary and Useful Expenses

These must be reimbursed for the buyer *a retro* is considered in the same category as a possessor in good faith. In the case of *Gargollo v. Duero, et al.*, L-15973, Apr. 29, 1961, the Supreme Court held that the vendor *a retro* is given NO option to require the vendee *a retro* to remove the useful improvements on the land subject of the sale *a retro*, unlike that granted the owner of land under Arts. 546 and 547 of the Civil Code. Under Art. 1616, the vendor *a retro* must pay for the useful improvements introduced by the vendee *a retro*, otherwise the latter may RETAIN possession of the land until reimbursement is made. (*Gargollo v. Duero, et al.*, L-15973, Apr. 29, 1961).

(5) No Reimbursement for Land Taxes

The buyer *a retro* is not entitled to be reimbursed for *land taxes* because these taxes are not considered expenses on the property. (*Cabigao v. Valencia*, 53 *Phil.* 646). This is true despite Art. 2175.

(6) Effect if Buyer Tells Seller That Redemption Would Be Refused

If the buyer *a retro* had previously notified the seller that redemption would be refused, said seller is not obliged to offer payment to redeem. (*Gonzaga v. Go*, 69 *Phil.* 678).

In such a case, tender would be a purposeless act and gesture, as empty as it is futile, and in some cases may even be an unnecessary burden on the prospective repurchaser who may find himself compelled to borrow either partially or wholly, in order to make the tender which he knew after all would be refused. (*Catalan v. Rivera*, [C.A.] 45 O.G. 4538).

(7) Bar

The wife during the marriage sold under *pacto de retro* her paraphernal property consisting of a house and lot. A few weeks later, she died. The husband thereupon repurchased the property with his exclusive capital. *Question:* To whom will the property belong, to the husband or to the heirs of the wife? Reasons.

ANS.: The property will belong to the heirs of the wife, one of whom is the husband himself. Being paraphernal property at the time of its sale under *pacto de retro*, its redemption or repurchase by the husband must be deemed as having revested its ownership in the heirs of the wife, subject to a lien in favor of the husband for the amount paid out with his exclusive capital. The nature of the property repurchased is not determined by the character of the money used for its repurchase, but by the ownership of the right of redemption. (*Art. 148, No. 3, Civil Code; Guinto v. Lin Bonfong, 48 Phil. 884 and Alvarez v. Espiritu, L-18833, Aug. 14, 1965*).

Art. 1617. If at the time of the execution of the sale there should be on the land, visible or growing fruits, there shall be no reimbursement for or prorating of those existing at the time of redemption, if no indemnity was paid by the purchaser when the sale was executed.

Should there have been no fruits at the time of the sale, and some exist at the time of redemption, they shall be prorated between the redemptioner and the vendee, giving the latter the part corresponding to the time he possessed the land in the last year, counted from the anniversary of the date of the sale.

COMMENT:**(1) Rule With Respect to Fruits**

Example:

S sold *B* land with *pacto de retro*. At time of sale, there were growing fruits. *B* did not pay any indemnity for said fruits.

At redemption, is *S* obliged to pay indemnity for fruits growing at said time of redemption?

ANS.: No.

(2) Reason for Prorating in the Second Paragraph

OWNERSHIP during the period concerned. (*See Sabinay v. Garrido, L-6766, May 10, 1964.*)

Art. 1618. The vendor who recovers the thing sold shall receive it free from all charges or mortgages constituted by the vendee, but he shall respect the leases which the latter may have executed in good faith, and in accordance with the custom of the place where the land is situated.

COMMENT:

(1) Property to Be Freed Generally from Charges and Mortgages

The Article states the general sale and the exception.

(2) Query

May the buyer *a retro* mortgage the property?

ANS.: Yes, because he acquires the right of the vendor, BUT when the thing is redeemed, the buyer must free it first from the mortgage.

(3) Lease

This includes leases which are registered and those which are not. Note, however, that they must have been executed in good faith and must be in accord with local customs.

If a buyer *a retro* retains the property although a redemption has been made, he shall be liable for damages such as rentals for the continued use of the property. (*See Cho Cun Choc v. Garcia, 47 Phil. 530.*)

Section 2

LEGAL REDEMPTION

Art. 1619. Legal redemption is the right to be subrogated, upon the same terms and conditions stipulated in the contract, in the place of one who acquires a thing by purchase or dation in payment, or by any other transaction whereby ownership is transmitted by onerous title.

COMMENT:

(1) Legal Redemption

Legal redemption is created by law. Under this Article, it can be exercised against a transferee who gets the property because of:

- (a) purchase, or
- (b) dation in payment, or
- (c) any other transaction whereby ownership is transmitted by *onerous* title. (Thus, not in case of a donation or succession.) (*See 10 Manresa 348-349*).

(2) Examples of Legal Redemption

- (a) Art. 1088: Should any of the heirs sell his hereditary rights to a stranger before the partition, any or all of the co-heirs may be subrogated to the rights of the purchaser by reimbursing him for the price of the sale, provided they do so within the period of one month from the time they were notified in writing of the sale of the vendor.
- (b) Art. 1620: A co-owner of a thing may exercise the right of redemption in case the shares of all the other co-owners or of any of them, are sold to a third person. If the price of the alienation is grossly excessive, the redemptioner shall pay only a reasonable one.

Should two or more co-owners desire to exercise the right of redemption, they may only do so in proportion to the share they may respectively have in the thing owned in common.

- (c) Art. 1621: The owners of adjoining lands shall also have the right of redemption when a piece of rural land, the area of which does not exceed one hectare, is alienated, unless the grantee does not own any rural land.

This right is not applicable to adjacent lands which are separated by brooks, drains, ravines, roads and other apparent servitudes for the benefit of other estates.

If two or more adjoining owners desire to exercise the right of redemption at the same time, the owner of the adjoining land of smaller area shall be preferred and should both lands have the same area, the one who first requested the redemption.

- (d) Art. 1622: Whenever a piece of urban land which is so small and so situated that a major portion thereof cannot be used for any practical purpose within a reasonable time, having been bought merely for speculation, is about to be resold, the owner of any adjoining land has a right of pre-emption at a reasonable price.

If the re-sale has been perfected, the owner of the adjoining land shall have a right of redemption, also at a reasonable price.

When two or more owners of adjoining lands wish to exercise the right of pre-emption or redemption, the owner whose intended use of the land in question appears best justified shall be preferred.

- (e) Art. 1634: When a credit or other incorporeal right in litigation is sold, the debtor shall have a right to extinguish it by reimbursing the assignee for the price the latter paid therefor, the judicial costs incurred by him, and the interest on the price from the day on which the same was paid.

A credit or other incorporeal right shall be considered in litigation from the time the complaint concerning the same is answered.

The debtor may exercise his right within thirty days from the date the assignee demands payment from him.

- (f) If a realty owner is delinquent in his payment of taxes on the real property, and it is sold, he has the right to redeem said property. (*Sec. 376, Revised Administrative Code*).

[NOTE: The one-year period of redemption commences to run not from the date of the auction or tax sale but from the day the sale is *registered* in the office of the Register of Property, so that the delinquent registered owners or third parties interested in the redemption may know that the delinquent property had been sold. (*Techico v. Serrano, L-12693, May 29, 1959*). If one of the heir, of the original owner should avail herself of the redemption, will the redemption inure to the benefit of the other heirs?

It will depend on what she states in her application for the redemption. If it is clear that she wants to purchase for her own exclusive and personal benefit, the other heirs will *not* share in the benefits. (*Director of Lands v. Abantao, L-20090, Dec. 29, 1975*).]

- (g) Rule 39, Sec. 27 (Revised Rules of Court): Who may redeem real property so sold — Real property sold as provided in the last preceding section, or any part thereof sold separately, may be redeemed in the manner hereinafter provided, by the following persons:
- 1) The judgment obligor, or his successor in interest in the whole or any part of the property;
 - 2) A creditor having a lien by virtue of an attachment, judgment or mortgage on the property sold, or on some part thereof, subsequent to the lien under which the property was sold. Such redeeming creditor is termed a redemptioner.

**Arnel Sy v. CA State Investment
House, Inc. and the Register of Deeds
of Rizal
GR 88139, Apr. 12, 1989**

The main issue raised in this petition is whether Act No. 3135, as amended, in relation to Sec. 30,

Rule 39 of the Revised Rules of Court, or Sec. 78 of RA 337 (General Banking Act), as amended by PD 1828, is the applicable law in determining the redemption price.

Act 3135, as amended, in relation to Sec. 28, Rule 39 of the Revised Rules of Court provides in part: “*Time and manner of, and amounts payable on, successive redemptions. Notice to be given and filed.* — The judgment debtor, or redemptioner, may redeem the property from the purchaser, at any time within one (1) year from the date of the registration of the certificate of sale, by paying the purchaser the amount of his purchase, with one *per centum* per month interest thereon in addition, up to the time of redemption, together with the amount of any assessments or taxes which the purchaser may have paid thereon after purchase, and interest on such last named amount at the same rate.”

Upon the other hand, Sec. 78 of the General Banking Act, as amended by PD 1828, states: “In the event of foreclosure, whether judicially or extrajudicially, of any mortgage on real estate which is security for any loan granted before the passage of this Act or under the provisions of this Act, the mortgagor or debtor whose real property has been sold at public auction, judicially or extrajudicially, for the full or partial payment of an obligation to any bank, banking or *credit institute* [like herein private respondent State Investment House, Inc. or SIHI], within the purview of this Act shall have the right, within one year after the sale of the real estate as a result of the foreclosure of the respective mortgage, to redeem the property by paying the amount fixed by the court in the order of execution, or the amount due under the mortgage deed, as the case may be, with interest thereon at the rate specified in the mortgage and all the costs, and judicial and other expenses incurred by the bank or institution concerned by reason of the execution and sale and

as a result of the custody of said property less the income received from the property.

Thus, in a situation where the mortgagee is a bank or banking or credit institution (like the SIHI), the General Banking Act partakes of the nature of an amendment to Act 3135 insofar as the redemption price is concerned.

Although the foreclosure and sale of the subject property was done by SIHI pursuant to Act 3136, as amended (whereby entities like SIHI are authorized to extrajudicially foreclose and sell mortgaged properties only under a special power inserted in or annexed to the real estate mortgage contract, and interested parties, like petitioner herein, are given one year from the date of sale within which to redeem the foreclosed properties), Sec. 78 of the General Banking Act, as amended, provides the amount at which the subject property is redeemable from SIHI, which is, in this case, the amount due under the mortgage deed, or the outstanding obligation, plus interest and expenses.

And inasmuch as petitioner failed to tender and pay the required amount for the redemption of the subject property pursuant to Sec. 78 of the General Banking Act, as amended, no valid redemption was effected by him. Consequently, there was no legal obstacle to the consolidation of title by SIHI.

- (h) Rule 68, Sec. 3 (Revised Rules of Court): Sale of mortgaged property: effect — When the defendant, after being directed to do so as provided in the next preceding section, fails to pay the amount of the judgment within the period specified therein, the court, upon motion, shall order the property to be sold in the manner and under the provisions of Rule 39 and other regulations governing sales of real estate under execution. Such sale shall not affect the rights of persons holding prior encumbrances upon the property or a part thereof, and when confirmed by an order of the court, also upon motion, it shall operate to divest the rights in the property of all the parties

to the action and to vest their rights in the purchaser, subject to such rights of redemption as may be allowed by law.

Upon the finality of the order of confirmation or upon the expiration of the period of redemption when allowed by law, the purchaser at the auction sale or last redemptioner, if any, shall be entitled to the possession of the property unless a third party is actually holding the same adversely to the judgment obligor. The said purchaser or last redemptioner may secure a writ of possession, upon motion, from the court which ordered the foreclosure.

(3) Pre-emption and Redemption Distinguished

<i>PRE-EMPTION</i>	<i>REDEMPTION</i>
(a) arises before sale	(a) arises after sale
(b) no rescission because no sale as yet exists	(b) there can be rescission of the original sale
(c) the action here is directed against prospective seller	(c) the action here is directed against the buyer

(4) Basis of Legal Redemption

This right is not predicated on any proprietary right, which after the sale of the property on execution, leaves the judgment debtor and vests in the purchaser, but on a bare statutory privilege to be exercised only by the persons named in the statute. (*Magno v. Viola*, 61 Phil. 803). Thus, the law does not make actual ownership at the time of redemption a condition precedent, the right following the person, and not the land. (*Ibid.*)

(5) Property Affected

Legal redemption can be effected against either *movable or immovable* property. (*Manresa*; *U.S. v. Caballero*, 25 Phil. 356).

(6) Sheriff's Sale

- (a) A buyer at a sheriff's sale of real property is not legally entitled to the possession of the property, rents and profits that have accrued until after the expiration of the period of the redemption, and the legal title to the land has become vested in him. (*Flores v. Lim*, 50 Phil. 738).
- (b) A delinquent taxpayer whose property is sold by the government is not entitled to recover the fruits that had accrued before the property is finally redeemed. (*Lucao v. Mun. of Alcala*, 65 Phil. 164).

Art. 1620. A co-owner of a thing may exercise the right of redemption in case the shares of all the other co-owners or of any of them, are sold to a third person. If the price of the alienation is grossly excessive, the redemptioner shall pay only a reasonable one.

Should two or more co-owners desire to exercise the right of redemption, they may only do so in proportion to the share they may respectively have in the thing owned in common.

COMMENT:**(1) Right of Legal Redemption of Co-Owner**

- (a) *Reason for the law:* To minimize co-ownership.
- (b) Note that for Art. 1620 to apply, the share must have been sold to a *third person*. Hence, if the purchaser is also a co-owner, there is no legal redemption. (*Estrada v. Reyes*, 33 Phil. 31). A tenant is a third person under this Article. (*T.S. Feb. 7, 1964*).

[**NOTE** further that the law says “sold.” Hence, redemption cannot exist in case of a mere *lease*. (*De la Cruz v. Marcelino*, 84 Phil. 709).]

**Oscar C. Fernandez, et al. v. Spouses
Carlos & Narcisa Tarun
GR 143868, Nov. 14, 2002**

FACTS: Respondents are petitioners' co-owners. The sale of the contested property to respondents-spouses

Tarun had long been consummated before petitioners succeed their predecessor, Angel Fernandez. By the time petitioners entered into the co-ownership, respondents were no longer “third persons,” but had already become co-owners of the whole property. A third person, within the meaning of Art. 1620, is anyone who is not a co-owner. *Issue:* The right of redemption may be exercised by a co-owner, only when part of the community property is sold to a stranger. When the portion is sold to a co-owner, does this right arise because a new participant is not added to the co-ownership?

HELD: No True, the right to redeem is granted not only to the original co-owners, but also to all those who subsequently acquire their respective shares while the community subsists. (*Viola v. Tecson*, 49 Phil. 808 [1926]). However, this right of redemption is available only when part of the co-owned property is sold to a third person. Otherwise put, the right to redeem referred to in Art. 1620 applies only when a portion is sold to a non-co-owner.

Legal redemption is in the nature of a privilege created by law partly for reasons of public policy and partly for the benefit and convenience of the redemptioner, to afford him a way out of what might be a disagreeable or an inconvenient association into which he has been thrust. (10 *Manresa*, 4th ed., 317). It is intended to minimize co-ownership. The law grants a co-owner the exercise of said right of redemption when shares of other owners are sold to a “third person.” (*Basa v. Aguilar*, 17 SCRA 128 [1982]).

(2) Who Can Exercise the Right of Legal Redemption

- (a) The right of legal redemption lies in all co-tenants of the things held in common. The law concedes to all, the use of the right of redemption whenever they exercise it within the period indicated for the purpose. This privilege facilitates and provides a method for terminating the tenancy in common and to establish the dominion in one sole owner. It can in no manner be exercised against a co-owner of the same property to whom the law allows

the same privilege; it must be exercised against the third person. (*Estrada v. Reyes*, 33 Phil. 31 and *Magno v. Viola and Sotto*, 61 Phil. 80).

- (b) This right is granted not only to the original co-owners but applies to all those who subsequently acquire their respective shares while the community subsists. (*Viola v. Tecson*, 49 Phil. 808). Upon the other hand, a former co-owner has NO right to redeem, because he has lost the status of co-owner. (*De la Cruz v. Marcelino*, 84 Phil. 709). If there be TWO buyers of the shares, both are co-owners and one cannot exercise the right against the other. (*Estrada v. Reyes*, 33 Phil. 31). Of course, if a sale is made AFTER partition, the right of legal redemption by a co-owner cannot be invoked, there being no more co-ownership. (*Umengan v. Manzano*, L-6036, Feb. 28, 1963).

Federis v. Sunga
L-34803, Jan. 17, 1985

If property has been partitioned, a former co-heir or co-owner has no right of redemption or pre-emption and cannot complain that he was not served notice of the disposition of the property.

(3) Entire Amount of Redemption

The co-owner who desires to redeem must tender the entire amount of the redemption price or validly consign the same in court. This is needed to show good faith. (*De Conejero v. Court of Appeals*, L-21812, Apr. 29, 1966 — where the Court held that if the price is P28,000 the tender of a check for only P2,000, with a promise to later on pay the balance after said balance is obtained from a bank — is not sufficient: first, because the check is not legal tender, and secondly, because the buyer cannot be compelled to receive the money in installments. The contention that a mere down payment is enough because it is the court that will determine whether the price is a reasonable one or not, is wrong because what should have been tendered was the full tender of the price that can honestly be deemed reasonable under the circumstances, without prejudice to final arbitration by the courts.)

Art. 1621. The owners of adjoining lands shall also have the right of redemption when a piece of rural land, the area of which does not exceed one hectare, is alienated, unless the grantee does not own any rural land.

This right is not applicable to adjacent lands which are separated by brooks, drains, ravines, roads and other apparent servitudes for the benefit of other estates.

If two or more adjoining owners desire to exercise the right of redemption at the same time, the owner of the adjoining land of smaller area shall be preferred; and should both lands have the same area, the one who first requested the redemption.

COMMENT:

(1) Legal Redemption by Adjacent Owner of Rural Property

- (a) *Reason for the law:* To foster the development of agricultural areas by adjacent owners who may desire the increase for the improvement of their own land. (*Del Pilar v. Catindig*, 35 Phil. 263).
- (b) *Reason for paragraph 2:* Here the properties can not be said to be adjacent. Proof of being non-adjacent is on grantee. (*Maturan v. Gules*, L-6298, Mar. 30, 1964).

(2) Against Whom Right Can Be Exercised

This right may be exercised only against a stranger (*Del Pilar v. Catindig*, *supra.*), and not against an adjacent rural owner who purchases the property. (See also *T.S.*, Dec. 1, 1902; 10 *Manresa* 362). For the right, however, to be exercised against the stranger, the stranger must already have RURAL land (not an adjacent rural one) (*Gonzales v. Carillo*, [C.A.] 51 O.G. 5672). This is because if the stranger has NO rural land at all, the right to redeem cannot be exercised against him. Evidently, the law grants everyone an opportunity to have rural land. (See *1st par.*, Art. 1621).

Case:**Fabia v. Intermediate Appellate Court
L-66101, Nov. 21, 1984**

The legal right of redemption of rural land refers to land that will be used for agricultural, not residential purposes. We must consider the legislative intent.

Art. 1622. Whenever a piece of urban land which is so small and so situated that a major portion thereof cannot be used for any practical purpose within a reasonable time, having been bought merely for speculation, is about to be re-sold, the owner of any adjoining land has a right of pre-emption at a reasonable price.

If the re-sale has been perfected, the owner of the adjoining land shall have a right of redemption, also at a reasonable price.

When two or more owners of adjoining lands wish to exercise the right of pre-emption or redemption, the owner whose intended use of the land in question appears best justified shall be preferred.

COMMENT:**Legal Pre-emption and Redemption by Adjacent Owners of Urban Property**

- (a) There are 2 rights here: pre-emption (par. 1) and redemption (par. 2)
- (b) In the case of *Sorfente v. Court of Appeals (L-17343, Aug. 31, 1963)*, the Court found that the lot purchased by the buyer (against whom the right of pre-emption was being sought to be enforced) was sufficiently BIG in area and so situated that the major portion of the whole area thereof could serve comfortably as a workshop which he was putting up in the exercise of his profession as engineer. The facts also showed that the buyer had *no* intention then or in the future of selling the property to others. It was held that under the circumstances the

owner of the adjoining lot could not invoke the right of pre-emption granted under this Article.

Ortega v. Orcine and Esplana
L-28317, Mar. 31, 1971

ISSUES:

- (1) Under Art. 1622, to what does the term “urban” refer?
- (2) Suppose the urban land is made into a SUBDIVISION, will the Article apply?

HELD:

- (1) “Urban” does not refer to the land itself nor to the purpose to which it is devoted, but to the character — of the COMMUNITY or REGION where it is found. So land may be *urban* although dedicated somehow to agriculture.
- (2) If the urban land that was sold is made into a SUBDIVISION, the Article will not apply. To make use of the right granted here, the land must be so *small* and so *situated* that a major portion thereof cannot be used for any practical purpose within a reasonable time, having been previously *bought by the seller* merely for speculation.

Fidela Legaspi v. Court of Appeals, et al.
L-39877, Feb. 20, 1976

FACTS: An urban lot, owned by a certain Pestejos, was sold to a certain Aguilar, an adjacent lot owner, although another adjoining lot owner, Legaspi, had offered to buy the same lot. Legaspi was interested in the purchase of Pestejos’ lot, because a portion of her (Legaspi’s) house was standing on a part of Pestejos’ lot. After the sale to Aguilar, Legaspi tried to redeem the lot by offering a reimbursement of the purchase price. The offer was refused.
Issue: Should redemption by Legaspi be allowed?

HELD: Yes, Legaspi’s redemption of the adjacent urban lot must be allowed. The controlling or determinate

factor in par. 3 of Art. 1622 of the Civil Code is the intended use that *appears best justified*, and not necessarily whether the lot was acquired for speculative purposes. To rule otherwise would be iniquitous to Legaspi.

Art. 1623. The right of legal pre-emption or redemption shall not be exercised except within thirty days from the notice in writing by the prospective vendor, or by the vendor, as the case may be. The deed of sale shall not be recorded in the Registry of Property, unless accompanied by an affidavit of the vendor that he has given written notice thereof to all possible redemptioners.

The right of redemption of co-owners excludes that of adjoining owners.

COMMENT:

(1) Within What Period Right May Be Exercised

- (a) The right of legal redemption is SUBSTANTIVE. (*Sempio v. Del Rosario*, 44 Phil. 1).
- (b) The periods given in the law are conditions precedent, and not periods of prescription. The offer to exercise the right of redemption must be within the period stipulated by the law, for said periods are requisites for the legal and effective exercise of the right. (*Alcover v. Panganan*, 40 O.G. [12th S] No. 18, p. 16). Once the offer is validly made, an action may LATER ON be brought to enforce the redemption. (*Lim Tuico v. Cu Unjieng*, 21 Phil. 493). Therefore, if claim or offer is not made within the period, no action will be allowed to enforce the right. (*Daza v. Tomacruz*, 58 Phil. 414; see also *Castillo v. Samonte*, L-13146, Jan. 30, 1960).

NOTE — The law says “notice in writing.” Now then, what is the effect if despite lack of written notice there was ACTUAL knowledge? **ANS.** — The person having the right to redeem is STILL entitled to the written notice. If the notice is not given, the 30-day period has not even begun to run.) (*Vda. de Cangco v. Escubido*, [C.A.] 64 O.G. 1401). Both the latter and the spirit of

the new Civil Code argue against any attempt to widen the scope of the “written notice” by including therein any other kind of notice such as an oral one, or by registration. If the intent of the law had been to include verbal notice or any other means of information as sufficient to give the effect of this notice, there would have been no necessity or reason to specify in the article that said notice be in writing, for under the old law, a verbal notice or mere information was already deemed sufficient. (*See Castillo v. Samonte, L-13146, Jan. 30, 1960*). However, no specific form of the written notice is required. Thus, the mere receipt by the co-owner from the vendor of a copy of the deed of sale would SUFFICE. As a matter of fact, this sending would serve all the purposes of the written notice, in a more authentic manner than any other writing could have done. (*De Conejero v. Court of Appeals, L-21812, Apr. 29, 1966*).

**Doromal v. Court of Appeals
L-36083, Sep. 5, 1975**

The 30-day notice in writing referred to in Art. 1623 should be counted from notice, not of the perfected sale, but of the actual execution and delivery of the document of sale. (Note that Art. 1623 speaks only of a “notice in writing” without specifying what the notice is all about).

(2) Preference of Co-Owners

Co-owners are preferred over adjacent owners. (*Par. 2, Art. 1623*).

(3) Problem

A, B, and C are co-owners in equal shares of a one-hectare rural land, the *adjoining* owner to which are *D* and *E*, the latter owning the smaller area. *A* donated his share of the land owned in common to *X* who is a rural land owner. Upon proper notice of the conveyance, *B, C, D, and E* sought to exercise the right of legal redemption over the share conveyed. Who among them, if any, should be preferred? Why?

ANS.: While co-owners are preferred over adjoining owners, still in the instant case, not one will be preferred. As a matter of fact, no right of legal redemption exists because A donated his share to X. There was no purchase, *no dation in payment*, *no transmission by onerous title*. (*See Art. 1619*).

(4) Notification to Buyer That Redemption Would Be Exercised

The would-be redemptioner is *not* required to notify the buyer, previous to bringing an action to compel redemption.

The general practice, however, is to first notify so that judicial trouble can be avoided. (*See Torio v. Rosario, 49 O.G. 3845*).

(5) Redemption Offer Must Be With Legal Tender

When the right of redemption is exercised (whether it be conventional or legal redemption) the offer to redeem must be in legal tender. Thus, if a check is offered, it is as if no tender had been made.

(6) Cases

**Etcuban v. CA
GR 45164, Mar. 16, 1987**

FACTS: A inherited a piece of land with an area of 14 hectares together with his co-heirs from their father. There after, the co-heirs of A executed in favor of B 11 deeds of sale of their respective shares in the co-ownership. The earliest of the deeds of sale was made on Dec. 9, 1963 and the last in Dec. 1967. In his complaint, A alleged that his co-owners leased or sold their shares without giving due notice to him as a co-owner despite his intimations to them that he will buy all their shares. So A filed a complaint for legal redemption. Defendant filed his answer with counterclaim on Mar. 18, 1972. Plaintiff deposited the redemption price on May 27, 1974. The trial court allowed A to exercise his right of redemption, but the appellate court reversed the trial court, saying that A failed to make a valid tender of the sale price of the land paid by defendants within the period fixed by Art. 1623.

HELD: Since the answer with counterclaim was filed on Mar. 18, 1972, the deposit made on May 27, 1974 was clearly outside the 30-day period of legal redemption. The period within which the right of legal redemption or pre-emption may be exercised is non-extendible. A failed to substantially comply with the requirements of Art. 1623 on legal redemption.

A's contention that the vendors (his co-heirs) should be the ones to give him written notice and not the vendees (defendants) is of no moment. Art. 1623 does not prescribe any particular form of notice, nor any distinctive method for notifying the redemptioner.

Cabrera v. Villanueva
GR 75069, Apr. 15, 1988

FACTS: Erlinda is a co-owner of a real property. On Mar. 12, 1968, by way of a deed of absolute sale, Feliciano and Antonio, co-owners of said property, sold their shares *pro indiviso* to Victoriana. The following year, 1969, a new transfer certificate of title was issued wherein Victoriana was constituted as a co-owner *pro indiviso* of the entire parcel. This was after Feliciano and Antonio had executed a joint affidavit, dated Apr. 1, 1968, attesting to the fact that they had notified in writing the co-owners of the property and said co-owners did not and could not offer any objection. In 1980, Victoriana as a new co-owner proposed to Erlinda the partition of the property in question. The latter did not agree to the proposal. Instead, she offered to redeem the share of Victoriana. Victoriana refused such proposal. Hence, Erlinda filed an action for legal redemption. The trial court adjudged in favor of Erlinda ordering Victoriana to re-sell to the former her *pro-indiviso* share.

The Court of Appeals held that Erlinda was duly notified in writing and that she failed to exercise her right of redemption within the period provided by law, and therefore she is barred from redeeming the property. Affirming the Court of Appeals, the Supreme Court —

HELD: The joint affidavit does not amount to that written notice required by law. However, it is a written affirmation

under oath that the required written notice of sale was given to the other co-owner. Against affiants' sworn written admission that the required notice of sale was duly served upon their co-owners, the oral denials should not be given much credence. Said written sworn statement was executed by them *ante litem motam*. Since there is no evidence on record as to when the written notice of the sale referred to in the joint affidavit was given, it can only be assumed that it was made before Apr. 1, 1968, the date of the joint affidavit. Counting from that date, Erlinda had already lost her right to redeem the property under Art. 1623, when she made her offer to redeem from Victoriana in her letter dated Oct. 30, 1980.

Furthermore, on Apr. 21, 1969, a new transfer certificate of title was issued, in which it is reflected that Victoriana is a co-owner of the property. It can be safely assumed that copy of the title reflecting Victoriana as a co-owner was also issued to Erlinda in 1969. Moreover, Sec. 50 of the Land Registration Code expressly provides that the registration of the deed is the only operational act to bind or affect the property. From that time on, Erlinda was already in full and actual knowledge of the fact that Victoriana had acquired the shares of Antonio and Feliciano. For more than ten years, Erlinda remained unperturbed by the fact that Victoriana was already registered as a co-owner. It was only several years later when the value of the property considerably increased that Erlinda asserted her claim to redeem under Art. 1623.

The receipt of a copy of the transfer certificate of title, indicating Victoriana as one of the co-owners, may be deemed as service of the written notice required by Art. 1623. The letter of Victoriana informing Erlinda of the acquisition of a portion of the property is by itself a written notice of the purchase. Since the 30-day period expired by Oct. 30, 1980 without redemption being exercised, it follows that the right to redeem has already been lost.

Mariano v. CA
41 SCAD 927
1993

In the absence of a written notification of the sale by the vendor, the 30-day period cannot be said to have even

begun to run. Thus, respondents have not lost their right to redeem.

Adalia B. Francisco v. Zenaida Boiser
GR 137677, May 31, 2000

FACTS: Petitioner, her sisters, and their mother Adela were co-owners of a parcel of land. Without the knowledge of the other co-owners, Adela sold her share to respondent. Petitioner instituted a complaint before the trial court, alleging that the 30-day period for redemption under Art. 1623 had not begun to run against her because the vendor, Adela, did not inform her and the other co-owners of the property about the sale to respondent. The trial court dismissed petitioner's complaint on the ground that petitioner received a letter from respondent informing her of the sale, and such was sufficient to notify petitioner of the sale. The Court of Appeals (CA) affirmed the trial court and denied the motion for reconsideration filed by petitioner. The Supreme Court reversed the CA.

HELD: It is notification from the seller which can remove all doubts regarding the fact of the sale, its perfection, and its validity since it is the latter who can best confirm whether consent to the sale has been given. Accordingly, the trial court is ordered to effect petitioner's right of legal redemption over the property.

Chapter 8

ASSIGNMENT OF CREDITS AND OTHER INCORPOREAL RIGHTS

Art. 1624. An assignment of credits and other incorporeal rights shall be perfected in accordance with the provisions of Article 1475.

COMMENT:

(1) Assignment of Credits and Rights

Assignment is the process of *transferring gratuitously* or *onerously* the right of the assignor to the assignee, who would then be allowed to proceed against the debtor.

(2) Perfection of Assignment

Note the cross-reference to Art. 1475.

“*Art. 1475.* The contract of sale is perfected at the moment there is a meeting of minds upon the thing which is the object of the contract and upon the price.

“From that moment, the parties may reciprocally demand performance, subject to the provisions of the law governing the form of contracts.”

Art. 1625. An assignment of a credit, right or action shall produce no effect as against third persons, unless it appears in a public instrument, or the instrument is recorded in the Registry of Property in case the assignment involves real property.

COMMENT:

(1) Effectivity Against Third Persons

(a) if *personal* property is involved — a *public* instrument

is needed to make the assignment effective against third persons.

- (b) if *real* property is involved — registration in the Registry of Property would be needed.

(2) Mortgage

A mortgage that is assigned is valid between the parties even if the assignment is not registered, because registration is only essential to prejudice third parties. (*Villanueva v. Perez, et al.*, 928).

(3) Gratuitous Assignments

A *gratuitous assignment* is a DONATION and must therefore comply with the formalities of a donation.

Art. 1626. The debtor who, before having knowledge of the assignment, pays his creditor shall be released from the obligation.

COMMENT:

(1) Rule If Debtor Pays Creditor Before Former Knows of the Assignment

Example:

A owes B, who assigns his credit to C. A, without knowing of the assignment, pays B. Is A's obligation extinguished?

ANS.: Yes.

[**NOTE:** Assignment is effective as to the debtor only from the time he has knowledge of it. (*Sison v. Yap Tico*, 37 Phil. 534).]

(2) Some Cross References

- (a) *Art. 1233:* A debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been completely delivered or rendered, as the case may be.

- (b) *Art. 1285*: The debtor who has consented to the assignment of rights made by a creditor in favor of a third person, cannot set up against the assignee the compensation which would pertain to him against the assignor, unless the assignor was notified by the debtor at the time he gave his consent, that he reserved his right to the compensation.

If the creditor communicated the cession to him but the debtor did not consent thereto the latter may set up the compensation of debts previous to the cession, but not of subsequent ones.

If the assignment is made without the knowledge of the debtor, he may set up the compensation of all credits prior to the same and also later ones until he had knowledge of the assignment.

(*NOTE: "Debts previous to the cession" refer to debts MATURING before the cession.*)

(3) Rule if a Third Party Has the Funds

Should there be an agreement between an obligee and an obligor that debt should be paid out of a fund belonging to the obligor in the hands of a third party and the agreement is communicated to such third party and is assented to by him, this will be effective in equity to transfer an interest in such fund to the extent of the debt, to the obligee. (*Pac. Com. Co. v. Hernaez & Alunan, 51 Phil. 494*).

(4) Case

**South City Homes, Inc., Fortune Motors
(Phils.), Palawan Lumber Manufacturing
Corp. v. BA Finance Corp.
GR 135462, Dec. 7, 2001**

In an assignment, the debtor's consent is not essential for the validity of the assignment (*Art. 1624 in relation to Art. 1475, Civil Code*) his knowledge thereof affecting only the validity of the payment he might make. (*Art. 1626, id.*).

Also, Art. 1626 shows that payment of an obligation which is already existing does not depend on the consent of the debtor. It, in effect, mandates that such payment of the existing obligation shall already be made to the new creditor from the time the debtor acquires knowledge of the assignment of the obligation. The law is clear that the debtor had the obligation to pay and should have paid from the date of notice whether or not he consented.

Art. 1627. The assignment of a credit includes all the accessory rights, such as a guaranty, mortgage, pledge or preference.

COMMENT:

Rights Included in the Assignment of a Credit

Accessory rights are included such as:

- (a) guaranty,
- (b) mortgage,
- (c) pledge,
- (d) preference.

Art. 1628. The vendor in good faith shall be responsible for the existence and legality of the credits at the time of the sale, unless it shall have been sold as doubtful; but not for the solvency of the debtor, unless it has been so expressly stipulated or unless the insolvency was prior to the sale and of common knowledge.

Even in these cases he shall only be liable for the price received and for the expenses specified in No. 1 of Article 1616. The vendor in bad faith shall always be answerable for the payment of all expenses, and for damages.

COMMENT:

(1) Warranties in the Assignment of a Credit

- (a) This Article talks of two kinds of warranties:
 - 1) objective — the credit itself (its existence and legality).

- 2) subjective — the person of the debtor (his solvency).
- (b) This Article also distinguishes between the liabilities of the seller in good faith and the seller in bad faith.

(2) Example

A owes B. B assigns the credit to C. B is in good faith.

- (a) But *A* is insolvent. Is *B* liable? *ANS.*: No —
 - 1) unless it was so expressly stipulated;
 - 2) or unless the insolvency was prior to the sale and of common knowledge.
- (b) Suppose in (a), the credit really did not exist anymore at the time of assignment, is *B* still responsible?

ANS.: Yes, unless the credit was sold as doubtful, such as a credit in litigation.

(3) 'Assignment of Credit' Defined

It is the process of transferring the right of the assignor to the assignee, who would then be allowed to proceed against the debtor. It may be done either gratuitously or onerously, in which case, the assignment has an effect similar to that of a sale. (*Nyco Sales Corp. v. BA Finance Corp.*, GR 71694, Aug. 16, 1991, *J. Paras, ponente*).

Nyco Sales Corp. v. BA Finance Corp. GR 71694, Aug. 16, 1991

FACTS: Nyco Sales Corporation, whose president and general manager is Rufino Yao, is engaged in the business of selling construction materials. In 1978, the brothers Santiago and Renato Fernandez, both acting in behalf of Sanshell Corporation approached Yao for credit accommodation. They requested Nyco, thru Yao, to grant Sanshell discounting privileges which Nyco had with BA Finance Corporation. Yao acquiesced; hence, on Nov. 15, 1978, the Fernandezes went to Yao for the purpose of discounting Sanshell's postdated check for P60,000. The check was payable to Nyco which

endorsed it in favor of Sanshell. Sanshell then made use of and/or negotiated the check. Accompanying the exchange of checks was a Deed of Assignment executed by Nyco in favor of BA with the conformity of Sanshell as represented by the Fernandez brothers. Under said deed, the subject of the discounting was the aforecited check. At the back thereof and of every deed of assignment was the continuing suretyship agreement whereby the Fernandezes unconditionally guaranteed to BA prompt payment of the indebtedness of Nyco. The drawee bank, however, dishonored the BPI check upon presentment for payment. BA immediately reported the matter to the Fernandezes who issued a substitute check dated Feb. 19, 1979 for the same amount in favor of BA. It was a Security Bank check, which was again dishonored when presented for payment. Despite repeated demends, Nyco and the Fernandezes, despite having been served with summons and complaint, failed to file their answer and were consequently declared in default. On May 16, 1980, the lower court ruled in favor of BA ordering them to pay the former jointly and severally P65,536 plus 14% interest *per annum* and attorney's fees. Nyco moved to set aside the order of default, to have its answer admitted and to be able to implead. Sanshell. Trial ensued once more until the court rendered a second division in favor of BA against Nyco by ordering the latter to pay the former. The Appellate Court upheld BA Finance. Nyco argues, among others, that: (a) The appellate court erred in affirming its liability for the "BPI check despite a similar finding of liability for the SBTC check rendered by the same lower court; (b) that it was actually discharged of its liability over the SBTC check when BA Finance failed to give a notice of dishonor; and (c) that there was novation when BA Finance accepted the SBTC check in replacement of the BPI check.

ISSUE: Whether or not the assignor is liable to its assignee for its dishonored checks.

HELD: The Supreme Court affirmed the Court of Appeals decision and held that under the facts, it is undisputed that Nyco executed a deed of assignment in favor of BA Finance with Sanshell Corporation as the debtor-obligor. BA Finance is actually enforcing said deed and the check covered thereby is merely an incidental or collateral matter. This particular

check merely evidenced the credit which was actually assigned to BA Finance. Thus, the designation is immaterial as it could be any other check. Both the lower and appellate courts recognized this and so it is misplaced to say that Nyco is being held liable for both the BPI and the SBTC checks. It is only what is represented by the said checks that Nyco is being asked to pay. Nyco's pretension that it had not been notified of the fact of dishonor is belief not only by the formal demand letter but also by the findings of the trial court that Rufino Yao of Nyco and the Fernandez Brothers of Sanshell had frequent contacts before and after the dishonor. More importantly, it fails to realize that for as long as the credit remains outstanding, it shall continue to be liable to BA Finance as its assignor. The dishonor of an assigned check simply stresses its liability and the failure to give notice of dishonor will not discharge it from such liability. This is because the cause of action stems from the breach of the warranties embodied in the deed of assignment, and not from the dishonoring of the check alone. (*Art. 1628, Civil Code*). In the instant case, there was no express agreements that BA Finance's acceptance of the SBTC check will discharge Nyco from liability. Neither is there incompatibility because both checks were given precisely to terminate a single obligation arising from Nyco's sale of credit to BA Finance. As novation speaks of two distinct obligation, such is inapplicable to this case.

Art. 1629. In case the assignor in good faith should have made himself responsible for the solvency of the debtor, and the contracting parties should not have agreed upon the duration of the liability, it shall last for one year only, from the time of the assignment if the period had already expired.

If the credit should be payable within a term or period which has not yet expired, the liability shall cease one year after the maturity.

COMMENT:

(1) Duration of the Warranty for the Debtor's Solvency

- (a) time agreed upon
- (b) if no time was agreed upon

- 1) one year from ASSIGNMENT — if debt was already due
- 2) one year from MATURITY if debt was *not* yet due

(2) Example

A owes *B*. *B* assigns the credit to *C*. *B* is in good faith. It was agreed that *B* would be responsible for *A*'s solvency. The parties did not agree on the duration of the liability. If the debt was due Jul. 6, 2004 and the assignment was made Aug. 8, 2004, until when is the guaranty?

ANS.: Until Aug. 8, 2005. The law says "one year from the time of the assignment if the period has already expired." (*Par. 1, Art. 1629*).

Art. 1630. One who sells an inheritance without enumerating the things of which it is composed, shall only be answerable for his character as an heir.

COMMENT:

(1) Warranty of a Person Who Sells an Inheritance Without an Enumeration of the Things Included Therein

If there is a sale of an enumerated list of future inheritance, this is prohibited, as a rule. (*See Art. 1347, Civil Code*). *Present* inheritance may be sold and this is what the Article contemplates. Since the sale does not enumerate the specific things sold, the warranty only extends to the fact of HEIRSHIP.

As a matter of fact, the part of an estate assigned to an heir by the will of the *deceased* testator can be sold by such heir, even before the partition of the estate is approved by the court. Such a sale cannot be questioned by the co-heirs so long as it does *not* prejudice the legitime of the compulsory heirs. (*Habasa v. Imbo, L-15598, Mar. 31, 1964*). Indeed, there is no legal provision which prohibits a co-heir from selling to a stranger his share of the common estate prior to judicial approval of the partition made by the testator.

(2) Sale of Future Inheritance

If the future inheritance is sold without specification of properties, this would only be a sale of future hereditary rights, and hence, is permissible. (*Abella v. Sinco*, 37 O.G. 924).]

Art. 1631. One who sells for a lump sum the whole of certain rights, rents, or products, shall comply by answering for the legitimacy of the whole in general; but he shall not be obliged to warrant each of the various parts of which it may be composed, except in the case of eviction from the whole or the part of greater value.

COMMENT:**Sale For a Lump Sum of the Whole of Certain Rights, Rents, or Products**

The warranty is on the LEGITIMACY of the *whole*.

Art. 1632. Should the vendor have profited by some of the fruits or received anything from the inheritance sold, he shall pay the vendee thereof, if the contrary has not been stipulated.

COMMENT:**Rule if Vendor Still Profits Despite Sale of the Inheritance**

Since the vendor has already sold the inheritance, he should not profit except, of course, insofar as the price is concerned. Hence, the obligation to pay, as a rule.

Art. 1633. The vendee shall, on his part, reimburse the vendor for all that the latter may have paid for the debts of and charges on the estate and satisfy the credits he may have against the same, unless there is an agreement to the contrary.

COMMENT:**Corresponding Duty of a Buyer**

The Article is clearly just and fair.

Art. 1634. When a credit or other incorporeal right in litigation is sold, the debtor shall have a right to extinguish it by reimbursing the assignee for the price the latter paid therefor, the judicial costs incurred by him, and the interest on the price from the day on which the same was paid.

A credit or other incorporeal right shall be considered in litigation from the time the complaint concerning the same is answered.

The debtor may exercise his right within thirty days from the date the assignee demands payment from him.

COMMENT:

Sale of a Credit or Other Incorporeal Rights in Litigation

(a) *Example:*

A sues B to recover a credit of P1 million. When the complaint is answered by B, the credit may now be said to be in litigation. If A sells the credit to a third party X for say, P200,000 (A may have done this to avoid the delay in collection) B may redeem the credit from X by paying X the sum of P200,000, within 30 days from the time X demands payment of the P1 million.

- (b) *Reason for the law: Equity. (Manresa).* Besides, this will prevent speculation on the part of the assignee. Thus, in the example given, X bought the credit only in the expectation that he would eventually collect the entire credit of P100,000. If after all A was willing to receive only P20,000, the debtor may just as well receive the benefit.
- (c) This is another example of legal redemption.
- (d) This is applicable only in the case of sale. Hence, the Article does not apply to a *barter* or a *donation*.
- (e) Two questions must be answered affirmatively before this Article can be applied:
 - (1) Was there a sale?

- (2) Was there a litigation or suit pending at the time or moment of assignment?

This Article applies only to a claim in litigation (*credito litigioso*), the meaning of which is NOT a claim open to litigation but one which IS actually litigated, that is to say, disputed or contested, which happens only after an answer is interposed in a suit. (*Robinson v. Garry*, 8 Phil. 275).

- (g) Regarding paragraph 3: The demand here is either judicial or extrajudicial.

Art. 1635. From the provision of the preceding article shall be excepted the assignments or sales made:

- (1) To a co-heir or co-owner of the right assigned;
- (2) To a creditor in payment of his credit;
- (3) To the possessor of a tenement or piece of land which is subject to the right in litigation assigned.

COMMENT:

Instances When the Legal Redemption is Denied

- (a) *Reason for paragraph 1:* The law does not favor co-ownership.
- (b) *Reason for paragraph 2:* The presumption here that the assignment is above suspicion. The assignment here in the form of "*dacio en pago*" is, thus, perfectly legal.
- (c) *Examples of paragraph 3:*
 - (1) A mortgaged his land to B, but A sold it to C. Later while suit is pending, C acquires mortgage credit assigned to him by B. A has no right to redeem the mortgage credit. This is because C's purpose is presumably to preserve the tenement.
 - (2) A owed B. For non-payment, B attached the property. Property was sold to C, who also acquired the credit. A cannot redeem. C's purpose is to preserve the tenement. There is evidently no speculation here.

Chapter 9

GENERAL PROVISIONS

Art. 1636. In the preceding articles in this Title governing the sale of goods, unless the context or subject matter otherwise requires:

(1) “Document of title to goods” includes any bill of lading, dock warrant, “quedan,” or warehouse receipt or order, for the delivery of goods, or any other document used in the ordinary course of business in the sale or transfer of goods, as proof of the possession or control of the goods, or authorizing or purporting to authorize the possessor of the document to transfer or receive, either by indorsement or by delivery, goods represented by such document.

“Goods” includes all chattels personal but not things in action or money of legal tender in the Philippines. The term includes growing fruits or crops.

“Order” relating to documents of title means an order by indorsement on the documents.

“Quality of goods” includes their state or condition.

“Specific goods” means goods identified and agreed upon at the time a contract a sale is made.

An antecedent or pre-existing claim, whether for money or not, constitutes “value” where goods or documents of title are taken either in satisfaction thereof or as security therefor.

(2) A person is insolvent within the meaning of this Title who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due, whether insolvency proceedings have been commenced or not.

(3) Goods are in a “deliverable state” within the meaning of this Title when they are in such a state that the buyer would, under the contract, be bound to take delivery of them.

COMMENT:

Definition of Certain Terms

The Article defines certain terms in connection with the sale of *goods*. Note that *real* properties are NOT involved here.

Art. 1637. The provisions of this Title are subject to the rules laid down by the Mortgage Law and the Land Registration Law with regard to immovable property.

COMMENT:

Protection to Innocent Third Persons in Connection With the Sale of REAL Property

Note the reference to:

- (a) The Mortgage Law
- (b) The Land Registration Law

**Republic v. Aquino
GR 33983, Jan. 27, 1983**

The principal distinction between the Land Registration Law and the Public Land Law is that in the *first*, there is already a title which is to be confirmed by the first court, while in the *second*, there is only an imperfect title (the presumption being that the land belongs to the State), and the claim or interest is based only on this imperfect title, or by virtue of open, adverse, and continuous possession.

TITLE VII

BARTER OR EXCHANGE

Art. 1638. By the contract of barter or exchange one of the parties binds himself to give one thing in consideration of the other's promise to give another thing.

COMMENT:

(1) 'Barter' Defined

The Article defines the contract of BARTER. The provision of Art. 1468 must, however, be considered.

Art. 1468: "If the consideration of the contract consists partly in money, and partly in another things, the transaction shall be characterized by the manifest intention of the parties. If such intention does not clearly appear, it shall be considered a barter if the thing given as a part of the consideration exceeds the amount of the money or equivalent; otherwise, it is a sale."

(2) Consummation and Perfection of the Contract

Barter, to be consummated, requires mutual delivery (*Biaglan v. Viuda de Oller, 62 Phil. 933*), but is perfected from moment of consent. (*Tagaytay Dev. Co. v. Osorio, 69 Phil. 180*).

If there is NO acceptance of the offer there is NO perfected contract of barter. (*Meads v. Lasedeco, 98 Phil. 119*).

(3) Strict Construction of the Price Control Law

Whisky was being bartered for sugar, but because there was no whisky, price was agreed upon. This is still barter, and is not affected by the Price Control Law (a law then in

force) which refers only to sales. Executive Order 62 must be strictly construed because it is in derogation of a natural right. (*Herrera v. Javellana*, 84 Phil. 608).

Art. 1639. If one of the contracting parties, having received the thing promised him in barter, should prove that it did not belong to the person who gave it, he cannot be compelled to deliver that which he offered in exchange, but he shall be entitled to damages.

COMMENT:

Effect if Giver was NOT the Owner of the Thing Delivered

The aggrieved person is freed from his own duty to DELIVER. Moreover, he can claim DAMAGES.

Art. 1640. One who loses by eviction the thing received in barter may recover that which he gave in exchange with a right to damages, or he may only demand an indemnity for damages. However, he can only make use of the right to recover the thing which he has delivered while the same remains in the possession of the other party, and without prejudice to the rights acquired in good faith in the meantime by a third person.

COMMENT:

Effect of Eviction in Case of Barter

If evicted, the loser can choose between

- (a) recovery of what he has given PLUS damages, or
- (b) claim DAMAGES

(**NOTE:** The right to recover is subject to the condition laid down in the Article.)

Art. 1641. As to all matters not specifically provided for in this Title, barter shall be governed by the provisions of the preceding Title relating to sales.

COMMENT:

Supplemental Use of the Provision on Sales

If one party fails to perform, the other can demand resolution of the contract. (*Biagtan v. Viuda de Oller*, 62 Phil. 933).

TITLE VIII

LEASE

Chapter 1

GENERAL PROVISIONS

Art. 1642. The contract of lease may be of things, or of work and service.

COMMENT:

(1) ‘Lease’ (In General) Defined

It is a consensual, bilateral, onerous, and commutative contract by which one person binds himself to grant temporarily the use of a thing or the rendering of some service to another who undertakes to pay some rent, compensation, or price. (*4 Sanchez Roman 736*).

(2) Kinds of Leases (From the Viewpoint of Subject Matter)

- (a) lease of things (whether of real or personal property)
- (b) lease of service (this includes household service, contract of labor, and common carriers)
- (c) lease of work (this should be properly termed a *contract for a piece of work*, instead of “lease of work” since this latter phrase may erroneously and with reason, be confused with “lease of service.”)

Art. 1643. In the lease of things, one of the parties binds himself to give to another the enjoyment or use of a thing for a price certain, and for a period which may be definite

or indefinite. However, no lease for more than ninety-nine years shall be valid.

COMMENT:

(1) 'Lease of Things' Defined

A contract of lease of things is a *consensual, bilateral, onerous, and commutative contract* by which a person temporarily grants the use or enjoyment of certain property to another who undertakes to pay rent or a price certain therefor, said contract to last for a period which is either definite or indefinite, *but in no case* should exceed 99 years. (Art. 1643; 4 Sanchez Roman 736; and *Lim Si v. Lim*, L-8496, Apr. 25, 1956).

[**NOTE:** Since lease is consensual and not imposed by law, only the owner has the right to fix the rents. The court cannot determine ordinarily the rent and compel the lessor or owner to conform thereto and to allow the lessee to occupy the premises on the basis of rents fixed by it. (*Lim Si v. Lim*, L-8496, Apr. 25, 1956 and 53 O.G. 1098). However, the increasing of the rent is *not* an absolute right on the part of the lessor. (*Legarda v. Zarate*, 36 Phil. 68; *Archbishop of Manila v. Ver*, 73 Phil. 336).]

(2) Characteristics or Requisites for Lease of Things

- (a) It is *consensual* (there must be a meeting of the minds).
- (b) It is a *principal* contract (not dependent on any other contract).
- (c) It is *nominate* (for it is known by a specific name).
- (d) Purpose is to allow *enjoyment* or use of a thing (the person to enjoy is the lessee; the person allowing the enjoyment by another is the lessor).
- (e) The subject matter must be *within the commerce of man* (hence, there can be no valid lease of properties of public dominion such as roads or plazas). (*Mun. of Cavite v. Rojas*, 30 Phil. 602 and *Iisseng Giap v. Mun. Council of Daet, C.A.*, O.G. [Supp.] Nov. 1, 1941, p. 217). [**NOTE:** If the subject matter is a fishpond appertaining to the

public domain, the lease is of course null and void, but the mere fact that the lessor had been granted an ordinary fishpond permit by the Bureau of Fisheries to fish in the portion of land in question six years after the contract of lease had been entered into is NO proof that said portion belongs to the government. This is particularly true if the fishpond is included in the land over which the lessor has a Torrens Title. To make the exclusion, judicial pronouncement to that effect would be necessary. Moreover, since the lessee had entered into the contract of lease, and since said contract has been found to be valid and binding, it is clear that the lessee is now prevented from denying the title of the lessor over said portion pursuant to the Rules of Court. (*Zobel v. Mercado, L-14515, May 25, 1960*).]

- (f) The purpose to which the thing will be devoted should *not be immoral* (hence, if the intent is to use the house for purposes of harlotry, or narcotics, the contract is *void* if such use is provided for in the contract; if not so provided for, but the purpose is subsequently made evident, the lessor can put an end to the contract, since clearly an act of immorality cannot be allowed under the law).
- (g) The contract is onerous (there must be *rent* or a *price certain*).
 - 1) The rent must *not* be fictitious or nominal; otherwise, there is a possibility that the contract is one of *commodatum* (which is essentially gratuitous).
 - 2) The rent must be capable of determination (since the law says “*price certain*”).
 - 3) The rent may be in form of products, fruits, construction — the important thing is that what is given should have VALUE. (*See Tolentino and Manio v. Gonzales Sy Chiam, 50 Phil. 558*).]
- (h) The period is *temporary* (not perpetual; hence, the longest period is 99 years).

[**NOTE:** Under the old Civil Code, there was no maximum period. (*Art. 1543, old Civil Code*). The maximum was fixed by the Code Commission because “it is

believed unsound economic policy to allow the ownership and the enjoyment of property to be separated for a very long time.” (*Report of the Code Commission*, p. 142).

[**NOTE:** It is believed that the period of 99 years is even very long, in fact, more than the average lifetime of an individual. Indeed, such a lease with a maximum duration would constitute a very long real encumbrance on property rights. As a matter of fact even the use thru lease by the American Army of bases in the Philippines, stipulated in the treaty to be for 99 years, is now sought to be reduced to only 25 years. Incidentally under that Philippine-United States Military Bases Agreement (now abrogated), the use of the bases is an unusual kind of “lease” since NO RENT is charged, by express provision of said Agreement.]

- (i) The period is either *definite* or *indefinite*.

[**NOTE:** If indefinite, for how long is the lease?

ANS.:

- 1) If *no term* is fixed, we should apply Art. 1682 (for leases) and Art. 1687 (for urban leases).
- 2) If a term is *fixed*, but the term is *indefinite*, as when the tenant may use for as long as he desires, the court will fix the term under the law of Obligations and Contracts. (*Eleizegui v. Lawn Tennis Club*, 2 *Phil.* 309).]

**LL and Company Development and Agro-
Industrial Corp. v. Huang Chao Chun
& Yang Tung Fa
GR 142378, Mar. 7, 2002**

FACTS: Petitioner contends that because the contract, as amended, had already expired, the Metropolitan Trial Court (MTC) had no power to extend the lease period.

HELD: Upon the lapse of the stipulated period, courts cannot belatedly extend or make a new lease for the parties (*Gindoy v. Tapucar*, 75 *SCRA* 31 [1977]),

even on the basis of equity. (*Martinez Leyba, Inc. v. CA, GR 140363, Mar. 6, 2001*). In the case at bar, because the lease contract ended on Sept. 15, 1996, without the parties reaching any agreement for renewal, respondents can be ejected from the premises.

In general, the power of the courts to fix a longer term for a lease of discretionary. Such power is to be exercised only in accordance with the particular circumstances of a case: a longer term to be granted where equities demanding extension come into play; to be denied where none appear — always with due deference to the parties' freedom to contract. (*La Jolla v. CA, GR 115851, Jun. 20, 2001*). Thus, courts are not bound to extend the lease. (*Heirs of Manuel T. Suico v. Suico, 26 SCRA 444, Jan. 21, 1997*).

- (j) The lessor *need not* be the owner (since after all, ownership is not being transferred).

[**NOTE:** A usufructuary thus may lease the premises in favor of a stranger, such lease to end at the time the usufruct itself ends; even a lessee himself may lease the property to another (this would result in a sublease).]

(3) 'Rent' Defined

Rent is the compensation either in money, provisions, chattels, or labor, received by the lessor from the lessee. (*Tolentino and Manio v. Gonzalez Sy Chiam, 50 Phil. 558*). In rural leases, the rent is usually in the form of a percentage of the fruits. This is the contract of *aparceria* or *land tenancy in shares*. Technically, this is a form of lease. However, under both our Codal Provisions and the Agricultural Tenancy Act (*Rep. Act 1199*), such a contract is more or less considered a form of partnership, where the landowner sort of furnishes the CAPITAL (land) and the tenant furnishes INDUSTRY (thru his labor). (*See also Arts. 1684 and 1685, Civil Code*). Hence, under Art. 1684, land tenancy shall be governed:

- (a) by special laws;
- (b) by the stipulations of the parties;

- (c) by the provisions on partnership;
- (d) by the customs of the place.

Moreover, under Art. 1685 “the tenant on shares cannot be ejected except in cases specified by law.” (*See Sec. 50, RA 1199*).

(4) Share Tenancy — When House is Constructed

When a tenant under a “share tenancy” (or tenancy in shares) erects a *house* on the agricultural lot that he is cultivating, is the relationship of landowner and tenant changed to that of lessor and lessee? It has been held that the original relationship of landowner and tenant exists, and therefore any question arising from such tenancy relationship, including ejectment, must be decided by the *Court of Agrarian Relations*, and not by any ordinary court. (*Ceferino Marcelo v. Nazario de Leon*, L-12902, Jul. 29, 1959). Indeed, the controlling laws are the tenancy laws, not those governing leases. (*Tumbangan v. Vasquez*, L-8719, Jul. 17, 1956). In fact, Rep. Act 1199 requires the landholder to give his tenant an area wherein the latter may construct his dwelling (Sec. 26), without thereby changing the nature of their relationship from landowner and tenant to lessor and lessee.

Ceferino Marcelo v. Nazario de Leon L-12902, Jul. 29, 1959

FACTS: On Feb. 14, 1957, Ceferino Marcelo, as attorney-in-fact of Severino Marcelo, filed in the Justice of the Peace Court of San Antonio, Nueva Ecija, a complaint to recover possession of a lot of 2,000 square meters belonging to said Severino Marcelo and held by the defendant, Nazario de Leon, “on the understanding that 1/2 of all the products raised in the occupied area, would be given to the landowner.” The complaint alleged that the defendant delivered the share of the products appertaining to the owner, but that when in Sept. 1956, the plaintiff notified the defendant that in addition thereto, he would have to pay a rental of two pesos per month, the latter refused, and continued refusing to pay such additional charges. Wherefore, the complaint prayed for judgment ordering the defendant to leave the premises, plus

damages and costs. The defendant questioned the court’s jurisdiction, arguing that the matter involved tenancy relations falling within the jurisdiction of the Agrarian Court; he also challenged the capacity of the plaintiff to sue.

HELD:

- (a) The Justice of the Peace Court had *no* jurisdiction, since this involves a tenancy relation, cognizable only by the Court of Agrarian Relations. The erection of the house did *not* change the relationship from landowner and tenant to lessor and lessee.
- (b) Moreover, the action was *not* brought in the name of the owner, the proper party in interest, hence the plaintiff in this case had no capacity to sue. (*Secs. 1 and 2, Rule 3, Rules of Court*).

(5) Distinctions Between ‘Lease of Things’ and ‘Other Contracts’

- (a) *Lease and Sale:*

<i>LEASE</i>	<i>SALES</i>
1. only <i>use</i> or <i>enjoyment</i> is transferred	1. ownership is transferred
2. transfer is temporary	2. transfer is permanent
3. lessor need not be the owner	3. seller must be the owner at the time the property is supposed to be delivered
4. the price of the object, distinguished from the rent, is usually not mentioned.	4. usually, the selling price is mentioned.

(*10 Manresa 445 and Heacock and Co. v. Buntal Mfg. Co., 6 Phil. 245*).

[**NOTE:** A lease of personal property with option to buy (at a nominal amount) (*Art. 1485*) at the end of the lease can be considered a sale. (*See Abella v. Gonzaga, 56*

Phil. 132; U.S. Com. Co. v. Halili, 49 O.G. 2281; Viuda de Jose v. Barrueco, 67 Phil. 191.)]

[**NOTE:** Civil law regards a lease even if for a number of years as a mere transfer of the use and enjoyment of the property, and holds the landlord (lessors bound), without any express covenant, to keep it in repair and otherwise fit for use and enjoyment for the purpose for which it is leased, even when the need of repair or the unfitness is caused by an inevitable accident, and if he does not do so, the tenant may have the lease annulled, or the rent abated. In the case of *Vda. de Villareal, et al. v. Manila Motor Co., Inc. and Colmenares (L-10394, Dec. 13, 1958)*, our Supreme Court distinguished this civil law rule from the rule in common law where the lease is regarded as conveyance to the lessee of a *temporary estate or title* so that loss of possession due to war or other fortuitous events leaves the tenant liable for the rent in the absence of stipulation.]

(b) *Lease and Simple Loan (Mutuum):*

<i>LEASE</i>	<i>SIMPLE LOAN</i>
1. lessor does <i>not</i> lose ownership	1. lender loses ownership
2. relationship is one of lessor and lessee	2. relationship is one of obligor and obligee
3. not governed by the Usury Law	3. governed by the Usury Law
4. if what is leased is <i>real property for more than one year</i> , the statute of frauds must be complied with	4. <i>not</i> governed by the Statute of Frauds
5. refers to real and personal property	5. refers only to personal property

(See Tolentino and Manio v. Gonzales Sy Chiam, 50 Phil. 558).

(c) *Lease and Commodatum:*

<i>LEASE</i>	<i>COMMODATUM</i>
<p>1. onerous contract (although the rent may later on be remitted)</p> <p>(NOTE: The lease, however, in favor of the U.S. Mil. Bases is <i>gratis</i>.)</p> <p>2. not essentially personal in character, hence right may be transmitted to heirs</p> <p>3. consensual contract</p>	<p>1. this is essentially <i>gratuitous</i>; if there is a price or rent, the contract ceases to be a <i>commodatum</i></p> <p>2. personal in character, thus death of either bailor or bailee ends the <i>commodatum</i></p> <p>3. real contract — requires delivery for perfection</p> <p>(NOTE: A contract, however, to <i>enter into a commodatum</i> is a consensual, not a real <i>contract</i>.)</p>

(d) *Lease and Usufruct:*

<i>BASIS</i>	<i>USUFRUCT</i>	<i>LEASE</i>
<p>1. as to EXTENT</p> <p>2. as to NATURE of the right</p> <p>3. as to the CREATOR of the right</p>	<p>1. covers all fruits and uses as a rule</p> <p>2. is <i>always a real</i> right</p> <p>3. can be created only by the <i>owner</i>, or by duly author-</p>	<p>1. Generally covers and uses as a rule only a particular or specific use</p> <p>2. is a real right only if, as in the case of a lease over REAL PROPERTY, the lease is REGISTERED, or is for MORE THAN ONE YEAR, otherwise, it is only a personal right</p> <p>3. the lessor <i>may</i> or <i>may not</i> be the owner (as when</p>

	ized agent, acting in behalf of the owner	there is a sub-lease)
4. as to ORIGIN	4. may be created by <i>law, contract, last will, or prescription (Art. 563)</i>	4. may be created as a rule only by <i>contract</i> ; and by way of exception by law (as in the case of an <i>implied</i> new lease, or when a builder has built in good faith a building on the land of another, when the land is considerably worth more in value than the building, etc.) (<i>See Art. 448</i>)
5. as to CAUSE	5. The owner is more or less PASSIVE and he ALLOWS the usufructuary to enjoy the thing given in usufruct — “ <i>dejagozar</i> ”	5. The owner or lessor is more or less ACTIVE, and he MAKES the lessee enjoy — “ <i>hace gozar</i> ”
6. as to REPAIRS	6. The usufructuary has the duty to make the ordinary repairs	6. The lessee <i>generally</i> has no duty to pay for repairs
7. as to TAXES	7. The usufructuary pays for the annual <i>charges and taxes</i> on the fruits	7. The lessee generally pays no taxes
8. as to other things	8. A usufructuary may lease the property itself to another. (<i>See Art. 572</i>)	8. The lessee cannot constitute a usufruct on the property leased

(e) *Lease and Employment*

In the leading case of *National Labor Union v. Dinglasan* (98 Phil. 64), the Supreme Court distinguished a contract of lease over chattels from a contract of employment, creating an employer-employee relationship.

In this case, the Court of Industrial Relations found that Dinglasan is the owner and operator of TPU jeepneys in Manila, while the petitioners are drivers who had oral contract with Dinglasan for the use of his jeepneys upon payment of P7.50 for 10 hours' use. This was also known as the boundary system. The drivers received no salaries or wages; their day's earnings being the excess over the P7.50 that they paid for the use of the jeepneys, and in the event they did not earn more, respondent Dinglasan did not have to pay them anything. Dinglasan's supervision over the drivers consisted in inspection of the jeepneys that they took out when they passed his gasoline station for water; and checking the route prescribed by the Public Service Commission, or whether any driver was driving recklessly and changing the tires of jeepneys.

The Supreme Court held that the petitioners, not having any interest in the business because they did not invest anything in the acquisition of the jeeps and did not participate in the management it — thereof, their service as drivers of the jeeps being their only contribution to the business, the relationship of lessor and lessee cannot be sustained. In the lease of chattels, the lessor loses complete control over the chattel leased although of course the lessee must not damage the property. In the present case, there is a supervision and sort of control that the owner of the jeeps exercises over the drivers. The only features that would make this apparently a case of lease are: the non-payment of a fixed wage and the collection as income of the excess over P7.50. These two features are not sufficient to withdraw from them the relationship of employer and employee. Indeed, the Court observed, the "boundary system" is an attempt to indirectly violate the labor and minimum wage laws. The Court concluded that as employees, the drivers are entitled to a *minimum compensation of P4.00 a day*.

(6) Queries

- (a) When a student boards and lodges in a dormitory, is there a contract of lease?

ANS.: No. The contract is not designated specifically under the Civil Code; hence, it is an innominate contract. It is, however believed that the contract can be denominated as the “contract of board and lodging.”

- (b) If for a certain amount I am given the use of a safety deposit box in a bank, is there a contract of lease?

ANS.: Yes, because I will be granted the use and enjoyment of the box for a price certain. This is certainly not a contract of deposit. (*T.S., Dec. 14, 1928, 3 Castan 121-122*).

(7) Cases

Syquia v. CA GR 61932, Jun. 30, 1987

The owner or lessor is free to choose the tenant of the premises under such terms and conditions as may enable him to realize reasonable and fair returns from it.

Imelda R. Marcos v. Sandiganbayan GR 126995, Oct. 6, 1998

All things viewed in proper perspective, it is decisively clear that there is a glaring absence of substantiation that the lease agreement under controversy is grossly and manifestly disadvantageous to the Government, as theorized upon by the prosecution.

That the sub-lease agreement was for a very much higher rental rate of P734,000 a month is of no moment. This circumstance did not necessarily render the monthly rental rate of P102,760 manifestly and grossly disadvantageous to lessor.

Evidently, the prosecution failed to prove that the rental rate of P102,760 per month was manifestly and grossly disadvantageous to the Government. Not even a single lease contract covering a property within the vicinity of the said leased premises was offered in evidence. The disparity between

the rental price of the lease agreement and that of the sub-lease agreement is no evidence at all to buttress the theory of the prosecution, “that the lease agreement in question is manifestly and grossly disadvantageous to the Government.” “Gross” is a comparative term. Before it can be considered “gross,” there must be a standard by which the same is weighed and measures.

What is more, when subject lease agreement was inked, the rental rate therein provided was based on a study conducted in accordance with generally-accepted rules of rental computation. On this score, a real estate appraiser who testified in the case as an expert witness and whose impartiality and competence were never impugned, assumed the court that the rental price stipulated in the lease agreement under scrutiny was fair and adequate. According to him (witness), the reasonable rental for subject property at the time of execution was only P73,000 per month. Suffice it to say, there are many factors to consider in the determination of what is a reasonable rate of what is a reasonable rate of rental.

That the lessee, PGHFI (Philippine General Hospital Foundation, Inc.), succeeded in obtaining a high rental rate of P734,000 a month, did not result in any disadvantage to the Government because obviously, the rental income realized by PGHFI from the sub-lease agreement augmented the financial support for and improved the management and operation of the Philippine General Hospital, which is, after all, a government hospital of the people and for the people.

(8) Membership in a Homeowners’ Association Is Voluntary and Cannot Be Unilaterally Forced

**Sta. Clara Homeowners’ Association
(thru its Board of Directors), etc. v. Spouses Victor Ma. Gaston & Lydia Gaston
GR 141961, Jan. 23, 2002**

FACTS: When private respondents purchased their property in 1974 and obtained Transfer Certificates of Titles (TCTs) T-126542 and T-127462 for Lots 11 and 12 of Block

37 along San Jose Ave., in Sta. Clara Subdivision (in Bacolod City, Negros Occidental), there was no annotation showing their automatic membership in the Santa Clara Homeowners' Association (SCHA).

Petitioners contend that even if private respondents are not members of the SCHA, an intracorporate controversy under the third type of dispute provided in Sec. 1(b) of Rule II of the HIGC (Home Insurance and Guaranty Corp.) Rules exists. Petitioners post that private respondent fall within the meaning of "general public."

ISSUE: Is membership in a homeowners' association compulsory and be unilaterally forced by a provision in the association's articles of incorporation or by-laws, which the alleged member has not agreed to be bound to?

HELD: No. Membership is vonluntary. In the case at bar, no privity of contracts arising from the title certificate exists between petitioners and private respondents. Records are bereft of any evidence that would indicate that private respondents intended to become members of the SCHA. Prior to the implementation of a Board Resolution of the SCHA, they and other homeowners who were not members of the association were issued non-member gate pass stickers for their vehicles. This fact has not been disputed by petitioners. Thus, the SCHA recognized that there were subdivision landowners who were not members thereof, notwithstanding the provisions of its Articles of Incorporation and By-Laws.

On the matter of whether an intracorporate controversy exists, the Supreme Court, in rule its is "not convinced" by petitioner's argument, had adduced two (2) cogent reasons, to wit:

1. The "third type of dispute" referred to refers only to cases wherein an association's right to exist as a corporate entity is at issue. In the present case, the Complaint filed by private respondents refers to the SCHA's acts allegedly amounting to an impairment of their free access to their place of residence inside the Sta. Clara Subdivision. The existence of SCHA as a corporate entity is clearly met an issue in the instant case.

2. In *United BF Homeowners' Association v. BF Homes, Inc.* (310 SCRA 304 [1999]), the Supreme Court held that Sec. 1(b), Rule II of HIGC's "Revised Rules of Procedure in the Hearing of Homeowner's Disputes" was void. The HIGC went beyond its lawful authority provided by law when it promulgated its revised rules of procedure. There was a clear attempt to unduly expand the provisions of PD 902-A. As provided by law, it is only the State — not the "general public or other entity" — that can question an association's franchise or corporate existence.

HIGC was initially called Home Financing Commission, thereafter Home Financing Corp., later Home Insurance and Guaranty Corp., until it finally became the Home Guaranty Corp. HIGC was created pursuant to RA 580. Originally, administrative supervision over homeowners' associations was vested by law in the Securities and Exchange Commission (SEC). (Sec. 3, PD 902-A). Pursuant to Executive Order 535, however, the HIGC assumed the regulatory and adjudicative functions of the SEC over homeowners' associations. The HIGC also assumed the SEC's original and exclusive jurisdiction to hear and decide cases involving controversies arising from intracorporate or partnership relations.

To reiterate, the HIGC exercises limited jurisdiction over homeowners' disputes. The law confines its authority to controversies that arise from any of the following intracorporate relations: (1) between and among members of the association; (2) between any and/or all of them and the association of which they are members; and (3) between the association and the state insofar as the controversy concerns its right to exist as a corporate entity. The aforesaid powers and responsibilities, which had been vested in the HIGC with respect to homeowners' associations, were later transferred to the Housing and Land Use Regulatory Board (HLURB) pursuant to RA 8763. (An Act Consolidating and Amending RA's 580, 1557, 5488, and 7835 and Executive Orders 535 and 90, as they apply to the Home Insurance and Guaranty Corp.).

Be it noted that in the instant case, the Complaint does not allege that private respondents are members of the SCHA. In point of fact, they deny such membership. Thus, the HIGC

has nor jurisdiction over the dispute. It is a settled rule that jurisdiction over the subject matter is determined by the allegations in the complaint. Jurisdiction is not affected by the pleas on the theories set up by the defendant in an answer or a motion to dismiss. Otherwise, jurisdiction would become dependent almost entirely upon the whims of the defendant. (*Commart [Phils.], Inc. v. SEC, 198 SCRA 73 [1991]*).

It should be stressed that the Complaint here is for damages. It does not assert membership in the SCHAs as its basis. Rather, it is based on an alleged violation of their alleged right of access thru the subdivision and on the alleged embarrassment and humiliation suffered by plaintiffs.

Art. 1644. In the lease of work or service, one of the parties binds himself to execute a piece of work or to render to the other some service for a price certain, but the relation of principal and agent does not exist between them.

COMMENT:

(1) Lease of ‘Work’ or ‘Service’

The Article speaks of a “lease of work or service.” Are not “work” and “service” synonymous?

ANS.: Yes, but what are evidently referred to are:

- (a) the contract for “a piece of work” (inaccurately referred to as *lease of work*);
- (b) the contract of “lease of services.”

(2) Distinctions Between the Lease of Services and Contract for a Piece of Work

<i>LEASE OF SERVICES</i> <i>(“locatio operatum”)</i>	<i>CONTRACT FOR A</i> <i>PIECE OF WORK</i> <i>(“locatio operis”)</i>
(a) The important object here is the <i>labor</i> performed for the lessor.	(a) The important object here is the <i>work done</i> (the <i>result</i> of the labor).

(b) The result is generally <i>not</i> important, hence, the laborer is entitled to be paid even if there is destruction of the work thru a fortuitous event.	(b) The result is generally important. Generally the price is not payable until the work is completed, and said price cannot generally be lawfully demanded if the work is destroyed before it is finished and accepted.
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(*Chartered Bank v. Constantino*, 56 Phil. 717; 3 *Castan* 193).

(3) Examples

(a) *Lease of Services*

- 1) If a shoemaker is employed by me for 8 hours a day, with the duty of making shoes.
- 2) The job of a pre-bar or pre-week reviewer. (Whether or not the pre-bar reviewees pass the bar is not generally important; what is controlling is the fact that the professor is paid for his efforts.)

(b) *Contract for a Piece of Work*

- 1) If a shoemaker is asked to make shoes “to order”
- 2) If a tailor is asked to make a suit of clothes
- 3) If an engineer or independent contractor is asked to construct a road or a house
- 4) If an orchestra is hired to furnish music, whether the service be done nightly or only on special occasions.

[However, if the individual musicians are hired individually by the management of a hotel for instance, if their instruments are selected, and if individually said musicians can be discharged, not by the orchestra leader, but by the management, this should be considered a lease of services. (*See Viuda de Tirso Cruz, et al. v. Manila Hotel*, 53 O.G. 8540).]

(4) Similarities

In *both* lease of services and contract for a piece of work:

- (a) There is a price certain (compensation);
- (b) The relation of principal and agent does not exist between the lessor and lessee. (*Art. 1644*).

(5) Distinctions Between 'Lease of Services' and 'Agency'

**Nielsen & Co., Inc. v.
Lepanto Consolidated Mining Co.
L-21601, Dec. 28, 1968**

FACTS: Nielsen was hired in 1937 by Lepanto Consolidated Co. to manage the Company, that is, to manage and operate the mining properties on behalf of Lepanto, and to act as purchasing agent of supplies, but before such purchase could be made, prior approval of the Company was required. The contract was for 5 years, subject to Nielsen's right to renew the same for another period of 5 years (hence, a total of 10 years). The contract also provided that in the event of war or fortuitous event that would make operation impossible the contract would be *suspended*. The contract likewise provided that if Nielsen would act in bad faith and mismanage the mining operations, he could be dismissed after a three-month notice. After working for more than 4 years (1937 to early 1942), Nielsen's work was interrupted because of the Pacific War. After liberation in 1945, Lepanto dismissed Nielsen and assumed management by itself. Nielsen insisted, however, on continuing his work (to rehabilitate the mines, to restore them to pre-war operating conditions). In 1948, however, after the rehabilitation, Nielsen was again dismissed and not allowed to continue as manager. Nielsen claims damages on the theory that of the 10-year tenure, only more than 4 years has elapsed; that from early 1942 to 1948, the contract of management was *suspended*, that, therefore, he was deprived of *more than 5 more years* of work. Lepanto however claims that Nielsen was merely its agent; that agency is revocable at the will of the principal; that the period of suspension of the contract should only be for three years (1942-1945, the end of the war).

ISSUES:

- (a) Was the contract one of agency or one of lease of services?
- (b) Was the contract terminable at the will of Lepanto?
- (c) For how long was the contract suspended?
- (d) Is Nielsen entitled to damages (unpaid salary for the remaining term; 10% of certain items such as dividends, interest, etc.)?

HELD:

- (a) The contract was one of lease of services, not one of agency. While in both lease of services and agency one party renders some service to another, there are distinctions:
 - 1) The basis of lease of services is *employment*; the lessor of services does *not represent* his employer, nor does he *execute juridical acts* (creation, modifications, relations between the employer and third parties).
 - 2) On the other hand, the basis of agency is *representation*, the agent *represents* his principal, and enters into juridical acts; moreover, agency is only a *preparatory* contract — because the purpose is to enter into other contracts.

Now then, Nielsen was to operate the mines, hire a sufficient and competent staff, and in doing so, act in accordance with accepted mining practices. Clearly, this is a *lease of service*. While it is true that Nielsen was supposed to be also a “purchasing agent” regarding supplies, he could not purchase without the prior approval of Lepanto; he could not therefore enter into “juridical acts.” Hence, even on this point, he was to act only as an *intermediary*, not as an agent.

- (b) Since the contract was not one of agency, it was not terminable at Lepanto’s will. In fact, the contract expressly provides that termination of services would only be in

cases of Nielsen's bad faith. There is no evidence of his bad faith.

- (c) Under the terms of the contract, war could suspend the effectivity of the contract. While the war ended in 1945, the period of the suspension should be counted up to 1948 (because not till then were the mines fully rehabilitated). The contract therefore should have been extended for more than 5 years more; this was not done.
- (d) In view of the unwarranted termination, Nielsen is entitled to various kinds of damages. (Incidentally, with respect to the "10% of the dividends," this did not mean that Nielsen should get 10% of the stock dividends given to the stockholders; otherwise, said stockholders would only get 90%. Rather, this meant that Nielsen would get 10% of the cash value of the dividend — computed as of the moment the dividends were declared — with legal interest thereon).

(6) Compensation in Lease of Services

- (a) If no specific agreement is made, the price should be the reasonable value or worth of the services that have been rendered. (*Perez v. Pomar*, 2 Phil. 262).
- (b) Custom or local use may be availed of in determining the compensation. (*Herrera v. Cruz*, 7 Phil. 275).
- (c) If no new agreement is required to fix the price, the price is already considered certain. Hence, when it was stipulated that the price for a lease of services would be the cost of the maintenance of a servant and her family, the Supreme Court has held that the price here is already fixed. All that remains to be proved would be the actual cost. (*Majarabas v. Leonardo*, 11 Phil. 272; see *Imperial v. Alexandre*, 14 Phil. 204 and *Arroyo v. Azur and Dura*, 76 Phil. 493). In some cases, the courts are authorized to fix the reasonable rates. (See *Arroyo v. Azur and Dura*, *supra*; *Urrutia and Co. v. Pasig Steamer and Lighter Co.*, 22 Phil. 330).
- (d) A served, but subsequently wrote the employer that he was renouncing his compensation. Is there still a lease of services here?

HELD: Yes, although in this case, the lease has become gratuitous. (*Arroyo v. Hospital de San Pablo*, 81 Phil. 333).

Art. 1645. Consumable goods cannot be the subject matter of a contract of lease, except when they are merely to be exhibited or when they are accessory to an industrial establishment.

COMMENT:

(1) General Rule for Lease of Consumable Goods

Consumable goods cannot be the subject matter of a contract of lease of things. (*Art. 1648, 1st part*).

REASON: To use or enjoy them, they will have to be consumed. This cannot be done by the lessee since ownership over them is NOT transferred to him by the contract of lease.

(2) Exceptions

They may be leased:

- (a) if they are merely to be *exhibited* as for display purposes (lease *ad pompan et ostentationem*);
- (b) or if they are *accessory* to an industrial establishment (*example* — oil in an industrial firm).

Chapter 2

LEASE OF RURAL AND URBAN LANDS

Section 1

GENERAL PROVISIONS

INTRODUCTORY COMMENT

(1) ‘Rural Lands’ Defined (Product-Producing Lands)

Regardless of site, if the principal purpose is to obtain products from the soil, the lease is of *rural lands*. Hence, as used here, rural lands are those where the lessee principally is interested in soil products. (*3 Castan 124*).

(2) ‘Urban Lands’ Defined (Non-Product Producing Lands)

Lands leased principally for purposes of residence are called urban lands. (*See 3 Castan 124*).

(3) Problem

If a professor rents as a summer resort a small house in a farm, is this a rural or an urban lease?

ANS.: Clearly, this would be an urban lease even in the house is situated on a farm.

(4) Form for the Contract of Lease of Things

Lease may be made ORALLY, but if the lease of real property is for more than one year, it must be in WRITING under the Statute of Frauds. (*Art. 1403, No. 2, Civil Code*).

[NOTE: Where the written contract of lease called for the erection by the tenant, of a building of strong wooden

materials, but what he actually did construct on the leased premises was semi-concrete edifice at a much higher cost, in accordance with a subsequent oral agreement with the lessor, oral evidence is admissible to prove the verbal modification of the original terms of the lease. (*Paterno, et al. v. Jao Yan, L-12218, Feb. 28, 1961*).]

Art. 1646. The persons disqualified to buy referred to in Articles 1490 and 1491, are also disqualified to become lessees of the things mentioned therein.

COMMENT:

Persons Disqualified to Be Lessees Because Disqualified to Buy

(a) A husband and a wife *cannot lease* to each other their separate properties except:

- 1) if a separation of property was agreed upon in the marriage settlement;
- 2) If there has been a judicial separation under Art. 135 of the Family Code. (*See Art. 1490, Civil Code*).

[**NOTE:** Reasons for the disqualification:

- 1) To prevent prejudice to creditors;
- 2) To prevent the stronger spouse from influencing unduly the weaker spouse.]

[**NOTE:** Does the prohibition apply even if the spouses are merely *common law spouses*?

ANS.: Yes, otherwise said spouses would be placed in a better position than legitimate spouses.]

(b) Persons referred to under Art. 1491 are disqualified because of *fiduciary relationships*. While foreigners in general cannot buy rural or urban lands, they may become lessees thereof since the reason for the law — fiduciary relationship — does not exist in this case. (*Smith, Bell and Co. v. Reg. of Deeds, 96 Phil. 53*). Hence, foreigners may lease land from others. (*Art. 1643*).

Art. 1647. If a lease is to be recorded in the Registry of Property, the following persons cannot constitute the same without proper authority: the husband with respect to the wife's paraphernal real estate, the father or guardian as to the property of the minor or ward, and the manager without special power.

COMMENT:

(1) Purpose in Recording a Lease

A lease does not have to be recorded in the Registry of Property to be binding between the parties; registration is useful only for the purposes of notifying strangers to the transaction. (*See Art. 1648*).

(2) Proper Authority Required

If a lease is to be recorded, the following persons must have PROPER AUTHORITY (power of attorney to constitute the lease):

- (a) the husband (with respect to the *paraphernal real estate* of the wife);
- (b) the father or guardian (with respect to the property of the minor or the ward);
- (c) the manager (administrator) (with respect to the property under his administration).

[NOTE: The “manager” here may be:

- 1) the administrator of conjugal property (*Rodriguez v. Borromeo*, 43 Phil. 479);
- 2) the administrator of a co-ownership (*Melencio v. Dy Tiao Lay*, 56 Phil. 91);
- 3) the administrator of state patrimonial property. (*Tipton v. Andueza*, 5 Phil. 477).]

(3) Administration of Paraphernal Property

Is the husband the administrator of the paraphernal real property of the wife?

ANS.: No, unless such administration has been transferred to him by virtue of a public instrument. (*Art. 110, Family Code*).

**Chua v. Court of Appeals
L-60015, Dec. 19, 1984**

If a husband, in a contract of lease, alienates the conjugal building (considered in the contract as personal property) without his wife's consent, the sale is VALID. Here, the lessor and lessee agreed that the lessor would become the owner of the improvements constructed. Be it noted that the contract is the law between the parties.

(4) Authority of Husband to Lease Paraphernal Property to Others

A husband was properly given by his wife authority to administer the paraphernal real property. Does this necessarily mean that just because the husband is now the administrator, he can lease said property without any further authority?

ANS: It depends.

- (a) If the lease will be for *one year or less*, no other authority is required.
- (b) But if the lease on the real property will be for *more* than one year, then a special power of attorney (aside from the public instrument transferring administration) is required. (*Art. 1878, No. 8, Civil Code*).
- (c) Furthermore, whether it be (a) or (b), if the lease is to be *recorded* (to prejudice third persons), there must be special power. (The authority for administration is not sufficient.) (*Art. 1647, Civil Code*).

(**NOTE:** If it is the wife who is administering her paraphernal real estate, the husband has NO authority whatever, to lease, in any way, or administer the property.)

[**NOTE:** Under the old Civil Code, an administrator could not lease real property for more than six years without special power (*Tipton v. Andueza*, 5 Phil. 477; *Rodriguez v. Borromeo*, 43 Phil. 497); in the new Civil

Code, the power of the administrator is decreased because if the lease is for *more than one year*, a special power of attorney is now required.]

Tan Queto v. Court of Appeals
GR 35648, May 16, 1983

If a husband leases his wife's paraphernal property (without her consent) in favor of another, the contract is *not effective* and may be annulled or cancelled by the Court.

(5) Reason for Requiring the Special Power of Attorney if the Lease is to be Recorded in the Registry of Property

Once said lease is recorded, it becomes binding on third persons (*Art. 1648*) and is, therefore, a real right — *an act of strict ownership* and not merely an act of administration.

(6) Authority of Father Administering Child's Real Estate

If a father who is administering the real estate of his minor son, wants to record the lease, should he ask for *judicial permission*?

ANS.: Yes. (*Art. 1647*). But even if no judicial authorization is asked, such defect cannot be invoked by a lessee who has dealt with him. (*Summers v. Mahinay, [C.A.] 40 O.G. [11th S] No. 18, p. 40*). Only the son or his own heirs may question the validity of the transaction.

Art. 1648. Every lease of real estate may be recorded in the Registry of Property. Unless a lease is recorded, it shall not be binding upon third persons.

COMMENT:

(1) Recording of Lease of Real Property

- (a) The Article applies only to *real* property. Leases of personal property cannot be registered.

[**NOTE:** How can leases of *personal* property be binding on third persons?

ANS.: By executing a public instrument. (See Art. 1625, by *analogy* with the rule on assignment of a credit right, or action involving personal property).]

- (b) Is lease a real or a personal right?

ANS.: Generally, it is a personal right. But it partakes of the nature of a real right if:

- 1) the lease of real property is for *more than one year*;
- 2) the lease of real property is *registered* regardless of duration.

[NOTE: In both cases a special power of attorney is required because these are acts of strict dominion, and *not* merely of administration. (See Arts. 1647, 1878, No. 8).]

(2) Effects if the Lease of Real Property is Not Registered

- (a) The lease is not binding on innocent *third persons* such as a purchaser. (*Salonga, et al. v. Acuña, C.A., 54 O.G. 2943*).
- (b) Naturally, such an innocent third person is allowed to terminate the lease in case he *buys* the property from the owner-lessor. (*Art. 1676*).
- (c) When a third person already knows of the *existence* and duration of the lease, he is bound by such lease even if it has not been recorded. The reason is simple: actual knowledge is, for this purpose, equivalent to registration. (*Quimson v. Suarez, 46 Phil. 90 and Gustilo v. Maravilla, 48 Phil. 442*).
- (d) If the stranger knows of the existence of the lease, but has been led to believe that the lease would expire very soon, or before the new lease in favor of him begins (when in fact this was not true), the stranger can still be considered innocent. (*Quimson v. Suarez, 46 Phil. 901*).

Art. 1649. The lessee cannot assign the lease without the consent of the lessor, unless there is a stipulation to the contrary.

COMMENT:**(1) Assignment of the Lease**

Example:

Sonia leased a house from Esperanza. In general, can Sonia assign the lease of the house to Bella, without Esperanza's consent?

ANS.: In general, no. *Exception* — If there was a stipulation in the lease contract between Sonia and Esperanza that Sonia could make the assignment. (*Art. 1649*).

(2) Reason for the Law

An assignment of this nature constitutes a NOVATION (by substituting the person of the debtor) so the creditor-lessor must consent. (*Vda. de Hijos de Barretto v. Sevilla, Inc.*, 62 *Phil.* 593). An assignment exists when the lessee has by the contract made an *absolute transfer* of his interest as lessee, and has thus dissociated himself from the original contract of lease. In such a case his personality disappears, and there remains only in the juridical relation, two persons: the lessor and the assignee, who is converted into a lessee. (*Manlapat v. Salazar*, 98 *Phil.* 366, *citing 10 Manresa, 1950 ed.*, p. 510; 32 *Am. Jur.* 290; 51 *C.J.S.* 553). Indeed, the rights of the assignee as a lessee are enforceable not against the assignor, but against the *lessor*. No wonder, the lessor has to give his approval to an assignment before it can validly be made. (*Sy Juco v. Montemayor*, 52 *Phil.* 73).

Dakudao v. Judge Consolacion
GR 54753, Jun. 24, 1983

The objective in Art. 1649 of the Civil Code in prohibiting assignment of the lease without the lessor's consent, is to protect the lessor. If the *illegal* assignee is sought to be ejected, he cannot claim that it is forcible entry that must be filed against him for the possession was illegal from the very beginning. A suit of unlawful detainer is all right. After all, substantial justice cannot be eroded by procedural technicalities, even if correct and valid.

(3) When ‘Assignment’ is Not Really an assignment

If in an assignment of a lease there is an express stipulation that the assignment “does not carry with it any of the liabilities and obligations” of the lessee-assignor, this contract by itself is NOT the assignment contemplated under this Article. Hence, here the consent of the lessor is not required; moreover, the lessor *cannot*, by virtue of such stipulation, have any right of action against the assignee. Thus, for example, the lessor cannot require the assignee to pay the unpaid rentals of the assignor. (*See Shotwell, et al. v. Manila Motor Co., et al., L-7637, Dec. 29, 1956, O.G. 1423*).

(4) Mortgage of the Lease Rights

Since the lessee is the owner of the lease right (not the property itself), it is possible and legal for him to mortgage the said right. Does he need the permission of the lessor for this?

ANS.: Yes, just as he needs such consent in “assignment.” However, it is submitted that a mortgage, if not consented to by the lessor, will not be void; it will merely be annullable or rescindable, insofar as the lessor’s rights are prejudiced.

Art. 1650. When in the contract of lease of things there is no express prohibition, the lessee may sublet the thing leased, in whole or in part, without prejudice to his responsibility for the performance of the contract toward the lessor.

COMMENT:**(1) Right of Lessee to Sublease**

Unlike in assignment, a lessee may generally *sublease* the property in the *absence of express prohibition*. Why is this so? The reason is simple: the *lessee remains a party* to the lease even if he has already created a sublease thereon. Hence, for example, he still must pay rents to the lessor.

(2) ‘Sublease’ Distinguished from ‘Assignment’

<i>SUBLEASE</i>	<i>ASSIGNMENT</i>
(a) the lessee retains an interest in the lease; he remains a party to the contract	(a) the lessee makes an absolute transfer of his interest as lessee; thus, he <i>dissociates</i> himself from the original contract of lease
(b) the sublessee does <i>not</i> have any direct action against the lessor	(b) the assignee has a direct action against the lessor
(c) can be done even without the permission of the lessor (unless there be an express prohibition)	(c) cannot be done unless the lessor consents

(*Manlapat v. Salazar*, 98 Phil. 356, citing 10 Manresa, 1960 ed., 510; 32 Am. Jur. 290; 51 C.J.S. 533; *Nava v. Yaptinchay*, C.A. 44 O.G. No. 9, p. 3332; Arts. 1649 and 1650).

Manlapat v. Salazar
98 Phil. 356

FACTS: A lease was entered into, the lease to last until Jun. 1, 1967. The lessee then entered into a contract with Salazar, stating that:

- (a) she would lease the *same* property to Salazar until May 31, 1967 (a *shorter* period than the original lease, by one day);
- (b) the lessee would respect the contract with Salazar and would pay the latter damages if she (the lessee) would again sublease the property to another;
- (c) the lessee (sublessor) would pay the land and other taxes on the property;
- (d) the cutting of any tree on the land was forbidden without the sublessor’s consent;

- (e) Salazar should return the land to the sublessor, upon the expiration of the sublease.

Inasmuch as the contract was entered into without the consent of the lessor, he alleged that the contract was void on the ground that the same was an assignment, not a sublease. *Issue:* Is this an assignment or a sublease?

HELD: This is a sublease, and therefore it could be effected even without the lessor's consent there being no express prohibition on a sublease. The sublessor has not stepped out of the original contract; she remains a party to it. All the terms (given above) of the sublease clearly indicate that indeed a sublease, not an assignment, has been agreed upon. Moreover, the underletting for a period less than the entire term in this case (indeed, the reservation of even so short a period as the last day of the term) makes the transfer a sublease, and not an assignment.

(3) Effect of Implied Prohibition to Sublease

Note that Art. 1650 says "express prohibition." Hence, if the prohibition is *merely implied*, a sublease will still be allowed. (*Susana Realty v. Fernandez, et al.*, C.A., 54 O.G. 2206).

(4) Problem

A lessee entered into a contract of sublease, although he was expressly prohibited to do so. He then placed the sublessee in possession of the premises. If you were the lessor, what right, if any, do you have?

ANS.: I can ask:

- (a) for *rescission* of the contract of lease and *indemnification for damages*; OR
- (b) for indemnification of damages only (the contract will be allowed to remain in force). (*Art. 1659*).

[NOTE: Can I have the above-mentioned remedies even if:

- (a) there is a subsisting contract of sublease?

- (b) the sublessee is financially solvent?

ANS.:

- (a) Yes, for the sublease does not alter the fact that there is a contract of lease which has been broken. Hence, if the lessor so desires, he may ask rescission of the lease contract. (*Cells v. De Vera, C.A., 39 O.G. 652*). And once the lessee is asked to get out, the sublessee must naturally also get out, for the existence of the sublease depends only on the existence of the lease. (*Sipin v. Court, 74 Phil. 640; Go King v. Geronimo, 81 Phil. 445*). (It should be noted, however, as a corollary that if the court finally finds that the lessee still has the right to continue in the lease, the lessor would have no legal right to dispossess the sublessee. Therefore, although in an unlawful detainer case against both the lessee and sublessee where the latter failed to appeal, execution cannot be issued against him pending disposal of the appeal of the lessee. (*Del Castillo v. Teodoro, Sr., et al., L-10486, Nov. 27, 1967*).
- (b) Yes, because whether the sublessee is financially solvent or not is completely beside the point. What is important is that the lease contract has been violated, in view of the express prohibition against the sublease. Moreover, where the law admits of no distinction, we should not distinguish.]

(5) Another Problem

A lessee subleased the property to another. The lessor had not expressly prohibited him to do so.

- (a) Is the sublease valid?
- (b) Does the lessee still remain bound to the lessor

ANS.:

- (a) Yes, in view of the absence of the express prohibition. (*Art. 1650*).
- (b) Yes, by express provision of the law which states that the lessee is still responsible for the performance of the lease contract.

(6) Case

**Filoil Refinery Corp., et al. v.
Judge Mendoza, et al.
GR 55526, Jun. 15, 1987**

FACTS: Garcia sued FILOIL and PETROPHIL to rescind a contract of lease over a parcel of land. Garcia alleged that the signatory FILOIL Refinery violated the terms and conditions of the lease agreement in that the latter subleased the land to FILOIL Marketing, which in turn assigned its sublease to PETROPHIL. The lease contract, however, contains no express prohibition against assignment of the leasehold right. The trial court rescinded the lease.

HELD: Under the law, when there is no express prohibition, the lessee may sublet the thing leased.

Art. 1651. Without prejudice to his obligation toward the sublessor, the sublessee is bound to the lessor for all acts which refer to the use and preservation of the thing leased in the manner stipulated between the lessor and the lessee.

COMMENT:**(1) Liability of Sublessee Towards Lessor**

Note that although the sublessee is not a party to the contract of lease, the sublessee is still **DIRECTLY** liable to the lessor for acts appertaining to the **USE** and **PRESERVATION** of the property. This is of course in addition to the sublessee's obligation to the sublessor. Note also that the liability for **RENT** is given in Art. 1652.

(2) Direct Action by the Lessor (*Accion Directa*)

If the sublessee misuses the property, the lessor may directly bring an action against him (**ACCION DIRECTA**). This is true, notwithstanding the fact that the sublessee is not a party to the lease contract.

Example: A sublessee did not use the thing leased properly, so the lessor brought an action against him directly. Defense was that the sublessor should have been joined as a defendant.

HELD: There was no need of the joinder because under the law the sublessee is directly responsible in a case like this. (*Ortiz v. Balgos*, 54 Phil. 171).

(3) Problem

Adelaida leased a house to Sonia who in turn validly subleased the house to Leopoldo. If Adelaida breaks the contract of lease, can Leopoldo sue her for damages?

ANS.: No, it is Sonia, the lessee, who can sue Adelaida.

In turn, Sonia should ask not only for damages she may personally suffer, but also for those damages which she will have to pay Leopoldo. It should be noted that it is Sonia herself who is directly liable to the sublessee Leopoldo. (*See A. Maluenda and Co. v. Enriquez*, 46 Phil. 916).

(4) Case

Marimperio Compania Naviera, SA v. CA GR 40234, Dec. 14, 1987

In a sublease, there are two leases and two distinct juridical relations although intimately connected and related to each other, unlike in a case of assignment of lease, where the lessee transmits absolutely his rights, and his personality disappears. There only remains in the juridical relation two persons, the lessor and the assignee who is converted into a lessee. In a contract of sublease, the personality of the lessor does not disappear. He does not transmit absolutely his rights and obligations to the sublessee. The sublessee generally does not have any direct action against the owner of the premises as lessor, to require the compliance of the obligations contracted with the plaintiff as lessee, or vice versa.

There are at least two instances in the Civil Code which allow the lessor to bring an action directly (*accion directa*) against the sublessee (use and preservation of the premises

under Art. 1651, and rentals under Art. 1652). In said two articles, it is not the sublessee, but the lessor, who can bring the action.

Art. 1652. The sublessee is subsidiarily liable to the lessor for any rent due from the lessee. However, the sublessee shall not be responsible beyond the amount of rent due from him, in accordance with the terms of the sub-lease, at the time of the extrajudicial demand by the lessor.

Payments of rent in advance by the sublessee shall be deemed not to have been made, so far as the lessor's claim is concerned, unless said payments were effected in virtue of the custom of the place.

COMMENT:

(1) Subsidiary Liability of Sublessee for the Rent

Note that the sublessee is only SUBSIDIARILY liable to the lessor for the rent owed by the lessee. And even this subsidiary liability is LIMITED to the rent owing from the sublessee at the time of EXTRA-JUDICIAL demand by the LESSOR (generally payment in ADVANCE is disregarded insofar as the lessor is *concerned* — except if justified by the custom of the place).

(2) Reason for the Disregard in General of Advanced Payment

This is to prevent a collusion between the sublessor, who may be insolvent, and the sublessee. The lessor should not be prejudiced. (*Celis v. De Vera, C.A., 39 O.G. 652*).

(3) Effect on Sublessee if the Lessee is Ousted

If the lessee is ejected, the sublessee should also be ousted. This is so even if the sublessee was not sued in the ejectment case. (*Go King v. Geronimo, 81 Phil. 645*). The right of the sublessee to remain depends on the right of lessee himself to remain. (*Sipin v. Court of First Instance, 74 Phil. 649; Phil. Consolidated Freight Lines, Inc. v. Ajon, et al., L-10206-08, Apr. 16, 1958; Madrigal v. Ang Sam To, 46 O.G.,*

p. 2173 and Duellome v. Gotico, L-17846, Apr. 29, 1963). If an unlawful detainer case is brought against the lessee and the sublessee, and the sublessee does NOT appeal, but the lessee appeals, in the meantime can execution issue against the sublessee? No, for the meantime, the lessee has a right to remain; therefore, and in the meantime also, the sublessee himself may remain. (*Del Castillo v. Teodoro, Sr., et al., L-10486, Nov. 27, 1957*).

Sipin, et al. v. CFI of Manila
74 Phil. 649

FACTS: A leased a house to B who in turn leased part of it to C. A ousted B thru lawful proceedings. Should C be also ousted? If so, what would be C's remedy?

HELD: Yes, C should also be ousted. The remedy of C would be to proceed against B. The sublessee can invoke no right superior to that of his sublessor, and the moment the latter is duly ousted from the premises, the former (sublessee) has no leg to stand on. The sublessee's right is to demand reparation for damages from his sublessor, should the latter be at fault.

Brodett v. De la Rosa
77 Phil. 572

ISSUE: When the sublessor is ousted in an unlawful detainer case, who else may be ousted even if they have not been made party-defendant?

HELD: The sublessee, the relatives, the friends of the sublessor and sublessee.

[NOTE: Also, the house guests of the sublessor and sublessee. (Cruz v. Roxas, 42 O.G. No. 3, p. 468).]

Phil. Consolidated Freight Lines,
Inc. v. Ajon, et al.
L-10206-08, Apr. 16, 1958

FACTS: The plaintiff, Phil. Consolidated Freight Lines, was the owner of the building built on a parcel of land leased by him from the government. The plaintiff leased the premises to somebody who in turn leased the building to the defendants

(Ajon). Upon the failure of the plaintiff to pay the fees for his possession of the land to the Bureau of Lands, the Director of Lands wrote the plaintiff to the effect that whatever rights it had over the land were considered forfeited. The Director also addressed letters to the defendants, who had previously been paying rentals to the plaintiff's lessee, to pay the rentals for the portions of the lot occupied by them. When they received these letters, the defendants refused to pay any further rentals to the plaintiff, either for the land or for the building, so plaintiff filed an action to eject the defendants. The defendants however claimed that since, the administrator of the lot, the Director of Lands, has ordered them to pay rentals directly to him, said official had withdrawn possession of the premises from the plaintiff and had transferred and ceded the same to them.

HELD: The defendants are occupying not only the land of the government, but the building of the plaintiff as well. If the defendants are in possession of the land, it is only because the plaintiff's building stands thereon. Their possession of the land is, therefore, dependent on and cannot be dissociated from their possession of the building. As the building admittedly belongs to the plaintiff, they cannot assert any superior right to possess the same as against plaintiff. They cannot likewise assert any better right to possess the land on which the building stands. So also the plaintiff cannot be deprived of its possession of the land without the proper court action (*Art. 536*), especially because it has a building in the premises of which it would be deprived without due process of law, if the Director of Lands is permitted to terminate its right to possess by a mere extrajudicial unilateral act. Lastly, the notice sent by the Director to the defendants to pay the rents directly to him, cannot legally constitute termination of the plaintiff's possession of the premises. In sending this notice, the Director merely availed himself of the remedy granted by law to collect from the sublessee in case of failure of the lessee to pay the rents due.

Syjuco v. CA and Pilipinas Bank
GR 80800, Apr. 12, 1989

When a lessee's right to remain terminates, the right of sublessees to continue in possession ceases to exist, being privies of the lessee.

**Julius C. Oreano v. CA, et al.
GR 96900, Jul. 23, 1992**

Although it is provided in Art. 1652 of the Civil Code that the sublessee is subsidiarily liable to the lessor for any rent due from the lessee, the sublessee shall not be responsible beyond the amount of rent due from him, in accordance with the terms of the sublease, at the time of the extrajudicial demand by the lessor.

Art. 1653. The provisions governing warranty, contained in the Title on Sales, shall be applicable to the contract of lease.

In the cases where the return of the price is required, reduction shall be made in proportion to the time during which the lessee enjoyed the thing.

COMMENT:

(1) Lessor's Warranties

The warranties are against:

- (a) eviction;
- (b) hidden defects.

(2) Partial Delivery of the Land

If only part of the land contracted for the lease is delivered, there can be a proportionate reduction of the rent. (*Villafuerte v. Velasco*, 48 O.G. 4896).

(3) Liability of Lessor for Hidden Defects

Should there be hidden defects, damages will not ordinarily be assessed against the lessor unless he acted with fraud or bad faith. (*Yap Kim Chuan v. Tiaoqui*, 31 Phil. 433). However, in one case, where the tenant's foodstuffs were destroyed by *rodents* found in the room, the lessor was found liable for damages for having violated the warranty. (*V.S. Lines Co. v. SMB*, L-19383, Apr. 30, 1964).

Section 2

RIGHTS AND OBLIGATIONS OF THE LESSOR AND THE LESSEE

Art. 1654. The lessor is obliged:

(1) To deliver the thing which is the object of the contract in such a condition as to render it fit for the use intended;

(2) To make on the same during the lease all the necessary repairs in order to keep it suitable for the use to which it has been devoted unless there is a stipulation to the contrary;

(3) To maintain the lessee in the peaceful and adequate enjoyment of the lease for the entire duration of the contract.

COMMENT:

(1) Three Important Duties of the Lessor

- (a) Delivery of the object
- (b) Making of necessary repairs
- (c) Maintenance in peaceful and adequate possession

(2) The Duty to Deliver

- (a) The object of the contract must be delivered; if the lessor does not do so, he can be compelled. (*Cruz v. Seminary*, 81 Phil. 330). Thus, it has been held that if the lessee fails to take possession of a leased fishpond on account of the presence of persons unwilling to vacate the premises because of some previous act or transaction of the lessor, there is a BREACH of the obligation of the lessor "to deliver the thing which is the object of the contract in such a condition as to render it fit for the use intended" as well as of his obligation "to maintain the lessee in the peaceful and adequate enjoyment of the lease for the entire duration of the contract." (*Rivera v. Halili*, L-16159, Sept. 30, 1963).

- (b) Its condition must be such as to render it fit for the use intended. (The use may be *agreed upon or merely implied*.)

(A clear contrary stipulation regarding the *fitness* of the thing may of course be allowed. This would therefore be a WAIVER.)

Query: Can the duty itself to DELIVER be waived?

ANS.: It is submitted that this cannot be done. Delivery may of course be actual or constructive. If no delivery of any kind is made it would be impossible for the lessee to enjoy the object leased.

(**NOTE:** Though delivery must be made, this does not mean that the contract of lease is a real contract. It is still **CONSENSUAL**, perfected by mere consent. In this regard, therefore, it is similar to a **SALE**.)

(3) The Duty to Make Necessary Repairs

- (a) *Repairs contemplated* — all the *necessary* repairs in order to keep it suitable for the *use* to which it has been devoted unless there is a stipulation to the contrary (as when the lessee had agreed to do the repairs). (*See Gonzales v. Mateo, 74 Phil. 373*).

HENCE, it includes:

- 1) The above-mentioned repairs whether due to nature, fortuitous event or lapse of time. (NOT those caused by the fault of the lessee himself or of his privies; otherwise, the lessor will be unduly prejudiced.)
 - 2) The above-mentioned repairs whether the defect is **PRIOR** to or **AFTER** the delivery of the object. This is evident since the law makes *no* distinction.
- (b) The term “repairs” does NOT include:
 - 1) A “reconstruction” of a leased house or *camarin* that has been *completely* destroyed by fire. *Reason:* Repairs” refers only to restoration caused by partial destruction, impairment, or deterioration due

to wear and tear or fortuitous events. (*Lizares v. Hernandez and Alunan*, 40 Phil. 981).

- 2) The *filling up of a lot*, since this would constitute an IMPROVEMENT *unless*:
 - a) there was a *contrary stipulation*;
 - b) or unless the lot was **ORIGINALLY** filled up.

[**NOTE:** To repair means to put back something into its original condition. (*Alburo v. Villanueva*, 7 Phil. 277).]

- 3) Those **UNKNOWN** defects to both parties, except if there was a contrary stipulation. (*Yap Kim Chuan v. Tiaoqui*, 31 Phil. 434).
 - 4) The construction of a house on rented land. Certainly, the construction cannot be considered a repair. (*Valencia v. Ayala de Roxas*, 13 Phil. 45).
- (c) If the lessor of a building used as a *cine* undertakes the necessary repairs, the lessee cannot cancel the contract for the remaining term. (*Gregorio Araneta, Inc. v. Lyric Film Exchange, Inc.*, 58 Phil. 735). Failure to do so will allow the lessee to leave, without being responsible for the rent for the remaining period. (*Donato v. Lack*, 20 Phil. 503). The lessee should not be made to suffer the discomfort, the damage, and the lack of privacy caused by the lessor's neglect to repair. (*Donato v. Lack*, *supra*).

(4) Maintenance in Possession

- (a) Peaceful and adequate enjoyment “refers to legal, not physical possession.” (*See Goldstein v. Roces*, 34 Phil. 562). Hence, a lessor is not, for instance, liable for physical disturbances in the neighborhood, but is liable if the lessee is **EVICTED** due to non-payment of taxes by the lessor. (*Heirs of Ormachea v. Cua Chee Gan and Co., C.A.*, 36 O.G. 3627).
- (b) If the property is *expropriated*, is the lessor liable? No, because expropriation is involuntary. (*Sayo v. Manila Railroad*, 43 Phil. 551).

- (c) In case of a legal disturbance in possession, the lessor is liable for whatever the lessee has lost by virtue of the breach of the contract. (*De la Cruz v. Seminary of Manila*, 18 Phil. 330).

Art. 1655. If the thing leased is totally destroyed by a fortuitous event, the lease is extinguished. If the destruction is partial, the lessee may choose between a proportional reduction of the rent and a rescission of the lease.

COMMENT:

(1) Effect of Total or Partial Destruction

Note that the law says “DESTRUCTION” (total or partial). In case of mere *deterioration*, the remedies referred to in this Article do NOT apply. In case of a “destruction” the Article applies.

(2) Example

In a lease contract for 5 years, fire caused by lightning completely destroyed the house leased at the end of 3 years. Is the lessee responsible for the remaining 2 years rent? Can he demand that the lessor reconstruct the house?

ANS.: No, because the lease has been extinguished. He cannot on the other hand demand that the house be reconstructed.

QUERY: In the preceding problem, will the lease continue on the *land*?

ANS.: It would seem that the answer is in the negative, unless the lease on the land can be, under particular circumstances, considered severable from the lease on the house. While the land undoubtedly has been preserved, still it must be borne in mind that generally the land was leased only incidentally with the lease of the house. (*See Shotwell, et al. v. Manila Motor Co.*, 53 O.G. 1423).

(NOTE: In some places, only the lot is leased, with the house being constructed thereon by the lessee, with the les-

sor's consent. In such a case, destruction of the house will evidently not extinguish the contract of lease on the land.)

(3) Cases

Roces v. Rickards **(C.A.) 45 O.G. (supp.), p. 97**

FACTS: A owned a building and a lot. B was renting a room in the building, but the building was subsequently destroyed by a fortuitous event. When A asked B to leave the premises, B insisted on staying on the lot, claiming that the lease was supposed to be continued on the lot this time. Is B correct?

HELD: No, B is not correct. His lease came to an end when the building was destroyed (32 *Am. Jur.* 706), so that to make him lessee of the land thereafter, a new contract of lease would have to be made.

Shotwell v. Manila Motor Co. **53 O.G. 1423, L-7637, Dec. 29, 1956**

FACTS: A lease involved a parcel of land and the buildings thereon. During the war, the buildings were destroyed. Does the lease continue on the land?

HELD: No. Although the land still remains, the lease of the land and the buildings *constituted in this case* one indivisible unit, especially so when we consider the fact that the lessee would *not* have entered into the lease were it not for the suitability of the buildings for its business. Moreover, the conditions of the lease would have been different had there been *no* buildings on the land. The stipulation of the rebuilding of the destroyed improvements being *potestative* on the part of the lessee, the latter is *not* bound to do so.

(*NOTE:* It was also held that the lessor *cannot* be compelled to reconstruct the buildings, since this would *not* be a case merely of necessary repairs.)

(4) Partial Destruction

The lessee has a choice:

- (a) proportional reduction of the lease rent (retroactive to the time the partial destruction was caused) (*5 Llerena 270*);
- (b) or rescission of the lease. (But only if the destruction is of SIGNIFICANCE, because as a rule, rescission should not be allowed for *trivial causes*; a contrary rule may result in the instability of contractual relations.)

(5) Illustrative Problem

A was leasing a house owned by B. The house was partially destroyed by a fortuitous event. The lessor B wanted the rentals reduced, but A insisted on rescinding the lease. Who should prevail?

ANS.: A, the lessee, should prevail, because it is he who is given the option. However, he prevails only if the partial destruction affects substantially or significantly his stay on the premises.

Art. 1656. The lessor of a business or industrial establishment may continue engaging in the same business or industry to which the lessee devotes the thing leased, unless there is a stipulation to the contrary.

COMMENT:

(1) Lessor's Right to Continue Engaging in Same Business or Industry

Reason for the provision — There is no warranty that the lessee's business would be successful; no warranty against competition. Competition offered by others cannot be considered a juridical disturbance. (*See City of Naga v. Court of Appeals, 96 Phil. 153*).

(2) May Lessor 'Begin' the Business?

The law says "may continue." Suppose the lessor will simply *begin*, does the Article apply?

ANS.: Considering the reason for the law, the answer is clearly in the affirmative.

(3) Example

A leased to B a business establishment dealing in the sale of shoes. A is allowed to also engage in the shoe sale business, unless there is a stipulation to the contrary.

Art. 1657. The lessee is obliged:

(1) To pay the price of the lease according to the terms stipulated;

(2) To use the thing leased as a diligent father of a family, devoting it to the use stipulated; and in the absence of stipulation, to that which may be inferred from the nature of the thing leased, according to the custom of the place;

(3) To pay the expenses for the deed of lease.

COMMENT:**(1) Duty of Lessee to Pay the LEASE PRICE (RENT)****(a) Who Fixes the Rent?**

The rent is fixed by the lessor, not the court, for lease is a consensual contract. If the lessee does not agree, there is no contract of lease. (*Lim Si v. Lim*, L-8496, Apr. 25, 1956, 53 O.G. 1098, citing *Poe v. Gonzales*, L-2554-56, Jul. 21, 1950). Incidentally, the lease of a building would naturally include the lease of the lot on which it is built; and the rentals of the building would include the rentals for the lot. (*Duellome v. Gotico*, L-17846, Apr. 29, 1963; *City of Manila v. Chan Kian*, L-10276, Jul. 24, 1957; *Phil. Consolidated Freight Lines, Inc. v. Emiliano Ajon*, L-10206-08, Apr. 16, 1958). Indeed, the occupancy of a building or a house not only suggests but implies the tenancy or possession in fact of the land on which it is constructed. An extensive elaboration of this rule may be found in *Baquiran v. Baquiran*, 53 O.G. 1130, citing *Martinez v. Bagonus*, 28 Phil. 550 and *De Guzman v. De la Fuente*, 55 Phil. 501.

Limpin Investment Corp. v. Lim Sy
GR 31920, Apr. 8, 1988

Only the owner has the right to fix the rents. The Court cannot determine the rents and compel the lessor or owner to conform to it and allow the lessee to occupy the premises on the basis of the rents fixed by it.

Filoil Refinery Corp., et al. v. Mendoza
GR 55526, Jun. 15, 1987

FACTS: The lessee admitted that on a few occasions, he paid late the rentals which were due within the first 15 days of each month, but the delay was only for a few days. For example, the delayed rentals for the months of May, Jul., Aug. and Sept., 1974, were remitted to the lessor on May 21, Jul. 19, Aug. 19, and Sept. 16, 1974, respectively.

HELD: Such breaches were not so substantial and fundamental as to defeat the object of the parties. *Reason:* The law is not concerned with such trifles.

(b) *Rent Not Fixed in Consignation Case*

The rule that consignation in court under Art. 1256 of the Code is not the proper proceeding to determine the relation between landlord and tenant, the period of life to the lease or tenancy, the reasonableness of the amount of rental, the right of the tenant to keep the premises against the will of the landlord, etc., has been reiterated in *Lim Si v. Lim* (L-8496, Apr. 25, 1956), where it was held that disagreement as to the amount of rent be decided, not in an action of consignation, but in that of unlawful detainer that the lessor institutes when the lessee refuses to pay the rents that he has fixed for the property.

In the *Lim Si* case, the plaintiff was allowed to occupy two rooms of an accessoria without any definite amount of rent fixed, but later on, the owner demanded the payment of P700 a month, upon the insistent demands of the plaintiff that he must fix the rent. Plaintiff, however, refused to pay the rental fixed by the owner,

and instead he brought an action for the court to fix the rental of the premises at P600, and to authorize him to continue occupying the premises, depositing the rental of P600 a month with the court. It was held that if the lessee disagrees with the rents fixed by the lessor, the lessee has no right to have the court fix the rents and continue occupying the premises pending judicial determination of the said rents. But as he continues to occupy the premises, and at the same time refuses to pay the rents by the lessor, it is the lessor who has a cause of action against him for his illegal occupancy.

(c) *What the Court Can Do*

While it is clear that the court cannot fix the rent save possibly in the case contemplated under Art. 448 (where a builder has built in good faith a building on land belonging to another, but the value of the land is considerably more than the value of the building), still once the rent is agreed upon, the court can fix *the time when said rent is to become effective*. According to the Supreme Court in the case of *Mayon Trading Co., Inc. v. Co Bun Kim (L-11251, Jul. 31, 1958)*, where the buyer of the land occupied by the building of the lessee thereof is willing to execute a new lease contract with the latter, and the parties have *agreed* on the amount of monthly rental, but they cannot agree on the date of the effectivity of the same, the court has the power to determine the date when it should take effect. Considering the fact that it has authority to fix the just and reasonable rental of a certain piece of property, the court must equally have the power to determine its date of effectivity.

(d) *Increase in Rent*

As we have already intimated, when a lessee refuses to pay rent, he may be ousted. (*Par. 2, Art. 1673*). Naturally, this duty to pay rent arises only if the subject matter of the lease has been delivered. (*Sugar Estates and the comments thereunder*).

If, at the expiration of a lease, the lessor raises the rent, the tenant has to *leave* if he does not pay the new rental (*Cortes v. Ramos, 46 Phil. 184*); otherwise,

he will be considered a possessor in bad faith of the properties involved, and may be ousted without need of any demand. (*Bulahan, et al. v. Tuason, et al.*, L-12020, Aug. 31, 1960. See Arts. 1671 and 1673 and the comments thereunder).

Does this mean that the lessor can at the end of a lease capriciously increase the rent? No, his right to increase the rent is NOT ABSOLUTE. The new rental rate must be reasonable. Since the rent is presumed reasonable, proof that it is exorbitant is on the lessee. (*Velasco v. Court of Agrarian Relations, et al.*, L-14737, Sept. 30, 1960). Proof, for instance, that another lessee is willing to rent it at said increased amount is *prima facie* proof that it is reasonable. (*Cortes v. Ramos*, 46 Phil. 184). If, however, the rent is increased by over 200% when its assessed value was increased by 25% merely, the new rate is *unreasonable*. Thus, the Court in the case of *Archbishop of Manila v. Ver* (40 O.G. 4171, 73 Phil. 363) held that if the reason relied upon for the increased rate is the increase in the government assessment of the property, the increase in rate should be proportionate to the increase in assessed valuation.

NOTE: As a piece of social legislation, Rep. Act 6126 was enacted providing that “no lessor of a dwelling unit or of land on which another’s dwelling is located shall, during the period of one year from Mar. 31, 1970 increase the monthly rental agreed upon between the lessor and the lessee prior to the approval of this Act when said rental does not exceed P300 a month.” Note that if the rent exceeds P300, the Act does not apply. This Act however is NOT RETROACTIVE. (*Espiritu v. Cipriano*, L-42743, Feb. 15, 1974). The Act was later amended, extending the period but allowing a moderate increase. To give further teeth to the law, Presidential Decree 20 prohibits ejectment in certain cases. (Refer to comments under Art. 1673 — *infra*).

In *no* case, however, is the lessor allowed to increase the rental when the term has *not* yet expired, unless of course, the tenant consents. (*Gomez v. Ng Fat, et al.*, 76 Phil. 555).

**Ramon Magsaysay Award Foundation
v. Court of Appeals
L-55998, Jan. 17, 1985**

The lessor has the right to increase the rent at the termination of the lease, and the lessee has the option to pay the new rental or to leave the premises. The exception is where the increase in rent is unreasonably exorbitant.

**Legarda v. Zarate
36 Phil. 68**

FACTS: In a contract of lease, it was agreed that the rent would be 10% per annum of the assessed value. Later, the government increased the assessment. *Issue:* What is the assessed value that should be considered, the value at the time the contract was entered into, or the assessed value from time to time (in view of the periodic assessments)?

HELD: The value of the assessment from time to time must be regarded as the basis of the rent. This was evidently the intention of the parties.

**Velasco v. Lao Tam
23 Phil. 495**

FACTS: In a lease of land, it was agreed that the lessee would build a building thereon and said building would belong to the lessor at the end of the 11-year lease. Unfortunately, the lessee's business in the building did not prosper. Is the lessee still required to pay rent?

HELD: Yes. There is nothing in the agreement that would make the payment of rent depend on the successful outcome of the lessee's business. The fact that the building would eventually belong to the lessor certainly does not matter.

**Parrada v. Jo-Juayco
4 Phil. 710**

FACTS: A lessee failed to pay rent. What can the lessor do?

HELD: The lessor can do *all* the following:

- (a) bring an action for unlawful detainer;
- (b) recover in said suit the accrued unpaid rents;
- (c) get 6% legal interest on said rents. (*See Avila v. Veloso, 69 Phil. 357*).

**Trinidad de Leon Vda. de Roxas v.
Court of Appeals
L-39146, Mar. 25, 1975**

FACTS: Petitioner executed a lease over her parcel of land in favor of private respondent. The lease was for three years at a rental of P1,000 monthly. The contract was “renewable for another three years at the option of the lessor, and under such other terms or conditions as she may impose.” At the end of the lease, lessor decided not to renew the original contract. Instead she allowed lessee to continue, but this time, with a P3,000 monthly rent. The lessee then paid the new rate for some time. Is the new agreement valid, or should the excess of P2,000 per month be returned to the lessee?

HELD: The new agreement is perfectly valid, if not being contrary to prohibitory or mandatory laws, public order, public policy, good morals, or good customs. Therefore, there will be no returning of the alleged excess.

If the lessee really did not want the new rate, what should have been done was to vacate the premises.

**Cabatan v. Court of Appeals
L-44875-76; L-45160; L-46211-12, Jan. 12, 1980**

In the absence of a statute fixing maximum rents in tenancy contracts, the landowner can rightfully ask for an increase in said rentals.

(2) Duty of Lessee to Use Properly the Thing Leased

- (a) The lessee must exercise the diligence of a good father of a family.

- (b) The use must be confined:
 - 1) to that stipulated
 - 2) if none was stipulated, to that inferred from the NATURE of the thing leased (according to the CUSTOM of the PLACE)

[**NOTE:** An illegal use (such as for prostitution) allows the lessor to end the contract.]

(3) Duty of Lessee to Pay the Expenses for the Deed of Lease

Observe that while in a sale, it is the seller who generally pays the expenses for the deed of sale; in the case of lease, it is the lessee who generally must pay the expenses for the deed of lease. Generally, said expenses should include those for the registration of the lease contract.

Art. 1658. The lessee may suspend the payment of the rent in case the lessor fails to make the necessary repairs or to maintain the lessee in peaceful and adequate enjoyment of the property leased.

COMMENT:

(1) When Lessee May Suspend the Payment of the Rent

- (a) if lessor fails to make the NECESSARY REPAIRS;
- (b) if lessor fails to maintain the lessee in *peaceful* and *adequate enjoyment* of the property leased.

(2) Effect if Cause for the Suspension Ceases

Suppose the cause for the suspension has ceased to exist, does the lessee have to pay NOW for the rentals that had been suspended?

ANS.: It is submitted that the answer is in the negative. The term “suspend” here should be construed to mean that for the intervening period, the lessee does NOT have to pay the rent. A contrary interpretation would cause the lessor to procrastinate in the fulfillment of his duties.

(3) Effectivity of the Suspension

From what moment does the lessee have the right to make the suspension?

ANS.: It is submitted that the right begins:

- (a) In the case of repairs, from the time he made the *demand* for said repairs, and the demand went *unheeded*.

[NOTE: Of course, if the lessee so desires, he may after the failure of the lessor to make the repairs, cause the repairs to be made by others, charging expenses to the negligent lessor. (*Johnson Pickett Rope Co. v. Grey, C.A., 40 O.G. 239*).]

- (b) In the case of eviction, from the time the final judgment for eviction becomes effective.

Art. 1659. If the lessor or the lessee should not comply with the obligations set forth in Articles 1654 and 1657, the aggrieved party may ask for the rescission of the contract and indemnification for damages, or only the latter, allowing the contract to remain in force.

COMMENT:**(1) Alternative Remedies of Aggrieved Party in Case of Nonfulfillment of Duties**

- (a) rescission and damages
- (b) damages only (*leaving the contract in force* — specific performance)

[NOTE: This is different from an action to eject. (*Tuason v. Uson, 7 Phil. 85*).]

**Baens v. Court of Appeals
GR 57091, Nov. 23, 1983**

The damages recoverable in ejectment cases are the rents or the fair rental value of the premises. Therefore, in said suits, the following *cannot* be successfully claimed:

- a) profits plaintiff could have earned were it not for the possible entry or unlawful detainer;
- b) material injury to the premises;
- c) actual, moral, or exemplary damages.

(2) Rescission

- (a) requires judicial action. (*Rep. v. Hospital de San Juan de Dios, L-1507, Oct., 1949*).
- (b) can be brought only by the aggrieved party. (*Fernandez Hermanos v. Pitt, 34 Phil. 549*).
- (c) can be allowed only for substantial, not trivial, breaches. (*Nava v. Yaptinchay, C.A., 44 O.G. 3332*).

Montenegro v. Roxas De Gomez **58 Phil. 726**

FACTS: A lessor failed to place the lessee in possession of the premises leased. May the lessee bring an action for rescission?

HELD: Yes, for failure of the lessor to comply with his legal obligation.

Philippine Amusement Enterprises, **Inc. v. Natividad** **GR 21876, Sep. 29, 1967**

FACTS: The Philippine Amusement Enterprises, Inc. leased to the defendant a jukebox for a stipulated period of three years for 75% of the gross receipts per week. However, because once in a while, the coins would be stuck, the lessee after six months wrote a letter to the lessor, asking it to get back the jukebox. The agent of the lessor refused to take back the contrivance, and the lessee deposited the same in a place on the premises. He then asked for a monthly rent of P60 for the occupied space. The lessor subsequently sued for specific performance and damages, alleging that the sticking-up of the coins was a normal occurrence, and therefore, the

lessee was unjustified in trying to return the jukebox.
Issue: Was the lessee justified in considering the contract automatically rescinded?

HELD: No. What the lessee should have done was to go to court and ask for a *judicial rescission*, in the absence of a stipulation to the contrary. Besides, for such an action of rescission to prosper, the breach must be substantial, not like the sticking up in this case, which happened only occasionally. Plaintiff should therefore win the case.

(3) Query

If the aggrieved party desires to rescind, but the other requests for *time* within which to comply with his duties, who will prevail?

ANS.: The aggrieved party seeking *rescission* will prevail. Under this art. 1659, the Court has *no discretion* to refuse rescission, *unlike* the situation covered by Art. 1191 in the general rules on *OBLIGATIONS*. (*Mina and Bacalla v. Rodriguez, et al.*, C.A., 40 O.G. [Supp.] Aug. 30, 1941, p. 65).

(4) The Remedy of Damages

- (a) Damages may be asked either by the lessor or the lessee, provided he is the aggrieved party. (*Fernandez Hermanos v. Pitt*, 34 Phil. 549).
- (b) But not by a lessee who *never* took possession of the premises against a *stranger* who unlawfully is in possession of the property. This is simply because there is no contractual relationship between the two. (*Donaldson Sim and Co. v. Smith, Bell and Co.*, 2 Phil. 766). The proper remedy of said lessee should be against the lessor, if the lessor failed to give him the possession he desired. (*See Montenegro v. Roxas de Gomez*, 58 Phil. 726).

Summers v. Mahinay
(CN) 40 O.G. (Supp.), Nov. 1, 1941, p. 40

FACTS: A leased to B certain property for a certain period. B, before the term ended, unjustifiably *abandoned*

the premises. So A resumed possession. May A still sue B for the fulfillment of the lease contract (specific performance)?

HELD: Yes, for B's duty was to respect the lease contract. A's resumption of possession in the meantime of the premises is of no significance, for, after all, it was B who abandoned the property.

Limjap v. Animas
L-53334, Jan. 17, 1985

A provision in a lease contract stating that all cases in connection therewith should be brought in Manila (venue by agreement) is a valid stipulation.

Art. 1660. If a dwelling place or any other building intended for human habitation is in such a condition that its use brings imminent and serious danger to life or health, the lessee may terminate the lease at once by notifying the lessor, even if at the time the contract was perfected the former knew of the dangerous condition or waived the right to rescind the lease on account of this condition.

COMMENT:

(1) Rule When Place Is Dangerous to Life or Health

This Article, allowing immediate termination of the lease, applies:

- (a) only to a dwelling place or any other building intended for *human habitation*;
- (b) even if at the time the contract was perfected, the lessee KNEW of the dangerous condition or WAIVED the right to rescind on account of this condition.

(2) Reason for the Law

Public safety cannot be stipulated against. (*Commission Report, p. 142*).

Art. 1661. The lessor cannot alter the form of the thing leased in such a way as to impair the use to which the thing is devoted under the terms of the lease.

COMMENT:

(1) Alteration of the Form of the Lease by the Lessor

The LESSOR can alter provided there is *no* impairment.

(2) Alteration by the Lessee

Alteration can also be made by the LESSEE so long as the value of the property is not substantially impaired. (*Enriquez v. Watson and Co.*, 22 Phil. 623).

Art. 1662. If during the lease it should become necessary to make some urgent repairs upon the thing leased, which cannot be deferred until the termination of the lease, the lessee is obliged to tolerate the work, although it may be very annoying to him, and although during the same, he may be deprived of a part of the premises.

If the repairs last more than forty days the rent shall be reduced in proportion to the time — including the first forty days — and the part of the property of which the lessee has been deprived.

When the work is of such a nature that the portion which the lessee and his family need for their dwelling becomes uninhabitable, he may rescind the contract if the main purpose of the lease is to provide a dwelling place for the lessee.

COMMENT:

(1) Rule in Case of Urgent Repairs

Note that in the case of URGENT REPAIRS (not improvements) the lessee must TOLERATE the work, even if very annoying to him (*1st par.*, Art. 1662), unless the place becomes UNINHABITABLE (*3rd par.*, Art. 1662), in which case he can ask for *RESCISSION*.

(2) Length of Time for Repairs

- (a) If less than 40 days, the lessee *cannot* ask for reduction of rent, or for rescission. (*Gregorio Araneta, Inc. v. Lyric Film Exchange, 58 Phil. 763*).
- (b) If 40 days or more, the lessee can ask for proportionate reduction (including the first 40 days).

(NOTE: In either case, RESCISSION may be availed of if the main purpose is to provide a *dwelling place* and the property becomes *uninhabitable*.)

Art. 1663. The lessee is obliged to bring to the knowledge of the proprietor, within the shortest possible time, every usurpation or untoward act which any third person may have committed or may be openly preparing to carry out upon the thing leased.

He is also obliged to advise the owner, with the same urgency, of the need of all repairs included in No. 2 of Article 1654.

In both cases the lessee shall be liable for the damages which, through his negligence, may be suffered by the proprietor.

If the lessor fails to make urgent repairs, the lessee, in order to avoid an imminent danger, may order the repairs at the lessor's cost.

COMMENT:**(1) Duties of Lessee Concerning Usurpation and Repairs**

- (a) To NOTIFY lessor of *usurpation* or untoward acts (so that lessor may bring the proper ouster actions, such as forcible entry). (*Simpao v. Dizon, 1 Phil. 261*).

[NOTE: It is unjust to compel the lessor to just stand by idly and to trust the defense of his property to a mere lessee. (*Roxas v. Mijares, 9 Phil. 252*).]

- (b) To NOTIFY lessor of need for REPAIRS (it is the lessee who must notify, for he is in possession; the lessor has

NO duty to make constant inspection). (*Gregorio Araneta, Inc. v. Lyric Film Exchange*, 58 Phil. 737).

[**NOTE:** Notification is not essential if the lessor actually knows of the need for the repairs. (*Johnson Picket Rope Co. v. Grey, C.A.*, 40 O.G. {Supp. 11} 239).]

(2) Effect if Lessee Fails to Comply

The lessee would be responsible for damages which the lessor would suffer, and which could have been *avoided* by lessee's diligence. (*3rd par.*, Art. 1663).

(3) Effects if Lessor Fails to Make the Urgent Repairs

- (a) Lessee, in order to avoid imminent danger, may order the repairs at the lessor's cost.
- (b) Lessee may sue for damages.
- (c) Lessee may suspend the payment of the rent. (Art. 1658).
- (d) Lessee may ask for rescission, in case of substantial damage to him. (Art. 1659 read together with Art. 1654).

Art. 1664. The lessor is not obliged to answer for a mere act of trespass which a third person may cause on the use of the thing leased; but the lessee shall have a direct action against the intruder.

There is a mere act of trespass when the third person claims no right whatever.

COMMENT:

Two Kinds of trespass With Respect to the Property Leased

- (a) Mere act of trespass (*disturbance in fact* — “*perturbacion de mere hecho*”)

(Here, the physical enjoyment is reduced and may take place, for example, in a case of FORCIBLE ENTRY. Here also, the third person claims no right whatever.)

[**NOTE:** If the leased premises are expropriated and the

tenant is evicted from the premises, the lessor is not liable for damages; the lessee must look to the expropriator for his compensation. (*Sayo v. Manila Railroad Co.*, 43 Phil. 551). (Here, it must be noted that strictly speaking, this is neither a case of trespass in fact nor in law.)]

- (b) Trespass in law (*disturbance in law*, “*perturbacion de derecho*”)

(Here, a third person claims a LEGAL right to enjoy the premises). (*See 10 Manresa 571-572 and Goldstein v. Rocas*, 34 Phil. 562).

Examples:

- 1) An *accion reivindicatoria* brought by the real owner against the lessor. (*See Pascual v. Bautista, et al.*, C.A., L-7878-F, Feb. 16, 1953).
- 2) The use by the Japanese Armed Forces during the war of property leased to another, the use being justified under the rules of “belligerent occupation” under Public International Law. (*Vda. de Villaruel, et al. v. Manila Motor Co. and Colmenares*, L-10394, Dec. 13, 1958, reversing *Reyes v. Caltex [Phil.] Inc.*, 84 Phil. 654 and distinguishing the ruling in *Lo Ching v. Archbishop of Manila* [81 Phil. 602].)

(**NOTE:** The *dissenting* opinion of Chief Justice Ricardo Paras in the *Reyes v. Caltex* case served as the *basis for the majority view* in the *Villaruel* case.)

**Vda. de Villaruel, et al. v.
Manila Motor Co. and Colmenares
L-10394, Dec. 13, 1958**

FACTS: The Manila Motor Co. leased from plaintiff Villaruel the latter’s building for a period of 5 years, beginning Oct. 1940, renewable for another 5 years. The lessee was then put in possession, but during the last war, the Japanese Army occupied the premises from 1942 to 1945, ousting the lessee therefrom. After liberation, and after executing a renewal of the lease, plaintiff demanded rents for the

period of the Japanese occupation of the premises. The lessee refused to pay said rents, but offered to pay the present rentals. The lessor stated that it was willing to accept payments of the *current* rates but without prejudice to its demand for rescission of the contract (for non-payment of rent during the war years). The lessee did *not* pay the rents from Jul. to Nov. 1946; nor did it consign said rent in court. (Later rents were however paid.) In view of the insistent refusal to pay for the Japanese occupation rent, the lessor filed an action to rescind the contract. Unfortunately, while the case was pending, the building leased was burned on March 2, 1948. The burning was *not* attributable to the lessee's fault.

ISSUES:

- (a) Was the occupation of the premises by the Japanese Armed Forces a *trespass in fact* or a *trespass in law*?
- (b) Was the lessee obliged to pay the rents for the war period?
- (c) Was not the occupation by the Japanese a *fortuitous event* that would exempt the lessor from the obligation of maintaining the lessee in the peaceful and legal possession of the premises?
- (d) Was the *lessee* ever in *default*?
- (e) Was the *lessor* ever in *default*?
- (f) Who bears the loss of the leased premises in view of the destruction by fire?
- (g) Is the lessee required to pay the rents from Jul. to Nov., 1946 (post-war)?
- (h) Should the contract be rescinded?

HELD:

- (a) The occupation by the Japanese Armed Forces was a *trespass in law*, not a *trespass in fact*.

Under the generally accepted principles of international law (which are made part of our law by our Constitution), a belligerent occupant (like the Japanese in 1942-1945) may legitimately billet or quarter its troops in privately owned land and building for the duration of its military operations, or as military necessity should demand. In evicting the lessee, the Manila Motor Co., from the leased building and occupying the same as quarters for troops, the Japanese authorities acted pursuant to a right recognized by international and domestic law. Its act of dispossession therefore did not constitute a *perturbacion de mere hecho*, but a *perturbacion de derecho*.

- (b) The lessee was NOT obliged to pay the rents for the war period since the lessor was responsible for the trespass in law. Indeed, the lessor must respond since the result of the disturbance was the deprivation of the lessee of the peaceful use and enjoyment of the property leased. Therefore, the lessee's corresponding obligation to pay rentals ceased during such deprivation.

(**NOTE:** In *Reyes v. Caltex*, 84 Phil. 669, the Court had said that the proper remedy of the lessee was to direct an action against the Japanese for the disturbance, which the Court at *that time* considered merely a trespass in fact. In this *Villaruel* case, the Court reversed itself, and stated that such an action of forcible entry does not evidently contemplate a case of dispossession of the lessee by a military occupant, as had already been pointed out by Chief Justice Paras in his *dissenting* opinion in the *Reyes v. Caltex* case, for the reason that the lessee could not have a direct action against the military occupant. It would be most unrealistic to expect that the occupation courts, placed under the authority of the occupying

belligerents, should entertain at the time a suit for forcible entry against the Japanese Army. The plaintiffs, their lawyers, and in all probability, the Judge and court personnel would face severest penalties for such defiance of the invader.)

- (c) While the coming of the Japanese may have been a fortuitous event, still the lessor was *not* excused from his obligation to warrant peaceful legal possession because lease is a particular kind of reciprocal obligation where the *causa* (cause or consideration) *must exist not only at the perfection but throughout the term of the contract*. No lessee would agree to pay rent for premises he could not enjoy. Indeed, lease is a contract that calls for prestations both reciprocal and repetitive (*tractum successivum*); and the obligations of either party are not discharged at any given moment, but must be fulfilled all throughout the term of the contract.

[**NOTE:** This effect of failure of reciprocity appears whether the failure is due to *fault* or to *fortuitous event*; the only difference being that in case of fault, the other party is entitled to rescind the contract *in toto*, and collect damages; while in a fortuitous event (casual non-performance) it becomes entitled only to a suspension *pro tanto* of its own commitments. This rule is recognized in paragraph 2 of Art. 1662 authorizing the lessee to demand reduction of rent in case of certain repairs; and in Art. 1680, enabling the lessee of rural property to demand reduction of the rent if more than one-half of the fruits are lost by extraordinary fortuitous event. Of course, where it becomes immediately apparent that the loss of possession or enjoyment will be permanent as in the case of accidental destruction of a leased building, the lease contract terminates. In short,

the law applies to lease re the rule enunciated by the Canonists and the Bartolist School of Post Glossatores that *contractus qui tractum successivim habent et dependentiam de futuro, subconditione rebus sic stantibus intelligentur* (contracts are understood entered into subject to the condition that things will remain as they are, without material change).]

- (d) The lessee was NEVER in default. Regarding the war rent, we have seen there was NO obligation; regarding the current rents they were either paid, or tender had already been made to the creditor-lessor which refused to accept. The fact that no consignation was made did not render the lessee liable for default nor did he become answerable for fortuitous events.
- (e) The lessor was in default (*mora creditoris* or *mora accipiendi*) for improperly refusing the tender to him of the current rents.
- (f) Since the lessor was in default, it is he who must bear all supervening risks of accidental injury or destruction of the leased premises. While this *is not* expressly declared by the Code, still this result is clearly inferrable from the nature and effects of default (*MORA*).
- (g) Because the lessee failed to consign the rents from Jul. to Nov. 1946, although he is not guilty of default, still he must pay said rents. (Note that other post-war rents had already been paid.)
- (h) The question of rescission had become moot in view of the destruction of the building and the consequent extinguishment of the lease.

[**NOTE:** This case of Villaruel is distinguished from *Lo Ching v. Archbishop of Manila* (81 Phil. 601) in that in said case the act is beyond the limits set by the Hague Conventions, in seizing the property and delivering it to another private person.]

Art. 1665. The lessee shall return the thing leased, upon the termination of the lease, just as he received it, save what has been lost or impaired by the lapse of time, or by ordinary wear and tear, or from an inevitable cause.

COMMENT:

(1) Duty of Lessee to Return the Property Leased

The lessee must return the property leased upon the end of the lease in the SAME CONDITION as he received it. But he is excused for:

- (a) what has been lost or impaired by *lapse of time*;
- (b) what has been lost or impaired by *ordinary wear and tear*;
- (c) what has been lost or impaired by *inevitable cause* (fortuitous event).

(2) How the Returning is Made

The return of the property (together with the necessary accessories) can be made:

- (a) actually (physically);
- (b) or constructively. (*See Gregorio Araneta, Inc. v. Montinola, et al., C.A., Jun. 1943, 573*).

(3) When Return Must Be Made

The return must be made at the TERMINATION of the lease, but of course the lessor may allow the lessee to remain even afterwards. In the meantime, the lessee's possession would naturally be legal. (*See Maceda v. Pedroza, C.A. 8644-R, Apr. 11, 1963*).

(4) Case

**Syjuco v. CA and Pilipinas Bank
GR 80800, Apr. 12, 1989**

No doubt the lessee in a contract of lease is obliged to return the thing subject of said contract upon the expiration of the period agreed upon. Art. 1665 expressly requires that

the thing leased be returned. And it stands to reason and the spirit of the law that, as a general rule, not only a portion of the thing leased be returned but the whole of it. Additionally, the law mandates that the thing leased be returned in the same condition.

Art. 1666. In the absence of a statement concerning the condition of the thing at the time the lease was constituted, the law presumes that the lessee received it in good condition, unless there is proof to the contrary.

COMMENT:

Presumption That Lessee Had Received the Things in Good Condition

- (a) There is a presumption that the lessee received the property in good condition at the beginning of the lease. (*Yap Kim Chuan v. Tiaoqui*, 31 Phil. 433).
- (b) The presumption is merely PRIMA FACIE.
- (c) The word “statement” does not necessarily refer to a *written* one. The “statement” may be ORAL.

Art. 1667. The lessee is responsible for the deterioration or loss of the thing leased, unless he proves that it took place without his fault. This burden of proof on the lessee does not apply when the destruction is due to earthquake, flood, storm or other natural calamity.

COMMENT:

(1) Responsibility for Deterioration or Loss — General Rule

There is a presumption that the lessee is responsible for DETERIORATION or LOSS. (The law presumes negligence rather than a fortuitous event). [*Santos v. Villegas*, 40 O.G. (5th S) No. 9, p. 136]. This presumption must be INVOKED; otherwise, it cannot be considered by the court. (See *Vda. de Villaruel, et al. v. Manila Motor Co. & Colmenares*, L-10394, Dec. 13, 1958).

(2) Exception

There is no such presumption in case of a NATURAL CALAMITY (like earthquake, flood, or storm).

[Reason — Here it is more probable that the lessee was not negligent. (Report of the Code Commission, p. 143).]

[NOTE: Ordinarily, fire is NOT a natural calamity. But if the tenant can prove that he had no fault in the case of fire, and that it was impossible for him to stop its spread, he will not be liable. (Lizares v. Hernaez and Alunan, 40 Phil. 981).]

Gonzales v. Mateo
74 Phil. 673

FACTS: In a lease contract, it was agreed that the lessee would be responsible for necessary repairs. The lessee failed to make them and as a consequence, the building was eventually destroyed. Is the lessee responsible for such destruction?

HELD: Yes, in view of negligence in carrying out the contractual stipulation on the necessary repairs.

Art. 1668. The lessee is liable for any deterioration caused by members of his household and by guests and visitors.

COMMENT:**(1) Deterioration Caused by Others**

The law makes the lessee liable for deterioration caused by:

- (a) himself;
- (b) members of his household;
- (c) guests and visitors.

(2) Reason

The lessee is supposed to be in control of the property leased. If he fails to exercise proper control, it is as if he

himself was negligent. He would thus be liable for *culpa CONTRACTUAL*, without prejudice to his rights to recover from whoever is responsible.

(3) Query

If a lessee's servant or guest deliberately sets fire to the property leased and it is destroyed, would the lessee still be liable to the lessor?

ANS.: Yes, under the theory of "command responsibility," for the law here makes no distinction between intentional and negligent acts. Reimbursement can, of course, be recovered from the guilty servant or guest.

Art. 1669. If the lease was made for a determinate time, it ceases upon the day fixed, without the need of a demand.

COMMENT:

(1) When Lease is Supposed to End

- (a) When the lease was made for a DETERMINATE TIME, the lease ends on the DAY FIXED, *without* need of a demand.
- (b) If the understanding between the parties as to the term of the lease was vague and uncertain, it cannot be said that a definite period was agreed upon; hence the proper Article to apply would be Art. 1687 of the Civil Code. (*Guitarte v. Sabaco, et al., L-3688-91, Mar. 28, 1960*).

(2) Necessity or Non-necessity of Demand

Sonia leased Bella's property for a period ending Nov. 4, 2000. On said day, the lease ceases, in accordance with the terms of the contract. Should there be a *demand*? (a demand to VACATE?)

ANS.:

- (a) If Sonia's purpose is merely to put an end to the lease and recover possession, the lease automatically ends. (This is true even if Bella had religiously been paying rent).

There is no necessity to make any demand to vacate. If Bella refuses to leave, an action for unlawful detainer can be brought immediately by Sonia. (*See Co Tiamco v. Boom Sim*, 43 O.G. No. 5, p. 1665; *De Tiamco v. Diaz*, 15 Phil. 672; *De Santos v. Vivas, et al.*, 96 Phil. 538).

- (b) If Sonia's purpose in filing the unlawfill detainer suit is to recover *unpaid rents*, and the suit is *brought BEFORE* the expiration of the lease contract, there must be a DEMAND for the unpaid rents (*Zobel v. Abreau, et al.*, 98 Phil. 343), followed by a DEMAND to vacate (this may be done in the form of an *alternative* proposal). The notice or demand must be made 5 days (in case of buildings) or 15 days (in case of lands) PRIOR to the suit for unlawful detainer. This is an imperative procedural requirement. (*Co Tiamco v. Boom Sim*, 43 O.G. No. 5, p. 1665).

Bernardo v. People
GR 62114, Jul. 5, 1983

Presidential Decree No. 772 punishes squatting in urban communities, not on agricultural land.

Dakudao v. Judge Consolacion
GR 54753, Jun. 24, 1983

A person who occupies the land of another thru the latter's tolerance and without any contract, may be ejected upon demand.

Caballero v. CA
GR 59888, Jan. 29, 1993

Petitioners, being mere squatters on the land, do not acquire a vested right to lease or buy the property. Thus, squatters and intruders who clandestinely enter into tied government property cannot, by such act, acquire any legal right to said property. There is no showing in the records that the entry of the private respondents into the lot was effected legally and properly. An act which was illegal from the start cannot ripen into lawful

ownership simply because the usurper has occupied and possessed the government lot for more than 10 years, cleared it of cogon grass, fenced it and built a house on the premises. No vested right should be allowed to arise from the social blights and lawless acts of squatting and clandestine entrance.

True, the government by an act of magnanimity and in the interest of buying social peace through the quieting of mass unrest may declare usurped property as a 'relocation' area for the squatters. However, the records fail to show that there has been such action insofar as the disputed lot is concerned or that the private respondents fall within such policy or that they have complied with the usual requirements before the benefits of relocation may be given them. At any rate, this is for the then People's Homesite and Housing Corporation, now the National Housing Authority, to decide and not the city court.

Lesaca v. Judge Cuevas
GR 48419, Oct. 27, 1983

- (a) If in a contract of lease, the lessor is given the option:
 - (1) to buy the improvements set up by the lessee (with the lessee vacating the premises); or
 - (2) to consider the contract automatically renewed — the lessor must give the lessee a definite demand to vacate (that is, if the lessor selects option No. 1). It would be unfair to keep the lessee in suspense.
- (b) If the lessor demands that lessee vacate the premises because the *lease has ended*, or to pay the increased rent, there is no need to make the demand to vacate because after all lease has ended.

(3) Offer to Sell

In a contract of lease for a certain period, when the term expires, the lessor may terminate the lease and order the lessee to vacate the premises. If the lessor makes an offer to the lessee to sell the property to the latter on or before

the termination of the lease and the lessee fails to accept the offer or to make the purchase on time, the lessee loses his right to buy the property later, on the terms and conditions set in the offer. (*Tuason, et al. v. De Asis, et al.*, L-11319-20, L-13507-08, and L-13504, Feb. 29, 1960).

(4) Rules on Extension of the Lease Period

- (a) If a lease contract for a definite term allows the lessee to extend the term, there is NO NECESSITY for the lessee to notify the lessor of his desire to so extend the term, unless the contrary has been stipulated. The continued stay of lessee is evidence of his desire to extend the lease. (*Cosmopolitan Ballet and Dance School, et al. v. Teodoro, C.A., O.G. Jan. 1943, p. 56*).
- (b) Meaning of “may be extended”: Here, the lessee can extend, without the lessor’s consent. BUT the lessee must NOTIFY the lessor. (*Koh v. Ongsiako, 36 Phil. 186*).
- (c) Meaning of “may be extended for 6 years *agreed upon* by both parties”: This provision ordinarily is to be interpreted in favor of the *lessee*, *not* the lessor; unless it is very clear that what is required for an extension is MUTUAL assent. Hence ordinarily the lessee, at the end of the original period, may either:
 - 1) leave the premises;
 - 2) or continue to remain. (*Cruz v. Alberto, 39 Phil. 991*).
- (d) In the case of *Leonzon v. Limlingan, et al.*, L-9552, Sept. 30, 1951, a parcel of land was owned in common by *three persons*. The land was leased to someone for 10 years, but later on, *two of them* agreed to extend the lease for 4 more years (after the expiration of the first 10 years). This extension was made without the consent of the third co-owner. The court held that the extension was void and ineffective as against him, the third co-owner, in view of his lack of consent thereto.
- (e) Where according to the terms of the contract, the lease can be extended only by the written consent of the par-

ties thereto, no right of extension can rise without such written consent. (*Teodoro v. Mirasol*, L-8934, May 18, 1956).

**Litao v. National Association of Retired
Civil Employees
L-18998, Jul. 31, 1963**

FACTS: A lease contract provided that the duration of the same shall be for a period of 5 years from a certain date, subject to “further extension regarding payment by the lessor of total expenses incurred by the lessee, which shall be fully satisfied.” *Issue:* Do the words “further extension” refer to the extension of the duration of the lease, or to the extension in time within which the lessor must make the reimbursement?

HELD: The obvious import of the stipulation is that the lease is automatically to be extended beyond its original terms (if need be) — until the lessee is repaid by the lessor, or until the accumulated fruits and income of the property since the expiration of the original period of lease, should equal the unpaid balance due to the lessee. Moreover, under such a stipulation, the lessor has the right to end the lease by reimbursing the balance of the lessee’s expenditures.

**Ramon Magsaysay Award Foundation
v. Court of Appeals
L-55998, Jan. 17, 1985**

(1) If from letters exchanged between the lessor and the lessee it can be inferred that they intended to renew their lease agreement, the renewal shall be deemed effective even if the draft of the actual lease renewal contract has *not* yet been signed.

(2) If the lease contract states that in no case should there be an extension of the lease the moment the renewed lease expires, that proviso must be given effect and the lessee’s stay cannot be prolonged.

Art. 1670. If at the end of the contract the lessee should continue enjoying the thing leased for fifteen days with the acquiescence of the lessor, and unless a notice to the contrary by either party has previously been given, it is understood that there is an implied new lease, not for the period of the original contract, but for the time established in Articles 1682 and 1687. The other terms of the original contract shall be revived.

COMMENT:

(1) Implied New Lease (*Tacita Reconduccion*)

This Article speaks of an *implied new lease (tacita reconduccion)* — that which arises if at the end of the contract, the *lessee should continue enjoying* the thing leased for 15 DAYS with the *acquiescence of the lessor* — unless of course a notice to the contrary had previously been given by EITHER PARTY.

**Pulido v. Lazaro
GR 72870, Feb. 23, 1988**

FACTS: Shell subleased to Pulido a gasoline station for which he was later issued a certificate to operate by the Bureau of Energy and Utilization (BEU). In 1976, Pulido authorized Rosal to manage the station in consideration of the monthly amount of P2,000. Later, Pulido sold to Rosal all his rights in the station for P90,000. At the same time Pulido executed a special power of attorney authorizing Rosal to administer the station. Pulido thereafter revoked this authorization because Rosal was selling diluted gasoline. He demanded the return of the station, but Rosal ignored him. Pulido then sued Rosal for unlawful detainer. The Court dismissed the complaint. Pulido did not appeal. On Sept. 20, 1979, Shell filed with BEU an application for authority to replace Pulido with Rosal. BEU granted the application on Apr. 7, 1980. Pulido challenged the authorization on the ground of due process. BEU dismissed Pulido's complaint.

HELD: Pulido cannot claim to still be the authorized dealer because his dealership contract with Shell expired long ago, much earlier than the contract of Shell with Rosal. Ros-

al's contract would itself have expired on Apr. 6, 1985, but it did not because the parties impliedly continued it under the original terms and conditions. There was *tacita reconduccion* under Art. 1670. Moreover, he had sold his rights thereunder to Rosal.

(2) Effects of the Implied New Lease

- (a) The period of the new lease is *not* that stated in the original contract, but the time in Arts. 1682 and 1687 (month to month, year to year, etc.).
- (b) Other terms of the original contract are revived.

Gustilo v. Court of Appeals GR 61083, Feb. 28, 1983

When there is a provision in a lease contract allowing the lessee to renew the lease at his option but without mentioning the lease rental for the extension, it is understood that the terms including the amount of rent stated in the old contract are to be followed in the renewed lease.

Miranda, et al. v. Lim Shi L-18494, Dec. 24, 1964

FACTS: In a contract of lease for 10 years, the following stipulation was found: "That after the expiration of this contract, the lessee Lim Shi, his heirs or legal representatives, may have *preference to continue renting* the said building, *the amount of rent to be determined anew by the parties* who shall take into consideration the current rental of commercial buildings in the locality at the time the new agreement is made." As will be noted, while the lessee is given the preference to continue renting without mentioning the period for the new lease, the clause leaves to the parties the determination of the new rent. Because of the silence as to the new period, lessee now contends that the new lease should be for the same period, *i.e.*, 10 years — otherwise, a different period should have been provided for. The lessee also maintains that inasmuch as it is only the new rent that is to be

determined by *implications*, the new term should be for another period of 10 years. After the first 10 years, the lessee for the 1st month paid the monthly rental.

HELD: Since the lessor accepted the monthly rent, the new lease should be on a month-to-month basis. The only rational conclusion that can be drawn from the failure to specify the term for the new lease is that said term would be subject to a new agreement. Art. 1670 is then clearly applicable because no new agreement has been reached.

(3) When There Is No Implied New Lease

- (a) When before or after the expiration of the term, there is a *notice to vacate* given by either party. (*Gonzaga v. Balone & San Pedro*, 43 O.G. No. 6, p. 2164 and *Vil-lanueva v. Canlas*, L-529, Sept. 18, 1946).
- (b) When there is no definite period fixed in the original lease contract, as in the case of successive renewals of the lease under Art. 1687. (*See Ottofy v. Dunn*, 38 Phil. 438). However, by way of exception, there may be an implied extension of a lease where the same is *not* for a fixed period but say from year to year and if at the end of the year, the owner demands a rental which is exorbitant. In such a case, the courts may determine what is a reasonable rent and allow the lessee to continue with the lease. It would be different if at the end of the year, the owner, instead of demanding an increased and exorbitant rental, insists that the lessee vacate the premises. (*Tuason, et al. v. De Asis, et al.*, L-11319-20, L-13607-08 and 13604, Feb. 29, 1960).

(4) Illustrative Problem

- (a) At the expiration of a 3-year contract, the lessor notified the lessee to vacate the premises, but the lessee still remained for more than 15 days. Is there an implied new lease here?

ANS.: No, in view of the demand to vacate. (*Art. 1670; see Gonzaga v. Balone and San Pedro*, 43 O.G. No. 6, p. 2164).

- (b) Resurreccion was leasing Salamanca's house. Although the term had already expired, Resurreccion still remained on the premises with Salamanca's consent. Sixteen (16) days later, Salamanca asked the lessee to vacate the premises, but the latter refused to leave. May Salamanca successfully institute a suit for unlawful detainer?

ANS.: No, in view of the implied new lease. The demand to vacate came after the statutory period of 15 days. (*Art. 1670*).

- c) Ledesma leased from Balla the latter's house. Since payment was made monthly, it was understood that the lease subsisted from month to month, instead of for a definite contractual period. It was *agreed* in the contract that the lease could be terminated upon 30 days written notice. If on Dec. 18, 1959, Balla notified Ledesma of the termination of the lease, when will the lease end in case monthly payment was to be made on the 2nd day of each month?

ANS.: The lease ends 30 days after Ledesma receives the notice, in view of the contractual agreement. This is true *whether or not* the end of the 30-day period coincides with the day rent is supposed to be paid; true also *regardless* of the lapse of 15 days from the last payment of the rent. (*See Ottoby v. Dunn, 38 Phil. 438*).

(5) Effect of Implied New Lease on Exceptional Conditions in the Contract

**Dizon v. Magsaysay
L-23399, May 31, 1974**

FACTS: In a lease contract, the lessee was given *preferential rights* in the purchase of the leased property. At the expiration of the original lease contract, there was an implied new lease because the lessee continued occupying the premises without objection on the part of the lessor. Later, the lessor told the lessee that he (the lessor) was terminating the lease. The lessor then sold the property to another. The lessee objected to this sale, claiming that under the terms of the lease, he was granted preferential rights in the purchase of the

property, and that while the old lease had already expired, still all the conditions thereof were implicitly revived in the implied new lease. Should he be granted the preference?

HELD: No. While it is true that under Art. 1670 of the Civil Code, all the terms (except the period) of the original lease are revived, said terms refer only to those *germane* or *connected* with the lessee's enjoyment of the leased property such as the rent, when payable, etc., not the preferential right to buy. This right expired with the old contract.

(6) No Implied Renewal of Lease

**Amiano Torres & Josefina Torres v. C.A.
& Adela B. Flores
GR 92540, Dec. 11, 1992**

In the case at bar, there was no acquiescence on the part of the lessor to the petitioners' continued stay in her property. On the contrary, she expressly informed them that she was not renewing the lease and, in fact, later demanded that they vacate her property.

The private respondent's acceptance of the rentals beyond the original term did not signify that she had agreed to the implied renewal of the lease. The simple reason is that the petitioners remained in possession of the subject lands and, regardless of the outcome of their case, had to pay rentals to the private respondent for the use of her property.

Art. 1671. If the lessee continues enjoying the thing after the expiration of the contract, over the lessor's objection, the former shall be subject to the responsibilities of a possessor in bad faith.

COMMENT:

Rule if Lessor Objects to Lessee's Continued Possession

Note that under Art. 1671, there are three requisites:

- (a) the contract has expired;

- (b) the lessee continues enjoying the thing;
- (c) the lessor has objected to this enjoyment.

If the three requisites are present, the lessee shall be considered a possessor in BAD FAITH.

If the lessee still makes a construction after he has become a possessor in bad faith, he may be compelled:

- (a) to forfeit the construction without indemnity;
- (b) or to buy the land regardless of whether or not its value is considerably more than the value of the construction;
- (c) or to demolish the construction at his expense.

[NOTE: In any of the 3 cases hereinabove referred to, he will still be subject to the payment of damages. (See Arts. 449-451, Civil Code).]

Dakudao v. Judge Consolacion
GR 54753, Jun. 24, 1983

If a lease expires, and the lessee continues to occupy the premises thru the lessor's tolerance, the unlawful deprivation is to be counted from the time there was a demand to vacate.

Uichangco, et al. v. Laurilla
L-13935, Jun. 30, 1960

FACTS: A tenant, unable to pay the stipulated monthly rentals, paid only *part* of said rents to the lessor who *accepted* the same. *Issues:* (a) Does the acceptance by the lessor mean that there is an implied new lease, and for a reduced rent?; (b) From what moment is the tenant to be considered in default, if at all he is?; and (c) What would be the remedy of the lessor, if any?

HELD: (a) The fact that the lessor had accepted the partial monthly payments made by the tenant, in amounts less than the stipulated monthly rentals, may not be considered as a renewal of the lease contract. While a lessor may tolerate the continued default of his lessee, waiting and hoping that the latter would eventu-

ally pay up all his back rentals, said lessor could not very well refuse to accept the various amounts tendered just because they did not cover the full monthly rentals. That would have been unwise and unbusiness-like for if he did that he might get nothing at all from his delinquent and recalcitrant tenant. (b) The tenant is considered in default from the time he begins paying monthly rentals *less* than the stipulated amount, and he can thus be considered as illegally possessing and occupying the property, if despite such default and the demands made on him to pay the rentals and to vacate the premises, he refuses to vacate the same and to pay the rentals. (c) The remedy of the lessor would be to bring the action to recover the possession of the premises — *unlawful detainer* — with the municipal or justice of the peace court, if the period from the time the lessee first defaulted in payment and refused to vacate the premises up to the filing of the action, is within one year; otherwise, with the CFI (now RTC) in an *accion publiciana*.

Art. 1672. In case of an implied new lease, the obligations contracted by a third person for the security of the principal contract shall cease with respect to the new lease.

COMMENT:

Effect of Implied New Lease on Sureties and Guarantors

Example: Salalima is renting Liwayway's house for a period of 5 years. Redondo is Salalima's guarantor for the payment of rentals. If there is an implied new lease (resulting as it does in a *novation* of the contract), Redondo's obligation as guarantor is extinguished, unless, of course, he consents to its continuation.

Art. 1673. The lessor may judicially eject the lessee for any of the following causes:

(1) When the period agreed upon, or that which is fixed for the duration of leases under Articles 1682 and 1687, has expired;

- (2) **Lack of payment of the price stipulated;**
- (3) **Violation of any of the conditions agreed upon in the contract;**
- (4) **When the lessee devotes the thing leased to any use or service not stipulated which causes the deterioration thereof; or if he does not observe the requirement in No. 2 of Article 1657, as regards the use thereof.**

The ejectment of tenants of agricultural lands is governed by special laws.

COMMENT:

(1) Causes for Ejectment of the Lessee

This Article enumerates the causes for which the lessor may JUDICIALLY eject the lessee.

**Cruz v. Judge Puno, Jr.
GR 50998, Jan. 31, 1983**

When in a lease contract each of the parties is given the right to terminate the lease on a 30-day notice, the proviso is valid and binding on the parties, since the same is not against the law, public policy, public order, good morals, or good customs.

**Peran v. Presiding Judge
GR 57259, Oct. 13, 1983**

The possession of a parcel of land by virtue of the owner's tolerance is lawful *until* the possessor refuses to follow the owner's demand to vacate. Prior physical possession by the owner is *not* essential in a suit brought by him for unlawful detainer.

Note, however, the provisions of Presidential Decree 20, copied *verbatim* hereunder:

AMENDING CERTAIN PROVISIONS OF REPUBLIC ACT 6359 ENTITLED “AN ACT TO REGULATE RENTALS FOR TWO YEARS OF DWELLING UNITS OR OF LAND ON WHICH ANOTHER’S DWELLING IS LOCATED AND PENALIZING VIOLATIONS THEREOF, AND FOR OTHER PURPOSES.”

WHEREAS, the effects of the recent calamities which befell the country tended to raise prices of the basic necessities of life including rentals for housing;

WHEREAS, the Government through various measures have successfully been able to stabilize the prices of basic commodities, and it is essential that rentals for housing should likewise be stabilized; and

WHEREAS, the freezing of rentals for the lower income group at their present levels is desirable as the equitable levels for both the lessor and the lessee;

NOW, THEREFORE, I, FERDINAND E. MARCOS, President of the Philippines, by virtue of the powers vested in me by the Constitution as Commander-in-Chief of all the Armed Forces of the Philippines and pursuant to Proclamation No. 1081 dated September 21, 1972, and General Order No. 1 dated September 22, 1972, as amended, do hereby adopt and make as part of the law of the land certain amendments to the provisions of Republic Act No. 6359, which shall read as follows:

“SECTION 1. No lessor of a dwelling unit or of land on which another’s dwelling is located shall, upon promulgation of this Decree and until otherwise provided, increase the monthly rental agreed upon between the lessor and the lessee, as of the effectivity of this Act when said monthly rental does not exceed three hundred (P300.00) pesos a month.”

“SEC. 3. No lessor of a dwelling unit or of land on which another’s dwelling is located may demand a deposit, for any purpose, of any amount in exceeds of two month’s rental in advance.

“SEC. 4. Except when the lease is for a definite period, the provisions of paragraph (1) of article 1673 of the Civil Code of the Philippines insofar as they refer to dwelling unit or land on which another’s dwelling is located shall be suspended until otherwise

provided; but other provisions of the Civil Code and the Rules of Court of the Philippines on lease contracts, insofar as they are not in conflict with the provisions of this Act, shall apply.

“SEC. 5. Any person violating any provision of this Act shall be punished by imprisonment of not less than one year nor more than five years and a fine of not less than five thousand pesos nor more than ten thousand pesos.”

This Decree shall take effect immediately.

Done in the City of Manila, this 12th day of October in the year of Our Lord, nineteen hundred and seventy-two.

(Sgd.) FERDINAND E. MARCOS

President

Republic of the Philippines

Caburnay v. Ongsiako
GR 57321, Feb. 24, 1983

A place may, for purposes of PD 20, be considered a dwelling place even if located in a commercial district.

Sinclair v. CA
GR 52435, Jul. 20, 1982

A party in bad faith may not avail of the benefits of PD 20 (the old Rent Control Law).

Extreme necessity for personal use of property entitles the owner of exemption under PD 20.

REPUBLIC ACT 9161

“An Act Establishing Reforms in the Regulation of Rentals of Certain Residential Units, Providing the Mechanisms Therefor and for Other Purposes”)

Overview

As a matter of declared policy, “[t]he State shall, for the common good, undertake a continuing program of urban land

reform and housing which will make available at affordable costs decent housing and basic services to underprivileged and homeless citizens in urban centers and resettlement areas. Towards this end, the State shall establish reforms in the regulation of rentals of certain residential units.” (*Sec. 2, RA 9161*).

Under the “Rental Reform Act of 2002” (*Sec. 1, id.*) beginning Jan. 1, 2002 and for a duration of 3 yrs. thereafter ending on Dec. 31, 2004, monthly rentals of all residential units in the National Capital Region (NCR) and other highly-urbanized cities not exceeding P7,500 and monthly rentals of all residential units in all other areas not exceeding P4,000 shall not be increased annually by the lessor, without prejudice to existing contracts, by more than 10%. (*Sec. 3, id.*).

The following terms are operationally defined/analyzed under the Act, thus:

1. “Rental” shall mean the amount paid for the use or occupancy of a residential unit whether payment is made on a monthly or other basis. (*Sec. 4[a, id.]*). Rental shall be paid in advance within the first 5 days of every current month or the beginning of the lease agreement unless the contract of lease provides for a later date of payment. The lessor cannot demand more than 1 mo. advance rental and 2 mos. deposit. (*Sec. 5, id.*).

2. “Residential unit” shall refer to an apartment, house and/or land on which another’s dwelling is located and used for residential purposes and shall include not only buildings, parts, or units thereof used solely as dwelling places, boarding houses, dormitories, rooms, and bedspaces offered for rent by their owners, except motels, motel rooms, hotels, hotel rooms, but also those used for home industries, retail stores or other business purposes, if the owner thereof and his or her family actually live therein and use it principally for dwelling purposes. (*Sec. 4[b], id.*).

3. “Immediate members of family of lessee or lessor,” for purposes of repossessing leased premises, shall be limited to his or her spouse, direct descendants or ascendants, by consanguinity or affinity. (*Sec. 4[c], id.*).

4. “Lessee” shall mean the person renting a residential unit. (*Sec. 4[d], id.*). “Owner-lessor” shall include the owner or administrator or agent of the owner of the residential unit. (*Sec. 4[e], id.*). “Sub-lessor” shall mean the person who leases or rents out a residential unit leased to him by an owner. (*Sec. 4[f], id.*) “Sub-lessee” shall mean the person who leases or rents out a residential unit from a sub-lessor. (*Sec. 4[g], id.*).

5. “Assignment of lease” shall mean the act contemplated in Art. 1649 of the Civil Code. (*Sec. 4[h], id.*). Assignment of lease or sub-leasing of the whole or any portion of the residential unit, including the acceptance of boarders or bed spacers, without written consent of owner/lessor is prohibited. (*Sec. 6, id.*).

Grounds for Judicial Ejectment

Ejectment shall be allowed on the following grounds, namely:

- (a) Assignment of lease or sub-leasing of residential units in whole or in part, including acceptance of boarders or bedspacers, without written consent of owner/lessor. (*Sec. 7[a], id.*).
- (b) Arrears in payment of rent for a total of 3 mos.: *Provided*, That in case of refusal by lessor to accept payment of rental agreed upon, lessee may either deposit, by way of consignation, the amount in court, or with city or municipal treasurer, as the case may be, or in a bank in the name of and with notice to lessor, within 1 mo. after refusal of lessor to accept payment. Lessee shall thereafter deposit rental within 10 days of every current month. Failure to deposit rentals for 3 mos. shall constitute a ground for ejectment. If an ejectment case is already pending, the court upon proper motion may order lessee or any person or persons claiming under him to immediately vacate the leased premises without prejudice to continuation of ejectment proceedings. At any time, lessor may, upon authority of the court, withdraw rentals deposited. Lessor, upon authority of the court in case of consignation or upon joint affidavit by him and lessee to be submitted to city or municipal treasurer

and to bank where deposit was made, shall be allowed to withdraw deposits. (*Sec. 7[b], id.*).

- (c) Legitimate need of owner/lessor to repossess his or her property for his or her own use of any immediate member of his or her family as residential unit: *Provided, however, That lease for a definite period has expired. Provided, further, That lessor has given lessee formal notice 3 mos. in advance of lessor's intention to repossess property and: Provided, finally, That owner/lessor is prohibited from leasing residential unit or allowing its use by third party for a period of at least 1 yr. from time of repossession. (Sec. 7[c], id.).*
- (d) Need of lessor to make necessary repairs of leased premises which is subject of an existing order of condemnation by appropriate authorities concerned in order to make said premises safe and habitable: *Provided, That after said repair, lessee ejected shall have first preference to lease same premises: Provided, however, That the new rental shall be reasonable commensurate with expenses incurred for repair of said residential unit and: Provided, finally, That if residential unit is condemned or completely demolished, lease of new building will no longer be subject to aforementioned rule in this subsection. (Sec. 7[d], id.).*
- (e) Expiration of period of lease contract. (*Sec. 7[e], id.*).

Prohibition Against Ejectment By Reason of Sale or Mortgage

No lessor or his successor-in-interest shall be entitled to eject lessee upon the ground that leased premises have been sold or mortgaged by third person regardless of whether lease or mortgage is registered or not. (*Sec. 8, id.*).

Rent-to-Own Scheme

At lessor's option, he or she may engage lessee in written rent-to-own agreement that will result in transfer of ownership of particular dwelling in favor of the latter. Such an agreement shall be exempt from coverage of Sec. 3 of this Act. (*Sec. 9, id.*).

Application of Civil Code and Rules of Court

Except when the lease is for a definite period, Art. 1673(1) of the Civil Code, insofar as it refers to residential units covered by this Act, shall be suspended (during this Act's effectivity), but other provisions of the Civil Code and the Rules of Court on lease contracts, insofar as they are not in conflict with this Act's provisions, shall apply. (*Sec. 10, id.*).

Miscellaneous Matters

All residential units in the NCR and other highly-urbanized cities the total monthly rental for each of which does not exceed P7,500 and all residential units in all other areas the total monthly rental for each of which does not exceed P4,000 as of the *effectivity date* of this Act shall be covered, without prejudice to existing contracts. (*Sec. 11, id.*). This Act shall take effect on Jan. 1, 2002 following its publication in at least 2 newspaper of general circulation. (*Sec. 17, id.*).

The Department of Interior and Local Government (DILG) and the Housing and Urban Development Coordinating Council (HUDCC), in coordination with other concerned agencies, are hereby mandated to conduct a continuing information drive about the provisions of this Act. (*Sec. 13, id.*). The HUDCC is hereby mandated to formulate, within 6 mos. from effectivity hereof, a transition program which will provide for safety measures to cushion the impact of free rental market. (*Sec. 14, id.*).

A fine of not less than P5,000 nor more than P15,000, or impairment of not less than 1 mos. and 1 day to not more than 6 mos. or both shall be imposed on any person, natural or juridical, found guilty of violating any provision of this Act. (*Sec. 12, id.*). If any provision or part hereof is held invalid or unconstitutional, the remainder of the law or the provision not otherwise affected shall remain valid and subsisting. (*Sec. 15, id.*). Any law, presidential decree or issuance, executive order, letter of instruction, administrative order, rule or regulation contrary to inconsistent with, the provisions of this Act is hereby repealed, modified, or amended accordingly. (*Sec. 16, id.*).

(2) Laws Affecting Urban Land Reform

Presidential Decree (PD) 1571, proclaiming urban land reform in the Philippines and providing for the implementing machinery thereof, empowers the President to proclaim urban and urbanizable lands as urban land reform zones.

Under Proclamation 1893, Metropolitan Manila was declared an urban land reform zone to prevent the unreasonable rise in the prices of lands in the area. Proclamation 1967 amends Proclamation 1893 by specifying 244 sites in Metro Manila as areas for priority and urban reform zones. PD 1640 freezes the prices of lands in Metro Manila at current Market value (as determined in accordance with PD 76, as amended, and other pertinent decrees, rules or regulations.)

There have been at least five (5) Presidential enactments on urban land reform zones, namely:

1. PROCLAMATION 1893, Declaring the Entire Metropolitan Manila Area as an Urban Land Reform.
2. PROCLAMATION 1967, Amending Proclamation No. 1893 by specifying 244 sites in Metropolitan Manila as areas for priority development and urban land reform zones.
3. The Annex attached to Proclamation No. 1967 enumerating areas as Priority Development and Urban Land Reform Zones.
4. PRESIDENTIAL DECREE 1517, Proclaiming Urban Land Reform in the Philippines and providing for the implementing machinery thereof.
5. LETTER OF INSTRUCTIONS 935.

(3) Cases

**Bermudez v. IAC
GR 73206, Aug. 6, 1986**

Even if the disputed land is in an area already proclaimed for priority development, its occupants cannot take advantage of the beneficent provisions (*e.g.*, the right of first refusal) granted by Presidential Decree 1517, if they are not *bona fide*

occupants of the property or are occupying it through the tolerance of the owner, and have nothing to support their claim that they have a valid contract of lease with the other.

**House International Building Tenants
Association, Inc. v. IAC
GR 75287, Jun. 30, 1987**

The ruling in *Mataas na Lupa Tenants Association, Inc., et al. v. Dimayuga, et al.*, 130 SCRA 30, where the Supreme Court upheld the lessee's right of first refusal over the land they had leased and occupied for more than ten (10) years and on which they had constructed their houses, a right given them under PD 1517 (and Proclamation 1967 of May 14, 1980), does not apply to tenants renting a building. PD 1517, in referring to the pre-emptive or redemptive right of a lessee, speaks only of urban land under lease on which a tenant has built a home and on which he has resided for ten years or more. If both the land and the building belong to the lessor, the pre-emptive right referred to in PD 1517 does not apply.

The Urban Land Reform Law (PD 1517) applies to a case where the owner of the property intends to sell it to a third party. Should this be the intent, the legitimate tenant may not be ejected should he decide himself to purchase the property. If the owner-lessor of the leased premises does not intend to sell the property in question, but seeks to eject the tenant on the ground that the former needs the premises, the tenant cannot invoke the Urban Land Reform Law.

(4) Expiration of the Period

- (a) The period may be *conventional* or *legal*. (*Arts. 1682 and 1687*).
- (b) At the end of the period, the lease ceases without need of any demand. (*Art. 1669*).
- (c) If the period ends, and there is no implied new lease, the lessee would be holding the property illegally. Therefore, he may be ousted by unlawful detainer proceedings. Moreover, the lessor may now lease the property to another. (*Rivera v. Trinidad*, 48 Phil. 316). Indeed, the lessee who refuses to vacate has become a *deforciant*

and can be ousted judicially without the need of a demand. (*Bulahan, et al. v. Tuason, et al., L-12020, Aug. 31, 1960*).

Cruz v. Puno, Jr.
GR 50998, Jan. 31, 1983

Presidential Decree 20 was enacted to regulate proprietary rights so that public welfare may be advanced. It was never meant to destroy the sanctity of contracts.

Santos, et al. v. Court of Appeals
GR 45071, May 30, 1983

The grounds under Batas Pambansa Bilang 25 (on house rentals) for ejectment may be applied retroactively.

Cruz v. Puno, Jr.
GR 50998, Jan. 31, 1983

An agreement in a lease that rents would be paid monthly (making the lease on a month-to-month basis) makes the lease one with a *definite* period.

Francisco Saure v. Hon. Pentecostas
L-46468, May 21, 1981

(1) Under PD 20 a tenant generally cannot be ousted if the premises are rented for P300.00 a month or less, even if a small photographic studio is maintained by the lessee. Failure to consign the rent in court may under certain circumstances be excused.

(2) It is the *use* of the premises, not its *location*, which determines if an apartment is residential or commercial.

Baens v. Court of Appeals
GR 57091, Nov. 25, 1983

(1) If the lease contract is in *writing*, and on a “month-to-month” basis, lease is for a definite period and may be terminated at the end of each month.

(2) If the lease contract is *oral*, and on a “month-to-month” basis, the mere termination every month is not sufficient (note that B.P. Bilang 25 speaks of a *written* lease with a definite period). However, if lessor needs the premises for the use of his immediate family, the lessee may be ejected at the end of the month.

Limpin Investment Corp. v. Lim Sy
L-31920, Apr. 8, 1988

Where a contract of lease is on a month-to-month basis, a lessor has a clear and indubitable right to eject the lessees upon oral or written notice of termination, the period of lease having expired by the end of every monthly period, and although the first action of the owner for the ejectment of the tenant was dismissed by the court under a judgment that became final and executory, such dismissal does not preclude the owner from making a new demand upon the tenant to vacate should the latter again fail to pay the rents due inasmuch as this second demand for the payment of the rents and for the surrender of the possession of the leased premises and the refusal of the tenant to vacate would constitute a new cause of action.

(5) Non-payment of Rent

- (a) Here, the period need not expire. It is sufficient that there was *non-payment* after a *demand for said rents* (*Zobel v. Abreau, et al.*, 98 *Phil.* 343) and a demand to vacate. (*Co Tiamco v. Boom Sim*, 43 *O.G.*, p. 1665). Observe, therefore, that mere failure to pay rent does not, *ipso facto*, make the tenant’s possession of the premises unlawful. It is the owner’s demand for the tenant to vacate the premises when the tenant fails to pay the rent in time, and the tenant’s refusal to vacate, which makes UNLAWFUL the withholding of possession of the property. Indeed, there is no legal obstacle for the owners of the rented property to allow the defaulting tenant to stay on the premises said consent or allowance makes *lawful* the tenant’s possession. Only when the consent is withdrawn and the owner demands that the tenant leave is the owner’s right of possession asserted. The tenant refusal or failure to move out makes

his possession unlawful because it is violative of the owner's right of possession. (*Casilan v. Tomas*, L-16574, Feb. 28, 1964). When the detention becomes unlawful, the lessor is free to sue the lessee in an ejectment or unlawful detainer case. (*Hautea v. Magallon*, L-20356, Nov. 28, 1964). The giving of a security to guarantee the payment of rentals falling due after date does not extinguish or novate the obligation to satisfy the same, or impair the right of the lessor to bring an action for unlawful detainer, for there is no incompatibility between either the remedy on said obligation, on the one hand, and the security on the other. On the contrary, the creation of the chattel mortgage therefor bolstered up said remedy and strengthened the effectivity of the obligation, by insuring the collection of the money judgment that may be rendered in the action for unlawful detainer. (*Leonor v. Sycip*, L-14220, Apr. 29, 1961).

- (b) Without prejudice to RA 6126, as amended, and the provisions of Presidential Decree 20 and Batas Pambansa 25, the following rulings are still applicable: A lessor may impose a *reasonable increase of rent*, after the original period has expired. This rent, the lessee may *accept or refuse*. If he accepts, he should pay said rate; if he defaults, ejectment can prosper against him. (*See Cortes v. Ramos*, 46 Phil. 184 and *Manotok v. Guinto*, 64 O.G. 7074). Indeed, a cause of action for unlawful detainer against the lessee exists when the lessor, at the end of the lease, increases the rental which does not appear to be exorbitant, and the lessee, without vacating the premises, fails to pay the increased rentals. (*Pilar G. Vda. de Kraut v. Manuel Lontok*, L-18374, Feb. 27, 1963).

In no case is the lessor allowed to increase the rental, when the term has not yet expired, unless of course, the lessee consents. (*Gomez v. Ng Fat, et al.*, 76 Phil. 555).

**Trinidad de Leon Vda. de Roxas v.
Court of Appeals
L-39146, Mar. 25, 1975**

FACTS: Petitioner executed a lease contract over her parcel of land in favor of private respondent. The lease

was for three years at a rental of P1,000 monthly. The contract was “renewable for another three years at the option of the lessor, and under such terms and conditions as she may impose.” At the end of the lease, lessor decided not to renew the original contract. Instead, she allowed lessee to continue, but this time, with a P3,000 monthly rent. The lessee then paid the new rate for some time. *Issue*: Is the new agreement valid, or should the excess of P2,000 per month be returned to the lessee?

HELD: The new agreement is perfectly valid, it not being contrary to prohibitory or mandatory laws, public order, public policy, good morals or good customs. Therefore, there will be no returning of the alleged excess. If the lessee really did not want the new rate, what he should have done was to vacate the premises.

Petra Vda. de Borromeo v. Pogoy
GR 63277, Nov. 29, 1983

A case involving a juridical person (like an estate of a deceased) does *not* have to pass the *barangay* court (*Lupong Tagapayapa*).

- (c) If a municipal government wants to lease municipal private property to another, the municipal board can fix the rental rate. The court will interfere only if:
 - 1) the rate is unreasonable;
 - 2) the passing of the pertinent ordinance is *ultra vires*. (*Umali, et al. v. City of Naga, et al.*, 53 O.G. 4102).
- (d) If a lessee refuses to pay rent because he alleges that it is *not* the rent agreed upon, and he can prove his contention, an action to eject him will not prosper. (*See Belmonte v. Marin*, 76 Phil. 198).
- (e) The rule requiring the occupant of property, where the decision in the unlawful detainer suit is adverse to him, to make a deposit of the rentals adjudged by the court, contemplates instances when the defendant is still in possession of the property subject of the litigation, the purpose being to compensate the lessor for having been

deprived of such possession of his premises. Otherwise, the reason behind the deposit ceases. Thus, when after judgment in the unlawful detainer case, but pending appeal by the lessee, the building of the lessee on the land of the lessor was demolished by the lessor upon permit issued by the city engineer, the defendant is relieved from the duty of making the deposit. (*Mayon Trading, Inc. v. Co Bun Kim, L-11261, Jul. 31, 1968*).

(6) Violation of Contractual Conditions

Example: If the contract provides that the lessee cannot construct any building on the property leased without the lessor's consent, and the lessee makes the improvement, the lessor, if his consent had *not* been obtained, may successfully judicially oust the lessee.

(7) No Authority to Use Force and Violence

**Heirs of Pedro Laurora & Leonora Laurora
v. Sterling Technopark III & S.P. Properties, Inc.
GR 146815, Apr. 9, 2003**

ISSUE: Whether private respondents have a valid and legal right to forcibly eject petitioners from the premises despite their resistance and objection, thru the use of armed men and by bulldozing, cutting, and destroying trees and plants planted by petitioners without court order, to the damage and prejudice of the latter.

HELD: No. Owners of property have no authority to use force and violence to eject alleged usurpers who were in prior physical possession of it. They must file the appropriate action in court and should not take the law into their own hands.

Art. 1674. In ejectment cases where an appeal is taken, the remedy granted in Article 639, second paragraph, shall also apply, if the higher court is satisfied that the lessee's appeal is frivolous or dilatory, or that the lessor's appeal is *prima facie* meritorious. The period of ten days referred to in said article shall be counted from the time the appeal is perfected.

COMMENT:**(1) Writ of Preliminary Mandatory Injunction in Ejectment Cases**

- (a) Art. 539, second paragraph, speaks of the writ of *preliminary mandatory injunction in forcible entry cases*. Note that Art. 1674 applies the same remedy in unlawful detainer or ejectment cases, but only in case of an APPEAL.
- (b) “Ejectment” here can properly refer to “unlawful detainer” cases.

Ubarra v. Tecson
Administrative Matter No. R-4-RTJ
Jan. 17, 1985

The purpose in granting a writ of preliminary mandatory injunction is to provide for the speedy adjudication in ejectment cases, so that the dispossessed will not be further damaged.

Roxas v. IAC
GR 74279, Jan. 20, 1988

To warrant ejectment of a tenant on the ground of need for personal use of the owner or the immediate member of his family, the requisites are:

- (1) the owner or lessor needs the property for his own use or for the use of any immediate member of the family;
- (2) such owner or immediate member of the family is not the owner of any available residential unit;
- (3) the period of lease has expired; and
- (4) the lessor has given the lessee notice three months in advance of lessor’s intention to repossess the property.

Even if the lessor owns other residential units, what the law requires is that the same is an available residential unit, for the use of such owner or lessor or

the immediate member of his family. Thus, even if an owner/lessor owns another residential unit, if the same is not available, as for example the same is occupied or it is not suitable for dwelling purposes, it is no obstacle to the ejectment of a tenant on the ground that the premises is needed for use of the owner or immediate member of his family. The owners/lessors are not rendered helpless and without any remedy if in the course of the ejectment proceedings, the tenant fails to pay the rentals for no reason at all except that the case is still pending in court. This is most inequitable and unlawful. If the tenants have admittedly not paid the rentals due beyond the three months grace period as provided in the law then existing, or beyond the stipulated period of payment thereof, or as is otherwise provided or required by law, the Court should not hesitate to suspend the rules by ordering the ejectment of such tenant or tenants although such non-payment of rentals is not one of the stated grounds for the litigation.

By the same token when it is clearly shown that pending litigation, the tenant lessee was subleasing the property without the knowledge or consent of the owners/lessors, the court should in the interest of justice suspend the rules and order the ejectment of the tenant/lessee, although this is not the ground for ejectment originally invoked in the suit. It is another ground for ejectment under the law. While it is the benign policy of the State to give all possible assistance to the tenants particularly those coming from the low-income group and to help the landless acquire their own homes, this should not be applied to the extent of oppressing the landowners/lessors, by enabling such tenants to occupy the premises when the landowner or the immediate member of his family needs the premises for his own use, or when the tenants have not paid the rentals due pending the litigation or otherwise subleased the premises without the knowledge nor consent of the owner/lessor. Under such circumstances, the courts should step in to see that the scales of justice are equitably tipped to relieve the owner/lessor of his unfortunate plight.

Top Rate International Services, Inc.**v. CA, et al.****GR 84141, Feb. 8, 1989**

While technicalities have their uses, resort to them should not be encouraged when they serve only to impede the speedy and just resolution of a case, least of all in an ejectment case which is supposed to be summary in nature.

(2) Conditions Before the Writ of Preliminary Mandatory Injunction May Be Availed of in Unlawful Detainer Cases

- (a) There must be an APPEAL. (Hence, it *cannot* be granted in the original case of unlawful detainer. *Reason:* The lessee is *presumed* to be in *lawful possession of the premises.*)
- (b) The lessee's appeal must be *frivolous or dilatory*; or the lessor's appeal is *prima facie meritorious*.

(NOTE: It is the lessor, *not* the lessee, who can ask for the writ since it is he who is NOT on the premises.)

- (c) The writ must be asked for within a period of 10 days, to be counted "from the time the appeal is perfected," that is, from the time the party petitioning is *informed* or *notified* that the appeal has been perfected. (*De la Cruz v. Bocar and Rilloraza, 99 Phil. 492*). In this *De la Cruz* case, the court held that an appellee, in the case appealed from the Justice of the Peace Court to the Court of First Instance, is *not* called upon to be always on guard in the inferior court to ascertain the exact date and hour when the appeal is perfected. All that an appellee is expected to do, is to wait for the official notice to him of said perfected appeal from the Court of First Instance when the appeal is taken. Otherwise, the appellee may be prematurely filing a petition for the issuance of the writ in the CFI before the appeal is actually received by the said court; and said appellee would not know how to entitle or number his petition

because there is as yet *no case* or record of a case to which it may be attached and incorporated.

- (d) The writ is to be granted by the “higher court,” that is, the Court of First Instance may grant the writ, since it is the appellate court in unlawful detainer cases. (*See Sycip v. Soriano, et al., C.A., 52 O.G. 1474*).
- (e) The case must involve a lease of lands and/or buildings thereon. After all, there is a legal principle that “accessory follows the principal.” (*Sycip v. Soriano, et al., supra*).

(3) Illustrative Problems

- (a) A, a lessor, filed an unlawful detainer case against B, his lessee. B lost the case, but appealed the same to the Court of First Instance (now Regional Trial Court). A asked for a writ of preliminary mandatory injunction 6 days after he had been notified that B’s appeal had been perfected. Will A be granted the writ?

ANS.: Yes, if the CFI (RTC) is satisfied that B’s appeal is frivolous or dilatory. Hence, A will be allowed to oust B in the meantime (during the pendency of the appeal). It would be unjust in such a case to allow B to remain in physical possession all throughout the pendency of the appeal.

- (b) A, the lessor, filed an unlawful detainer case against B in the Justice of the Peace Court (now MTC). Pending decision is A allowed to ask for a writ of preliminary mandatory injunction?

ANS.: No, because there is *no appeal as yet*.

The rule in unlawful detainer cases is DIFFERENT from the rule in forcible entry cases, where, even if there is *no appeal*, such a writ may be granted. (*Art. 539, paragraph 2; Art. 1674*).

- (c) Liwayway purchased land from Marlene, but found on the premises Amalia, a lessee, whose term has however *already expired*. Is Liwayway allowed to sue Amalia for unlawful detainer, and ask for a writ of preliminary mandatory injunction?

ANS.: Yes, a suit of unlawful detainer may prosper, but the writ of preliminary mandatory injunction will have to wait for the appeal. (*See De la Cruz v. Bocar and Rilloraza*, 99 *Phil.* 492).

Art. 1675. Except in cases stated in Article 1673, the lessee shall have a right to make use of the periods established in Articles 1682 and 1687.

COMMENT:

When the Legal Periods for the Lease Cannot Be Availed of

Naturally, the legal periods referred to in Arts. 1682 and 1687 cannot be availed of if there is a proper ground for *ejectionment*.

**La Jolla, Inc. v. CA & Pelagia Viray Aguilar
GR 115851, Jun. 20, 2001**

Art. 1675 excludes cases falling under Art. 1673 (which provides, *inter alia*, that the lessor may judicially eject the lease when the period agreed upon or that which is fixed has expired) from the cases wherein, pursuant to Art. 1687, counts may fix a longer period of lease.

Art. 1676. The purchaser of a piece of land which is under a lease that is not recorded in the Registry of Property may terminate the lease, save when there is a stipulation to the contrary in the contract of sale, or when the purchaser knows of the existence of the lease.

If the buyer makes use of this right, the lessee may demand that he be allowed to gather the fruits of the harvest which corresponds to the current agricultural year and that the vendor indemnify him for damages suffered.

If the sale is fictitious, for the purpose of extinguishing the lease, the supposed vendee cannot make use of the right granted in the first paragraph of this article. The sale is presumed to be fictitious if at the time the supposed vendee demands the termination of the lease, the sale is not recorded in the Registry of Property.

COMMENT:**(1) Rules in Case the Leased Land Is Sold to a Buyer**

- (a) Art. 1676 gives the rules when the leased land is sold.
- (b) Comment of the Code Commission:

The last paragraph is calculated to discourage the practice which has developed in recent years, of fictitiously selling the premises, in order to oust the lessee before the termination of the lease. (*Report of the Code Commission, p. 143*).

(2) Query: Must a Purchaser of Property Respect a Lease Thereon?

ANS.: It depends:

- (a) If the lease is registered or if he has actual knowledge of its *terms and duration*, the purchaser must respect the lease, and therefore he cannot yet oust the lessee. (*Art. 1676; Gustilo v. Maravilla, 48 Phil. 442; Sayo v. Manila Railroad, 43 Phil. 561 and Yusay v. Alojado, et al., L-14881 and L-15001-07, Apr. 30, 1960*).
- (b) Otherwise, he is not duty bound to respect the lease, unless there be a contrary stipulation in the contract of sale. (*Art. 1676; Ventura v. Miller, 2 Phil. 22 and Saul v. Nawkins, 1 Phil. 275*).

(3) Illustrative Problems

- (a) Brigitte was leasing Jayne's land. The term of the lease was for 5 years, and the lease was registered. One year before the expiration of the lease, Jayne sold the land to Marilyn. Does Marilyn have the right to oust Brigitte right now? If Jayne had *donated* the land instead, would your answer to be same?

ANS.: No, Marilyn cannot oust Brigitte. Marilyn must respect the recorded lease, and must therefore wait for its expiration. A registered or recorded lease is binding on third persons. (*See Art. 1676 and Co Tiongco v. Co Guia, 1 Phil. 210; see also Quimson v. Suarez, 45*

Phil. 901). If instead of sale, a donation had taken place, it is believed that the answer should be the same, on account of the principles concerning registration, as well as the reason and purpose behind Art. 1676.

- (b) Diomedes is Cenon's tenant. The lease of 5 years is recorded. If Ruben purchases the property before the expiration of the five years, we know he has to respect the lease. Now then, to whom should Diomedes pay the rents from the time of purchase to the time of expiration of the lease?

ANS.: Naturally to Ruben, the purchaser, unless there is a contrary stipulation in the deed of sale. This is of course in the supposition that the lessee has been informed of the purchase. If notwithstanding proper notice from Ruben, the lessee still pays Cenon (the former owner), Ruben may still recover the rent from Diomedes. Here, Diomedes (the lessee) is clearly at fault. (*See De Jesus v. Sociedad Arrendataria*, 23 *Phil.* 76).

- (c) A is renting B's property. The lease is unrecorded. B sold the property fictitiously to C, just to terminate the lease. Is C allowed to terminate the lease?

ANS.: No, because the sale was fictitious. (*Art. 1676, 3rd paragraph*).

[NOTE: The sale to C is presumed to be fictitious if at the time C demands the termination of the lease, the sale to him (C) is *not yet recorded* in the Registry of Property. (*Art. 1676, last sentence*).]

(4) Some Doctrines and Cases

A true purchaser in the proper case has a RIGHT, not duty, to put an end to an existing lease. Therefore, he may or may not terminate the same.

Pang Lim and Galvez v. Lo Seng **42 Phil. 282**

FACTS: A and B were C's lessees. A sold his right as lessee to B, with C's consent. Later, C sold the property to

A. A now wants to terminate B's lease on the ground that the lease is *unrecorded*. Is A allowed to do so?

HELD: No, A is not allowed to do so. He must respect B's right as lessee, as B is his (A's) own buyer. As vendor of the leasehold, he is bound to respect the rights of his own vendee (B). The fact that the lease is unregistered is immaterial since A actually knows of the existence of the lease, which he himself participated in.

Quimson v. Suarez
45 Phil. 901

FACTS: Land registered with a Torrens Title and a lease which was NOT recorded. A purchaser of the land had been told that the lease was to terminate at a certain period. Said period was however SHORTER than the true period. Is the buyer required to respect the lease insofar as it *exceeds* the duration known to him?

HELD: No, for he had no prior knowledge of said *unregistered excess*. He had a right to rely on the certificate of title, and since the lease was not annotated, the lessee does not deserve to be protected.

(5) Rural Leases

Governing rule: If the buyer terminates the rural lease, the lessee has the following rights:

- (a) He may demand that he be allowed to gather the *fruits of the harvest* which corresponds to the current agricultural year.

[NOTE: "Fruits of the harvest" *cannot* include the gathering of fishes. This is because said fish require two years before they can be of any commercial value. (See *Manila Building and Loan Assn. v. Green, C.A., 37 O.G., 2088; 10 Manresa 645*).]

- (b) He may also demand that the vendor *indemnify* him for damages suffered. (*Art. 1676, 2nd paragraph*).

Art. 1677. The purchaser in a sale with the right of redemption cannot make use of the power to eject the lessee until the end of the period for the redemption.

COMMENT:

When Buyer *A Retro* Can Eject

Example:

A bought the house of *B a retro*. There was an unrecorded lease on the house in favor of C. When is A allowed to terminate the lease?

ANS.: Only when the period of redemption expires. (*Art. 1677*).

Reason for the Law:

To prevent a useless disturbance of the lease if the vendor *a retro* should redeem the property within the period of redemption. (*Dorado & Vista v. Verina*, 34 Phil. 264).

**Dorado and Vista v. Verina
34 Phil. 264**

FACTS: A, owner of a house, sold the same to *B a retro*, and with the condition that he (A) would remain in the house, not as an owner, but as a tenant bound to pay rentals. If A does not pay his rents' or does not fulfill any of the conditions of the lease, may B, the purchaser *a retro*, terminate the lease even if the period of redemption *has* not yet expired?

HELD: Yes. The prohibition referred to in Art. 1677 is *not applicable* in this case, because there is no third person involved.

Thus, the Supreme Court has stated that this "legal provision is not applicable to a case where the vendor, on disposing of real property under the right of repurchase, continues nevertheless in possession thereof by virtue of a special agreement, not as an owner, but as a tenant of the purchaser."

Art. 1678. If the lessee makes, in good faith, useful improvements which are suitable to the use for which the lease is intended, without altering the form or substance of the property leased, the lessor upon the termination of the lease shall pay the lessee one-half of the value of the improvements at that time. Should the lessor refuse to reimburse said amount, the lessee may remove the improvements, even though the principal thing may suffer damage thereby. He shall not, however, cause any more impairment upon the property leased than is necessary.

With regard to ornamental expenses, the lessee shall not be entitled to any reimbursement, but he may remove the ornamental objects, provided no damage is caused to the principal thing, and the lessor does not choose to retain them by paying their value at the time the lease is extinguished.

COMMENT:

(1) Right of Lessee to Useful Improvements and Ornamental Expenses

This Article speaks of the right of the lessee to:

- (a) useful improvements;
- (b) ornamental or luxurious expenses.

(2) Example With Reference to Useful Improvement

A is renting B's house. A constructed a fence. When the lease ends, what is A's right regarding this useful improvement?

ANS.: A has the right to be reimbursed one-half of the value of the fence. The value is computed as of the time the lease ENDS.

If B refuses to make the reimbursement, A can remove the fence even if in doing so, the concrete pavement to which the fence may be attached would suffer damage thereby. The injury must however be minimized. (*Art. 1678, par. 1*).

Salonga v. Farrales
L-47088, Jul. 10, 1981

A lessee of a lot who constructs in good faith thereon a house may remove said house, but cannot compel the lessor to sell to him the lot, unless there be an agreement to this effect.

(3) Rule Under the Old Law

Under the old law, the lessee had no right to be reimbursed for he might improve the landlord out of the latter's property. He could not be given the right of a possessor in good faith (for the lessee knows that the land does not belong to him; and certainly from the very outset, he is aware of the precarious nature of his possession); but neither could be considered a possessor in bad faith (for certainly, as lessee, he had a right to stay on the property). He, therefore, was entitled under the old law merely to the rights of a **USUFRUCTUARY** (right of removal and set-off, but not that of reimbursement). (See *Alburo v. Villanueva*, 7 Phil. 277; *Rivera v. Trinidad*, 48 Phil. 396; *Guitarte v. Sabaco*, L-13688-91, Mar. 28, 1960; *Cortez v. Manimbo*, L-15596-97, Oct. 31, 1961).

(4) Comment of the Code Commission

The first paragraph is intended to prevent the unjust enrichment of the lessor. The lessor is to pay only one-half of the value of the improvements at the time the lease terminates because the lessee has already enjoyed the same. On the otherhand, the lessor will enjoy them indefinitely thereafter. (*Report of the Code Commission*, pp. 144-146.)

(5) Meaning of 'Good Faith' in the Article

"Good faith" as used in Art. 1678 is not the "good faith" defined in the law of possession. (Art. 526). Evidently, "good faith" under Art. 1678, refers to a case where the lessee introduces improvements *not calculated to harm or destroy the property* leased. (If improvements are made contrary to agreement with the lessor, it is evident that the lessee is *not* in good faith, and is therefore not entitled to any reimbursement.) (See *Susana Realty v. Hernandez, et al.*, C.A., 54 O.G. 2206).

(6) Rule if Lessor Refuses to Reimburse

If the lessee demands reimbursement for half, and the lessor refuses, who should prevail?

ANS.: In a sense the lessor prevails in that the lessee cannot insist on reimbursement. It is clear that the option of reimbursing belongs to the lessor, and not to the lessee. (*See Lapena, et al. v. Pineda, L-10089, Jul. 31, 1957*). This does *not* mean that the lessee is left helpless, for under the law it is clear that he may, as a remedy, *remove* the improvements, even though the leased premises may suffer some damage thereby. (*See Art. 1678, par. 1*).

**Juanito A. Rosario v. CA & Alejandro Cruz
GR 89554, Jul. 10, 1992**

It would be inequitable to allow the petitioner, as new owner of the Lot 3-A; to occupy that part of private respondent's house built thereon without reimbursing the latter for one-half of its value as provided in Art. 1678 of the Civil Code.

(7) Bar

O, the owner of a residential house and lot in Manila, leased the property to *L* for 10 years. There was no stipulation between the parties as to improvements. The property had a driveway for cars, but it had *no* garage. *L* built a garage.

- (a) What is the legal nature of the garage as an improvement?

ANS.: The garage is in the nature of a useful improvement or expense since it adds value to the property. (*See Aringo v. Arenas, 14 Phil. 263 and Robles, et al. v. Lizarraga Hermanos, et al., 42 Phil. 584*).

- (b) Can *O* retain the garage after the expiration of the lease?

ANS.: Yes. The owner of the house and lot can retain the garage after the expiration of the lease, but he must pay the lessee *one-half* of the value of the garage at that time, inasmuch as the lessee made in *good faith* a useful improvement suitable to the use for which the lease was

intended, without altering the form or substance of the property leased. (*Art. 1678*).

- (c) Can *O* require *L* to remove the garage after the expiration of the lease?

ANS.: Evidently, the law does not authorize *O* to require *L* to remove the garage after the expiration of the lease. As a matter of fact, it is *L* who is allowed to remove the garage should the lessor refuse to reimburse the amount stated in the preceding paragraph. After all, considering the presence of a driveway for cars, it cannot be doubted that under the law, the lessee had every right to construct the garage. (*See Art. 1678*).

(8) Rule if Useful Improvements Are Not Suitable

Art. 1678 refers to “useful improvements, *which are suitable* to the use for which the lease is intended.” Now then, suppose said useful improvements are NOT suitable, it is clear that the first paragraph of Art. 1678 will *not* apply. What then should apply? It is submitted that they should be considered in the category of “ornamental expenses” since undoubtedly they are “expenses” and purely “ornamental” in the sense that they are not *suitable*. Therefore, the second paragraph of Art. 1678 should apply.

(9) Rule if There Is No True Accession

Note that under the first paragraph of Art. 1678, the law on the right of REMOVAL says that “should the lessor refuse to reimburse said amount, the lessee may remove the improvements, *even though* the principal thing may suffer thereby.” While the phrase “even though” implies that Art. 1678 always applies regardless of whether or not the improvements can be removed without injury to the leased premises, it is believed that application of the Article cannot always be done. The rule is evidently intended for cases where a *true accession* takes place as when part of the land leased is, say, converted into a fishpond; and certainly *not* where an easily removable thing (such as a wooden fence) has been introduced. There is no doubt that in a case involving such a detachable fence, the lessee can take the same away *with him* when the lease expires.

(10) Query

R, the owner of a brick building rented it to *F* for a period of 5 years under a written lease which contained no agreement as to improvements but did provide that it was to be used as the office of a real estate broker. After six months of occupancy, *F* requested a new glass brick front, and the installation of a cooling system. *R* refused the request for improvements. Without advising *R*, *F* took down the existing glass front, and replaced it with one constructed with glass brick. He also installed a cooling system which was connected to the pipes of the hot air furnace in such a manner that it could be removed without injury to the building or heating system. Near the expiration of the term of the lease, *F* demanded that *R* pay the cost of these improvements. When *R* refused to make payment, *F* threatened to remove the glass brick front and the cooling system from the building. *R* has filed an action to establish the ownership of these improvements and to prevent their removal by *F*. Discuss and decide.

(NOTE: The reader will please answer the query stated hereinabove. *Hints:* Are the improvements useful ones or only for ornament? Were the improvements made in good faith or in bad faith? Are they suitable for use in the office of a real estate broker? Is *F* responsible for any damages?)

(11) Stipulation Giving Lessor the Improvements

The condition that ownership of the improvements constructed on the land leased shall pass to the lessor at the expiration of the contract of lease, or in case of violation of the terms thereof, is NOT IMMORAL and UNCONSCIONABLE. This kind of resolutive condition is quite common in lease contract, and there are two reasons given for the imposition of such conditions. *Firstly*, they serve as a *guaranty* to the lessors; they tend to compel the timely payment of rentals by the lessees who had chosen to enter into a long term lease contract. *Secondly*, the rentals are relatively low, and the lessees would, therefore, after a number of years, be able to obtain a fair return of their investment. (*Co Bun Kim v. C.A. and Tiongson, et al.*, L-9617, Dec. 14, 1956).

(12) Conclusive Presumption

**Spouses Dario Lacap & Matilde Lacap
v. Jouvett Ong Lee,
represented by Reynaldo de los Santos
GR 142131, Dec. 11, 2002**

FACTS: During the tenancy relationship, petitioner-spouses admitted the validity of title of their landlord. *Issue:* Does a conclusive presumption arise from this fact?

HELD: Yes. This admission negated their previous claim of title. (*Sec. 2[b], Rule 131, Rules of Court*). If, indeed they believed in good faith they had at least an imperfect title of dominion over the subject premises, they should have tried to prevent the foreclosure and objected to the acquisition of title by the bank. Their supposed belief in good faith of their right of dominion ended when the bank foreclosed and acquired title over the subject premises.

With regard to indemnity for improvements introduced by petitioner-spouses on the subject property, they are entitled to be paid only 1/2 of the value of the useful improvements at the time of termination of the lease or to have the said improvements removed if the respondent refuse to reimburse them. Thus, the Supreme Court affirms the appellate court's holding that petitioner-spouses could not be builders in good faith inasmuch as their payment of rentals to the bank was indication that they were lessees. Thus, in the indemnification for improvements made, Art. 1678, not Art. 448, should govern.

Art. 1679. If nothing has been stipulated concerning the place and the time for the payment of the lease, the provisions of Article 1251 shall be observed as regards the place; and with respect to the time, the custom of the place shall be followed.

COMMENT:**(1) Rules Regarding Place of Payment of the Rent**

- (a) Follow the stipulation

- (b) If no stipulation, pay at the *domicile of lessee*. (See Art. 1251).

[**NOTE:** If a lessor does not go to said place in order to collect, it is unjust to eject the lessee on the ground of non-payment. (*Gomez v. Ng Fat*, 76 Phil. 555).]

(2) Rules Regarding Time of Payment of the Rent

- (a) Follow the stipulation
- (b) If no stipulation, follow the custom of the place (LOCAL CUSTOM).

(3) Prescription in Unlawful Detainer

Peran v. Presiding Judge GR 57259, Oct. 13, 1983

The one-year period of prescription in unlawful detainer starts from the date demand to vacate is made. If several demands have been made, the period is counted from the date of *last* demand.

(4) Judgment in an Ejectment Case

Salinas v. Judge Navarro GR 50299, Nov. 29, 1983

If in an ejectment case the plaintiff wins, the judgment of the trial court is immediately executory, but the losing defendant may stay execution by complying with the following:

- (a) perfecting the appeal
- (b) filing the supersedeas bond (for the accrued rents)
- (c) paying the current rentals as fixed by the municipal court. Failure to do any of these will result in the court's *ministerial* duty to order immediate execution.

Section 3
SPECIAL PROVISIONS FOR LEASES
OF RURAL LANDS

Art. 1680. The lessee shall have no right to a reduction of the rent on account of the sterility of the land leased, or by reason of the loss of fruits due to ordinary fortuitous events; but he shall have such right in case of the loss of more than one-half of the fruits through extraordinary and unforeseen fortuitous events, save always when there is a specific stipulation to the contrary.

Extraordinary fortuitous events are understood to be: fire, war, pestilence, unusual flood, locusts, earthquake or others which are uncommon, and which the contracting parties could not have reasonably foreseen.

COMMENT:

(1) Effect of Sterility of Land in Case of Rural Lease

Here, there is NO reduction of rent. *Reason:* The fertility or sterility of the land has already been considered in the fixing of the rent.

(2) Effect of LOSS Due to a Fortuitous Event

(a) *Ordinary fortuitous event* —

NO reduction. The lessee being the owner of crops must bear the loss. *Res perit domino.*

(b) *Extraordinary fortuitous event* —

- 1) If *more* than one-half of the fruits were lost, there is a reduction, except if there is a specific stipulation to the contrary.
- 2) If less than one-half, or if the loss is exactly one-half, there is no reduction. (*Art. 1680, par. 1 [Second half].*)

[**NOTE:** Examples of *extraordinary* fortuitous events:

- 1) fire, war, pestilence, *unusual* flood, locusts, earthquake
- 2) uncommon things which cannot reasonably be foreseen like armed robbery. (*See Reyes v. Crisostomo, C.A., 47 O.G. 3625*).]

(3) Illustrative Case

Cuyugan v. Dizon 79 Phil. 80

FACTS: A leased land from B for the purpose of growing crops thereon. As early as 1942 (the Pacific War had already begun), B, the lessor, wanted to cancel the lease so that A, the tenant, might not lose his crops, should the exigencies of war result in this. The tenant refused this offer, and wanted to go ahead with the contract. Later, most the crops were destroyed due to the war. A, the tenant, now asks for a reduction of the rent.

HELD: A will NOT be given any reduction. It is not enough that the event (war) be an extraordinary one. It should also be one that could not have been reasonably foreseen. In this case, it was clearly foreseen. Furthermore, there was already war in 1942. The tenant was then fully aware of the hazards of war.

(4) Amount of Reduction

The rent must be reduced proportionately. (*Reyes v. Crisostomo, C.A., 47 O.G. 3626*).

(5) Problem

A leased land from B for the purpose of growing crops thereon. More than one-half of the crops were destroyed due to an *extraordinary* fortuitous event. In the contract, the rent was fixed at an *aliquot* (proportional) part of the crops. Is A entitled to a reduction in rents?

ANS.: NO, because here the rent is already fixed at an aliquot part of the crops. Thus, everytime the crops decrease

in number, the rent is reduced automatically. (*Hijos de I. de la Rama v. Benedicto*, 1 Phil. 495). If, therefore, the tenant here refuses to give the stipulated percentage, he can be evicted. (*Ibid.*)

(6) Non-Reduction of Rent Even if Business Where Lessee Is Engaged In Becomes Poor

**Laguna Tayabas Bus Co. v. Manabat
L-23546, Aug. 29, 1974**

FACTS: A lease of a certificate of public convenience was leased for five years at the monthly rent of P2,500. After some time, a petition was filed with the Public Service Commission for authority to suspend operations because of lack of passengers and inability to purchase certain spare parts. Authority to suspend was granted. During the period of suspension, should the rentals for the lease be reduced?

HELD: No, the rents will not be reduced. Art. 1680, which allows a reduction of rent in certain case, applies only to leases of *rural lands*. In all other cases, the rule is that a person must perform his obligation, and unless performance is impossible because of a fortuitous event, the law, or the act of other party. Thus, stagnation of business is not a proper excuse.

Art. 1681. Neither does the lessee have any right to a reduction of the rent if the fruits are lost after they have been separated from their stalk, root or trunk.

COMMENT:

Loss of Fruits After Separation from Stalk, Root, or Trunk

The reduction referred to in Art. 1680 can be availed of only if the loss occurs **BEFORE** the crops are separated from their stalk, root, or trunk. If the loss is **AFTERWARDS**, there *is no* reduction of rent.

Art. 1682. The lease of a piece of rural land, when its duration has not been fixed is understood to have been made for all the time necessary for the gathering of the fruits which the whole estate leased may yield in one year, or which it may yield once, although two or more years may have to elapse for the purpose.

COMMENT:

Duration of Rural Lease

- (a) How long is a rural lease with an unspecified duration if it takes only 3 months to plant and harvest the crops, and therefore, 4 harvest can be made in one year?

ANS.: One year. (*Art. 1682*).

- (b) How long is a rural lease of unspecified duration if to plant and harvest crops once will take 3 years?

ANS.: 3 years. (*Art. 1682, last part*).

Iturralde v. Garduno
9 Phil. 605

FACTS: A rural lease was agreed upon to last for a certain *definite* period. But the tenant planted fruit trees which would require a long period of time to bear fruit, as well as introduced certain more or less valuable improvements. Has this act of the tenant *changed* the duration of the contract?

HELD: No, the duration of the lease has *not* been changed. *Reason:* There was a fixed period for the lease and therefore the nature of the fruit trees or valuable improvements is immaterial.

Art. 1683. The outgoing lessee shall allow the incoming lessor the use of the premises and other means necessary for the preparatory labor for the following year; and, reciprocally, the incoming lessee or the lessor is under obligation to permit the outgoing lessee to do whatever may be necessary for the gathering or harvesting and utilization of the fruits, all in accordance with the custom of the place.

COMMENT:**(1) Use of the Premises for Preparatory Labor**

Note the reciprocal privilege given under this Article even in the absence of an agreement to said effect. A contrary agreement should of course prevail. If there is no agreement, the custom of the place shall control.

(2) Ownership of Pending Crops

If at the end of the lease, there are still pending crops, who will own them?

ANS.: Evidently, the lessee; otherwise this article cannot be given its full import. However, a contrary stipulation will prevail. Moreover, Art. 1682 must *not* be violated.

(3) Example of a Proper Action Under the Article

If a lease of a sugar hacienda is to expire with the 1953-1954 sugar crop year, an action filed on Nov. 27, 1953 to allow the next crop is *not premature*. This is *not* an action for unlawful detainer, since it does *not* seek to oust the lessee before the expiration of the lease, but one based on Art. 1683 of the new Civil Code. (*Escay v. Jose Teodoro, et al.*, L-9287, Apr. 20, 1956).

Art. 1684. Land tenancy on shares shall be governed by special laws, the stipulations of the parties, the provisions on partnership and by the customs of the place.

COMMENT:**(1) Rule for Land Tenancy on Shares**

This refers to the contracts of “*aparceria*” governed by: (a) special laws — like *the Agricultural Tenancy Act, RA 1199*;

(b) the stipulations of the parties;

(c) the provisions on PARTNERSHIP;

(d) the customs of the place. (*See Samson v. Enriquez, et al.*, L-15264, Dec. 22, 1961; *see also Del Espiritu v. David*,

L-13135-36, May 31, 1961 and Mendoza v. Manguiat, 51 O.G. 137, transferring to the Court of Agrarian Relations (CAR) cases pending in the Court of First Instance (CFI) which dealt with agrarian controversies).

(2) Meaning of ‘Tenant’

Under RA 1199, a tenant is a person who, himself, and with the aid available from within his immediate farm household, cultivates the land belonging to, or possessed by another, with the latter’s consent for the purpose of production, sharing the produce with the landholder under the share tenancy system, or paying to the landlord a price certain or ascertainable in produce, or in money or both, under the leasehold tenancy system. (*Pangilinan, et al. v. Alvendia, L-10690, Jun. 28, 1957*).

[**NOTE:** “Immediate farm household” in the above-given definition includes “the members of the family of the tenant, and such other person or persons, whether related to the tenant or not, who are dependent upon him for support, and who usually help him operate the farm enterprise.” (*Pangilinan, et al. v. Aluendia, L-10690, Jun. 28, 1957*).]

(3) When a Tenant Works for Different Landowners

Sec. 24 of Rep. Act No. 1199 prohibits a tenant, whose holding is 5 hectares or more, to contract to work at the same time on two or more separate holdings belonging to *different* landholders without the knowledge and consent of the landholder with whom he had first entered into the tenancy relationship. In the case of *Buencamino v. Hon. Pastor R. Reyes and Pallasique, L-11961, Nov. 29, 1958*, the Supreme Court held that this prohibition applies whether or not the two separate holdings be planted to the same crop. The Court stated the reason for the interpretation. The statute presumes that farmhand cannot adequately cultivate more than a 5-hectare field. The tenant’s need to plant rice for his family constitutes no valid reason to decline enforcement of the statute and economic necessity furnishes no excuse for violating the express prohibition.

Art. 1685. The tenant on shares cannot be ejected except in cases specified by law.

COMMENT:

(1) Ejectment of Tenant on Shares

Sec. 50, RA 1199 enumerates the grounds for ejectment of the tenant on shares.

- (a) Tenancy is extinguished by the voluntary surrender of the land by, or the death or incapacity of, the tenant, but the heirs or the members of his immediate farm household may continue to work on the land until the close of the agricultural year.
- (b) The expiration of the period of the contract as fixed by the parties, and the sale or alienation of the land do *not* of themselves extinguish the relationship. In the latter case, the purchaser or transferee shall assume the rights and obligations of the former landholder in relation to the tenant. In case of death of the landholder, his heirs shall likewise assume his rights and obligations.

**Adriano Amante v. Court of Agrarian Relations
& Sergio Pama
L-21283, Oct. 22, 1966**

The expiration of the period of the contract of tenancy as fixed by the parties does *not* of itself extinguish the relationship between landlord and tenant. A landlord, moreover, cannot take the law into his own hands, by forcibly ejecting the tenant upon the alleged expiration of their contract. The landlord is required by law, if the tenant does not voluntarily abandon the land or turn it over to him, to ask the court for an order of dispossession of the tenant. (*Sec. 49 of RA 1199, as amended by RA 2263*).

- (c) The tenant shall not be dispossessed of his holdings except for any of the causes provided by Rep. Act No. 1199.
 - 1) *Bona fide* intention of the landholders to cultivate the land himself personally or thru the employment of farm machinery and implement.

- 2) When the tenant violates or fails to comply with the terms and conditions of the contract or of the Act.
- 3) The tenant's failure to pay the agreed rental or deliver the landholder's share, except when caused by fortuitous event or *force majeure*.
- 4) When the tenant uses the land for a purpose other than that specified by agreement of the parties.
- 5) When a share-tenant fails to follow those proven farm practices which will contribute towards the proper care of the land and increase agricultural production.
- 6) When the tenant thru negligence permits serious injury to the land which will impair its productive capacity.

[**NOTE:** Malicious destruction of constructions on the landlord's land, however small the damage, is a valid ground for ejectment. (*Law v. Reyes, et al. L-11391, May 14, 1958*).]

- 7) Conviction by a competent court of a tenant or any member of his immediate family or farm household of a crime against the landholder or a member of his immediate family.

(2) Some Doctrines

- (a) The mere fact that the landowner has leased the land held in tenancy to another person is not a ground to terminate the tenancy relationship and dispossess the tenant. The lessee must assume the obligations of the landholder in relation to the tenant. (*Primero v. Court of Agrarian Relations, L-10594, May 29, 1957*).
- (b) If the tenants entrust the work of plowing and harrowing to their sons-in-law or grandson, said tenants cannot be ejected on this ground, because said relatives fall within the phrase of the members of the family of the tenant." The law does not require that these members of the tenant's family be dependent upon him for support, such qualification being applicable only to "such other

person or persons, whether related to the tenant or not,” and “usually help him operate the farm enterprise” the law considers also part of the tenant’s immediate household. (*Pangilinan, et al. v. Aluendia, L-10690, Jun. 28, 1957*).

- (c) If a tenant is convicted of the crime of light threats against the farm manager of the landowner, is this conviction sufficient ground for the ejectment of the tenant?

ANS.: No, because the farm manager is not a member of the immediate family of the landlord. [*Sec. 50, par. (g), RA 1199; Lao v. Non. Pastor Reyes, et al., L-11391, May 14, 1958*].

- (d) *Reinstatement of Tenants*

If tenants were illegally deprived of their landholdings, they have a *right to be reinstated*. Merely sentencing those who later on occupied the land after ousting said tenants to pay damages instead of making them vacate the land to give way to the old occupant would be contrary to the purpose of the Agricultural Tenancy Act which is to give security of tenure to legitimate tenants. (*Joson, et al. v. Lapuz, L-10793, May 30, 1958*).

**Joson, et al. v. Lapuz
L-10793, May 30, 1958**

FACTS: *T*, tenant of *L*, was illegally ousted by *S* who then took possession of the property. *T* however subsequently became a tenant of *another* landowner. May *T* still be reinstated to his former landholding despite the second tenancy relationship?

HELD: Yes, so long as the *total* area of the landholding does not exceed five hectares.

- (e) *Prejudicial Matter*

**Maristela, et al. v. Reyes and Valerio
L-11537, Oct. 31, 1958**

FACTS: During the existence of a tenancy agreement, landowner sold the land to a stranger. An action

was brought in the Agrarian Court to eject the tenant. *Meantime*, the tenant had filed an action in the CFI (RTC) to CANCEL the sale of the land by the landlord to the buyer. *Issue*: Can the Agrarian Court proceed with the ejectment case?

HELD: No, the Agrarian Court cannot proceed with the ejectment case while the suit is in the CFI for the cancellation of the sale is still pending. The Agrarian Court should *not* take for granted that there already exists tenancy relationship.

(f) *Ejectment Proceedings in an Ordinary Court*

If the petitioner has been a tenant of a landowner for more than 15 years on a parcel of agricultural land, upon which he has erected a house for him and his family, BUT subsequently he constructs another house on a parcel of land distinct and separate from that cultivated by him *without the consent of the landlord*, said tenant is a mere intruder on the latter parcel of land which has not been turned over to him for cultivation and lease. Therefore, an ejectment case may be filed against him in the *ordinary courts*. (*Tumaga v. Vasquez, et al.*, 99 *Phil.* 105).

- (g) Sec. 7, RA 1267, as amended, vests in the Court of Agrarian Relations (CAR) exclusive and original jurisdiction to determine controversies arising from a landlord-tenant relationship. From this, it may be inferred that it also has jurisdiction to hear and determine actions for recovery of damages arising from the unlawful dismissal or dispossession of a tenant by the landlord, as provided for in Act 4064 and RA 1199, as amended. To hold otherwise would result in multiplicity of suits and expensive litigations abhorred by the law. For that reason, the reinstatement to his landholding of a tenant dispossessed of or dismissed from such landholding without just cause and his claim for damages arising from such legal dispossession or dismissal should be litigated in one and the same cause. (*David v. Cruz and Calma*, 54 O.G. 8073; *Militar v. Torcillera, et al.*, L-15065, Apr. 28, 1961; *Gabani, et al. v. Reas, et al.*, L-14579, Jun. 30,

1961 and Santos v. CIR, et al., L-17196, Dec. 28, 1961). The CAR has authority to admit evidence of ownership for the purpose of determining who between the parties is the landholder to whom the share in the produce should be delivered by the tenants. (*Tomacruz v. Court of Agrarian Relations, L-16542-43, May 31, 1961*).

(3) Rural Leases

The lease rental shall not be reduced simply because of the sterility of the land because said sterility was already considered in fixing the rent.

However, the rent can be decreased on account of an extraordinary fortuitous event which could not have been reasonably foreseen if more than 50% of the crops, while still connected with the ground, stalk, root, or trunk, was lost or destroyed.

There have been several Presidential enactments affecting rural leases, such as the following:

- (a) Presidential Decree 2 — which made our entire country a land reform area (Sept. 26, 1972)
- (b) Presidential Decree 27 — which emancipated the tenant from share, crop or lease tenancy (effective Oct. 2, 1972). This in effect abolished share tenancy. The tenant would be deemed owner of 5 hectares of rice or corn land (if unirrigated) and 3 hectares (if irrigated). The landowner would be entitled to retain 7 hectares if he would cultivate the land. The price for the tenant would be 2 1/2 times the average harvest of 3 normal crop years

**Rolando Sigre v. CA & Lilia Y. Gonzales,
as Co-administratrix
of the Estate of Matias Yusay
GR 109568, Aug. 8, 2002**

ISSUE: Does RA 6657 or the Comprehensive Agrarian Reform Program (CARP) Law operate distinctly from PD 27?

HELD: Yes. RA 6657 covers all public and private agricultural land, including other lands of the public domain suitable for agriculture as provided for in Proclamation 131 and Executive Order 229, while PD 27 covers rice and corn lands.

On this score, EO 229 (issued on Jul. 22, 1987, entitled “Providing the Mechanisms for the Implementation of the Comprehensive Agrarian Reform Program”) specifically provides: “PD 27, as amended, shall continue to operate with respect to rice and corn lands, covered thereunder.” (*Sec. 27, EO 229*).

It cannot be gainsaid, therefore, that RA 6657 did not repeal or supersede, in any way, PD 27. And whatever provisions of PD 27 that are not inconsistent with RA 6657 shall be suppletory to the latter (*Sec. 75, RA 6657*), and all rights acquired by the tenant-farmer under PD 27 are retained even with the passage of RA 6657. (*Association of Small Landowners in the Phils., Inc. v. Sec. of Agrarian Reform, 175 SCRA 343 [1989]*).

Be it remembered that PD 27 (issued on Oct. 21, 1972 by then Pres. Ferdinand E. Marcos) proclaimed the entire country as the “land reform area” and decreed the emancipation of tenants from the bondage of the soil, transferring to them the ownership of the land they till. To achieve its purpose, the decree laid down a system for the purchase by tenant-farmers, long recognized as the backbone of the economy, of the lands they were tilling. Owners of rice and corn lands that exceeded the minimum retention area were bound to sell their lands to qualified farmers at liberal terms and subject to conditions. (*Pagtalunan v. Tamayo, 83 SCRA 252 [1990]*).

On the matter of “just compensation,” its determination under PD 27, like in Sec. 16(d) of RA 6657 or the CARP Law, is not final or conclusive. (*Vinzons-Magana v. Estrella, 201 SCRA 536 [1991]*). Clearly, therefrom, unless both the land owner and the tenant-farmer accept the valuation of the property by the Barrio Committee on Land Production and the Department of Agrarian Reform, the parties may bring the dispute to court in order to

determine the appropriate amount of compensation, a task unmistakably within the prerogative of the court. (See Sec. 2, EO 228, issued on Jul. 18, 1987, entitled “Declaring Full Land Ownership to Qualified Farmer Beneficiaries Covered by PD 27; Determining the Value of Remaining Unvalued Rice and Corn Lands Subject of PD 27; and Providing for the Manner of Payment by the Farmer Beneficiary and Mode of Compensation to the Land Owner”).

- (c) Letter of Instruction 474 — the landowner would not be entitled to retain 7 hectares if he owns 7 hectares somewhere else (Oct. 21, 1976)
- (d) Presidential Decree 57 — amending PD 27 (effective Nov. 27, 1972)
- (e) Presidential Decree 84 — authorizing the Secretary of Agrarian Reform to sign land transfer certificates in behalf of the President (Dec. 25, 1972)
- (f) General Order 53 — moratorium on ejectment of tenants or lessees in agricultural and residential lots converted or to be converted into subdivisions or commercial centers or establishments (Aug. 21, 1975)
- (g) Presidential Decree 619 — dealing with grazing areas for development into large-scale ranching projects (Dec. 20, 1974)
- (h) Presidential Decree 815 — punishing conversion of ricecorn lands to “other crops” to avoid land reform, and to oust tenants (Oct. 21, 1975)
- (i) Presidential Decree 816 — tenant-farmers/agricultural lessees to forfeit Certificate of Land Transfer for failure to pay leasehold rents for 2 years (Oct. 21, 1975)
- (j) Presidential Decree 861 — allowing pasture lessees to use their pasture lands for agricultural purposes under certain conditions. After the conversion, there will be reappraisal of the rent (Dec. 29, 1975)
- (k) Presidential Decree 1038 — strengthening the security of tenure of tenants-tillers in private agricultural lands not

devoted to rice/corn. The tenant cannot be ousted without a court hearing by the Court of Agrarian Relations. Under Sec. 2, if it is claimed that a tenancy relationship exists, the Court of First Instance (Regional Trial Court) refers the matter to the Secretary of Agrarian Reform. Then the matter is referred back to the CFI (RTC), which is not bound by the CAR's determination of jurisdiction (Oct. 21, 1976)

- (l) Presidential Decree 1040 — reiterating the prohibition against agricultural share-tenancy in all agricultural lands and providing penalties therefor, share-tenancy is rewarded as contrary to public policy. Note that while the Title refers to all agricultural lands, Sec. 1 of the Presidential Decree refers only to those covered by Presidential Decree 27 (Oct. 21, 1976)
- (m) Presidential Decree 1066 — exempting from land reform untenanted sugar lands provided they have been converted to rice lands (Dec. 31, 1976)

(4) Pertinent Provisions on Agricultural Lessees

- (a) Sections 36, 37 and 38, Code of Agrarian Reforms
- (b) Section 12 of PD 946 on Jurisdiction of the Court of Agrarian Reforms (CAR)
- (c) Presidential Decree 316, Prohibiting the Ejectment of Tenant-Tillers from their Farmholdings Pending the Promulgation of the Rules and Regulations Implementing Presidential Decree 27
- (d) Presidential Decree 583, Prescribing Penalties for the Unlawful Ejectment, Exclusion, Removal or Ouster of Tenant-Farmers from their Farmholding

(5) Agricultural Leasehold Relationship

Milestone Realty & Co. v. CA GR 135999, Apr. 19, 2002

This is *not* extinguished by death or incapacity of parties. In case agricultural lessee dies or is incapacitated, the

leasehold relation shall continue between agricultural lessor and any of legal heirs of agricultural lessee who can cultivate the landholding personally, in the order of preference provided under Sec. 9 of RA 3844, as chosen by lessor within one month from such death or permanent incapacity.

Said RA allows agricultural lessor to sell landholding, with or without knowledge of agricultural lessee and at the same time recognizes preemption right and redemption of agricultural lessee. Thus, the existence of tenancy rights of agricultural lessee cannot affect nor derogate from right of agricultural lessor as owner to dispose of property. The only right of agricultural lessee of his successor in interest is right of preemption and/or redemption.

(6) Agricultural Leasehold Relation Not Extinguished by Death or Incapacity of the Parties

**Dionisia L. Reyes v. Ricardo L. Reyes,
Lazaro L. Reyes, Narciso L. Reyes &
Marcelo L. Reyes
GR 140164, Sep. 6, 2002**

FACTS: Defendants-Appellants seemingly confused the law on succession provided for in the Civil Code with succession in agrarian cases. *Issue:* Where lies the difference, if any?

HELD: In the former, the statute spreads the estate of the deceased throughout his heirs; while in agrarian laws, the security of tenure of the deceased tenant shall pass on to only one heir in the manner provided for in Sec. 9 of RA 3844.

The Supreme Court said the DARAB or Department of Agrarian Reform Adjudication Board as correct in its finding. Said the DARB on this point: "When an agricultural tenant dies, the choice for the substitute tenant is given to the landowner. It is the latter who has the option to place a new tenant of his choice on the land. That choice is, however, not absolute as it shall be exercised from among the surviving compulsory heirs of the deceased tenant. Hence, the surviving heirs cannot pre-empt that choice by deciding among themselves who shall take over the cultivation or opting to

cultivate the land collectively. It is only the landowner fails to exercise such right, or waive the same, that the survivors may agree among themselves regarding the cultivation.”

The law is specific on the matter as so provided in Sec. 9 of RA 3844, thus: “In case of death or permanent incapacity of the agricultural lessee to work his landholding, the leasehold shall continue between the agricultural lessor and the person who can cultivate the landholding personally chosen by the agricultural lessor within one month from such death or incapacity, from among the following: (a) the surviving spouse; (b) the eldest direct descendant by consanguinity; or (c) the next eldest descendant or descendants in the order of their age: *Provided*, That in case the death or permanent incapacity of the agricultural lessee occurs during the agricultural year such choice shall be exercised at the end of that agricultural year. *Provided, further*, That in the event the agricultural lessor fails to exercise his choice within the periods herein provided, the priority shall be in accordance with the order herein established. In case of death or permanent incapacity of the agricultural lessor, the leasehold shall bind his legal heirs.”

[**NOTE:** The law governing agricultural leasehold is RA 3844, which, except for Sec. 35 thereof, was not specifically repealed by the passage of the Comprehensive Agrarian Reform Law of 1988 (RA 6657), but was intended to have suppletory effect to the latter law. Under RA 3844 (“An Act to Ordain the Agricultural Land Reform Code and to Institute Land Reforms in the Philippines, Including the Abolition of Tenancy and the Channeling of Capital Into Industry, Provided for the Necessary Implementing Agencies, Appropriate Funds Therefor and for Other Purposes”), two (2) modes are provided for in the establishment of an agricultural leasehold relation: (1) by operation of law in accordance with Sec. 4 of said Act. This means the abolition of the agricultural share tenancy system and the conversion of share tenancy relations into leasehold relations; or (2) by oral or written agreement, either express or implied. This is the agricultural leasehold contract, which may either be oral or in writing. (*Dionisia L. Reyes v. Ricardo L. Reyes, et al., supra*).]

(7) Appropriate Mode of Appeal From Decisions of Special Agrarian Courts

**Land Bank of the Phils. v. Arlene de
Leon & Bernardo de Leon
GR 143275, Mar. 20, 2003**

Sec. 60 of RA 6657 ("The Comprehensive Agrarian Reform Law" [CARL]) is clear in providing a petition for review as the appropriate mode of appeal from decisions of Special Agrarian Courts.

Upon the other hand, Sec. 61 of the Act makes a general reference to the Rules of Court and does not categorically prescribe ordinary appeal as the correct way of questioning decisions of Special Agrarian Courts. Thus, Sec. 61 is interpreted to mean that the specific rules for petition for review in the Rules of Court and other relevant procedures of appeals shall be followed in appealed decisions of Special Agrarian Courts.

(8) Case

**Rodolfo Arzaga & Francis Arzaga v. Salvacion
Copias & Prudencio Calandria
GR 152404, Mar. 28, 2003**

FACTS: Petitioners filed with RTC San Jose, Antique Br. 11, a complaint for recovery of possession and damages against private respondents contending they are co-owners of Lot 5198, being purchasers thereof in a tax delinquency sale under a Certificate of Sale of Delinquent Real Property. Private respondents allegedly entered and occupied the disputed property without consent of petitioners. Despite several demands, private respondents refused to vacate the premises, hence, the petitioners filed a complaint for recovery of possession and damages.

Private respondents, in their answer with counterclaim, prayed that the complaint be dismissed on the ground that the subject matter thereof was cognizable by the DARAB and

not by the regular courts, because the controversy involves an agricultural tenancy relationship.

The trial court issued a resolution dismissing the case on the ground of lack of jurisdiction. It ruled that the case was cognizable by the DARAB because it involved possession and ownership of agricultural lands, as well as issuance of emancipation patents. Petitioners appealed to the Court of Appeals (CA) which affirmed *in toto* the assailed resolution of the trial court. A motion for reconsideration of said decision was denied, hence, the instant petition.

ISSUE: Whether or not the CA erred in affirming the trial court's dismissal of the case at bar on the ground of lack of jurisdiction.

HELD: From the averments of the complaint in the instant case, it is clear that petitioners' action does not involve an agrarian dispute, but one for recovery of possession, which is perfectly within the jurisdiction of the RTCs.

The basic rule is that jurisdiction over the subject matter is determined by the allegations in the complaint. Jurisdiction is not affected by the pleas or the theories set up by the defendant in answer or a motion to dismiss. Otherwise, jurisdiction would become dependent almost entirely upon the whims of the defendant.

Section 4

SPECIAL PROVISIONS FOR THE LEASE OF URBAN LANDS

Art. 1686. In default of a special stipulation, the custom of the place shall be observed with regard to the kind of repairs on urban property for which the lessor shall be liable. In case of doubt it is understood that the repairs are chargeable against him.

COMMENT:

(1) Repairs for Which Urban Lessor is Liable

Applicable rules:

- (a) Special stipulation;
- (b) If none, custom of the place.

(2) Rule in Case of Doubt

Doubt is construed *against* the *lessor*.

Art. 1687. If the period for the lease has not been fixed, it is understood to be from year to year, if the rent agreed upon is annual; from month to month, if it is monthly; from week to week, if the rent is weekly; and from day to day if the rent is to be paid daily. However, even though a monthly rent is paid, and no period for the lease has been set, the courts may fix a longer term for the lease after the lessee has occupied the premises for over one year. If the rent is weekly, the courts may likewise determine a longer period after the lessee has been in possession for over six months. In case of daily rent, the courts may also fix a longer period after the lessee has stayed in the place for over one month.

COMMENT:

(1) General Rules if Duration of Lease Is Not Fixed

- (a) If there is a *fixed* period (*Conventional period — whether definite or indefinite*) the lease will be for said period.
- (b) If there is NO fixed period, apply the following rules (legal periods):
 - 1) If rent is paid *daily*, lease is from day to day.
 - 2) If rent is paid *weekly*, lease is from week to week.
 - 3) If rent is paid *monthly*, lease is from month to month.
 - 4) If rent is paid *yearly*, lease is from year to year.

[NOTE: Under Art. 1581 of the old Civil Code, “the lease ceases without the necessity of special notice, upon the expiration” of the periods (daily, weekly, etc.) stated hereinabove. Under the New Civil Code, the courts are in certain cases allowed to fix a *longer* period:

- a) If *daily* rent, court may fix a longer period if the lessee has stayed for over one month.
- b) If *weekly* rent, court may fix a longer period if the lessee has stayed for *over six months*.
- c) If *monthly* rent, court may fix a longer period if the lessee has stayed for *over one year*.]

[NOTE:

- 1) *Reason for the change* — This is obviously to reward the long-staying lessee.
- 2) Note that there is NO provision regarding a case where the rent is paid *yearly*. The Supreme Court has held however that the mere absence of a provision under Art. 1687 authorizing the Court to fix a longer term where the rental is payable *yearly*, does not prevent the Court from having still the power to fix the period under the general rule stated in Art. 1197, specially where the contract is basically a compromise to settle contradictory claims, and is *not* therefore to be classified as an ordinary lease. (*Inco, et al. v. Enriquez, L-13367, Feb. 29, 1960*).]

Crisostomo v. CA
L-43427, Aug. 30, 1982

Knowledge by buyer of real property of occupancy thereof by third parties is notice that the land he bought was in the possession of said third parties.

Right of the lessor to eject a lessee upon termination of the lease in accordance with Art. 1687 of the Civil Code has been suspended by express mandate of Sec. 4 of BP 25, such suspension to last for 5 yrs. from and after effectivity of said Act.

Roxas v. Alcantara
L-49659, Mar. 25, 1982

Upon expiration of the term of lease of a building, the lessee's right to stay in the premises is terminated.

Lessor has right to demand a higher rental as condition or renewal of lease. A court has no authority to extend the lease and fix the rental.

(2) When Art. 1687 Applies

- (a) When there is no period fixed for the duration of the lease. (*Lapena v. Pineda*, L-10089, Jul. 31, 1957).

[NOTE: The lease of market stalls, where the duration is not fixed by agreement, terminates every day if the fee is paid daily or every week if the fee is paid weekly, or every month if the fee is paid monthly, or every year if the rent is paid annually. Upon such expiration, the municipal council can revoke the lease privilege. (*Chua Lao, et al. v. Raymundo, et al.*, L-12662, Aug. 18, 1958).]

- (b) When at first there was a period but said term has expired, and an *implied new lease* has been created under Art. 1670. (See also *Santi v. CA*, 227 SCRA 541 [1993]).

**Divinagracia Agro-Commercial, Inc. v.
CA and Rufino Fernandez
L-47350, Apr. 21, 1981**

Art. 1687 of the Civil Code applies to both residential and commercial buildings, since said Article makes no distinction.

**Ligaya S. Santos v. CA & Phil. Geriatrics
Foundation, Inc.
GR 135481, Oct. 23, 2001**

FACTS: Under the contract, petitioner obligated herself to pay a monthly rental, denominated as donation per PGFI (Phil. Geriatrics Foundation, Inc.) policy, to PGFI in the amount of P1,000 a month. The lease period was two years. PGFI issued receipts, whose existence and issuance petitioner admitted, for petitioner's monthly payments which was eventually increased from P1,000 to P1,500. The agreement expired in Dec. 1991. In Dec. 1993, petitioner admittedly stopped paying PGFI, while still occupying the subject premises.

HELD: Petitioner's obligation to pay rentals did not cease with the termination of the original agreement. When she failed to remit the required amounts after Dec. 1993, the time when she stopped paying, PGFI was justified in instituting ejectment proceedings against her. Petitioner clearly violated the provisions of the lease when she stopped making payments to PGFI.

(3) When Art. 1687 Will Not Apply

- (a) When the contract involved is *not* one of lease (whether express or implied).
- (b) When a mere occupant (not a lessee) is involved. (*Ibid.*).
- (c) When the person involved is a mere *sublessee* (since here, there is no contractual relation with the lessor). (*Ibid.*).
- (d) When there is a *fixed* period for the lease (whether the time be definite or indefinite). (*See Eleizegui v. Manila Lawn Tennis Club, 2 Phil. 309.*)
- (e) When the period of the lease is expressly left to the will of the lessee. (Here, there is a *fixed* period, although *indefinite*. Therefore, Art. 1197 of the Law on Obligations will apply, and the Court will fix the term.) (*See Eleizegui v. Manila Lawn Tennis Club, 2 Phil. 309.*)

[NOTE: If the period of the lease is left to the will of the lessor, the Supreme Court has held that such a lease should continue to subsist as long as the lessor desires. Here, the Court said that the lessor should be considered as the creditor, and a potestative term dependent on a creditor is all right, therefore, neither Art. 1687 nor Art. 1197 can apply. In other words, here the Court is not allowed to fix the term. (*See Lim, et al. v. Vda. de Prieto, et al., 53 O.G. 7678.*)]

[NOTE: If a lease is for as long as the lessee faithfully complies with the obligation of paying rent, this provision should be considered void for performance depends on the lessee. This is different from a case where the term, not the fulfillment of the contract, depends on

the lessee. The latter case is valid. (*See Encarnacion v. Baldomar, et al.*, 77 Phil. 470 and *Eleizegui v. Manila Lawn Tennis Club*, 2 Phil. 309).]

- (f) When the lease provides that the lessee will leave as soon as the lessor needs the premises. (Here, the period is really fixed, hence Art. 1687 does not apply.) (*See Lim, et al. v. Vda. de Prieto, et al.*, 53 O.G. 7678).

[**NOTE:** In the case of *Lim, et al. v. Vda. de Prieto*, 53 O.G. 7678, L-9189, Mar. 30, 1957, it was held that where the lessor and lessee agreed that the lessee would vacate the premises as soon as the lessor needed the same, and the lessor subsequently notified the lessee that she needed the land for her own exclusive use, the lease was *terminated*, and it is error for the Court to give the lessee a longer term by applying Art. 1687. Said Article applies only “if the period for the lease has not been fixed,” while in the case at hand, the period of the lease was fixed, that is, until the lessor needed the premises. Neither does Art. 1197 which provides that the Court may fix the duration of the period if it has been left to the will of the DEBTOR, apply, because in the present case, the lessee is the debtor (regarding the return of the land) because he had the obligation to return the land leased, while the lessor is the creditor who has the right to get back the premises in question.]

[**NOTE:** In all instances when the lease is for an indefinite term, and the Court is required to fix the term, an action for ejectment PRIOR to the fixing by the Court of the term is PREMATURE. (*See Eleizegui v. Manila Lawn Tennis Club*, 2 Phil. 309).]

Rivera v. Florendo
GR 60066, Jul. 31, 1986

What Sec. 6, Batas Pambansa 25 suspends is Art. 1673 (grounds for ejectment) of the Civil Code and not Art. 1687 (lease period) of the same Code. The effect of said suspension is that independently of the grounds for ejectment enumerated in Batas Pambansa 25, the lessor cannot eject the tenant by reason of the expiration of

the period of lease as fixed or determined under Art. 1687. It does not mean that the provisions of Art. 1687 itself has been suspended. Thus, the period of a lease agreement can still be determined in accordance with Art. 1687.

(4) Fixing of the Longer Period (As a Sort of Reward)

- (a) The longer period stated in the second half of Art. 1687 if *discretionary*, not mandatory, with the Court. Hence, the Court may refuse to grant it. It should be noted that the law uses the word "MAY." The power is thus potestative to be exercised in accordance with the particular circumstances of the case; a longer term to be granted where equities come into play demanding extension; to be denied where none appear, always with due deference to the parties' freedom to contract. (*Prieto v. Santos & Gaddi*, 98 Phil. 609; *Acasio v. Corporacion de los P.P. Dominicos de Filipinas*, 100 Phil. 523).

**Divinagracia Agro-Commercial, Inc.
v. CA and Rufino Fernandez
L-47350, Apr. 21, 1981**

Under Art. 1687, the mere fact that the lessee is aware that the lessor may need the premises anytime and ask for his ejectment is not a sufficient ground to refuse an extension by reason of equity. For precisely the extension granted has for its objective the elimination of unfairness. To put an immediate and abrupt end to the contract would, under the circumstances, result in injustice.

**Guiang v. Samano
GR 50501, Apr. 22, 1991**

The power granted to the courts by Art. 1687 of the Civil Code to fix a longer period for the lease is merely discretionary, not mandatory. A judge cannot be faulted for refusing to extend the term of the lease, where the lessee has not sought such extension either in the trial

court or in the Court of Appeals. Besides, the fact that the lessee has not paid the rentals (for 4 years, since Aug. 1975 up to the time the decision was rendered in 1979) hardly justifies an extension of the lessee's occupancy of the premises.

The power of the courts to fix a longer term for lease is potestative or discretionary. "May" is the word to be exercised or not in accordance with the particular circumstances of the case; a longer term to be granted where equities come into play demanding extension, to be denied where none appear, always with due deference to the parties' freedom to contract.

La Jolla, Inc. v. CA & Pelagia Viray de Aguilar
GR 115851, Jun. 20, 2001

The power of the court to "fix a longer term for lease is potestative or discretionary — 'may' is the word — to be exercised or not in accordance with particular circumstances of the case; a longer term to be granted where equities come into play, demanding extension, to be denied where none appear, always with due deference to the parties' freedom to contract." (*Acasio vs. Corporacion delos P.P. Dominicos de Filipinos*, 100 Phil. 523 [1956] and *Ferrer vs. CA*, 274 SCRA 219 [1997]).

Eulogia "Eugui" Lo Chua v. CA, et al.
GR 140886, Apr. 19, 2001

FACTS: The lease period was not agreed upon by the parties, rental was paid monthly, and the lessee has been occupying the premises for a couple of years. **Issue:** Given these facts, will the law step in to fix the period, or authorize the court to fix a longer period?

HELD: The power of the courts to establish a grace period pursuant to Art. 1687 is protective or discretionary, to be exercised or not depending on the particular circumstances of the case: a longer term to be granted where equities come into play demanding extension, to be denied where none appears, always with due deference to the parties' freedom to contract. (*Acacio v. Corpora-*

cion de los P.P. Dominicos de Filipinas, 100 Phil. 523 [1956]).

Here, even as this Court has the discretion to fix a longer term for the lease, it finds that petitioners' continuing possession as lessee of the premises from the supposed expiration of the lease on Mar. 31, 1996 up to the present, or for a period now of more than 5 years, suffices as an extension of the period. There is no longer need to extend it any further. (*Paterno vs. CA, GR 115763, May 29, 1997*).

- (b) The extension can only be given to a lessee, not to a sublessee. (*Acasio v. Corp. de los P.P. Dominicos de Filipinas, 100 Phil. 523*).

**Acasio v. Corporacion de los P.P. Dominicos
de Filipinas
100 Phil. 523**

FACTS: The respondent corporation leased to Esteban Garcia a certain house for P75 a month. Garcia in turn sub-leased two rooms in the house to petitioner Acasio. When the lessee Garcia left, Acasio's wife went to the respondent corporation to request that the house be leased to her. The corporation told her that the rent would be increased to P100. Upon refusal of Acasio to pay the increased rate, the respondent sued to eject Acasio from the house. The Court allowed Acasio to continue leasing the premises for more time at a monthly rental of P75 under Art. 1687. *Issue:* May the extension be granted?

HELD: Although the rule is that the Court has discretion to grant an extension, here in this case, discretion is NOT even given to the Court. Discretion is granted in a case where a contractual relationship exists; in the instant case, there *is no* such relationship for Acasio is a mere sublessee. Indeed, the article cannot refer to a mere "occupant," otherwise even "squatter" may stand on the privilege of "extension" which obviously may not be granted, because there was NEVER a term to be extended, and because the law should not be presumed to encourage bad faith.

- (c) The right of a lessee to an extension of the lease is a proper and legitimate issue that can be raised in the action for *unlawful detainer* filed against him by the lessor, because it may be used as a defense to the action. (*Teodoro v. Mirasol*, L-8934, May 18, 1966, 53 O.G. 8088). However, the defense *can prosper* only if said extension had already PREVIOUSLY been asked for by the lessee and granted by the court, in the exercise of its discretion. (*Prieto v. Santos and Gaddi*, 98 Phil. 509).

[NOTE: In the *Prieto* case, the Court held that a lease contract where the rent is payable *monthly* expires at the end of each month, *unless* PRIOR thereto, the extension of the term has been sought by *appropriate action*, and judgment is eventually rendered granting said relief. There is therefore *unlawful detainer* by the lessees of the premises where the lessees are told to vacate at the end of a certain month, but *refuse* to do so, in the absence of a judgment of a court granting a longer term for the lessee. It is clear that the extension must be asked PRIOR to the expiration of the month, for if asked for after, there is NO more term to be extended. (See, however, the case of *Divinagracia*).]

**F.S. Divinagracia Agro-Commercial, Inc. v.
CA and Rufino Fernandez
L-47350, Apr. 21, 1981**

If a lessee begins to occupy a building in 1899, and his son continues the lease after the former's death, the son is entitled to have an extension (he was being ejected in 1975 after a notice of only one month) on equitable consideration. (*Art. 1687*). The 5-year extension given by the Court of Appeals is fair enough. This extension is not really a new contract. It merely makes definite what was indefinite. Incidentally, the lessor here had purchased the property from the original owner in 1974. While the lease was not registered, the purchaser was bound because he knew of its existence. (*See Art. 1676, Civil Code*).

[NOTE: Incidentally, for the purpose of extending the term, the action for declaratory relief is NOT the proper remedy. However, it may be placed in issue in

an *unlawful detainer case*. (*Teodoro v. Mirasol*, L-8934, May 18, 1956).]

**Divinagracia Agro-Commercial, Inc. v.
CA and Rufino Fernandez
L-47350, Apr. 21, 1981**

To get the extension contemplated by Art. 1687, the lessee need *not* file a separate action. The extension may be claimed as *a defense* in the answer or as a *counterclaim*.

- (d) If the contract of lease provides that the lease can be extended only by the written consent of the parties, it is evident that no right or privilege of extension can ever arise without such written consent. (*Teodoro v. Mirasol*, L-8934, May 18, 1956).
- (e) The power of the Court to grant an extension presupposes a case where the lessor wants to end the lease, *although the lessee has committed no fault*. If the lessee is at fault, as when he has made prohibited improvement, the lessor is allowed to eject the tenant, who thereby loses even the right to remain for the period fixed by law (daily, weekly, monthly, yearly). (*See Susana Realty v. Hernandez, et al.*, [C.A.] 54 O.G. 2206).

[NOTE: In the above-mentioned case it is *not* even essential for the lessor to first file an independent action asking the Court to fix the term of the lease. The matter of prohibited improvement may be set up in the unlawful detainer case itself. (*See Prieto v. Lim*, C.A., 51 O.G. 5254)

And this is so, *even if previously* the lessee had himself already asked the court to grant to him an extension under Art. 1687. (*See Teodoro v. Mirasol*, L-8934, May 18, 1956)].]

**Heirs of Manuel T. Suico v. CA
GR 120615, Jan. 21, 1997
78 SCAD 159**

The power of a court to extend the term of the lease under the second sentence of Art. 1687 of the Civil Code

is potestative, or more precisely, discretionary. The court is not bound to extend it, and its exercise depends upon the circumstances surrounding the case. It may grant a longer term where equities come into play.

Art. 1688. When the lessor of a house, or part thereof, used as a dwelling for a family, or when the lessor of a store, or industrial establishment, also leases the furniture, the lease of the latter shall be deemed to be for the duration of the lease of the premises.

COMMENT:

Duration of Lease of Furniture if Premises Are Also Leased

- (a) This Article does NOT say that when the house or store is leased, the furniture is also presumed to have been leased.
- (b) What this Article states is that in the case contemplated, that is, where the furniture is ALSO leased, the law presumes that the *duration* of the lease of the *furniture* is for the *same period* as the *lease of the premises*.

Chapter 3

WORK AND LABOR

Section 1

HOUSEHOLD SERVICE

Art. 1689. Household service shall always be reasonably compensated. Any stipulation that household service is without compensation shall be void. Such compensation shall be in addition to the house helper's lodging, food, and medical attendance.

COMMENT:

(1) Scope of Household Service

Household service includes the work of family servants and driver (*Baloloy v. Uy, [C.A.] 52 O.G. 5561*) but not that of laborers in a commercial or industrial enterprise. The latter are governed generally by special laws on labor. (*See Zarrura, et al. v. Sy, [C.A.] 52 O.G. 1513*).

(2) Service Without Compensation

To work as a servant for free is not allowed, but to work for a fee which will reduce one's indebtedness is all right.

Art. 1690. The head of the family shall furnish, free of charge, to the house helper, suitable and sanitary quarters as well as adequate food and medical attendance.

COMMENT:

(1) Medical Attendance

The medical attendance referred to shall be given free only if the injury or illness arose out of and in the course of

employment. If needed because of a personal grudge, fight or drunkenness or similar causes, the head of the family shall not be responsible therefor.

(2) Head of the Family

This may refer to the husband, or the father, or the eldest brother or sister. It may even refer to an unmarried person who lives alone but who has servants in his employ.

Art. 1691. If the house helper is under the age of eighteen years, the head of the family shall give an opportunity to the house helper for at least elementary education. The cost of such education shall be a part of the house helper's compensation, unless there is a stipulation to the contrary.

COMMENT:

Education of House Helper

- (a) This Article is enforceable by court action, but in practice, may not be easy to enforce.
- (b) If at the age of 18, the house helper has *not* yet finished elementary education, is he given the right to continue the same at the head of the family's expense? Literally construed, this Article seems to answer in the *negative*.
- (c) While it may be agreed upon that the cost of education will be borne by the house helper, still what is left as *compensation* for his work should still be adequate.

Art. 1692. No contract for household service shall last for more than two years. However, such contract may be renewed from year to year.

COMMENT:

(1) Duration of Contract for Household Service

If the contract is for more than two years, it shall be considered void insofar as the excess is concerned.

(2) Formalities of the Contract

No formalities are required for the contract of household service, and even if the term of employment should exceed one year, the Statute of Frauds will *not* apply because in the contract, performance is supposed to commence right away. In other words, performance is ordinarily not suspended till some future time.

Art. 1693. The house helper's clothes shall be subject to stipulation. However, any contract for household service shall be void if thereby the house helper cannot afford to acquire suitable clothing.

COMMENT:**Clothing of House Helper**

Note that while it may be agreed that the house helper will pay for his clothes, still ultimately, the burden is on the head of the family, for the compensation left must still be adequate.

Art. 1694. The head of the family shall treat the house helper in a just and humane manner. In no case shall physical violence be used upon the house helper.

COMMENT:**Treatment of the House Helper**

- (a) House helpers are still human beings, entitled to the rights of men and women.
- (b) The use of physical violence can lead to a criminal action or to a civil one for damages. Moreover, the use of violence is a justifiable ground for leaving the employer.

Art. 1695. House helpers shall not be required to work more than ten hours a day. Every house helper shall be allowed four days' vacation each month, with pay.

COMMENT:**(1) Ten Hours Work Daily**

The law says “shall not be required.” Hence, if the helper agrees to work overtime, this is clearly permissible. (*Baloloy v. Uy*, [C.A.] 62 O.G. 5661).

(2) Additional Compensation

Additional compensation for voluntary overtime work can be demanded only in the following instances:

- (a) if voluntary overtime work is agreed upon;
- (b) if the nature of the work so demands such overtime service. (*See Zamora v. Sy*, [C.A.] 52 O.G. 1613).

(3) Computation of Period

The hours of work include not only those of actual work but also the time during which the services of the helper are “available” to the employer, even if said services are *not* availed of.

(4) Rule for *Yayas*

A “*yaya*” or nursemaid for small children, by the nature of her work, may render more than 10 hours work, but she is evidently entitled to a higher rate of compensation.

(5) Vacation for Helper

The law says “four days” vacation each month, with pay. If the helper insists on this, the employer must grant the vacation, and he cannot insist on merely giving the monetary value. This is because such a “vacation” is essential to health. Extraordinary circumstances may, of course, allow an exemption from this rule. On the other hand, if the helper does not ask for the vacation, the number of vacation days cannot be accumulated. In such a case, he would be entitled only to the monetary equivalent. (*See Zamora v. Sy*, [C.A.] 52 O.G. 1513).

Art. 1696. In case of death of the house helper, the head of the family shall bear the funeral expenses if the house helper has no relatives in the place where the head of the family lives, with sufficient means therefor.

COMMENT:

Rule if Helper Dies

The Article applies only in the absence of relatives referred to.

Art. 1697. If the period for household service is fixed, neither the head of the family nor the house helper may terminate the contract before the expiration of the term, except for a just cause. If the house helper is unjustly dismissed, he shall be paid the compensation already earned plus that for fifteen days by way of indemnity. If the house helper leaves without justifiable reason, he shall forfeit any salary due him and unpaid, for not exceeding fifteen days.

COMMENT:

Termination of the Contract if Period is Fixed

Even if the term of service is fixed, either party may terminate the same, with or without just cause; otherwise, there would be oppression for the employer, or involuntary servitude for the helper. However, in case of an *unjustifiable* cause, the damages referred to in this Article may be availed of.

Art. 1698. If the duration of the household service is not determined either by stipulation or by the nature of the service, the head of the family or the house helper may give notice to put an end to the service relation, according to the following rules:

(1) If the compensation is paid by the day, notice may be given on any day that the service shall end at the close of the following day;

(2) If the compensation is paid by the week, notice may be given, at the latest, on the first business day of the

week, that the service shall be terminated at the end of the seventh day from the beginning of the week;

(3) If the compensation is paid by the month, notice may be given, at the latest, on the fifth day of the month, that the service shall cease at the end of the month.

COMMENT:

Rule if Term is Not Fixed

- (a) This Article applies if there is NO term (express or implied) for the household service.
- (b) In lieu of the required notice, the monetary value may be given. (*Baloloy v. Uy*, [C.A.] 52 O.G. 5561).

Art. 1699. Upon the extinguishment of the service relation, the house helper may demand from the head of the family a written statement on the nature and duration of the service and the efficiency and conduct of the house helper.

COMMENT:

Written Certification by Head of Family or by Employer

The Article is self-explanatory.

Section 2

CONTRACT OF LABOR

INTRODUCTORY COMMENT:

Comment of the Code Commission

“The Republic of the Philippines, thru the people’s constitutional mandate, is definitely committed to the present-day principle of social justice. In keeping with this fundamental policy, the new Civil Code, while on the one hand guaranteeing property rights, has on the other, seen to it that the toiling mass are assured of a fair and just treatment by capital or management.” (*Report of the Code Com.*, p. 13).

National Housing Corporation v. Juco
L-64313, Jan. 17, 1985

Employees of government-owned or controlled corporations such as the National Housing Authority are governed by the Civil Service Law, not by the Labor Code, and this is true whether the corporation were formed by special law, or created as mere subsidiaries.

If they would not be governed by Civil Service rules the Constitution would be, to that extent, emasculated.

Art. 1700. The relations between capital and labor are not merely contractual. They are so impressed with public interest that labor contracts must yield to the common good. Therefore, such contracts are subject to the special laws on labor unions, collective bargaining, strikes and lockouts, closed shops, wages, working conditions, hours of labor and similar subjects.

COMMENT:

(1) 'Contract of Labor' Defined

It is a consensual, nominate, principal, and commutative contract whereby one person, called the employer, compensates another, called the laborer, worker, or employee, for the latter's service. Under the new Civil Code, the relationship of the two is not merely contractual, but is impressed with a public interest (*See Art. 1700*) in keeping with our constitutional policy of social justice. (*Macleod and Co. v. Progressive Federation of Labor*, 97 Phil. 205).

(2) Essential Characteristics of the Contract of Labor

- (a) the employer freely enters into a contract with the employee, laborer, or contractor;
- (b) the employer can select who his workers will be;
- (c) the employer can dismiss the worker; the worker in turn can quit his job;
- (d) the employer must give remuneration; and

- (e) the employer can control and supervise the conduct of the employee. (*See Viana v. Al-Lagadan, et al.*, 99 *Phil.* 408).

[**NOTE:** A conductor of a bus who is working under a *boundary* system and not paid by the owner of the bus is considered an *employee* of the latter, and an employer-employee relationship exists between them. The same is true with reference to a driver of a jeep under the *boundary system*. (*Isabelo Doce v. Workmen's Compensation Commission & Dado Jadoo*, L-9417, Dec. 22, 1958, reiterating *National Labor Union v. Dinglasan*, 98 *Phil.* 64). The boundary system is one where the driver or conductor is supposed to turn over a minimum quota for the day, week, or month.

An employer-employee relationship exists where the person for whom the services are performed reserves a right to control not only the end to be achieved but also the means to be used in reaching such end, the intervention of an independent contractor who has the power to hire and fire the workers, notwithstanding. (*LVN Pictures, Inc. v. Phil. Musicians Guild*, L-12698, Jan. 28, 1961).]

**Pan American World Airways, Inc. v.
Tomas M. Espiritu and Court of Appeals
L-35401, Jan. 20, 1976**

FACTS: An employee of Pan American World Airways Inc. (Tomas M. Espiritu), then employed as mail/cargo supervisor of the PAN AM, was accused, together with others, of violating the Tariff and Customs Code, by the Customs Police of the Manila International Airport. He was thus barred by the MIA Collector of Customs from transacting business with the airport. Because of this, the employer PAN AM first suspended him from office, and finally separated him from the service. Although acquitted eventually of the criminal charges, he was refused reinstatement with the PAN AM. *Issue:* Is he entitled to such reinstatement?

HELD: No, for the fact is, the company has lost confidence in him, and this is a valid ground for dismissal. Conviction in a criminal case is not indispensable in the dismissal of an

employee. (*See Gatmaitan v. Manila Railroad Co., L-19892, Sept. 2, 1967*).

(3) Labor Union or Organization

It is an organization, association, or union of laborers duly registered and permitted to operate by the Department of Labor, and governed by a Constitution and By-Laws, not repugnant to or inconsistent with the laws of the Philippines. (*Com. Act 213*). Its principal purpose is collective bargaining or dealing with employers concerning terms and conditions of employment. (*Sec. 2[e], RA 870*).

Montaner v. National Labor Relations Commission GR 55814, Feb. 21, 1983

Appeals from the decision of a labor arbiter must be appealed to the National Labor Relations Commission, not to the Supreme Court.

(4) ‘Collective Bargaining’ Defined

It is the process whereby laborers, combining their collective strength thru a labor union, are able to obtain concessions and privileges in the terms of their employment.

(5) ‘Strike’ and ‘Lockout’ Distinguished

- (a) A *strike* is any temporary stoppage of work by the concerted action of employees as a result of an industrial dispute. (*See Art. 212, Labor Code, as amended*).

(NOTE: It is a weapon of LABOR.)

- (b) A *lockout* is the temporary refusal of any employer to furnish work as a result of an industrial dispute. [*See Art. 212[p], Labor Code, as amended*].

(NOTE: It is a weapon of CAPITAL.)

(6) When a Strike is Lawful

A strike is lawful:

- (a) when the *purpose* is lawful;
- (b) AND when the *means* employed are lawful. (*Rex Taxicab Co. v. Court*, 70 Phil. 21).

**Philippine Marine Officers Guild
v. Compania Maritima, et al.
L-20662, Mar. 19, 1968**

(a) *Ruling on Illegality of Strikes*

In cases not falling within the prohibition against strikes, the legality or illegality of a strike depends first upon the purpose for which it is maintained, and second, upon the means employed in carrying it on. Thus, if the purpose which the laborers intend to accomplish by means of a strike is trivial, unreasonable or unjust; or if in carrying on the strike, the strikers could commit violence or cause injuries to persons or damage to the property, the strike, *although not prohibited by injunction*, may be declared by the court illegal with adverse consequences to the strikers. (*See also Luzon Marine Dept. Union v. Roldan*, 86 Phil. 507). The reason is clear:

“A labor philosophy based upon the theory that might is right, in disregard of law and order, is an *unfortunate philosophy of regression* whose sole consequences can be disorder, class hatred, and intolerance.” (*Grater City Master Plumbers Association v. Qahme*, 1939 NYS 2nd 589 and *Liberal Labor Union v. Phil. Can Co.*, 91 Phil. 78).

(b) *Effect on Reinstatement*

Strikers who are active participants in an illegal and unjust strike have no right to be reinstated by the employers.

NOTE:

A strike to obtain better terms and conditions of employment is a legitimate labor activity recognized by law,

and its legality does not depend on the reasonableness of the demands. If they cannot be granted they should be rejected, but without other reasons, the strike itself does NOT become illegal. Unfair labor practice acts may be committed by the employer against workers on strike. A strike is not abandonment of employment, and workers do not cease to be employed in legal contemplation, simply because they have struck against their employer. (*Caltex [Phil.], Inc. v. Phil. Labor Organizations Caltex Chapter*, 93 Phil. 295).

United CMC Textile Workers Union v. Ople
GR 62037, Jan. 27, 1983

When the Minister (now Secretary) of Labor certifies a labor dispute for compulsory arbitration and issues a “return-to-work order, he does not violate the workers’ right to collective bargaining, self-organization, and picketing. Referral for compulsory arbitration does not necessarily mean that the Minister is siding with the employer. After all, this act of referral itself does not as yet indicate a decision one way or another.

(7) Pay of Laborers During the Strike

If a strike is declared LEGAL, are the strikers entitled to receive their pay for the time when they did NOT work? Why?

ANS.: No, because they did *not* work. “A fair day’s wage for a fair day’s work.” (*J.P. Heilbronn Co. v. Nat. Labor Union*, 92 Phil. 575; *Manila Trading and Supply Co. v. Manila Trading Labor Assn.*, 92 Phil. 997). If the striker is illegal, with greater reason will the pay *not* be given. For strikers to be legally entitled to backpay, the following requisites must concur:

- a) the strike must be legal;
- b) there must be unconditional offer to return to work;
- c) the strikers were refused reinstatement.

It is clear from the statement of the rule that those who strike voluntarily — even if in protest of unfair labor practice — are entitled to backpay only —

“When the strikers abandon the strike and apply for reinstatement despite the unfair labor practice, and the employer either refuses to reinstate them or imposes new conditions that constitute unfair labor practices.” (*Philippine Marine Officer’s Guild v. Co. Maritima, et al.*, L-20662, Mar. 19, 1968, citing *Cromwell Commercial Employees’ Union-PTUC v. CIR and Cromwell Com. Co., Inc.*, L-19778, Feb. 16, 1965).

**Philippine Association of Free Labor Unions
v. Court of First Instance
GR 49580, Jan. 17, 1983**

It is the National Labor Relations Commission (NLRC), and ultimately the President of the Philippines, who determines the legality or illegality of a strike, and therefore it is premature to file criminal charges against the striking workers during the pendency of the strike issue before the NLRC.

(8) ‘Closed Shop’ as Distinguished from an ‘Open Shop’ and a ‘Closed Union Shop with Open Union’

- (a) A “*closed shop*” is one where only members of a particular union can be employed by a company.
- (b) An “*open shop*” is one that does *not* require union membership as a requisite for employment.
- (c) A “*closed union shop with open union*” is one where generally, only union members may be employed; if none are available, non-unionist may be employed, but as soon as they are employed, they must join the union.

[NOTE: A “closed shop” or a “closed union shop with open union” CANNOT be imposed against the employer’s will. (See *Pambusco Bus Co. v. Pambusco Employees’ Union*, 68 Phil. 541). “Closed Shop” agreements apply to persons to be hired or to employees who are *not* yet member of any labor organization. They are inapplicable to those already in the service who are members of another union. To hold otherwise would render nugatory the right of all employees to self-organization. Employees dismissed because of the “agreement” simply because of a justified refusal to join the union must be reinstated.

(Freemen Shirt Manufacturing Co. v. CIR, L-16561, Jan. 28, 1961).]

(9) Case

**Visayan Transportation Co. v. Pablo Java
93 Phil. 962**

ISSUE: When one company is so *bona fide* to another company, is the latter duty bound to also employ the workers of the former?

HELD: No, unless there was a stipulation to this effect in the contract between the two companies. This is so because a contract of labor creates merely a PERSONAL, *not* a REAL right. The remedy of an aggrieved worker is to go against the first company for damages.

(10) National Labor Relations Commission (NLRC)

The NLRC is attached to the Department of Labor and Employment for program and policy coordination only. (*Art. 213, PD 442, as amended*). It shall have exclusive appellate jurisdiction over all cases decided by labor arbiters (*e.g.*, unfair labor practice, termination of disputes, etc.) and cases arising from the interpretation or implementation of collective bargaining agreements and those arising from the interpretation or enforcement of company personnel policies. (*Art. 217, id.*).

(11) Regular Employment

**Paguio v. NLRC & Metromedia Times Corp.
GR 147816, May 9, 2003**

FACTS: Petitioner was hired as an account executive whose main duty was to solicit advertisement for a newspaper, the respondent having reserved its right not only to control the results to be achieved but likewise the manner and the means used in reaching that end.

ISSUE: Where respondent was required to submit a daily sales activity report and also a monthly sales report

as well, and where the president, advertising manager, and advertising director directed and monitored the sales activities of petitioner, was the employment of petitioner regular or casual?

HELD: It is regular, not casual. An employment is deemed *regular* where the employee has been engaged to perform activities which are usually necessary or desirable in the usual business or trade of the employer, except where the employment has been fixed for a specific project or undertaking the completion or termination of which has been determined at the time of engagement of the employee or where the work or services to be performed is seasonal in nature and employment is for the duration of the season. An employment shall be deemed to be casual if it is not covered by the preceding paragraph. (*Art. 280, Labor Code*).

A “regular employment,” whether it is one or not, is aptly gauged from the concurrence, or the non-concurrence, of the following factors:

- (a) the manner of selection and engagement of the putative employees;
- (b) the mode of payment of wages;
- (c) the presence or absence of the power of dismissal; and
- (d) the presence or absence of the power to control the conduct of the putative employee with respect to the means or methods by which his work is to be accomplished. (*Hijos de F. Escano, Inc. v. NLRC, GR 59229, Aug. 22, 1991*).

The “control test” assumes primary in the overall consideration. Under this test, an employment relation obtains where work is performed or services are rendered under the control and supervision of the party contracting for the service, not only as to the result of the work but also as to the manner and details of the performance desired. (*Iloilo Chinese Commercial School v. Fabrigar, GR L-16600, Dec. 27, 1961*).

In the instant case, petitioner was an account executive in soliciting advertisements, clearly and necessary in soliciting advertisements, clearly and necessary and desirable, for the survival and continued business of respondent. As admitted

by respondent's president, the income generated from paid advertisements was the lifeblood of the newspaper's existence. Implicitly, respondent recognized petitioner's invaluable contribution to the business when it renewed, not just once but five times, its contract with petitioner.

(12) Muslim Holiday Pay

San Miguel Corp. v. CA, etc. GR 14775, Jan. 30, 2002

FACTS: On Oct. 17, 1992, the Department of Labor and Employment (DOLE), Iligan District Office (IDO) or DOLE-IDO — conducted a routine inspection in the premises of San Miguel Corporation (SMC) in Sta. Filomena, Iligan City. In the course of the inspection, it was discovered that there was underpayment by SMC of regular Muslim holiday to its employees. Hence DOLE-IDO issued a compliance order, dated Dec. 17, 1993, directing SMC to consider Muslim holidays as regular holidays and to pay both its Muslim and non-Muslim employees holiday pay within 30 days from the receipt of the order. SMC appealed to the DOLE main office in Manila but its appeal was dismissed for lack of merit and the order of DOLE-IDO was affirmed.

SMC went to the Supreme Court for relief *via* a petition for *certiorari*, but which said Court referred to the Court of Appeals (CA). The CA modified DOLE-IDO's order with regards the payment of Muslim holiday pay from 200% to 150% of the employees' basic salary, and remanded the case to the Regional Director for proper consultation of said holiday pay. Its motion for reconsideration having been denied for lack of merit, SMC filed a petition for *certiorari* before the Supreme Court.

HELD: This Court finds no reason to reverse the CA's decision. For one, petitioner asserts that Presidential Decree 1083 (otherwise known as "The Code of Muslim Personal Laws"), in its Art. 3(3) provides that "[t]he provisions of this Code shall be applicable only to Muslims." However, there should be no distinction between Muslims and non-Muslims as regards payment of benefits for Muslim holidays.

Citing the CA, the Supreme Court opines: “[W]ages and other emoluments granted by law to the working man are determined on the basis of the criteria laid down by laws and certainly not on the basis of the worker’s faith or religion.” At any rate, PD 1083 also declares that “nothing herein shall be construed to operate to the prejudice of a non-Muslim.”

(13) Voluntary Arbitration

Union of Nestlé Workers Cagayan de Oro Factory (UNWCF) v. Nestlé Phils., Inc. GR 148303, Oct. 17, 2002

FACTS: Respondent Nestlé’s Drug Abuse Policy provides that “illegal drugs and use of regulated drugs beyond the medically-prescribed limits are prohibited in the workplace. Illegal drug use puts at risk the integrity of Nestlé operations and the safety of [its] products. It is detrimental to the health, safety, and work performance of employees and is harmful to the welfare of families and the surrounding community.” This pronouncement is a guiding principle adopted by Nestlé to safeguard its employees’ welfare and ensure their efficiency and well-being. To respondents’ mind, this is a company personnel policy. *Issue:* Considering that the Drug Abuse Policy is a company personnel policy, is it the Voluntary Arbitrators or the RTC which exercises jurisdiction over this case?

HELD: Jurisdiction to hear and decide all unresolved grievances arising from the interpretation or enforcement of company personnel policies lies on the Voluntary Arbitrators. (See Art. 261, Labor Code). (See also *SMC v. NLRC*, 255 SCRA 133 [1996] and *Maneja v. NLRC*, 290 SCRA 603 [1998]).

Art. 1701. Neither capital nor labor shall act oppressively against the other, or impair the interest or convenience of the public.

COMMENT:

(1) Protection for Capital, Labor, and the Public

Note that both CAPITAL and LABOR, as well as the PUBLIC, must be protected.

(2) Examples of ‘Unfair Labor Practices’ (BAR)**(a) On the part of the EMPLOYER:**

- 1) to dismiss or discriminate against any employee for filing charges or giving testimony under Art. 248 of the Labor Code, as amended
- 2) to discriminate in hiring and firing because of membership or non-membership in a labor organization
- 3) to refuse to bargain collectively
- 4) to dominate, assist in, or interfere with a labor organization
- 5) to contribute financially or otherwise to a labor organization. (*See Art. 248[d], Labor Code*).

[NOTE: The discharge and non-employment of workers because of their refusal to join another union is an unfair labor practice on the part of the employer, except when there is a closed-shop arrangement. (*Compania Maritima v. United Seamen’s Union, L-9923, Jun. 20, 1958*). However, the disapproval of an application for leave of absence with pay does *not* necessarily indicate discrimination unless it can be shown that such disapproval was due to an employee’s union membership or activity. (*Lueon Stevedoring Co. v. CIR, L-17411, 18681, 18683, Dec. 31, 1965*).]

(b) On the part of the EMPLOYEE:

- 1) to refuse to bargain collectively with the employer
- 2) to restrain or coerce employees in their rights to self-organization
- 3) to exact or extort money or property from the employer for services *not performed or not to be performed*
- 4) to cause an employer to discriminate against an employer on matters of union activity, except in cases permitted by law. (*See Sec. 4, RA 875*).

(3) Some Rights Particularly Affecting Filipino Women Laborers or Employees

- (a) the right to be free from discrimination of employment and wages, on account of their sex (“equal pay for equal work”)
- (b) the right to maternity *leave* privileges (six weeks before delivery, and eight weeks after delivery)
- (c) the right to have maternity *feeding* privileges
- (d) the right *not* to work constantly standing (seats are supposed to be provided)
- (e) the right to be exempted in certain cases from *night* labor
- (f) the right to be exempted from carrying heavy loads or devices

(4) Remedy**Kapisanan (KMP) v. Trajano
L-62306, Jan. 21, 1985**

The remedy against labor union officials who err is *union expulsion*, not referendum.

(5) Illegal Recruitment**People v. Angeles
GR 132376, Apr. 11, 2002**

FACTS: Samina Angeles, accused-appellant, did not deceive complainants into believing she could find employment for them abroad. Nonetheless, she made them believe that she was processing their travel documents for France and Canada. They parted with their money believing that Angeles would use it to pay for their plane tickets, hotel accommodations and other travel requirements. Upon receiving various amounts from complainants, Angeles used it for other purposes and then conveniently disappeared.

Accused-appellant alleges that she never promised nor offered any job to complainants. To be engaged in the practice

of recruitment and placement, it is plain that there must at least be a promise or offer of an employment from the person posing as a recruiter whether locally or abroad.

To prove illegal recruitment, it must be shown that accused-appellant gave complainants the distinct impression that the former had the power or ability to send complainants abroad for work such that the latter were convinced to part with their money in order to be employed. As already alluded to, “[r]ecruitment and placement’ refers to any act of canvassing, enlisting, contracting, transporting, utilizing, hiring or procuring workers, and includes referrals, contract services, promising or advertising for employment locally or abroad, whether for profit or not: *Provided*, That any person or entity which in any manner, offers or promises for a fee employment to two or more persons shall be deemed engaged in recruitment and placement.” (*Art. 13[b], Labor Code*). *Issue*: Is Angeles guilty of illegal recruitment?

HELD: True, Angeles defrauded complainants by falsely pretending to possess the power and capacity to process their travel documents. However, a perusal of the records reveals that not one of the complainants testified that accused-appellant lured them to part with their hard-earned money with promises of jobs abroad. On the contrary, they were all consistent in saying that their relatives abroad were the ones who contacted them and urged them to meet accused-appellant who would assist them in processing their travel documents. Accused-appellants did not have to make promises of employment abroad as these were already done by complainants’ relatives. Hence, accused Angeles cannot be lawfully convicted of illegal recruitment.

(6) Elements Present In an Employer-Employee Relationship

There are four (4) elements present in determining whether an employer-employee relationship exists between the parties.

These are: (1) selection and engagement of services; (2) payment of wages; (3) power to hire and fire; and (4) power to control not only the end to be achieved, but the means to

be used in reaching such an end. (*Ramos v. CA, GR 124354, Apr. 11, 2002*).

(7) Quitclaims are Contracts of Waiver

MC Engineering v. CA GR 104047, Apr. 3, 2002

Freedom to enter into contracts, such as *quitclaims*, is protected by law and courts are not quick to interfere with such freedom unless the contract is contrary to law, morals, good customs, public policy, or public order.

Quitclaims, being *contracts of waiver*, involve relinquishment of rights, with knowledge of their existence and intent to relinquish them. And being duly notarized and acknowledged before a notary public, quitclaims deserve full credence and are valid and enforceable absent overwhelming evidence to the contrary.

Art. 1702. In case of doubt, all labor legislation and all labor contracts shall be construed in favor of the safety and decent living for the laborer.

COMMENT:

Rule in Case of Doubt

- (a) The rule stated above applies only in case of DOUBT. The rule is justified on grounds of public policy. (*See Report of the Code Com., pp. 13-14*).
- (b) Although the welfare of labor must be promoted, capital must not be forgotten. As a matter of fact, the laborer's welfare can be better cared of if capital is *not* abused. Thus, if the employer imposes and insists on a regulation designed for the safety of the laborers themselves (like a prohibition against smoking in a painting booth which is an extremely hazardous act), a violation of said rule by the laborers is a just cause for outright dismissal. Such a dismissal protects labor and at the same time gives capital its due. (*Northern Motors, Inc. v. Nat. Labor and the CIR, L-10022, Jan. 31, 1968*).

Art. 1703. No contract which, practically amounts, to involuntary servitude, under any guise whatsoever, shall be valid.

COMMENT:

Involuntary Servitude Prohibited

- (a) Involuntary servitude is, in general, prohibited by the Constitution. (*See also Rubi v. Prov. Board of Mindoro, 39 Phil. 660*).
- (b) In the law of obligations (personal obligations) specific performance is *not* a remedy.

Art. 1704. In collective bargaining, the labor union or members of the board or committee signing the contract shall be liable for non-fulfillment thereof.

COMMENT:

(1) Formation of Bargaining Units

It is possible that in a company, there are various unions or units, all with variant or diverse interest from one another. In such a case it would be proper for the court to order the existence or formation of *two or more collective bargaining units*. (*Democratic Labor Assn. v. Cebu Stevedoring Co., Inc., L-19321, Feb. 28, 1958; See Benguet Consolidated, Inc., et al. v. Bobok Lumber Jack Assn., et al., L-11029 and 11065, May 23, 1958*). The determination of the proper unit for collective bargaining is *discretionary* upon the court and its judgment in this respect is entitled to almost complete finality, unless its action is arbitrary or capricious. (*LVN Pictures, Inc. v. Phil. Musicians Guild, et al., L-12582, L-12598, Jan. 28, 1961*).

**George and Peter Lines v. Associated
Labor Unions
L-51602, Jan. 17, 1985**

It is the constitutional right of employers and laborers to choose the labor organization they wish to join.

The choice can be ascertained best by the holding of a certification election. In this way they can choose what entity can represent them in their negotiations with management.

(2) Factors Which May Be Considered by the Court to Determine Whether or Not a Bargaining Unit Has Been Properly Formed

- (a) the will of the employees;
- (b) the affinity and unity of the employees' interest (such as similarity in duties and in compensation);
- (c) the precedent *history* of collective bargaining between the employer and the proposed bargaining unit (though this factor may become insignificant in case of a substantial alteration of conditions);
- (d) the status of employment (whether the employees are permanent or temporary). (*Democratic Labor Assn. v. Cebu Stevedoring Co., Inc., L-19321, Feb. 28, 1958.*)

(3) Certification Proceedings

Certification proceedings consist of the official designation or selection of the proper bargaining units. Here, there is an affirmation of the employee's express choice of a bargaining agent. (*Benguet Consolidated, Inc., et al. v. Bobok Lumber Jack Ass'n., et al., L-11029, 11065, May 23, 1958.*) The proceedings may begin with what we generally referred to as "certification elections." (*See Maligaya Ship Watchmen Agency, et al. v. Assn. of Watchmen and Security Union, L-1224-17, May 28, 1958.*)

The certification election is not vitiated simply because of the participation therein of nuns and priests. After all, one's religious convictions can exempt him from affiliating with any labor organization or from what is known as a "closed shop." (*United Employees Union v. Noriel, L-40810, Oct. 3, 1975.*)

The object of the proceeding is *not* the determination of alleged commission of wrongs but the ascertainment of the employee's choice of the proper bargaining representative. (*Benguet Const., Inc., et al. v. Bobak Lumber Jack Ass'n., et al., supra.*)

Issues involving “internal labor organization procedures” such as the determination as to which of two sets of officers representing different factions of the same labor union has authority to demand compliance with a collective bargaining agreement — fall within the exclusive jurisdiction of the CIR. (*National Brewery v. Cloribel*, L-25171, Aug. 17, 1967).

(4) Case

**Samahang v. Noriel
L-56588, Jan. 17, 1985**

In the absence of a collective bargaining agreement and as long as 30% of the employees demand the same, it is the duty of the Bureau of Labor Relations to conduct a certification election.

Art. 1705. The laborer’s wages shall be paid in legal currency.

COMMENT:

(1) Payment of Wages in Legal Currency

In general, this is to prevent payment in kind or in temporary money. If voluntarily requested by the worker, payment may of course be made in some other form.

(2) Rule Re Government Employees

Government employees appointed under the Civil Service Law and whose salaries are fixed by law, have *no* right overtime compensation. The granting of such compensation a matter of administrative policy that is discretionary and dependent upon the financial condition of the office concerned. (*Department of Public Services Union v. CIR*, L-15458, Jan. 2, 1961).

(3) Jurisdiction of Labor Arbiters Re Wages, Etc.

The Labor Arbiters shall have original and exclusive jurisdiction to hear and decide, within 30 calendar days after

the submission of the case by the parties for decision without extension, even in the absence of stenographic notes, the following cases involving all workers, whether agricultural or on agricultural: ... if accompanied with a claim for reinstatement those cases that workers may file involving wages, rates of pay, hours of work and other terms and conditions of employment. (*Art. 217, Labor Code*).

(4) Cases

Congson v. NLRC
GR 114250, Apr. 5, 1995
60 SCAD 324

Wage shall be paid only by means of legal tender. The only instance when an employer is permitted to pay wages in forms other than legal tender, *i.e.*, by checks or money order, is when the circumstances prescribed in the second paragraph of Art. 102 are present.

**Willington Investment &
Manufacturing Corp. v. Trajano**
GR 114698, Jul. 3, 1995
62 SCAD 284

Every worker should be paid his regular daily wage during regular holidays, except in retail and service establishments regularly employing less than 10 workers — this, of course, even if the worker does not work on these holidays.

Metro Transit Organization, Inc. v. NLRC
GR 116008, Jul. 11, 1995
62 SCAD 477

Wage distortions have often been the result of government-decreed increases in minimum wages. There are, however, other causes of wage distortions, like the merger of two companies (with differing classifications of employees and different wage rates) where the surviving company absorbs all the employees of the dissolved corporation.

The concept of wage distortion assumes an existing grouping or classification of employees which establishes distinc-

tions among such employees on some relevant or legitimate basis. This classification is reflected in a differing wage rate for each of the existing classes of employees.

Art. 1706. Withholding of the wages, except for a debt due, shall not be made by the employer.

COMMENT:

Withholding of Wages

Withholding of wages can be made in the following cases:

- (a) for debt due (*Art. 1706*);
- (b) for purposes of the Income Tax Law;
- (c) for *facilities* obtained at a fair price by the employee from the employer, provided there is a prior agreement to this effect. (*Atok-Big Wedge Mutual Benefit Assn. v. Atok-Big Wedge Mining Co.*, 97 Phil. 294).

Art. 1707. The laborer's wages shall be a lien on the goods manufactured or the work done.

COMMENT:

(1) Wage Lien

Reason for Art. 1707: "By virtue of this new lien, the laborers who are *not* paid by an unscrupulous and irresponsible industrialist or manager may by legal means have the goods manufactured thru the sweat of their brow sold, and out of the proceeds get their salary, returning the excess, if any." (*Report of the Code Com.*, p. 14).

(2) Query

Is this an unjustifiable application of social justice?

ANS.: "At first sight, it seems so. But under Art. 1600 of the old Civil Code, which has its counterpart in any countries, he who has executed work upon a *movable* has a right

to retain it by way of pledge until he is paid. What is the difference between the watchmaker who repairs a watch, and the laborer in a factory who, with the aid of machinery, produces cigars, building materials, foodstuffs, or other articles? Moreover, the laborer, having spent his energy in the production of the goods, should have a right to sell them if he is not paid in due time.” (*Report of the Code Com.*, p. 14).

(3) Terms Defined

The “goods manufactured or the work done” refer to personal property, *not* real property. And even here, the lien is allowed the laborer *only* if he was directly employed or engaged by the owner. The rule does not apply if a contractor, with men under him, had undertaken the job. (*See Bautista v. Aud. Gen.*, L-6799, Jun. 29, 1955).

Art. 1708. The laborer’s wages shall not be subject to execution or attachment, except for debts incurred for food, shelter, clothing and medical attendance.

COMMENT:

(1) Generally, Wages Are Not Subject to Execution

- (a) There can be execution or attachment however, for debts incurred for support (food, shelter, clothing, and medical attendance). (*Art. 1708*).
- (b) The rule applies even when the wages are still in the possession of the *employer* whose properties may have been attached. (*Pac. Customs Brokerage Co., Inc. v. Inter-Island Dockmen and Labor Union*, L-4610, Aug. 24, 1951).

(2) Salaries of Government Employees

Salaries due *to government* employees *cannot* be garnished before they are paid to the employees concerned —

- (a) because the incentive for work would be lost;
- (b) because, generally, the state cannot be sued; and finally,

- (c) because, technically, before disbursements, the money still belongs to the government. (*Director of Commerce v. Concepcion*, 43 Phil. 384).

Art. 1709. The employer shall neither seize nor retain any tool or other articles belonging to the laborer.

COMMENT:

No Seizure or Retention by Employer

The Article is self-explanatory.

Art. 1710. Dismissal of laborers shall be subject to the supervision of the Government, under special laws.

COMMENT:

(1) Dismissal of Laborers

May an employer discharge at WILL an employee, whether or not there is a fixed term for employment?

ANS: Generally, YES; otherwise, this would be oppressive to the employer, subject to the following conditions:

- (a) If there is a period of employment, and the dismissal is UNJUST, the employer is liable for damages.
- (b) If there is NO period of employment, and the dismissal is UNJUST, *one month's pay (mesada)* must be given or a notice of one month. [*Rep. Act 1052 (1954) and Rep. Act 1787 (1957); see Monteverde v. Casino Español, L-11365, Apr. 18, 1959.*]

[In both cases, the employer is *NOT OBLIGED* to continue employing the employee. (*See Ricardo Gutierrez v. Bachrach Motor Co., L-11298, 11586, 11603, Jan. 19, 1959.*)]

[NOTE: There are *several exceptions* to the rule enunciated above, exceptions justified by the doctrine of police power. *Examples* of the exceptions are the *dismissal of an employee for union activity* (such dismissal being an unfair labor practice); or for *complaints under the Minimum Wage Law*, or for the purpose of *avoiding*

obligations under the maternity leave privilege law). (See *Gutierrez v. Bachrach Motor Co., Inc., supra*.)]

(**NOTE:** Even in said cases, it believed that the employer cannot be compelled to continue the employment so long as he prefers to be **CRIMINALLY LIABLE**.)

[**NOTE:** We may safely conclude that *unless* regulated or restricted by express statutory provision, an employer may freely dismiss his employee or laborer provided he gives the *one-month notice or the pay*. In other words, the traditional and age-old right of an employee or laborer to quit singly or collectively *at any time and without cause* and the right of the employer to dismiss his employee or laborer at any time without cause, still exist although qualified and restricted by statutory provisions. (*Ricardo Gutierrez v. Bachrach Motor Co., L-11298, 11586, and 11603, Jan. 19, 1959, citing dissenting opinion — for another reason — Nat. Labor Union v. Berg Department Store, L-6953, Mar. 3, 1955*).]

Alzosa v. National Labor Relations Commission
GR 50296, Feb. 14, 1983

If an employee has been illegally dismissed and an order of reinstatement has been issued, he must be given backwages; otherwise, the constitutional provision on security of tenure will not be accorded full respect.

Nicanor M. Baltazar v. San Miguel Brewery
L-23076, Feb. 27, 1969

FACTS: Baltazar was a salesman-in-charge of the Dagupan warehouse of the San Miguel Brewery. His employment was without a definite period. Because of 48 days of absence without permission or proper reason, Baltazar was dismissed by the Company for what was admittedly a just cause. Now then, is he entitled to the one-month (*mesada*) separation pay provided for in Rep. Act No. 1052, as amended?

HELD: No, because his dismissal was for a just cause. It is well settled in this jurisdiction that if the dismissal is for a just cause, a person without a definite term of

employment is not entitled to one-month notice or in lieu thereof, to one-month salary. If an employee hired for a definite period can be dismissed for a just cause without the need of paying him a month's salary, an employee hired without a definite tenure should not be allowed to enjoy better rights.

Polymedic General Hospital v. NLRC
L-64190, Jan. 31, 1985

If an employer accuses an employee of sleeping while on duty or of abandonment of post, the employer has the burden of proof with respect to the accusation.

Villadolid v. Inciong
GR 52364, Mar. 25, 1983

Reasonable basis for loss of confidence, not proof beyond reasonable doubt, is what is needed for a dismissal on this ground.

Bustillos v. Inciong
GR 45396, Jan. 27, 1983

If an employee is dismissed for loss of confidence, there must be a *basis* for said loss of confidence. This right of dismissal must not be abused.

FEM's Elegance Lodging House v. Murillo
GR 117442-43, Jan. 11, 1995
58 SCAD 79

Failure to submit a position paper on time is not one of the grounds for the dismissal of a complaint in labor cases.

Marcelo v. NLRC
GR 113458, Jan. 31, 1995
58 SCAD 643

To be a valid ground for dismissal, loss of trust and confidence must be based on a willful breach of trust and founded on clearly established facts sufficient to warrant the employee's separation from work.

General Textile, Inc. v. NLRC
GR 102969, Apr. 4, 1995
60 SCAD 296

Backwages represent compensation that should have been earned by the employee but were lost because of the unjust or illegal dismissal.

Unicraft Industries International Corp., etc.
v. CA, etc.
GR 134903, Jan. 16, 2002

The award of separation pay cannot be executed before trial is terminated since to do so would be to preempt the proceedings before the voluntary arbitrator.

It is worth noting that the case filed was for illegal dismissal. Affirmance of the award of separation pay would be tantamount to a judicial declaration that private respondents were indeed illegally dismissed.

(2) Some Justifiable Causes for Dismissal

- (a) Misfeasance or malfeasance towards the employer. (*Manila Trading D. Zulueta, 40 O.G. [6th S, p. 183], 69 Phil. 485*).
- (b) When continuance in the service would be patently inimical to the interest of the employer. (*Phil. Village Hotel v. NLRC, GR 105033, Feb. 28, 1994, 48 SCAD 607*).
- (c) A publisher's loss of confidence is sufficient cause for the dismissal of a newspaper editor. (*Phil. Newspaper Guild, Evening News Local v. Evening News, Inc., CIR, No. 187-V, Sept. 4, 1948*).
- (d) Introduction of labor-saving mechanical devices to effect more economy and efficiency. (*Phil. Sheet Metal Worker's Union v. CIR, L-2028, Apr. 27, 1949*).
- (e) A driver's dereliction of duty such as forgetting to get gasoline, racing with other buses, and not helping the passengers with their baggage. (*Batangas Transportation Co. v. Bagong Pagkakaisa, 40 O.G. 9th S. p. 51*).

- (f) If a driver allows another person to operate the vehicle, in violation of company rules. (*Manila Chauffeur's League v. Bachrach Motor Co.*, 40 O.G. 7th S. p. 159).
- (g) The separation of an employee from the service is justified when it appears that the funds allotted for his position are discontinued and he is merely a *temporary* employee. He has *no* fixed tenure of office and as such, his employment can be terminated at the pleasure of the appointing power, there being no need to show that the termination is for cause. (*Univ. of the Phil. v. CIR*, L-13064, Dec. 26, 1958).
- (h) Sleeping during the assigned working hours. (*Ormoc Sugar Co. v. Osco Workers Fraternity Labor Union*, L-15826, Jan. 23, 1961).

[**NOTE:** A conviction in a criminal case is NOT necessary to justify a discharge. (*Nat. Labor Union v. Standard Vacuum Oil Co.*, 40 O.G. 3503).]

[**NOTE:** Generally, a worker must NOT be dismissed for infractions that are *not serious*. Moreover, before dismissal, a fair hearing must be given him. (*Batangas Trans. Co. v. Bagong Pagkakaisa*, *supra*).]

- (i) Challenging superior officers, insubordination, sleeping in the post, dereliction of duty — these are offenses of security guards which warrant dismissal, if only as a measure of self-protection for the employer. (*Luzon Stevedoring Co. v. Court of Industrial Relations, etc.*, L-17411, 18681, 18683, Dec. 31, 1965).

Sumandi v. Leogardo
L-67635, Jan. 17, 1985

Just because an employee quoted to a customer the price of a certain article at P0.50 higher than the price charged by other stores, the employer is *not* justified in dismissing him.

(3) Reinstatement Provided There is No Laches

Whenever reinstatement is proper, action by a private employee for the same must be brought within a reasonable

time to allow the management to conduct its business affairs. Within a reasonable time of one year (as in the case of government employees), the management may keep the post vacant by not filing it or covering it with a temporary employee making the latter understand that should the management be later ordered to make the reinstatement, the temporary employee should not be allowed to continue indefinitely. (*Ricardo Gutierrez v. Bachrach Motor Co.*, L-11298, L-11586, L-11603, Jan. 19, 1959).

(**NOTE:** In his dissenting opinion in the *Gutierrez* case, Justice J.B.L. Reyes said that the rule on the filing of an action for reinstatement by public officials should *not* be applied to private disputes. As reason therefor, he stated that as between *private* parties, it is the Statute of Limitations that fixes the period during which courts will be willing to entertain the complaints of one against the other except if there are extraordinary circumstances. In the case of *government* employees and officials, the rule is *different* because the overriding need for *prompt dispatch of government business* justifies the requirement that claims for restoration to office should be speedily presented and dissolved.)

(4) **BAR**

A collective bargaining agreement has been entered into between Manila Commercial Company, and its Employees' Union valid for two years from Jan. 1, 1955. It provides *inter alia* that the employer may summarily dismiss any employee guilty of negligence, inefficiency, insubordination, lack of respects to his superior and habitual tardiness or absenteeism. May the Company during the life of the agreement dismiss an employee upon 30 days notice, or upon payment of a ME-SADA? Explain your answer.

ANS.:

- (a) If the cause is just (one of those mentioned in the collective bargaining contract), the employee may be dismissed, *without notice or mesada*.
- (b) If the cause is NOT one of those enumerated, *no* dismissal may be made, despite the notice or *mesada* (RA

1052) unless the employer wants to be held liable for damages. This is because of the restrictive enumeration of causes in the collective bargaining contract. (*See Nat. Labor Union v. Berg Dept. Store, Inc.*, 51 O.G. 1866).

(5) Unfair Labor Practice Committed on Agricultural Laborers

Under RA 2263, agricultural workers are given the right to file an action for unfair labor practice, not before the CIR but before the Court of Agrarian Relations. (*Santos v. CIR*, L-17196, Dec. 28, 1961).

Art. 1711. Owners of enterprises and other employers are obliged to pay compensation for the death of or injuries to their laborers, workmen, mechanics or other employees, even though the event may have been purely accidental or entirely due to a fortuitous cause, if the death or personal injury arose out of and in the course of the employment. The employer is also liable for compensation if the employee contracts any illness or disease caused by such employment or as the result of the nature of the employment. If the mishap was due to the employee's own notorious negligence, or voluntary act, or drunkenness, the employer shall not be liable for compensation. When the employee's lack of due care contributed to his death or injury the compensation shall be equitably reduced.

COMMENT:

Death or Injuries to Laborer

This will be discussed under the next Article.

Art. 1712. If the death or injury is due to the negligence of a fellow-worker, the latter and the employer shall be solidarily liable for compensation. If a fellow-worker's intentional or malicious act is the only cause of the death or injury, the employer shall not be answerable, unless it should be shown that the latter did not exercise due diligence in the selection or supervision of the plaintiff's fellow-worker.

COMMENT:**(1) Background of Compensation Laws for Death or Injuries**

The old laws on compensation of laborers for accident or illness were modified to extend better protection to the laborer. (*Report of the Code Commission, p. 14*). Thus, we may say that Arts. 1711 and 1712 modify such acts as the Employers' Liability Act and the Workmen's Compensation Act. (*J.B.L. Reyes' Observations on the New Civil Code, Lawyers' Journal, Feb. 28, 1951, p. 94*). And this is true *despite* the fact that under the second sentence of Art. 2196 of the new Civil Code, "compensation for workmen and other employees in case of death, injury, or illness is regulated by special laws."

[**NOTE:** If claims have already been filed under the Workmen's Compensation Act, *no* further claim for the *same injury* may be filed under either the new Civil Code or other laws. (*Manalo v. Foster Wheeler Corp., et al., 52 O.G. 2514*).]

[**NOTE:** A waiver by an heir of a deceased laborer for compensation under the Workmen's Compensation Law is void. (*Jose C. Aquino, et al. v. Pilar Chaves Conato, the Workmen's Compensation Commission, L-18333, Dec. 29, 1965*).]

(2) Rules Re Employer's Liability

- (a) If the cause of the death or personal injury arose out of and in the course of employment, *employers are liable* (even if the event was *purely accidental or fortuitous*). (*Art. 1711*).

[**NOTE:** Employer is also liable for illness or disease caused by the employment. (*Art. 1711*).]

[**NOTE:** The words "arising out of" refer to the origin or cause of the accident, and are descriptive of its character; while the words "in the course of" refer to the time, place, and circumstances under which the accident took place. (*Afable v. Singer Sewing Machine Co., 58 Phil. 39; Dietzen Co. v. Ind. Board, 279 Ill. 116 N.E. 684*).]

[**NOTE:** If the employee had undergone the pre-employment physical examinations prescribed by the employer, and was found by the company physician to

be physically fit, the employer cannot allege that the employee was already sick even before his employment. (*National Shipyard Corp. v. Asuncion, et al.*, L-10307, Feb. 28, 1958).]

- (b) If the cause was due to the employee's own *notorious negligence*, or *voluntary* act or *drunkenness*, the employer shall NOT be liable. (Art. 1711).

[**NOTE:** If a bus inspector rides on an overcrowded bus on the running board while checking tickets this is not notorious negligence. (*Gevero, et al. v. Mindanao Bus Co.*, [C.A.] GR 7434-R, Apr. 5, 1953). Neither is failure to avoid a usual danger, if the worker was engrossed in his work. (*Flores v. Mindanao Lumber Co., Inc.*, L-43096, May 28, 1935). But an *experienced* laborer who works after a rain on a roof the sheets of which have not yet been nailed down, is guilty of notorious negligence, and *cannot* recover, if by virtue of the slippery condition of the roof, he falls. (*Caunan v. Compania General de Tabacos*, 56 Phil. 542).]

- (c) If the cause was *partly due* to the employee's lack of due care, the compensation shall be equitably reduced. (Art. 1711).
- (d) If the cause was due to the *negligence of a fellow worker*, the employer and the *guilty fellow worker* shall be liable solidarily. (Art. 1712).
- (e) If the cause was due to the *intentional* or *malicious act* of a *fellow worker*, the fellow worker is liable; *also*, the employer UNLESS he exercised due diligence in selecting and supervising said fellow worker. (Note, however, that *such diligence is presumed.*) (Art. 1712).

(3) Cases

Avendaño v. Employees' Compensation Commission GR 48593, Apr. 30, 1980

FACTS: Per certification of the claimant's physician, her breast cancer was contracted sometime in 1959, although the clinical manifestations thereof started only in 1969.

HELD: The Workmen's Compensation Act is applicable to a claim for disability income benefit arising from breast carcinoma although said claim was filed only in 1976 after the effectivity of the Labor Code.

Cayco v. ECC
GR L-49755, Aug. 21, 1980

FACTS: The deceased employee's breast carcinoma first showed up in 1972 or 6 years before she died on Apr. 26, 1978.

HELD: The presumption on compensability under the WCA governs since her right accrued before the Labor Code took effect.

Ajero v. ECC
GR L-44597, Dec. 29, 1980

FACTS: The claimant was confined and treated for pulmonary tuberculosis and cancer of the breast from Jan. 5 to 15, 1976.

HELD: In granting the employee's claim for income benefit, the Court said that her ailments, especially pulmonary tuberculosis, must have supervened several years before, when the WCA was still in force.

Mandapat v. ECC
191 Phil. 47
(1981)

Since the deceased underwent radical mastectomy on May 10, 1975, it is obvious that the tumor in her right breast started to develop even before 1975.

The onset of cancer is quiet and gradual, in contrast to many diseases. It takes 6 to 12 mos. for a breast cancer to grow from a size actually encountered at the time of surgery. (*Illustrated Medical & Health Encyclopedia*, Vol. 2, pp. 285, 397).

Nemaria v. ECC
GR L-57889, Oct. 28, 1987

FACTS: The deceased employee was confined for cancer of the liver, duodenal cancer, and cancer of the breast, from

Sep. 8 to 25, 1978, before she succumbed to death on Oct. 16, 1978.

HELD: Recognizing that cancer is a disease which is often discovered when it is too late, it can be surmised that the possibility that its onset was even before the effectivity of the new Labor Code, cannot be discounted.

De Leon v. ECC
GR L-46474, Nov. 14, 1988

The governing Law on the claim for income benefit filed by the mother of the deceased on Jun. 8, 1976 is the WCA.

The modified radical mastectomy conducted on the deceased on Sep. 16, 1968 obviously showed that she contracted breast carcinoma before the effectivity of PD 626.

(4) Retirement Benefits

**Gamogamo v. PNOC Shipping &
Transport Corp.**
GR 141707, May 7, 2002

ISSUE: Whether, for the purpose of computing an employee's retirement pay, prior service rendered in a government agency can be tasked in and added to the creditable services later acquired in a government-owned and controlled corporation without original charter.

HELD: No. In the instant case, petitioner's service with the Department of Health (DOH) cannot be included in the computation of his retirement benefits. And since the retirement pay solely comes from respondent's funds, it is but natural that respondent shall disregard petitioner's length of service in another company for computation of his retirement benefits.

**Norma Orate v. CA, Employees Compensation
Commission, Social Security System
(Manila Bay Spinning Mills, Inc.)**
GR 132761, Mar. 26, 2003

FACTS: Petitioner Norma Orate was employed by Manila Bay Spinning Mills, Inc. (MBSMI), as a regular machine

operator. Diagnosed to be suffering from invasive ductal carnicoma (breast, left), commonly referred to as cancer of the breast, she underwent modified radical mastectomy. The operation incapacitated her from performing heavy work, far which reason she was forced to go on leave and, eventually, to retire from service at the age of 44.

Later, petitioner applied for employees compensation benefits with the Social Security System (SSS), but the same was denied on the ground that her illness is not work-related. She moved for reconsideration contending that her duties as machine operator which included lifting heavy objects increased the risk of contracting breast cancer. The SSS, however, reiterated its denial of petitioner's claim for benefits under the Employees' Compensation Program (ECP) and instead approved her application as a sickness benefit claim under the SSS, and classified, the same as a permanent partial disability equivalent to a period of 23 months.

Petitioner requested the elevation of her case to the Employees' Compensation Commission (ECC), which affirmed the decision of the SSS. The ECC ruled that petitioner's disability due to breast cancer is not compensable under the ECP because said ailment is not included among the occupational diseases under the rules on employees' compensation, and where it was not established that the risk of contracting said ailment was increased by the working conditions at MBSMI.

A petition for review was filed by petitioner with the Court of Appeals (CA) which reversed the ECC's decision, and granted petitioner's claim for compensation benefit under the Workmen's Compensation Act (WCA) (ACT 3428). It ruled that petitioner's breast cancer must have intervened before the effectivity of Title II, Book IV of the Labor Code on Employees' Compensation and State Insurance Fund on Jan. 1, 1975, hence, the governing law a petitioner's claim for compensation benefit is Art. 3428, which works upon the presumption of compensability and not the provisions. of the Labor Code on employees' compensation. The CA further ruled that since MBSMI failed to discharge the burden of proving that petitioner's ailment did not arise out of or in the course of employment, the presumption of compensability prevails, entitling her to compensation.

Thereupon, petitioner filed a motion for reconsideration arguing that it is the Labor Code which should be applied that it is the Labor Code which should be applied to her case inasmuch as there is no evidence that the onset of her breast carcinoma occurred before Jan. 1, 1975. She claimed that the basis of the computation of her compensation benefits should be the Labor Code and not the WCA. The appellate court denied her motion for reconsideration, hence, the instant petition that her disability should be compensated under the provisions of the Labor Code and not under the WCA.

ISSUES: (1) What is the law applicable to petitioner's claim for disability benefits?; and (2) Is she entitled under the applicable law to be compensated for disability arising from breast carcinoma?

HELD: (1) In workmen's compensation cases, the governing law is determined by the date when the claimant contracted the disease. An injury or illness which intervened prior to Jan. 1, 1975, the effectivity dated of PD 626, shall be governed by the provisions of the WCA, while those contracted on or after Jan. 1, 1975 shall be governed by the Labor Code, as amended by PD 626. (*Gonzaga vs. ECC*, 212 Phil. 405 [1984], citing *Najera vs. ECC*, 207 Phil. 600 [1983]).

In the case at bar, petitioner was found to be positive for breast cancer on Mar. 22, 1995. No evidence, however, was presented as to when she contracted said ailment. Hence, the presumption is that her illness intervened when PD 262 was already the governing law. The instant controversy is not on all fours with the cases where the Court applied the "presumption of compensability" and "aggravation" under the WCA, even though the claim for compensation benefit was filed after Jan. 1, 1975. In said cases, the symptoms of breast cancer manifested before or too close to the cut-off date — Jan. 1, 1975, that it is logical to presume that the breast carcinoma of the employee concerned must have intervened prior to Jan. 1, 1975. Clearly, therefore, the "presumption of compensability" and "aggravation" under the WCA cannot be applied to petitioner's claim for compensation benefit arising from breast cancer. Said the supreme on this point: "We are not experts in this field to rule that the onset of

her breast carcinoma occurred prior to Jan. 1, 1975, or almost 20 years ago.” Hence, the provisions of the Labor Code govern.

(2) While the Supreme Court sustains petitioner’s claim that it is the Labor Code that applies to her case, it is, nonetheless, constrained to rule that under the same code, her disability is not compensable.

Opined the Court: “Much as we commiserate with her, our sympathy cannot justify an award not authorized by law. it is well to remember that if diseases not intended by the law to be compensated are inadvertently or recklessly included, the integrity of the State Insurance Fund is endangered. Compassion for the victims of diseases not covered by law ignores the need to show a greater concern for the trust fund to which the tens of millions of workers and their families look to for compensation whenever covered accidents, diseases, and deaths occur. This stems from the development in the law that no longer is the poor employee still arrayed against the might and power of his rich corporate employer, hence, the necessity of affording all kinds of favorable presumptions to the employee. This reasoning is no longer good policy. It is now the trust fund and not the employer which suffers if benefits are paid to claimants who are not entitled under the law.”

The CA’s decision is reversed and set aside. The ECC’s decision dismissing petitioner’s claim for compensation benefits under the ECP is reinstated.

[NOTE: On Nov. 1, 1974, the Workmen’s Compensation Act (WCA) was repealed by the Labor Code (Presidential Decree 442). On Dec. 27, 1974, PD 626 (which took effect on Jan. 1, 1975) was issued. It extensively amended the provisions of Title II, Book IV of the Labor Code on Employee’s Compensation and State Insurance Fund. (This explains why the present law on employees’ compensation, although part of the Labor Code, is also known as PD 626. [*Orate v. CA, etc., GR 132761, Mar. 26, 2003*].). The law as it now stands requires the claimant to prove a positive thing — that the illness was caused by employment and the risk of contracting the disease is increased by the working conditions. It discarded, *inter alia*, the concepts of “presumption of compensability” and “aggravation” and substituted a system based on social security principles. The present system is also

administered by social insurance agencies — the Government Service Insurance System (GSIS) and Social Security System (SSS) — under the Employee's Compensation Commission (ECC). The intent was to restore a sensible equilibrium between the employer's obligation to pay workmen's right to receive reparation for work-connected death or disability. (*Raro v. ECC, GR 58445, April 27, 1989*).].

[**NOTE:** Cancer is a disease that strikes people in general. The nature of a person's employment appears to have no relevance. Cancer can strike a lowly paid-laborer or a highly-paid executive or one who works on land, in water, or in the deep bowels of the earth. It makes no difference whether the victim is employed or unemployed, a white collar employee or a blue collar worker, a housekeeper, an urban dweller or a resident of a rural area. There are certain cancers which are reasonable considered as strongly induced by specific causes. Heavy does of radiation as in Chernobyl, U.S.S.R., cigarette smoke over a long period for lung cancer, certain chemicals for specific cancers, and asbestos dust, *inter alia*, are generally-accepted as increasing the risks of contracting specific cancers. What the law requires for others is proof. (*Raro v. ECC, supra*). (*See Orate v. CA, supra*).].

[**NOTE:** Some industrial chemicals create a cancer hazard for people who work with them. Such chemicals include aniline dyes, arsenic, asbestos, chromium and iron compounds, lead, nickel, vinyl chloride, and certain products of coal, lignite, oil shale, and petroleum. Unless industrial plants carefully control the use of such chemicals, excessive amounts may escape or be released into the environment. The chemicals then create a cancer hazard for people in surrounding areas. (*Orate v. CA, supra, citing World Book Encyclopedia, Vol. 3, 1992 ed., p. 119*).]

Section 3

CONTRACT FOR A PIECE OF WORK

Art. 1713. By the contract for a piece of work the contractor binds himself to execute a piece of work for the employer, in consideration of a certain price or compensation. The contractor may either employ only his labor or skill, or also furnish the material.

COMMENT:**(1) ‘Contract for a Piece of Work’ Distinguished from ‘Lease of Services’**

- (a) In the former, the *object* is the resultant work or object; in the latter, it is the service.
- (b) In the former, the risk is borne by the worker before delivery; in the latter, the risk is generally borne by the employer, not by the laborer unless the latter is guilty of fault or negligence.

(2) Elements of the Contract of Work

- (a) consent
- (b) object — execution of a piece of work
- (c) cause — certain price or compensation

(3) ‘Contractor’ Defined

The worker is also called a CONTRACTOR. He in turn may obtain the services of others, who will work under him.

(4) Test

To determine if a person who performs work for another is an independent contractor or an employee, the “right of control” test is used. If the person for whom services are to be performed controls only the END to be achieved, the worker is a contractor; if the former controls not only the end but also the MANNER and MEANS to be used, the latter is an employee. (*LVN Pictures, Inc. v. Phil. Musicians Guild, et al.*, L-12582 and L-12598, Jan. 28, 1961).

(5) What Contractor May Furnish

The contractor may furnish:

- (a) both the material and the labor,
- (b) or only the labor.

(6) Contract for a Piece of Work Distinguished from the Contract of Sale

In *Celestino and Co. v. Collector* (L-8506, Aug. 3, 1956), the Supreme Court held that when a company or factory does nothing more than sell the goods that it *mass produces or habitually makes* — sash, panels, mouldings, frames — cutting them to sizes and combining them in such forms as its customers may desire; *not* merely selling its services, but also the materials ordinarily manufactured by it, although in such form or combination as suited the fancy of the purchaser, it is still a manufacturer, and *not* a contractor for a piece of work or a lessor of services, and its transactions with its customers are *contracts of sale* under Art. 1467 of the Civil Code.

When a factory accepts a job that requires the use of *extraordinary or additional* equipment or involves services not generally performed by it, it thereby *contracts for a piece of work*. However, a sawmill that cuts lumber in accordance with peculiar specifications of a customer is a *seller*, not a contractor for a piece of work, *even though* the sizes referred to are *not* previously held in stock for sale to the public.

(7) ‘Pakyao’ Arrangement**Dingcong v. Guingona
GR 76044, Jun. 28, 1988**

The criteria for a daily wage rate contract can hardly be applied to “*pakyao*” arrangements, the two being worlds apart. In “*pakyao*,” a worker is paid by results. It is akin to a contract for a piece of work whereby the contractor binds himself to execute a piece of work for the employer, in consideration of a certain price for consideration. The contractor may either employ his labor or skill or also furnish the material. Not so in a contract on a daily wage basis, where what is paid for is the labor alone.

Under the “*pakyao*” system, payment is made in a lump sum. The laborer makes a profit for himself, which is justified by the fact that any loss would also be borne by him. On the other hand, no profit inures to the daily wage worker and no materials are furnished by him.

The “*pakyao*” arrangement is not without its advantages. The tendency to dilly-dally on the work generally experienced in a daily wage contract, is hardly present in labor on a “*pakyao*” basis. The latter can also be more flexible, with the need for supervision reduced to the minimum. It is not necessarily frowned upon. In fact, it is recognized in the Labor Code, and even in the Revised Manual of Instructions to Treasurers, which provides that except in construction or repairs requiring technical skill such as upon buildings, bridges, water works structures, culverts, etc., when the total cost of the work does not exceed P3,000, the same may be performed under the “*pakyao*” contract.

Art. 1714. If the contractor agrees to produce the work from material furnished by him, he shall deliver the thing produced to the employer and transfer dominion over the thing. This contract shall be governed by the following articles as well as by the pertinent provisions on warranty of title and against hidden defects and the payment of price in a contract of sale.

COMMENT:

Duties of Contractor Who Furnishes Both Work and the Material

Here, *both* work and material are furnished by the contractor. This is equivalent to a sale; therefore, these are the duties:

- (a) to deliver;
- (b) to transfer ownership;
- (c) to warrant against eviction and hidden defects.

Art. 1715. The contractor shall execute the work in such a manner that it has the qualities agreed upon and has no defects which destroy or lessen its value or fitness for its ordinary or stipulated use. Should the work be not of such quality, the employer may require that the contractor remove the defect or execute another work. If the contractor

fails or refuses to comply with this obligation, the employer may have the defect removed or another work executed, at the contractor's cost.

COMMENT:

Remedy of Employer in Case of DEFECTS

- (a) Ask contractor to remove the defect or to execute another work.
- (b) If contractor fails or refuses, employer can ask ANOTHER, at the first's expense. If a building is involved, expenses for correction and completion may be recovered. (*Marker v. Garcia*, 5 Phil. 557).

Art. 1716. An agreement waiving or limiting the contractor's liability for any defect in the work is void if the contractor acted fraudulently.

COMMENT:

Agreement Waiving or Limiting Contractor's Liability

- (a) In the absence of fraud, the agreement would ordinarily be valid.
- (b) In the absence of a prohibitory statute, the validity of a limitation of the amount of liability is generally *upheld*, where, with a view of obtaining a compensation commensurate to the risk assumed, an ARRASTRE operator stipulates that unless the valuation of the property committed to his care is disclosed, his responsibility for loss or damage shall not exceed a certain amount. (*Northern Motor, Inc. v. Prince Line, et al.*, L-13884, Feb. 29, 1960).

Art. 1717. If the contractor bound himself to furnish the material, he shall suffer the loss if the work should be destroyed before its delivery, save when there has been delay in receiving it.

COMMENT:**(1) Risk of Loss if Contractor Furnished Also the Material***Example:*

A asked B to make a radio cabinet. B bound himself to furnish the materials. Before the radio cabinet could be delivered, it was destroyed by a fortuitous event.

(a) Who suffers the loss?

B suffers the loss of both the materials and the work, unless there was *MORA ACCIPIENDI*. If there was *mora accipiendi*, it is evident that A suffers the loss. (*Art. 1717; See Tuason and San Pedro v. Zamora, 2 Phil. 305*, where a building was burned under a *mora accipiendi* and the employer was required to pay.)

(b) Is the contract extinguished?

No, and therefore B may be required to do the work all over again, unless there had been a prior stipulation to the contrary or unless a re-making is impossible. Note that the law merely refers to the burden of the loss, and *not* to the extinguishment of the contract.

(2) Fortuitous Event or Unavoidable Accident

As a general principle, in the absence of an express agreement to the contrary, the contractor must bear the loss from destruction of work underway, even in case of an unavoidable accident. (*Atlantic Gulf Co. v. Gov't., 10 Phil. 166*).

Art. 1718. The contractor who has undertaken to put only to work or skill, cannot claim any compensation if the work should be destroyed before its delivery, unless there has been delay in receiving it, or if the destruction was caused by the poor quality of the material, provided this fact was communicated in due time to the owner. If the material is lost through a fortuitous event, the contract is extinguished.

COMMENT:

(1) Arts. 1718 and 1717 Distinguished (Re Risk of Loss)

<i>ART. 1718</i>	<i>ART. 1717</i>
(a) Contractor here furnishes only his work or skill.	(a) The contractor furnishes the material as well as the work.
(b) Here, if the material is lost thru a fortuitous event, the contract is extinguished.	(b) No extinguishment is referred to in Art. 1717. <i>(NOTE: Even if the employer wants to replace the materials, he cannot compel the worker to work again. If both agree, this would be different.)</i>

(2) Problem

A asked B to build a cabinet for him (A). A furnished good materials. B then worked, but the cabinet was destroyed by a fortuitous event before delivery.

(a) Is B entitled to compensation for his work?

ANS.: No, unless A was in *mora accipiendi*.

(b) Is B required to pay for the materials?

ANS.: No, in view of the loss thru a fortuitous event.

Art. 1719. Acceptance of the work by the employer relieves the contractor of liability for any defect in the work, unless:

(1) The defect is hidden and the employer is not, by his special knowledge, expected to recognize the same; or

(2) The employer expressly reserves his right against the contractor by reason of the defect.

COMMENT:**(1) Effect When Employer Accepts the Work**

- (a) Note that when the employer accepts the work the contractor is generally relieved of liability. Two exceptions are given.
- (b) The Article also applies to a building contract. If acceptance is made without objection, the employer may still sue for hidden defects. (*Chan Suanco v. Alonzo*, 14 Phil. 517).

(2) Filing of a Complaint

The filing of a complaint against the contractor is equivalent to a protest objection, or non-acceptance. (*Castro v. Tamporong*, 44 O.G. No. 12, p. 4930).

(3) Inspection of a Concrete Wall

From the very nature of things, it is impossible to determine by a simple inspection of a concrete wall whether or not it is made of reinforced concrete for the reason that this work is done by embedding iron or steel rods in the concrete in such a way as to increase its strength. (*Limjap v. Machuca & Co.*, 38 Phil. 451).

Art. 1720. The price or compensation shall be paid at the time and place of delivery of the work, unless there is a stipulation to the contrary. If the work is to be delivered partially, the price or compensation for each part having been fixed, the sum shall be paid at the time and place of delivery, in the absence of stipulation.

COMMENT:**(1) Place of Payment**

Payment is to be made:

- (a) *where stipulated*;
- (b) if no stipulation, then at TIME and PLACE of delivery.

**Gonzales v. Court of Appeals
GR 55943, Sep. 21, 1983**

If an architect promises to finish a construction in three (3) stages, with him being paid after each stage, his failure to finish the 3rd stage will not entitle him to compensation for said stage, but he must be paid for the first two (2) stages, which after all, have already been completed. And this is true even if the entire project is later abandoned.

(2) Applicability of Article to Partial Delivery

The second sentence states the rule when the work is to be delivered partially.

**Pasay City Government v. CFI, Manila
L-32162, Sep. 28, 1984**

If construction is on a stage-by-stage basis with payment after each stage, performance bond is proportionate to unfinished work.

Art. 1721. If, in the execution of the work, an act of the employer is required, and he incurs in delay or fails to perform the act, the contractor is entitled to a reasonable compensation.

The amount of the compensation is computed, on the one hand, by the duration of the delay and the amount of the compensation stipulated, and on the other hand, by what the contractor has saved in expenses by reason of the delay, or is able to earn by a different employment of his time and industry.

COMMENT:

Default of the Employer

- (a) "In delay" means DEFAULT.
- (b) "Is able to earn" should be construed to mean not only what has been earned but also *could have* been earned; otherwise, a premium would be placed on idleness.

Art. 1722. If the work cannot be completed on account of a defect in the material furnished by the employer, or because of orders from the employer, without any fault on the part of the contractor, the latter has a right to an equitable part of the compensation proportionally to the work done, and reimbursement for proper expenses made.

COMMENT:

(1) Non-completion Due to Defective Materials or Orders from Employer

Here, under the conditions given, *proportionate* compensation and reimbursement must be made even if the work is INCOMPLETE.

(2) Rules of Professional Organizations

Rules of professional organizations like those of the Philippine Society of Architects can be referred to in computing the compensation, say, of an architect. (*See Antonio v. Enriquez, [C.A.] 51 O.G. 3536*).

Art. 1723. The engineer or architect who drew up the plans and specifications for a building is liable for damages if within fifteen years from completion of the structure, the same should collapse by reason of a defect in those plans and specifications, or due to the defects in the ground. The contractor is likewise responsible for the damages if the edifice falls, within the same period, on account of defects in the construction or the use of materials of inferior quality furnished by him, or due to any violation of the terms of the contract. If the engineer or architect supervises the construction, he shall be solidarily liable with the contractor.

Acceptance of the building, after completion, does not imply waiver of any of the causes of action by reason of any defect mentioned in the preceding paragraph.

The action must be brought within ten years following the collapse of the building.

COMMENT:**(1) Liability for Collapse of a Building**

- (a) The COLLAPSE of the building must be *within 15 years* from the *completion* of the structure.
- (b) The PRESCRIPTIVE PERIOD is *10 years* following the collapse.
- (c) Note the SOLIDARY LIABILITY in the last sentence of the first paragraph.
- (d) The Article applies to a collapse or a *ruin, not to minor defects*. (*Bosque v. Chipco, 14 Phil. 95*).
- (e) Even if *payment* has already been made, an action is still possible under this Article. (*Hospicio de San Jose v. Findlay Miller Timber Co., 50 Phil. 277*).

(2) Reason for the Liability

A contractor's engagement is to build according to plans and specifications; the designs are made by the architect; and therefore, as to the sufficiency or inadequacy of the structure carrying the weight of the building the builder-contractor should *not* be made responsible. Thus, where the foundation was designed to carry a specified load (the building WITHOUT the swimming pool and other additions without a change in the foundation, the fault does *not* lie in the building-contractor, but in the owner himself, and in the failure of his architect to provide the adequate foundation to take care of the new weight caused by the additions. (*Koster, Inc. v. Zulueta, L-9305, Nov. 8, 1956*).

(3) Collapse of a Building During an Earthquake

If the proximate cause of the collapse of a building is an earthquake, no one can be held liable in view of the fortuitous event. If the proximate cause is, however, defective designing or construction, or directly attributable to the use of inferior or unsafe materials, it is clear that liability exists.

Art. 1724. The contractor who undertakes to build a structure or any other work for a stipulated price, in conformity with plans and specifications agreed upon with the landowner, can neither withdraw from the contract nor demand an increase in the price on account of the higher cost of labor or materials, save when there has been a change in the plans and specifications, provided:

(1) Such change has been authorized by the proprietor in writing; and

(2) The additional price to be paid to the contractor has been determined in writing by both parties.

COMMENT:

(1) Applicability of the Article Re Structure

The Article applies to the building of a STRUCTURE or ANY OTHER WORK.

**Nakpil and Sons v. CA
GR 47851, Oct. 3, 1986**

The engineer or architect who drew up the plans and specifications for the building and the contractor are solidarily liable for damages occasioned by the collapse of the structure by reason of defects in the plans and specifications and in the construction or use of materials.

(2) General Rule

Contractor CANNOT *withdraw or demand a higher price* EVEN IF there be a higher cost of labor or materials.

(3) Exception

A higher price can be demanded:

- (a) IF there was a WRITTEN authorized change in plans and specifications;
- (b) AND IF the additional price is also in WRITING, agreed upon by BOTH PARTIES.

[Hence, if the authorization was only ORAL, the higher price cannot be demanded. This is so even if the owner had benefited. (*See Marquez v. Cruz*, {C.A.} 54 O. G. 2547).]

Royal Lines, Inc. v. CA
GR 27239, Aug. 20, 1986

Art. 1724 which provides that the contractor cannot demand an increase in the price on account of change in the plans and specifications unless such change has been authorized by the proprietor in writing and the additional price to be paid to the contractor has been determined in writing by both parties, refers to a structure or any other work to be built on land by agreement between the contractor and the landowner. It cannot apply to work done upon a vessel, which is not erected on land or owned by the landowner.

Arenas, et al. v. CA and Cruz
GR 56524, Jan. 27, 1989

Art. 1724 cannot apply to a case involving contractors who undertake to build a structure or any other work and contemplates disputes arising from increased costs of labor and materials.

(4) Purpose of Requiring Written Authorization

Recovery for additional cost in a construction contract can indeed be had only if a written authorization to make such additions is obtained from the proprietor, the evident purpose of the *rule being to prevent litigation for said additional costs*. This written requirement is not governed by the Statute of Frauds; it is a mandatory substantive provision or condition, precedent to recovery. (*San Diego v. Sayson*, L-16258, Aug. 31, 1961).

Art. 1725. The owner may withdraw at will from the construction of the work, although it may have been com-

menced, indemnifying the contractor for all the latter's expenses, work, and the usefulness which the owner may obtain therefrom, and damages.

COMMENT:

(1) Withdrawal by Owner

The right of the owner to withdraw for any reason, economic or otherwise, is absolute, provided that damages are given. The contractor cannot insist upon completing the contract and enforcing payment of the full amount of the contract price. (*10 Manresa 705*).

(2) Effect of Advance Payment

The right of the owner being absolute, it follows that its exercise cannot be made to depend upon whether the contract price has or has not been paid in advance, wholly or partially. If the total amount paid the builder or contractor at the time the owner elects to abandon the projected building is more than sufficient to reimburse him for his outlay, he is duty bound to return the difference. If the owner however insists on the completion, he would be entitled to do so. It is understood that he should be responsible for damages caused by his delay, this in addition to the contract price that had previously been agreed upon. (*Adams & Smith v. Sociedad Naton & Aldea, 39 Phil. 383*).

Art. 1726. When a piece of work has been entrusted to a person by reason of his personal qualifications, the contract is rescinded upon his death.

In this case the proprietor shall pay the heirs of the contractor in proportion to the price agreed upon, the value of the part of the work done, and of the materials prepared, provided the latter yield him some benefit.

The same rule shall apply if the contractor cannot finish the work due to circumstances beyond his control.

COMMENT:**Instances When Contract Can Be Rescinded**

- (a) Impossibility of finishing due to *unavoidable circumstances*.
- (b) Death of the contractor when his *personal qualifications* had been considered (hence, his obligations are not transmissible to his heirs by the mere operation of law). (*Estate of Hemady v. Luzon Surety Co., Inc., L-8407, Nov. 28, 1956*). The *death* of the *lone operator* of a security agency, such as the Javier Security Special Watchmen Agency ends the contract even before the period set forth in the contract expires. (*Javier Security Special Watchmen Agency v. Shell-Craft & Button Corporation, L-18639, Jan. 31, 1963*). In this *Javier* case, the Court found the following facts: Swiryn engaged the services of the plaintiff agency to guard the premises of the defendant corporation. The contract was supposed to have expired Dec. 1, 1957. But Javier, the agency operator, died on May 9, 1957. Swiryn then engaged the services of another agency on the same day. The heirs of Javier thus sued defendant for breach of contract with damages. The Court, however, found that the primordial reasons which prompted Swiryn to enter into the contract were the personality and the qualifications of the deceased who supervised personally the watchmen employed and controlled by him. The Court held that Javier's death consequently lawfully terminated the contract, and defendant corporation cannot be held liable.

[Note, however, the payment of a *proportionate* price.]

Art. 1727. The contractor is responsible for the work done by persons employed by him.

COMMENT:**Contractor's Responsibility for His Own Employees**

- (a) This stresses the master and servant rule: the negligence of the servant is the negligence of the master.

- (b) For breach of contract (*culpa contractual*), the contractor *cannot* present as a valid and complete defense the fact that he exercised due diligence in the selection and supervision of his employees. (*See Manila Railroad Co. v. Compania Transatlantica*, 38 Phil. 875). This defense can however mitigate the damages.

Art. 1728. The contractor is liable for all the claims of laborers and others employed by him, and of third persons for death or physical injuries during the construction.

COMMENT:

Effect of Death or Physical Injuries

- (a) Note that the claim here is for damages because of DEATH or PHYSICAL INJURIES during the construction.
- (b) Damage to property may however be recovered under other provision, such as Art. 1727.
- (c) Note the reference to *third* persons.

Art. 1729. Those who put their labor upon or furnish materials for a piece of work undertaken by the contractor have an action against the owner up to the amount owing from the latter to the contractor at the time the claim is made. However, the following shall not prejudice the laborers, employees and furnishers of materials:

- (1) Payments made by the owner to the contractor before they are due;
- (2) Renunciation by the contractor of any amount due him from the owner.

This article is subject to the provisions of special laws.

COMMENT:

- (1) **Subsidiary Liability of Owners to Laborers and Materialmen**

This Article is self-explanatory.

(2) Special Law Regarding Contractor's LABOR BOND**ACT 3959**

An act making it obligatory for any person, company, firm or corporation owning any work of any kind executed by contract to require the contractor to furnish a bond guaranteeing the payment of the laborers, providing penalties for the violation hereof, and for other purposes.

Be it enacted by the Senate and House of Representatives of the Philippines in Legislature assembled and by the authority of the same:

Section 1. Any person, company, firm, or corporation or any agent or partner thereof, carrying on any construction or other work through a contractor, shall require such contractor to furnish bond in a sum equivalent to the cost of labor, and shall take care not to pay to such contractor the full amount which he is entitled to receive by virtue of the contract, until he shall have shown that he first paid the wages of the laborers employed in said work, by means of an affidavit made and subscribed by said contractor before a notary public or other officer authorized by law to administer oaths: *Provided*, That the bond herein provided for shall be automatically cancelled at the expiration of one year from the completion of the work, unless a claim for payment of laborers' wages has been filed within said period, in which case said bond shall continue in force and effect, until such claim has been paid or otherwise finally settled.

Section 2. Any person, company, firm or corporation, or any agent or partner thereof, who shall violate the provisions of the preceding section by paying to the contractor the entire cost of the work before receiving the affidavit mentioned in said section, shall be responsible jointly and severally with the contractor for the payment of the wages of the laborers employed in the work covered by the contract.

Section 3. Any contractor making a false statement in the affidavit required to be made by him under section one of this Act, shall be guilty of the crime of perjury defined and penalized in article one hundred and eighty-three of Act

Numbered Thirty-eight hundred and fifteen, known as the Revised Penal Code.

Section 4. All acts or parts of acts inconsistent with the provisions of this Act are hereby repealed.

Section 5. This Act shall take effect on its approval.

Approved, December 2, 1962.

(3) Remedies Under Act 3688

New Manila Lumber Co. v. Republic L-14248, Apr. 28, 1960

FACTS: The complaint of the plaintiff, the New Manila Lumber Co., seeks to enforce against the Republic of the Philippines a money claim for the payment of materials it furnished for the construction of two public school buildings undertaken by a contractor, on the basis of a power of attorney executed by the latter, authorizing said plaintiff to collect and receive from the defendant Republic any amount due or may be due for the payment of the materials so supplied. However, the defendant Republic had already instituted a pending suit against the contractor for the forfeiture of the latter's bond posted to secure the faithful performance of stipulations in the construction contract with regard to one of the school buildings. The contractor has a similar bond with respect to the other school building. *Issue:* Is plaintiff's complaint against the Republic the proper remedy?

HELD: No. Pursuant to Act 3688, the plaintiff's legal remedy is not to sue the government, there being *no privity* of contract between them, but to intervene *in* the civil case hereinabove adverted to OR to file an action in the name of the Republic against said contractor, on the latter's bond. Besides, plaintiff's action being a claim of money arising from an implied contract between it and the Republic of the Philippines, the same should have been lodged with the Auditor-General (Chair of Audit Commission). The state cannot be sued without its consent. Where the state points to the proper remedy, the same ought to be availed of if redress is sought.

Art. 1730. If it is agreed that the work shall be accomplished to the satisfaction of the proprietor, it is understood that in case of disagreement the question shall be subject to expert judgment.

If the work is subject to the approval of a third person, his decision shall be final, except in case of fraud or manifest error.

COMMENT:

(1) Satisfactory Completion of the Work

The Article speaks of two kinds of stipulations:

- (a) When the work is to be accomplished to the satisfaction of the owner.
- (b) When the work is subject to the approval of a third person.

(2) Effect of Certification by Owner's Architect

The owner of a building is bound by the certificate of sufficiency and completion made by his own duly appointed architect. (*Takao v. Belando*, 49 Phil. 957).

(3) Effect if There Is No Stipulation Requiring Approval by a Third Person

If there is no stipulation in a contract regarding the necessity of the approval of a third person, the second paragraph of the article cannot be given effect; in other words, approval by such third person cannot of course be insisted upon. (*Taylor v. Pierce*, 20 Phil. 103).

Art. 1731. He who has executed work upon a movable has a right to retain it by way of pledge until he is paid.

COMMENT:

(1) Possessory Lien of Worker

- (a) Personal property which was made the object of a chattel mortgage was repaired. Who has a superior lien — the repairer or the mortgagee?

ANS.: The repairer, provided he retains the chattel in his possession. (*Bank of the P.I. v. Smith & Co.*, 5 *Phil.* 533). (See, however, Art. 2247 of the Civil Code.)

- (b) In the preceding case, suppose the thing is sold to satisfy the lien, and *X* is the buyer, does *X* acquire a valid title to the thing?

ANS.: Yes. (*B.P.I. v. Smith & Co.*, *supra*).

(2) Some Doctrines

- (a) A garage which retains a truck which has been sent to it for repairs can lawfully retain said truck until duly paid for said repairs. (*Bachrach Motor Co. v. Mendoza*, 43 *Phil.* 410).
- (b) If a mortgagee of a chattel which has been mortgaged delivers to a garage said chattel for repairs, and supervises the work thereon, said mortgagee is liable personally for the cost of said repairs. (*Bachrach v. Mantel*, 25 *Phil.* 410).
- (c) The article does NOT apply to a *salaried employee*. (*Chartered Bank v. Constantino*, 56 *Phil.* 717).

Section 4

COMMON CARRIERS

Subsection 1

GENERAL PROVISIONS

INTRODUCTORY COMMENT:

(1) A 'Carrier' Defined

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." (*See Art. 1732; 9 Am. Jur.* 429).

**Japan Airlines v. CA, et al.
GR 118664, Aug. 7, 1998**

A contract to transport passengers is quite different in kind and degree from any other contractual relation. It is safe to conclude that it is a relationship imbued with public interest.

Failure on the part of the common carrier to live up to the exacting standards of care and diligence renders it liable for any damages that may be sustained by its passengers. However, this is not to say that common carriers are absolutely responsible for all injuries or damages even if the same were caused by a fortuitous event. To rule otherwise would render the defense of “*force majeure*,” as an exception from any liability, illusory and ineffective.

(2) Private Carrier Distinguished from Common Carrier

- (a) Private Carrier — one available only to certain individuals
- (b) Common Carrier — one available to the general public. (*See Art. 1732; City of New Orleans v. Le Banc, 139 La. 113.*)

[**NOTE:** If the entity enters into a contract to merely *furnish* vehicles (and not to actually carry) it is understandably neither a private nor a common carrier; it is not a carrier at all. (*U.S. ex rel. Chicago, NY and B. Refrigerator Co. v. Interstate Commerce Commission, 265 U.S. 292.*)]

**Sarkies Tour Philippines v.
Intermediate Appellate Court
GR 63723, Sep. 2, 1983**

In case of accidents involving carriers, it is generally the employee in charge of the vehicle (not the owner) who should be held liable for the payment of damages. The owner himself can be held liable if he is *wantonly at fault, fraudulent, reckless, or oppressive*. (*See Art. 2232 of the Civil Code*).

**Home Insurance Company v. American
Steamship Agencies, Inc., et al.
L-25599, Apr. 4, 1968**

FACTS: A ship was employed as a *private carrier* (not as a common carrier). In the contract (charter party) it was agreed that the ship would be exempted from liability in case of loss. Is such a stipulation valid?

HELD: Generally, yes. The Civil Code provisions on common carriers should not be applied where the carrier is not acting as such but as a *private carrier*. The stipulation in the charter party absolving the owner of the ship from liability for loss due to the negligence of its agents would be void only if the strict public policy governing common carriers would be applied. Such policy has no force where the public at large is not involved, as in the case of a ship totally chartered for the use of a single party.

(3) Liability for Damages if Common Carriage Has Been Transferred

**Perez v. Gutierrez
53 SCRA 149**

It is the registered owner of the common carrier, not the transferee of his rights (which transfer is not yet registered), who is liable for damages resulting from the breach of contract of common carriage, BUT the transferee is liable to the registered owner for said damages.

(4) Prescription

The prescriptive period of one year established in the Carriage of Goods by Sea Act modified *pro tanto* the provisions of Act No. 190 as to goods transported to and from Philippine ports in *foreign trade*, the former being a special act, while the latter is a law of general application. (*Chua Hay v. Everett Steamship Corporation*, 50 O.G. No. 1, p. 159; *Go Chan & Co. v. Aboitiz and Co.*, L-8319, Dec. 29, 1955). The pendency of an extrajudicial claim for damages filed with the carrier does NOT suspend the running of the prescriptive period of one year, unless there is an express agreement to the contrary. (*Ibid.*)

Art. 1732. Common carriers are persons, corporations, firms or associations engaged in the business of carrying or transporting passengers or goods or both, by land, water, or air, for compensation, offering their services to the public.

COMMENT:

(1) Test Whether Carrier Is Common or Private

An oft-relied upon test may be used to determine if a given carrier at a given place and at a given time is private or common. Is it generally obliged to carry *all persons indifferently* as long as they apply for passage, and as long as there is *room and no* legal excuse for refusing? If the answer is in the *affirmative*, the carrier is a *common carrier*; otherwise, it is a *private one*. (*Vinton v. R. Co.*, 11 *Alen [Mass]* 309; 87 *Am. Dec.* 714.)

Our Supreme Court has enunciated the *dictum* that:

“In the case of common carriers, the general public is given a RIGHT which the law compels the owner to give. The true criterion by which to judge the character of the use of a carrier is whether the public may enjoy it by RIGHT or only by PERMISSION.” (*United States v. Tan Piaco*, 40 *Phil.* 853).

Indeed, it is a common carrier if it has the duty to carry ALL ALIKE. (*See U.S. v. Quinajon*, 31 *Phil.* 189).

(2) Distinction Between a ‘Common or Public Carrier’ and a ‘Private or Special Carrier’

**Philippine American General Insurance
Co. v. PKS Shipping Co.
GR 149038, Apr. 9, 2003**

Such distinction lies in the character of the business, *i.e.*, 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 (*Planters Products, Inc. v. CA*, GR 101503, Sept. 15, 1993),

the person or corporation providing such service could very well be just a private carrier.

A typical case is that of a charter party which includes both the vessel and its crew, such as in a bareboat or demise, where the charterer obtains the use and service of all or some part of a ship for a period of time or a voyage or voyages (*National Steel Corp. v. CA, GR 112897, Dec. 12, 1997*) and gets the control of the vessel and its crew. (*Ibid.*).

[**NOTE:** The prevailing doctrine in the question is that enunciated in the leading case of *De Guzman v. CA* (168 SCRA 612). Applying Art. 1732 of the Civil Code, in conjunction with Sec. 13(b) of the Public Service Act, the Supreme Court has held: “The above Article 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’). Art. 1732 also carefully avoids making any distinction between a person or enterprises offering transportation services on a *regular or scheduled basis* and one offering such service on an *occasional, episodic, or unscheduled basis*. Neither does Art. 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. Art. 1732 deliberately refrained from making such distinctions. So understood, the concept of ‘common carrier’ under Art. 1732 may be seen to coincide neatly with the notion of ‘public service,’ under the Public Service Act (Commonwealth Act 1416, as amended) which at least partially supplements the law on common carriers set forth in the Civil Code.”].

(3) Examples

The ordinary passenger jitney, or an autobus line, or a taxi company is a common carrier. (*See Batangas Transportation Co. v. Orlanes, 52 Phil. 455*). The same may be said of a vessel licensed to engage in interisland trade. (*De Villola v. Stanley, 32 Phil. 541*). But a school bus or a funeral car or a chartered vehicle cannot be classed under the same category, for they are only private carriers.

(4) Contract of Towage

A contract of towage, it would seem, is not even a contract of carriage, whether private or common. (*Baer Senior and Co. v. Compania Maritima*, 6 Phil. 215).

(5) Some Cases**De Guzman v. CA and Cendana
L-47822, Dec. 22, 1988**

The term “common carriers” as defined by Art. 1732 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”). Said proviso 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 the proviso 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. It is believed that said proviso deliberately refrained from making such distinctions.

**Chua Yek Hong v. IAC, et al.
GR 74811, Sep. 30, 1988**

Considering the “real and hypothecary nature” of liability under maritime law, the provisions of the Civil Code on common carriers would not have any effect on the principle of limited liability for shipowners and shipagents.

In arriving at this conclusion, the fact is not ignored that the ill-fated SS *Negros*, as a vessel engaged in interisland trade, is a common carrier, and that the relationship between the petitioner and the passenger who died in the mishap rests on a contract of carriage. But assuming that petitioner is liable for a breach of contract of carriage, the exclusively real and hypothecary nature of maritime law operates to limit such liability to the value of the vessel, or to the insurance

thereon, if any. In the instant case, it does not appear that the vessel was insured.

In other words, the primary law is the Civil Code (Arts. 1732-1766) and in default thereof, the Code of Commerce and other special laws are applied. Since the Civil Code contains no provisions regulating liability of shipowners or agents in the event of total loss or destruction of the vessel, it is the provision of the Code of Commerce, more particularly Art. 587, that governs in this case.

**FGU Insurance Corp. v. G.P. Sarmiento Trucking
Corp. & Lambert M. Eroles
GR 141910, Aug. 6, 2002**

FACTS: G.P. Sarmiento Trucking Corp. (GPS) undertook to deliver on Jun. 18, 1994 30 units of Condura S.D. white refrigerator aboard one of its Isuzu trucks, driven by Lambert Eroles, from the plant site of Concepcion Industries, Inc. (C11), along South Superhighway in Alabang, Metro Manila, to the Central Luzon Appliances in Dagupan City. While the truck was traversing the north diversion road along McArthur Highway in Barangay Anupol, Bamban, Tarlac, it collided with an unidentified truck, causing it to fall into a deep canal, resulting in damage to the cargoes.

FGU Insurance Corp., an insurer of the shipment, paid to C11, the value of the covered cargoes in the sum of P204,450. FGU, in turn, being the subrogee of the rights and interests of C11, sought reimbursement of the amount it had paid to the latter from GPS. Since the trucking company failed to heed the claim, FGU filed a complaint for damages and breach of contract of carriage against GPS and its driver. Lambert Eroles with the RTC Br. 66 of Makati City. In its answer, respondents asserted that GPS was the exclusive hauler only of C11, since 1988, and it was not so engaged in business as a common carrier. Respondents further claimed that the cause of damage was purely accidental. FGU presented its evidence, establishing the extent of damage to the cargoes and the amount it had paid to the assured. GPS, instead of submitting its evidence, filed with leave of count of motion to dismiss the complaint by way of demurrer to evidence on

the ground that petitioner had failed to prove that it was a common carrier.

The trial court, in its order of Apr. 29 1996, granted the motion to dismiss. The subsequent motion for reconsideration having been denied, plaintiff interposed an appeal to the Court of Appeals (CA), contending that the trial court had erred: (a) in holding that the appellee corporation was not a common carrier defined under the law and existing jurisprudence; and (b) in dismissing the complaint on a demurrer to evidence. The CA rejected the appeal of petitioner and ruled in favor of GPS. Petitioner's motion for reconsideration was likewise denied, hence, the instant petition.

ISSUES: (1) Whether respondent GPS may be considered as a common carrier as defined under the law and existing jurisprudence; (2) Whether respondent GPS, either as a common carrier or a private carrier, may be presumed to have been negligent when the goods it undertook to transport safely were subsequently damaged while in its protective custody and possession; and (3) Whether the doctrine of *res ipsa loquitur* is applicable in the instant case.

HELD: (1) The Supreme Court finds the conclusion of the trial court and the CA to be amply justified. GPS, being an exclusive contractor and hauler of C11, rendering or offering its services to no other individual or entity, cannot be considered a common carrier.

(2) GPS cannot escape from liability. Respondent trucking corporation recognizes the existence of a contract of carriage between it and petitioner's assured, and admits that the cargoes it has assumed to deliver have been lost or damaged while in its custody. In such a situation, a default on, or failure or compliance with, the obligation — in this case, the delivery of goods in its custody to the place of destination — gives rise to a presumption of lack of care and corresponding liability on the part of the contractual obligor the burden being on him to establish otherwise. GPS has failed to do so.

(3) *Res ipsa loquitur*, a doctrine being invoked by petitioner, holds a defendant liable where the thing which caused the injury complained of is shown to be under the latter's management and the accident is such that, in the

ordinary course of things, cannot be expected to happen if those who have its management or control use proper care. In the case of the truck driver, in the instant case, whose liability in a civil action is predicated on *culpa acquiliana*, while he admittedly can be said to have been in control and management of the vehicle which figured in the accident, it is not equally shown, however, the accident could have been exclusively due to his negligence, a matter that can allow, forthwith, *res ipsa loquitur*, to work against him.

If a demurrer to evidence is granted but on appeal the order of dismissal is reversed, the movant shall be deemed to have waived the right to present evidence. (*Sec. 1, Rule 35, Rules of Court and Sec. 1, Rule 33, 1997 Rules of Civil Procedure*). Thus, respondent corporation may no longer offer proof to establish that it has exercised due care in transporting the cargoes of the assured so as to still warrant a remand of the case to the trial court.

The order, dated Apr. 30, 1996 of the RTC Br. 66 of Makati City, and the decisions, dated Jun. 10, 1999, of the CA, are affirmed only insofar as respondent Lambert M. Eroles is concerned, but said assailed order of the trial court and decision of the appellate court are reversed as regards GPS which, instead, is ordered to pay FGU the value of the damaged and lost cargoes in the amount of P204,450.

[**NOTE:** A contract can only bind the parties who have entered into it or their successors who have assumed their personality or their juridical position. (*Art. 1311, Civil Code*). Consonantly with the axiom *res inter alias acta aliis neque nouit protest*, such contract can neither favor nor prejudice a third person. (*FGU Insurance Corp. v. G.P. Sarmiento Trucking Corp. & Lambert M. Eroles, supra*).]

(6) Findings of Fact

Philippine American General Insurance Co. v. PKS Shipping Co. GR 149038, Apr. 9, 2003

ISSUE: Whether or not an entity is a private or common carrier on the basis of the facts found by a trial court

or the appellate court can be a valid and reviewable question of law. Otherwise put, are conclusions derived from findings of facts reviewable?

HELD: In giving its affirmance, the Supreme Court said conclusions derived from factual findings are not necessarily just matters of fact as when they are linked to, or inextricably intertwined with a requisite appreciation of the applicable law. Conclusions made in such instances could well be raised as being appropriate issues in a petition for review before the Supreme Court.

In the case under consideration, the determination of a possible liability on the part of the shipping company boils down to the question of whether it is a private carrier or a common carrier and in either case, to the other question of whether or not it has observed the proper diligence (ordinary, if a private carrier, or extraordinary, if a common carrier) required of it given the circumstances.

Art. 1733. 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 the passengers transported by them, according to all the circumstances of each case.

Such extraordinary diligence in the vigilance over the goods is further expressed in Articles 1734, 1735, and 1745, Nos. 5, 6, and 7, while the extraordinary diligence for the safety of the passengers is further set forth in Articles 1755 and 1756.

COMMENT:

Extraordinary Diligence

- (a) The hazards of modern transportation demand an *extraordinary* diligence (*See Report of the Code Commission, pp. 66-67*) in the vigilance over the goods they carry. (*Philippine American General Insurance Co. v. PKS Shipping Co., GR 149038, Apr. 9, 2003*). A common carrier is invested with public interest. (*Pangasinan Trans. Co. v. Pub. Serv. Com., 70 Phil. 221*).

- (b) The relationship between common carrier and shipper contains factors which make up the concept of trust. (*Yu Con v. Ipil*, 41 Phil. 770). However, a common carrier should not be considered as an absolute insurer against all risks of travel. (*Lasam v. Smith*, 45 Phil. 657).

Zulueta v. Pan American World Airways, Inc.
43 SCRA 397

Passengers should be treated by the employees of an airplane carrier with kindness and courtesy and should be protected against indignities, abuses, and injurious language from such employees. In case of breach of contract, the airline company should be liable for damages. Be it noted further that the contract of common air carriage generates a relation attended with a public duty.

Davila v. Phil. Air Lines
49 SCRA 497

If passengers of an air carrier are injured or killed, the air carrier is presumed to have been at fault or to have acted negligently. To escape liability, the carrier must prove it observed *extraordinary diligence* as prescribed in Arts. 1733 and 1755, Civil Code.

Samar Mining Co. v. Nordeutecher Lloyd
L-28873, Oct. 23, 1984

A vessel is liable as a common carrier only up to the point of destination. After that, in case of a transshipment, it is a mere agent of the consignee and will not be liable for loss or damage in the absence of its own negligence or malice.

Eastern Shipping Lines, Inc. v. CA
GR 94151, Apr. 30, 1991

FACTS: On Sept. 4, 1978, 13 coils of uncoated-wire stress relieved wire strand for prestressed concrete were shipped on board a vessel owned by defendant Eastern Shipping, at Kobe, Japan, for delivery to Stressteck Inc. in

Manila, insured by First Nationwide Assurance Corporation for P171,923. The carrying vessel arrived in Manila and discharged the cargo to Razon's custody from the consignee's warehouse. A year later, Nationwide Assurance indemnified Stressteck in the amount of P171,923 for damage and loss of the insured cargo, whereupon Nationwide was subrogated for Stressteck. Nationwide now seeks to recover from Eastern Shipping what it has indemnified Stressteck, less P48,293, the salvage value of the merchandise of P123,629. The trial court dismissed the complaint. The Court of Appeals set aside the decision of the trial court and ordered Eastern Shipping to pay Nationwide P123,629, with legal rate of interest.

HELD: The Supreme Court sustained the Court of Appeals and held that while the cargo was delivered to while the cargo was delivered to the arrastre operator in apparent good order condition it is also undisputed that while en route from Kobe to Mamla, the vessel encountered "very rough seas and stormy weather, the coils wrapped in burlap cloth and cardboard paper were stored in the lower hatch of the steel which was flooded with water about one foot deep. The water entered the hatch. A survey of bad order cargo conducted in the Pier in the presence of representatives of the consignee and the arrastre operator showed that seven coils were rusty on one side. The survey conducted at the consignee's warehouse showed that the wetting of the cargo was caused by fresh water that entered the hatch when the vessel encountered heavy rains en route to Manila. All thirteen coils were rusty and totally unsuitable for the intended purpose. The heavy seas and rains referred to in the master's report were not *caso fortuito*, but normal occurrences that an ocean-going vessel, particularly in the month of September which, in our area, is a month of rains and heavy seas would encounter as a matter of routine. They are not unforeseen nor unforeseeable. These are conditions that an ocean-going vessel would encounter and provide for, in the ordinary course of a voyage. That rain water (not sea water) found its way into the holds of the ship indicates that care and foresight did

not attend the closing of the ship's hatches so that rain water would not find its way into the cargo holds of the ship. Since the carrier has failed to establish any *caso fortuito*, the presumption by law of fault or negligence on the part of the carrier applies. The carrier must present evidence that it has observed the extraordinary diligence required by Article 1733 of the Civil Code in order to escape liability for damage or destruction to the goods that it had admittedly carried. No such evidence exists. Thus, the carrier cannot escape liability. The presumption is that the cargo was in apparent good condition when it was delivered by the vessel to the arrastre operator but the clean tally sheets has been overturned and traversed. The damage to the cargo was suffered while aboard the shipowner's vessel.

**Belgian Overseas Chartering & Shipping N.V.
and Jardine Davies Transport Services, Inc.
v. Phil. First Insurance Co., Inc.
GR 143133, Jun. 5, 2002**

FACTS: On Jun. 13, 1990, CMC Trading A.G. shipped on board the M/V 'Anangel Sky' at Hamburg, Germany 242 coils of various Prime Coiled Steel sheets for transportation to Manila consigned to the Philippine Steel Trading Corp. (PSTC). On Jul. 28, 1990, M/V Anangel Sky arrived at the Port of Manila and, within the subsequent days, discharged the subject cargo. Four coils were found to be in bad order. Finding the coils in their damaged state to be unfit for the intended purpose, consignee PSTC delared the same as total loss.

Despite receipt of a formal demand, defendants-appellees refused to submit to consignee's claim. Consequently, plaintiff-appellant paid consignee P506,086.50, and was subrogated to the latter's rights and causes of action against defendants-appellees. Subsequently, plaintiff-appellant instituted this complaint for recovery of the amount paid by them, to the consignee as insured.

Impugning the propriety of the suit against them, defendants-appellees imputed that the damage and/or loss was due to preshipment damage, to the inherent nature, vice or defect of the goods, or to perils, danger and accidents of the sea, or

to sufficiency of packing thereof, or to the act or omission of the shipper of the goods or their representatives.

In addition thereto, defendants-appellees argued their liability, if there be any, should not exceed the limitations of liability provided for in the bill of lading and other pertinent laws. Finally, defendants-appellees averred that, in any event, they exercised due diligence and foresight required by law to prevent any damage/loss to said shipment.

ISSUE: Whether petitioners have overcome the presumption of negligence of a common carrier.

HELD: Proof of delivery of goods in good order to a common carrier and of their arrival in bad order at their destination constitutes *prima facie* fault or negligence on the part of the carrier. If no adequate explanation is given as to how the loss, destruction, or deterioration of the goods happened, the carrier shall be held liable therefor.

That petitioners failed to rebut the *prima facie* presumption of negligence is revealed by a review of the records and moreso by evidence adduced by respondent. Thus:

1. As stated in the Bill of Lading, petitioners received the subject shipment in good order and condition in Hamburg, Germany.

2. Prior to the unloading of the cargo, on Inspection Report prepared and signed by representatives of both parties showed the steel bands broken, the metal envelopes rust-stained and heavily buckled, and the contents thereof exposed and rusty.

3. Bad Order Tally Sheet issued by Jardine Davies Transport Services, Inc., stated that the four coils were in bad order and condition. Normally, a request for a bad order survey is made in case there is an apparent or a presumed loss or damage. (*International Container Services, Inc. v. Prudential Guarantee & Assurance Co., Inc.*, 320 SCRA 244 [1999]).

4. The Certificate of Analysis stated that, based on the sample submitted and tested, the steel sheets found in bad order were wet with fresh water.

5. Petitioners — in a letter — addressed to the Philippine Steel Coating Corp. and dated Oct. 12, 1990 — admitted that they were aware of the conditions of the four coils found in bad order and condition.

All these conclusively proved the fact of shipment in good order and condition and the consequent damage to the four coils while in the possession of petitioner. (*Tabuena Insurance Co. v. North Front Shipping Services, Inc.*, 272 SCRA 527 [1997]), who notably failed to explain why. (*Ibid.*)

Subsection 2

VIGILANCE OVER GOODS

Art. 1734. Common carriers are responsible for the loss, destruction, or deterioration of the goods, unless the same is due to any of the following causes only:

(1) Flood, storm, earthquake, lightning, or other natural disaster or calamity;

(2) Act of the public enemy in war, whether international or civil;

(3) Act or omission of the shipper or owner of the goods;

(4) The character of the goods or defects in the packing or in the containers;

(5) Order or act of competent public authority.

COMMENT:

(1) When Common Carrier Is Not Liable

In the instances enumerated in this article, the common carrier is NOT responsible. However, if there be *fault* on the part of the carrier, it will be LIABLE. (*See Art. 1739*).

Philippine American General Insurance Company v. PKS Shipping Company GR 149038, Apr. 9, 2003

FACTS: Davao Union Marketing Corp. (DUMC) contracted the services of respondent PKS Shipping Co. (PKS)

for the shipment to Tacloban City of 75,000 bags of cement worth P3,375,000. DUMC insured the goods for its full value with petitioner Philippine American General Insurance Co. (Philamgen). The goods were loaded aboard the barge *Limar I* belonging to PKS Shipping. On Dec. 22, 1993, about 9 p.m., while *Limar I* was being towed by respondent's tugboat, *MT Iron Eagle*, the barge sank a couple of miles off the coast of Dumagasa Point, in Zamboanga del Sur, bringing down with it the entire cargo of 75,000 bags of cement. DUMC filed a formal claim with Philamgen for the full amount of the insurance. Philamgen promptly made payment; it then sought reimbursement from PKS Shipping of the sum paid to DUMC but the shipping company refused to pay.

HELD: As gathered from testimonies and sworn marine protests of the respective vessel masters of *Limar I* and *MT Iron Eagle*, there was no way by which the barge's or the tugboats crew could have prevented the sinking of *Limar I*. The vessel was suddenly tossed by waves of extraordinary height of 6-8 ft. and buffeted by strong winds of 1.5 knots resulting in the entry of water into the barge's hatches. The official Certificate of Inspection of the barge issued by the Philippine Coastguard and the Coastwise Load Line Certificate would attest to the seaworthiness of *Limar I*. All given then, PKS is absolved from liability for the loss of the DUMC cargo.

(2) Burden of Proof

- (a) The owner of a vessel is obliged to prove that the damage was caused by one of the excepted causes if it seeks exemption from responsibility. (*Martini Limited v. Macondray and Co.*, 39 Phil. 934).
- (b) If the parties agreed that the payment of the price of the copra sold was to be according to the "net landed weight" upon arrival in New York, the vendor has the burden of proof to show that the shortage in weight upon arrival was due to the risks of the voyage and not to the natural drying up of the copra while in transit. (*General Foods Corporation v. Nat. Coconut Corp.*, L-8717, Nov. 20, 1956, 53 O.G. 652).

(3) Concept of ‘Public enemy’

This refers to the government with which the country of the carrier is at *war*; also to *pirates*, who are enemies of all mankind. (*See 9 Am. Jur.*, p. 860).

(4) Act or Omission

The “act or omission of the shipper or owner of the goods” may be willful or negligent. (*See 9 Am. Jur.*, p. 865).

(5) Order or Act of Competent Public Authority

“Order or act of competent public authority”: may refer to destruction or seizure because the goods may be “prohibited goods” or “dangerous to life and property” or “infected with disease.” Over and above contractual stipulations is POLICE POWER. (*See 9 Am. Jur.*, pp. 861-862).

Art. 1735. In all cases other than those mentioned in Nos. 1, 2, 3, 4, and 5 of the preceding article, if the goods are lost, destroyed or deteriorated, common carriers are presumed to have been at fault or to have acted negligently unless they prove that they observed extraordinary diligence as required in Article 1733.

COMMENT:**(1) Presumption of Fault or Negligence****(a) General Rule**

Carrier is presumed at fault. (*Tan Lico v. American President Lines, Ltd.*, 98 Phil. 203).

(b) Exceptions (Nos. 1 to 5, Art. 1734)

Here, the carrier is NOT presumed to be at fault. (*Gov’t. v. Ynchausti*, 40 Phil. 219). But shipper may prove carrier’s fault, in which case the carrier will be liable. (*NOTE: Here the onus probandi will be on the shipper.*) (*G. Martini, Ltd. v. Macondray and Co.*, 39 Phil. 934).

**Philippine American General Insurance
Co. v. PKS Shipping Co.
GR 149038, Apr. 9, 2003**

Art. 1735 provides that in case of loss, destruction, or deterioration of goods, common carriers are presumed to have been at fault or to have acted negligently and the burden of proving otherwise rests on them.

[**NOTE:** Carriers or depositaries sometimes require the presentation of claims within a short period of time after delivery as a condition precedent to their liability for losses. Such a requirement is not empty formalism. It has a definite purpose, *i.e.*, to afford the carrier or depositary a reasonable opportunity as well as facilities to check the validity of the claims while the facts are still fresh in the minds of the persons who took part in the transaction and documents are still available. (*Consunji, et al. v. Manila Port Service, et al.*, L-15551, Nov. 29, 1960).]

(2) Defense Under Art. 1735

The carrier must prove *extraordinary diligence*. If the employees were at fault, the carrier is necessarily at fault, in view of the master and servant rule in *culpa contractual*; and here, due diligence by the carrier in the selection and supervision of its employees would *not* be a complete and valid defense. (See *MRR v. Compania Transatlantica*, 38 Phil. 875). The owner of a vessel who had caused the same to sail *without* licensed officers, is liable for the injuries caused by the collision *over and beyond* the value of his vessel; hence, he cannot escape liability because of the sinking of the vessel. (*Manila Steamship Co. v. Insa Abdulhanan and Lim Hong To*, L-9534, Sept. 29, 1956, 52 O.G. 7587).

Art. 1736. 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, without prejudice to the provisions of Article 1738.

COMMENT:**(1) Reason for the Extraordinary Responsibility of the Common Carrier**

The carrier is in POSSESSION, so it must be responsible. (*Yu Con v. Ipil*, 41 Phil. 770). The obligation of the carrier to carry the goods includes the duty *not to delay* their transportation, so that if the goods are lost or damaged by reason of an unjustified delay, the carrier is held liable therefor. (*Tan Liao v. American President Lines, Ltd.*, 98 Phil. 203).

(2) When Liability may be Limited

If the property has been turned over to the *customs authorities*, it is permissible here to limit the liability of the carrier although strictly speaking, the consignee has *not* yet received the goods. (*Lu Do v. Binamira*, 101 Phil. 120).

(3) Misdelivery

If a carrier delivers to the WRONG person, there is a misdelivery for which it can be held responsible. And this is true even if the shipper has already attempted to recover from such WRONG person. (*Tan Pho v. Dalamal*, 67 Phil. 555).

Ang v. Compania Maritima
L-30806, Dec. 26, 1984

An action for damages because of *misdelivery* of cargo by an ocean-going liner (a common carrier) prescribes in 10 years from the time of the accrual of the cause of action (if the action is based on a written contract) or in 4 years if the suit is based on a quasi-delict. Hence, if action is filed 3 years after accrual, no prescription has set in. In case of *loss of cargo*, the period is only one (1) year.

Art. 1737. The common carrier's duty to observe extraordinary diligence in the vigilance over the goods remains in full force and effect even when they are temporarily unloaded or stored in transit, unless the shipper or owner has made use of the right of stoppage *in transitu*.

COMMENT:**(1) Continuing Liability**

Note that liability exists even if the goods are:

- (a) temporarily unloaded, or
- (b) stored in transit.

(2) Exception

Exception is when the right of *stoppage in transitu* has been exercised. Here, strictly speaking, there is no more contract of carriage. And the carrier as depositary, will also be liable as such depositary, and *not as carrier*. (9 *Am. Jur.* 829).

Art. 1738. The extraordinary liability of the common carrier continues to be operative even during the time the goods are stored in a warehouse of the carrier at the place of destination, until the consignee has been advised of the arrival of the goods and has had reasonable opportunity thereafter to remove them or otherwise dispose of them.

COMMENT:**Liability While in the Warehouse**

Here, for the extraordinary liability to continue, the right of *stoppage in transitu* must *not* have been exercised.

Art. 1739. In order that the common carrier may be exempted from responsibility, the natural disaster must have been the proximate and only cause of the loss. However, the common carrier must exercise due diligence to prevent or minimize loss before, during and after the occurrence of flood, storm, or other natural disaster in order that the common carrier may be exempted from liability for the loss, destruction, or deterioration of the goods. The same duty is incumbent upon the common carrier in case of an act of the public enemy referred to in Article 1734, No. 2.

COMMENT:**Natural Disaster Being the Cause**

If the proximate cause is a combination of both natural disaster and negligence, the carrier is also liable. (*9 Am. Jur.* 864). In case of collision between two vessels imputable to their mutual fault, each vessel shall suffer her own damage and both shall be solidarily liable for the damages occasioned to their cargoes. (*Art. 827, Code of Commerce and Manila Steamship Co. v. Insa Abdulhanan, L-9534, Sept. 29, 1956*).

**Philippine American General Insurance Co.,
Inc. v. MGG Marine Services, Inc. &
Doroteo Gaerlan
GR 135645, Mar. 8, 2002**

FACTS: This petition for review seeks the reversal of a Court of Appeals (CA) decision which absolved private respondents MCG Marine Services, Inc. and Doroteo Gaerlan of any liability regarding the loss of the cargo belonging to San Miguel Corp. (SMC) due to the sinking of the M/V Peatheray Patrick-G (M/V PP-G) owned by Gaerlan with MCG Marine Services, Inc. as agent. SMC insured beer bottle cases with an aggregate value of P5,836,222.80 with petitioner Philippine American General Insurance Co. The cargo were loaded on board the M/V PP-G to be transported from Mandaue City to Bislig, Surigao del Sur.

The weather was calm when the vessel started its voyage. But the following day, M/V PP-G listed and subsequently sunk off Cawit Point, Cortes, Surigao del Sur. As a consequence thereof, the cargo belonging to SMC was lost. The latter, as a subsequence, claimed the amount of its loss from petitioner. Upon investigation, it was found out that the proximate cause of the listing and subsequent sinking of the vessel was the shifting of ballast water from starboard to portside, and which allegedly affected the stability of M/V PP-G. Thereafter, petitioner paid SMC the full amount of P5,836,222.80 pursuant to the terms of their insurance contract. Petitioner as subrogee of SMC thereupon filed with the Makati RTC a collection case against private respondents to recover the amount it paid to SMC for the loss of the latter's cargo.

Meanwhile, the Board of Marine Inquiry (BMI) conducted its own investigation of the sinking of M/V PP-G. After 1/2 years, the Board rendered its decision exonerating the captain and crew of the ill-fated vessel for any administrative liability. It found that the cause of the vessel's sinking was existence of strong winds and enormous waves in Surigao del Sur, a fortuitous event that could not have been foreseen at the time M/V PP-G left the port of Mandaue City, and further holding that said fortuitous even was the proximate and only cause of the vessel's sinking.

Accordingly, the Makati RTC promulgated its decision finding private respondents solidarily liable for the loss of SMC's cargo and ordering them to pay petitioner the full amount of the lost cargo plus legal interest, attorney's fees, and costs of suit. Private respondents appealed the trial court's decision to the Court of Appeals (CA). The latter issued the assailed decision, which reversed the RTC's ruling. The CA held that private respondents could not be held liable for the loss of SMC's cargo because said loss occurred as a consequence of a fortuitous event, and that such fortuitous even was proximate and only cause of the loss. Petitioner, thus, filed the present petition.

ISSUES: Whether the loss of the cargo was due to the occurrence of a natural disaster, and if so, whether such national disaster was the sole and proximate cause of the loss or whether private respondents were partly to blame for failing to exercise due diligence to prevent the loss of the cargo.

HELD: Common carriers, from the nature of their business and for reasons of public policy, are mandated to observe extraordinary diligence in the vigilance over the goods and for the safety of the passengers transported by them. (*Art. 1733 [par. 1]*). Owing to this high degree of diligence required of them, common carriers as a general rule, are presumed to have seen at fault or negligent if the goods transported by them are lost, destroyed, or if the same deteriorated. However, this presumption of fault or negligence does not arise in the case enumerated under Art. 1734. In order that a common carrier may be absolved from liability where the loss, destruction, or deterioration of the goods is due to a natural disaster or calamity, it must further be shown that such natural disaster or calamity was the proximate cause of the loss (*Art. 1739*)

there must be an entire exclusion of human agency from the cause of the injury or the loss.

Even in cases where a natural disaster is the proximate and only cause of the loss, a common carrier is still required to exercise due diligence to prevent or minimize loss before, during, and after the occurrence of the natural disaster, for it to be exempt from liability under the law for the loss of the goods. (*Art. 1739*). (*Yobido v. CA*, 281 SCRA 1 [1997]). If a common carrier fails to exercise due diligence — or that ordinary care which the circumstances of the particular case demand (*See Compania Maritima v. Insurance Co. of North America*, 12 SCRA 213 [1964]) — to preserve and protect the goods carried by it on the occasion of a natural disaster, it will be deemed to have been negligent, and the loss will not be considered as having been due to a natural disaster under Art. 1734(1).

In the instant controversy, although the BMI ruled only on the administrative liability of the captain and crew of M/V PP-G, it had to conduct a thorough investigation of the circumstances surrounding the sinking of the vessel and the loss of its cargo in determining their responsibility, if any. The results of its investigation as embodied in its decision on the administrative case clearly indicate that the loss of the cargo was due solely to the attendance of strong winds and huge waves which caused the vessel to accumulate water, tilt to the port side, and to eventually keel over. There was, thus, no error on the part of the CA in relying on the factual findings of the BMI, for such factual findings, being supported by substantial evidence are persuasive, considering that said administrative body is an expert in matters concerning marine casualties. (*See Vasquez v. CA*, 138 SCRA 553 [1985]).

Since the presence of strong winds and enormous waves at Cortes, Surigao del Sur shown to be the proximate and only cause of the sinking of M/V PP-G and the loss of the cargo belonging to SMC, private respondents cannot be held liable for the said loss. The assailed CA Decision is affirmed and the petition denied.

Art. 1740. If the common carrier negligently incurs in delay in transporting the goods, a natural disaster shall not free such carrier from responsibility.

COMMENT:**(1) Effect of Default Caused by Negligence**

If the natural disaster occurs when the carrier is already in default (because of its negligence), the carrier can still be held liable.

(2) BAR

Under what circumstances is the carrier liable for the losses and deterioration suffered by the goods transported by reason of fortuitous events, *force majeure*, or the inherent nature and defects of the goods?

ANS.:

- (a) If the carrier is in default. (*Art. 1740*).
- (b) If the carrier did not exercise due diligence to prevent or minimize the loss. (*Arts. 1739 and 1742*).

Art. 1741. 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.

COMMENT:**Contributory Negligence of the Shipper or Owner**

The contributory fault of the shipper or owner *reduces* the carrier's liability. The carrier's negligence must of course still be the proximate cause.

Art. 1742. 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.

COMMENT:**If Cause Be the Character of the Goods or Faulty Packing**

This Article stresses the duty of the carrier to prevent or minimize the loss, even if it was not at fault.

Art. 1743. If through the order of public authority the goods are seized or destroyed, the common carrier is not responsible, provided said public authority had power to issue the order.

COMMENT:**Seizure or Destruction by Order of Public Authority**

The public authority must have had the power, not merely apparent power.

Art. 1744. A stipulation between the common carrier and the shipper or owner limiting the liability of the former for the loss, destruction, or deterioration of the goods to a degree less than extraordinary diligence shall be valid, provided it be:

- (1) In writing, signed by the shipper or owner;**
- (2) Supported by a valuable consideration other than the service rendered by the common carrier; and**
- (3) Reasonable, just and not contrary to public policy.**

COMMENT:**Diligence Less Than Extraordinary**

- (a) Note that the three requisites are necessary. Note also that if the stipulation is oral, said stipulation is VOID.

Moreover, the diligence, while less than *extraordinary*, should NOT be less than *ordinary*. (See Art. 1745, No. 4).

- (b) If there be a reduction in the freight or rate, there is a sufficient “valuable consideration,” which can *limit* but *not exempt* the carrier’s liability for negligence. (*See 9 Am. Jur. 870; Art. 1758*).

Art. 1745. Any of the following or similar stipulations shall be considered unreasonable, unjust and contrary to public policy:

(1) That the goods are transported at the risk of the owner or shipper;

(2) That the common carrier will not be liable for any loss, destruction, or deterioration of the goods;

(3) That the common carrier need not observe any diligence in the custody of the goods;

(4) 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;

(5) That the common carrier shall not be responsible for the acts or omissions of his or its employees;

(6) 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;

(7) 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.

COMMENT:

Void Stipulations

- (a) The seven stipulations enumerated in the Article are void.
- (b) *Meaning of No. (1):* Necessarily, goods are transported at the risk of the owner or shipper. Thus, when goods are lost by a fortuitous event, the owner or shipper bears

the loss. What No. (1) of Art. 1745 means is simply that it is unreasonable, unjust and contrary to public policy to stipulate that the owner or shipper bears the risk or loss in ALL cases.

(c) Case:

Pedro de Guzman v. CA & Ernesto Cendaña
L-47822, Dec. 22, 1988

FACTS: Armed men held up the second truck owned by private respondent which carried petitioner's cargo. The record shows that an information for robbery in band was filed in the CFI (now RTC) of Tarlac, Branch 2, in Criminal Case No. 198 entitled "*People of the Phils. v. Felipe Boncorno, Napoleon Presno, Armando Mesina, Oscar Oria and one John Doe.*"

There, the accused were charged with wilfully and unlawfully taking and carrying away with them the second truck, driven by Manuel Estrada and loaded with 600 cartons of *Liberty* filled milk destined for delivery at petitioner's store in Urdaneta, Pangasinan. The decision of the trial court shows that the accused acted with grave, if not irresistible, threat, violence or force. Three (3) of the five (5) hold-uppers were armed with firearms. The robbers not only took away the truck and its cargo but also kidnapped the driver and his helper, detaining them for several days and later releasing them in another province (in Zambales). The hijacked truck was subsequently found by the police in Quezon City. The CFI (now RTC) convicted all the accused of robbery, though not of robbery in band.

HELD: In these circumstances, the occurrence of the loss must reasonably be regarded as quite beyond the control of the common carrier and properly regarded as a fortuitous event. It is necessary to recall that even common carriers are not made absolute insurers against all risks of travel and of transport of goods, and are not held liable for acts or events which cannot be foreseen or are inevitable, provided that they shall have complied with the rigorous standard of extraordinary diligence. Accordingly, therefore, private respondent Cendana is not liable for the value of the undelivered merchandise

which was lost because of an event entirely beyond private respondent's control.

Art. 1746. An agreement limiting the common carrier's liability may be annulled by the shipper or owner if the common carrier refused to carry the goods unless the former agreed to such stipulation.

COMMENT:

When Stipulation Is Vitiating by Threat or Undue Influence

- (a) The agreement here is only voidable, not *void*.
- (b) *Reason for the Article:* There is a sort of threat or undue influence here.
- (c) Note that no judicial action is needed for the annulment.

Art. 1747. If the common carrier without just cause, delays the transportation of the goods or changes the stipulated or usual route, the contract limiting the common carrier's liability cannot be availed of in case of the loss, destruction, or deterioration of the goods.

COMMENT:

Effect of Default or Change of Route

Limited liability, even if previously agreed upon, cannot be availed of in case of:

- (a) unjustified DEFAULT,
- (b) or unjustified CHANGE OF ROUTE.

Art. 1748. An agreement limiting the common carrier's liability for delay on account of strikes or riots is valid.

COMMENT:

Effect of Strikes or Riots

The Article is self-explanatory. Whether the strikes are legal or illegal is immaterial.

Art. 1749. 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.

COMMENT:

(1) Stipulation Limiting Carrier's Liability

This rule was enunciated in *Heacock Co. v. Macondray and Co.*, 42 Phil. 205; *Freixas and Co. v. Pac. Mail Steamship Co.*, 42 Phil. 198.

(2) Rule in Carriage of Goods by Sea Act

The provision in Sec. 4(5) of the Carriage of Goods by Sea Act stating that the carrier shall not be liable in an amount exceeding \$500 per package unless the value of the goods had been declared by the shipper and inserted in the bill of lading is similar to Art. 1749 of the Civil Code. (See *American President Lines, Ltd. v. Klepper, et al.*, L-15671, Nov. 29, 1960).

(3) Cases

**Belgian Overseas Chartering & Shipping
N.V. v. Phil. First Insurance Co.
GR 143133, Jun. 5, 2002**

Under the COGSA, the notice of claim need not be given if the state of the goods, at the time of their receipt, has been the subject of a joint inspection or survey.

Failure to file a notice of claim within 3 days will not bar recovery if it is nonetheless filed within 1 year. This 1-year prescriptive period also applies to the shipper, the consignee, the insurer of the goods or any legal holder of the bill of lading.

A stipulation in the bill of lading limiting to a certain sum of the common carriers liability for loss or destruction of a cargo unless the shipper or owner declares a greater value is sanctioned by law. There are, however, two (2) conditions to be satisfied: (1) the contract is reasonable and just under

the circumstances; and (2) it has been fairly and freely agreed upon by the parties.

**Wallem Philippines Shipping, Inc. & Seacoast
Maritime Corp. v. Prudential Guarantee
& Assurance, Inc. and CA
GR 152158, Feb. 7, 2003**

FACTS: Private respondent Prudential Guarantee & Assurance, Inc. brought an action for damages and attorney's fees against Wallem Philippines Shipping Inc. and Seacoast Maritime Corp. Prudential sought the recovery of the sum of P995,677, representing the amount it had paid to its insured, General Milling Corp. (GMC), for alleged shortage incurred in the shipment of "Indian Toasted Soyabean Extraction Meal, Yellow," with 6% legal interest thereon from the date of filing of the complaint up to and until the same is fully paid, and 25% of the claim as attorney's fees.

In its answer, Wallen denied liability for damage or loss to the shipment. It was alleged that:

1. the complaint did not state a cause of action against it;
2. Prudential, Wallen, and Seacoast were not the real parties-in-interest;
3. the action had prescribed;
4. the damage or loss, if any, was due to the inherent vice or defect of the goods, or to perils, dangers, and accidents of the sea, for which Wallen was not liable;
5. the damage or loss to the shipment was due to an act or omission of Prudential or the owner of the goods or their representative, or to pre-shipment damage for which Wallen was not liable;
6. the shipment was carried on a "shipper's description of pages and content," "said to weigh," "in bulk," and "free out" basis;
7. based on the provisions of the bill of lading, Prudential had the burden of proving the actual quantity of cargo loaded at the loading port;

8. Prudential had not contract with Wallen, which acted as a mere agent of a disclosed principal;

9. Wallen had observed the diligence required under the law in the care of the shipment;

10. the shipment was discharged in the same quantity as when it was loaded at the port of loading;

11. any loss incurred during and after discharge from the vessel was no longer the responsibility of the carrier;

12. Wallen could not be made liable for the loss or damage, if any, of the goods which happened whilst the same were not on its possession and control;

13. Prudential's claim was excessive and exaggerated; and

14. Wallen's liability, if any, should not exceed the invoice value of the alleged loss or to applicable package limitation, whichever was lower, or the limit of liability set in the bill of lading.

Wallen filed a compulsory counterclaim against Prudential as the complaint was allegedly a clearly unfounded civil action. Wallen filed a cross-claim against its co-defendant seacoast, in the even that it was made liable by Prudential. Upon motion of Prudential's counsel, defendant Seacoast was declared in default. After termination of the pre-trial conference, this case was tried on the merits.

The trial court ruled that private respondent Prudential failed to prove by clear, convincing, and competent evidence that there was a shortage in the shipment. The court said that Prudential failed to establish by competent evidence the genuineness and due execution of the bill of lading, and, therefore, the true and exact weight of the shipment when it was loaded unto the vessel. Hence, there was no way by which a shortage could be determined. The court further ruled that the shortage, if any, could only have been incurred either before the loading of the shipment, or after the unloading of the shipment from the vessel, the latter instances being admit-

ted. Accordingly, the trial court dismissed both the complaint and the counterclaim.

On appeal, the Court of Appeals (CA) reversed and ruled that the bill of lading was *prima facie* evidence of the goods therein described, both notations “said to contain” and “weight unknown” on the bill of lading being inapplicable to shipments in bulk; that losses were incurred during the loading operations, and that these losses were the liability of the carrier. The CA also ruled that the principle of indemnity is violated if the insured is paid a benefit more than the loss incurred in light of the admission of a 20% mark-up on the indemnity paid to GMC. Petitioner Wallen moved for reconsideration, but its motion was denied. Hence, this appeal.

HELD: The CA erred in finding that a shortage had taken place with Prudential claims processor’s testimony regarding the contents of the documents considered hearsay, based as it is on the knowledge of another person not presented on the witness stand. (*See Benguet Exploration, Inc. v. CA, 351 SCRA 445 [2001]*). Nor has the genuineness and due execution of these documents been established.

In ruling that the contents of the bill of lading cannot be controverted by evidence to the contrary because it was “*prima facie* evidence of the goods therein described,” the CA further erred. Wallem’s evidence casts doubt on the veracity of the documents upon which Prudential bases its claim. There could have been no spillage while the shipment was on board the vessel because the hatches were closed. It was shown that, after the shipment was unloaded from the vessel, it was weighed with the use of GMC’s weighing scale, which was later found to be defective.

The CA’s decision and resolution is reversed and the decision of RTC Makati Br. 134, dismissing the complaint and counterclaim, is reinstated.

Art. 1750. 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.

COMMENT:**Fixing of Sum That May Be Recovered**

The Article is self-explanatory.

Art. 1751. 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.

COMMENT:**Effect of Lack of Competition**

Lack of competition may lead to undue influence.

Art. 1752. Even when there is an agreement limiting the liability of the common carrier in the vigilance over the goods, the common carrier is disputably presumed to have been negligent in case of their loss, destruction or deterioration.

COMMENT:**Presumption of Negligence Even if There Is Agreement on Limited Liability**

Note that the *presumption* of negligence is present even here.

Art. 1753. The law of the country to which the goods are to be transported shall govern the liability of the common carrier for their loss, destruction or deterioration.

COMMENT:**(1) Conflicts Rule — Law of Destination**

- (a) The law of the country of destination applies even if the goods never reach the destination, but does not apply if the goods were NEVER transported.
- (b) If the country of destination is the Philippines, it is Philippine internal law on loss, destruction, or deterioration

that must govern — the Civil Code *principally*, and the Code of Commerce and special laws like the Carriage of Goods by Sea Act, *suppletorily*. (*American President Lines, Ltd. v. Klepper, et al.*, L-15671, Nov. 29, 1960).

- (c) If an unpaid seller exercises his right of STOPPAGE IN TRANSITU, the new destination will be the country of the seller. Hence, it is the law of his country that will apply.

(2) Cases

Sea-Land Service, Inc. v. IAC GR 75118, Aug. 31, 1987

Since the liability of a common carrier for loss of or damage to goods transported by it under a contract of carriage is governed by the laws of the country of destination and the goods were shipped from the United States to the Philippines, the liability of the carrier to the consignee is governed primarily by the Civil Code, and as ordained by said Code, *suppletorily*, in all matters not determined thereby, by the Code of Commerce and special laws.

One of the suppletory special laws is the Carriage of Goods by Sea Act, U.S. Public Act 521 which was made applicable to all contracts for the carriage of goods by sea to and from Philippine ports in foreign trade by Commonwealth Act 65, approved on Oct. 22, 1936.

Section 4(5) of said Act in part reads: “Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with the transportation of goods in an amount exceeding \$500 per package lawful money of the United States, or in case of goods not shipped in packages, per customary freight unit, or the equivalent of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading. This declaration embodied in the bill of lading shall be *prima facie* evidence, but shall not be conclusive on the carrier.” “By agreement between the carrier, master, or agent of the carrier, and the shipper another maximum amount than that mentioned in this paragraph may be fixed: *Provided*, That such maximum shall not

be less than the figure above-named. In no event shall the carrier be liable for more than the amount of damage actually sustained.”

Art. 1766 of the Civil Code expressly subjects the rights and obligations of common carriers to the provisions of the Code of Commerce and of special laws in matters not regulated by said (Civil) Code. There is nothing in the Civil Code which absolutely prohibits agreements between shipper and carrier limiting the latter’s liability for loss of or damage to cargo shipped under contracts of carriage. The Civil Code in fact contemplates such agreements in Articles 1749 and 1750.

Even if Section 4(5) of the Carriage of Goods by Sea Act did not exist, the validity and binding effect of the liability limitation clause in the bill of lading are nevertheless fully sustainable on the basis alone of the provisions of Articles 1749 and 1750 of the Civil Code.

The right of the consignee to recover a shipment consigned to him under a bill of lading drawn upon only by and between the shipper and the carrier, springs from either a relation of agency that may exist between him and the shipper or consignor, or his status as a stranger in whose favor some stipulation was made in said contract, and who becomes a party thereto when he demands fulfillment of that stipulation, in this case the delivery of the goods or cargo shipped. In neither capacity can he assert personally, in bar to any provision of the bill of lading, the alleged circumstance that fair and free agreement to such provision was vitiated by its being in such fine print as to be hardly readable.

Section 4(5) of the Carriage of Goods by Sea Act gives more flesh and specificity to the rather general terms of Article 1749 and of Article 1750, to give effect to just agreements limiting carrier’s liability for loss or damage which are freely and fairly entered. Freely-agreed-upon stipulations in a contract of carriage or bill of lading limiting the liability of the carrier to an agreed valuation unless the shipper declares a higher value and inserts it into the said contract or bill is valid and enforceable. The Carriage of Goods by Sea Act applies up to the final port of destination. The fact that transshipment was made on an inter-island vessel did not remove the contract of goods from the operation of said Act.

Art. 1754. The provisions of Articles 1733 to 1753 shall apply to the passenger's baggage which is not in his personal custody or in that of his employees. As to other baggage, the rules in Articles 1998 and 2000 to 2003 concerning the responsibility of hotel-keepers shall be applicable.

COMMENT:

(1) Rules as to Baggage

- (a) If in *personal custody* of the passenger or his employees, the carrier has the same responsibility as that of an inn-keeper.
- (b) If otherwise (as when it is in the baggage compartment), the carrier's responsibility is that of a common carrier of GOODS (with extraordinary diligence being required).

(2) Effect of Non-Payment of Baggage Fare

The non-payment of baggage fare, or the non-issuance of a bill of lading therefor is not *important*. (*See Robles v. Santos, C.A., 44 O.G. 2268*).

(3) Freight Tickets

Freight tickets of bus companies are "bills of lading or receipts" within the meaning of the Documentary Stamp Tax Law. Bills of Lading, in modern jurisprudence, are not those issued by masters of vessels alone; they now comprehend all forms of transportation, whether by sea or land, and includes bus receipts for cargo transported. (*Interprovincial Autobus Co. v. Coll. of Internal Revenue, L-6741, Jan. 31, 1956, 52 O.G. 791*).

(4) Case

**Compania Maritima v. Limson
GR 27134, Feb. 28, 1986**

A shipper may be held liable for freightage on bills of lading signed by another person, where the shipper appears as shipper or consignee; on bills of lading where persons other than the former (herein defendant) appear as shipper; and on bills of lading not signed by the shipper where the testimonial

evidence shows that goods shipped actually belong to him as shipper.

Subsection 3

SAFETY OF PASSENGERS

Art. 1755. A common carrier is bound to carry the 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.

COMMENT:

(1) Reason for ‘Utmost Diligence’ in the Carriage of Passengers

Concededly, one of the most fantastic phenomena in vehicle-cursed cities of the Philippines is the death defying pedestrian. But almost as reckless, and equally blame-worthy in vehicular accidents is the *average* bus, jitney, or taxi driver. Too often, the man at the wheel does not care, ostensibly whether he lives or not. To him life seems deadly cheap, and he apparently has resolved to make it cheaper. The pleas of his passengers are amazingly unavailing; the driver, intrigued by his own nonchalance, answers with laughter, derisive and cruel and as a final taunt, steps on the gas with an even greater ferocity.

So concerned with the driver’s mode of conduct were the members of the Code Commission that under the new Civil Code, instead of being required to exercise mere ordinary diligence, a common carrier is exhorted “to carry the passengers safely as far as human care and foresight can provide, using the utmost diligence of very cautious persons.” (*Art. 1755*). The Commission, undoubtedly remembering that the contract of carriage is a trust (*Yu Con v. Ipil, 41 Phil. 770*), rationalizes: “This high degree of care is imperatively demanded by the preciousness of human life, and by the consideration that every person must in every way be safeguarded against all *injury*.” (*Report of the Code Commission, pp. 35-36*).

Civil actions specifically based upon an alleged breach of the contractual relation between the owner and operator

of a vehicle and its passengers are governed by the Civil Code. Such actions are entirely SEPARATE and DISTINCT from the criminal action that may be brought by the injured party, and should proceed independently of the criminal proceedings and regardless of the result of the latter. (*Bisaya Land Trans. Co. v. Mejia, et al.*, 99 Phil. 50). Where there is a breach of the carrier's contractual obligations to carry his passengers safely to their destination (*culpa contractual*), the liability of the carrier is not merely subsidiary or secondary, but direct and immediate. (*Vda. de Medina, et al. v. Cresencia, et al.*, 99 Phil. 506).

Davila v. Philippine Air Lines
49 SCRA 497

If passengers of an air carrier are injured or killed, the air carrier is presumed to have been at fault, or to have acted negligently. To escape liability, the carrier must prove it observed *extraordinary* diligence as prescribed in Arts. 1733 and 1755, Civil Code.

Philippine Air Lines v. Court of Appeals
L-46558, Jul. 31, 1981

Utmost diligence, which is required of common carriers, such as an airplane, refers not only to the safety of the passengers but also to that of the crew, particularly the pilot.

(2) Perfection of the Contract of Common Carriage of Passengers

In dealing with the contract of common carriage (of passengers), we have for the sake of accuracy, to distinguish two stages or aspects of the same:

- (a) Firstly, we have the contract "*to carry (at some future time)*." This is *consensual*, and is necessarily perfected, by *mere consent*. (See Art. 1356, Civil Code).
- (b) Secondly, there exists the contract "*of carriage*" or "*of common carriage*" itself. This understandably should be considered as a *real contract*, for not until the carrier is *actually* used can we consider the contract perfected

that is, till the moment of actual use, the carrier cannot be said to have already assumed the obligation of a carrier.

It is the second kind, that is, the “real contract of common carriage, that is the subject of this particular SECTION of the new Civil Code. This contract is perfected even if the passenger has not yet paid; in fact, even if he has no money for his fare. (*See Barker v. Ohio River R. Co.*, 51 W. Va. 423). It does *not* even matter that he has *not* boarded the vehicle completely; the all-important fact is that he has, with the express or implied consent of the carrier, placed a part of his body on any part of the jitney, taxi, or bus — such as the stepping platform or the running board. (*See Illinois C.R. Co. v. O’Keefe*, 686 Ill. 115).

(3) Parties to the Contract

The parties to the contract of common carriage of passengers are the passenger on the one hand, and the person, entity, or corporation undertaking the business of common carrier on the other. The carrier may or may not be the owner of the vehicle. (In the case of *Keetenbofen v. Globe Transfer and Stock Co.*, 70 Wash 645, it was held that the common carrier need not own the means of transportation.)

It follows therefore that any action for culpa contractual must be directed against said operator or owner, and not against the driver, who in this instance, has acted only as the agent or employee of the former. (*See Sudo v. Zamora*, C.A., 37 O.G. 962; *Enrico v. Nacoco*, C.A., 46 O.G. 962, both of which cases give the CORRECT rule. The dictum in *Gutiérrez*, 56 Phil. 177 on the point is clearly WRONG.)

If a TPU operator (common carrier) leases his jitney to another who now temporarily operates the same by himself or thru a hired driver, any suit for *culpa contractual* should be brought by the injured passenger against said TPU operator, and not the lessee — if the lease was effected without the necessary approval of the Public Service Commission as required by Sec. 16(h) of the Public Service Law. This was the Supreme Court’s ruling in *Timbol v. Osias, et al.*, L-7547, Apr. 30, 1955.

Perez v. Gutierrez
53 SCRA 149

It is the registered owner of the common carrier, not the transferee of his rights (which transfer is not yet registered), who is liable for damages resulting from the breach of contract of common carriage, BUT the transferee is liable to the registered owner for said damages.

(4) Passengers

A *passenger* is one who has entered into a contract of carriage, express or implied, with a carrier. In addition to regular passengers as commonly understood by the term, the following persons, among others, have been held to possess all the rights granted a passenger:

- (a) Newsboys allowed to peddle on a train or bus. (*Smallgood v. Baltimore and A.R. Co.*, 216 Pa. 540).
- (b) Concessionaires doing business aboard a train, such as the concessionaires of the dining room or newsstand there. (*See Baker v. Chicago*, 90 N.E. 1057).
- (c) One who has boarded the wrong train or bus. (*Hanson v. Chicago R.I. and P.R. Co.*, 83 Kan. 533).]

[As a matter of fact, this passenger is entitled either to be returned to the place of boarding or to be left at any place where no serious annoyance would be caused to him (28 LRA 611), but only if he is in need of assistance. (*Illinois C.R. Co. v. Hampen*, 83 Miss. 560).

- (d) One who with the consent of the carrier's employees rides in a dangerous or unusual place in the vehicle, such as the roof, or the running board. (*See Springer v. Bryan*, 137 Ind. 15).

[**NOTE:** This contributory negligence of his may, of course, in case of accident, preclude recovery. On the other hand, if the consent of the carrier's employees had not been obtained, he would NOT be considered a passenger. (*Twiss v. Boston Eleven, R. Co.*, 208 Mass. 108).]

- (e) One who upon arriving at the place of destination, is asleep, but is not awakened by the carrier's employees. (If subsequently, an accident occurs, he is entitled still to all the rights of a passenger). (*Bass v. Cleveland, CC & St. L.R. Co.*, 142 Mich. 177).

(5) Non-passenger

The following are NOT considered as passengers:

- (a) One who has *not yet* stepped on any part of the vehicle regardless of whether or not he has already purchased a ticket. (*See Villa v. United Electric R. Co.*, 51 R.I. 384).

[**NOTE:** One who has merely purchased a ticket but has not yet boarded the car or train, is not yet a passenger; he is only a *would-be* passenger, hence here, the contractual relationship of passenger and common carrier has not yet arisen. (*Barker v. Ohio River Co.*, 51 W. Va. 423).]

- (b) One who has called a taxi but has *not yet* actually begun to board it. (*Jaquette v. Capital Traction Co.*, 34 App. DC 41).
- (c) One who enters a vehicle *without any intention of paying* (*Higlay v. Gilmore*, 3 Mont. 90) or *refuses on demand to pay his fare*. (*Condran v. Chicago Mand. St. P.R. Co.*, 28 L.R.A. 6F. 522).

[**NOTE:** The presence or absence of money or a ticket is, however, not important; as long as entrance to the vehicle is made, the entrant becomes a passenger, save as provided in (c). (*Barker v. Ohio River R. Co.*, 51 W. Val. 423).]

- (d) One who remains on a common carrier for an *unreasonable* length of time after he has been afforded every safe opportunity to alight. (*Chicago R.I. and P.R. Co. v. Thurlow*, 78 F. 894, 30 L.R.A.[N.S.] 57.)

(**NOTE:** At one time, he had been a party to the contract of common carriage; under the circumstances stated, the contract has come to an end.)

- (e) One who is able to obtain transportation by *fraud* or *deceit*, and payment of the fare is immaterial if it had been received without previous knowledge of the fraud or deceit. (*See Walsey v. Chicago B. & Q.R. Co.*, 39 Neb. 798).
- (f) One who rides *stealthily*, that is, *without* knowledge on the part of the carrier that he is *already* inside. This is so even if a contract of carriage had already been entered into. (*See 2 LRA 67*).
- (g) One who *attempts to board* a moving vehicle, although he already has a ticket, unless the attempt be with the carrier's consent. (*See Kentucky Highlands, R. Co. v. Creal*, 166 Ky. 649).

[**NOTE:** Under the circumstances, he is nothing but a *trespasser*. However, upon the carrier's discovery of his perilous position, the carrier must exercise *ordinary* care (as distinguished from the *extraordinary* diligence to which a passenger is entitled); otherwise it will be liable in case of injury, *not* because of *culpa contractual* but because of *culpa aquiliana*. (*See Kentucky Highlands, R. Co. v. Creal*, 166 Ky. 649).]

- (h) One who upon entering the *wrong* vehicle (that is, a vehicle with a different destination, for example), is *properly informed* of such fact, and on alighting is injured by the sudden starting of the carrier.

[**NOTE:** This is because *no* contract of carriage had really been entered into. He is not a passenger because he *has not been accepted as such*; moreover, his alighting evidences an *abandoned intention* to become a passenger. (*Robertson v. Boston & N. Street R. Co.*, 990 Mass. 180).]

(6) Burden of Proof and Proceedings

Once a passenger in the course of travel is injured, or does *not* reach his destination safely, the carrier and the driver are presumed to be at fault (*Cangco v. MRR Co.*, 38 Phil. 368), and it is not incumbent upon the passenger to show the negligence of the driver of a vehicle that fell into

an unfortunate mishap. Nevertheless, it is axiomatic that the driver has the right to prove his prudence and care to absolve himself and his employer from any liability. To deny him his right to do so is tantamount to depriving both him and his employer of their day in court. (*Macawili, et al. v. Panay Auto Bus Co., et al., C.A., 52 O.G. 3995*).

(7) Procedural Techniques

A passenger hurt because of the negligence of the driver of a common carrier, is confronted with a choice of several procedural (and also truly substantive) remedies. The choices at his disposal are the following:

- (a) He can institute a civil case based on *culpa contractual*.
- (b) He can institute a criminal case and with it, the civil aspect based on *culpa criminal*.
- (c) He can institute a criminal case, and either *waive* the civil aspect, or *expressly reserve* the right to bring the civil aspect later.
- (d) He can institute an independent civil action based, not necessarily on a breach of contract, but on account of the physical injuries received in accordance with Art. 33 of the Civil Code. (*See Edgardo L. Paras, "The Concept of Culpa Contractual And Its Implications in Contracts of Common Carriage of Passengers," Far Eastern Law Review, Vol. V, No. 4, Dec., 1957, p. 331*).

(8) Query

Once a passenger institutes a criminal case (and with it, the civil aspect) against the driver of a common carrier, is he allowed *at the same time* (or at any stage of the pendency of the criminal case) to bring a civil suit based on *culpa contractual*?

ANS.: It would seem that the correct answer to this problem is YES for at least three very cogent reasons:

- (a) *Firstly*, an independent civil action is allowed under Art. 33 of the Civil Code for "defamation, fraud, and *physical*

injuries.” (The term “physical injuries” has been held to be used in its GENERIC sense.) (*See Carandang v. Santiago, L-8238, May 28, 1955*).

- (b) *Secondly*, Art. 31 of the same Code expressly provides that “when the civil action is based on an obligation *not arising* from the act or omission complained of, such civil action may proceed independently of the criminal proceedings and regardless of the result of the latter.

(**NOTE:** Example of an obligation *not* arising from the act or omission complained of — an obligation *ex contractu* as when there exists a contract of *common* carriage. The *act* or *omission* complained of refers to an obligation *ex delicto* or *ex maleficio*.)

- (c) *Thirdly*, Supreme Court decisions seem to have upheld this rule — as in the case of *Bisaya Land Transportation Co., Inc. v. Mejia, et al., 99 Phil. 50* where the civil cases filed by the injured passengers (or the heirs of the deceased passengers) *simultaneously* with the criminal case, were allowed to continue despite the pendency of the latter on the ground that the complaints in the civil cases were based upon an *alleged breach of the contractual relation* between the common carrier and the passengers, which relation is governed by Arts. 1755 to 1763 of the Civil Code, and not by the pertinent provisions of the Revised Penal Code.

AND yet, the same Court has invariably held that in view of the lack of pecuniary interest therein, an offended party loses his right to intervene in the prosecution of a criminal case in at least three instances: *firstly*, when the civil action is waived; *secondly*, when the right to institute the same is expressly reserved; and *thirdly*, when he has ACTUALLY instituted the civil action, even if no waiver or reservation had been previously made. (*Gorospe v. Gatmaitan, et al., L-9609, Mar. 9, 1956; Española v. Simpson, L-8724, Apr. 13, 1956*). The implication is that whenever an independent civil action is brought, the civil aspect of the criminal case has ended automatically.

(9) Case

**Light Rail Transit Authority & Rodolfo Roman
v. Marjorie Navidad, Heirs of the Late Nicanor Navidad & Prudent Security Agency
GR 145804, Feb. 6, 2003**

Law and jurisprudence dictate that a common carrier, both from the nature of its business and for reasons of public policy, is burdened with the duty of exercising utmost diligence in ensuring the safety of passengers. (*Arada v. CA*, 210 SCRA 624).

Such duty of a common carrier to provide safety to its passengers so 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. (*Dangwa Transportation Co., Inc. v. CA*, 202 SCRA 575).

Art. 1756. In case of death of or injuries to passengers, common carriers are presumed to have been at fault or to have acted negligently unless they prove that they observed extraordinary diligence as prescribed in Articles 1733 and 1755.

COMMENT:**(1) Presumption of Negligence**

In *culpa contractual*, as in the case of the contract of common carriage, the moment a passenger dies or is injured, the carrier is presumed to be at fault. (*Sy v. Malate Taxicab and Garage, Inc.*, 54 O.G. 658).

[THEREFORE, the passenger does not have to prove that the carrier was at fault or was negligent. All he has to prove is the *existence* of the contract, and the *fact of non-performance*. (See *Cangco v. MRR*, 38 Phil. 768).]

**LRT v. Navidad
GR 145804, Feb. 6, 2003**

In case of death or injury, a carrier is presumed to have been at fault or been negligent (*Gatchailan v. Delim*, 203 SCRA

126; *Yobido v. CA*, 281 SCRA 1, and *Landingin v. Pangasinan Transportation Co.*, 33 SCRA 284), and by simple proof of injury the passenger is relieved of the duty to still establish the fault or negligence of the carrier or of its employees and the burden shifts upon the carrier to prove that the injury is due to an unforeseen event or to *force majeure*. (*Mercado v. Liva*, 3 SCRA 124).

Absent any satisfactory explanation by the carrier on how the accident occurred, the presumption would be that it has been at fault (Art. 1756), an exception from the general rule that negligence must be proved. (*Vda. de Abeto v. PAL*, Jul. 30, 1982).

(2) How Presumption is Rebutted

The presumption of fault or negligence may be rebutted by the carrier if it can prove:

- (a) that a fortuitous event was the proximate cause;
- (b) and that the carrier had observed the required extraordinary diligence. (*Sy v. Malate Taxicab and Garage, Inc.*, 54 O.G. 658).

HOWEVER, if the *driver* is proved at fault or negligent, the carrier must answer. In this case, the defense of a good father of a family in selecting or supervising employees will not be a complete and valid defense (*See 2nd paragraph of Art. 1759; the master and servant rule*), although same may serve to *mitigate* the liability.

(3) Liability of Carrier

The carrier may be liable because of:

- (a) recklessness on the part of the driver;
- (b) or recklessness on the part of the owner or operator himself.

(4) Recklessness on the Part of the Driver

Instances of imprudence are: driving at an unjustified rate of speed, flagrant violation of the elementary courtesies

of the road, failure to properly signal, deliberate entry into one-way streets.

The driver's *intoxication* at the time of the mishap (as distinguished from the mere drinking of hard liquor) (*Wright v. Manila Electric Co.*, 28 Phil. 122) is CULPABLE negligence, and the same may be proved during the trial even if the complaint did *not* allege the fact of intoxication. (*See Fox v. Hopkins*, 343 Ill. App. 404). Similarly, a driver is *not* justified generally in his attempt to pass another vehicle which fails to give way. (*See Clayton v. McLllorath*, 241 Iowa 1162). However, if the carrier which is being *overtaken* itself tries to overtake a third car ahead, and in so doing crashes into the carrier behind it, and which had been trying to overtake it, it (the carrier in the middle) would be responsible for the crash, since it evidently failed, before turning to the left to keep a lookout for the carrier which it thought was still directly behind it. (*Ibid.*)

There is also authority for the rule that while overcrowding in a bus is *not negligence per se*, still the bus is under a duty to exercise a high degree of care to protect its passengers from damages likely to arise therefrom. Thus, if as a result of overcrowding, a passenger falls, and an attempted rescue by a fellow passenger is frustrated, because the bus driver immediately starts the vehicle, the bus company can be held liable. (*Miller v. Public Service Coordinated Transport*, 7 N.U. 185 [1953]).

(5) Recklessness on the Part of the Owner or Operator Himself

The lack of proper care on the part of the owner or operator is best illustrated in his failure to repair defective parts in the vehicle. This was held in *Lasam v. Smith* (46 Phil. 657) and reiterated in *Jose Son v. Cebu Autobus Co.* (L-6155, Apr. 30, 1954). In the latter case, the mechanical defect lay in the draglink spring which unexpectedly broke. Needless to say, recovery was had on the basis of contractual negligence.

In *Strong v. Iloilo-Negros Air Express Co.*, C.A., 40 O.G. (Supp. 12) p. 269, the Court of Appeals had occasion to note that a carrier is *not* an absolute insurer of the safety of the passengers, and not required absolutely and at all events

to carry said passengers safely and without injury. It thus absolved the carrier for a defect in the ignition cable used in the airplane, for it was proved that the cable had been bought from a competent and ordinarily reputable manufacturer.

HOWEVER, in the case of *Necesito, et al. v. Paras, et al.* (104 Phil. 75), the Supreme Court held that a common carrier is liable for the breakage of the steering knuckle that caused the autobus to overturn, injuring the passengers. This is true even if the knuckle was already defective at the time of purchase. The Court held that the defect could have been discovered by the carrier if it had exercised the degree of care which under the circumstances was incumbent upon it, *with regard to inspection and application of the necessary tests*. The *rationale* of this doctrine is the fact that a passenger has *neither choice nor control over the carrier in the selection and use of the mechanical part which eventually proved fatal*. In the *Necesito v. Paras* case, the carrier was held liable to damages for the death of the mother and injury to her one-year-old son, both passengers, when the bus on which they were riding fell into a creek as a result of the fracture of a defective right steering knuckle. It appeared that the periodical usual inspection of the steering knuckle as practiced by the carrier's agents did NOT measure up to the legal standard of utmost diligence of very cautious persons. Therefore, the fracture cannot be considered a fortuitous event.

In the case of *Cerf v. Medal* (33 Phil. 37), the High Tribunal had occasion to say that it is the duty of a common carrier whose business is to let automobiles for hire and furnish drivers therefor, to furnish not only a safe machine, but also a competent and tested driver, to whom it must issue, when essential, proper instruction for safe maneuvering on the highway.

(6) No Recklessness

If the carrier was not in any way at fault (as when the cause was a fortuitous event), the carrier is certainly not liable. Thus, Art. 1174 regarding fortuitous events applies also to common carriers. (*Guillaco v. MRR*, 51 O.G. 5596 and *Lasam v. Smith*, 45 Phil. 657). If a third party, like another vehicle, was solely at fault, the carrier itself is also

free from all responsibility. (*Ampang v. Guinoo Transportation Co.*, 92 *Phil.* 1085 and *Vda. de Alfaro v. Ayzon*, C.A., 54 *O.G.* 7920).

However, if a shipowner knowing the dangerous and weak condition of his vessel, nevertheless orders his captain to embark on a voyage, and during said voyage, a disastrous typhoon mercilessly wrecks the ship and renders asunder its valuable cargo, the owner will not escape legal and moral liability. He surely cannot be allowed to absolve himself by crying out "an act of Divine Providence." (*Tan Chiong Sian v. Inchausti and Co.*, 22 *Phil.* 152).

Art. 1757. The responsibility of a common carrier for the safety of passengers as required in Articles 1733 and 1755 cannot be dispensed with or lessened by stipulation, by the posting of notices, by statements on tickets, or otherwise.

COMMENT:

Effect of Contrary Stipulation

To lessen the responsibility should for obvious reasons not be allowed. (*Report of the Code Commission*, p. 67). Hence, the Article.

Art. 1758. When a passenger is carried gratuitously, a stipulation limiting the common carrier's liability for negligence is valid, but not for wilfull acts or gross negligence.

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

COMMENT:

(1) Effect of Gratuitous Carriage or Carriage at a Reduced Rate

Generally even if a passenger is carried free, he is still a passenger, and, therefore ordinarily, extraordinary diligence would still be required. However, for obvious reasons, the stipulation referred to in the first part of this article is expressly allowed.

(2) Effect of Reduction of Fare

A reduced fare does not justify limited liability.

(3) Some Rules re Non-paying Persons

- (a) Ordinarily, if one is a stranger, but he rides free, he should be considered a passenger. (*See William v. Oregon Shortline R. Co.*, 18 Utah 210).
- (b) If he is an employee of the common carrier, and he rides, not as an employee, but as an ordinary stranger — he is deemed a passenger (even if for *free*), for his travel is for his own purpose. (*Bowtes v. Indiana R. Co.*, 27 Ind. App. 672, 62 NE 94). If he rides on a pass, he is also a passenger. (*See William v. Oregon Shortline R. Co.*, 18 Utah 210).
- (c) If he is an employee, and he rides as an employee (that is, his presence on the carrier is *required*, as in the case of a bus conductor), he is *not* deemed a passenger, insofar as the contract of common carriage is concerned. (*Louisville and NR Co. v. Stuber*, 108 F. 934, 54 L.R.A. 696).
- (d) If he is a *public officer*, granted free passage, he is considered as possessed of the rights of a passenger. (*Todd v. Old Colony F. River R. Co.*, 80 Am. Dec. 49).

(4) Invited Guests or Accommodation Passengers

In *Lara, et al. v. Valencia* (L-9907, Jun. 30, 1958), a forestry inspector requested the defendant for a ride on the latter's truck. The request was granted. The defendant did not charge the passenger any fee. While sleeping in a crouched position in the truck, the passenger fell when the truck jerked along some stones. Subsequently, he died.

HELD: The defendant should not be held liable. When passengers are invited, the owner or operator of a vehicle owes to them merely the duty to exercise *reasonable care in its operation*, and not unreasonably to expose them to danger and injury by increasing the hazard of trail. The deceased was merely an accommodation passenger, and can be considered an invited guest within the meaning of the law. The defendant was thus not duty bound to exercise extraordinary diligence

as required of a common carrier. A passenger, on the other hand, is expressly required by the law to observe the diligence of a good father of a family to avoid injury to himself. (*Art. 1761*). Consequently, where it appears that the injury to the accommodated passenger was *proximately caused* by *his own negligence*, and there is no showing of lack of precaution of an ordinary prudent man under similar circumstances on the part of the owner-operator of the vehicle, such owner cannot be held liable.

Art. 1759. Common carriers are liable for the death of or injuries to passengers through the negligence or wilful 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.

This liability of the common carriers does not cease upon proof that they exercised all the diligence of a good father of a family in the selection and supervision of their employees.

COMMENT:

(1) Liability of Carrier for Death of or Injuries to Passengers Due to NEGLIGENCE or WILFULL ACTS

Note that here the carrier is liable even if:

- (a) the employees may have acted beyond the scope of their authority;
- (b) or they acted in violation of the orders of the common carriers.

(2) Query

If a bus, or a train, or jitney driver or conductor or guard kills a passenger because of a personal previous grudge, is the common carrier liable?

ANS.: While *apparently* the answer is YES in view of the sweeping import of the wording of the article ("although such employees may have acted *beyond* the scope of their authority or in *violation* of the orders of the common carriers") *still* in the case of *Guillaco v. Manila Railroad Co.* (51 O.G.

5596), it has been held that for such an act on the part of the employee, the carrier is NOT liable because it *cannot* reasonably foresee every personal rancour that may exist between any of its employee and the countless passengers the carrier may have. However, in the much later case of *Maranan v. Perez*, L-22272, Jun. 26, 1967, the Supreme Court answered the query in the AFFIRMATIVE.

Maranan v. Perez
L-22272, Jun. 26, 1967

FACTS: A taxi passenger was killed deliberately by the driver. Is the operator civilly liable?

HELD: Yes, under Art. 1759 of the Civil Code, even when the driver acted beyond his authority. What is important is that the act occurred within the course of the driver's duty. In fact the carrier's liability is absolute; it bears the risk of its employees' *wrongful* or *negligent* acts for after all it has the power to select and to fire. The liability here of the operator is on the basis of an *obligatio ex contractu*. Incidentally, the driver in the *civil* case is *not* liable to the heirs of the deceased, for he (the driver) was not a party to the contract of common carriage. Any civil liability on the part of the driver would arise from his own criminal act (for every person criminally liable is also civilly liable).

[**NOTE:** Under American law, the carrier would be liable for its inability to protect the passenger from injury or assault. Thus, the employee of the carrier need not have acted within the scope of his authority. (*See 10 Am. Jur.*, pp. 263-265).]

Art. 1760. The common carrier's responsibility prescribed in the preceding article cannot be eliminated or limited by stipulation, by the posting of notices, by statements on the tickets or otherwise.

COMMENT:

Effect of Contrary Stipulation

The Article is self-explanatory.

Art. 1761. The passenger must observe the diligence of a good father of a family to avoid injury to himself.

COMMENT:

Duty of Passenger to Observe Diligence

- (a) Note that the law does *not* require extraordinary diligence on the part of the passenger. Ordinary diligence would suffice.
- (b) Art. 1761 applies to an invited guest or accommodation passenger. (*Lara, et al. v. Valencia, L-9907, Jun. 30, 1958*).
- (c) If an invited passenger falls off a vehicle because of his own negligence, the carrier will *not* be liable. (*Lara, et al. v. Valencia, supra*).
- (d) The carrier of a passenger who negligently thrusts his arm out of a bus window and is hurt in the process by another vehicle, recklessly driven, should not be held liable. (*See Isaac v. A.L. Ammen Trans. Co., 101 Phil. 1046*).

Art. 1762. 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.

COMMENT:

Contributory Negligence of Passenger

If the contributory negligence of the passenger is the *proximate* cause of the death or injury, no recovery can be had. If otherwise, the amount of damages will only be equitably reduced.

Art. 1763. A common carrier responsible for injuries suffered by a passenger on account of the wilfull 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.

COMMENT:

(1) Responsibility of Common Carriers for Wilfull Acts or Negligence of Strangers or other Passengers (Passengers Other Than the Victims)

The Article is self-explanatory. Note that here the wilfull or negligent acts are those of *other passengers or of strangers* (not the employees of the carrier).

(2) Example

A bus passenger was injured by a hold-up man who had boarded the vehicle. Is the carrier liable? It depends. If the driver or the conductor, with due diligence, *could have prevented the injury, but did not*, the carrier would be liable.

(3) Case

**Fortune Express, Inc. v. CA, et al.
GR 119756, Mar. 18, 1999**

FACTS: A bus company received a warning from the Phil. Constabulary (PC) that certain men were planning to burn some of its buses. Four days later, three armed men pretending to be passengers seized and burned a bus owned by petitioner-bus company, resulting in the death of one of the passengers. The heirs of the victim filed before the trial court a complaint against petitioner for damages based on breach of contract of carriage, but the trial court dismissed the complaint. However, the Court of Appeals (CA) reversed the trial court. On appeal, the Supreme Court affirmed the CA.

HELD: Despite the warning aired from the PC, the employees did not take precautions to prevent the seizure of the bus, such as frisking the passengers or inspecting their baggage. Nor can such event be considered *force majeure*. Petitioner received

a report from the PC of the danger posed by certain men to the safety of its buses and passengers, hence, the element of unforseeability is looking in this case. Furthermore, the victim could not be considered guilty of contributory negligence because he was merely playing the role of the Good Samaritan when he was killed in the ambush involving said bus.

Subsection 4

COMMON PROVISIONS

Art. 1764. Damages in cases comprised in this Section shall be awarded in accordance with Title XVIII of this Book, concerning Damages. Article 2206 shall also apply to the death of a passenger caused by the breach of contract by a common carrier.

COMMENT:

(1) Is a Common Carrier Liable for Moral Damages?

- (a) If the passenger is MERELY INJURED — no, unless there was fraud or bad faith. (*Cachero v. Manila Yellow Taxicab Co., Inc.*, L-8721, May 23, 1957; see Arts. 2206 and 2219).
- (b) If the passenger DIES — yes. (*Art. 1764 read together with Art. 2206 and Necesito v. Paras*, 104 Phil. 75).

(2) Rule in Case of Physical Injuries

Ordinarily, *culpa contractual* (or breach of contract) of a common carrier does NOT result in the award of moral damages, unless there was *fraud* or *bad faith*. (*Art. 2220*).

[Thus, the Supreme Court in *Tranquilino Cachero v. Manila Yellow Taxicab Co., Inc.*, L-8721, May 23, 1957, stated that inasmuch as Art. 2219 of the new Civil Code (enumerating the instances when moral damages may be recovered) does NOT mention “breach of contract” or “*culpa contractual*,” it follows that NO moral damages may be recovered, as a rule, for *physical injuries*.]

(3) Rule in Case of Death

The rule in case of DEATH is, however, different. *Reason:* Art. 1764 says: “Art. 2206 shall also apply to the death of a passenger caused by the breach of contract by a common carrier.” Art. 2206, No. 3 in turn states: “The *spouse, legitimate and illegitimate descendants and ascendants* of the deceased may demand *moral damages* for mental anguish by reason of the *death* of the deceased.” Thus, it is clear that if the passenger dies the persons named hereinabove may recover moral damages. And this is true notwithstanding the fact that if the passenger who was injured had *managed to survive* such passenger himself would *not* have been *ordinarily* entitled to recover said moral damages. (*Necesito, et al. v. Paras, et al.*, 104 Phil. 75; *Motion for Reconsideration, Sept. 11, 1958*).

(**NOTE:** The contrary rule in *Tamayo v. Aquino*, L-12663, L-12720, May 29, 1959, *denying* moral damages *despite DEATH*, is obviously **WRONG** for evidently both Art. 1764 and the leading case of *Necesito v. Paras* were **FORGOTTEN**.)

(4) Death of a Foetus

If a pregnant woman passenger is hurt in an accident caused by a bus driver, and as a result of such accident, foetus inside her is aborted, can there be recovery of damages on account of the death of said foetus?

ANS.: I distinguish:

- (a) For injury to the *aborted foetus*, the parents can have *no recovery* in the form of damages. This is because the dead foetus *never* attained juridical personality under Art. 40 of the new Civil Code, and consequently had *no rights* whatsoever. Therefore, it also follows that no right of action could *derivatively* accrue to its parents or heirs.
- (b) For injury to the parents themselves, moral damages may be obtained. The parents have been injured, and may, insofar as the foetus is concerned recover moral damages for the illegal arrest of the normal development of the foetus, *i.e.*, the distress and anguish attendant to

the loss of the child, the disappointment of their parental expectation, etc. (*Art. 2217, Civil Code*), as well as exemplary damages, if so warranted by the circumstances. (*Art. 2230 Civil Code*). (*See Antonio Geluz v. Court of Appeals & Oscar Lazo, L-16439, Jul. 20, 1961*).

(5) Damages for Ill-Treatment of Air Passengers

Zulueta v. Pan American World Airways, Inc. 43 SCRA 397

FACTS: Zulueta and his wife were passengers of a Pan American airplane. At a stop-over, Zulueta was ill-treated and was left at the airport. Is he entitled to recover damages?

HELD: Yes. Passengers should be treated by the employees of an airplane carrier with kindness and courtesy, and should be protected against indignities, abuses, and injurious language from such employees. In case of breach of contract the airline company should be held liable for damages. Be it noted further that the contract of common air carriage generates a relation attended with a public duty.

Art. 1765. The Public Service Commission may, on its own motion or on petition of any interested party, after due hearing, cancel the certificate of public convenience granted to any common carrier that repeatedly fails to comply with his or its duty to observe extraordinary diligence as prescribed in this Section.

COMMENT:

Cancellation of the Certificate of Public Convenience

The certificate of public convenience may be CANCELLED by the Public Service Commission on —

- (a) its own motion, or
- (b) on petition of any interested party.

Art. 1766. In all matters not regulated by this Code, the rights and obligations of common carriers shall be governed by the Code of Commerce and by special laws.

COMMENT:

Civil Code Prevails Over Other Laws

Note that in case of conflict on the law of common carriers between the Civil Code and other laws, it is the *Civil Code that applies*.

TITLE IX

PARTNERSHIP

Chapter 1

GENERAL PROVISIONS

Art. 1767. By the contract of partnership two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves.

Two or more persons may also form a partnership for the exercise of a profession.

COMMENT:

(1) 'Partnership' Defined

It is a *contract* whereby two or more persons bind themselves to contribute *money, property, or industry* to a *common fund*, with the intention of dividing the profits among themselves, or in order to exercise a profession. (*See Art. 1767*). It is also a *status* and a *fiduciary relation* subsisting between persons carrying on a business in common with a view on profit.

(**NOTE:** While strictly speaking the exercise of a profession is not a business undertaking nor an enterprise for profit — the law considers the joint pursuit thereof, for mutual help, as a partnership.)

**Fernando Santos v. Sps. Arsenio &
Nieves Reyes
GR 135813, Oct. 25, 2001**

FACTS: The “Articles of Agreement” stipulated that the signatories shall share the profits of the business in a 70-15-15

manner, with petitioner getting the lion's share. *Issue:* Was there a partnership established?

HELD: The stipulation clearly proved the establishment of a partnership. By the contract of partnership, two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profits among themselves.

(2) Characteristics of the Contract

- (a) The contract is *consensual*, because it is perfected by mere consent, although such consent must be manifested in certain cases by the proper formalities; *bilateral* or *multi-lateral*, because it is entered into between two or more persons; *nominate*, because it is designated by a specific name; *principal*, because its existence does not depend on the life of another contract; *onerous*, because certain contributions have to be made; and *preparatory*, in the sense that *after* it has been entered into, other contracts essential in the carrying out of its purposes can be entered into. (*See 4 Sanchez Roman 519*).
- (b) There must be a contribution of *money, property or industry to a common fund* (credit, such as that evidenced by a promissory note, or even mere goodwill — *economic goodwill* or commercial credit, which is the sheer ability to obtain funds on credit — may be contributed for both credit and goodwill are considered properties — but not mere “political credit” or personal influence, since this may be contrary to good customs). (*11 Manresa 273 and 2 Castan 644*). (A license to construct and operate a cockpit can be given as contribution to a partnership.) (*Baron v. Pajarillo, et al., C.A., 146-R, Nov. 29, 1956*).

[**NOTE:** The “industry” contributed may be intellectual or physical. (*11 Manresa 273*).]

[**NOTE:** A limited partner cannot contribute mere “industry.” (*Art. 1845, Civil Code*).]

- (c) The object must be a *lawful one*. (*Art. 1770, Civil Code*).
- (d) There must be an intention of dividing the profit among the partners (*Art. 1767*) since the firm is for the *common*

benefit or interest of the partners. (Art. 1770, Civil Code). (See Evangelista, et al. v. Coll. of Int. Rev., L-9996, Oct. 15, 1957).

In the case of *Evangelista, et al. v. Coll. of Int. Rev., L-9996, Oct. 15, 1957*, it was held by the Supreme Court that where two people jointly borrowed from their father a sum of money which, together with their own personal funds, was used by them in buying real properties for lease to third parties, such investment consisting of a series of transactions and the management thereof being under one person for more than 10 years, the legal entity created by them is a partnership. Similar results had been arrived at in *Duterte v. Rallos, 2 Phil. 509* and *Kial v. Estate of Saber, 46 Phil. 193*.

[**NOTE:** The object must be for profit and not merely for common enjoyment; otherwise, only a *co-ownership* has been formed. However, pecuniary profit need not be the only aim; it is enough that it is the *principal* purpose. Thus, other ends — like social, moral, or spiritual objectives — may also properly exist. (11 *Manresa* 264).]

- (e) There must be the *affectio societatis* — the desire to formulate an ACTIVE union (*Fernandez v. De la Rosa, 1 Phil. 671*) with people among whom there exist *mutual confidence* and trust (*delectus personarum*).

[**NOTE:** Just because the terms “partnership and “partners” appear in a contract between certain persons does not necessarily mean that a partnership has been entered into. (*Paterson v. Eppler, 67 N.Y.S. {2nd} 498*).]

A new personality — that of the firm—must arise, distinct from the separate personality of each of the members. (*See Art. 1768*).

(3) Historical Notes

- (a) Under *Roman Law*, partnerships existed. Such partnerships had, among other things, the following features:
 - 1) There was *no* limit as to the number of partners.
 - 2) In the Roman partnership (*societas*) one partner was not considered the implied agent of the oth-

ers. Thus, to bind others, a partner had to obtain an express mandate (*mandatum* or authorization) from each of the others.

- 3) The partners were liable *jointly*, not solidarily.
 - 4) The partners had the right to the *beneficium competentiae*, that is, they were held financially liable only insofar as they would not be reduced to destitution.
 - 5) The heirs (*heres*) of a deceased partner could not succeed to the rights of the deceased, even by express stipulation.
 - 6) A Roman partner could not retire in order to enjoy alone a gain which he knew was awaiting him.
- (b) Before the new Civil Code became effective on Aug. 30, 1950 (*Lara v. del Rosario*, L-6339, 50 O.G. 1957) there were two kinds of partnerships in the Philippines, namely, the civil partnership, and the commercial or mercantile partnership. (Art. 1665, old Civil Code; Art. 116, par. 1, Code of Commerce). While the first was engaged in civil purposes, the latter's object was to deal in *mercantile* transactions. (*Prautch, Scholes and Co. v. Hernandez*, 1 Phil. 705, decided Feb. 10, 1903). Whether it was registered or not was not important — for the difference lay in the ends desired, not the manner of organization — although, in the *absence* of a clear showing as to whether the object was civil or commercial, the *form* of organization, that is, registration in the mercantile registry, was held indicative of its nature as a commercial partnership. (*Compania Agricola de Ultramar v. Reyes*, 4 Phil. 2). While the civil partnership was governed by the old Civil Code, the Code of Commerce controlled the mercantile variety.

With the advent of the new Civil Code, the provisions of the Code of Commerce relating to mercantile partnerships, and the provisions of the old Civil Code concerning civil partnerships have been repealed. (Art. 2270, No. 2). Therefore, without prejudice to the transitional provisions of the new Civil Code, the new Code

now governs all transactions of all partnerships, whether the object be civil or mercantiles.

[**NOTE:** Bar Exam Question — “What are commercial partnerships?” (*See the foregoing discussion*).]

(4) ‘Partnership’ Distinguished from a ‘Corporation’

<i>DISTINGUISHING FACTOR</i>	<i>PARTNERSHIP</i>	<i>CORPORATIONS</i>
(a) HOW CRE- ATED	(a) VOLUNTARY agreement of parties	(a) created by the state in the form of a <i>spe- cial charter</i> or by a <i>general</i> enabling law (<i>The Corpora- tion Code</i>)
(b) HOW LONG IT EXISTS	(b) no time limit ex- cept agreement of parties	(b) not more than 50 years; (<i>Sec. 11, Corp. Code</i>), may be reduced, but never ex- tended
(c) LIABILITY TO STRANGERS	(c) may be liable with their pri- vate property beyond their contribution to the firm	(c) liable only for payment of their subscribed capital stock
(d) TRANSFER- ABILITY OF INTEREST	(d) even if a part- ner transfers his interest to another, the transferee does not become a partner unless all other part- ners consent (This is due to the principle of	(d) a transfer of interest makes the transferee a stockholder, even without the consent of the others

	mutual trust and confidence — the “ <i>delectus personarum.</i> ”)	
(e) ABILITY TO BIND THE FIRM	(e) generally, partners acting on behalf of the partnership are <i>agents</i> thereof; consequently they can bind both the firm and the partners	(e) generally, the stockholders cannot bind corporation since they are not agents thereof
(f) MISMANAGEMENT	(f) a partner can sue a partner who mismanages	(f) a stockholder cannot sue a member of the board of directors who mismanages: the action must be in the name of the corporation
(g) NATIONALITY	(g) a partnership is a national of the country it was created	(g) a corporation is a national of the country under whose laws it was incorporated, <i>except</i> for wartime purposes or for the <i>acquisition</i> of land, <i>natural resources</i> and the operation of public <i>utilities</i> in the Philippines, in which case the veil of corporate identity is pierced and we go to the nationality of the controlling stockholders

(h) ATTAINMENT OF LEGAL PERSONALITY	(h) the firm becomes a juridical person from the time the contracts begins	(h) the firm becomes a juridical person from the time it is <i>registered in the Securities and Exchange Commission, and all requisites have been complied with</i>
(i) DISSOLUTION	(i) death, retirement, insolvency, civil interdiction, or insanity of a partner dissolves the firm	(i) such causes do not dissolve a corporation

(5) ‘Ordinary Partnership’ Distinguished from the ‘Conjugal Partnership of Gains’

<i>FACTORS</i>	<i>ORDINARY PARTNERSHIP</i>	<i>CONJUGAL PARTNERSHIP</i>
(a) HOW CREATED	(a) by will or consent of the parties	(a) created by operation of law upon the celebration of the marriage
(b) LAW THAT GOVERNS	(b) in general, it is the will of the partners that governs matters like object, length of existence, etc.; the law is only subsidiary	(b) in general, it is the law that governs
(c) LEGAL PERSONALITY	(c) possesses a legal personality (<i>Art. 1768, Civil Code</i>)	(c) does <i>not</i> possess any legal personality distinct from that of the husband or wife; hence, it cannot

		sue or be sued as such
(d) COMMENCEMENT OF THE PARTNERSHIP	(d) begins from the moment of the execution of the contract but a contrary stipulation is allowed (<i>Art. 1784, Civil Code</i>)	(d) commences precisely on the <i>date</i> of the celebration of the marriage — no contrary stipulation is allowed
(e) PURPOSE	(e) formed for profit	(e) not formed particularly for profit
(f) DIVISION OF PROFITS	(f) as a rule, profits are divided according to previous agreement; and if there is no agreement, in proportion to the amount contributed (<i>Art. 1797, Civil Code</i>)	(f) as a rule, profits are divided equally (but settlement can provide otherwise) (<i>Art. 106, Family Code</i>)
(g) MANAGEMENT	(g) as a rule, management is conferred upon the partners so appointed by the others; otherwise, all are equally considered agents of the firm (<i>Art. 1803, Civil Code</i>)	(g) as a rule, the administration and enjoyment of the conjugal partnership property belong to both spouses jointly (<i>Art. 124, Family Code</i>)
(h) DISSOLUTION	(h) there are <i>many</i> grounds for dissolution	(h) there are <i>few</i> grounds for dissolution
(i) LIQUIDATION OF PROFITS	(i) there may be division of profits even without dissolution	(i) there will be no liquidation or giving of profits till after dissolution

**(6) ‘Partnership’ Distinguished from ‘Co-ownership’
(Community of Property; Tenancy in Common)**

<i>FACTORS</i>	<i>PARTNERSHIP</i>	<i>CO-OWNERSHIP</i>
(a) CREATION	(a) created by contract only (express or implied)	(a) created by contract, law and other things
(b) JURIDICAL	(b) has legal or juridical personality	(b) has no juridical personality (hence, it cannot sue or be sued as such)
(c) PURPOSE	(c) for profit	(c) collective enjoyment (hence, not necessarily for profit) (<i>Red Men v. Veteran Army</i> , 7 Phil. 685)
(d) AGENCY OR REPRESENTATION	(d) as a rule, there is no mutual representation	(d) as a rule, there is no mutual representation (although it is enough for one co-owner to bring an action for ejectment against a stranger) (<i>Art. 487, Civil Code</i>)
(e) TRANSFER OF INTEREST	(e) cannot substitute another as partner in his place, <i>without unanimous consent</i>	(e) can dispose of his share without the consent of the others
(f) LENGTH OF EXISTENCE IF CREATED BY CONTRACT	(f) no term limit is set by the law	(f) must not be for more than 10 years (although agreement after <i>termination</i>)

		<i>may be renewed</i>) (hence, if more than 10 years, the excess is VOID) (NOTE: 20 years is the maximum if imposed by the <i>testator or donee</i> of the common property.)
(g) PROFITS	(g) may be stipulated upon	(g) profits must <i>always</i> depend on proportionate shares (any stipulation to the contrary is VOID) (<i>Art. 485</i>)
(h) DISSOLUTION	(h) dissolved by death or incapacity of a partner	(h) <i>not</i> dissolved by the death or incapacity of co-owner
(i) FORM	(i) may be made in any form except when real property is contributed (Here, a public instrument is required.)	(i) no public instrument needed even if real property is the object of the co-ownership

(7) ‘Partnership’ Distinguished from ‘Joint-Stock Company’

<i>FACTORS</i>	<i>PARTNERSHIP</i>	<i>JOINT-STOCK COMPANY</i>
(a) COMPOSITION	(a) Essentially, an association of <i>persons</i>	(a) Essentially, an association of capital (<i>See Figueras v. Rocha</i>

(b) DIVISION OF CAPITAL	(b) capital is NOT divided into shares	<i>and Co., 13 Phil. 504)</i> (b) although a special form of partnership, its capital is divided into shares, like in a corporation
(c) MANAGEMENT	(c) generally, in all the partners	(c) generally, in a board of directors
(d) LIABILITY	(d) partners may be liable with their individual properties after exhaustion of the partnership assets	(d) liability of the members is only up to the extent of their shares if such is what the statute provides (<i>See Hibbs vs. Brown, 190 N.Y. 167</i>)
(e) EFFECT OF TRANSFER OF INTEREST	(e) transferee of partner's share does <i>not</i> become a partner unless all the other partners consent	(e) transferee of member's shares himself becomes a member without any necessity of consent from the other members

(8) ‘Partnership’ Distinguished from ‘Social Organizations’

<i>FACTORS</i>	<i>PARTNERSHIP</i>	<i>SOCIAL ORGANIZATION</i>
(a) CONTRIBUTION	(a) capital is given in money, property, or services	(a) <i>no</i> capital is given although, of course, fees are usually collected

(b) LIABILITY FOR DEBTS	(b) partners are liable only <i>after</i> the partnership assets are exhausted	(b) members are the ones individually liable for the debts of the organization, debts authorized or ratified by said members
(c) PURPOSE OF OBJECTIVE	(c) organized for gain, principally financial	(c) organized usually only for social or civic objectives
(d) PERSONALITY	(d) a legal person	(d) <i>not</i> a legal person

(9) ‘Partnership’ Distinguished from ‘Business Trusts’

When certain persons entrust their property or money to others who will manage the same for the former, a business trust is created. The investors are called *cestui que trust*; the managers are the trustees. In a *true* business trust, the *cestui que trust* (beneficiaries) do not at all participate in the management; hence, they are exempted from personal liability, in that they can be bound only to the extent of their contribution. (*See Home Lumber Co. v. Hopkins, 107 Kan. 153; See also Schumann-Heink v. Folsom et al., 328 Ill. 321*).

(10) ‘Partnership’ Distinguished from ‘Tenancy’

- (a) A partner acts as agent for the partnership whom he represents; the tenant does not represent the landlord. (This is true even if the rent is measured by the amount of the tenant’s profits while conducting a business on the premises, particularly if there is no agreement as to the sharing in losses.) (*Sc. 35 C.J. Landlord and Tenant, Sec. 1, p. 955*).
- (b) A partnership is a legal person; no such person is created in the relationship between landlord and tenant.

(11) ‘Partnership’ Distinguished from ‘Agency’

- (a) “Agency” may in one sense be considered the broader term because “partnership” is only a form of “agency.”
- (b) An agent never acts for himself but only for his principal; a partner is both a principal (for his own interests) and an agent (for the firm and the others).

(12) ‘Partnership’ Distinguished from a ‘Joint Adventure’ (or JOINT ACCOUNTS)

- (a) A joint adventure (an American concept similar to our *joint accounts*) is a sort of informal *partnership*, with no firm name and no legal personality. In a joint account, the participating merchants can transact business under their own name, and can be *individually liable* therefor.
- (b) Usually, but not necessarily, a joint adventure is limited to a SINGLE TRANSACTION, although the business of pursuing it to a successful termination may continue for a number of years; a partnership *generally* relates to a continuing business of various transactions of a certain kind. (*See 33 C.J., pp. 341-342*).

(13) ‘Partnership’ Distinguished from a ‘Syndicate’

A syndicate (of American origin) is usually a particular partnership, that is, it may have been organized to carry out a particular undertaking or for some temporary objective. (*See Minot v. Burroughs, 112 N.E. 620; see also Gates v. Megargel 266 F. 811*).

(14) Capacity to Become Partner

- (a) In general, a person capacitated to enter into contractual relations may become a partner. (*40 Am. Jur. 140*).
- (b) An *unemancipated minor* cannot become a partner unless his parent or guardian *consents*. Without such consent, the partnership contract is *voidable*, unless other partners are in the same situation, in which case the contract is unenforceable. (*Arts. 1327, 1403, and 1407, Civil Code*).

- (c) A *married woman*, even if already of age, cannot contribute conjugal funds as her contribution to the partnership, unless she is permitted to do so by her *husband* (See Art. 125, *Family Code*), or unless she is the *administrator* of the conjugal partnership, in which *latter case*, the court must give its consent/authority. (See Art. 124, *Family Code*).
- (d) A *partnership* being a juridical person by itself *can*, it is believed, form another partnership, either with private individuals or with other partnerships, there being no prohibition on the matter.
- (e) The majority view is that a *corporation cannot* become a partner on grounds of *public policy*; otherwise, people other than its officers may be able to bind it. (40 *Am. Jur.*, Sec. 22; See also *Whittenton Mills v. Upton*, 71 *Am. Dec.* 681). However, a corporation can enter into a *joint venture* with another where the nature of that venture is in line with the business authorized in its charter. Thus, a corporation, like the Gregorio Araneta Co., may act as a sort of “managing partner” of another corporation, for the purpose of conducting a lawsuit in line with the corporate business of the corporations concerned. (*J.M.T. Wason and Co., Inc. v. Bolanos*, L-4935, May 28, 1968).

(15) Some Cases

Sevilla v. CA **GR 41182-3, Apr. 15, 1988**

FACTS: Lina agreed to manage the Tourist World Service, Inc.’s Ermita office. She solicited airline fares, but did so for and on behalf of her principal, Tourist Service, Inc. As compensation she received 4% of the proceeds in the concept of commissions. She conceded the principal’s authority as owner of the business undertaking. In her letter she “concedes your [Tourist World Service Inc.’s] right to stop the operation of your branch office.”

HELD: Considering the circumstances, the parties contemplated a principal-agent relationship, rather than a joint management or a partnership.

Neither is there an employer-employee relationship between Lina and the Tourist World Service. Lina was not subject to control by the Tourist World Service, either as to the result of the enterprise or as to the means used in connection therewith. In the first place, under the contract of lease covering the Ermita Branch, she had bound herself *in solidum* and for rental payments, an arrangement that would belie claims of master-servant relationship. In the second place, when the branch office was opened, the same was run by Lina payable to the Tourist World Service by any airline for any fare brought in on the effort of Lina. Stated otherwise, a joint venture, including a partnership, presupposes generally a parity of standing between the joint co-ventures or partners, in which each party has an equal proprietary interest in the capital or property contributed, and where each party exercises equal rights in the conduct of business.

Estanislao, Jr. v. CA
GR 49982, Apr. 27, 1988

FACTS: Eligio, Remedios, Emilio and Leocadio are brothers and sisters, who are co-owners of a lot which was then being leased to Shell. They agreed to open and operate a gas station, with an initial investment of P15,000 to be taken from the advance rentals due from Shell. They executed a joint affidavit, where they agreed to help Eligio by allowing him to operate the gasoline station. For practical purposes they agreed that Eligio would apply for the dealership. Remedios helped in co-managing the business.

Later, the parties entered into an additional cash pledge agreement with Shell where it was reiterated that the P15,000 advance rental shall be deposited with Shell to cover advances of fuel to Eligio as dealer with a proviso that said agreement “cancels and supersedes the joint affidavit.” For sometime, Eligio submitted financial statements regarding the operation of the business to his brothers, but later he failed to render subsequent accounting. So the brothers and sisters of Eligio sued the latter for accounting and for payment of their lawful shares.

The trial judge dismissed the complaint. Another judge who took over from the first judge set aside the aforesaid decision and rendered another decision in favor of the brothers and sisters of Eligio. The Court of Appeals affirmed the decision of the second judge. Eligio contends that whatever partnership agreement there was in the previous joint affidavit had been superseded by the “additional cash pledge agreement.”

HELD: Said cancelling provision was necessary for the Joint Affidavit speaks of P15,000 advance rentals starting May 25, 1966, while the latter agreement also refers to advance rentals of the same amount starting May 24, 1966. There is therefore a duplication of reference to the P15,000; hence, the need to provide in the subsequent document that it “cancels and supersedes” the previous one.

Other evidence shows that there was a partnership agreement. Eligio submitted to his brothers and sisters periodic accounting of the business. He gave a written authority to Remedios to examine and audit the books of their “common business.” Remedios assisted in running the business. They bound themselves to contribute money to a common fund with the intention of dividing the profits among themselves. The sole dealership by Eligio and the issuance of all government permits in his name merely complies with Shell’s policy and the parties’ understanding of having only one dealer of Shell products.

Dan Fue Leung v. IAC and Leung Yiu
GR 70926, Jan. 31, 1989

A partner shares not only in profits but also in the losses of the firm. If excellent relations exist among the partners at the start of a business and all the partners are more interested in seeing the firm grow rather than get immediate returns, a deferment of sharing in the profits is perfectly plausible. It would be incorrect to state that if a partner does not assert his rights anytime within 10 years from the start of operations, such rights are irretrievably lost.

The private respondent’s cause of action is premised upon the failure of the petitioner to give him the agreed profits in

the operation of Sun Wah Panciteria. In effect, the private respondent was asking for an accounting of his interests in the partnership.

Ferdinand Santos v. Sps. Arsenio & Nieves Reyes
GR 135813, Oct. 25, 2001

For the purpose of determining the profits that should go to an industrial partner who shares in the profits but is not liable for the losses, the gross income from all the transactions carried on by the firm must be added together, and from this sum must be subtracted the expenses or the losses sustained in the business.

Only in the difference representing the net profits does the industrial partner share. But if, on the contrary, the losses exceeded the income, the industrial partner does not share in the losses.

Art. 1768. The partnership has a juridical personality separate and distinct from that of each of the partners, even in case of failure to comply with the requirements of Article 1772, first paragraph.

COMMENT:

(1) Effect on Non-Compliance With Art. 1772, 1st Paragraph (Registration With the Securities and Exchange Commission)

Under Art. 1772, “every contract of partnership having a capital of *P3,000 or more*, in money or property, shall appear in a public instrument, which *must* be recorded in the office of the Securities and Exchange Commission.” Now then, suppose this requirement has *not* been complied with, is the partnership still a juridical person, assuming that all *other* requisites are present?

ANS.: Yes, in view of the express provision of Art. 1768. According to Dean Capistrano, member of the Code Commission, par. 1 of Art. 1772 “is not intended as a prerequisite for the acquisition of juridical personality by the partnership, but

merely as a condition for the *issuance of licenses* to engage in business or trade. In this way, the tax liabilities of big partnerships cannot be evaded, and the public can also determine more accurately their membership and capital before dealing with them.” (*Capistrano, Civil Code of the Philippines, Vol. IV, p. 260*).

**Lilibeth Sunga-Chan & Cecilia Sunga
v. Lamberto T. Chua
GR 143340, Aug. 15, 2001**

Art. 1768 explicitly provides that the partnership retains its juridical personality even if it fails to register. Failure to register the contract of partnership does not invalidate the same as among partners, so long as the contract has the essential requisites, because the main purpose of registration, is to give notice to third persons; and it can be assumed that the members themselves knew of the content of their contract.

In the case at bar, non-compliance with this directory provision of the law will not invalidate the partnership considering that the total of the evidence proves that respondent and Jacinto indeed forged the partnership in question.

(2) Consequences of the Partnership Being a Juridical Entity

- (a) Its juridical personality is SEPARATE and DISTINCT from that of *each* of the partners. (Thus, in the partnership “Sundiang and Castillo,” there are *three persons*: Sundiang, Castillo, and the firm “Sundiang and Castillo”).)
- (b) The partnership can, in *general*:
 - 1) acquire and possess property of all kinds (*Art. 46, Civil Code*);
 - 2) incur obligations (*Art. 46, Civil Code*);
 - 3) bring civil or criminal actions (*Art. 46, Civil Code*);
 - 4) can be adjudged INSOLVENT even if the individual members be each financially solvent. (*Campos Rueda and Co. v. Pac. Com. Co., 44 Phil. 916*).

- (c) Unless he is personally sued, a partner has no right to make a separate appearance in court, if the partnership being sued is already represented. (*Hongkong & Shanghai Bank v. Jurado & Co.*, 2 Phil. 671).

(3) Limitations on Alien Partnerships

- (a) If at least 60% of the capital of a partnership is *not* owned by Filipinos (or by Americans, for the duration of the Parity Act), the firm *cannot acquire by purchase or otherwise* agricultural Philippine lands. (*Sec. 5, Art. XIII, 1935 Const.*) If land is neither *timberland* nor *mineral land*, it is for necessity agricultural — and would include “residential, commercial, or industrial lands.” (*Krivenko v. Reg. of Deeds*, 79 Phil. 461). Of course, if the land was purchased during the Japanese occupation, at a time when the Constitution, being political in nature, was suspended, the prohibition would not apply. (*Cabauatan v. Uy Hoo*, L-2207, Jan. 23, 1951). Neither would the prohibition apply with reference to lands purchased before the effectivity date of the Constitution, or to those acquired by the exercise of the right of conventional redemption — even if the redemption took place after the Constitution took effect — as long as the sale *a retro* had been made *before* said Constitution. To hold otherwise would be to impair a vested right. (*See Secs. 2, 7, 10 & 11, Art. XII, The 1987 Phil. Const.*).

Pedro R. Palting v. San Jose Petroleum, Inc. L-14441, Dec. 17, 1966

ISSUE: Assuming that 60% of a partnership or a corporation is controlled by American citizens, does it necessarily follow that said entity can engage in the exploitation and development of our natural resources?

HELD: No. For, it is still essential to prove that the *particular State* in the U.S. of which the members or stockholders (of the partnership or corporation concerned) are citizens, allow *reciprocal rights* to Filipino citizens and associations or corporations in said State. (*See par. 3, Art. VI of the Laurel-Langley Agreement*).

- (b) Foreign partnerships may lease lands provided the period does not exceed 99 years (*Smith, Bell & Co. v. Reg. of Deeds of Davao, L-7084, Oct. 27, 1954*), there being no prohibition regarding lease. (*Krivenko v. Reg. of Deeds, supra*).
- (c) Foreign partnerships may be the *mortgagees* of land, the mortgage to last for 5 years, renewable for another years. However, they *cannot* purchase the same at the foreclosure sale. (*RA 133*).

(4) Rules in Case of Associations Not Lawfully Organized as Partnerships

- (a) If an association is not lawfully organized as a partnership (though it apparently carries on the business as a partnership), it possesses no legal personality. Therefore, it *cannot* sue as such. However, the “partners”, in their individual capacity, can. (*Lopez, et al. v. Yu Sefao, et al., 31 Phil. 319*).
- (b) One who enters into contract with a “partnership” as such (as when he borrows money therefrom) *cannot*, when sued later on for recovery of the debt, allege the *lack of legal personality* on the part of the firm, even if indeed it had no personality. The reason is that the borrower is in estoppel. (*Behn, Meyer & Co. v. Rosatin, 5 Phil. 660*).

(5) Distinction Between Partnerships in the Philippines and Those in America

While Philippine partnerships have a juridical personality, those formed in America generally do not have (*except for the purpose of insolvency proceedings*). (*Campos Rueda & Co. v. Pac. Com. Co., 44 Phil. 916*). However, it must be stated here that in the United States today, two divergent legal theories as to the nature of a partnership have been developed by United States Courts, one adhering to the old common law conception that a partnership is simply an aggregate of individuals, and the other building up the newer conception that a partnership exists as an entity distinct from the partners.

(6) Partnership From the Viewpoint of Private International Law

From the viewpoint of Private International Law, it is clear that whether a partnership has juridical personality or not depends on its *personal law*. The personal law of a partnership is the law of the place where the partnership was *organized*.

Art. 1769. In determining whether a partnership exists, these rules shall apply:

(1) Except as provided by Article 1825, persons who are not partners as to each other are not partners as to third persons;

(2) Co-ownership or co-possession does not itself establish a partnership, whether such co-owners or co-possessors do or do not share any profits made by the use of the property;

(3) The sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived;

(4) The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment:

(a) As a debt by installments or otherwise;

(b) As wages of an employee or rent to a landlord;

(c) As an annuity to a widow or representative of a deceased partner;

(d) As interest on a loan, though the amount of payment vary with the profits of the business;

(e) As the consideration for the sale of a goodwill of a business or other property by installments or otherwise.

COMMENT:**(1) Purpose of Art. 1769 (Rules for Determining Existence of Partnerships)**

To indicate some tests to determine if what *may seem* to be a partnership really is one, or it is not.

(2) Requisites for Existence of Partnership

In general, to show the existence of a partnership, all of its essential characteristics (*See comments under Art. 1767*) must be proved; in particular it must be proved that:

- (a) there was an *intention* to create a partnership
- (b) there was a common fund obtained from contributions
- (c) there was a joint interest in the profits. (*See Fernandez v. De la Rosa, 1 Phil. 669*)

THEREFORE:

- (a) mere co-ownership or co-possession (even with profit-sharing)
- (b) mere sharing of GROSS returns (even with joint ownership of the properties involved) do *not* establish a partnership.

(3) Sharing of Net Profits

Sharing of NET profits is *prima facie* evidence that one is a *partner* except in the *five instances* enumerated under Art. 1769 (No. 4).

[**NOTE:** In the case of *People v. Juan A. Alegre, Jr., (CA) L-7244-R, Sept. 16, 1952*, the Court of Appeals observed that the payment of a commission on sales made by a partner does not preclude (exclude) the existence of a partnership. In fact, such a practice is oftentimes adopted in business circles as an added impetus among partners in the sale and disposition of goods that make up their common assets and property.]

Example:

D, to carry on a business, borrowed money from *C*. It was agreed that *D* would return the money in install-

ments and that said installments would come from *D*'s profits in the business. Is a partnership created between *D* and *C*?

ANS.: No. (See *Pastor v. Gaspar*, 2 *Phil.* 592). A difference must be made between LENDING money to a business proprietor, and contributing money and INVESTING it as CAPITAL in the business. (*Dinkelspeed v. Lewis*, 50 *Wyo.* 380).

(4) Cases

Fortis v. Gutierrez Hermanos **6 Phil. 100**

FACTS: Fortis was a bookkeeper in a partnership named "Gutierrez Hermanos", with a yearly salary amounting to 5% of the net profits for each year. Fortis, however, had no vote at all in the management of the business. Was he a partner?

HELD: No, for clearly this was a mere contract of employment.

Bastida v. Menzi and Co. **58 Phil. 188**

FACTS: Bastida worked for Menzi and Co., as *procurer* of contracts for fertilizers to be manufactured by the firm, and as *supervisor* of the mixing of the fertilizers. However, he had no *voice* in the management of the business except in his task of supervising the mixing of said fertilizers. For his *services*, he was entitled to 35% of the net profits in the fertilizer business. Aside from this, he sued the firm for 35% of the value of its *goodwill* on the ground that he had become a partner thereof. Decide.

HELD: He was *not* a partner, but a mere employee with no power to vote. While the parties had used the phrase "*en sociedad con,*" the truth is that this should not be interpreted to mean "in partnership with" but only as "*en reunion con*" or "*in association with.*"

Lyons v. Rosenstock
56 Phil. 632

FACTS: Eliser and Lyons were real estate dealers who often associated with each other in their business deals, and who owned together a certain parcel of land. With Lyon's consent, Wiser mortgaged the *common land* to obtain money for the development of the *San Juan Estate*. Lyons however expressed a desire *not* to participate in the project of development. The business of Eliser prospered and later on Lyons asked for a share obtained from the mortgage of the common property, and that therefore, he and Eliser had been partners. Decide.

HELD: No partnership was created, for Lyons himself did not want to engage in the development project, the mortgage of the common property being immaterial.

(5) Bar

Valderrama and Co., a general merchandise partnership, has become insolvent for maladministration of the business and entered into an agreement with its creditors to the effect that the business should be continued for the time being under the direction and management of an experienced businessman appointed by the creditors, an arrangement to be carried out until the claims of the creditors are fully satisfied. Can you consider the creditors who are parties to the agreement partners? Reasons.

ANS.: The creditors are not partners, for their only interest in the sharing of profits is the *receipt or payment of their credits*. (Art. 1769). Moreover, in a partnership, the partners are supposed to trust and have confidence in all the partners — this element is not present in the instant case.

(6) Proof Needed to Establish the Existence of a Partnership

No definite criterion can be set up except that all the characteristics of the contract must be proved as being present. In one case it was shown that there was *no* firm name, *no* firm accounts, *no* firm letterheads, *no* certificate of partner-

ship, *no* agreement as to profits and losses, *no* time fixed for the expiration of the alleged partnership. The Court correctly ruled that a partnership did not exist. (*Morrison v. Meister*, 180 N.W. 395). In another case, the testimony of the witnesses regarding the existence of the partnership as well as documentary evidence (letters) thereon resulted in the court's finding that indeed a partnership existed. (*Kiel v. Estate of P.S. Sobert*, 46 Phil. 193). An attempt to prove the existence of a partnership concerning the operation of a cinema house upon a 60-40 basis proved fruitless because of insufficient and contradictory evidences. There was no written agreement. Of course, this was not essential. But its absence, together with other circumstances and the fact that there was not even an attempt to submit an accounting for the whole period, negates the assumption that a partnership existed. (*Salada v. Salazar, et al.*, C.A., L-5258, Jun. 28, 1956). In still another case, the court held that it is hard to believe that a partnership has been formed without any book, any single written account, or any memorandum concerning it. Moreover, if the business licenses have been issued separately in favor of private individuals, how can we say that a partnership exists? (*Padilla v. Tomas Lim Hon, et al.*, C.A., L-163-R, Feb. 14, 1947).

(7) Partnership by Estoppel

If two persons not partners represent themselves as partners to strangers, a partnership by estoppel results. Similarly when 2 persons, who are partners, in connivance with a friend (who is *not* a partner), inform a stranger that said friend is their partner, a partnership by estoppel may also result to the end that the stranger should not be prejudiced. (See Art. 1769 [No. 1] and Art. 1825, Civil Code).

Art. 1770. A partnership must have a lawful object or purpose, and must be established for the common benefit or interest of the partners.

When an unlawful partnership is dissolved by a judicial decree, the profits shall be confiscated in favor of the State, without prejudice to the provisions of the Penal Code governing the confiscation of the instruments and effects of a crime.

COMMENT:**(1) Lawful Object or Purpose**

The object or purpose must be **LAWFUL**, *i.e.*, it must be *within the commerce of man, possible, and not contrary to law, morals, good customs, public order or public policy* (See also Arts. 1347 and 1348, Civil Code). Otherwise, the partnership contract is **VOID AB INITIO**. (Art. 1409, Civil Code).

[**NOTE:** If a partnership has several purposes, one of which is unlawful, the partnership can still validly exist so long as the illegal purpose can be separated from the legal purposes. (See 40 Am. Jur., pp. 144-145).]

(2) Query: Is a Judicial Decree Needed to Dissolve an Unlawful Partnership?

ANS.: No, for the contract is void from the very beginning, and therefore never existed from the viewpoint of the law. (See Art. 1409, Civil Code; see also *People v. Mendoza*). However, there would be nothing wrong in having the court dissolve the partnership. This will be good and convenient for everybody; moreover, there may be a question as to *whether or not* the partnership is indeed unlawful. This is particularly true when the object was lawful at the beginning but has *later on* become unlawful.

(**NOTE:** Under Art. 1830 of the Civil Code, one of the causes for the dissolution of a partnership is “any event which makes it unlawful for the business of the partnership to be carried on, or for the members to carry it on in partnership.”)

(3) Instances When a Partnership Is Unlawful

- (a) A partnership formed to furnish apartment houses which would be used for prostitution. (*Chateau v. Singla*, 114 Cal. 1015).
- (b) A partnership formed to create illegal monopolies or combinations in restraint of trade. (See Art. 186, Rev. Penal Code).
- (c) A partnership for gambling purposes. (See *Arbes, et al. v. Polistico, et al.*, 53 Phil. 489).

- (d) A partnership formed for the purpose of acquiring parcels of land much in excess of the maximum allowed by the Friar Lands Act. (*Torres v. Puzon, et al.*, C.A., L-4474, Sept. 28, 1950).

(4) Consequences of Unlawful Partnership

- (a) If the firm is also guilty of a crime, the Revised Penal Code governs both the criminal liability and the “*forfeiture of the proceeds of the crime and the instruments or tools with which it was committed*.” Such proceeds and instruments or tools shall be confiscated and forfeited in favor of the Government, unless they be the property of a *third person not liable* for the offense, but those articles which are not subject of lawful commerce shall be destroyed.” (*Art. 45, Rev. Penal Code*).
- (b) The partners forfeit the proceeds or profits, but NOT their contributions, provided no criminal prosecution has been instituted. (*Arbes v. Polistico, 53 Phil. 489*). If the contributions have already been made, they can be RETURNED; if the contributions have *not* yet been made, the partners cannot be made to make the contribution. (*See 1 Manresa 279*).
- (c) An unlawful partnership has no legal personality.

Arbes v. Polistico, et al. 53 Phil. 489

FACTS: An organization, “Turnuhan Polistico and Co.,” was engaged in conducting a lottery among its partners-members every weekend. The members contributed a weekly amount, all of which except a certain amount were distributed in turn to the lottery winners. Obviously, the court had no alternative except to declare the partnership an unlawful one. **Issue:** Can the partners get back their capital? their profits?

HELD: The partners can get back their capital, for the law speaks only of the confiscation of profits which certainly should not be returned, first because of the express provision of the law on profits, and second,

because to legally get profits, the action must be based on a lawful contract or transaction, not an illegal one like this.

Recovery of the capital indeed may be had, except if the same can come under the category of “instruments and effects of the crime.”

Art. 1771. A partnership may be constituted in any form, except where immovable property or real rights are contributed thereto, in which case a public instrument shall be necessary.

COMMENT:

(1) Formalities Needed

- (a) For VALIDITY of the contract (among the parties) as well as for ENFORCEABILITY, NO FORM is required as a *general rule, regardless* of the value of the contributions. Therefore, the contract may even be ORAL. (*Magalona v. Pesayco*, 59 Phil. 453). (Note that a partnership contract is not one of those covered by the Statute of Frauds.)

Exception: Whenever *real properties* or *real rights in real properties* are contributed — *regardless* of the value — a PUBLIC INSTRUMENT is needed. (The contract itself must be in the public instrument; moreover, there must be an INVENTORY of the immovables. This INVENTORY must be *signed* by the parties and *attached to the public instrument*.) (See Art. 1773, Civil Code).

[NOTE: Without the public instrument, the partnership is VOID. (Art. 1773, Civil Code).]

[NOTE: The inventory is important to show how much is due from each partner to complete his share in the common fund and how much is due to each of them in the event of liquidation. (*Tablason v. Bollozos, et al.*, C.A., 51 O.G. 1966). Without such inventory, the contract is void. (11 Manresa 278-279 and Art. 1773)].

(NOTE: The rules for limited partnerships are different.)

- (b) For EFFECTIVITY of the partnership contract insofar as innocent third persons are concerned, the same must be REGISTERED if REAL PROPERTIES are involved.

(2) Problem

A partnership was formed orally though more than P500 was contributed in cash. Now then, under the last paragraph of Art. 1358, contracts “where the amount involved exceeds P500 [such contract] must appear in *writing, even a private one.*” Should the oral partnership formed be considered valid?

ANS.: Yes, because Art. 1358 applies only for the purpose of *convenience* and not for validity or enforceability. Being valid, the contract can be put in writing upon the demand of any of the parties. (*Art. 1357, Civil Code; see also Thunga Chui v. Que Bentec, 2 Phil. 661; see also Magalona v. Pesayco, 59 Phil. 453.*)

[NOTE: Had *real property* been contributed, the oral partnership would be *void*; and therefore not one of the partners can compel the others to execute the public instrument. (*See Art. 1773, Civil Code.*)]

(3) Cases

Magalona v. Pesayco **59 Phil. 453**

FACTS: Pesayco, a partner in an *oral* partnership for the catching of fish, with *cash* as the only contributions thereto refused to account for proceeds of the firm on the ground that the agreement was not in writing. Is he correct?

HELD: No, because the oral partnership is valid, real properties not having been contributed. (*See also Fernandez v. De la Rosa, 1 Phil. 671.*)

Borja v. Addison, et al. **44 Phil. 895**

FACTS: *H* and *W*, husband and wife, owned conjugal land registered in the name of *H*. When *H* became a wid-

ower, *H* and the son *S* (of *H* and *W*) jointly administered the property. *H*, without *S*'s permission, sold the land to *X* who had *no knowledge* of the common ownership of the land. *X* now seeks registration of the land, against the opposition of the heirs of *S*. The opposition claimed that *H* had no right to sell *S*'s share of the land.

HELD: *X* can register the land in his name because although there may have been a partnership between the father and the son, still this fact was *unknown to third persons*. Moreover, since the contribution was in the form of land, a public instrument was needed to constitute the partnership.

Agad v. Mabato
L-24193, Jun. 28, 1968

FACTS: On Aug. 29, 1952, a partnership was entered into between Mauricio Agad and Severino Mabato "to *operate* a fishpond." Neither partner contributed a fishpond or a real right to any fishpond. Their contributions were limited to the sum of P1,000 each. The partnership contract was in a *public instrument*, but an inventory of the fishpond to be operated was *not attached to said instrument*.

ISSUE: Is the contract of partnership valid?

HELD: Yes, the contract is valid, despite the lack of the inventory. The purpose of the partnership was *not "to engage in a fishpond business"* but "*to operate a fishpond.*" Neither said fishpond nor a real right thereto was contributed to the partnership, or became part of the *capital* thereof, even if a fishpond or a real right thereto could become part of its assets. Art. 1773 which states that "a contract of partnership is void, whenever immovable property is *contributed* thereto, if inventory of said property is not made, signed by the parties, and attached to the public instrument," is, therefore, NOT APPLICABLE.

(4) Problems

- (a) If two persons agree to form a partnership in the future, does the partnership immediately arise from the moment of said agreement?

ANS.: No. An agreement to *form* a partnership does not of itself create a partnership. When there are conditions to be fulfilled or when a certain period is to elapse, first, the partnership is not created till after the fulfillment of the conditions or the arrival of the term, and this is true even if one of the parties has already advanced his agreed share of the capital.

Moreover, “there is a marked distinction between a partnership actually consummated and an agreement to enter into a partnership at a future time. So long as an agreement remains *executory*, the partnership is *inchoate*, not having been called into being by the concerted action necessary under the partnership agreement.” (*Limuco v. Calinao*, L-10099-R, *prom. Sept. 30, 1953, citing 40 Am. Jur. 142, Sec. 27*).

- (b) A and B today orally agreed to form a partnership one and a half years from today, each one to contribute P1,000. If at the arrival of the period, one refuses to go ahead with the agreement, can the other enforce the agreement?

ANS.: No, because the agreement was merely *oral* and *executory*. It is true that a partnership contract is not governed by the Statute of Frauds but here, there is merely an agreement to form a partnership in the future. Since therefore the agreement is to be enforced *after one year* from the making thereof, the same should be in writing to be enforceable under the *Statute of Frauds*. (*Art. 1403, No. [2][a]*).

[**NOTE:** In one case our Supreme Court ruled that even if there was a prior agreement to form in the future a partnership, still if one of those who had so agreed refuses to carry the agreement and to execute the necessary partnership papers, he cannot be obliged to do so. For here, his obligation is one to DO, *not* to GIVE. This is, therefore, a very personal act (*acto personalisimo*) of courts may not compel compliance, as it is an act of violence to do so. (*Woodhouse v. Halili*, L-4811, *Jul. 31, 1953*).]

Art. 1772. Every contract of partnership having a capital of three thousand pesos or more, money or property, shall appear in a public instrument, which must be recorded in the Office of the Securities and Exchange Commission.

Failure to comply with the requirements of the preceding paragraph shall not affect the liability of the partnership and the members thereof to third persons.

COMMENT:

(1) Purpose of the Registration with the Office of the Securities and Exchange Commission

The registration is to set “a condition for the issuance of licences to engage in business or trade. In this way, the tax liabilities of big partnerships cannot be evaded, and the public can also determine more accurately their membership and capital before dealing with them.” (*Dean Capistrano, IV Civil Code of the Philippines, p. 260*).

(2) Effect of Non-Registration

- (a) Even if *not* registered, the partnership having a capital of P3,000 or more is *still* a valid one, and therefore has legal personality. (*Art. 1768, Civil Code*).

(**NOTE:** Of course if real properties had been contributed, *regardless of value*, a public instrument is needed for the attainment of legal personality.)

- (b) If registration is needed or desired, any of the partners of a valid partnership can compel the others to execute the needed public instrument, and to subsequently cause its registration. (*Art. 1357, Civil Code*).

[**NOTE:** This right cannot be availed of if the partnership is *void*. (*Art. 1356 and Art. 1357, Civil Code*).]

Art. 1773. A contract of partnership is void, whenever immovable property is contributed thereto, if an inventory of said property is not made, signed by the parties, and attached to the public instrument.

COMMENT:**(1) Requirements Where Immovable Property is Contributed**

- (a) There must be a *public instrument* regarding the partnership. (*See Art. 1773*).
- (b) The *inventory* of the realty must be *made*, signed by the *parties*, and attached to the *public instrument*. (*Art. 1773*).

(2) Applicability of the Article

- (a) Art. 1773 applies *regardless of* the value of the real property.
- (b) Art. 1773 applies even if only *real rights over real properties* are contributed.
- (c) Art. 1773 applies also if, *aside from real property*, cash or personal property is contributed. (But here, the inventory need not include the *personalty*.)

(3) Registration in the Register of Property

The transfer of the land to the partnership must be duly recorded in the Register of Property to make the transfer effective insofar as third persons are concerned.

Art. 1774. Any immovable property or an interest therein may be acquired in the partnership name. Title so acquired can be conveyed only in the partnership name.

COMMENT:**(1) Acquisition of Property Under the Partnership Name**

Though the Article speaks only of *immovable*, same can apply also to *personalty* because the partnership is a juridical entity, capable of owning and possessing property. (*Art. 46*).

(2) Alien Partners

If the partnership has *aliens*, it cannot own lands, whether *public* or *private*, or whether *agricultural* or *commer-*

cial, except thru hereditary succession (by the partners who in turn convey the same to the partnership) or when 60% of the *capital is owned by Filipinos* (or Americans during the duration of the Parity Amendment). (*Art. XIII, Secs. 1 and 5, 1935 Constitution; Krivenko v. Reg. of Deeds, 79 Phil. 461 and Art. XII, Sec. 7, 1987 Constitution*).

The same rule applies to the development, exploitation, or utilization of public agricultural, timber or mineral lands. (*See 1935 and 1987 Constitutions*).

(3) Limitations on Acquisition

A partnership, *even if entirely of Filipino capital* may not:

- (a) *acquire, lease, or hold public agricultural lands in excess of 1,024 hectares.*
- (b) *lease public lands adapted to grazing in excess of 2,000 hectares.*

Art. 1775. Associations and societies, whose articles are kept secret among the members, and wherein any one of the members may contract in his own name with third persons, shall have no juridical personality, and shall be governed by the provisions relating to co-ownership.

COMMENT:

(1) If Articles Are Kept Secret

- (a) The association here is certainly *not* a partnership and therefore not a legal person, because “anyone of the members may contract in his *own name* with third persons” and not in the name of the firm.
- (b) Although not a juridical entity, it may be *sued* by third persons under the “common name” it uses; otherwise, said innocent third parties may be prejudiced. (*Rule 3, Sec. 15, Rules of Court*).
- (c) However, it cannot sue as such, because it has no legal personality and, therefore, cannot ordinarily be a party to a civil action. (*Rule 3, Sec. 1, Rules of Court*). Moreover,

the fact that it has no legal personality as a partnership cannot be invoked by the “partners” for the purpose of evading compliance with obligations contracted by them, because they who caused the nullity of a contract are prohibited from availing of its benefits. (*11 Manresa 289-290*).

- (d) Therefore, insofar as innocent third parties are concerned, the partners can be considered as members of a partnership; but as between themselves, or insofar as third persons are prejudiced, only the rules on co-ownership must apply. (*See Art. 1775*). The same rule applies in the case of a partnership by *estoppel*. (*See Art. 1825, Civil Code*).

(2) Effect of Certain Transactions

Thus, contracts entered into by a “partner” in his *own name* may be sued upon still by him in his *individual* capacity, notwithstanding the absence of a partnership. (*See Prautch v. Jones, 8 Phil. 1*). It has also been held that when two or more individuals having a common interest in a business bring a court action, it should be presumed that they prosecute the same in their individual capacity as co-owners, and not in behalf of a partnership which does not exist in legal contemplation. (*Smith, et al. v. Lopez, et al., 5 Phil. 78*).

Art. 1776. As to its object, a partnership is either universal or particular.

As regards the liability of the partners, a partnership may be general or limited.

COMMENT:

(1) Classification of Partnerships

- (a) *According to manner of creation:*
 - 1) orally constituted
 - 2) constituted in a private instrument
 - 3) constituted in a public instrument

- 4) registered in the Office of the Securities and Exchange Commission
- (b) *According to object:*
 - 1) universal
 - a) with all present property
 - b) with all profits (the individual properties here continue to be owned by the partners, but the usufruct thereof passes to the firm)
 - 2) particular — here the object are determinate things, their use or fruits; a specific undertaking, or the exercise of a profession or occupation (*Art. 1783, Civil Code*).
- (c) *According to liability:*
 - 1) *limited partnership* — that where at least one partner is a general partner, and the rest are limited partners. (*NOTE: A general partner is liable beyond his contribution; a limited partner is liable only to the extent of his contribution.*)
 - 2) *general partnership* — that where all the partners are *general* partners.
- (d) *According to legality:*
 - 1) lawful or legal
 - 2) illegal or unlawful
- (e) *According to duration:*
 - 1) for a specific period or till the purpose is accomplished
 - 2) partnership at will
 - a) here, no period, express or implied, is given and so its duration depends on the will of the partners;
 - b) if the period has expired, but the partnership continued, without liquidation, by the partners who habitually acted as such during the term. (*Art. 1785, Civil Code*).

(f) *According to representation to others:*

- 1) ordinary partnership
- 2) partnership by estoppel

(2) Classification Into General and Limited

- (a) A *general* partnership is one where *all* the partners are *general partners* (that is, they are liable even with respect to their *individual* properties, after the assets of the partnership have been exhausted).
- (b) A limited partnership is one where at *least one partner* is a *general* partner and the others are limited partners. (A *limited partner* is one whose liability is limited only up to the extent of his contribution.)

(NOTE: A partnership where all the partners are “limited partners” cannot exist as a limited partnership; it will even be refused registration. If at all it continues, it will be a *general partnership*, and all the partners will be general partners.)

(3) Example of Partnership De Facto

If upon the death of the wife, the husband continues to manage the formerly conjugal properties now owned by *him and the common children*, and said children allow their father to so manage the property, without even causing their rights to the property to be recorded in the Office of the Register of Deeds or in the Assessor’s *Office*, a *partnership de facto* has been created. It is therefore to be presumed that all the acts performed by the father, as managing partner, were for the benefit of all the partners. (*Andres de Jesus, et al. v. Nicanor Padilla and Roman de Jesus, C.A., L-12191-R, Apr. 19, 1955*).

(4) Example of Partnership by Estoppel

When two or more persons attempt to create a partnership but fail to comply with the legal formalities essential for juridical personality, the law considers them as partners, and the association is a partnership insofar as it is favorable to third persons, by reason of the equitable principle of estoppel.

(*MacDonald, et al. v. Nat. City Bank of New York*, 99 Phil. 156).

(5) Formalities Needed for the Creation of a Partnership

- (a) *Personal property*
 - 1) *less than P3,000 (total)* — may be oral
 - 2) *P3,000 or more* — must be in a public instrument and registered in the Securities and Exchange Commission. But even if this is not complied with, the partnership is still valid and possesses a distinct personality. (*Arts. 1772, 1768, Civil Code*). Evidently, the requirement is merely for administrative and licensing purposes.
- (b) *Real property* — Regardless of the value contributed, a *public instrument* is needed, with an *attached inventory*; otherwise the partnership is VOID and has NO juridical personality even as between the parties. (*Art. 1773, Civil Code*). Moreover, to be effective against third parties, the partnership must also be registered in the Registry of Property of the province where the real property contributed is found. After all, there is an alienation here of a *real right* on real property.
- (c) *Limited partnership* — must be registered AS SUCH in the Office of the Securities and Exchange Commission; otherwise, it is *not valid as a limited partnership*. (**NOTE:** However, even without such registration, it may still be considered a general *partnership*, and as such, possesses juridical personality). (*See Arts. 1843, 1844, Civil Code*).

Art. 1777. A universal partnership may refer to all the present property or to all the profits.

COMMENT:

Kinds of Universal Partnerships

- (a) Partnership of all present property
- (b) Partnership of all profits

Art. 1778. A partnership of all present property is that in which the partners contribute all the property which actually belongs to them to a common fund, with the intention of dividing the same among themselves, as well as all the profits which they may acquire therewith.

COMMENT:

Definition of Universal Partnership of All Present Property

The contribution here consists of:

- (a) All the properties actually belonging to the partners
- (b) The profits acquired with said properties.

Art. 1779. In a universal partnership of all present property, the property which belonged to each of the partners at the time of the constitution of the partnership, becomes the common property of all the partners, as well as all the profits which they may acquire therewith.

A stipulation for the common enjoyment of any other profits may also be made; but the property which the partners may acquire subsequently by inheritance, legacy, or donation cannot be included in such stipulation, except the fruits thereof.

COMMENT:

Transfer of Ownership From the Partners to the Universal Partnership

See Comments under the next Article.

Art. 1780. A universal partnership of profits comprises all that the partners may acquire by their industry or work during the existence of the partnership.

Movable or immovable property which each of the partners may possess at the time of the celebration of the contract shall continue to pertain exclusively to each, only the usufruct passing to the partnership.

COMMENT:

(1) Universal Partnership of Profits

The Article speaks of the universal partnership of profits.

(NOTE: This Article and the three preceding ones speak of the two kinds of universal partnership.)

(2) Distinctions

ALL PROFITS	ALL PRESENT PROPERTY
(a) Only the USUFRUCT of the properties of the partners becomes COMMON PROPERTY (owned by them and the partnership); NAKED OWNERSHIP is retained by each of the partners. (See also <i>Jackson v. Blum</i> , 1 Phil. 4).	(a) <i>All the property</i> actually belonging to the partners are CONTRIBUTED — and said properties become COMMON PROPERTY (owned by all the partners and by the partnership).
(b) ALL PROFITS acquired by the INDUSTRY or WORK of the partners become COMMON PROPERTY (regardless of <i>whether or not</i> said profits were obtained through the usufruct contributed).	(b) <i>As a rule</i> , aside from the contributed properties, <i>only the PROFITS</i> of said contributed COMMON PROPERTY (not other profits). (NOTE: Profits from other sources may become COMMON, but only if there is a stipulation to such effect.) <i>Properties subsequently</i> acquired by <i>inheritance, legacy, or donation</i> , cannot be included in the stipulation, BUT the <i>fruits thereof</i> can be included in the stipulation.)

(3) Future Property

Reasons why future (by inheritance, legacy, donation) property cannot be included in the stipulation regarding the *universal partnership of all present property*:

- (a) *First*, as a rule, contracts regarding *successional rights* cannot be made.
- (b) *Secondly*, a partnership demands that the contributed *things be determinate, known, and certain*.
- (c) *Thirdly*, a universal partnership of all present properties really implies a donation, and it is well-known that generally, future property cannot be donated. (*See 11 Manresa, pp. 304-314 and Art. 751, Civil Code*).

(4) Some Hypothetical Problems on ALL PRESENT PROPERTY

- (a) *A and B entered into a universal partnership of all present property. No stipulation was made regarding other properties. Subsequently, A received a parcel of land by inheritance from his father; and another parcel of land from the San Beda College as remuneration for A's work as professor therein. Question: Are the two parcels of land and their fruits to be enjoyed by the partnership?*

ANS.: No, because there was no stipulation regarding future properties or their fruits.

- (b) *Same as (a) except that in the contract, it was stipulated that all properties subsequently acquired would belong to the partnership.*

ANS.: The land acquired as salary as well as its fruits will belong to the firm; but the land acquired later by *inheritance* will NOT belong to the partnership since this cannot be stipulated upon. (*Art. 1780*). The fruits of the inherited land will go to the firm because said fruits may be considered as properties *subsequently acquired*, and there is no *prohibition to stipulate on fruits*, even if the fruits be those of properties acquired later on by inheritance, legacy, or donation.

(5) Some Hypothetical Problems on Profits

- (a) In a universal partnership of profits, A contributed the use of his car. At the end of the partnership, should the car be returned to him?

ANS.: Yes, because the naked ownership had always been with him, and upon the end of the usufruct, full ownership reverts to him. Remember that only its use had been previously contributed. (*See 11 Manresa 303*).

- (b) A and B entered into a universal *partnership of profits*. Subsequently, A won 1st prize in the sweepstakes. Will the money belong to the partnership?

ANS.: No, because it was not acquired by “industry or work.” (*Art. 1780, par. 1, Civil Code*).

- (c) A and B entered into a universal *partnership of profits*. Subsequently A became a teacher at the Poveda Learning Centre. Will A’s salary belong to the partnership?

ANS.: Yes, even though no stipulation was made on this point because after all the salary was acquired by A’s “industry or work during the existence of the partnership.” (*Art. 1780, par. 1*). Such “profit” belongs therefore to the firm as a matter of RIGHT. Of course, had there been a stipulation that such salary would be excluded, the stipulation would be VALID. (*See 11 Manresa 308*).

- (d) A and B entered into a universal *partnership of profits*. Later, A purchased a parcel of land. Will the fruits of said land belong to the partnership?

ANS.: As a rule, NO, because the usufruct (use and fruits) granted to the firm under Art. 1780, par. 2 refers only to that of the property possessed by the partner at the *time of the celebration of the contract*. It follows that fruits of after-acquired property do not belong to the firm as a matter of right. However, it would be *valid to stipulate* that the usufruct of after-acquired properties would belong to the partnership.

Art. 1781. Articles of universal partnership, entered into without specification of its nature, only constitute a universal partnership of profits.

COMMENT:

Presumption in Favor of Partnership of Profits

- (a) The Article applies only when a *universal* partnership has been entered into.
- (b) *Reason for the Article.* Less obligation is imposed in the universal partnership of profits because their real and personal properties are *retained* by them in *naked ownership*.
- (c) If however a universal partnership of all *present properties* is desired, REFORMATION is the proper remedy. (*See Arts. 1359, et seq., Civil Code*).

Art. 1782. Persons who are prohibited from giving each other any donation or advantage cannot enter into universal partnership.

COMMENT:

(1) Persons Who Together Cannot Form a Universal Partnership

Examples of people prohibited:

- (a) Husband and wife — as a rule. (*Art. 133, Civil Code*).
- (b) Those guilty of adultery or concubinage. (*Art. 739, Civil Code*).
- (c) Those guilty of the same criminal offense, if the partnership was entered into in consideration of the same. (*Art. 739, Civil Code*).

**Commissioner of Internal Revenue v.
William J. Suter & the Court of Tax Appeals
L-25532, Feb. 28, 1969**

FACTS: A limited partnership named “William J. Suter ‘Morcoin’ Co., Ltd.” was formed on 30 Sept.

1947 by William J. Suter as general partner (one liable even beyond his contribution), and Julia Spirig and Gustav Carlson, as limited partners (those liable only to the extent of their contribution). In 1948, Suter and Spirig got married, and sometime later, Carlson sold his share in the partnership to Suter and his wife. *Issue*: Did the marriage dissolve or put an end to the partnership?

HELD: No, the marriage did not dissolve the partnership. While spouses cannot enter into a universal partnership, they can enter into a particular partnership or be members thereof. The partnership was not, therefore, ended.

(2) Reason for the Article

A universal partnership is virtually a donation to each other of the partner's properties (or at least, their usufruct). Therefore, if persons are prohibited to donate to each other, they should not be allowed to do indirectly what the law forbids directly. (*See 11 Manresa 317*).

(3) Effect of Violation

The partnership violating Art. 1782 is null and void, and its nullity may be raised anytime. No legal personality was ever acquired. (*11 Manresa 317*).

Art. 1783. A particular partnership has for its object determinate things, their use or fruits, or specific undertaking, or the exercise of a profession or vocation.

COMMENT:

(1) 'Particular Partnership' Defined

The Article defines a "particular" partnership.

(2) Examples

To construct a building; to buy and sell real estate; to practice the law profession. Here in a sense, it is as if all

the members are industrial partners. (*Compania Maritima v. Muñoz*, 9 *Mil.* 326).

(**NOTE:** A husband and his wife may enter into a particular partnership.)

(3) Doctrine

If two individuals form a particular partnership for a deal in realty, it does not necessarily follow that all deals are for the benefit of the partnership. In the absence of agreement, each particular deal results in a particular partnership. If one of them, on his own account, and using his own funds, should make transactions in the same business, it is *his* own undertaking. (*Lyons v. Rosenstock*, 56 *Phil.* 632).

Chapter 2

OBLIGATIONS OF THE PARTNERS

Section 1

OBLIGATIONS OF THE PARTNERS AMONG THEMSELVES

Different Relationships

When two persons, *A* and *B*, form a partnership, different relations may arise:

- (a) Relations between *A* and *B*;
- (b) Relations between *A* and *B* on the one hand, and the *partnership* on the other hand;
- (c) Relations between *A* and *B* on the one hand, and *third persons* on the other hand;
- (d) Relations between the *partnership* and the *third persons*.

Some Obligations of a Partner

- (a) To give his contribution. (*Arts. 1786, 1788, Civil Code*).
- (b) Not to convert firm money or property for his own use. (*Art. 1788, Civil Code*).
- (c) Not to engage in unfair competition with his own firm. (*Art. 1808, Civil Code*).
- (d) To account for and hold as trustee, unauthorized personal profits. (*Art. 1807, Civil Code*).
- (e) Pay for damages caused by his fault. (*Art. 1794, Civil Code*).
- (f) Duty to credit to the firm, payment made by a debtor who owes him and the firm. (*Art. 1792, Civil Code*).

- (g) To share with the other partners the share of the partnership credit which he has received from an insolvent firm debtor. (*Art. 1743, Civil Code*).

Some Rights of a Partner

- (a) property rights. (*Art. 1810, Civil Code*).
 - 1) rights in specific partnership property (example —rights in a car contributed to the firm).
 - 2) interest in the partnership (share in the profits and surplus). (*Art. 1812, Civil Code*).
 - 3) right to participate in the management. (*Art. 1810, Civil Code*).

[NOTE: This right is not given to the limited partner. (Art. 1848, Civil Code).]

- (b) right to associate with another person in his share. (*Art. 1804, Civil Code*).
- (c) right to inspect and copy partnership books. (*Art. 1805, Civil Code*).
- (d) right to demand a formal account. (*Art. 1809, Civil Code*).
- (e) right to ask for the dissolution of the firm at the proper time. (*Arts. 1830-1831, Civil Code*).

Art. 1784. A partnership begins from the moment of the execution of the contract, unless it is otherwise stipulated.

COMMENT:

(1) When a Partnership Begins

- (a) Generally, from the *moment* of the execution of the contract.
- (b) Exception — When there is a contrary stipulation.

(2) Intent to Create a Future Partnership

The Article presupposes that there can be a future partnership which at the moment has no juridical existence yet.

The agreement for a future partnership does not of itself result in a partnership. The intent must later on be actualized by the formation of the intended partnership. (*See Limuco v. Calinao, C.A., L-10099-R, Sept. 30, 1953*).

(3) Rule if Contributions Have Not Yet Been Actually Made

Generally, even if contributions have not yet been made, the firm already *exists*, for partnership is a *consensual* contract (of course all the requisite formalities for such consent must be present).

Art. 1785. When a partnership for a fixed term or particular undertaking is continued after the termination of such term or particular undertaking without any express agreement, the rights and duties of the partners remain the same as they were at such termination, so far as is consistent with a partnership at will.

A continuation of the business by the partners or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is *prima facie* evidence of a continuation of the partnership.

COMMENT:

(1) Duration of a Partnership

A partnership is unlimited as to its duration in the sense that no time limit is fixed by law. The duration may be agreed upon — expressly (as when there is a definite period) or *impliedly* (as when a particular enterprise is undertaken — it being understood that the firm ends as soon as its purpose has been achieved).

(2) Partnership “At Will”

There are two kinds of a partnership “at will.”

- (a) *1st* kind — when there is no term, express or implied
- (b) *2nd* kind — when it is continued by the habitual managers — although the period has ended, or the purpose

has been accomplished. (**NOTE:** This is “*prima facie*” evidence of the firm’s continuation.)

[**NOTE:** It is called “at will” because its continued existence really depends upon the will of the partners, or even on the will of any of them. (40 *Am. Jur.*, Sec. 19, 139).]

Art. 1786. Every partner is a debtor of the partnership for whatever he may have promised to contribute thereto.

He shall also be bound for warranty in case of eviction with regard to specific and determinate things which he may have contributed to the partnership, in the same cases and in the same manner as the vendor is bound with respect to the vendee. He shall also be liable for the fruits thereof from the time they should have been delivered, without the need of any demand.

COMMENT:

(1) Three Important Duties of Every Partner

The Article speaks of *three* things:

- (a) the duty to *contribute* what had been promised;
- (b) the duty to deliver the *fruits* of what should have been delivered; and
- (c) the duty to warrant.

(2) The Duty to Contribute

- (a) The contribution must be made ordinarily at the time the partnership is entered into, unless a different period is stipulated. In either case, no demand is needed to put the partner in default, because in a partnership the obligation to contribute is one where *time is of the essence* (for without the contribution, the partnership is useless).
- (b) The partner must exercise due diligence in preserving the property to be contributed, before he actually contributes the same; otherwise, he can be held liable for

losses and deterioration. (*See 11 Manresa 344; see also Art. 1794, Civil Code*).

Moran, Jr. v. Court of Appeals
L-59956 Oct. 31, 1984

(1) A partner who promises to contribute to the partnership becomes a promissory debtor of the latter.

(2) If the partnership venture is a failure, a partner is not entitled to his promised commission, if said promise does not state the basis of the commission.

(3) The Duty to Deliver the Fruits

- (a) If *property* has been promised, the fruits thereof should also be given. The fruits referred to are those arising from the time they *should have been delivered*, without need of any demand. If the partner is in bad faith, he is liable not only for the fruits actually produced, but also for those that could have been produced. (*See 11 Manresa 344*).
- (b) If money has been promised, “*interest and damages from the time he should have complied with his obligation*” should be given. (*Art. 1788*). Here again, no demand is needed to put the partner in default.

Query: Who owns the property before it is delivered?

ANS.: It is submitted that both in the case of money or property, it is the partner who still owns the same before delivery, for it is delivery, actual or constructive, that transfers ownership.

(4) The Duty to Warrant

- (a) The warranty in case of eviction refers to “specific and determinate things” *already contributed*. (*See Art. 1786, Civil Code*).
- (b) There is “eviction” whenever by a final *judgment* based on a right prior to the sale or an act imputable to the partner, the partnership is deprived of the whole or a part of the thing purchased. The parties may however

suppress, increase, or diminish this legal obligation. (*See Art. 1548, Civil Code*). The partner who made the contribution should be summoned in the suit for eviction, at the instance of the partnership. (*Art. 1558, Civil Code*).

(5) Problem

If a partner fails to contribute within the stipulated time what was promised, may the partnership contract be rescinded?

ANS.: As a general rule, NO. The reason is, rescission is not the proper remedy; the remedy should be to collect what is owing, as well as damages. The general rule in obligations cannot apply in the case of partnership. (*Sancho v. Lizarraga, 55 Phil. 601*). However, if the defaulting partner is already dead, rescission may prosper. (*Pabalan v. Velez, 22 Phil. 29*).

Art. 1787. When the capital or a part thereof which a partner is bound to contribute consists of goods, their appraisal must be made in the manner prescribed in the contract of partnership, and in the absence of stipulation, it shall be made by experts chosen by the partners, and according to current prices, the subsequent changes thereof being for the account of the partnership.

COMMENT:

(1) When Contribution Consists of Goods

Appraisal of value is needed to determine how much has been contributed.

(2) How Appraisal Is Made

- (a) Firstly, as prescribed by the contract.
- (b) Secondly, in default of the first, by EXPERTS chosen by the partners, and at CURRENT prices.

(3) Necessity of the Inventory-Appraisal

Proof is needed to determine how much goods or money had been contributed. An inventory is therefore useful. (*See Tablason v. Bollozos, C.A., 51 O.G. 1966*).

(4) Risk of Loss

After goods have been contributed, the partnership bears the risks of subsequent changes in their value. (*Art. 1787*).

Art. 1788. A partner who has undertaken to contribute a sum of money and fails to do so becomes a debtor for the interest and damages from the time he should have complied with his obligation.

The same rule applies to any amount he may have taken from the partnership coffers, and his liability shall begin from the time he converted the amount to his own use.

COMMENT:**(1) Rules of Failure to Contribute and for Conversion**

Cases covered by the Article:

- (a) when money promised is not given on time;
- (b) when partnership money is *converted* to the personal use of the partner.

(2) Coverage of Liability

Liability covers ALSO *interest* and *damages*:

- (a) Interest at the agreed rate; if none, at the legal rate of 6% per annum.
- (b) Damages that may be suffered by the partnership.

(3) Why No Demand Is Needed to Put Partner in Default

- (a) In the case of the *contribution*, because *time is of the essence*, a partnership is formed precisely to make use of the contributions, and this use should start from its formation, unless a different period has been set; otherwise the firm is necessarily deprived of the benefits thereof. Thus, the injury is constant. (*11 Manresa 332-335*).
- (b) In the case of conversion, because the firm is deprived of the benefits of the money, from the very moment of conversion.

[**NOTE:** Even if no actual injury results, the liability exists, because the article is absolute. (See *11 Manresa 335-336*).]

(4) Some Cases

- (a) *Martinez v. Ong Pong Co*, 14 Phil. 726

A managing partner who fails to account for the money received by him must return to the other partners their shares plus *legal interest* in the *absence* of any proof of actual loss.

- (b) *Colbert v. Bachrach*, 12 Phil. 84

A partner who fails to collect “chits” entrusted to him for collection must pay for the *value* of the chits which he cannot return to the firm, insofar as his *partner’s shares* are concerned. This is true *whether or not* he was actually able to collect, unless he can adequately explain the loss of the “chits.”

- (c) *Teague v. Martin*, 53 Phil. 504

A partner who uses for his own purposes partnership funds must ACCOUNT for the same.

- (d) *U.S. v. Clarin*, 17 Phil. 84

Mere failure of the managing partner to return to the others their share of the *capital* does not necessarily constitute estafa.

(**NOTE:** After all, there may really have been a business loss. Moreover, what should be brought is a *civil case*.)

Art. 1789. An industrial partner cannot engage in business for himself, unless the partnership expressly permits him to do so, and if he should do so, the capitalist partners may either exclude him from the firm or avail themselves of the benefits which he may have obtained in violation of this provision, with a right to damages in either case.

COMMENT:

(1) Classification of Partners

(a)	From the viewpoint of CONTRIBUTION	}	Capitalist Industrial
(b)	From the viewpoint of LIABILITY	}	General Limited
(c)	From the viewpoint of MANAGEMENT	}	Managing Silent Liquidating Ostensible
(d)	Miscellaneous	}	Secret Dormant Nominal

(2) Definitions and Some Characteristics

- (a) *Capitalist partner* — one who furnishes capital. (He is not exempted from losses; he can engage in other business provided there is NO COMPETITION between the partner and his business.) (See Art. 1808, Civil Code).
- (b) *Industrial partner* — one who furnishes industry or labor. [He is exempted from losses as between the partner; he cannot engage in any other business without the express consent of the other partners; otherwise:
 - 1) he can be EXCLUDED from the firm (PLUS DAMAGES);
 - 2) OR the benefits he obtains from the other businesses can be *availed* of by the other partners (PLUS DAMAGES). (Art. 1789, Civil Code).]

[**NOTE:** The rule remains true whether or not there is COMPETITION. *Reason:* All his industry is supposed to be given only to the partnership. (*Limuco v. Calinao, C.A., L-10099-R, Sept. 30, 1953*).]

- (c) *Capitalist-industrial partner* — one who contributes both capital and industry.

- (d) *General partner* — one who is liable beyond the extent of his contribution.
- (e) *Limited partner* — one who is liable only to the extent of his contribution.

[**NOTE:** An industrial partner can only be a general partner, never a limited partner. (See Art. 1845, Civil Code).]

- (f) *Managing partner* — one who manages actively the firm's affairs.
- (g) *Silent partner* — one who does not participate in the management (though he shares in the profits or losses).
- (h) *Liquidating partner* — one who liquidates or winds up the affairs of the firm after it has been dissolved.
- (i) *Ostensible partner* — one whose connection with the firm is public and open (that is, not hidden). (Usually his name is included in the firm name.)
- (j) *Secret partner* — one whose connection with the firm is concealed or kept a secret.
- (k) *Dormant partner* — one who is both a secret (hidden) and silent (not managing) partner.
- (l) *Nominal partner* — one who is not really a partner but who may become liable as such insofar as third persons are concerned. (*Example:* a partner by estoppel.)

(3) Distinctions Between a 'Capitalist' and an 'Industrial Partner'

- (a) *As to contribution:*
 - 1) the capitalist partner contributes *money* or *property*
 - 2) the industrial partner contributes his *industry* (mental or physical)
- (b) *As to prohibition to engage in other business:*
 - 1) the capitalist partner cannot generally engage in the *same* or *similar* enterprise as that of his firm

- (the test is the possibility of unfair competition).
(*Art. 1808, Civil Code*).
- 2) the industrial partner cannot engage in *any* business for himself (*Reason*: all his industry is supposed to be contributed to the firm). (*Art. 1789, Civil Code*).
- (c) *As to profits*:
- 1) the capitalist partner shares in the profits according to the *agreement* thereon; if none, *pro rata* to his contribution. (*Art. 1797, Civil Code*).
 - 2) the industrial partner receives a just and equitable share. (*Art. 1797, Civil Code*).
- (d) *As to losses*:
- 1) capitalist
 - a) first, the stipulation as to losses
 - b) if none, the agreement as to *profits*
 - c) if none, *pro rata* to contribution
 - 2) the industrial partner is exempted as to losses (as between the partners). But is liable to strangers, without prejudice to reimbursement from the capitalist partners. (*Art. 1816, Civil Code*).

Art. 1790. Unless there is a stipulation to the contrary the partners shall contribute equal shares to the capital of the partnership.

COMMENT:

(1) Amount of Contribution

- (a) It is permissible to contribute unequal shares, if there is a stipulation to this effect.
- (b) In the absence of proof, the shares are presumed equal.

(2) To Whom Applicable

The rule applies to *capitalist* partners apparently; however, the share of the industrial partner is undoubtedly also

available, for his industry may be worth even more than the entire capital contributed.

Art. 1791. If there is no agreement to the contrary, in case of an imminent loss of the business of the partnership, any partner who refuses to contribute an additional share to the capital, except an industrial partner, to save the venture, shall be obliged to sell his interest to the other partners.

COMMENT:

(1) When a Capitalist Partner Is Obligated to Sell His Interest to the Other Partners

- (a) If there is *imminent* loss of the business of the partnership;
- (b) and he *refuses* (deliberately and not because of poverty, otherwise this would be unjust) to contribute an *additional share to the capital*;
- (c) and provided further that there is no *agreement to the contrary*.

(2) Reason

Because of his apparent lack of *interest*, and granting that he sincerely believes that efforts to save the firm would be futile, the capitalist partner referred to should get out of the firm.

(3) Rule for the Industrial Partners

Note that the industrial partner is exempted. *Reason:* He is already giving his *entire industry*.

Art. 1792. If a partner authorized to manage collects a demandable sum, which was owed to him in his own name, from a person who owed the partnership another sum also demandable, the sum thus collected shall be applied to the two credits in proportion to their amounts, even though he

may have given a receipt for his own credit only, but should he have given it for the account of the partnership credit, the amount shall be fully applied to the latter.

The provisions of this article are understood to be without prejudice to the right granted to the debtor by Article 1252, but only if the personal credit of the partner should be more onerous to him.

COMMENT:

(1) Rule if Managing Partner Collects a Credit

For this Article to apply the following requisites must concur:

- (a) The existence of at least 2 debts (one where the *firm* is the creditor; the other, where the *partner* is the creditor).
- (b) Both sums are demandable.
- (c) The *collecting* partner is a *managing* partner.

(2) Example

P, a managing partner, is *X*'s creditor to the amount of P1 million, already demandable. *X* also owes the partnership P1 million, also demandable. *P* collects P1 million.

- (a) If *P* gives a receipt for the *firm*, it is the *firm's credit* that has been collected.
- (b) If *P* gives a receipt for his *own credit* only, P500,000 will be given to him; the other P500,000, to the firm. (*Note the use of the word "proportion."*)

[*Reason for the law:* To prevent furtherance of the partner's personal interest to the detriment of the firm. (*See 11 Manresa 361*).]

Exception: *X* may decide that he is paying only *P's credit* in accordance with his right of "application of payment." (*Art. 1262, Civil Code*). This is all right; BUT only if the personal credit of *P* is more onerous to *X* (*Art. 1792, Civil Code*).

(3) When Article Does Not Apply

Art. 1792 does *not* apply if the partner collecting is *not* a *managing partner*. Here there is no basis for the *suspicion* that the partner is in BAD FAITH. (*11 Manresa 351*).

Art. 1793. A partner who has received, in whole or in part, his share of a partnership credit, when the other partners have not collected theirs, shall be obliged, if the debtor should thereafter become insolvent, to bring to the partnership capital what he received even though he may have given receipt for his share only.

COMMENT:

(1) Art. 1792 Compared With Art. 1793 (Where a Partner Receives His Share of a Partnership Credit)

<i>Art. 1792</i>	<i>Art. 1793</i>
(a) <i>two debts</i>	(a) one debt only (<i>firm credit</i>)
(b) applies only to managing partner	(b) applies to <i>any</i> partner

(2) Example

X owes a firm P1 million. *P*, a partner, was given his share of P500,000, there being only two partners. Later *X* becomes insolvent. Must *P* share the P500,000 with the other partner?

ANS.: Yes, even if *P* had given a receipt for his share only. *Reason for the law:* Equity demands proportionate share in the benefits and losses. (*See 11 Manresa 353*).

Note that Art. 1793 applies whether the partner has received HIS SHARE wholly or in part. (*See Art. 1793*).

(3) Query

Does Art. 1793 apply even if the collecting was done AFTER the dissolution of the partnership?

ANS.: *No more*, because:

- (a) strictly speaking, when the firm is dissolved, there is no more *partnership credit or capital*. (A mere co-ownership exists. *Note* that the law uses “partnership capital.”)
- (b) no more trust relations really still exist.
- (c) equity demands the rewarding of one’s diligence in collecting. (*Manresa and Ricchi*).

Art. 1794. Every partner is responsible to the partnership for damages suffered by it through his fault, and he cannot compensate them with the profits and benefits which he may have earned for the partnership by his industry. However, the courts may equitably lessen his responsibility if through the partner’s extraordinary efforts in other activities of the partnership, unusual profits have been realized.

COMMENT:**(1) Why General Damages Cannot Be Offset by Benefits**

- (a) Firstly, the partner has the DUTY to secure benefits for the partnership; on the other hand, he has the DUTY also not to be at fault.
- (b) Secondly, since both are *duties*, compensation should not take place, the partner being *the debtor* in both instances. (*See 11 Manresa 377*). Compensation requires 2 persons who are reciprocally *debtors* and *creditors* of each other.

(2) Mitigation of Liability

Note however that equity may mitigate liability if there be “extraordinary efforts” resulting in “unusual profits.”

(3) Need for Liquidation

Before a partner sues another for alleged fraudulent management and resultant damages, a *liquidation* must first

be effected to know the extent of the damage. (*Soncuya v. De Luna*, 67 Phil. 646).

(4) Effect of Death of the Negligent Partner

If a negligent partner is already *dead*, *suit* for recovery may be had against his estate. (See *Po Yeng Cheo v. Lim Ka Yam*, 44 Phil. 172).

Art. 1795. The risk of specific and determinate things, which are not fungible, contributed to the partnership so that only their use and fruits may be for the common benefit, shall be borne by the partner who owns them.

If the things contributed are fungible, or cannot be kept without deteriorating, or if they were contributed to be sold, the risk shall be borne by the partnership. In the absence of stipulation, the risk of things brought and appraised in the inventory, shall also be borne by the partnership, and in such case the claim shall be limited to the value of which they were appraised.

COMMENT:

Risk of Loss

- (a) *Specific and determinate things (NOT fungible)* — whose *usufruct* is enjoyed by a firm — like a car — *partner* who owns it bears loss for ownership was never transferred to the firm.
- (b) *Fungible or Deteriorable* — *Firm bears loss* for evidently, ownership was being transferred; otherwise, use is impossible.
- (c) *Things Contributed to be Sold* — *Firm bears loss* for evidently, firm was intended to be the *owner*; otherwise, a sale could not be made.
- (d) *Contributed under Appraisal* — *Firm bears loss* because this has the effect of an implied sale. (See 11 *Manresa* 360-361).

Art. 1796. The partnership shall be responsible to every partner for the amounts he may have disbursed on behalf of the partnership and for the corresponding interest, from the time the expenses are made, it shall also answer to each partner for the obligations he may have contracted in good faith in the interest of the partnership business, and for risks in consequence of its management.

COMMENT:

Responsibility of Firm

- (a) To *refund amounts* disbursed on behalf of firm plus interest (legal) from the time *expenses were made* (and not from *demand*, since after all, a partner is an agent, and the rule on agency applies to him). (*11 Manresa 365*).

[**NOTE:** Refund must be made even in case of *failure* of the enterprise entered into, provided the partner is not at fault. *Reason:* Being a mere agent, the partner should *not* assume personal liability. (*See Arts. 1897 and 1912*). Moreover, conversion by the partner results in liability from the moment of conversion. (*See Art. 1788, par. 2*).]

[**NOTE:** The “amounts disbursed” referred to in the Article does not refer to the original capital. (*Martinez v. Ong Pong Co, 14 Phil. 726*).]

[**NOTE:** A partner who advances funds from his own pocket for *taxes on partnership land*, must be reimbursed the same from *partnership assets*. If the firm is *insolvent*, the other partners must reimburse the paying partner *except* for the latter’s proportionate share in the taxes. (*See Pabalan v. Velez, 22 Phil. 29*).]

- (b) To *answer* to each partner for *obligations*, he may have entered into in *good faith* in the interest of the partnership, as well as for RISKS in consequence of its management. (*Reason:* The partner is an AGENT.)

Example: Debts incurred, by the manager for the firm’s interest, impliedly acquiesced in by the others, must be shouldered by the firm. (*Agustin v. Inocencio, 9 Phil. 134*).

Art. 1797. The losses and profits shall be distributed in conformity with the agreement. If only the share of each partner in the profits has been agreed upon, the share of each in the losses shall be in the same proportion.

In the absence of stipulation, the share of each partner in the profits and losses shall be in proportion to what he may have contributed, but the industrial partner shall not be liable for the losses. As for the profits, the industrial partner shall receive such share as may be just and equitable under the circumstances. If besides his services he has contributed capital, he shall also receive a share in the profits in proportion to his capital.

COMMENT:

(1) How Profits Are Distributed

- (a) according to *agreement* (but not *inequitously* to defeat). (*Art. 1799*).
- (b) if none, according to amount of contribution. (*See 11 Manresa 377*).

(2) How Losses are Distributed

- (a) according to agreement — as to *losses* (but not *inequitously*)
- (b) if none, according to agreement as to *profits*
- (c) if none, according to amount of contribution. (*See 11 Manresa 377*).

(3) Industrial Partner's Profits

A *just* and equitable share (under the *old law*, a share equivalent to that of the capitalist partner with the *least* capital).

[**NOTE:** If he also contributed capital, see (1).]

(4) Industrial Partner's Losses

While he may be held liable by third persons, still he can recover whatever he is made to give them, from the other

partners, for he is exempted from LOSSES, with or without stipulation to this effect.

(5) Non-Applicability to Strangers

Art. 1797 applies only to the partners, not when liability in favor of strangers are concerned, particularly with reference to the industrial partner. (*Cia Maritima v. Muñoz*, 9 Phil. 326).

Art. 1798. If the partners have agreed to intrust to a third person the designation of the share of each one in the profits and losses, such designation may be impugned only when it is manifestly inequitable. In no case may a partner who has begun to execute the decision of the third person, or who has not impugned the same within a period of three months from the time he had knowledge thereof, complain of such decision.

The designation of losses and profits cannot be intrusted to one of the partners.

COMMENT:

Designation by Third Person of Shares in Profits and Losses

- (a) The Article speaks of a “third person,” not a partner.
Reason: To avoid partiality. (11 *Manresa* 375).
- (b) When designation by 3rd party may be *impugned* – “when it is **MANIFESTLY INEQUITABLE**.”
- (c) When designation by third party *cannot be impugned* even if manifestly inequitable:
 - 1) if the aggrieved partner has already *begun to execute* the decision;
 - 2) or if he has *not* impugned the same within a period of *three months* from the time he had *knowledge* thereof (*not* from the time of *making*).

Art. 1799. A stipulation which excludes one or more partners from any share in the profits or losses is void.

COMMENT:**(1) Stipulation Excluding a Partner from Profits or Losses**

- (a) The general rule is that a stipulation excluding *one or more partners* from any share in the profits or losses is void. *Reason:* The partnership is for COMMON BENEFIT.
- (b) One exception is in the case of the *industrial partner* whom the *law itself excludes* from losses. (*Art. 1797, par. 2*). If the law itself does this, a *stipulation* exempting the industrial partner from losses is naturally *valid*. (Of course, it is permissible to stipulate that even the industrial partner shall be liable for losses.)

(2) Reason Why Industrial Partner Is Generally Exempted from Losses

While capitalist partners can withdraw their capital, the industrial partner cannot withdraw any labor or industry he had already exerted. Moreover, in a certain sense, he already *has shared in the losses* in that, if the partnership shows no profit, this means that he has labored in vain. (*See 11 Manresa 377*).

(3) Problem

A, B, and C were partners, the first one being an industrial partner. During the first year of operation, the firm made a profit of P3 million. During the second year, a loss of P1.5 million was sustained. Thus, the net profit for the two years of operation was only P1.5 million. In the articles of partnership it was stipulated that A, the industrial partner would get 1/3 of the profits, but would not participate in the losses.

- (a) Is the stipulation valid? Why?
- (b) How much will A get: 1/3 of P3 million or 1/3 of P1.5 million? Why?

ANS.:

- 1) The stipulation is *valid*, for even the law itself exempts the industrial partner from losses. His share in the profits is presumably fair.

- 2) A will get only 1/3 of P1.5 million, the net profit and not 1/3 of P3 million. While it is true that he does not share in the *losses*, this only means that *he will not share in the net losses*. It is understood that he share in the losses insofar as these can be accommodated in the profits. It is but fair to compute *all* the various transactions in determining the net profits or losses. (*See Criado v. Gutierrez Hermanos*, 37 Phil. 883).

Art. 1800. The partner who has been appointed manager in the articles of partnership may execute all acts of administration despite the opposition of his partners, unless he should act in bad faith; and his power is irrevocable without just or lawful cause. The vote of the partners representing the controlling interest shall be necessary for such revocation of power.

A power granted after the partnership has been constituted may be revoked at any time.

COMMENT:

(1) Appointment of Manager

Art. 1800 speaks of two modes of appointment:

- (a) appointment as manager in the articles of *partnership*;
- (b) appointment as manager made in an instrument *other* than the articles of partnership or made *orally*.

(2) Appointment in Articles of Partnership

- (a) Power is *irrevocable without just or lawful* cause.

THEREFORE:

- 1) to remove him for JUST cause, the *controlling partners* (controlling financial interest) should vote to OUST HIM. (*See Art. 1800, par. 1*)
- 2) to remove him WITHOUT CAUSE, or FOR AN UNJUST CAUSE, there must be *UNANIMITY* (including his *own vote*).

Reason: This represents a change in the will of the parties: a change in the terms of the contract; a *novation*, so to speak, requiring unanimity. (See 11 *Manresa* 382).

(b) *Extent of power:*

- 1) if he acts in GOOD faith, he may do all acts of ADMINISTRATION (not ownership) *despite* the opposition of his partners.
- 2) if in BAD faith, he *cannot* (however, he is presumed to be acting in good faith; moreover, if he really is in bad faith the controlling interest should remove him.)

(3) Appointment Other Than in the Articles of Partnership

- (a) Power to act may be revoked at *any time, with or without* just cause.

[Reason: Such appointment is a mere delegation of power, revocable at any time. (11 *Manresa* 381).]

[**NOTE:** Of course, removal should also be done by the controlling interest].

(**NOTE:** Moreover, the controlling partners should not abuse this right, otherwise damages are recoverable from them under Arts. 19 and 20.)

- (b) Extent of power: As long as he remains manager, he can perform all acts of ADMINISTRATION, but of course, if the others oppose and he persists, he can be removed.

(4) Scope of Powers of a Manager

Unless his powers are specifically restricted, he has the powers of a general agent, as well as all the *incidental* powers needed to carry out the objectives of the partnership, such as, for example, the power to *issue official receipts*, in the transaction of business; otherwise, this would not be in keeping with present day business dealings. (*Ng Ya v. Sugbu Commercial Co., C.A., 50 O.G. 4913*). Indeed, when the object of a partnership has been determined, the manager has all

the powers necessary for the attainment of such objective. (*Smith, Bell & Co. v. Aznar & Co.*, 40 O.G. 1882). Moreover, as manager, he has, even without the approval of the other partners, the power to dismiss an employee, particularly when a justifiable cause *exists*. (*Matela v. Chua-Sintek, et al.*, C.A., L-12165, Apr. 6, 1955).

(**NOTE:** In the *Matela* case, Matela, a pharmacy clerk in a drug store operated by a partnership, was suspected of having misappropriated P300 worth of anti-tetanus serum; whereupon, while being investigated by the police, he hurled abusive and unsavory language against the *manager*, in the presence of customers of the firm. The manager then dismissed him, which dismissal the Court of Appeals held to be highly justified.)

Art. 1801. If two or more partners have been intrusted with the management of the partnership without specification of their respective duties, or without a stipulation that one of them shall not act without the consent of all the others, each one may separately execute all acts of administration, but if any of them should oppose the acts of the others, the decision of the majority shall prevail. In case of a tie, the matter shall be decided by the partners owning the controlling interest.

COMMENT:

(1) Rule When There Are Two or More Managers

Art. 1801 applies when:

- (a) two or more partners are managers;
- (b) there is NO specification of respective duties;
- (c) there is no stipulation requiring unanimity.

THEREFORE: Art. 1801 does not apply if *unanimity* is required; or when there is a designation of respective duties.

(2) Specific Rules

- (a) Each may separately execute all acts of administration (unlimited powers to administer).

- (b) Except if *any* of the managers should oppose. (Here the decision of the MAJORITY of the managers shall prevail.)

(Suppose there is a *tie*, the partners owning the CONTROLLING INTEREST prevail — provided they are also managers.)

[NOTE: The rights to oppose is *not* given to non-managers because in appointing their other partners as managers, they have stripped themselves of all participation in the administration. (See 11 Manresa 385).]

(3) When Opposition May Be Made

When must the other managers make the *opposition*?

ANS.: Before the acts produce legal effects insofar as third persons are concerned. *Reason* — For them to delay or for them to protest after third parties are affected would be *unfair* to said third parties. Moreover, the acts of the firm would be unstable. (11 Manresa 387).

Art. 1802. In case it should have been stipulated that none of the managing partners shall act without the consent of the others, the concurrence of all shall be necessary for the validity of the acts, and the absence or disability of any one of them cannot be alleged, unless there is imminent danger of grave or irreparable injury to the partnership.

COMMENT:

(1) When Unanimity Is Required

- (a) This Article applies when there must be *unanimity* in the actuations of the *managers*.
- (b) Suppose one of the managers is *absent* or *incapacitated*, is unanimity still required?

ANS.: Yes, for absence or incapacity is *no excuse*. EXCEPTION — when there is *imminent danger of grave or irreparable injury* to the partnership. (Art. 1802).

(2) Duty of Third Persons

The rule that third persons are not required to inquire as to whether or not a partner with whom he transacts has the consent of all the managers, for the presumption is that he acts with due authority and can bind the partnership (*Litton v. Hill and Ceron, et al.*, 67 Phil. 509, citing *Mills v. Niggle*, 112 Pac. 617 and *Le Roy v. Johnson*, 7 US Law ed.) applies only when they innocently deal with a partner apparently carrying on in the usual way the partnership business (*See Art. 1818*) because under Art. 1802, it is imperative that if *unanimity* is required it is essential that there be unanimity; otherwise, the act shall not be valid, that is, the partnership is not bound. (*Art. 1802, first clause*). It would be wise therefore if the third person could inquire whether or not unanimity is required, and if so, if such unanimity is present. This is for his own protection. Thus, it has been held that a sale by a partner of partnership assets without the consent of the other managers is not valid. (*See Santos v. Villanueva, et al., C.A., 50 O.G. 175*).

Smith, Bell and Co. v. Aznar
(CA) 40 O.G. 1882

FACTS: Tobes, an *industrial* partner, was authorized to “manage, operate, and direct the affairs, business, and activities of the partnership” and “to make, sign, seal, execute, and deliver contracts — *upon terms and conditions acceptable to him duly approved in writing by the capitalist partner.*” The firm was engaged in the business of buying and selling merchandise of all kinds. One day, Tobes purchased “on credit” certain goods regularly purchased by the Company, but *without* first getting the authority of the capitalist partner.

ISSUE: Is the partnership bound?

HELD: Yes, since the transaction, even if “on credit” was a *routine one*. Moreover, authority to purchase carries with it the *implied* authority to purchase on credit. The requirement of written authority refers obviously to formal and unusual contracts in writing.

Art. 1803. When the manner of management has not been agreed upon, the following rules shall be observed:

(1) All the partners shall be considered agents and whatever any one of them may do alone shall bind the partnership, without prejudice to the provisions of Article 1801.

(2) None of the partners may, without the consent of the others, make any important alteration in the immovable property of the partnership, even if it may be useful to the partnership. But if the refusal of consent by the other partners is manifestly prejudicial to the interest of the partnership, the court's intervention may be sought.

COMMENT:

(1) Rules to Be Observed When Manner of Management Has Not Been Agreed Upon

- (a) Generally, each partner is an agent.
- (b) Although each is an agent, still if the acts of one are opposed by the *rest*, the majority should prevail (*Art. 1801*) for the presumed intent is for *all* the partners to manage, as in *Art. 1801*.
- (c) When a partner acts as agent, it is understood that he acts in behalf of the firm; therefore when he acts in his own name, he does not bind the partnership generally. (*Criado v. Gutierrez Hermanos*, 37 *Phil.* 838). Generally, a sale made by a partner of partnership property is not binding on the firm if *not* authorized. (*Santos v. Villanueva, et al.*, CA, L-8876-R, Sept. 7, 1953). However, said transaction may be ratified as when the proceeds thereof are spent for the benefit of the firm. (*Ventura v. Smith, et al.*, C.A., L-122-R, July 14, 1947).
- (d) On the other hand, paragraph 1 or the authority to bind the firm does not apply if somebody else had been given authority to manage in the articles of organization or thru some other means. (*Red Men v. Veteran Army*, 7 *Phil.* 685). Of course, proof on this point that somebody else was authorized must be given; otherwise, the general rule — “all are agents” — prevails. (*Bachrach v. La Protectora*, 37 *Phil.* 441).

(e) Alterations require unanimity. (*Art. 1803, No. 2*).

(2) Cases

Red Men v. Veteran Army **7 Phil. 685**

FACTS: The Veteran Army, composed of veterans in the Spanish-American War, had a constitution where it empowered a “department of 16 members” to manage its affairs. The constitution also provided that “six members of the department constituted a quorum to do business.” One day, *one* of the members of the department *leased for the use of the organization* a certain building. But the organization refused to pay later the unpaid rents on the ground that it never authorized the *signing member* to enter into such a contract of lease.

HELD: The Veteran Army, not having been formed for profit, is not a partnership, but even if it be one, it cannot be held liable for the *unauthorized* contract entered into in its name. For while a partner is an agent, and can bind the firm, still this power is allowed only when the articles of partnership make no provision for the management of the partnership business. In this case, it is evident that the power to manage was given to the “department” as a *whole* and *not* to any person or officer.

Criado v. Gutierrez Hermanos **37 Phil. 883**

FACTS: *A* and *B* were partners. *A* was indebted to *X*. On *A*’s death, *B* voluntarily assumed *A*’s debts, so that *X* would not sue *A*’s estate anymore. But *B* did not pay later on. Therefore, *X* sued the partnership. Is the firm liable?

HELD: No, the firm is not liable for *B*’s act was an independent, private act unconnected with the mercantile operations of the partnership. Moreover, the partnership never voluntarily assumed the obligation. Therefore only *B*, not the partnership, should be held responsible.

Sy-Boco v. Yap Teng
7 Phil. 12

FACTS: Yap and Yapsuan were partners in a store. Yap contracted with Sy-Boco to furnish native cloth for the store. Yap then introduced Sy-Boco to Yapsuan, the business manager of the partnership. Yap told Sy-Boco that Yapsuan, as manager, had authority to receive the cloth for him (Yap) and that the value of the cloth should be CHARGED to YAP'S ACCOUNT. Yap failed to pay on the ground that the goods were delivered to the firm and that therefore the firm itself, or the 2 partners jointly, must be held liable, and not him alone.

HELD: Yap alone should be held liable. Firstly, he contracted in his *own name*. Secondly, he himself had instructed Sy-Boco to charge the value to him (Yap) personally. It follows that the firm should *not* be held liable.

(3) Rule on Alterations

- (a) Par. 2 deals with “important alterations” in “immovable property of the partnership.” Why is the reference only to immovables?

ANS.: First, because of their comparative greater importance than personalty. Second, because, in a proper case, they should be returned to the partners in the same condition as when they were delivered to the partnership. (*11 Manresa 393*).

- (b) “Alteration” here contemplates useful expenses, not necessary ones.
- (c) Consent of the others may be *express* or *implied* (as when the partners had knowledge of the alteration and no opposition was made by them). (*11 Manresa 392*).

Art. 1804. Every partner may associate another person with him in his share, but the associate shall not be admitted in the partnership without the consent of all the other partners, even if the partner having an associate should be a manager.

COMMENT:**Associate of Partner**

- (a) For a partner to have an *associate* in his share, consent of the other partners is *not* required.
- (b) For the associate to become a *partner*, ALL must consent (whether the partner having the associate is a manager or not).

Reasons:

- 1) mutual trust is the basis of partnership;
- 2) change in membership is a modification or novation of the contract. (*See 11 Manresa 395*).

Art. 1805. The partnership books shall be kept, subject to any agreement between the partners, at the principal place of business of the partnership, and every partner shall at any reasonable hour have access to and may inspect and copy any of them.

COMMENT:**(1) Partnership Books**

- (a) The right in this Article is granted to enable the partner to obtain true and full information of the partnership affairs (*Art. 1806*), for after all, he is a co-owner of the properties, including the books. (*Art. 1811*).
- (b) However, the Article presupposes a “going partnership,” not one pending dissolution, for here the right depends on the court’s discretion (*Geist v. Burnstine, 1940; 20 N.Y.S. 2d, 417*); nor to one already dissolved, for here, although the books belong to all the partners (in the absence of a contrary agreement), still no single partner is duty-bound to continue the place of business for the benefit of the others. (*Sanderson v. Cooke, 1931, 256 N.Y.S. 73*). Neither is a purchaser of the firm’s goodwill duty-bound to keep the books for the inspection of the former partners. (*Sanderson v. Cooke, supra*).

- (c) Art. 1806 says areasonable hour.” What is this? Our Supreme Court has held that the reasonable hour should be on *business days throughout* the year, and not merely during some capricious or arbitrary period selected by the managers. (*See Pardo v. Hercules Lumber Co. and Ferrer, 47 Phil. 964*).

(2) Value of Partnership Books of Account as Evidence

They constitute an admission of the facts stated therein, an admission that can be introduced as evidence against the keeper or maker thereof. And this is true even if the books are kept strictly in accordance with the provision of the law. The only way out is to prove that the entries had been placed therein as a result of fraud or mistake, which of course must be proved. (*Garrido v. Asencio, 10 Phil. 691*).

Garrido v. Asencio 10 Phil. 691

FACTS: Garrido and Asencio were partners in the firm “Asencio y Cia,” which was later on dissolved by mutual agreement. Garrido later sued Asencio, who was in charge of the books and funds, for the amount of capital which he (Garrido) has invested. Asencio’s defense was that the partnership had lost, and therefore nothing was due Garrido. As proof, Asencio presented the books which admittedly were kept and made *jointly by him and Garrido*. Garrido charged however that the books should not be admitted in evidence because they were not kept strictly in accordance with legal provisions. *Issue:* Are the books admissible in evidence?

HELD: Yes, for after all the entries had been jointly made, and therefore their correctness must be taken to be admitted by Garrido (and Asencio) except so far as it is made to appear that they are erroneous as a result of fraud or mistake. Garrido has failed to prove that he has been misled by fraud or mistake.

Art. 1806. Partners shall render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or of any partner under legal disability.

COMMENT:**(1) Duty of Partners to Give Information**

Reason for the law — There must be no concealment between partners in all matters affecting the firm's interest. This is required by good faith. Thus, this duty to give on demand "true and full information."

[**NOTE:** Even without the demand, honesty demands the giving of vital information, the refraining from all kinds of concealment. (See *Poss v. Gottlieb*, 1922, 18 Misc. 318).

Poss v. Gottlieb
1922, 18 Misc. 318

FACTS: A and B were real estate partners. A heard of a possible purchaser of a certain parcel of land owned by the firm. But A did not inform B. Instead, A persuaded B to sell to him (A) B's share at a nominal amount, after which A sold the whole parcel at a big profit. B sued A for damages for alleged deceit A's defense was that he after all had not been asked by B about a possible purchaser.

HELD: A is liable, for he should not have concealed. "Good faith not only requires that a partner should not make any false concealment, but he should abstain from all concealment."

(2) Errors in the Books

If partnership books contain errors, but said errors have not been alleged, the books must be considered entirely *correct* insofar as the keeper of said *books* of account is concerned. (*Ternate v. Aniversario*, 8 Phil. 292).

Ternate v. Aniversario
8 Phil. 292

FACTS: Ternate was the managing partner in a firm engaged in coastwise shipping. He was also the keeper of the books. As manager he was entitled to 2% of the net income; the rest was to be distributed to all the partners in proportion to their respective contributions. Later Ternate rendered

a statement of accounts, giving each partner his share of the profits. Still later he sued for his 2% from each of the partners, *without* however explaining why he had not deducted his 2% beforehand. *Issue*: Can he recover the 2%?

HELD: No, because he may be said to be in *estoppel*, having made and signed the accounts himself without explaining the omission of the 2%. Presumably, this 2% had already been obtained by him.

(3) Who Can Demand Information

Note that under Art. 1806, the following are entitled to true and full information:

- (a) any partner
- (b) legal representative of a *dead* partner
- (c) legal representative of any partner under *legal disability*

[**NOTE**: The duty to give information is distinct from the duty to account under Art. 1807.]

Art. 1807. Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

COMMENT:

(1) Duty to Account

- (a) *Reason for the law*: The fiduciary relations between the partners are relationships of trust and confidence which must not be abused (*Pang Lim & Galvez v. Lo Seng*, 42 Phil. 282) or used to personal advantage. (*Einsweiler v. Einsweiler*, 1945, 390 Ill. 286).
- (b) The trust relations exist only *during the life* of the partnership, not before, nor after. Hence, fiduciary relations do *not* exist between the persons still negotiating for the

formation of partnership. (*Walker v. Patterson*, 1926, 166 Minn. 215). The trust relations end with the death of the partnership (*Bayer v. Bayer*, 1926, 214 N.Y.S. 322) unless the foundation for the breach of trust took place even during the existence of the firm. (See *Hanlon v. Haussermann and Beam*, 40 Phil. 796).

(2) Some Problems

- (a) A partner with partnership funds, and unknown to the others, purchased a house in his own name. Who owns the house?

ANS.: The partnership owns the house. The buying partner should only be considered a trustee. (See Art. 1807).

- (b) A partner in the real estate business, without the knowledge of the other partners, bought a parcel of land in his daughter's name and subsequently sold the same at a profit. Should the other partners share in the profits?

ANS.: Yes, for the transaction can be considered an affair of the partnership. (*Watson v. Kellogg*, 1933, 19 P-2d. 253).

- (c) A, B and C are partners. A, as a result of a transaction connected with the conduct of the partnership, has in his hands, so *that it may be traced*, a specific sum of money or other property. A is insolvent. Is the claim of the partnership against A a claim against him as an ordinary creditor, or is it a claim to the specific property or money in his hands?

ANS.: The words "and hold as trustee for the partnership any profits" indicate clearly that the partnership can claim as their own (hence, *specific* property) any property or money that can be traced. (*Commissioner's Note*, 7 ULA, Sec. 21, pp. 29-30).

(NOTE: Art. 1807 was taken from Sec. 21 of the Uniform Partnership Act of the United States which was drafted, of course, by a Commission.)

(3) Some Cases**Buenaventura v. David
37 Phil. 435**

FACTS: David and Buenaventura were partners in the real estate business, David being the capitalist and Buenaventura, the industrial partner. David with *his own funds* purchased the land in Tarlac known as the “Hacienda de Guitan.” Legal title was issued in David’s name and from that moment David exercised all acts of ownership over it, with Buenaventura’s assistance. Later David offered a half-interest on the land to Buenaventura for approximately P2,000, but Buenaventura *refused* the offer, and did not make the advance. Later, both partners broke up the partnership. More than 7 years later, Buenaventura sued for the transfer to his name of the title to half of the property on the ground that David should be considered merely the trustee. Will the action prosper?

HELD: The action will not prosper for clearly under the facts, David was the sole owner of the land. Had there really been a trust, the action would be successful and title could be transferred (*Uy Aloc v. Cho Jan Ling*, 19 Phil. 202), yet here no such trust existed. Perhaps, had the money for the half-interest been advanced, the answer would have been different. But the truth is, no such advance was made. Finally, Buenaventura is guilty of “laches” — long delay in the bringing of the action — such undue delay being strongly persuasive of a lack of merit in the claim. “Time inevitably tends to obliterate occurrences from the memory of witnesses, and where the recollection appears to be entirely clear, the true cause to the solution of a case may be hopelessly lost. These considerations constitute one of the pillars of the doctrine long familiar in equity jurisprudence to the effect that *laches* or unreasonable *delay* on the part of a plaintiff in seeking to enforce a right is not only persuasive of a want of merit, but may, according to the circumstances, be destructive of the right itself. *Vigilantibus non dormientibus equitas subvenit.*”

**Tuason and San Pedro v. Gavino Zamora and Sons
2 Phil. 305**

FACTS: Don Mariano Tuason, a partner in the firm of “Tuason and San Pedro,” engaged in building construction, by

himself entered into a contract for the construction of a house, although in reality the contract was for and in behalf of the partnership, and as a matter of fact, partnership funds were used. When the partnership sued the defendant, the latter questioned the firm's right to bring the action for payment.

HELD: The partnership had the right, for after all the contract was really entered in its behalf, and with the use of the firm's funds. And payment to the firm will really be payment to Tuason himself, for the firm can be said to be the true creditor. The defendant need not fear therefore the lack of authority of the firm to receive payment.

Pang Lim and Galvez v. Lo Seng
42 Phil. 282

FACTS: Pang Lim and Lo Seng were partners in the distillery business. The firm was renting for its use a certain parcel of land, upon which the firm made *certain improvements*. In the lease contracts, it was agreed that the owner of the land *would become the owner also of all the improvements* made by the firm at the end of 15 years. Before the end of the lease, Pang Lim withdrew as partner and sold his interests to Lo Seng. He also bought the land from its owner. He now wants to terminate the lease on the ground that a purchaser of the leased estate is generally allowed to end the lease. When Lo Seng refused to vacate, Pang Lim brought this action for unlawful detainer.

HELD: The suit will not prosper because of Pang Lim's evident bad faith. He obviously desired the termination of the lease, in order to avail himself of the benefits of the improvements which would go to the owner of the land, as per stipulation in the lease contract. Moreover, when he sold his rights as a partner, this included the right to the lease. For him to now disregard the lease, *from which sale he had profited*, would be most unfair, considering that he seeks to destroy an *interest derived from himself*, and for which he has already received full value. Finally, one partner cannot, to the detriment of another, apply exclusively to his own benefit the results of the knowledge and information gained in the character of partner.

Hanlon v. Haussermann and Beam
40 Phil. 796

FACTS: Haussermann and Beam, officers of the Benguet Consolidated Mining Company, entered into an agreement with Sellner and Hanlon whereby in consideration of P50,000 to be raised by the latter two (to rehabilitate certain essential machineries) within a six-month period, the two would receive certain shares in the company. Because the P50,000 was not raised within the proper period, Haussermann and Beam had to look for other sources of capital. Fortunately they were able to do so, and the shares in the company rose to 10 times their original value. Sellner and Hanlon now desire to participate in said profits on the ground that the four of them had jointly agreed to improve the company, and it is but fair that they should also share in the profits.

HELD: Sellner and Hanlon are wrong. In the first place, they were not partners. In the second place, granting that they were originally joint ventures, still the fiduciary relations between them ceased when Sellner and Hanlon were unable to raise the needed P50,000. It is true that the defendants had obliged themselves to seek financial assistance from the plaintiff, but only for the period of six months, not *indefinitely afterwards*. Moreover, “after the termination of *an agency, partnership, or joint venture*, each of the parties is free to act in his own interest, provided he has done nothing during the continuance of the relation to lay a foundation for an undue advantage to himself.”

Teague v. Martin, et al.
53 Phil. 504

If a partner without authority of the partnership uses firm funds for the purchase of certain articles registered in his name, he will have, in the suit for dissolution, to account for said funds. If the firm has on the other hand made use of the articles for its own benefit, it will likewise be obliged to account for the reasonable value of its use.

Art. 1808. The capitalist partners cannot engage for their own account in any operation which is of the kind of

business in which the partnership is engaged, unless there is a stipulation to the contrary.

Any capitalist partner violating this prohibition shall bring to the common funds any profits accruing to him from his transactions, and shall personally bear all the losses.

COMMENT:

(1) Business Prohibition on Capitalist Partners

Note that while the industrial partner is prohibited from engaging “in business for himself” (any business), the capitalist partner is prohibited from engaging for his own account in any operation “which is of the kind of business in which the partnership is engaged” (same or similar business that may result in competition). (*See 2 Blanco 426*). The competition may become unfair in view of the knowledge by the capitalist partner of the firm’s business secrets. (*2 Blanco 426*).

(2) Instances When There Is No Prohibition

- (a) When it is expressly stipulated that the capitalist partner can so engage himself. (*Art. 1808, par. 1*).
- (b) When the other partners *expressly* allow him to do so.
- (c) When the other partners *impliedly* allow him to do so.

(*Example: When ALL of them are likewise violating the article.*)

- (d) When the company *ceases* to be engaged in business (hence during the period of liquidation and winding up, the article no longer applies, even if the “engaging” partner is himself the “liquidating partner”). (*2 Vivante 107-108*). The reason is clear: there can possibly be no unfair competition.
- (e) When the general-capitalist partner becomes merely a *limited* partner in a competitive enterprise for after all, a limited partner *does not manage*.

(3) Effect of Violation

- (a) the violator shall bring to the partnership all the profits illegally obtained

- (b) but he shall *personally* bear all the losses.

[**NOTE:** Suppose he gains a total of P10 million and losses for a total of P2 million, how much must he bring to the firm?

ANS.: Strictly construed, he must bring P1 million, and suffer the P2 million loss all by himself; however this would be unduly harsh, and the proper interpretation, it is submitted, is for him to give only P8 million. In other words, losses can be deducted from profits. It is only net losses which he must shoulder.]

- (c) Although not mentioned in the law expressly, it is believed that the violator can be *ousted* from the firm on the ground of loss of trust and confidence, particularly if the violation is repeated after due warning. This would of course result in the dissolution of the firm.

Art. 1809. Any partner shall have the right to a formal account as to partnership affairs:

(1) If he is wrongfully excluded from the partnership business or possession of its property by his co-partners;

(2) If the right exists under the terms of any agreement;

(3) As provided by Article 1807;

(4) Whenever other circumstances render it just and reasonable.

COMMENT:

(1) Right to Demand a Formal Account

- (a) Generally, no formal accounting is demandable till after dissolution. *Reason:* After all there is access to the books. (*Art. 1805*).
- (b) However, in the instances enumerated in Art. 1809, it is evident that the formal accounting can properly and justifiably be asked for thus:

- 1) in No. 1 — he may have access to the books
- 2) in No. 2 — there is no express stipulation

Leung v. IAC and Yiu
GR 70926, Jan. 31, 1989

The right to demand an accounting exists as long as the partnership exists. Prescription begins to run only upon the dissolution of the partnership when the final accounting is done.

- 3) in No. 3 — it is unfair if other partners can take undue advantage of partnership funds or partnership transactions. (*See Art. 1807*).
- 4) in No. 4 — as when one partner has been travelling for a long period of time on a business involving the firm.

[NOTE: In no other case can a formal accounting be demanded. (*Commissioner's Note, 7 ULA, Sec. 22, pp. 30-31*).]

(2) Estoppel

An accounting made *cannot* be questioned anymore if it was accepted *without objection* for this would now be a case of *estoppel* (*Spitz v. Abrans, 1941, 128 Conn. 121*), unless of course fraud and error are alleged and proved. (*See Ornum v. Lasala, 74 Phil. 242*).

(3) Stipulation About Continuing Share

If a partnership is entered into by 2 physicians, with the stipulation that should one of them join the Army, the remaining partner continuing to practice would give the former 25% of the net profits — such stipulation is valid, and proper accounting should be made. Of course, if the practicing doctor does not want to continue practicing anymore, this is all right. (*See Liden v. Hoshal, 1943, 307 Mich. 568*).

Section 2
PROPERTY RIGHTS OF A PARTNER

Art. 1810. The property rights of a partner are:

- (1) His rights in specific partnership property;**
- (2) His interest in the partnership; and**
- (3) His right to participate in the management.**

COMMENT:

Property Rights of a Partner

- (a) *Example* of “specific partnership property”:

A and B each contributed a car for the partnership.

The two cars are *specific* partnership property.

- (b) *Example* of “interest in the partnership” — the partner’s share of the profits and losses (*without* mentioning any particular or specific property).
- (c) Note that the right to participate in the management is a very valuable property right.

Art. 1811. A partner is co-owner with his partners of specific partnership property.

The incidents of this co-ownership are such that:

(1) A partner, subject to the provisions of this Title and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners;

(2) A partner’s right in specific partnership property is not assignable except in connection with the assignment of rights of all the partners in the same property;

(3) A partner’s right in specific partnership property is not subject to attachment or execution, except on a claim

against the partnership. When partnership property is attached for a partnership debt the partners, or any of them, or the representatives of a deceased partner cannot claim any right under the homestead or exemption laws;

(4) A partner's right in specific partnership property is not subject to legal support under Article 291.

COMMENT:

(1) Co-Ownership in Specific Partnership Property

The law says "a partner is co-owner with his partners of specific partnership property." What does this mean?

ANS.: Simply that they are co-owners (tenants in common with proportional, sometimes equal) right thereto. *However*, the rules on co-ownership do not necessarily apply; the rules on "co-ownership in partnership" are applicable. Said rules are detailed in the subsequent paragraphs. (*See Commissioner's Note, 7 ULA, Sec. 25, pp. 32-33*).

(2) Rights of a Partner in Specific Partnership Property

(*Example:* a car contributed by one of the partners to the partnership)

- (a) In general, he has an *equal* right with his partners to possess the car but only for *partnership purposes* (not for other purposes, except if the others *expressly* or *impliedly* give their consent).
- (b) He *cannot* assign his right in the car (except if all the other partners assign their rights in the same property).

[**NOTE:** If this rule is violated, the assignment is VOID (*See Cayton v. Hardy, 27 Mo. 536*), where the other partners were able to recover what had been sold or assigned). The same rule applies if the right is *mortgaged*. (*Walcox v. Jackson, 7 Colo. 521*). The assignee or purchaser does NOT become a co-owner of the specific partnership property with the other partners. (*See Freeman v. Abramson, 30 Misc. 101, 61 N.Y.S. 839*).]

(**NOTE:** Reason for *rule* of non-assignability: It is hard to determine how much it exactly is until after liquidation.)

- (c) His right in the car is *not* subject to the attachment or execution (except on a claim against the partnership).

(**NOTE:** If there is a partnership debt, the specific property can be attached. Here, the partners or any of them or the representatives of a deceased partner *cannot claim* any right under the homestead or exemption laws. This is because in *a sense*, the property is not considered their individual or separate property.)

[**NOTE:** Reason why in general, the right of the partner in the car *cannot* be attached by his *separate or individual creditor*: If he cannot make a *voluntary* assignment, neither should his separate creditors be allowed an *involuntary* assignment because “the beneficial rights of the separate creditors of a partner in specific partnership property should be *no greater* than the beneficial rights of their debtor.” (See *Case v. Beauregard*, 99 U.S. 119 and *Nixon v. Nash*, 80 Am. Dec. 390).]

- (d) His right in the car is NOT subject to legal support under Art. 291 (said Article enumerates the people who are obliged to support each other).

(3) Some Cases

Kimbal v. Hamilton F. Ins. Co. (1861), 8 Bos. (N.Y.) 495

FACTS: A and B were partners. Without A's consent B assigned all the specific partnership properties to X. Do A and B have *insurable interest* in said properties?

HELD: Yes, for the assignment is void and is clearly against the law.

McGrath v. Cowen (1898), 57 Ohio St. 385

FACTS: A and B were partners. A mortgaged his right in a certain specific partnership property. Later the firm

creditor wanted to get said property. Who should prevail, the firm creditor or the mortgagee?

HELD: The firm creditors, for the mortgage in specific partnership property is void, *B* not having also assigned his right. This is so, even if the mortgagee's right therein be entirely destroyed (without prejudice of course to his recovery from *A*).

Sherwood v. Jackson
8 P. (2d) 943

FACTS: *A* and *B* were partners. Because *A* suffered certain damages from *B*, *A* sued *B*. *A* won. *A* then obtained an order of execution to levy on *B*'s interest in certain specific partnership properties. Execution was made, and *A* bought *B*'s interest in said specific properties. **Issue:** Was the execution lawful?

HELD: The execution is not valid, for *B*'s right in specific partnership property is NOT subject to attachment or execution. The only exception (that is, a *claim against the property*) is not present in this case.

Art. 1812. A partner's interest in the partnership is his share of the profits and surplus.

COMMENT:

A Partner's Interest in the Partnership

While in general, a partner's interest in specific partnership property *cannot be assigned, cannot be attached, and is not subject to legal support*, a partner's interest in the partnership (his share in the profits and surplus) can in general *be assigned, be attached, be subject to legal support*. (See Arts. 1813 and 1814).

Art. 1813. A conveyance by a partner of his whole interest in the partnership does not of itself dissolve the partnership, or, as against the other partners in the absence of agreement, entitle the assignee, during the continuance of the partnership, to interfere in the management or adminis-

tration of the partnership business or affairs, or to require any information or account of partnership transactions, or to inspect the partnership books; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled. However, in case of fraud in the management of the partnership, the assignee may avail himself of the usual remedies.

In case of a dissolution of the partnership, the assignee is entitled to receive his assignor's interest and may require an account from the date only of the last account agreed to by all the partners.

COMMENT:

(1) Effects of Conveyance By Partner of His Interest in the Partnership

- (a) If a partner CONVEYS (assigns, sells, donates) his WHOLE interest in the partnership (his share in the profits and surplus), either of two things may happen:

- 1) the partnership may still remain; or
- 2) the partnership may be dissolved.

(**NOTE:** However, such mere conveyance does NOT of itself dissolve the firm, therefore in general the partnership remains.)

- (b) The assignee (conveyee) does not necessarily become a partner. The assignor is still the partner, with a right to demand accounting and settlement. (*See Herman v. Pepper, 1933, 311 Pa. 104.*)
- (c) The assignee *cannot* even interfere in the management or administration of the partnership business or affairs.
- (d) The assignee *cannot* also demand:
- 1) information;
 - 2) accounting;
 - 3) inspection of the partnership books.

(2) Rights of the Assignee

- (a) To get whatever profits the assignor-partner would have obtained.

Question: Is he to be considered an outside creditor who would be entitled to collect before the partners get their own profits?

ANS.: No, for he merely shares in the profits, the same as the assignor-partner whose share he (the assignee) will now get. Hence, outside creditors would have to be preferred. (*See Machuca v. Chuidian, Buenaventura and Co., 2 Phil. 210*).

- (b) To avail himself of the usual remedies in case of fraud in the management.
- (c) To ask for annulment of the contract of assignment if he was induced to enter into it thru any of the vices of consent (fraud, error, intimidation, force, undue influence) or if he himself was incapacitated to give consent (minor, insane).
- (d) To demand an accounting — (but only if indeed the partnership is dissolved, but even then, the account can cover the period *only from the date of the last accounting which has been agreed to by all the partners*). (*Art. 1813, 2nd paragraph*).

(3) Rule in Case of Mortgages

Does Art. 1813 cover also a case when the partner merely mortgages his interest in the profits?

ANS.: Yes, but here said interest is not alienated; it is merely given as security, and therefore the rules on securities for loans, etc. can properly apply. (*See Herman v. Pepper, 311 Pa. 104*).

White v. Long
1927, 289 Pa. 526

FACTS: A, B, C, and D were partners. A assigned his interest in the partnership to his son S. S now wanted to join in the management of the enterprise. B, C, and D refused. Is the partnership necessarily dissolved?

HELD: No, the mere assignment did not dissolve the firm. This is so even if *B*, *C* and *D* did not allow *S* to participate in the firm's business conduct. After all, *S* did not become a partner. He was a mere assignee (entitled to collect only whatever profits his father *A* could have collected).

Art. 1814. Without prejudice to the preferred rights of partnership creditors under Article 1827, on due application to a competent court by any judgment creditor of a partner, the court which entered the judgment, or any other court, may charge the interest of the debtor partner with payment of the unsatisfied amount of such judgment debt with interest thereon, and may then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and make all other orders, directions, accounts and inquiries which the debtor partner might have made, or which the circumstances of the case may require.

The interest charged may be redeemed at any time before foreclosure, or in case of a sale being directed by the court, may be purchased without thereby causing a dissolution:

(1) With separate property, by any one or more of the partners; or

(2) With partnership property, by any one or more of the partners with the consent of all the partners whose interests are not so charged or sold.

Nothing in this Title shall be held to deprive a partner of his right, if any, under the exemption laws, as regards his interest in the partnership.

COMMENT:

(1) Charging the Interest of a Partner

Example:

A, *B* and *C* are partners. *A* personally owes *X* a sum of money. *X* sues *A*, and obtains a final judgment in this favor. But *A* has no money. What can *X* do?

ANS.: *X* may go to the same court (or any other court possessed of jurisdiction) and ask that *A*'s interest in the partnership be "charged" (attached, or levied upon) for the payment to him (*X*) of whatever has not yet been paid him with *interest* thereon.

[**NOTE:** While a partner's interest in the partnership (his share in the profits or surplus) may be *charged* or levied upon, his interest in a specific firm property cannot as a rule be attached.]

(2) Preferential Rights of Partnership Creditors

The law says "without prejudice to the preferred rights of *partnership creditors* under Art. 1827." What does this mean?

ANS.: This simply means that partnership creditors are entitled to *priority* over *partnership assets* (including the partner's interest in the profits), that is, the *separate* creditors will get only *after* the firm creditors have been satisfied.

Art. 1827 reads: "The creditors of the partnership shall be preferred to those of each partners as regards the partnership property. *Without prejudice to this right, the private creditors* of such partner may ask the attachment and public sale of the share of the latter in the partnership assets."

[**NOTE:**

- (a) *Partnership* creditors have preference in *partnership* assets.
- (b) *Separate* or *individual* creditors have preference in *separate* or *individual* properties (not those included in the firm).]

(3) Receivership

- (a) When the charging order is applied for and granted, the court MAY (discretionary) at the *same time* or *later* appoint a receiver of the partner's share in the PROFITS or other MONEY due him. (Art. 1814).
- (b) The receiver appointed is entitled to any RELIEF necessary to conserve the partnership assets for partnership

purposes. Thus, he may nullify all efforts to assign *specific* partnership property. (See *Windom Nat. Bank v. Klein*, 1934, Minn. 447).

- (c) Suppose the other partners owe the firm some money, may the receiver be authorized to demand that such amount be collected?

HELD: Yes, for such credit forms part of the partnership assets. (*Upton v. Upton*, 1934, 268 Mich. 26).

(4) Redemption of the Interest Charged

- (a) “Redemption” here merely means the *extinguishment* of the charge or attachment on the partner’s interest in the profits.
- (b) How is this “redemption” made?

ANS.:

- 1) The “charge” may be “redeemed” or bought at any-time BEFORE foreclosure.
- 2) AFTER foreclosure, it may still be “bought,” with *separate* property (by any one or more of the partners); or with *partnership property* (with consent of all the *other* partners).

(NOTE: The consent of the delinquent partner is *not* needed.)

(5) Exemption Laws

Regarding a partner’s interest in the partnership, may the partner still avail himself of the *exemption* laws?

ANS.: Yes, because in a sense, this is his private property.

[NOTE: He *cannot* however avail himself of the exemption laws insofar as his interest in specific partnership property is concerned. (*Art. 1811, No. 3*).]

Section 3**OBLIGATIONS OF THE PARTNERS
WITH REGARD TO THIRD PERSONS**

Art. 1815. Every partnership shall operate under a firm name, which may or may not include the name of one or more of the partners.

Those who, not being members of the partnership, include their names in the firm name shall be subject to the liability of a partner.

COMMENT:**(1) Firm Name**

- (a) This is the name of the juridical entity.
- (b) Under Art. 126 of the Code of Commerce, the name of at least one of the general partners in the general partnership should appear with the words “and company” (in case not all the partners were included).

The rule has now been *changed*. Thus, under the Civil Code, the firm name *may or may not* include the name of one or more of the partners.

- (c) Suppose the firm name is changed in good faith but the members remain the same, will the partnership under the new name retain all the rights it had under the old name?

ANS.: Yes. (See Sharruf case).

**Sharruf and Co. v. Baloise Fire Insurance Co.
64 Phil. 258**

FACTS: Sharruf and Eskenazi, partners under the name “Sharruf and Co.,” insured for P40,000 their goods. Later, the name was changed to “Sharruf and Eskenazi.” The insured goods were subsequently burned, but the insurance company refused to pay on the ground that its name, having been changed, the partnership now had no juridical personality to sue, nor did it have insurable interest in the goods.

HELD: The change of name is not important, not having been done to defraud the insurance company. Moreover, the members remain the same. Therefore, the firm can collect the insurance indemnity.

(2) Liability of Strangers Who Include Their Names

Strangers (those not *members* of the partnership) who include their names in the firm are liable as partners because of estoppel (*Art. 1815, par. 2*) but do not have the rights of partners for after all, they had not entered into any partnership contract. The purpose of the law is to protect customers from being misled as to whom they are dealing with. (*See Sagal v. Fylar, 89 Conn. 293*).

[**NOTE:** If a person *misrepresents* himself as a partner, and as a consequence thereof, a stranger is misled, the deceiver is *liable* as a partner (without the rights of a partner) and this is true, even if he did *not* include his name in the firm name.]

[**NOTE:** Under Art. 1846, if a limited partner includes his name in the firm name, he has *obligations*, but not the rights of, a general partner.]

[**NOTE:** The mere fact that a partnership has assumed a fictitious or assumed name, other than its real one, does not affect the validity of contracts otherwise validly entered into. (*38 Am. Jur., Name, Sec. 15, p. 15*).]

Art. 1816. All partners, including industrial ones, shall be liable *pro rata* with all their property and after all the partnership assets have been exhausted, for the contracts which may be entered into in the name and for the account of the partnership, under its signature and by a person authorized to act for the partnership. However, any partner may enter into a separate obligation to perform a partnership contract.

COMMENT:

(1) Liability Distinguished from Losses

While an industrial partner is exempted by *law* from *losses* (as between the partners), he is not exempted from *li-*

ability (insofar as third persons are concerned). This means that the third person can sue the firm and the *partners, including the industrial partner*. Of course, the partners will be *personally liable (jointly or pro rata)* only after the assets of the partnership have been exhausted. Even the industrial partner would have to pay, but of course he can recover later on what he has paid, from the capitalist partners, unless there is contrary agreement. (*De los Reyes v. Lukban & Borja*, 35 Phil. 757; *Compania Maritima v. Muñoz, et al.*, 9 Phil. 326).

(2) Example

A, B and C, capitalist partners, each contributed P100,000; and D, the *industrial* partner contributed his *services*. Suppose X, a customer, is the creditor of the firm to the amount of P900,000, what should X do?

ANS.: X must sue the firm and *all* the partners, including D. After getting the P3 million (capital assets of the firm) he can still recover P6 million from the 4 partners *jointly* or *pro rata* (not solidarily). Hence, he can recover P1.5 million from D. D can later on recover P1.5 million from A, B, and C at the rate of P500,000 each, for after all, he is exempted by the law from *losses*, as distinguished from *liabilities*.

(NOTE: Under the law the liability of the partners is *subsidiary* and *joint*, not principal and solidary.)

(3) Liability of a Partner Who Has Withdrawn

A partner who withdraws is not liable for liabilities contracted after he has withdrawn, for then he is no longer a partner. If his interest has *not* yet been paid him, his right to the same is that of a mere *creditor*. (*See Robles v. Pardo y Robles Hermanos*, 59 Phil. 482).

(4) Unequal Contribution of Capitalist Partners

Suppose *capitalist* partners had contributed unequally to the capital, will their liability to strangers be *equal* or *proportionate* to their contributions?

ANS.: Proportionate for the law says “*pro rata*” (proportionate). (*See Art. 1815*).

(5) BAR

X, Y, and Z organized and registered a commercial regular general co-partnership with a capital of P10 million, X contributing 50% of the capital, Y 30% and Z 20%. A certain creditor who has a claim of P2 million against the co-partnership desired to file suit to collect his claim.

- (a) Who should be made party defendant or defendants in the creditor's suit?
- (b) Whose assets are liable for the satisfaction of the creditor's judgment? Explain the extent of liability of the defendant or defendants.

Answer:

- (a) The defendants should be the firm itself and the three partners. (*Art. 1816*). (*NOTE* — Since there are no more commercial partnerships today, the new Civil Code provisions should be applied).
- (b) First, the assets of the firm (P10 million) must be exhausted, then X, Y and Z will be liable *pro rata* in the proportion of 50-30-20 for the remaining P10 million. (*Art. 1860*). Hence, X will pay from his individual assets P5 million; Y, P3 million; and Z, P2 million. As among themselves the losses will be divided, in the absence of agreement on losses or profits, in accordance with their contribution of 50%, 30%, and 20%. (*Art. 1797*).

**Island Sales, Inc. v. United Pioneers
General Construction Co., et al.
L-22493, Jul. 31, 1975**

FACTS: The plaintiff sued a partnership composed of five (5) general partners for payment of a promissory note. Later, the plaintiff filed a motion to dismiss the case against *one* of the partners. The motion was granted. If the defendants lose the case, how much will each of the four remaining defendants pay — 1/5 or 1/4 of the debt?

HELD: Each of the four will pay 1/5 of the debt. Under Art. 1816 of the Civil Code, the partners are liable "*pro rata*," meaning "joint" (as distinguished from solidary). Originally, each of the five (5) partners was

liable for 1/5. The discharge from the complaint of one of them did not mean that said discharged defendant is no longer a partner. So each of the remaining four should pay 1/5. They must not be made liable for the share of the fifth partner. When plaintiff moved to dismiss the complaint against said fifth partner, it was merely condoning or remitting his individual liability to the plaintiff. Said condonation or remission will not benefit the other “joint” debtors or partners.

(6) Effect of Stipulation Exempting Liability to Third Persons

Suppose it is stipulated that all the *industrial partners* and *some of the capitalist partners* would be exempted from liability insofar as third persons are concerned, would the stipulation be valid?

ANS.: The stipulation would be null and void. (*See Compania Maritima v. Muñoz, et al., 9 Phil. 326*).

(7) Comment of the Code Commission

“The basic rule (formulated in Art. 1698 of the old Code for *civil* partnerships) on the *personal* but *subsidiary* liability of the partners *pro rata* for the obligations of the partnership has been retained. The Commission considers the solidary liability laid down in the Code of Commerce (for commercial partnerships) as inadvisable, such liability being the cause for the *reluctance* and *fear* with which the formation of business partnerships has been regarded by all.”

(8) Partner Acting in His Own Name

Note that under Art. 1816, any partner may however “enter into a separate obligation to perform a partnership contract.” (Here, he does not act in behalf of the partnership; he acts *in his own name*, although for the benefit of the *partnership*.)

Art. 1817. Any stipulation against the liability laid down in the preceding article shall be void, except as among the partners.

COMMENT:**(1) Stipulation Eliminating Liability**

Query: As among the partners, is it permissible to stipulate that a *capitalist* partner be exempted from *liability*?

ANS.: The answer is YES, under Art. 1817. And yet under Art. 1799, a stipulation which excludes one or more partners (capitalist) from any share in the profits or *losses* is VOID. How can these two articles be reconciled? It would seem that the only way to harmonize the two articles (insofar as *capitalist* partners are concerned) is this: it is permissible to stipulate among *them* that a capitalist partner will be exempted from liability in *excess of the original capital contributed*; but will *not* be exempted insofar as his capital is concerned.

Example:

A, B, and C, *capitalist* partners, each contributed P1 million. The firm's indebtedness amounts to P9 million. It was stipulated that A would be exempted from liability. Assuming that the capital of P3 million is still in the firm, what would be the rights of the firm's creditors?

ANS.: To get the P3 million and to get still P2 million *each* from the 3 partners (a total of P9 million). A will thus be liable to the third persons for P2 million. How much, if any, can A recover from B and C? It is submitted that he can recover P2 million from B and C (P1 million each) for as to liability as among them, he is *exempted* (Art. 1817) but he cannot recover his original capital of P1 million. (Art. 1799).

(2) 'Liability' and 'Losses' Distinguished

Note that while in general "liability" refers to responsibility towards third persons, and "losses" refers to responsibility as among the partners (*Compania Maritima v. Muñoz, et al.*, 9 Phil. 326), still Art. 1817, a new codal provision, can refer to "liability" as "among the partners."

(3) BAR

In the articles of a general co-ownership, one of the partners is expressly exempted from personal liability for the losses of the partnership. Is this agreement valid? Explain.

Answer:

- (a) If the exempted partner is an industrial one — the agreement is valid as among themselves, but *not* insofar as creditors are concerned.
- (b) If the exempted partner is a capitalist one — the agreement is *void* as against creditors of the firm. As among themselves, it is valid — regarding contributions in excess of the capital (*Art. 1817*); but void, regarding the *original* contribution. (*Art. 1799*).

Art. 1818. Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

An act of a partner which is not apparently for the carrying on of business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.

Except when authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to:

- (1) Assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership;
- (2) Dispose of the goodwill of the business;
- (3) Do any other act which would make it impossible to carry on the ordinary business of a partnership;
- (4) Confess a judgment;
- (5) Enter into a compromise concerning a partnership claim or liability;

(6) **Submit a partnership claim or liability to arbitration;**

7) **Renounce a claim of the partnership.**

No act of a partner in contravention of a restriction on authority shall bind the partnership to persons having knowledge of the restriction.

COMMENT:

(1) When A Partner Can Bind or Cannot Bind the Firm

This Article speaks of:

- (a) the fact that the partner is an *agent*;
- (b) the instances when he can bind the partnership;
- (c) the instances when he cannot bind the partnership (in which case, should he enter into the contract, he *alone*, and not the firm nor the partner would be liable).

(2) Agency of a Partner

It has been truthfully said that a partnership is a contract of “mutual agency,” each partner acting as a *principal* on his own behalf, and as an agent for his co-partners or the firm. (*Commercial Casualty Ins. Co. v. North*, 1943, 320 Ill. App. 221, 60 N.E. 2d 434).

(3) When Can a Partner Bind the Partnership

A partner binds the partnership when the following requisites are present:

- (a) when he is *expressly* authorized or *impliedly* authorized;
- (b) when he acts *in behalf* and *in the name* of the partnership.

Instances of *implied authorization*:

- 1) when the other partners do *not* object, although they have knowledge of the act;

- 2) when the act is for “*apparently carrying on* in the usual way the *business* of the partnership.” (This is *binding* on the firm even if the partner was *not really authorized*, provided that the third party is in GOOD FAITH.)

Example:

A and B are partners in buying and selling automobiles. A, by the partner’s agreement, was authorized to BUY automobiles on a CASH basis, *never* on the INSTALLMENT plan. One day A bought on CREDIT or on the INSTALLMENT PLAN a car from X, a client. X did not know of A’s lack of authority. A’s purchase was made on behalf and in the name of the partnership. Is the partnership *bound*?

ANS.: Yes, the partnership is bound because although A was not really authorized, still for “*apparently carrying on* in the usual way the business of the partnership” A is *implicitly* authorized and X was in good faith. Had X known of A’s actual lack of authority, the answer would be different, that is, the partnership would not be bound. (See *Smith, Bell & Co. v. Azaar & CA*, 40 O.G. 1882, citing 20 RCL, pp. 894-895: “Where a business of a partnership is to buy and sell, a partner who purchases *on credit* in the name of the firm is acting within his implied powers, since it is usual to buy and sell on credit.”)

[NOTE: For apparently carrying on the business in the usual way, is a partner legally authorized to enter into FORMAL contracts that would bind the firm?]

ANS.: Yes. The words “including the execution in the partnership name of any *instrument*” avoid any possible doubt as to whether a partner has authority, in the ordinary course of business, to enter into *formal* contracts for his partnership, or to convey partnership property when the conveyance is the result of a sale in the ordinary course of partnership business. (*Commissioner’s Note*, 7 ULA, Sec. 9, pp. 17-18). Indeed, it is as if he had *full power of attorney* from all co-partners. (*Rouse v. Pollard*, 1941, 129 N.J. Eq. 47, 18 A.2d. 5).]

[**NOTE:** How can we determine whether or not the transaction *is within the scope* of the partnership business?

ANS.: The “scope of business may be gauged by the usual manner in which it *is carried out* in the *locality*; but scope may be *broadened* by actual conduct of business, as carried out with knowledge, actual or presumed, of the partner (partners, or partnership) sought to be charged.” (*Rouse v. Pollard, supra*). If a partnership is engaged in “buying and selling real estate” the act of a general partner in selling “three parcels of land” is within her powers as a general partner. (*Goquiolay v. Sycip, L-11840, Dec. 10, 1963*).]

[**NOTE:** If a contract is entered into in the name of the *partner*, he who alleges that it was really in behalf of the partnership, has the burden of proof. (*Bank of America Nat. Trust & Savings Assn. v. Kumle, 1948 — Cal. App. 100 p. 2d. 875*).]

(4) When Will the Act of the Partner Not Bind the Partnership

- (a) When, although for “apparently carrying on in the usual way the business of the partnership,” still the partner has in fact NO AUTHORITY, and the 3rd party *knows* that the partner has no *authority*. (This is to penalize customer or client in *bad faith*.)
- (b) When the act is NOT for “apparently carrying on in the usual way” of the partnership and the partner has NO AUTHORITY.

(**NOTE:** Here, *whether or not* the 3rd party knows of the LACK of AUTHORITY is *NOT IMPORTANT*. As long as there was really no authority, the firm is not bound.)

[**NOTE:** The 7 kinds of acts enumerated in Art. 1818 are instances of acts which are NOT for “apparently carrying on in the usual way the business of the partnership.” In those seven instances, the authority must be UNANIMOUS (from ALL the partners) *except* if the business has been abandoned.]

Examples:

(a) *A, B, and C are partners. A assigned the assets of the firm to X on the condition that X would pay the debts of the firm. The assignment had the approval of B, but C had objected. Is the assignment valid?*

ANS.: The assignment is not valid. And this is true whether or not X knew of A's actual lack of authority. For the act is considered "unusual." (See Art. 1818, 3rd paragraph, No. 1; see also Hapmorth v. Grierson, 1939, N.Y.S. 2d 700; and In Re Messenger, D.C. Pa. 1940, 32 Supp. 400 — which involved a truck owned by the partnership.)

(b) *A, B, and C are partners. X owes the firm P10 million. A, who is X's friend, remitted or renounced, in behalf of the firm, the claim. X did not know of A's lack of authority. May the firm still collect from X?*

ANS.: Yes, for the act was not authorized, and is "unusual." (See Art. 1818, 3rd par., No. 7).

(5) Reasons Why the 7 Acts of Ownership are "Unusual"

- (a) "assign the partnership property" — the firm will virtually be dissolved
- (b) "dispose of the goodwill" — goodwill is *valuable* property
- (c) "do any other act which would make it *impossible* to carry on" — this is evidently prejudicial
- (d) "confess a judgment" — if done *before* a case is filed, this is *null and void*; if done later, the firm would be jeopardized
- (e) "compromise" — this is an act of ownership and may be said to be equivalent to alienation (which may *not* be justified)
- (f) "arbitration" — this is also an act of ownership which may not be justified
- (g) "renounce a claim" — why should a partner renounce a claim that does not belong to him but to the partnership?

De la Rosa v. Ortega Go-Cotay
48 Phil. 605

FACTS: Go and Vicente were partners for the purchase and sale of merchandise. Vicente died, and his place in the firm was taken over by his son Enrique. Go later died and De la Rosa was appointed administrator of his estate. De la Rosa asked Enrique to liquidate the firm, and petitioned the court for the appointment of a receiver. A receiver was duly appointed, but to prevent the receiver from assuming his office, Enrique filed a bond for P10,000. Whereupon, Enrique *continued* the business of the firm *without* court authorization. Later, Enrique liquidated the assets but claimed that as a result of his transaction *after* he had filed the bond, the firm had lost, and the losses offset the profits that had been made during the previous years. *Issue:* Must Enrique still give Go's share in the previous profits to Go's estate?

HELD: Yes. It is true that Enrique had authority to manage and conduct the business *before* the death of Go, but when Enrique filed the bond, he in effect ceased to be a partner, and instead, became a *receiver* whose duty is *merely to preserve* and not to continue the business, unless judicial authorization had been obtained. Being unauthorized, Enrique is the only one to bear the losses of his own transactions and, therefore, he must still give to the estate of Go the share of Go in the profits of the previous years.

Art. 1819. Where title to real property is in the partnership name, any partner may convey title to such property by a conveyance executed in the partnership name; but the partnership may recover such property unless the partner's act binds the partnership under the provisions of the first paragraph of Article 1818, or unless such property has been conveyed by the grantee or a person claiming through such grantee to a holder for value without knowledge that the partner, in making the conveyance, has exceeded his authority.

Where title to real property is in the name of the partnership, a conveyance executed by a partner, in his own

name, passes the equitable interest of the partnership, provided the act is one within the authority of the partner under the provisions of the first paragraph of Article 1818.

Where title to real property is in the name of one or more but not all the partners, and the record does not disclose the right of the partnership, the partners in whose name the title stands may convey title to such property, but the partnership may recover such property if the partner's act does not bind the partnership under the provisions of the first paragraph of Article 1818, unless the purchaser or his assignee, is a holder for value, without knowledge.

Where the title to real property is in the name of one or more or all partners, or in a third person in trust for the partnership, a conveyance executed by a partner in the partnership name, or in his own name, passes the equitable interest of the partnership, provided the act is one within the authority of the partner under the provisions of the first paragraph of Article 1818.

Where the title to real property is in the names of all the partners a conveyance executed by all the partners passes all their rights in such property.

COMMENT:

(1) Conveyance of Real Property

- (a) This is a particular elaboration of Art. 1818, but is applicable to real property alone.
- (b) The Article was adopted to do away with the existing uncertainty surrounding the subject of the conveyance of *real property belonging to the partnership*. (*Commissioner's Note, 7 ULA, Sec. 10, p. 19*).
- (c) It will be noticed that in some instances, what is conveyed is TITLE, and in other instances, what is conveyed is merely the "EQUITABLE INTEREST." What does this phrase mean?

ANS.: An equitable interest or title is one not only recognized by law, but also by the principles of equity. (*See 30 C.J.S. 401*). Evidently, as used in Art. 1819, it

refers to “all interest which the partnership had, *except TITLE*,” that is, the beneficial interests like use, fruits, but not the naked ownership.

- (d) Art. 1819 speaks of “to convey” or a “conveyance.” Doubtless this includes a *sale*, or a *donation*. Does it include a mortgage?

ANS.: While under the rules of *agency*, a special power to sell does not *include* the power to *mortgage*, and *vice uersa* (Art. 1879), still Art. 1819 has been interpreted in the U.S. *to include* under the term “conveyance” the right to mortgage. (See *Bosler v. Sealfrom*, 1923, 92 Pa. Super. Ct. 254).

- (e) Notice that *real property may* be registered or owned in the name of:

- 1) the *partnership*;
- 2) *all the partners*;
- 3) *one, some, or not all* the partners;
- 4) one, some, or not all the partners in TRUST for the partnership;
- 5) *third person* in TRUST for the partnership.

Notice also the act of *conveyancing* may be in the name of the registered *owner* or in the name of the *partners all together*, or in the name of one, some but not all of the partners, or in the name of the partnership (the registration being apparently disregarded).

(2) Example of Par. No. 1

A, B, C, and D are partners of the firm “Edimus.” A parcel of land registered under the name “Edimus” was sold by A on behalf and in the *name of the firm* “Edimus,” but without express authority. The purchaser is X. Does X become the ownership.

ANS.: Ordinarily YES, but the firm may get back the land *unless*:

- (a) the firm is engaged in the buying and selling of land (consequently, the act of A is “usual”);

- (b) *X* had in turn sold the same land to *Y* for value and *Y* did not know of *A*'s actual lack of authority. (This is the case even when the selling of the land was *not* for apparently carrying on the business in the usual ways.) Thus, in the case presented, the firm cannot get back the land. *Reason*: Because the property has in turn been "conveyed by the grantee (*X*) to a holder for value (*Y*) without knowledge that the partner, in making the conveyance, has exceeded his authority." (*Art. 1819, 1st par.*)

(3) Example of Par. No. 2

A, B, C, and D are partners of the firm "Edimus" engaged in the buying and selling of land. A parcel of land registered in the name "Edimus" was sold by *A* in *his own name*. Does the buyer become the owner of the land? If not, what right does the buyer have?

ANS.: The buyer does not become the owner of the land. However, he gets the "equitable interest" of the firm insofar as the land is concerned, because after all the selling of land was in the "usual" course of business. Of course, the buyer may later on ask for the *reformation* of the contract, so that now, the seller's name would appear to be that of Edimus, provided of course that the other partners would *not object*. (They would object, of course, if indeed *A* did not have actual authority to sell, unless the buyer did *not* know of such lack of authority.) If the contract be thus reformed, it is clear that the buyer has also been given TITLE.

(**NOTE:** If the partnership had not been engaged in the purchase and sale of land, the buyer would *not even* be entitled to the "equitable interest.")

(4) Example of Par. No. 3

A, B, C and D were partners in the real estate firm of "Edimus." Although a certain parcel of land really belonged to the firm, it was registered in the name of *A* and *B*. *A* and *B* sold, in their own name, the land to *X*. May the firm get back the land?

ANS.: Since the firm is engaged in the real estate business, the act of selling the land was for carrying on in the

usual way the firm's business. So, the firm cannot get back the land, for *title* thereto has been conveyed to *X*.

Question: Suppose in the preceding problem *A* and *B* had not been expressly disauthorized by the firm to sell land, would your answers remain the same?

ANS.: It *depends*:

- (a) If *X* had been in *good faith*, that is, he had no knowledge of the lack of authority, the answer would be the same. (*1st par., Art. 1818*).
- (b) If *X* had been in BAD FAITH, the firm can get back the land unless *X* in turn had sold the property to *Y* who is in GOOD faith. (Here the assignee *Y* of the purchaser *X* is a "holder for value without knowledge.")

(5) Example of Par. No. 4

A, B, C, and D were partners in the real estate firm of "Edimus." A certain parcel of land was in the name of "*A*, in trust for the firm Edimus."

- (a) If *A* sells the land to *X* in the name of Edimus, will *X* become the owner?

ANS.: No. What *X* gets will only be the *equitable interest* of the firm.

- (b) If *A* sells the land to *X* in his (*A's*) *own* name, will *X* become the owner?

ANS.: No. What *X* gets will also be only the *equitable interest* of the firm.

Reason: It is clear in both instances that under the registry records *A* is only the *trustee*.

(6) Example of Par. No. 5

A, B, C and D were partners in the real estate firm of "Edimus." A certain parcel of land was registered, not in the name of the firm, but in the name of *A, B, C and D*. If *A, B, C, and D* will sell the land to *X*, will *X* become the owner, or will he have only the equitable interest?

ANS.: *X* will get the title. Consequently, he becomes the owner, for the law says that “where the title to real *property* is in the names of all the partners, a conveyance executed by *all* the partners passes *all* their rights in such property.” (*Art. 1819, par. 5*). The phrase “all their rights” includes “ownership” because under Art. 1811 — “A partner is *co-owner* with his partners of specific partnership property.”

Art. 1820. An admission or representation made by any partner concerning partnership affairs within the scope of his authority in accordance with this Title is evidence against the partnership.

COMMENT:

(1) Admission or Representation Made By a Partner

Generally, an admission by a *partner* is an admission against the partnership under the conditions given:

- (a) the admission must concern partnership affairs
- (b) *within the scope of his authority*

(2) Restrictions on the Rule

- (a) Admissions made BEFORE dissolution are binding only when the partner has *authority* to act on the *particular matter*.
- (b) Admissions made AFTER dissolution are binding only if the admissions were necessary to WIND UP the business.

Reason: If the admission is not the “act of the partnership (thru the partner), it should NOT be evidence against it.” The words “within the scope of his authority” produce this result. (*See Commissioner’s Note, 7 ULA, Sec. 11, p. 20*).

[**NOTE:** Needless to say, an admission by a former partner, made AFTER he has *retired* from the partnership, is NOT evidence against the firm. (*Ormachea Tin Congco v. Trillana, 13 Phil. 194*).]

Ormachea Tin Congco v. Trillana
13 Phil. 194

FACTS: Trillana owed a distillery partnership the sum of P5,000, but when sued for the debt, he put up the defense of payment. As proof thereof, he introduced as evidence a declaration made by the *former managing partner* to the effect that Trillana owed the partnership *nothing*. The declaration was made however AFTER the declarant had ceased to be a partner. *Issue:* Is the declaration evidence against the partnership?

HELD: No, it cannot be used against the firm because it was made by a person no *longer* a partner at the time of declaration. Trillana's debt therefore still exists.

(3) Previous Admission

When is a previous *admission* (not present court testimony) of a partner admissible in evidence against the partnership?

ANS.: When it was made WITHIN the scope of the partnership, and DURING its existence, provided of course that the existence of the partnership is first proved by evidence OTHER than such act or declaration. (*Sec. 26, Rule 130, Revised Rules of Court*).

Art. 1821. Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership, committed by or with the consent of that partner.

COMMENT:

(1) Effect of Notice to a Partner

- (a) In general, notice to a partner is notice to the partnership, that is, a partnership cannot claim ignorance if a

partner knew. BUT this rule has *restrictions* and *qualifications*.

- (b) *Notice to a partner*, given while ALREADY a partner, is a notice to the *partnership*, provided it relates to *partnership affairs*.

(2) Effect of Knowledge Although No Notice Was Given

It may be that *no notice* has been given, *but knowledge has been somehow acquired*. (Thus, while nobody made any *notification*, still the partner perhaps because of *analysis* or *deduction* came to know of something.) Is this knowledge of a partner also to be considered *knowledge* of the partnership?

ANS.: Knowledge of the partner is also knowledge of the firm provided:

- (a) The knowledge was acquired by a partner who is *acting in the particular matter* involved.

(NOTE: The knowledge may have been acquired while *already* a partner, or even PRIOR TO THAT TIME, provided he still *remembers* the same, that is, “present to his *mind*.”)

- (b) Or the knowledge may have been acquired by a partner NOT *acting* in the particular matter involved. But here it is essential that “the partner having ‘knowledge’ had reason to believe that the fact related to a matter which had some *possibility* of being the subject of the partnership business, and then only if he was so situated that he could communicate it to the partner acting in the particular matter before such partner gives binding effect to his act. The words “who reasonably could and should have communicated it to the acting partner accomplish this result.” (*Commissioner’s Note, 7 ULA, Sec. 12, pp. 20-21*).

(NOTE: Here, the knowledge must have been obtained while ALREADY a partner, because the phrase “then present to his mind” applies only to the partner ACTING in the particular matter involved.)

(3) Problem

P acquired some knowledge about *S*'s credit *before P* became a partner. Later *P* became a partner, and one day *S* had a transaction with the firm. *P* never conveyed the information he knew to the firm although he could have done so. Another partner *R* was the person who dealt with *S*'s transaction. Nobody else in the firm knew what *P* already knew. *Question*: Is *P*'s knowledge also the knowledge of the partnership?

ANS.: No, because *P* was not the partner acting in the particular matter involved. He had acquired the knowledge BEFORE he became a partner, not afterwards. The words "present to his mind" (remembered) do not apply, for they apply only to the person ACTING in the particular matter. Thus, the Commissioners have said: "Where the knowledge or notice has been received by the partner *before he became a partner*, and his partners are ignorant of this, and he is *not the partner acting in the particular matter*, there is no doubt that there has been neither knowledge of nor notice to the partnership." (*Commissioner's Note*, 7 ULA, Sec. 12, pp. 20-21).

(4) Service of Pleading on a Partner in a Law Firm

It has been held that service of pleadings on the partner in a law firm is also service on the whole firm and the other partners. (As a matter of fact, service on the firm, as evidenced by the signature of the receiving clerk of the firm who received in behalf of the firm, is indeed service on the law partners, and this is true whether or not the clerk forgot to inform the partners.) It has also been held that service on a partner is effectual not only to bind the party served but also to reach the assets of the partnership (*Rodel v. Seib*, 1932, 159 Atl. 182) which may be affected by a final judgment. (See *Peterson v. W. Davis & Sons*, 1943, 216 Minn. 60).

Art. 1822. Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership or with the authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act.

COMMENT:**(1) Wrongful Act or Omission of a Partner**

Example:

A, B, and C were partners. While acting within the scope of the firm's business, A committed a tort against X, a third person. Is the firm liable?

ANS.: Yes. (Art. 1822). Moreover A, B, and C, as well as the firm itself, are liable *in solidum*. (Art. 1824). Note that even the *innocent* partners are civilly *personally* liable (*Baxter v. Wunder*, 1927, 89 Pa. Super. Ct. 585), without prejudice of course to their right to recover from the guilty partner. (See Art. 1217). (See also *Fairman v. Darney*, 1919, 73 Pa. Super. Ct. 238, where the court held that a wrongful refusal to return a customer's machine rendered ALL the partners personally liable.)

(2) Injury to an Employee

The law speaks of an injury to "any person, not being a *partner*." Does Art. 1822 apply to an injury to an *employee*, not a partner, of the firm?

ANS.: It would seem that the answer is YES, for a mere employee is not necessarily a partner. (See *Parish v. Pulley*, 101 S.E. 236). And yet in a *Utah* case, the court decided otherwise (*Palle v. State Industrial Commission*, 1932, 79 Utah 47) apparently because the injury should have been caused a person *not connected* in any way with the firm.

(3) When the Firm and the Other Partners are NOT Liable

- (a) If the wrongful act or omission was not done within the scope of the partnership business and for its benefit (*Schlos v. Silverman*, 172 Md. 632) or with the *authority of the co-partners*. (Art. 1822).
- (b) If the act or omission was NOT wrongful. (See Art. 1822 which uses the term "wrongful".)
- (c) If the act or omission, although wrongful, did *not* make the partner concerned liable himself. (See *Caplan v. Caplan*, 268 N.Y. 455).

- (d) If the wrongful act or omission was committed after the firm had been dissolved (stopped its business) and same was not in connection with the process of winding up. (*Halton v. American Pastry Products Corp.*, 274 Mass. 268).

Art. 1823. The partnership is bound to make good the loss:

(1) Where one partner acting within the scope of his apparent authority receives money or property of a third person and misapplies it; and

(2) Where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership.

COMMENT:

Liability of Partnership for Misappropriation

The difference between par. 1 and par. 2 is that in the former the misappropriation is made by the *receiving* partner, while in the latter, the culprit may be any partner. The effect however is the same in both cases, as can be seen from *Art. 1824*.

Art. 1824. All partners are liable solidarily with the partnership for everything chargeable to the partnership under Articles 1822 and 1823.

COMMENT:

(1) Solidary Liability of the Partners With the Partnership

- (a) While in *torts* and *crimes*, the liability of the partners is solidary, in *contractual obligations*, it is generally merely *joint*. (*Art. 1816*). While *Art. 1816* speaks of *pro rata* liability of the partners, and while the Code Commission says that *pro rata* in this article means “in proportion to their contribution” (*Memorandum of The Code Com-*

mission, Lawyer's Journal, Oct. 1955, p. 518), still the Supreme Court has ruled that "pro rata" here means *joint*, such that if 5 partners are liable, each would be responsible for 1/5 of the debt (regardless of amount of contribution) and if one of the five would be excused (as when the plaintiff after suing the five partners dismisses the claim against one of them, each of the remaining four would be responsible for 1/5. Thus "pro rata" is used in the sense of "joint" to distinguish the same from *solidary* liability. (See *Island Sales v. Pioneers Gen. Construction Co.*, 22493, Jul. 31, 1975). (However, in compensation cases under the Workmen's Compensation Act, the liability of the business partners should be *solidary*. If the responsibility of the partners were to be merely *joint* and not *solidary*, and one of them happens to be insolvent, the amount awarded to the dependents of the deceased employee would be only partially satisfied. This is evidently contrary to the intent and purpose of the law to give full protection to the employee. (*Liwanag v. Workmen's Comp. Com.*, L-12164, May 22, 1959).

- (b) Note that torts and crimes result from individual acts of the *partners*; while contractual liabilities arise from *partnership obligations*.
- (c) Note that it is not only the partners that are liable *in solidum*; it is also the partnership.

(2) Example

A and *B* are partners. *A* misappropriates a sum of money belonging to a customer *X* but which was already in the custody of the partnership. Whom can *X* hold liable?

ANS.: *X* can hold liable either the firm or *A* or *B*, and the liability is for the whole amount because it is *solidary*. However, if *B* is made to pay the full amount, he can recover the *whole* amount, plus the interest from *A* later on instead of only *A*'s share, for the simple reason that it is only *A* who is guilty.

Art. 1825. When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to anyone, as a partner in an existing part-

nership or with one or more persons not actual partners, he is liable to any such persons to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made:

(1) When a partnership liability results, he is liable as though he were an actual member of the partnership;

(2) When no partnership liability results, he is liable *pro rata* with the other persons, if any, so consenting to the contract or representation as to incur liability, otherwise separately.

When a person has been thus represented to be a partner in an existing partnership, or with one or more persons not actual partners, he is an agent of the persons consenting to such representation to bind them to the same extent and in the same manner as though he were a partner in fact, with respect to persons who rely upon the representation. When all the members of the existing partnership consent to the representation, a partnership act or obligation results; but in all other cases it is the joint act or obligation of the person acting and the person consenting to the representation.

COMMENT:

(1) Partner and Partnership By Estoppel

This Article refers to a “*partner by estoppel*” and to a “*partnership by estoppel*.”

(2) How the Problem May Arise

A person may:

- (a) represent himself as a partner of an *existing* partnership, *with or without* the consent of the partnership.

(**NOTE:** If a third person is misled and acts because of such misrepresentation, the deceiver is a partner by estoppel. If the partnership *consented* to the misrepresentation, a partnership liability results. We have here a case of “partnership by estoppel” with the *original members and the deceiver* as partners. If the firm had not consented, no partnership liability results, but the deceiver is considered still as a “partner by estoppel,” with all the *obligations* but *not* the rights of a partner.)

- (b) represent himself as a partner of a *non-existent partnership*. (Here, clearly no partnership liability results, but the deceiver and all persons who may have aided him in the misrepresentation are still liable.)

(**NOTE:** The liability in such a case would be joint or *pro rata*.)

(3) When Estoppel Does Not Apply

When although there is *misrepresentation*, the third party is *not* deceived, the doctrine of estoppel does not apply. Note that the law says “liable to any such persons to whom such representation has been made, who has, *on the faith of such representation*, given credit as to the actual or apparent partnership.” (Art. 1825). (See *In re Ganaposki D.C. Pa., 1939, 27 F. Supp. 41*).

(4) Examples of a “Partner by Estoppel”

- (a) To obtain better credit facilities for a partnership of which he was not a member, X represented himself as having a *half-interest* therein. If the misrepresentation is believed and acted upon by innocent strangers, X should be considered as a partner by estoppel. (*Meyer v. Newmann, 1922, 222 Ill. App. 191*).
- (b) X, a rich man, wanted to give better financial credit to a partnership, so he signed the partnership agreement as partner when in fact, he was not really one. People who rely on the misrepresentation can consider him a partner by estoppel. (*Hobbs v. Virginia Nat. Bank, 1926, 147 V. 892*).

(**NOTE:** The estoppel may really be termed an estoppel by contract, which is really a form of estoppel by deed, in view of the document signed.)

- (c) A partnership which for want of the proper legal formalities is not given legal personality, may be considered, at least insofar as their contractual obligations to strangers are concerned, as a “partnership by estoppel.” Persons dealing with it are estopped from denying its partnership existence. (*See MacDonald v. Nat. City Bank of N.Y., L-7991, May 21, 1956, 53 O.G. 1783*, where a “partnership” not given legal personality was not *allowed* to impugn a chattel mortgage on three automobiles, a contract which it had voluntarily entered into.) According to the Court, for the purpose of its *de facto* existence it has such attributes of a partnership as domicile. (*MacDonald v. Nat. City Bank of N.Y., supra*).

(5) Burden of Proof

The creditor, or whoever alleges the existence of a partner or partnership by estoppel has the burden of proving the *existence of the misrepresentation* and the *innocent reliance on it*. (*See Orofino Rochdale Co. v. Fred A. Shore Lumber Co., 1927, 43 Idaho 425*).

(6) Problem

A is engaged in business all by *himself*. With a view to obtaining a better financial standing in the community, A pretended to friends and clients that B was his partner. The misrepresentation was with B's consent. Who would be preferred later on as to the assets of the business-creditors who trusted only A or creditors who relied on the alleged partnership of A and B?

ANS.: While partnership creditors are preferred over separate creditors (*See Art. 1827*), still in this particular case, there was *no real partnership*, and therefore *neither* partnership assets nor partnership creditors properly exist. Therefore, also no preference is given to creditors who relied on the existence of the fictitious firm. Inasmuch as NO partnership

liability results, it follows that *deceived* creditors may only hold both *A* and *B* as jointly liable. (See *Commissioner's Note*, 7 ULA, Sec. 16, pp. 24-25).

Art. 1826. A person admitted as a partner into an existing partnership is liable for all the obligations of the partnership arising before his admission as though he had been a partner when such obligations were incurred, except that this liability shall be satisfied only out of partnership property, unless there is a stipulation to the contrary.

COMMENT:

(1) Entry of a New Partner Into an Existing Partnership

Example:

A, B, and C are partners. *D* is admitted as a new partner. Will *D* be liable for partnership obligations contracted PRIOR to his admission to the partnership?

ANS.: Yes, but his liability will extend only to his share in the partnership property, not to his own individual properties. (*Art. 1826*).

(*NOTE:* Had he been an original partner, he would be liable both insofar as his share in the firm is concerned, and his *own individual* property.)

(*NOTE:* It is understood that the newly admitted partner would be liable as an *ordinary original* partner for all partnership obligations incurred AFTER his admission to the firm.)

(2) Creation of a New Partnership in View of the Entry

Does the admission of a new partner dissolve the old firm and create a new one?

ANS.: Yes, and it is precisely because of this principle that Art. 1826 has been enacted. The reason is simple: since the old firm is dissolved, the original *creditors* would *not* be the creditors of the new firm, but only of the original partners; hence, they may lose their *preference*. To avoid this injustice,

under the new Civil Code (together with the new creditors of the new firm), they are also considered creditors of the NEW firm. (*See also Art. 1840*, which among other things provide that generally “creditors of the dissolved partnership are also creditors of the person or partnership continuing the business.”) Thus, it is essential that the partnership assets of the new firm (*with the capital of the new partner*) be available even to the old creditors. (*See Commissioner’s Note, 7 ULA, Sec. 17, pp. 26-27*).

[**NOTE:** It is *wrong* to state that “the *theory* that a new firm is created by the admission of a new partner, has been abandoned.” It is wrong because indeed a new firm is created; but the old creditors of the firm retain their preference as partnership creditors. (*See Commissioner’s Note to Sec. 41, ULA*).]

“*Art. 1826* should be read together with *Art. 1840*. Both are based on the principle that there has been one continuous business. The fact that *A* has been admitted to the business, or *C* ceased to be connected with it, should not be allowed to cause endless confusion as to the claims of the creditors on the property employed in the business. All creditors of the business, irrespective of the times when they became creditors, and the exact combinations of persons then owning the business, should have equal rights in such property. The recognition of this principle solves one of the most perplexing problems of the partnership law.” (*Commissioner’s Note, 7 ULA, Sec. 17, pp. 26-27*).

(3) Liability of New Partner for Previous Obligations

Is not the rule of holding the new partner liable (with his share of the *firm’s assets*) for PREVIOUS obligations of the firm unduly harsh on said new partner?

ANS.: No, it is not unduly harsh. After all “the incoming partner partakes of the *benefit* of the *partnership property*, and an *established business*. He has every means of obtaining full knowledge and protecting himself, because he may insist on the liquidation or settlement of existing partnership debts. On the other hand, the creditors have no means of protect-

ing themselves.” (*Commissioner’s Note, 7 ULA, Sec. 17, pp. 26-27*).

Art. 1827. The creditors of the partnership shall be preferred to those of each partner as regards the partnership property. Without prejudice to this right, the private creditors of each partner may ask the attachment and public sale of the share of the latter in the partnership assets.

COMMENT:

(1) Reason for the Preference of Partnership Creditors

After all, the partnership is a juridical person with whom the creditors have contracted. Moreover, the assets of the partnership must first be exhausted.

(2) Reason Why Individual Creditors May Still Attach the Partner’s Share

After all, the remainder (after paying partnership obligations) really belongs to the partners.

(**NOTE:** The purchaser at the public sale does not necessarily become a partner.)

(3) Sale by a Partner of His Share to a Third Party

If a partner sells his share to a third party, but the firm itself still remains *solvent*, creditors of the partnership cannot assail the validity of the sale by alleging that it is made in fraud of them, since they have not really been prejudiced. (*See Walch v. Lim & Chay Seng, 58 Phil. 13*).

Chapter 3

DISSOLUTION AND WINDING UP

Art. 1828. The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.

COMMENT:

Dissolution Defined

See Comments under the next Article.

Art. 1829. On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.

COMMENT:

(1) ‘Dissolution’ Defined

Dissolution is the change in the relation of the partners caused by any partner *ceasing* to be associated in the carrying on of the business. (*Art. 1828*). It is that point of time when the partners cease to carry on the business together. (*Com. Note, 7 ULA, Sec. 29, p. 43*).

(2) ‘Winding Up’ Defined

Winding up is the process of *settling business affairs after dissolution*.

(**NOTE:** Examples of winding up: the *paying of previous obligations*; the *collecting of assets previously demandable*; even the contracting for *new business* if needed to wind up, such as the contracting with a *demolition company* for the *demolition* of the garage used in a “used car” partnership.)

**Recentes v. Court of First Instance
GR 40504, Jul. 29, 1983**

In an action for accounting and for payment of money allegedly due a partner, a receiver must be appointed to wind up the dissolved partnership.

(3) ‘Termination’ Defined

Termination is the point in time *after* all the partnership affairs have been wound up. (*Com. Note, 7 ULA, Sec. 29, p. 43*).

(4) Effect on Obligations

- (a) Just because a partnership is dissolved, this does not necessarily mean that a partner can *evade previous* obligations entered into by the partnership. (*Testate Estate of Mota v. Serra, 47 Phil. 464*).
- (b) Of course, generally, dissolution saves the former partners from new obligations to which they have not expressly or impliedly consented, unless the same be essential for winding up. (*See Art. 1843, par. 1; see also Testate Estate of Mota v. Serra, 47 Phil. 464*).

Art. 1830. Dissolution is caused:

(1) Without violation of the agreement between the partners:

(a) By the termination of the definite term or particular undertaking specified in the agreement;

(b) By the express will of any partner, who must act in good faith, when no definite term or particular undertaking is specified;

(c) By the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking;

- (d) By the expulsion of any partner from the business *bona fide* in accordance with such a power conferred by the agreement between the partners;
- (2) In contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this article, by the express will of any partner at any time;
- (3) By any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership;
- (4) When a specific thing, which a partner had promised to contribute to the partnership, perishes before the delivery; in any case by the loss of the thing, when the partner who contributed it having reserved the ownership thereof, has only transferred to the partnership the use or enjoyment of the same; but the partnership shall not be dissolved by the loss of the thing when it occurs after the partnership has acquired the ownership thereof;
- (5) By the death of any partner;
- (6) By the insolvency of any partner or of the partnership;
- (7) By the civil interdiction of any partner;
- (8) By decree of court under the following article.

COMMENT:

(1) Causes of Dissolution

- (a) Arts. 1830 and 1831 give the causes for dissolution.
- (b) Note that in Art. 1830, eight causes are given, the first one of which is subdivided into four instances.

(2) No Violation of Agreement

In No. 1 cause (in Art. 1830), the partnership agreement has NOT been violated —

- (a) termination of the *definite term* or *specific undertaking*

Here the contract is the law between the parties, if the firm however still continues after said period, it becomes a *partnership at WILL*.

- (b) express will of a partner who must act in *good* faith when there is NO definite term and NO specified undertaking

If he insists on leaving in bad faith, the firm is dissolved, but he may be responsible for damages.

- (c) express will of all partners (except those who have AS-SIGNED or whose interests have been CHARGED)

[**NOTE:** If one partner says he will *not* have anything more to do with the firm, and the other does not object, there is dissolution by implied mutual consent. (*Le Gualt v. Lewis Zimmerman*, 205 Pac. 157). Also, when one buys out the interest of ALL the others. (*French v. Mulholland*, 187 N.W. 254).]

- (d) expulsion in good faith of a member

(**NOTE:** If one is expelled, the number of partners is decreased; hence, the dissolution.)

(**NOTE:** If a partner is expelled in *bad* faith, there can also be eventual dissolution for here, there would be apparent lack of confidence, without prejudice of course to liability for damages.)

(3) Cause No. 2 — Vilolation of Agreement

Even if there is a specified term, one partner may cause its dissolution by expressly withdrawing *even before* the expiration of the period, with or without justifiable cause. Of course, if the cause is *not justified*, or *no cause* was given, the withdrawing partner is liable for *damages*, but in no case can he be compelled to remain in the firm. With his withdrawal, the number of members is decreased, hence, the dissolution.

Reason for allowing withdrawal:

Partnership is based on mutual confidence. Thus, it has been held in one case that even if a firm still has three years to run, still a letter received by it from one partner withdrawing

from the firm, served to dissolve the firm, without prejudice to resulting damages. (*See Crossman v. Gibney, 1916, 164 Wis. 396, 160 N.W. 172; see also Lichauco, et al. v. Soriano, 26 Phil. 593.*)

(4) Cause No. 3 — Unlawfulness of the Business

If the business later on becomes unlawful, it follows that the firm will not be allowed to carry on. On the other hand if the business or object had been unlawful from the very beginning, the firm never had any juridical personality.

(5) Cause No. 4 — LOSS

- (a) If a specific thing promised as contribution is lost BEFORE delivery.

Reason: The firm is dissolved because the partner has NOT given his contribution.

(NOTE: If lost after delivery, the firm bears the loss, and the partner remains, since after all, he *had given his contribution.*)

(NOTE: The rules just given do *not* apply to generic things, for genus does *not* perish.)

- (b) If *only* the use of a specific thing is contributed, and it is LOST BEFORE or AFTER delivery to the firm.

Reason: Here, the naked owner reserved the ownership, its loss is borne by him, so it is as if he had *not* contributed anything.

(6) Cause No. 5 — DEATH of ANY Partner

The death of any partner, whether known or unknown to the others causes a decrease in the number of partners, hence there is automatic dissolution (but not automatic *termination* for the affairs must still be wound up). Be it noted that a deceased partner is no longer associated in the active business of the partnership; in a sense however, this dissolution may be partial or total: partial, when the surviving partners

continue the business among themselves; and total, when the survivors, instead of continuing the enterprise, proceed to the liquidation of partnership's assets.

[**NOTE:** The status of the firm would be that of a "partnership in liquidation." (See *Bearneza v. Dequilla*, 43 Phil. 237).]

(**NOTE:** The dissolution is without prejudice to Art. 1833.)

Goquiolay v. Sycip
L-11840, Dec. 10, 1963

FACTS: The articles of a general partnership expressly stipulated that "in the event of the death of any of the partners at any time before the expiration of said term, the co-partnership shall not be dissolved, but will have to be *continued*, and the deceased partner shall be represented by his heirs or assigns in said co-partnership." One of the partners subsequently died, and this was before the expiration of the partnership life. The deceased partner was then replaced by his widow. *Issue:* Does the widow or substitute become also a *general* partner or only a *limited* partner?

HELD: She became a mere *general* partner. The articles did not provide that the heirs of the deceased would be merely limited partners; on the contrary, they expressly stipulated that in case of death of either partner, "the co-partnership... will have to be continued" with the heirs or assigns. It certainly could not be continued if it were to be converted from a general partnership into a limited partnership since the difference between the two kinds of associations is fundamental, and specially because the conversion into a limited association would leave the heirs of the deceased partner without a share in the management. Hence, the contractual stipulation actually contemplated that the heirs would become general partners rather than limited ones.

Bearneza v. Dequilla
43 Phil. 237

FACTS: Bearneza and Dequilla were partners for the exploitation of a fish pond. Bearneza died in 1912. In 1919,

Bearneza's legal heir demanded from Dequilla the deceased's share in the profits between the time of his death and 1919.
Issue: Should said profits be given?

HELD: No, because they were profits made *after* the firm had been *dissolved* by Bearneza's death. The plaintiff is entitled only to the profits obtained already at the time of death, for after death, what existed was merely a "partnership in liquidation."

(NOTE: Of course profits already accruing before death but collected or realized only afterwards should be included, for the basis therefor had already been laid.)

[NOTE: Who liquidates?

ANS.: Although it has been held that when the death of one of the partners dissolves the partnership, the liquidation of its affairs is by law entrusted to the *surviving partners*, or to liquidators appointed by them, *and NOT* to the executors of the deceased partner (*Wahl v. Donaldson Sim & Co.*, 5 Phil. 900), still under the new Civil Code it is provided that "any partner, his legal representative, or his assignee, upon cause shown may obtain winding up by the court." (*Art. 1836*).]

(7) Cause No. 6 — Insolvency of any Partner or of the Partnership

- (a) The insolvency need not be judicially declared; it is enough that the assets be *less* than the liabilities.

(NOTE: It is submitted that no judicial decree is needed to dissolve the partnership here, for otherwise, this cause would have been inserted under No. 8, "by decree of the court.")

[NOTE: Contrast the rule just given with the case of an *insane* partner. While insanity for the purpose here may be either *declared judicially* or not (as when evidence has been given to show that the partner is "of unsound mind," still there must be a *judicial decree for dissolution*). (*See Art. 1831, No. 1*).]

- (b) Reason why *insolvency* is a ground for dissolution: The

business of a firm requires *solvency* or ability to meet the financial demands of creditors.

(8) Cause No. 7 — Civil Interdiction of any Partner

Civil interdiction (or civil death) results in incapacity to enter into *dispositions* of property, *inter vivos*.

(9) Cause No. 8 — Decree of the Court under Art. 1831

(See Art. 1831)

(**NOTE:** The decree must be a *final judgment* rendered by a court of competent jurisdiction.)

(10) Decrease of Causes of Dissolution

Can the partners in their contract *decrease* or limit the causes of dissolution?

ANS.: No. (See *Lichauco v. Lichauco*, 33 Phil. 350, where the Supreme Court held that a contractual provision prohibiting dissolution except by authorization of *two-thirds* of the members, *cannot be sustained* when the firm had lost its capital, or had become bankrupt, or had utterly abandoned the enterprise for which it had been organized.)

(11) Cases

**Eugenia Lichauco, et al. v. Faustino Lichauco
33 Phil. 350**

FACTS: Faustino Lichauco was the managing partner of a firm for the carrying on of a rice-cleaning business. Because the enterprise was unprofitable, same was discontinued and the rice machinery was dismantled. When sued for an accounting he refused on the ground that under the terms of the partnership contract, dissolution could be done only by a vote of 2/3 of the members, and such vote had not yet taken place. *Issue:* Is his contention correct?

HELD: His contention is wrong, for when the enterprise was abandoned, and the machines sold, undoubtedly the firm

was dissolved by provision of the law; and therefore he has the duty to liquidate and account to all and to each of his associates.

Walter Jackson v. Paul Blum, et al.

1 Phil. 4

FACTS: A and B were partners in a partnership at will. They dissolved the partnership, and A assigned his interest to X. Because of a debt, the partnership assets were in the possession of a fourth party, Y, as security. May X demand accounting from Y?

HELD: Yes, even if X was not a partner of A and B for after the partnership was dissolved, A and B became co-owners and A could assign his interest or share. One of A's rights was to demand an accounting so that his share could be determined. This right, he could transfer to X. So X can demand the accounting.

Solomon v. Hollander

55 Mich. 256

FACTS: Kirkwood and Hollander were partners in the jewelry business by virtue of a contract which stipulated an existence for at least *one year*. A month after the firm began, Kirkwood became dissatisfied and announced in the newspapers the *dissolution* of the partnership, for he did not want anymore to be a partner. Hollander, although he knew this, nevertheless still ordered new goods in the partnership's name. Is Kirkwood still liable for these new transactions?

HELD: No more, since the firm was already dissolved, and he had given no authority to his former partner. He is entitled to his share of the assets as of the date of dissolution. However, *damages* may be deducted therefrom in view of his wrongful dissolution of the firm. That he had the right to withdraw even before the expiration of the term is clear, because said right to dissolve "is a right inseparably incident to every partnership."

Art. 1831. On application by or for a partner the court shall decree a dissolution whenever:

(1) A partner has been declared insane in any judicial proceeding or is shown to be of unsound mind;

(2) A partner becomes in any other way incapable of performing his part of the partnership contract;

(3) A partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business;

(4) A partner wilfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him;

(5) The business of the partnership can only be carried on at a loss;

(6) Other circumstances render a dissolution equitable.

On the application of the purchaser of a partner's interest under Article 1813 or 1814:

(1) After the termination of the specified term or particular undertaking;

(2) At any time if the partnership was a partnership at will when the interest was assigned or when the charging order was issued.

COMMENT:

(1) Dissolution by Judicial Decree

This Article speaks of a dissolution by *decree of the court*. In a suit for dissolution, proof as to the existence of the firm must first be given. (*Armstrong v. Richard*, 192 N.Y. 502).

(2) Who Can Sue for Dissolution

ANS.:

- (a) A *partner* for any of the 6 causes given in the first paragraph.

- (b) The purchaser of a partner's interest in the partnership under Art. 1813 or 1814, provided that the period has *expired* or if the firm was a *partnership at will* when the interest *was assigned or charged*.

(**NOTE:** If the period is not yet over, said purchaser cannot sue for dissolution.)

(3) Insanity of a Partner

- (a) Even if a partner has *not* yet been previously declared insane by the court, dissolution may be asked, as long as the insanity is *duly proved* in court.
- (b) *Reason* for making insanity a cause: The partner will be incapacitated to contract.

(4) Incapability to Perform Part

This may happen when the partner enters the government service which would prohibit him from participating in the firm; or when he will have to stay abroad for a long time.

(5) Prejudicial Conduct or Persistent Breach of the Agreement

- (a) When the managers fail to hold regular meetings as provided for in the agreement, fail to make reform or to hear grievances, and fail to give proper financial reports, an action for dissolution would prosper. (*Gatdula v. Santos*, 29 Phil. 1). The same rule holds if accounting is unjustifiably refused. (*Lavoine v. Casey*, 251 Mas. 124).
- (b) True exclusion from the management of one of the persons authorized to manage, is indeed a ground for dissolution; but not occasional friction among the managers or trivial faults, particularly if the firm is financially prosperous. (*Potter, et al. v. Brown, et al.*, 328 Pa. 554, 118 ALR 1415).

Potter, et al. v. Brown, et al. 328 Pa. 554, 118 ALR 1415

FACTS: In 1934 an insurance partnership was formed, giving *almost unlimited* powers to Mr. Brown,

the partner owning the controlling interest. Mr. Brown, as general manager, was also given the powers to fix, increase, and reduce the salaries of the other partners who helped in the business. However, the power to *admit new partners* was given to the *numerical majority* (not financial majority). One day, Brown proposed the admission of a new partner, Mr. Moore, but he was defeated by a vote of 7 to 3 on the ground that Moore was *not* an insurance man. Later, Brown called a special meeting for the board of managers to reconsider their vote; but in said meeting Brown's proposal was again defeated. So, Brown retaliated by *reducing* the salaries of the others. He relented however, and *restored* the salaries after a week. But from that time on, the others refused to attend the meeting (the seven partners who had voted against Brown's proposal of Moore). These seven later on sued for dissolution; and for the right to continue the business. They admitted however that Brown was a wonderful executive, and that the firm was making immense profits, and that finally Brown had occasionally contributed additional capital whenever the firm needed the same. They alleged however that the measure of compulsion adopted by Brown to force the acceptance of Moore as a partner constituted misconduct on the part of Brown.

HELD: The partnership will NOT be dissolved. After all:

- 1) There was neither allegation nor proof of fraudulent or dishonest practices.
- 2) The plaintiffs were not really denied their proper share of participation in the management of the business, such rights being stipulated in the partnership agreement. Notice that almost exclusive control was vested in one partner, and this stipulation can strictly be enforced. (*Peacock v. Cummings*, 46 Pa. 434).
- 3) If the plaintiffs are aggrieved because they are unable to exercise the direction over partnership affairs that they feel is their due, the reason is to be found primarily in the partnership agreement rather than because of any misconduct of Mr. Brown.

- 4) While the attempt to reduce salaries was really made, still this did not constitute gross misconduct as the restoration was done speedily; nor did the firm suffer.
- 5) Differences and discord should be settled by the partners themselves by the application of mutual forbearance rather than suits for dissolution. Equity is not a referee of partnership quarrels.
- 6) The business is a highly prosperous one.
- 7) The plaintiffs are not also faultless. It would appear that they are willing to pick up the gauntlet of partnership conflict, and to seize upon incidents constituting at their gravest import, mere technical misconduct of a partner, for the purpose of acquiring as *their own* a long established and valuable business to the exclusion of the partner who is the owner of the major interest therein.

(6) Appointment of Receiver

In a suit for dissolution, the court may appoint a receiver at its discretion (*Salonga v. Lipka*, 224 Mich. 278) but a receiver is not needed when practically all the firm assets are in the hands of a sheriff under a writ of replevin (*Gianuso v. Weiss*, 191 N.Y.S. 118) or when the existence of a partnership with the plaintiff is *denied*, particularly if the business of the firm is being conducted successfully. (*Armstrong v. Richard*, 192 N.Y.S. 502).

(7) Time of Dissolution

It is understood that a firm whose dissolution is petitioned for in court becomes a dissolved partnership at the time the judicial decree becomes a final judgment. (See *Scheckter v. Rubin*, 1944, 349 Pa. 102).

Art. 1832. Except so far as may be necessary to wind up partnership affairs or to complete transactions begun but not then finished, dissolution terminates all authority of any partner to act for the partnership:

(1) With respect to the partner;

(a) When the dissolution is not by the act, insolvency or death of a partner; or

(b) When the dissolution is by such act, insolvency or death of a partner, in cases where Article 1833 so requires;

(2) With respect to persons not partners, as declared in Article 1834.

COMMENT:

(1) Effects of Dissolution

- (a) When a partnership is dissolved, certain effects are inevitable, insofar as the *relations of the firm toward third persons* are concerned; and insofar as the partners *themselves* are affected in their relations with one another. Arts. 1832, 1833, and 1834 speak of said relationships.
- (b) Art. 1832 merely states a *general rule*, that when the firm is dissolved, a partner can no longer bind the partnership. The exceptions will be discussed later.

(2) Effect on Previous Contracts

When a firm is dissolved, does this mean that the contracts and obligations previously entered into, whether the firm is the creditor or the debtor, automatically cease?

ANS.: No, otherwise the result would be unfair. The firm is still allowed to collect previously acquired credits; it is also bound to pay off its debts. A dissolved partnership still has personality for the winding up of its affairs. (*See Testate Estate of Mota, et al. v. Serra, 47 Phil. 464*).

(3) Creditors Who Have Not Been Prejudiced

If the *obligations and rights* of a dissolved firm are *transferred* to another firm, should creditors still hold the former liable even if said creditors have not been prejudiced?

ANS.: No more, as long as the new firm can indeed take care of said creditors. It would be erroneous to let the old firm still pay, if the new firm can really pay. (*Aboitiz v. Quinena and Co. [Ltd.]*, 39 Phil. 926).

Art. 1833. Where the dissolution is caused by the act, death or insolvency of a partner, each partner is liable to his co-partners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved unless:

(1) The dissolution being by act of any partner, the partner acting for the partnership had knowledge of the dissolution; or

(2) The dissolution being by the death or insolvency of a partner, the partner acting for the partnership had knowledge or notice of the death or insolvency.

COMMENT:

(1) Two Kinds of Causes for Dissolution

Dissolution may be caused:

(a) *On the one hand by:*

A — act (like withdrawing of a partner)

I — insolvency

D — death

(b) *On the other hand by other things, like TERMINATION of the period.*

(2) Dissolution Caused by A-I-D

Art. 1833 speaks of dissolution caused by A-I-D, and the effects on the *partners as among themselves*, if a *partnership liability is incurred* (that is, if the firm is STILL BOUND).

(**NOTE:** If the firm is not bound, see Art. 1834, where only the partner acting is liable.)

(3) Effect of A-I-D

In Art. 1833, all the partners are still bound to each other generally, *except* in the 2 instances mentioned, namely:

- (a) If the partner acting had KNOWLEDGE (as distinguished from mere NOTICE, but without actual knowledge), if dissolution is caused by an ACT (*like withdrawing, retiring*). (Here, only the partner acting assumes liability, in that even if the firm *may* be held by strangers, and even if the partners will still be individually liable, *still* the other partners can always *recover* from the partner acting.)
- (b) If the partner acting had KNOWLEDGE or NOTICE, if dissolution was caused by *death* or *insolvency*. Here again, while the firm may be liable, in proper cases, *recovery* can be had by the other partners from the partner acting.

(4) Examples

- a) *A, B, and C* were partners. *A* resigned from the firm. Therefore it was dissolved. *B* *knew* this, and yet he still deliberately entered into *new* transactions with *X*, an innocent *customer*. (The meaning of “innocent customer” will be discussed in the next article.) The transactions were *not* needed for winding up. Will the *firm* be still liable?

ANS.: Yes. (*See Art. 1834*). If the firm assets are not enough, *X* can still go after the individual assets of *A, B, and C*. After all of them have paid *X*, can *A* and *C* still recover from *B*, the partner who *acted* despite his knowledge of the firm’s dissolution?

ANS.: Yes, because *B* should not have done what he did.

- (b) If in the preceding problem, *X* *knew* of the dissolution, the firm cannot be held liable. Neither will *A* or *C* be liable. Only *B* and *X* are concerned, and they will have to settle with each other, depending on their reason why they still entered into the contract.

- (c) Note that for (a) to apply, *B*, must have *knowledge*, not merely *notice*. If *A* had *died* or had become *insolvent*, the principles in (a) will be followed whether *B* had *knowledge* or mere *notice*. (According to the Commission, “notice” should be sufficient if the fact to be notified is an ordinary business fact as when a letter concerning transactions is placed on the desk of *B*, but *B* never opened the letter.) But dissolution caused by an act, prior to the termination of the period agreed upon is certainly *not* an ordinary fact. In this case, mere notice *not* producing knowledge would *not* be sufficient. True dissolution takes place automatically by virtue of such act, but *B*, the partner acting should not be prejudiced. (See *Commissioner’s Note*, 7 ULA, Sec. 84, pp. 48-50).

[**NOTE:** Death or insolvency, being more ordinary than an “act, notice is enough. Hence, the law provides “knowledge or notice.” However, it is still essential that there be “knowledge or notice” of the fact of *death* or *insolvency* to justify non-liability of the other partners to the partner acting. Otherwise, it would be unfair to let the partner acting assume the whole liability. Thus, the Commission has said: “In the case of death, to hold a partner acting for the partnership *bona fide* in ignorance of the death of one of his co-partners must assume the entire liability, even though all other partners are ignorant of the death of the partner, and even though such deceased partner was entirely inactive, and may have resided at any distance from the actual place of business, is *entirely unjust* to the acting partner or partners. What has been said of the death of a partner applies also to the *bankruptcy* of a partner. If there are a number of partners, and one of them becomes bankrupt, and another having no *knowledge* or *notice* of this fact, makes a contract in the ordinary course of the business, there appears no reason why he should not be able to call on his other partners not bankrupt or deceased, to contribute towards any loss which his separate estate may sustain on account of the contract.” (*Commissioner’s Note*, 7 ULA, Sec. 84, pp. 48-50).]

Art. 1834. After dissolution, a partner can bind the partnership, except as provided in the third paragraph of this article:

(1) By any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution;

(2) By any transaction which would bind the partnership if dissolution had not taken place, provided the other party to the transaction:

(a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of the dissolution;

(b) Though he had not so extended credit, had nevertheless known of the partnership prior to dissolution, and having no knowledge or notice of dissolution, the fact of dissolution had not been advertised in a newspaper of general circulation in the place (or in each place if more than one) at which the partnership business was regularly carried on.

The liability of a partner under the first paragraph, No. 2, shall be satisfied out of partnership assets alone when such partner had been prior to dissolution:

(1) Unknown as a partner to the person with whom the contract is made; and

(2) So far unknown and inactive in partnership affairs that the business reputation of the partnership could not be said to have been in any degree due to his connection with it.

The partnership is in no case bound by any act of a partner after dissolution:

(1) Where the partnership is dissolved because it is unlawful to carry on the business, unless the act is appropriate for winding up partnership affairs; or

(2) Where the partner has become insolvent; or

(3) Where the partner has no authority to wind up partnership affairs, except by a transaction with one who —

(a) Had extended credit to the partnership prior to dissolution and had no knowledge or notice of his want of authority; or

(b) Had not extended credit to the partnership prior to dissolution, and, having no knowledge or notice of his want of authority, the fact of his want of authority has not been advertised in the manner provided for advertising the fact of dissolution in the first paragraph No. 2(b).

Nothing in this article shall affect the liability under Article 1825 of any person who after dissolution represents himself or consents to another representing him as a partner in a partnership engaged in carrying on business.

COMMENT:

(1) When Firm Is Bound or Not Bound

This Article speaks of two possibilities:

- (a) when the partnership is *bound* to strangers;
- (b) when the partnership is not *bound* to strangers.

(2) When Partnership Is BOUND (a partnership liability is created)

- (a) business is for WINDING UP

Example: Selling of property of firm to pay off partnership debts; mortgaging firm assets for same purposes. (See *State Bank v. Bagley*, 1932, 44 Wyo. 303)

- (b) business is to complete unfinished transactions
- (c) COMPLETELY NEW BUSINESS with third parties considered innocent. [See (a) & (b) of No. (2) of the 1st paragraph.]

[NOTE: The differences between (a) and (b), No. 2 of the 1st paragraph are these: In (a), the customer had previously extended credit, that is, was a *previous* creditor. In case of dissolution he deserves to ACTUALLY KNOW. In (b), he was *not* a previous creditor. Here, if

there was *publication* of the dissolution, it is *presumed* he already *knows*, *regardless of actual knowledge or non-knowledge.*]

Examples:

A, B, and C are partners. A dies. B knows this, but still he later transacts new business with X, a business not connected with winding up. This notice of dissolution was in the paper but X did not read the notice, and when X transacted with B, X thought all the time that the firm had not yet been dissolved.

- (a) If *X* had been a previous creditor, is the firm liable?

ANS.: Yes [Art. 1834, 1st par. (2)(a)] BUT later on, as among the partners, B alone will be liable, because he knew of A's death.

- (b) If *X* had *never* extended credit before, is the firm liable?

ANS.: No, because after all there had been a publication of the dissolution and it is his fault that he did not read the advertisement. He did not deserve special attention for after all he had never been a previous creditor of the firm.

(NOTE: Only *B* would be personally liable to *X*.)

(NOTE: Had there been *no notice of dissolution* and *X* did not actually know of the dissolution, the firm would have been liable.)

NOTE: Liability of the *Unknown or Inactive Member:*

A, B, and C are partners. A withdraws. B knows this, but he entered into a new contract with X, a previous creditor of the firm who had no actual knowledge of the dissolution. C was not known by X to be ever a partner of the firm, so it could not be because of C that X had transacted the business.

Question: Is the firm liable?

ANS.: YES.

Question: If the partnership assets are insufficient, can *X* go after the *individual* properties?

ANS.: Yes, *except* with reference to *C*, because the law says that *C*'s liability "shall be satisfied out of the *partnership* assets alone."

(3) When Is the FIRM Not BOUND?

ANS.:

- (a) in all cases not included in our answer in COMMENT No. 2 of this article.

Example: new business with 3rd parties who are in BAD FAITH, as already explained.

- (b) where the firm was dissolved because it was UNLAWFUL to carry on the business (as when its objects were later declared by law to be outside the commerce of man)

EXCEPT — when the act is for WINDING UP

- (c) where the partner that *acted* in the transaction has become INSOLVENT
- (d) where the partner is UNAUTHORIZED to wind up

EXCEPT — if the transaction is with a customer in *good faith* (as already defined or explained).

It is understood that if *after dissolution* a stranger will represent himself as a partner although he is not one, he will be a partner by estoppel. (*See Art. 1825 and comments thereon*).

(4) Some Decided Cases

JCH Service Station v. Patrikes (1944) 181 Misc. 401

FACTS: After a firm was dissolved, a partner borrowed money under the firm name from *X*. *X* knew that the firm had already been dissolved. Is the firm liable?

HELD: No, because of *X*'s knowledge of the dissolution.

McNeil Co. v. Hamlet
(1919) 213 Ill. App. 501

FACTS: A, B and C are partners under a certain firm name. A retires. B and C continue the business. Is A liable to *previous* customers who transact with the new firm if the *firm still uses* the OLD firm name?

HELD: YES, unless A actually notifies said old customers or unless said customers actually know of his retirement.

Froess v. Froess
289 Pa. St., 691, 137 A. 124

FACTS: Jacob and Philip, brothers, were partners in the piano business. Philip *died* and Jacob continued the under the same name, over the objection of Philip's widow who was continually asking for the liquidation. Regarding the partnership assets, who should be preferred, the widow regarding Philip's share OR the creditors who still transacted with Jacob AFTER knowing that Philip was dead?

HELD: The widow is preferred, because she had the right to ascertain Philip's interest after his death. The creditor-customers cannot have preference for they knew of the death of Philip, and still they transacted with the firm.

Art. 1835. The dissolution of the partnership does not of itself discharge the existing liability of any partner.

A partner is discharged from any existing liability upon dissolution of the partnership by an agreement to that effect between himself, the partnership creditor and the person or partnership continuing the business; and such agreement may be inferred from the course of dealing between the creditor having knowledge of the dissolution and the person or partnership continuing the business.

The individual property of a deceased partner shall be liable for all obligations of the partnership incurred while he was a partner, but subject to the prior payment of his separate debts.

COMMENT:**(1) Dissolution Ordinarily Does Not Discharge Existing Liability of Partners**

Just because the firm is dissolved does not automatically mean that the existing liability of any partner is discharged.

Reason: Otherwise, creditors would be prejudiced, particularly if a partner will just withdraw anytime from the firm.

(2) How a Partner's Liability is Discharged

There must be an agreement. The following must agree:

- (a) the partner concerned;
- (b) the other partners;
- (c) the creditors.

[NOTE: If there be a novation of the old partnership debts, and such novation is done after one of the partners has retired, and *without* the consent of such retired partner, said partner cannot be held liable by creditors who made the novation with *knowledge* of the firm's dissolution. (*General Tire and Rubber Co. v. Noble, et al.*, 222 Mich. 545).

(3) Problem

A, B, and C are partners. A dies. Is A's estate (separate properties) liable for his share of the partnership obligations incurred while he was still a partner?

ANS.: Yes, but of course his individual creditors (as distinguished from the firm creditors) are to be preferred. (*3rd par.*, Art. 1835).

(4) Effect of Death on Pending Action

An action for accounting against a managing partner should be discontinued if he dies during the pendency of the action. The suit must be conducted in the *settlement proceedings of the deceased's estate*, particularly if this is the desire of his administrator. (*Po Yeng Cheo v. Lim Ka Yam*, 44 Phil.

172). Thus, it is wrong to just continue the action for accounting and substitute the dead defendant with his heirs. (*Lota v. Tolentino*, 90 Phil. 829).

Art. 1836. Unless otherwise agreed, the partners who have not wrongfully dissolved the partnership or the legal representative of the last surviving partner, not insolvent, has the right to wind up the partnership affairs, provided, however, that any partner, his legal representative or his assignee, upon cause shown, may obtain winding up by the court.

COMMENT:

(1) Extrajudicial and Judicial Winding-Up

(a) *Extrajudicially* —

- 1) by the partners who have not wrongfully dissolved the partnership
- 2) or by the legal representative of the *last surviving partner* (when all the partners are already dead), provided the last survivor was *not* insolvent.

NOTE:

Where the managing partners of the partnership has the necessary authority to liquidate its affairs under its article of co-partnership, he may sell the partnership properties even AFTER the life of the partnership has already expired since he as manager, is empowered to wind up the business affairs of the partnership. (*Ng Cho Cio, et al. v. Ng Diong and Hodges*, L-14832, Jan. 28, 1961).

(b) *Judicially* —

Under the control and direction of the court, upon proper cause that is shown to the court.

[**NOTE:** Here the person to wind up must be appointed by the court. And said appointee should not be the legal representative of a deceased partner but should be instead a surviving partner. (*Po Yeng Cheo v. Lim Ka Yam*, 44 Phil. 172).]

[**NOTE:** The petition, however, for a judicial winding up can be done by any partner, his legal representative, or his assignee. (*Art. 1836, 2nd part*).]

(2) Rule if Survivor Is Not the Manager

If the surviving member of the firm is not the general manager or administrator thereof, he is NOT required to serve as liquidator thereof without compensation. If he liquidates the affairs upon promise of a certain compensation by the managing partners, he is naturally entitled to receive compensation. (*Criado v. Gutierrez Hermanos, 37 Phil. 883*).

(3) Profits

Profits are supposed to accrue only during the *existence* of the partnership before dissolution. Of course, profits that will actually enter the firm after dissolution as a consequence of transactions already made before dissolution are included because they are considered as profits existing **AT THE TIME OF DISSOLUTION**. Any other income earned after the time, like *interest* or *dividends* on stock owned by the partners or partnership at the time of dissolution should not be distributed as profits (hence, the agreement here as to the distribution of “profits” will *not* govern), but as merely additional *income to the capital* (to be distributed under the rules on co-ownership, that is, to be divided in proportion to the amount of *capital given*).

[**NOTE:** Said “capital given” is computed as to the *time of dissolution*, that is, after profits and losses have already been computed (*Wood v. Wood, 312 Pa. 374, 167 A 600*).]

[**NOTE:** Indeed said income is not considered as “profits” for after dissolution, the firm has ceased to continue the business of the *partners together*.)]

Art. 1837. When dissolution is caused in any way, except in contravention of the partnership agreement, each partner, as against his co-partners and all persons claiming through them in respect of their interests in the partnership, unless otherwise agreed, may have the partnership property applied

to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners. But if dissolution is caused by expulsion of a partner, *bona fide* under the partnership agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under the second paragraph of Article 1835, he shall receive in cash only the net amount due him from the partnership.

When dissolution is caused in contravention of the partnership agreement the rights of the partners shall be as follows:

(1) Each partner who has not caused dissolution wrongfully shall have:

(a) All the rights specified in the first paragraph of this article, and

(b) The right, as against each partner who has caused the dissolution wrongfully, to damages for breach of the agreement.

(2) The partners who have not caused the dissolution wrongfully, if they all desire to continue the business in the same name either by themselves or jointly with others, may do so, during the agreed term for the partnership and for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable under the second paragraph, No. 1(b) of this article, and in like manner indemnify him against all present or future partnership liabilities.

(3) A partner who has caused the dissolution wrongfully shall have:

(a) If the business is not continued under the provisions of the second paragraph, No. 2, all the rights of a partner under the first paragraph, subject to liability for damages in the second paragraph, No. 1(b), of this article.

(b) If the business is continued under the second paragraph, No. 2, of this article, the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damage caused to his co-partners by the dissolution, ascertained and paid to him in cash, or the payment secured by a bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner's interest the value of the goodwill of the business shall not be considered.

COMMENT:

(1) Two Aspects of Causes of Dissolution

Dissolution may be caused:

(a) although the partnership contract is NOT VIOLATED
(*Example:* death, or arrival of term) (The rights of partners are governed by the FIRST PARAGRAPH of this article.)

(b) because the partnership contract is VIOLATED

Example: Deliberate withdrawal of a partner although the period of the firm has not yet expired, thus causing damage to the firm.

(**NOTE:** The rights of the partners here are governed BUT the SECOND PARAGRAPH of this article.)

(2) Better Rights for Innocent Partners

Note that innocent partners have better rights than guilty partners, and that the latter are required to indemnify for the *damages* caused.

(3) Right of Innocent Partners to Continue

Note also that the innocent partners may *continue* the business (but this time, there is really a NEW partnership). They can even use the same firm name if they wish to;

moreover, they can ask new members to join, BUT always, the rights granted to the guilty partners are safeguarded by:

- (a) a BOND approved by the court;
- (b) a PAYMENT of his interest at the time of dissolution MINUS damages. (Moreover, the guilty partner who is excluded will be indemnified against all PRESENT or FUTURE partnership liabilities. This is because he is no longer a partner.)

(4) Right to Get Cash

In case of non-continuance of the business, the interest of the partner should, if he desires, be given in CASH. (Firm assets may be sold for this purpose.)

[**NOTE:** “The right given to each partner, where no agreement to the contrary has been made to have his share of the surplus paid to him in CASH makes *certain* an existing (under the old law) *uncertainty*. At present (under the old law) it is not certain whether a partner may or may not insist on a physical partition of the property remaining after third persons have been paid. (*Commissioner’s Note, 7 ULA, Sec. 38, p. 57*).]

(5) No Share in Goodwill for Guilty Partner

A guilty partner, in ascertaining the value of his interest is *NOT* entitled to a proportionate share of the value of the GOODWILL. (This is a necessary consequence of his *bad faith*.)

[**NOTE:** The deprivation of his share in the goodwill is not unconstitutional, and cannot be considered as unlawful taking of property without due process of law. (*See Zeibak v. Nasser, 1938, 12 Cal. 2nd 1, 82P. 2d 374*).]

(6) Partner Wrongfully Excluded

When a partner is excluded wrongfully, he should be considered as the innocent partner, and the others as the guilty partners. It is now said that other partners “must account not only for what is due to him at the date of the dissolution

but also for *damages* or for his share of the profits realized from the appropriation of the *partnership business and good will*. (Of course), it is otherwise if the excluded partner had substantially broken the partnership agreement.” (*Schnitzer v. Josephthal*, 1923, 122 Misc. 15, 202 N.Y.S. 77). Indeed, he has a *pecuniary* interest in every existing contract that was *incomplete* and in the *trade name* of the co-partnership and assets at the time he was wrongfully expelled. (See *Halfouba v. Miss*, 1936, 248 App. Div. 901, 290, N.Y.S. 708).

(7) Division of Losses

Although such things as “depreciation, obsolescence, or diminished market value of capital assets” are *not* strictly speaking to be considered losses because they merely constitute a decrease in capital assets (and not the result of business transactions), still they should, in fairness be considered as *losses*, and the rules on losses must apply, provided that their *real market values* at the time of liquidation are the values considered. (See *Greiss v. Platzer*, 131 N.J. Eq. 160, 24 A. 2d 408).

Art. 1838. Where a partnership contract is rescinded on the ground of the fraud or misrepresentation of one of the parties thereto, the party entitled to rescind is, without prejudice to any other right, entitled:

(1) To a lien on, or right of retention of, the surplus of the partnership property after satisfying the partnership liabilities to third persons for any sum of money paid by him for the purchase of an interest in the partnership and for any capital or advances contributed by him;

(2) To stand, after all liabilities to third persons have been satisfied, in the place of the creditors of the partnership for any payments made by him in respect of the partnership liabilities; and

(3) To be indemnified by the person guilty of the fraud or making the representation against all debts and liabilities of the partnership.

COMMENT:**(1) Rescission or annulment of Partnership Contract**

- (a) Although the law here uses the term “rescind,” the proper technical term that should have been used is “annulled,” in view of the “fraud or misrepresentation.”
- (b) The “fraud or misrepresentation” here vitiates the consent whereby the contract of partnership had been entered into, hence, it is really “*dolo causante*.”

(2) Three Rights

The Article speaks of 3 rights (without prejudice to his other rights under other legal provisions):

- (a) right of LIEN or RETENTION
- (b) right of SUBROGATION
- (c) right of INDEMNIFICATION

Art. 1839. In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

(1) The assets of the partnership are:

- (a) The partnership property;
- (b) The contributions of the partners necessary the payment of all the liabilities specified in No. 2.

(2) The liabilities of the partnership shall rank in order of payment, as follows:

- (a) Those owing to creditors other than partners;
- (b) Those owing to partners other than for capital and profits;
- (c) Those owing to partners in respect of capital;
- (d) Those owing to partners in respect of profits.

(3) The assets shall be applied in the order of their declaration in No. 1 of this article to the satisfaction of the liabilities.

(4) The partners shall contribute, as provided by Article 1797, the amount necessary to satisfy the liabilities.

(5) An assignee for the benefit of creditors or any person appointed by the court shall have the right to enforce the contributions specified in the preceding number.

(6) Any partner or his legal representative shall have the right to enforce the contributions specified in No. 4, to the extent of the amount which he has paid in excess of his share of the liability.

(7) The individual property of a deceased partner shall be liable for the contributions specified in No. 4.

(8) When partnership property and the individual properties of the partners are in possession of a court for distribution, partnership creditors shall have priority on partnership property and separate creditors on individual property, saving the rights of lien or secured creditors.

(9) Where a partner has become insolvent or his estate is insolvent, the claims against his separate property shall rank in the following order:

- (a) Those owing to separate creditors;
- (b) Those owing to partnership creditors;
- (c) Those owing to partners by way of contribution.

COMMENT:

(1) Rules for Settling Accounts

- (a) Commissioner's Comment on No. (1) subdivision (b) "*the contributions* of the partners necessary for the payment of all liabilities . . .":

"The adoption of this clause will end the present (under the old law) confusion as to whether the contribution of the partners toward the losses of the partnership are partnership assets or not. The Commissioners believe that the opinion that such contributions are assets is supported by the better reasoning." (*Commissioner's Note, 7 ULA, Sec. 40, p. 59*).

- (b) Art. 1839 speaks of the methods of settling the accounts of the partnership, that is to say — its LIQUIDATION.

[**NOTE:** Before liquidation is made, no action for accounting of a partner's share in the profit or for a return of his capital assets can properly be made, since it is essential to first pay-off the creditors. Thus, a partner who has retired must first ask for the liquidation before he can recover his proportionate share of the partnership assets. (*Po Yeng Cheo v. Lim Ka Yam, supra.*)]

[**NOTE:** The managing partner of a firm is not a debtor of the other partners for the capital embarked by them in the business; thus, he can only be made liable for the capital, when upon liquidation of the business, there are found to be assets in his hands applicable to the capital account. (*Po Yeng Cheo v. Lim Ka Yam, supra.*)]

- (c) Art. 1839 can apply only if there is a contrary agreement. Of course, such agreement cannot prejudice innocent third parties.

(2) The Assets of the Partnership

- (a) The partnership property (including goodwill).
- (b) The contributions of the partners, which are made to pay off the partnership liabilities.

(3) Order of Payment of Firm's Liabilities

- (a) First give to *creditors* (who are strangers), otherwise they may be prejudiced.
- (b) Then give to partners who are also *creditors* (they should be placed in a subordinate position to outside creditors for otherwise they may *prefer* their own interests).

[**NOTE:** Example of credits owing to partners which are neither capital nor profits, are those for reimbursement of business expenses. (*See Geist v. Burnstine, 1940, Misc. 19 N.Y. 2d 76.*)]

- (c) Then give to the partners their *capital*.

(**NOTE:** Capital should be given ahead of profit for it is only the surplus profit over capital that should be considered as the *gain* or the *profit* of the firm.)

[**NOTE:** An industrial partner, who has not contributed money or property at all is, in the absence of stipulation, not entitled to participate in the capital. He shares in the profits, however. (*See Hunter v. Allen, 1944, 147 P. 2d 213*).]

- (d) Lastly, the profits must be distributed.

[**NOTE:** If, during the liquidation of a firm, the profits for a *certain period of time* cannot be exactly determined because no evidence or insufficient evidence thereof is available, the court should determine the *profit for the period* by finding the *average* profits during the period BEFORE and AFTER the period of time in question. (*See De la Rosa v. Ortega Go-Cotay, 48 Phil. 605*).]

(4) New Contributions

If the partnership assets are insufficient, the other partners must contribute more money or property. Who can enforce these contributions?

ANS.:

- (a) In general, any *assignee* for the benefit of the creditor; or any *person appointed* by the court (like a receiver). (*Upton v. Upton, 1934, 268 Mich 26*). (*Reason:* Said enforced contributions may be considered as partnership assets, and should therefore be available to the creditors). (*See Upton v. Upton, supra*).
- (b) Any *partner* or his *legal representative* (to the extent of the amount which he has paid in excess of the share of the liability). (*Art. 1839, No. 1[b]*).

(5) Problem

A, B, and C are partners. A died. Is A's estate still liable for the contributions needed to pay off the partnership obligations?

ANS.: Yes. (*Generally*, as long as the said obligations had been incurred prior to his death.)

(6) Preference With Respect to the Assets

Suppose both the partnership property and the individual properties of the partners are in the possession of the court for distribution, who should be preferred?

ANS.: It depends:

- (a) *Regarding partnership property*, partnership creditors have preference.
- (b) *Regarding individual properties* of the partners, the individual creditors are preferred.

(7) Rule if Partner is Insolvent

If a partner is insolvent, how will his individual properties be distributed?

ANS.:

- (a) First, give to the individual or separate creditors.
- (b) Then, to the partnership creditors.
- (c) Then, those owing to the other partners by way of contribution.

(**NOTE:** Insolvency here of the partner or his estate does not necessarily mean no more money or property; it is enough that the assets are less than the liabilities.)

[**NOTE:** A person who alleges himself to be a partner of a deceased individual has the right to intervene in the settlement of the decedent's estate, particularly in the approval of the executor's or administrator's account for after all it may be that he (the alleged partner) was indeed a partner to whom the deceased partner owed something. Administrators and executors, instead of opposing the intervention of interested parties, should welcome the participation of the same for their own protection. Of course, mere intruders should not be allowed. (*Villanueva v. De Leon*, 47 Phil. 780).]

Art. 1840. In the following cases creditors of the dissolved partnership are also creditors of the person or partnership continuing the business:

(1) When any new partner is admitted into an existing partnership, or when any partner retires and assigns (or the representative of the deceased partner assigns) his rights in partnership property to two or more of the partners, or to one or more of the partners and one or more third persons, if the business is continued without liquidation of the partnership affairs;

(2) When all but one partner retire and assign (or the representative of a deceased partner assigns) their rights in partnership property to the remaining partner, who continues the business without liquidation of partnership affairs, either alone or with others;

(3) When any partner retires or dies and the business of the dissolved partnership is continued as set forth in Nos. 1 and 2 of this article, with the consent of the retired partners or the representative of the deceased partner, but without any assignment of his right in partnership property;

(4) When all the partners or their representatives assign their rights in partnership property to one or more third persons who promise to pay the debts and who continue the business of the dissolved partnership;

(5) When any partner wrongfully causes a dissolution and the remaining partners continue the business under the provisions of Article 1837, second paragraph, No. 2 either alone or with others, and without liquidation of the partnership affairs;

(6) When a partner is expelled and the remaining partners continue the business either alone or with others without liquidation of the partnership affairs.

The liability of a third person becoming a partner in the partnership continuing the business, under this article, to the creditors of the dissolved partnership shall be satisfied out of the partnership property only, unless there is a stipulation to the contrary.

When the business of a partnership after dissolution is continued under any conditions set forth in this article the creditors of the dissolved partnership, as against the separate creditors of the retiring or deceased partner or the representative of the deceased partner have a prior right to any claim of the retired partner or the representative of the deceased partner against the person or partnership continuing the business, on account of the retired or deceased partner's interest in the dissolved partnership or on account of any consideration promised for such interest or for his right in partnership property.

Nothing in this article shall be held to modify any right of creditors to set aside any assignment on the ground of fraud.

The use by the person or partnership continuing the business of the partnership name, or the name of a deceased partner as part thereof, shall not of itself make the individual property of the deceased partner liable for any debts contracted by such person or partnership.

COMMENT:

(1) Right of Old Creditors to be Creditors of the New Firm

Reason for the law (in making creditors of the dissolved firm also creditors of the persons or partnership continuing the business): So that said creditors will not lose their preferential rights as creditors to the partnership property.

(2) Example

A and B are partners. Later, C was admitted as member or partner and the firm's business was continued. The creditors of the old firm continue to be creditors of the new partnership but the liability of C shall be satisfied out of partnership property only. Exception: if there is a stipulation to the contrary.

Art. 1841. When any partner retires or dies, and the business is continued under any of the conditions set forth in the preceding article or in Article 1837, second

paragraph, No. 2, without any settlement of accounts as between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such person or partnership may have the value of his interest at the date of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interests the profits attributable to the use of his right in the property of the dissolved partnership; provided that the creditors of the dissolved partnership as against the separate creditors, or the representative of the retired or deceased partner shall have priority on any claim arising under this article as provided by Article 1840, third paragraph.

COMMENT:

Retirement or Death of a Partner

- (a) This Article speaks of the rights of retiring partners or of the estate of a deceased partner when the business is continued without any statement of accounts.
- (b) As a general rule when a partner retires from the firm, he is entitled to the payment of what may be due him after a liquidation. But no liquidation is needed when there already is a settlement as to what the retiring partner shall receive. (*Bonnevie v. Hernandez*, 95 Phil. 175).

Art. 1842. The right to an account of his interest shall accrue to any partner, or his legal representative as against the winding up partners or the surviving partners or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary.

COMMENT:

(1) When Right to Account Accrues

- (a) See Arts. 1807 and 1809 which also deal with the duty to account. Under the present Article (1842), the right

to demand the account accrues at the *date* of dissolution in the absence of any contrary agreement.

- (b) Note that the *legal representative* of a partner is also, under Art. 1842, entitled to the accounting.

(2) Possible Defendants

The action can be against:

- (a) the winding up partners;
- (b) the surviving partners;
- (c) the person or partnership continuing the business.

Chapter 4

LIMITED PARTNERSHIP

Art. 1843. A limited partnership is one formed by two or more persons under the provisions of the following article, having as members one or more general partners and one or more limited partners. The limited partners as such shall not be bound by the obligations of the partnership.

COMMENT:

Reason for and History of Limited Partnerships

“The business reason for the adoption of acts making provisions for limited or special partners is that men in business often desire to secure capital from others. There are at least three classes of contracts which can be made with those from whom the capital is secured: One, the ordinary loan on interest; another, the loan where the lender, in lieu of interest, takes a share in the profits of the business; third, those cases in which the person advancing the capital secures, besides a share in the profits, some measure of control over the business.

“At first, in the absence of statutes, the courts, both in this country and in England, assumed that one who is interested in a business is bound by its obligations, carrying the application of his principle so far that a contract where the only evidence of interest was a share in the profits made one who supposed himself a lender, and who was probably unknown to the creditors at the time they extended their credits, is unlimitedly liable as a partner for the obligations of those actually conducting the business.

“Later decisions have much modified the earlier case. The lender who takes a share in the profits, except possibly in one or two of our jurisdiction, does not by reason of that fact, run a risk of being held as a partner. If, however, his contract falls

within the third class mentioned, and he has any measure of control over the business, he at once runs serious risk of being liable for the debts of the business as a partner; the risk increasing as he increase the amount of his control.

“The first Limited Partnership Act was adopted by New York in 1822; the other commercial states, during the ensuing 30 years, following her example. Most of the statutes follow the language of the New York statute with little material alteration. Those statutes were adopted, and to a considerable degree interpreted by the courts, during that period when it was generally held that any interest in a business should make the person holding the interest liable for its obligations. As a result the courts usually assume in the interpretation of those statutes two principles as fundamental.

“*First:* That a limited (or as he is also called, a “special”) partner is a partner in all respects like any other partner, except that to obtain the privilege of a limitation on his liability, he has conformed to the statutory requirements in respect to filing a certificate and refraining from participation in the conduct of the business.

“*Second:* The limited partner, on any failure to follow the requirement in regard to the certificate or any participation in the conduct of his business, loses his privilege of limited liability and becomes, as far as those dealing with the business are concerned, in all respects a partner.

“The courts in thus interpreting the statutes, although they made an American partnership with limited members something very difficult from the French *Societe in Commandite* from which the idea of the original statutes was derived, unquestionably carried out the intent of those responsible for their adoption. This is shown by the very wording of the statutes themselves. For instance, all the statutes require that all partners, limited and general, shall sign the certificate, and nearly all state that: ‘If any false statement be made in such certificate all the persons interested in such partnership shall be liable for all the engagements thereof as general partners.’

“The practical result of the spirit shown in the language and in the interpretation of existing statutes, coupled with the fact that a man may now lend money to a partnership and

take a share in the profits in lieu of interest running serious danger of becoming bound for partnership obligations, has, to a very great extent, derived the existing statutory provisions for limited partners of any practical usefulness. Indeed, apparently their use is largely confined to associations in which those who conduct the business have not more than one limited partner.

“One of the causes forcing business into the corporate form, in spite of the fact that the corporate form is ill-suited to money business conditions, is the failure of the existing limited partnership acts to meet the desire of the owners of a business to secure necessary capital under the existing partnership form of business association.

“The draft herewith submitted proceeds on the following assumptions:

“First: No public policy requires a person who contributes the capital of a business, acquires an interest in the profits, and some degree of control over the conduct of business, provided creditors have no reason to believe at the times their credits were extended that such person was so bound.

“Second: That persons in business should be able, while remaining themselves liable without limit for the obligations contracted in its conduct, to associate with themselves, others who contribute to the capital and acquire rights of ownership, provided that such contributors do not compete with creditors for the assets of the partnership.

“The attempt to carry out these ideas has led to the incorporation into the draft submitted of certain features, not found in, or differing from, existing limited partnership acts.

“First: In the draft the person who contributes the capital, though in accordance with custom called a limited partner, is not in any sense a partner. He is, however, a member of the association. (*See Sec. 1*).

“Second: As limited partners are not partners securing a certificate, the association is formed when substantial compliance in good faith is had with the requirements of a certificate. (*Sec. 2[2]*). This provision eliminates the difficulties which arise from the recognition of *de facto* associations,

made necessary by the assumption that the association is not formed unless a strict compliance with the requirements of the act is had.

“Third: The limited partner not being in any sense a principal in the business, failure to comply with the requirements of the act in respect to the certificate, while it may result in the non-formation of the association, does not make him a partner or liable as such. The exact nature of his liability in such cases is set forth in Sec. 11.

“Fourth: The limited partner, while not as such in any sense a partner, may become a partner as any person not a member of the association may become a partner, and, becoming a partner, may nevertheless restrain his rights as limited partner this last provision enabling the entire capital embraced in the business to be divided between the limited partners, all the general partners being also limited partners. (Sec. 12).

“Fifth: The limited partner is not debarred from loaning money or transacting other business with the partnership as any other non-member; provided he does not, in respect to such transactions, accept from the partnership collateral security, or receive from any partner or the partner of the partnership any payment, conveyance, release from liability, if at the time the assets of the partnership are not sufficient to discharge its obligation to persons not general or limited partners. (Sec. 13).

“Sixth: The substitution of a person as limited partner in place of an existing limited partner, or the withdrawal of a limited partner, or the addition of new limited partners, does not necessarily dissolve the association (Secs. 16[2b]); no limited partner, however, can withdraw his contribution until all liabilities to creditors are paid. (Sec. 16[1a]).

“Seventh: As limited partners are not principals in transactions of the partnership, their liability, except, for known false statements in the certificate (Sec. 6), is to the partnership, not to the creditors of the partnership. (Sec. 17). The general partners cannot, however, waive any liability of the limited partners to the prejudice of such creditors.” [Sec. 17 (3)]. (Commissioner’s Note, Vol. 8, Uniform Laws, Annotated, pp. 2-5).

Art. 1844. Two or more persons desiring to form a limited partnership shall:

- (1) Sign and swear to a certificate which shall state –**
 - (a) The name of the partnership, adding thereto the word “Limited”;**
 - (b) The character of the business;**
 - (c) The location of the principal place of business;**
 - (d) The name and place of residence of each member, general and limited partners being respectively designated;**
 - (e) The term for which the partnership is to exist;**
 - (f) The amount of cash and a description of and the agreed value of the other property contributed by each limited partner;**
 - (g) The additional contributions, if any, to be made by each limited partner and the times at which or events on the happening of which they shall be made;**
 - (h) The time, if agreed upon, when the contribution of each limited partner is to be returned;**
 - (i) The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution;**
 - (j) The right, if given, of a limited partner to substitute an assignee as contributor in his place, and the terms and conditions of the substitution;**
 - (k) The right, if given, of the partners to admit additional limited partners;**
 - (l) The right, if given, of one or more of the limited partners to priority over other limited partners, as to contributions or as to compensation by way of income, and the nature of such priority;**
 - (m) The right, if given, of the remaining general partner or partners to continue the business on the**

death, retirement, civil interdiction, insanity or insolvency of a general partner; and

(n) The right, if given, of a limited partner to demand and receive property other than cash in return for his contribution.

(2) File for record the certificate in the Office of the Securities and Exchange Commission.

A limited partnership is formed if there has been substantial compliance in good faith with the foregoing requirements.

COMMENT:

(1) Requisites in the Formation of a Limited Partnership

Two important things are needed:

- (a) The *signing under oath* of the required certificate (with all the enumerated items), and
- (b) The filing for record of the certificate in the Office of the Securities and Exchange Commission.

(2) Non-Fulfillment of the Requisites

If the proposed limited partnership has not conformed substantially with the requirements of this article, as when the name of *not* one of the general partners appear in the *firm name*, it is *not* considered a limited partnership but a general partnership. (*Jo Chung Cang v. Pacific Com. Co.*, 45 Phil. 142; *Mechem, Elements of Partnership*, p. 412 and *Coll. of Int. Rev. v. Isasi*, L-9186, Apr. 29, 1957). This is because a firm transacting business as a partnership is presumed to be a general partnership. (*Vanhorn v. Gorcoran*, 127 Pa. 255).

(3) Effect if Only Aggregate Contribution Is Stated

The law says that the contribution of each limited partner must be stated. Therefore if the aggregate sum given by two or more limited partners is given, the law has not been complied with. (*Spencer Optical Mfg. Co. v. Johnson*, 53 S.C. 533).

(4) Effect of Omitting the Term “Limited” in the Firm Name

The law requires the firm name to have the word “Limited.” If this provision is violated, the name cannot be considered the firm name of a limited partnership. (*Hungman Yoc v. Kieng-Chiong-Seng*, 6 Phil. 498).

Art. 1845. The contributions of a limited partner may be cash or other property, but not services.

COMMENT:

(1) What the Limited Partner Can Contribute

Note that a limited partner is not allowed to contribute industry or services alone.

(2) Industrial Partner Can Join

An industrial partner can become a *general* partner in a *limited partnership*, for the article speaks only of a “limited partner.”

Art. 1846. The surname of a limited partner shall not appear in the partnership name unless:

(1) It is also the surname of a general partner, or

(2) Prior to the time when the limited partner became such, the business had been carried on under a name in which his surname appeared.

A limited partner whose surname appears in a partnership name contrary to the provisions of the first paragraph is liable as a general partner to partnership creditors who extend credit to the partnership without actual knowledge that he is not a general partner.

COMMENT:

Non-Inclusion of Name of the Limited Partner

Note that a limited partner violating this article is *liable* as a general partner to innocent third parties, *without* however the rights of a general partner.

Art. 1847. If the certificate contains a false statement, one who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false:

- (1) At the time he signed the certificate, or
- (2) Subsequently, but within a sufficient time before the statement was relied upon to enable him to cancel or amend the certificate, or to file a petition for its cancellation or amendment as provided in Article 1865.

COMMENT:

Liability for a False Statement

This speaks of liability for a false *statement*. The person who suffers loss can sue for damages.

Art. 1848. A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.

COMMENT:

Effect of Taking Part in the Control of the Business

- (a) The following acts do *not* constitute taking “part in the control of the business”:
 - 1) mere dealing with a customer. (*Rayne v. Terell*, 33 La. Ann. 812).
 - 2) mere consultation on one occasion with the general partners. (*Ulman v. Briggs*, 32 La. Ann. 655).
- (b) The following have been held to constitute taking “part in the control of the business”:
 - 1) selection of who will be the managing partners. (*Stranger v. Thomas*, 114 Wis. 699).
 - 2) supervision over a superintendent of the business of the firm. (*Richardson v. Hogs*, 38 Pa. St. 153).

- (c) Participation in the control of the business makes the limited partner liable as a *general* partner without however getting the latter's rights.

Art. 1849. After the formation of a limited partnership, additional limited partners may be admitted upon filing an amendment to the original certificate in accordance with the requirements of Article 1865.

COMMENT:

(1) When Additional Limited Partners May Be Admitted

Note that even after a limited partnership has already been formed, the firm may still admit new *limited partners*, provided there is a proper *amendment* to the certificate.

(2) Effect of Failure to Amend

If additional limited partners are taken in, without proper amendment of certificate with the SEC, this does not necessarily mean the dissolution of the limited partnership. (See *Tec Bi and Co. v. Collector of Int. Rev.*, 61 Phil. 351).

Art. 1850. A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners. However, without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partner's have no authority to:

- (1) Do any act in contravention of the certificate;
- (2) Do any act which would make it impossible to carry on the ordinary business of the partnership;
- (3) Confess a judgment against the partnership;
- (4) Possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose;
- (5) Admit a person as a general partner;
- (6) Admit a person as a limited partner, unless the right so to do is given in the certificate;

(7) Continue the business with partnership property on the death, retirement, insanity, civil interdiction or insolvency of a general partner, unless the right so to do is given in the certificate.

COMMENT:

(1) Acts of Strict Dominion

Note that *as a rule*, in the instances enumerated, the general partners (even if already unanimous among themselves) must still get the *written* CONSENT or RATIFICATION of ALL the limited partners.

Reason: In a sense the acts are acts of strict dominion or ownership, and are not generally essential for the routine or ordinary conduct of the firm's business.

(2) Conflicts Rule Governing Capacity of the Limited Partner

If a general partner in a limited partnership goes abroad, his capacity to bind the firm is governed by the law of the place where the limited partnership was formed. (*Barrows v. Downs*, 3 R.I. 446 cited in 8 ULA, p. 21).

Art. 1851. A limited partner shall have the same rights as a general partner to:

(1) Have the partnership books kept at the principal place of business of the partnership, and at a reasonable hour to inspect and copy any of them;

(2) Have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable; and

(3) Have dissolution and winding up by decree of court.

A limited partner shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in Articles 1856 and 1857.

COMMENT:**Rights of a Limited Partner**

- (a) A limited partner necessarily has lesser rights than a general partner. These rights are enumerated in the Article.
- (b) Note however that among other things he also has the right to have dissolution and winding up by decree of the court.
- (c) He cannot however bind the firm by a contract. (*Columbia Land Co. v. Dally*, 40 Kan. 504).

Art. 1852. Without prejudice to the provisions of article 1848, a person who has contributed to the capital of a business conducted by a person or partnership erroneously believing that he has become a limited partner in a limited partnership, is not by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership, provided that on ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income.

COMMENT:**(1) Contributor Who Erroneously Believes He Has Become a Limited Partner***Example:*

A, B, C, D, and E agreed to form a limited partnership, with the first two as general partners and the rest as limited partners, but as recorded in the Securities and Exchange Commission and in the certificate, *A* and *B* were really named general partners, but only *C* and *D* were included as limited (special) partners. *E*, who had contributed money, was LEFT OUT. If *E* erroneously believes that he has become a limited partner (erroneously, for clearly, he is not) and thereupon

exercises the rights of a *limited* partner, he should not generally be considered as liable as a *general partner* (general because the public *cannot* be blamed for not considering him a limited partner). (*See In Re Marcuse, 281 Fed. 928*).

(2) When He Becomes Liable As a General Partner

In the example given, however, he can still be liable as a *general* partner:

- (a) unless on *ascertaining the mistake*, he *promptly renounces* his interest in the profits of the business, or other compensation by way of income; or
- (b) unless, even if no such renouncing is made, partnership creditors are NOT prejudiced. (*See In Re Marcuse, 281 Fed. 928*).

(3) Limited Partner Who Participates in the Control Cannot Take Advantage of the Article

The person referred to under Art. 1848 *cannot* take advantage, naturally, of Art. 1852.

Art. 1853. A person may be a general partner and a limited partner in the same partnership at the same time, provided that this fact shall be stated in the certificate provided for in Article 1844.

A person who is a general, and also at the same time a limited partner, shall have all the rights and powers and be subject to all the restrictions of a general partner; except that, in respect to his contribution, he shall have the rights against the other members which he would have had if he were not also a general partner.

COMMENT:

(1) General — Limited Partner

Note that a person may be a general and a *limited* partner at the same time, provided same is stated in the certificate.

(2) Rights

Generally, his rights are those of a general *partner* (hence, third parties can go against his individual properties).

EXCEPTION: Regarding his *contribution* (like the right to have it returned on the proper occasions) he would be considered a limited partner, with the rights of a limited partner, insofar as the other partners are concerned.

Art. 1854. A limited partner also may loan money to and transact other business with the partnership, and, unless he is also a general partner, receive on account of resulting claims against the partnership, with general creditors, a *pro rata* share of the assets. No limited partner shall in respect to any such claim:

(1) Receive or hold as collateral security any partnership property, or

(2) Receive from a general partner or the partnership any payment, conveyance, or release from liability, if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners.

The receiving of collateral security, or payment, conveyance, or release in violation of the foregoing provisions is a fraud on the creditors of the partnership.

COMMENT:

Right of a Limited Partner to Lend Money and Transact Other Business With the Firm

- (a) Note that 3rd parties are always given preferential rights insofar as the firm's assets are concerned.
- (b) Note also that while the limited partner, in the case of a claim referred to in the article, is prohibited to "*receive or hold* as COLLATERAL SECURITY any partnership property," still he is not prohibited to *purchase* partnership assets which are used to satisfy partnership obligations towards third parties.

Art. 1855. Where there are several limited partners the members may agree that one or more of the limited partners shall have a priority over other limited partners as to the return of their contributions, as to their compensation by way of income, or as to any other matter. If such an agreement is made it shall be stated in the certificate, and in the absence of such a statement all the limited partners shall stand upon equal footing.

COMMENT:

(1) Preference to Some Limited Partners

- (a) Note that preference can be given to *some limited partners* over the other *limited partners*.
- (b) However, the preference must be “stated in the certificate.”

(2) Nature of the Preference

This preference may involve:

- (a) the return of contributions;
- (b) compensation;
- (c) other matters.

Art. 1856. A limited partner may receive from the partnership the share of the profits or the compensation by way of income stipulated for in the certificate; provided, that after such payment is made, whether from the property of the partnership or that of a general partner, the partnership assets are in excess of all liabilities of the partnership except liabilities to limited partners on account of their contributions and to general partners.

COMMENT:

Profit or Compensation of Limited Partners

- (a) Whereas Art. 1856 speaks of “profit or compensation by way of income,” Art. 1857 deals generally with the return of the *contributions*.

- (b) Note that for Art. 1856 to apply, partnership assets must be in excess of partnership *liabilities* to 3rd persons, not liabilities to partners.

Art. 1857. A limited partner shall not receive from a general partner or out of partnership property any part of his contributions until:

(1) All liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have been paid or there remains property of the partnership sufficient to pay them;

(2) The consent of all members is had, unless the return of the contribution may be rightfully demanded under the provisions of the second paragraph; and

(3) The certificate is canceled or so amended as to set forth the withdrawal or reduction.

Subject to the provisions of the first paragraph, a limited partner may rightfully demand the return of his contribution:

(1) On the dissolution of a partnership, or

(2) When the date specified in the certificate for its return has arrived, or

(3) After he has given a month's notice in writing to all other members, if no time is specified in the certificate, either for the return of the contribution or for the dissolution of the partnership.

In the absence of any statement in the certificate to the contrary or the consent of all members, a limited partner, irrespective of the nature of his contribution has only the right to demand and receive cash in return for his contribution.

A limited partner may have the partnership dissolved and its affairs wound up when:

(1) He rightfully but unsuccessfully demands the return of his contribution, or

(2) The other liabilities of the partnership have not been paid, or the partnership property is insufficient for their payment as required by the first paragraph, No. 1, and the limited partner would otherwise be entitled to the return of his contribution.

COMMENT:

(1) When Contributions of Limited Partners Can Be Returned

- (a) The 1st paragraph deals with the **CONDITIONS** that must exist before contributions (or part thereof) by a limited partner can be returned to him.
- (b) The second paragraph deals with the **TIME** when such contributions can be returned, provided that the *conditions* are complied with.
- (c) Note that as a rule, even if a limited partner has contributed *property*, he has the right to demand and receive **CASH** in return.
- (d) If paragraph one is violated, *previous* creditors can sue, but they must *allege* and prove the *non-existence* of the **CONDITIONS**. (*Snipler v. Leland*, 127 Mass. 291). Among these in the same category as previous creditor is the assignee in insolvency of a bankrupt limited partnership. (*Wilkins v. Davis*, 29 Fed. Case No. 17, p. 644).

(2) Liability of a Limited Partner Who Has Withdrawn

Suppose a limited partner *withdraws rightfully* his contribution (all conditions being fulfilled, particularly the *complete solvency* of the firm as of the *time of withdrawal*) and the certificate is amended properly, would he still be liable to previous creditors if later on the firm becomes *insolvent*?

ANS.: Yes, if by chance, the very next day the partnership assets are all destroyed by an earthquake, etc., it is unfair for him to keep the cash, and leave the creditors with nothing. His contribution (even if already returned to him) is to be treated as a trust fund for the discharge of liabilities. Moreover, the sum should include the interest presumably

earned. (*See Kittredge v. Langley*, 1933, 252 N.Y. 405; see also last paragraph of Art. 1858).

[**NOTE:** Future creditors cannot make use of the principle enunciated in the above-cited case in view of the recorded amended certificate, except of course if the money had been wrongfully returned to the limited partner. (*See Art. 1858*).]

Art. 1858. A limited partner is liable to the partnership:

(1) For the difference between his contribution as actually made and that stated in the certificate as having been made, and

(2) For any unpaid contribution which he agreed in the certificate to make in the future at the time and on the conditions stated in the certificate.

A limited partner holds as trustee for the partnership:

(1) Specific property stated in the certificate as contributed by him, but which was not contributed or which has been wrongfully returned, and

(2) Money or other property wrongfully paid or conveyed to him on account of his contribution.

The liabilities of a limited partner as set forth in this article can be waived or compromised only by the consent of all members; but a waiver or compromise shall not affect the right of a creditor of a partnership who extended credit or whose claim arose after the filing and before a cancellation or amendment of the certificate, to enforce such liabilities.

When a contributor has rightfully received the return in whole or in part of the capital of his contribution, he is nevertheless liable to the partnership for any sum, not in excess of such return with interest, necessary to discharge its liabilities to all creditors who extended credit or whose claims arose before such return.

COMMENT:

(1) Liabilities of a Limited Partner

(a) This is a new provision of the new Civil Code.

Source: Sec. 17, Uniform Limited Partnership Act.

- (b) *A* and *B* are limited partners of a partnership. In the certificate, it was stated that *A* contributed P1.8 million when as a matter of fact he had given only P1.5 million. In the certificate too is a promise made by *B* to pay P200,000 additional contribution on Dec. 1, 2004. Should *A* and *B* make good the P300,000 and P200,000 respectively?

ANS.: Yes, *A* should pay now; *B* on Dec. 1, 2004.

- (c) May the liabilities in the preceding problem be waived or compromised?

ANS.: Yes, but two conditions must be followed:

- (a) All the other partners must agree.
- (b) Innocent third party creditors must not be prejudiced. They are innocent when their claim for extension of credit was before the cancellation or amendment of the certificate.

(2) Problem Involving Liability to Creditors

A, a limited partner, received the return of his contribution on the date stated in the certificate. It was discovered that the remaining assets were insufficient to pay two creditors, *X* and *Y*. *X*'s claim arose before the return; *Y*'s claim arose after the return. Should *A* be compelled to give back what he had received?

ANS.: I distinguish:

- (a) *X*'s claim should be satisfied out of what has been returned to *A*.

Reason: *X*'s claim arose before the return. If there is a balance, it should be returned to *A*. If there is a deficit, *A* is not liable for this because he is only a limited partner.

- (b) *Y*'s claim does not have to be satisfied from what has been returned to *A* as contribution.

Reason: His claim arose after the return. *Y*'s claim should be directed against the general partners.

Art. 1859. A limited partner's interest is assignable.

A substituted limited partner is a person admitted to all the rights of a limited partner who has died or has assigned his interest in a partnership.

An assignee, who does not become a substituted limited partner, has no right to require any information or account of the partnership transaction or to inspect the partnership books; he is only entitled to receive the share of the profits or other compensation by way of income, or the return of his contribution, to which his assignor would otherwise be entitled.

An assignee shall have the right to become a substituted limited partner if all the members consent thereto or if the assignor, being thereunto empowered by the certificate, gives the assignee that right.

An assignee becomes a substituted limited partner when the certificate is appropriately amended in accordance with Article 1865.

The substituted limited partner has all the rights and powers, and is subject to all the restrictions and liabilities of his assignor, except those liabilities of which he was ignorant at the time he became a limited partner and which could not be ascertained from the certificate.

The substitution of the assignee as a limited partner does not release the assignor from liability to the partnership under Articles 1847 and 1858.

COMMENT:

(1) Assignment of a Limited Partner's Interest

- (a) This is a new provision of the new Civil Code.

Source: Sec. 19, Uniform Limited Partnership Act.

- (b) May the interest of a limited partner be assigned?

ANS.: Yes. (*Par. 1, Art. 1859*).

- (c) Does the assignee of the interest of the limited partner become necessarily a substitute partner?

ANS.: No.

- 1) In some cases, he becomes one.
- 2) In others, he remains a mere assignee.

(2) Some Problems

- (a) A, a limited partner, assigned his interest to B. In the certificate, A was expressly given the right to give the assignee the right to become a substituted limited partner. Is B now a substituted limited partner?

ANS.: Not yet. He has to wait until the certificate is appropriately amended. (*Pars. 4 and 5, Art. 1859, Civil Code*).

- (b) A, a limited partner, assigned his right to X. In the certificate, A was not given the right to give his assignee the right to become a substituted limited partner. How can X acquire said right to become a substituted limited partner?

ANS.: Only if all the members of the partnership so consent. If they do consent, X acquires the right to become a substituted limited partner, BUT is not yet one, until after the certificate is appropriately amended. (*4th and 6th paragraphs, Art. 1869, Civil Code*).

- (c) Suppose in problem (b) X was not given the right to become a substituted limited partner by the partners, what will be his status and his rights?

ANS.: He will be a mere assignee. He has NO RIGHT.

- 1) to require any information or account of the partnership transactions;
- 2) to inspect the partnership books.

BUT, he has the right to receive the share of the profits or other compensation by way of income, or the return of his contribution to which his assignor would otherwise be entitled. (*Par. 3, Art. 1859, Civil Code*).

(3) Substituted Limited Partner

He is a person admitted to all the rights of a limited partner who has died or has assigned his interest in a partnership. (*2nd par., Art. 1859, Civil Code*).

(4) Some Problems

- (a) Is a substituted limited partner responsible for the liabilities of his assignor?

ANS.: Yes, except those liabilities of which he was ignorant at the time he became a limited partner and which could not be ascertained from the certificate. (*Par. 6, Art. 1859, Civil Code*).

- (b) A, a limited partner, assigned his interest to X, who subsequently became a substituted limited partner. Is A completely relieved of all his liabilities to the partner to the partnership?

ANS.: No. A is still liable under Art. 1847 to a person who relies on a false statement in the certificate, and under Art. 1858 to creditors who extended credit or whose claims rose before the assignment. (*Last par., Art. 1859, Civil Code*).

Art. 1860. The retirement, death, insolvency, insanity or civil interdiction of a general partner dissolves the partnership, unless the business is continued by the remaining general partners:

- (1) Under a right so to do stated in the certificate, or
- (2) With the consent of all members.

COMMENT:**Some Causes for the Dissolution of a Limited Partnership**

- (a) This is a new provision of the new Civil Code.

Source: Sec. 20, Uniform Limited Partnership Act.

Keyword: DRICI (death, retirement, insolvency, civil interdiction, insanity of a GENERAL partner)

(b) *Example:*

A, B, C, D, and E were partners, A and B being general partners, and the rest, limited partners. A dies. Is the partnership dissolved?

ANS.: Yes, unless it is continued by the remaining general partners.

Query: When may the remaining general partners continue the business?

ANS.:

- 1) If the right to do so is stated in the certificate; or
- 2) If all the members consent.

BUT, at any event, there should be an amendment of the certificate.

[NOTE: The instances set forth in Art. 1860 (retirement, etc.) do not apply in the case of the limited partner, for in such a case, the firm is not dissolved. (See *Com. Note, 8 Uniform Laws Annotated, pp. 2-5*).]

Art. 1861. On the death of a limited partner his executor or administrator shall have the rights of a limited partner for the purpose of settling his estate and such power as the deceased had to constitute his assignee a substituted limited partner.

The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner.

COMMENT:**(1) Death of a Limited Partner**

- (a) This is a new provision of the new Civil Code.

Source: Sec. 21, Uniform Limited Partnership Act.

- (b) *A, a limited partner, while still alive contracted certain liabilities as such. Is his estate liable for them?*

ANS.: Yes. (*2nd par., Art. 1861, Civil Code*).

(2) Problem

A, a limited partner, was given the right to constitute his assignee as a substituted limited partner. On his death, may his administrator do the same?

ANS.: Yes. Furthermore, said administrator shall have all the rights of a limited partner for the purpose of settling the estate of the deceased.

Art. 1862. On due application to a court of competent jurisdiction by any creditor of a limited partner, the court may charge the interest of the indebted limited partner with payment of the unsatisfied amount of such claim, and may appoint a receiver, and make all other orders, directions, and inquiries which the circumstances of the case may require.

The interest may be redeemed with the separate property of any general partner, but may not be redeemed with partnership property.

The remedies conferred by the first paragraph shall not be deemed exclusive of others which may exist.

Nothing in this Chapter shall be held to deprive a limited partner of his statutory exemption.

COMMENT:**(1) Charging the Interest of a Limited Partner**

This is a new provision of the new Civil Code.

Source: Sec. 22, Uniform Limited Partnership Act.

(2) Example

A is a limited partner who is indebted to X. X applies to the court to charge the interest of A in the partnership. May the interest charged be redeemed by partnership property?

ANS.: No. The law says that the interest may be redeemed with the separate property of any general partner, but cannot be redeemed with partnership property.

Art. 1863. In settling accounts after dissolution the liabilities of the partnership shall be entitled to payment in the following order:

(1) Those to creditors, in the order of priority as provided by law except those to limited partners on account of their contributions, and to general partners;

(2) Those to limited partners in respect to their share of the profits and other compensation by way of income on their contributions;

(3) Those to limited partners in respect to the capital of their contributions;

(4) Those to general partners other than to capital and profits;

(5) Those to general partners in respect to profits;

(6) Those to general partners in respect to capital.

Subject to any statement in the certificate or to subsequent agreement, limited partners share in the partnership assets in respect to their claims for capital, and in respect to their claims for profits or for compensation by way of income on their contribution respectively, in proportion to the respective amounts of such claims.

COMMENT:

Payment of Liabilities of the Limited Partnership

(a) This is a new provision of the new Civil Code.

Source: Sec. 23, Uniform Limited Partnership Act.

(b) Notice that profits are given priority over capital.

Art. 1864. The certificate shall be cancelled when the partnership is dissolved or all limited partners cease to be such.

A certificate shall be amended when:

(1) There is a change in the name of the partnership or in the amount or character of the contribution of any limited partner;

- (2) A person is substituted as a limited partner;
- (3) An additional limited partner is admitted;
- (4) A person is admitted as a general partner;
- (5) A general partner retires, dies, becomes insolvent or insane, or is sentenced to civil interdiction and the business is continued under Article 1860;
- (6) There is a change in the character of the business of the partnership;
- (7) There is a false or erroneous statement in the certificate;
- (8) There is a change in the time as stated in the certificate for the dissolution of the partnership or for the return of a contribution;
- (9) A time is fixed for the dissolution of the partnership, or the return of a contribution, no time having been specified in the certificate; or
- (10) The members desire to make a change in any other statement in the certificate in order that it shall accurately represent the agreement among them.

COMMENT:

(1) When Certificate Is Cancelled or Amended

This is a new provision of the new Civil Code.

Source: Sec. 24, Uniform Limited Partnership Act.

(2) Cancellation

When the partnership is dissolved, or when all the limited partners cease to be limited partners, the certificate shall be cancelled, not merely amended. This is obvious for if there be *no more* limited partners, the limited partnership *cannot* exist as such. The writing to cancel a certificate shall be signed by all members. (*Art. 1865, 2nd par.*).

Art. 1865. The writing to amend a certificate shall:

(1) Conform to the requirement of article 1844 as far as necessary to set forth clearly the change in the certificate which it is desired to make; and

(2) Be signed and sworn to by all members, and an amendment substituting limited partner or adding a limited or general partner shall be signed also by the member to be substituted or added, and when a limited partner is to be substituted, the amendment shall also be signed by the assigning limited partner.

The writing to cancel a certificate shall be signed by all members.

A person desiring the cancellation or amendment of a certificate, if any person designated in the first and second paragraphs as a person who must execute the writing refuses to do so, may petition the court to order a cancellation or amendment thereof.

If the court finds that the petitioner has a right to have the writing executed by a person who refuses to do so, it shall order the Office of the Securities and Exchange Commission where the certificate is recorded, to record the cancellation or amendment of the certificate, and when the certificate is to be amended, the court shall also cause to be filed for record in said office a certified copy of its decree setting forth the amendment.

A certificate is amended or cancelled when there is filed for record in the Office of the Securities and Exchange Commission, where the certificate is recorded:

(1) A writing in accordance with the provisions of the first or second paragraph; or

(2) A certified copy of the order of court in accordance with the provisions of the fourth paragraph;

(3) After the certificate is duly amended in accordance with this article, the amended certificate shall thereafter be for all purposes the certificate provided for in this Chapter.

COMMENT:**(1) Requisites for Amending or Cancelling the Certificate**

This is a new provision of the new Civil Code.

Source: Sec. 25, Uniform Limited Partnership Act.

(2) Problems

- (a) *X*, a limited partner, assigned his interest to *Y*, who thereby acquired the right to be a substituted limited partner. Aside from the others, should *X* and *Y* sign the amendment?

ANS.: Yes.

- (b) In the preceding problem, suppose *X* refuses to sign the amendment, may *Y* petition the court to order the court to order the amendment?

ANS.: Yes.

Art. 1866. A contributor, unless he is a general partner, is not a proper party to proceeding by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership.

COMMENT:**When Contributors (Other Than General Partners) Should Be Made Parties to Proceedings**

The Article is self-explanatory.

Art. 1867. A limited partnership formed under the law prior to the effectivity of this Code, may become a limited partnership under this Chapter by complying with the provisions of Article 1844, provided the certificate sets forth:

- (1) The amount of the original contribution of each limited partner, and the time when the contribution was made; and**

(2) That the property of the partnership exceeds the amount sufficient to discharge its liabilities to persons not claiming as general or limited partners by an amount greater than the sum of the contributions of its limited partners.

A limited partnership formed under the law prior to the effectivity of this Code, until or unless it becomes a limited partnership under this Chapter, shall continue to be governed by the provisions of the old law.

COMMENT:

Transitional Provisions on Limited Partnerships

- (a) This is a new provision of the new Civil Code.

Source: Sec. 30, Uniform Limited Partnership Act.

- (b) On June 1, 1946, a limited partnership was formed. May it become a limited partnership under the new Civil Code?

ANS.: Yes, by following the conditions in Art. 1867.

- (c) Suppose the limited partnership in question (b) does not want to become one under the new Civil Code, what laws will govern said partnership?

ANS.: The old law.

TITLE X

AGENCY

Chapter 1

NATURE, FORM, AND KINDS OF AGENCY

Art. 1868. By the contract of agency a person binds himself to render some service or to do something in representation or on behalf of another, with the consent or authority of the latter.

COMMENT:

(1) Defective Definition of the Contract of Agency

The definition of AGENCY given in Art. 1868 is very broad, and therefore, *defective*.

- (a) As worded, the definition includes the relationship of master and servant, of employer and employee, of lessor and independent contractor. The servant, the employee, and the independent contractor all render some work or service in representation or on behalf of another.

(NOTE: What the agent really does for the principal is a JURIDICAL ACT, and not merely a material one. In other words, while an agent may exercise *discretionary* powers, the lessee of services ordinarily performs only *ministerial* functions.)

- (b) As worded, it would seem that the agent must always expressly represent the principal. This is not necessarily so, for sometimes an agent does not disclose his principal; he may even act in behalf of himself, but here the prin-

principal would still be BOUND “when the contract involves things BELONGING to the principal.” (*Art. 1883, 2nd par., Civil Code*).

[THUS, Justice J.B.L. Reyes had stated that “this article does not draw clearly the distinction between lease of services and agency without representation. The laborer also does something or renders service on behalf of another. The true essence of the distinction, it is submitted, lies in that the agent enters or is designed to enter judicial relations, with or without representation of the principal.” (*Justice Jose B.L. Reyes’ Observation on the new Civil Code, XVI Lawyers Journal, Mar. 31, 1951, p. 138*).]

**Bert Osmeña and Associates
v. Court of Appeals
GR 56545, Jan. 28, 1983**

When a man designates himself as the *seller* in a contract of sale (and not merely as the *agent* of the seller), and he alone signs the contract, he will be regarded as the seller with resultant liabilities as such (*e.g.*, for damages).

**Alfred Hahn v. CA & Bayerische
Motoren Werke Aktiengesellschaft (BMW)
GR 113074, Jan. 22, 1997
78 SCAD 240**

FACTS: As to the service centers and showrooms which he said he had put up at his own expense, petitioner Hahn said that he had to follow BMW specifications as exclusive dealer of BMW in the Philippines. According to Hahn, BMW periodically inspected the service to see to it that BMW standards were maintained. Indeed, it would seem from BMW’s letter to Hahn that it was for Hahn’s alleged failure to maintain BMW standards that BMW was terminating Hahn’s dealership.

HELD: The fact that Hahn invested his own money to put up these service centers and showrooms does not necessarily prove that he is not an agent of BMW. For as noted, there are facts in the record which sug-

gest that BMW exercised control over Hahn's activities as a dealer and made regular inspections of Hahn's premises to enforce compliance with BMW standards and specifications. An agent receives a commission upon the successful conclusion of a sale. Upon the other hand, a broker earns his pay merely by bringing the buyer and the seller together, even if no sale is eventually made.

(2) Other Definitions

- (a) "An agency may be defined as a contract either express or implied upon a consideration, or a gratuitous undertaking, by which one of the parties confides to the other, the management of some business to be transacted in his name or on his account, and by which that other assumes to do the business and renders an account of it." (2 *Am. Jur.* 13).
- (b) "Agency is the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consented by the other so to act." (*Restatement of the Law of Agency, Sec. 1*).
- (c) "Agency is an act which one person gives to another the power to do something for the principal and in his name." (*French Civil Code; Holland, Jurisprudence, 12th Ed., 302-303*).

(3) Roman Law

In Roman Law, there was the contract of *mandatum* where one person called *mandans* authorized another called the *mandatarius* to do something for him. This originated from the obligation or right of a son or a slave to represent the *pater familias*. (*Holland, Jurisprudence, pp. 302-303*).

(NOTE: In Spanish, the principal is called *mandante*, while the agent is referred to as the *mandatario*. The contract itself is a *mandato*.)

(4) Importance of Agency

It enables a man to increase the range of his individual and corporate activity by enabling him to be constructively

present in many places and to carry on diverse activities at the same time. (*Mechem, Outlines of Agency, 3rd ed., p. 5*).

Smith, Bell & Co., Inc. v. CA
GR 110668, Feb. 6, 1997
79 SCAD 38

Every cause of action *ex contractu* must be founded upon a contract, oral or written; either express or implied. The only involvement of petitioner in the subject contract of insurance was having its name stamped at the bottom left portion of the policy as "Claim Agent." Without anything else to back it up, such stamp cannot even be deemed by the remotest interpretation to mean that petitioner participated in the preparation of said contract. Hence, there is no privity of contract, and correspondingly there can be no obligation or liability, and, thus, no cause of action against petitioner attaches.

The Insurance Code is quite clear as to the purpose and role of a resident agent. Such agent, as a representative of the foreign insurance company, is tasked only to receive legal processes on behalf of its principal and not to answer personally for any insurance claims.

(5) History

Formerly, there was a difference between a *commercial* agency or commission on the one hand, and a *civil* agency on the other. A commercial agency was entered into for commercial purposes; the civil agency, for other objectives.

Today, however, there is no more commercial agency or commission in view of the repeal by the new Civil Code of the Code of Commerce provisions thereon. (*Art. 2270*). Therefore, today, whether the agency be for a civil or a commercial purpose, it is now called a civil agency, and is governed by the Civil Code.

(6) Characteristics

- (a) Agency is a *principal, nominate, bilateral, preparatory, commutative, and generally onerous contract*.

- (b) Generally, it is also a *representative relation*, not a *status* since agency is *not inherent* or *permanent*.
- (c) It is a *fiduciary* relation since it is based on *trust and confidence*. (See *Severino v. Severino*, 44 Phil. 343).

Philpotts v. Phil. Mfg. Co., et al.
40 Phil. 471

FACTS: W.G. Philpotts, a stockholder of the Philippine Manufacturing Co., wanted to inspect the corporate books thru his *agent*, but the Company refused, stating that this right to inspect the books was purely personal, and could not be exercised thru an agent. Philpotts petitions for a writ of *mandamus* to compel the PMC to show its books to his agent.

HELD: *Mandamus* can be issued, for the inspection can be done thru an agent. This is in conformity with the *general* rule that what a man may do in person, he may do thru another. Nothing in the Corporation Law is contrary to this general rule.

[**NOTE:** Some acts cannot however be made thru an agent. An example is the making of a will, since this is considered a strictly personal act under the law.]

(7) Parties to the Contract

The two parties to the contract are the *principal* and the *agent*.

Definitions:

- (a) *Principal* — he whom the agent represents and from whom he derives authority; he is the one primarily concerned in the contract. (*Sec. 3, 2 C.J. 420*).
- (b) *Agent* — he who acts or stands for another. Usually, he is given full or partial discretion, but sometimes he acts under a specific command. (*Bishop on Contracts, Sec. 1027*).

(**NOTE:** He, therefore, acts in *another's name*. If he acts under *another name*, that is, if he pretends to be

someone else, he is *not* an agent, for here he certainly acts in his own name.)

(**NOTE:** An agent may have his own agent, who is thus referred to as *sub-agent*.)

Gelano v. Court of Appeals
L-39050, Feb. 24, 1981
103 Phil. 90

The word “trustee” as used in the corporation statute must be understood in the general concept, and may include the attorney prosecuting the case filed by the corporation.

(8) Capacity of the Principal

- (a) In general, if he is capacitated to act for himself, he can act thru an agent. He must, therefore, be capacitated to give consent. (2 *C.J.* 429-430). If any special capacity is needed, it is he who must possess it and *not* the agent, for the latter merely acts in his behalf.
- (b) The principal may be *natural* or a juridical person. (As a matter of fact, a private corporation and a partnership can only act thru agents.) (*Mechem*, p. 33).

(**NOTE:** A social club or any other organization cannot act as a principal if it has no juridical personality. Individual members thereof can be bound only if an express or implied agency has been consented to by each of them.)

- (c) Generally, an emancipated minor can be a principal. So may a married woman. As a matter of fact, the husband may appoint her as agent or administrator of his capital or of the conjugal partnership. Similarly, a married woman may appoint her husband as an agent of her paraphernal property.
- (d) A husband, as administrator of the conjugal partnership (*Art. 165, Civil Code*) is in that sense an agent who can bind conjugal property, subject to legal restrictions, such as those imposed by Art. 166, Civil Code. Thus, a conveyance of conjugal real property without the needed

consent of the wife is VOIDABLE, and the wife is given ten years within which to bring an action for annulment. (*Rodolfo Lanuza v. Martin de Leon*, L-22331, Jun. 6, 1967). Ratification may of course be made by the wife. (*Ibid.*)

(9) Capacity of an Agent

His capacity is in general the same as in the law of contracts, that is, he must be able to bind himself, but only insofar as his obligations to his principal are concerned. Insofar as third persons are concerned, however, it is enough that his principal be the one capacitated, for generally an agent assumes no personal liability. Usually, therefore, the contract with a stranger is valid, even if the agent be a minor so long as his principal was capacitated. However, as between them (principal and agent), the minor-agent can set up his incapacity, provided he is not in estoppel.

Mendoza v. De Guzman 33 O.G. 1505

FACTS: *P* appoints *A*, a minor, as his agent to sell certain goods. *A* sells the goods to a buyer *B*. *P* afterwards seeks to disaffirm the sale, and brings an action to recover the goods on the ground that *A*'s act was void, as an infant cannot be an agent. Judgment for whom and why?

HELD: Judgment should be for the buyer *B* and against the principal *P*. The agent *A* is deemed to be an extension of the personality of the principal, who himself is of *legal age*. Hence, *P* cannot avoid the contract on the ground of the agent's incapacity.

Gelano v. Court of Appeals L-39050, Feb. 24, 1981

A lawyer who has been defending the interests of a corporation may, in the case of a litigation in court still pending after the expiration of the three-year period after dissolution, still continue as TRUSTEE of the corporation at least with respects to the matter in litigation. This would be in substantial compliance with the law which allows the

conveyance of the properties of a corporation to a trustee to enable it to prosecute and defend suits by or against the corporation beyond the three-year period.

(10) Distinctions

(a) *Agency from Partnership*

An agent acts not for himself, but for his principal; a partner acts for himself, for his firm, and for his partners. It may even be said that partnership is a branch of the law on agency.

(b) *Agency from Loan*

An agent may be given funds by the principal to advance the latter's business, while a borrower is given money for purposes of his own, and he must generally return it, whether or not his own business is successful. A lot however depends on the intent of the parties. (2 *CJS* 1030).

**Atcheson R. Co. v. Maber
23 Kan. 163**

FACTS: A furnished B with money for current expenses. B was obliged to render monthly accounts of such expenses to A. It was also agreed that eventually B would pay for them. B then obtained goods from C on credit. *Issue:* May C sue A on the theory that A is B's principal, and that B is only an agent?

HELD: No, for it is clear that B was a borrower, not an agent of A.

(c) *Agency from Guardianship*

<i>AGENCY</i>	<i>GUARDIANSHIP</i>
1) The agent represents a <i>capacitated</i> person.	1) A guardian represents an <i>incapacitated</i> person.

2) The agent is appointed by the principal and can be removed by the latter.	2) The guardian is appointed by the court, and stands in <i>loco parentis</i> .
3) The agent is subject to the directions of the principal.	3) The guardian is NOT subject to the directions of the ward, but must of course act for the benefit of the latter.
4) The agent can make the principal <i>personally liable</i> .	4) The guardian has no power to impose personal liability on the ward.

(See 2 Am. Jur. 15 and 18 *Fessenden v. Jones*, 52 N.C. 14).

(d) *Agency from Judicial Administration*

AGENCY	JUDICIAL ADMINISTRATION
1) Agent is appointed by the principal.	1) Judicial administrator is appointed by the court.
2) He represents the principal.	2) He represents not only the court but also the heir and creditors of the estate.
3) Agent generally does <i>not</i> file a bond.	3) The administrator files a bond.
4) Agent is controlled by the principal thru their <i>agreement</i> .	4) His acts are subject to specific orders from the court.

(See *San Diego v. Nombre & Escamlar*, L-19265, May 29, 1964).

(e) *Agency from Lease of Property*

<i>AGENCY</i>	<i>LEASE OF PROPERTY</i>
1) The agent is controlled by the principal.	1) The lease is not controlled by the lessor.
2) The agency may involve things other than property.	2) Obviously, a lease of property involves property only.
3) The agent can bind the principal.	3) The lessee, as such, cannot bind the lessor.

(See *Mechem*, p. 16; 2 C.J. 246).

Hawley v. Curry
74 Ill. A. 309

FACTS: A Bon was allowed by his father to use the latter's land and to make improvements on it. The son was also authorized to get profits as a result of whatever improvements may be introduced. One day, the son purchased certain materials which he needed for the improvements. Is the father liable?

HELD: The father is not liable, since he did not constitute his son his agent. The relationship between them insofar as the land is concerned is similar to that of lessor and lessee, *not* that of principal and agent.

State v. Page
40 Am. D. 608

FACTS: A hotel and X entered into a contract which allowed the latter to keep the hotel for 7 years. X was to reside in the hotel with his family, but would be allowed free rent and board. X's duty was to run the hotel with books of account subject to inspection by the board of directors of the hotel. X was also authorized to hire a

bookkeeper, who however could be discharged by him, at the instance of the board of directors. *X* was forbidden to contract debts in behalf of the hotel without prior permission from the hotel board. *Issue:* Is *X* a lessee or an agent?

HELD: It is clear from the foregoing facts that *X* is *not* a lessee. He is an agent, subject to the control of the board of directors of the hotel.

- (f) *Agency from Lease of Services (or Master-Servant Relationship)*

<i>AGENCY</i>	<i>LEASE OF SERVICES</i>
1) Agent represents the principal.	1) The worker or the lessor of services does not represent his employer.
2) Relationship can be terminated at the will of either principal or agent.	2) Generally, the relationship can be terminated only at the will of both.
3) Agent exercises <i>discretionary</i> powers.	3) The employee has ministerial functions.
4) Usually involves 3 persons: the principal, the agent, and a stranger.	4) Usually involves only two persons.

(See *Mechem*, p. 11).

(**NOTE:** It should be understood however that an agent may incidentally render acts of service, while a lessor of services or employee may incidentally make contracts.)

(g) *Agency from a Contract with an Independent Contractor*

<i>AGENCY</i>	<i>INDEPENDENT CONTRACTOR</i>
1) The agent acts under the control of the principal.	1) The independent contractor is authorized to do the work <i>according to his own method</i> , without being subject to the other party's control, except insofar as the RESULT of the work is concerned. (<i>Fressel v. Uy Chaco and Sons</i> , 34 Phil. 122).
2) The agent of the agent may be controlled by the principal.	2) The employees of the contractor are not the employees of the employer of the contractor. (<i>Mechem</i> , pp. 13-14).
3) Agent can bind the principal.	3) Ordinarily, the independent contractor cannot bind the employer by tort. (<i>Mechem</i> , pp. 13-14).
4) The negligence of the agent is imputable to the principal. (<i>Shell Co. v. Firemen's Ins. Co.</i> , 100 Phil. 757).	4) The negligence of the independent contractor is generally not imputable to his employer.

Shell Co. v. Firemen's Ins. Co.
100 Phil. 757

FACTS: Operators of gasoline station owned by the Shell Company sell only products of the company; use

company equipment lent to them; dispose of stock at prices fixed by the company; are in fact appointed and are removable by the company. If said operators by their negligence cause damage to third parties, will the Shell Company be liable?

HELD: Yes, for clearly, they are agents, not independent contractors. The negligence of an agent if certainly imputable to the principal.

(h) *Agency from Negotiorum Gestio*

<i>AGENCY</i>	<i>NEGOTIORUM GESTIO</i>
1) There is a contract caused by a <i>meeting of the minds</i> , expressly or impliedly.	1) This is only a <i>quasi-contract</i> , there having been no meeting of the minds. Hence, the representation was not agreed upon. <i>(NOTE: Once there is an agreement or ratification, there arises an express agency.)</i>
2) Agent is controlled by the principal.	2) The officious manager follows his judgment and the <i>presumed</i> will of the owner. <i>(NOTE: The manager is of course supposed to act with due diligence.)</i>
3) The legal relation is created by the parties.	3) The legal relation is created by the law (occasioned of course by the acts of the manager).

(i) *Agency from Trust*

<i>AGENCY</i>	<i>TRUST</i>
1) Agent usually holds no title at all.	1) Trustee may hold legal title to the property.
2) Usually, agent acts in the name of the principal.	2) The trustee may act in his own name.
3) Usually, agent may be terminated or revoked at any time.	3) The trust is usually ended by the accomplishment of the purposes for which it was formed.
4) Agency may not be connected at all with property.	4) Trust involves control over property.
5) Agent has authority to make contracts which will be binding on his principal.	5) Trustee does not necessarily or even possess such authority to bind the trustor or the <i>cestui que trust</i> .
6) Agency is really a contractual relation.	6) A trust may be the result of the contract or not; it may be created also by law.

(j) *“Agency to Sell” from Sale*

<i>AGENCY TO SELL</i>	<i>SALE</i>
1) Ownership of the goods is not transferred to the agent.	1) Ownership is transferred to the buyer (after delivery).
2) Here, the agent DELIVERS the price.	2) The buyer PAYS the price.
<i>(See Quiroga v. Parsons, 38 Phil. 501).</i>	

[**NOTE:** The mere testimony of the person who drafted the contract that it was one of agency is of *no* importance, for a contract is what the law defines it to be, and not what it is called by the contracting parties. (*Quiroga v. Parsons*, 38 Phil. 501).]

**Quiroga v. Parsons Hardware Co.
38 Phil. 501**

FACTS: Quiroga granted Parsons (in the Visayas) exclusive right to sell “Quiroga” bed in the Visayas. Quiroga was to furnish beds to Parsons, and would demand the *price* sixty days from shipment, minus a *commission or deduction* of 25%. Parsons agreed not to sell any other kind of bed, and to pay the price as agreed upon. *Issue:* Is this a contract of agency to sell, or a contract of sale?

HELD: This is a contract of *SALE*. In order to classify a contract, due regard must be given to its essential clauses. In the contract in question, what was essential, as constituting its cause and subject matter, is that Quiroga was to furnish the Parsons with the beds, which the latter might order at the price stipulated. The price agreed upon was the one determined by Quiroga with a certain discount. Payment was to be made at the end of sixty days. These are precisely the essential features of a contract of purchase and sale. There was the obligation on the part of Quiroga to supply the beds, and on the part of Parsons to pay their price. These features *exclude* the legal conception of an agency or order to sell whereby the *mandatary* or agent received the thing to sell it, but does not pay its price. Instead, he is supposed to *deliver* to the principal the price he obtains from the sale of the thing to a third person, and if he does not succeed in selling it, he returns it. By virtue of the contract between Quiroga and Parsons, the latter, on receiving the beds, was *necessarily obliged to pay their price* within the term fixed, without any other consideration, and *regardless as to whether he had or had not sold the beds*.

[**NOTE:** If there is an agreement to return *all unsold goods*, with no obligation to pay for them, this is *not* a

sale, but an agency to sell or a contract of CONSIGNMENT. (*Brown v. John Church Co.*, 55 Ill. App. 615).]

(k) “Agency to Buy” from Sale

<i>SALE</i>	<i>AGENCY TO BUY</i>
1) The buyer acquires ownership for himself.	1) The agent acquires ownership in behalf of the principal.
2) The buyer who obtains a discount does not have to reveal such fact to its own buyer. (<i>See Gonzalo Puyat and Sons, Inc. v. Arco Amusement Co.</i> , 72 Phil. 402).	2) The agent must account for all benefits or discounts received from the seller.
3) The buyer pays the price.	3) The agent delivers the price.

**Gonzalo Puyat and Sons, Inc. v. Arco
Amusement Co.
72 Phil. 402**

FACTS: Gonzalo Puyat and Sons was the exclusive agent of an American Piano Company, the Starr Piano Company of Richmond, Indiana, U.S.A. The Arco Amusement entered into a contract with Puyat and Sons, whereby the latter would order, on behalf of the Arco Amusement Company, certain sound equipment. It was also agreed that the company would pay Puyat and Sons a 10% commission, plus all expenses.

Puyat and Sons cabled the U.S. company for the price *without* discount. The price given was P1,700. Puyat and Sons, with the approval of the Amusement Company, placed the order when it came. Puyat and Sons received P1,700 from the company plus 10%. Puyat and Sons however did NOT reveal to the Amusement Company that the former was always given a DISCOUNT by the

U.S. Company. When the amusement Company discovered that the P1,700 was only the list price, and not the net price, it sued Puyat and Sons for reimbursement of the difference, on the ground that the latter was only its AGENT in obtaining the equipment. Puyat and Sons however countered that the contract was *not* an agency to buy, but was one of sale. *Issue*: Is the contract between them a sale, or an agency to buy?

HELD: The contract between them is a SALE, and not an agency to buy; therefore, Puyat and Sons will not be required to reimburse the difference. It is clear from the facts that had there been a change of price upwards or a mistake, Puyat and Sons would have been required to give the equipment to the Arco Amusement Co. at *only* the agreed amount of P1,700 plus 10%. It follows therefore that Puyat and Sons could not have been an agent of the Amusement Company, for a true agent is entitled to indemnity for damages incurred in carrying out the agency without fault, that Puyat and Sons was to receive a 10% commission, this does not necessarily make it an agent of the Amusement Company. The provision only meant that the Amusement Company bound itself to pay an additional price. This stipulation is not incompatible with the contract of purchase and sale.

Moreover, since it is an admitted fact that Puyat and Sons was the agent of the U.S. Company, it is out of the ordinary for it to be also the agent of the Amusement Company. Seldom is the seller also the agent of the buyer.

(NOTE): A similar ruling was made in a WHISKY transaction in *Velasco v. Universal Trading Co., Inc.*, 45 O.G. 4504).

(11) ‘Agent’ and ‘Broker’ Distinguished

Manuel B. Tan, Gregg M. Tecson & Alexander Saldaña v. Eduardo R. Gullas & Norma S. Gullas
GR 143978, Dec. 3, 2002

An agent receives a commission upon the successful conclusion of a sale. Upon the other hand, a broker earns

his pay merely by bringing the buyer and the seller together, even if no sale is eventually made. (*Alfred Hann v. CA & Bayerische Motorer Worke Aktiengesellschaft [BMW]*, 266 SCRA 537 [1997]).

A *broker* is “one who is engaged, for others, on a commission, negotiating contracts relative to property with the custody of which he has no concern; the negotiator between other parties, never acting in his own name but in the name of those who employed him. A broker is one whose occupation is to bring the parties together, in matters of trade, commerce, or navigation.” (*Schmid & Oberly v. RJJ Martinez Fishing Corp.*, 166 SCRA 493 [1988]).

Art. 1869. Agency may be express, or implied from the acts of the principal, from his silence or lack of action, or his failure to repudiate the agency, knowing that another person is acting on his behalf without authority.

Agency may be oral, unless the law requires a specific form.

COMMENT:

(1) Kinds of Agency According to Manner of Constitution

- (a) express
- (b) implied — from
 - 1) acts of the principal;
 - 2) principal’s silence;
 - 3) principal’s lack of action;
 - 4) principal’s failure to repudiate the agency.

(**NOTE:** In these cases of implied agency the principal knows that another person is acting on his behalf without authority.)

De la Peña v. Hidalgo
16 Phil. 450

FACTS: The properties of De la Peña were being administered by his agent *Federico Hidalgo*, who, for reasons of health, informed De la Peña that he (Fed-

erico) was turning over the administration to *Antonio Hidalgo*. Federico also informed his principal that he had conferred a general power of attorney on Antonio, and requested that in case this would not be sufficient, De la Peña could send to Antonio a new power of attorney. De la Peña did not repudiate the designation of Antonio, nor did he appoint a new agent. Moreover, he remained silent for 9 years, all the while allowing Antonio to administer the property. *Issue*: Was Antonio the agent of De la Peña?

HELD: Yes. From the facts given, this is a clear case of an implied agency. In permitting Antonio to administer, De la Peña created in Antonio's favor an implied agency.

(NOTE: In *Gutierrez Hermanos v. Orense*, 28 Phil. 571, it was held that if an owner of land testifies that he consented to its sale by a hitherto unauthorized person, such person becomes his agent. The principal now has the duty of fulfilling the obligations contracted by the agent in pursuit of such agency.)

(NOTE: In *Soliman v. U.S. Life Ins. Co.*, L-11975, Jun. 27, 1958, it was held that if an applicant for insurance allows the insurance agent to answer some of the blank spaces in the health certificate, and then signs the same, he is responsible for the agent's acts, the latter having become his agent for that purpose.)

Lim v. People
L-34338, Nov. 21, 1984

P told *A* to surrender proceeds of the sale after *A* has sold the tobacco. This is not a contract of sale, but an agency to sell, with *A* as the agent.

The turnover of the proceeds to the principal must be made *immediately*. The court need not fix a period under Art. 1197 of the Civil Code for this case already contains a definite period.

(2) Kinds of Agency According to Form

- (a) Oral — (Generally, this is sufficient.)

(b) Written

(NOTE: An example of an instance when the law requires a specific form for the agency is in Art. 1874 which states that “when a sale of land or any interest therein is through an agent, the authority of the latter shall be in *writing*; otherwise, the sale shall be *void*.”)

Art. 1870. Acceptance by the agent may also be express, or implied from his acts which carry out the agency, or from his silence or inaction according to the circumstances.

COMMENT:

Express and Implied Agencies

The Article is self-explanatory.

Art. 1871. Between persons who are present, the acceptance of the agency may also be implied if the principal delivers his power of attorney to the agent and the latter receives it without any objection. (n)

COMMENT:

Another Form of Implied Agency

Note that here the persons are “present” — meaning “face to face”, or conversing with each other thru *mobile cellphone*.

Art. 1872. Between persons who are absent, the acceptance of the agency cannot be implied from the silence of the agent except:

(1) When the principal transmits his power of attorney to the agent, who receives it without any objection;

(2) When the principal entrusts to him by letter or telegram a power of attorney with respect to the business in which he is habitually engaged as an agent, and he did not reply to the letter or telegram.

COMMENT:**Rules if the Parties Are “Absent” (Not “Present”)**

In No. (1) as distinguished from No. (2), just because the offeree did not reply does *not* mean that the agency has been accepted. For if this would be equivalent to implied acceptance, there would be no difference between No. (1) and No. (2).

A good instance of implied acceptance in No. (1) would be when the offeree writes a letter acknowledging the receipt of the offer, but offers no *objection* to the agency. If he does *not* write such a letter, it may be because he simply wants to ignore the offer, or he may have forgotten about it, or he is still undecided; hence, in this latter case, it would be unfair to presume acceptance.

Another instance of implied acceptance is when the silent offeree begins to act under the authority conferred upon him. (*George v. Sandel*, 18 La. Ann. 535). Indeed, acceptance can be implied from acts which carry out the agency. (*Art. 1870*).

Garvey v. Scott
9 Ill. A. 19

FACTS: A had a horse deposited with B. One day A asked a friend C if C would take the horse from B and sell it for him (A) — If A would write him (C) a letter to that effect. C answered “yes.” Subsequently A wrote C to get the horse from B and to sell it. C did *not* answer, but proceeded to get the horse, and was subsequently able to sell it. *Issue:* Did C act as A’s agent?

HELD: Yes, for the acceptance of the agency could clearly be inferred from his acts.

Art. 1873. If a person specifically informs another or states by public advertisement that he has given a power of attorney to a third person, the latter thereby becomes a duly authorized agent, in the former case with respect to the person who received the special information, and in the latter case with regard to any person.

The power shall continue to be in full force until the notice is rescinded in the same manner in which it was given. (n)

COMMENT:

(1) Informing Other People of the Existence of the Agency

Two ways are given here:

- (a) special information;
- (b) public advertisement.

(2) Comment of Justice J.B.L. Reyes

To forestall fraud, the following paragraph must be added to Art. 1873.

“But revocation made in any manner shall be effective against all persons having actual knowledge thereof.” (*Observations on the new Civil Code, 16 Lawyer’s Journal, p. 138*).

(3) Problem

A company wrote a circular letter to its customers introducing a certain *X* as its duly authorized agent. One customer then dealt with the company thru *X*. One day, *X*’s authority was revoked, but the customer continued to deal thru *X* since it never was informed by circular or otherwise of the revocation. *Issue*: Is the Company still liable for *X*’s acts even after the revocation of the agency?

ANS.: Yes, for the customer was in good faith, not having been informed by circular or otherwise, of the revocation. (*See Compania Gen. de Tabacos v. Diaba, 20 Phil. 321 and Rallos v. Yangco, 20 Phil. 269*).

(4) Agency by Estoppel

If *A* leads *B* to believe that *C* is his (*A*’s) agent, when as a matter of fact such is *not* true, and *B* acts on such misrepresentation, *A* cannot disclaim liability, for he has created an agency by estoppel.

Thus, our Supreme Court in *Macke, et al. v. Camps*, 7 *Phil. 553*, has said: “One who clothes another with apparent authority as his agent, and holds him out to the public as such, cannot be permitted to deny the authority of such person to act as his agent, to the prejudice of innocent third parties dealing with such person in good faith, and in the honest belief that he is what he appears to be.”

(5) Agency by Estoppel Distinguished from Implied Agency

(a) As between the *principal* and the *agent*:

- 1) In an *implied agency*, the agent is a true agent, with rights and duties of an agent.
- 2) In an agency by estoppel (caused for instance by estoppel on the part of the *agent*), the “agent” is not a true agent; hence he has no rights as such. (*See 2 C.J. 444-445*).

(b) As to *third persons*:

- 1) If the estoppel is caused by the *principal*, he is liable, but only if the third person acted on the misrepresentation; in an implied agency, the principal is always liable. (*See 2 C.J. 444-445*).
- 2) If the estoppel is caused by the agent, it is only the agent who is liable, *never* the alleged principal; in an implied agency, the agent is never personally liable.

Art. 1874. When a sale of a piece of land or any interest therein is through an agent, the authority of the latter shall be in writing; otherwise, the sale shall be void.

COMMENT:

(1) Agency to Sell Land or Any Interest Therein

Note that this refers to the *sale* of a “piece of *land* or *any interest* therein.” “Any interest therein” includes usufruct, easement, etc. Does it also include “buildings”? Strictly

speaking it does *not*, *but* if this would be the construction, it would follow that in an agency to sell a *building*, it does not have to be in writing. Could this have been the intent of the Code Commission?

(2) Effect if the Article is Violated

Note also that if Art. 1874 is violated, the sale is VOID, not merely unenforceable. Therefore, the principal cannot technically RATIFY. If he does so, there should be *no retroactive effect*.

Jimenez v. Rabat 38 Phil. 318

FACTS: A brother *wrote* his sister to sell his parcels of land. The lands were purchased by a third person, but the sister did not forward the money. The brother now wants to recover the parcel of lands.

HELD: Since the agency was in writing, the sale is VALID, hence the lands cannot be recovered. The letter was sufficient authority.

Rosario S. Juat, et al. v. Land Tenure Administration L-17080, Jan. 28, 1961

Under Com. Act 539 the President is authorized to acquire private lands and thereafter subdivide the same into small lots for resale at reasonable prices to their *bona fide* tenants or occupants. The act of the Secretary of Agriculture and Natural Resources in making the sale has the same effect as if done *by the President himself* by virtue of the legal truism that the acts of a department secretary are presumed to be the acts of the Chief Executive. (*See Villena v. Sec. of Interior*, 67 Phil. 461 and *Donnelly v. Agregado*, L-4510, May 31, 1954).

Art. 1875. Agency is presumed to be for a compensation, unless there is proof to the contrary.

COMMENT:**(1) Agency Is Presumed to Be Onerous**

Under the old Civil Code (*Art. 1711*), agency was presumed to be gratuitous. In the present Code, agency is presumed to be for a compensation.

(2) Form of Compensation

Compensation may be in the form of gratuitous use by the agent of the principal's real estate. (*Acuña v. Larena*, 57 *Phil.* 630). In the absence of stipulation, the agent is entitled to compensation only after he has completely or substantially completed his obligation as agent. (*Arts. 1233, 1234*). The compensation may be *contingent* or *dependent* upon the realization of profit for the principal. This is so in case there is a stipulation to this effect.

**Fiege and Brown v. Smith, Bell and
Co. and Cowper
43 Phil. 118**

FACTS: Fiege and Brown acted as the agents of Smith, Bell and Co., for the sale of machinery. It was agreed that the agents were to receive *one-half* of the profits derived from the sale of the machines. They were able to sell the goods, and as soon as the customers' contracts were signed the agents demanded their 50% fee, although the buyers had not yet paid for the machines. *Issue:* Were they entitled to their share as soon as the properties were sold?

HELD: *No*, because the machines had not yet been paid for. Said the court: "Until such time as the company made a profit on a given contract, plaintiff's commission was not earned as to that contract. There was no profit thru the mere signing of the contract by the purchaser and its acceptance by the company. There would not be any profit until the purchaser *paid* all the money and complied with his contract. Until such time as the company realized a profit on the contract, there was nothing to share or divide."

(3) Brokers

A broker is one who in behalf of others, and for a commission or fee, negotiates contracts relative to property (with the custody of which he has no concern). He is the negotiator between parties, never acting in his own name, but in the name of those who employ him; he is strictly a *middleman*, and for some purposes, the agent of both parties. Indeed, he is one whose occupation is to bring parties together to bargain, or to bargain for them in matters of trade, commerce, or navigation. (*Behn, Meyer and Co., Ltd. v. Nolting and Garcia*, 35 Phil. 274 [1916].)

Although a broker is an agent, he is distinguishable from an agent generally by reason of the fact that his authority is of a special and limited character in most respects. As to physical activities, he is an independent contractor. (8 Am. Jur. 991).

(4) Compensation of Brokers

- (a) Since his only job is to bring together the parties to a transaction (*Pac. Com. Co. v. Yatco*, 68 Phil. 398), it follows that if the broker does not succeed in bringing the mind of the purchaser and the vendor to an agreement with reference to the terms of a sale, he is not entitled to a commission. (*Rocha v. Prats and Co.*, 43 Phil. 397).
- (b) The doctrine stated above is true even if the sale can later on be effected between buyer and seller, BUT thru a DIFFERENT broker. The first broker can be called UNSUCCESSFUL even if it was he who first interested the purchaser in the sale, negotiated with him, and even indirectly influenced him to come to terms. The fact remains that he did not succeed in bringing about the sale. It was the second broker that accomplished the sale. (*Quijano v. Esguerra, et al.*, 40 O.G. [11th S.] p. 166). Even if no subsequent broker had intervened, still if authority of the first broker had already been *withdrawn prior* to the sale, such broker is not entitled to any fee. (*See Reyes, et al. v. Mosqueda, et al.*, 53 O.G. 2158, L-8669, May 25, 1956).
- (c) So long as the sale is *pushed thru*, the broker is entitled to a commission, even if the sale had *been temporarily*

delayed due to the principal's lack of tact. The important thing is that the sale really eventually was entered into. (*Ysmael and Co., Inc. v. William Lines, Inc.*, L-9614, May 12, 1952). Indeed, a broker should not be made to suffer for the consequences of the principal's lack of tact in handling a delicate situation. (*Ibid.*).

- (d) A broker, however, is not entitled to recover his expenses during the negotiations for the sale, such expenses having been incurred at his own risk, and in consideration of the commission agreed upon. (*Ysmael and Co., Inc. v. William Lines, Inc.*, L-9614, May 12, 1952).

**Reyes, et al. v. Mosqueda and the Court
of Appeals
L-8699, May 25, 1956, 53 O.G. 2158**

FACTS: Mosqueda authorized a certain Mrs. Reyes to sell his land for P7.50 a square meter, promising to give her a 5% commission. Reyes found a buyer (Lim) who wanted to pay only P7.30 per square meter, but Mosqueda refused to sell at this price. He then wanted to withdraw the authority, but Reyes asked for one more day to find another buyer. This request was granted, but when Reyes failed to find another buyer the next day, Mosqueda informed her that he was *cancelling* her authority to look for a buyer. Subsequently, Lim contacted Mosqueda personally, and the two were able to agree on the sale. When Reyes learned of this she asked Mosqueda for her 5% commission, on the ground that the sale had been perfected thru her efforts. Mosqueda refused to pay. Hence, this action was instituted by Reyes.

HELD: Reyes is *not* entitled to any commission, for the actual sale was made without her intervention. Furthermore her authority to sell had already been withdrawn prior to the sale. It is true that there are times when the principal cannot revoke the authority given to a broker, as when the negotiations thru the broker's efforts have reached such a stage that it would be unfair to deny the commission earned. This is especially true when the property owner acts in bad faith, and revokes

the authority only to evade the payment of the commission. In this case, however, Mosqueda did not *act in bad faith* in cancelling the authority to Reyes.

[**NOTE:** If the principal breaks off from negotiations with a buyer brought by the agent in order to deliberately deal later with the buyer personally, this is evident bad faith. In such a case, justice demands compensation for the agent. (*See Infante v. Cunanan, et al.*, 93 Phil. 691 and *Perez de Tagle v. Luzon Surety Co.*, C.A., 38 O.G. 1213).]

**Perez de Tagle v. Luzon Surety Co.
(C.A.) 38 O.G. 1213**

FACTS: The Luzon Surety Co. wanted to sell in Ermita, Manila, a house and lot for P15,000. Tagle, a licensed real estate broker, asked the Company if it was willing to pay a commission of 5%. The Company suggested that Tagle first find a buyer, and then make an offer stating his (Tagle's) fees. Tagle found a prospective buyer, one Rodriquez. Rodriquez signed a letter prepared by Tagle, offering to pay P14,000. Tagle delivered this offer to the Company and asked for a 5% commission. The Company then promised to take up the matter with its Board of Directors. Finally, Tagle was informed that the buyer's offer was **REJECTED** by the Company. Subsequently, however, Tagle discovered that the Company had dealt with Rodriquez personally, and had accepted the latter's offer (with the same terms and conditions as those made thru Tagle). Tagle wanted to get his commission, but the Company refused. Hence, this action was brought.

HELD: Tagle is entitled to the 5% usual commission, which incidentally is the amount he has demanded for his services. It is evident under the facts that Tagle's service were taken advantage of by the Company, and it cannot now justly refuse to compensate him.

(**NOTE:** The court cited the rule that "a broker is entitled to a commission on a sale effected by the owner to the person produced by the broker after the breaking

of the original negotiations, if the breaking up was a mere subterfuge, and the sale was in fact brought about by what the broker had done.”)

[NOTE HOWEVER that “where the person introduced by the broker is not able, ready, and willing to buy on the terms prescribed by the owner, the broker is not entitled to compensation on a sale subsequently made on those terms by the principal to the same person thru another broker.” (*Quijano v. Esguerra*, 40 O.G. 11th Supp. 166).]

Art. 1876. An agency is either general or special.

The former comprises all the business of the principal. The latter, one or more specific transactions.

COMMENT:

General and Special Agencies

- (a) The distinction here depends on the *EXTENT* of the *business* covered.
- (b) In a sense, the more special the power is, the more specific it is.

PROBLEM:

Question: Absent substantial evidence to show a special agent’s authority from his principal to give consent to the creation of a tenancy relationship, can the former’s actions give rise to an implied tenancy?

Answer: No. (*Dionisia L. Reyes v. Ricardo L. Reyes, et al.*, GR 140164, Sept. 6, 2002).

Art. 1877. An agency couched in general terms comprises only acts of administration, even if the principal should state that he withholds no power or that the agent may execute such acts as he may consider appropriate, or even though the agency should authorize a general and unlimited management.

COMMENT:**(1) Agency Couched in General Terms and in Special Terms**

According to the POWER or AUTHORITY conferred, the agency may be:

- (a) couched in general terms (*Art. 1877*);
- (b) or couched in specific terms (special power of attorney). (*Art. 1878*). (Here what is important is the nature of the juridical act.) (*11 Manresa 466*).

(2) Observation

A general agency may be:

- (a) couched in general terms;
- (b) or couched in specific terms.

A special agency may be:

- (a) couched in general terms;
- (b) or couched in specific terms.

[**NOTE:** An agency couched in *general terms* comprises only ACTS OF ADMINISTRATION (even if the management be apparently unlimited, and even if the principal states that he withholds no power from the agent).]

(3) Example

Conchita made Sonia her agent in this manner:

“I make you my agent for all my properties. I withhold no power from you. You may execute such acts as you may consider appropriate. You are hereby given general and unlimited management.”

- (a) May Sonia compromise in behalf of Conchita?

ANS.: No.

- (b) May Sonia accept or repudiate an inheritance for Conchita?

ANS.: No.

- (c) May Sonia sell or mortgage Conchita's lands?

ANS.: No.

Reason for all the answers: These are acts of strict dominion, not mere acts of administration. To do the acts above-mentioned, an agency couched in general terms is *not* sufficient; *special* powers of attorney are *needed*.

(**NOTE:** A power given to an agent to *sell* ALL of the properties of the principal is NOT an agency couched in general terms; it is a special power of attorney.)

(4) Examples of Acts of Mere Administration

- (a) To sue for the collection of debts. (*Germane and Co. v. Donaldson, Sim and Co.*, 1 Phil. 63)
- (b) To employ workers or servants and employees needed for the conduct of a business. (*Yu Chuck v. Kong Li Po*, 46 Phil. 608).
- (c) To engage counsel to preserve the ownership and possession of the principal's property. (*Gov't. v. Wagner*, 54 Phil. 132).
- (d) To lease real property to another person for one year or less, provided the lease is *not* registered. (*See Art. 1878, No. 8 by implication*).
- (e) To make customary gifts for charity or to employees in the business managed by the agent. (*See Art. 1878, No. 6*).
- (f) To borrow money if it be urgent and indispensable for the preservation of the things under administration. (*See Art. 1878, No. 7*).

(**NOTE:** In order to SELL, an agent must have a special power of attorney, unless the act of selling itself is part of ADMINISTRATION, as in the case of the sale of goods in a retail store.)

Art. 1878. Special power of attorney are necessary in the following cases:

- (1) **To make such payments as are not usually considered as acts of administration;**

(2) To effect novations which put an end to obligations already in existence at the time the agency was constituted;

(3) To compromise, to submit questions to arbitration, to renounce the right to appeal from a judgment, to waive objections to the venue of an action or to abandon a prescription already acquired;

(4) To waive any obligation gratuitously;

(5) To enter into any contract by which the ownership of an immovable is transmitted or acquired either gratuitously or for a valuable consideration;

(6) To make gifts, except customary ones for charity or those made to employees in the business managed by the agent;

(7) To loan or borrow money, unless the latter act be urgent and indispensable for the preservation of the things which are under administration;

(8) To lease any real property to another person for more than one year;

(9) To bind the principal to render some service without compensation;

(10) To bind the principal in a contract of partnership;

(11) To obligate the principal as a guarantor or surety;

(12) To create or convey real rights over immovable property;

(13) To accept or repudiate an inheritance;

(14) To ratify or recognize obligations contracted before the agency;

(15) Any other act of strict dominion.

COMMENT:

(1) When Special Powers of Attorney Are Needed

According to Justice J.B.L. Reyes, the acts referred to in this article can be reduced to *three*:

- (a) acts of strict dominion or ownership (as distinguished from acts of mere administration)
- (b) gratuitous contracts
- (c) contracts where personal trust or confidence is of the essence of the agreement. (*J.B.L. Reyes, Observations on the new Civil Code*, 16 *L.J.* 138).

PNB v. CA
70 SCAD 37
1996

Where payment has been made to an agent, aside from proving the existence of a Special Power of Attorney, it is also necessary for evidence to be presented regarding the nature and extent of the alleged powers and authority granted to the agent.

(2) Reason for the Rule

In the cases enumerated under this article, we have in general acts of strict ownership or dominion, and *not* mere acts of administration, hence the necessity of special powers of attorney except in the cases expressly so mentioned.

(3) Meaning of “Special Powers of Attorney”

This refers to a clear mandate (express or implied) specifically authorizing the performance of the act, and must therefore be distinguished from an agency couched in general terms. (*See Strong v. Repide*, 6 *Phil.* 680). A *general* power of attorney may *however* include a special power if such special power is mentioned or referred to in the general power, *e.g.*, “I authorize you to sell *ALL* my properties.” (This does not need a special power to sell for each property involved, since such special power has already been given.

[**NOTE:** In general, the execution of a power of attorney does not need the intervention of any notary public. (*Barretto v. Tuason*, 59 *Phil.* 845).]

(4) Re Paragraph 1

Note that if the payment is usually considered an act of administration, no, special power of attorney is needed. It

should be noted, however, that some acts of administration carry with them the exercise of acts of dominion, *e.g.*, the sale by an administrator of fertile land or the products of the land. (*See 11 Manresa 469-470*).

**Dominion Insurance Corp. v.
CA, Rodolfo S. Guevarra & Fernando Austria
GR 129919, Feb. 6, 2002**

FACTS: The instruction of petitioner as principal could not be any clearer. Respondent Guevarra was authorized to pay the claim of the insured, but payment shall come from the revolving fund or collection in his possession.

Issue: Is the payment of claims an act of administration?

HELD: No. The settlement of claims is not included among the acts enumerated in the Special Power of Attorney (SPA) under Art. 1878; neither is it of a character similar to acts enumerated therein. Under said Art. 1878, special power of attorney are necessary in the following cases including, *inter alia*: to make such payments as are not usually considered as acts of administration, or any other act of strict dominion.

An SPA is required before respondent Guevarra could settle the insurance claims of the insured. Guevarra's authority to settle claims is embodied in the Memorandum of Management Agreement dated Feb. 18, 1987 which enumerates the scope of Guevarra's duties and responsibilities as agency manager for San Fernando, Pampanga. In settling the claims, respondent Guevarra's authority is limited by the written standard authority to pay, which provides that payment shall come from respondent Guevarra's revolving fund or collection.

By the contract of agency, a person binds himself to render some service or to do something in representation or on behalf of another, with the consent or authority of the latter. (*Art. 1869*). The basis for agency is representation. (*Bordador v. Luz, 347 SCRA 154 [1997]*). On the part of the principal, there must be an actual intention to appoint or an intention naturally inferable from his words or actions. On

the part of the agent, there must be an intention to accept the appointment and act on it, and in the absence of such intent, there is generally no agency. (*Victorias Milling Co., Inc. v. CA*, 333 SCRA 663 [2000]). A perusal of the SPA would show that petitioner (represented by third-party defendant [Austria] and respondent by Guevarra intended to enter into a principal-agent relationship. Despite the word “special” in the title of the document, the contents reveal that what was constituted was actually a general agency.)

Agency comprises all the business of the principal (*Art. 1876*), but, couched in general terms, it is limited only to acts of administrations. (*Art. 1877*). A general power permits the agent to do all acts for which the law does not require a special power. Thus, the acts enumerated in the Special Power of Attorney cited in the case at bar, do not require a SPA. As already alluded to, Art. 1878 enumerates the instances when an SPA is required.

(5) Re Paragraph 2

Note here that the obligations must already be in existence at the time of the constitution of the agency.

(6) Re Paragraph 3

Note that there are five (5) different powers mentioned here. A right given regarding one is not enough to grant the others.

(7) Re Paragraph 4

This is similar to a donation or remission.

(8) Re Paragraph 5

Note that this refers only to *immovables*. (*Examples: To sell or to buy land.*) Note the use of the term “*transmitted*” or “*acquired*.”

Under paragraph 15, however, *generally* the sale or purchase of personal property should also be covered by a special power of attorney, since this is an act of *strict dominion*.

B.H. Macke, et al. v. Camps
7 Phil. 553

FACTS: Camps, the owner of the Washington Café, left Mr. Flores in charge as managing agent of the Café. As manager, Flores purchased goods for the Café from Macke, et al. Is Camps liable for the purchase price of the goods.

HELD: Yes. Flores, as managing agent of the Washington Café, had authority to buy such reasonable quantities of supplies as might from time to time be necessary in carrying on the business of the Café.

Scope of Authority to Purchase:

Where an agent's power to purchase is *general and unrestricted*, he has implied authority to do whatever is usual and necessary in the exercise of such power. He may determine the usual and necessary details of the contract, agree upon the price, modify or rescind the contract of purchase, accept delivery for his principal, give directions for the delivery of the property purchased, and may borrow money to pay for the *care and preservation* of the property purchased (*Art. 1878, par. 7*); but he has NO special power to settle a contest between his principal and a third person as to the ownership of the goods purchased, or to agree to an account stated, or to do anything not usual and necessary to the exercise of such authority.

Where the agency is a *special* one, or is restricted to purchases upon certain terms and conditions, the agent has *no* authority to purchase upon different terms and conditions from those authorized or to modify or rescind a contract of purchase made by the principal. (*2 C.J. 588-590*).

(9) Re Paragraph 6

The making of customary gifts is considered here as an act of administration only.

(10) Re Paragraph 7

Note that the *exception* here refers to the *latter* act, namely, "borrow," not "loan."

Rural Bank of Caloocan v. Court of Appeals
L-32116, Apr. 21, 1981

For a person to be able to borrow money in behalf of another, the latter must give him a special power of attorney. If the would-be borrower gets the loan, the same cannot be regarded as having been made thru an agent.

(11) Re Paragraph 8

Note here that the lease of *real* property is referred to, and not the lease of personal property. Note also that if the lease of the real property is for one year or less, the act is one of mere administration.

(12) Re Paragraph 9

Reason: Here the contract is gratuitous.

(13) Re Paragraph 10

Reason: The principal has to personally have trust and confidence in the proposed partners.

(14) Re Paragraph 11

Director of Public Works v. Sing Juco, et al.
53 Phil. 205

FACTS: Tan Ong Sze gave a power of attorney to Mariano de la Rama to sell or to lease her property and generally “to perform and execute all and every lawful and reasonable act as fully and effectually as I might or could do if personally present.” With the authorization, Rama signed in behalf of his principal a *security bond* in favor of the government in connection with the purchase of certain materials dredged from a fish pond. When the buyer failed to pay suit was instituted against Tan Ong Sze on the strength of the contract of suretyship (security bond). Tan contended that she was NOT bound by such contract.

HELD: Tan is NOT bound, for the power of attorney given De la Rama did not authorize him to create an obligation in

the nature of surety binding on his principal. The power to execute a contract of so exceptional a nature as a contract of suretyship or guaranty cannot be inferred from the general words contained in Rama's power of attorney.

Bank of the Phil. Islands v. De Coster
47 Phil. 594

FACTS: A *businesswoman* authorized her husband to "loan or borrow any sum of money or fungible things at the rate of interest and for the time and under the conditions which he might deem convenient." Later the husband mortgaged his wife's property as security for HIS own personal debt. Was he authorized to do so?

HELD: No, for it is evident from the face of the instrument that the whole purpose of the power of attorney was to authorize the husband to look after the interest of his wife and the business, and not for his own interest.

(15) Re Paragraph 12

Examples: to mortgage, to create an easement.

(16) Cases

Domingo Lao v. Estrella Villones-Lao
GR 126777, 106 SCRA 42
Apr. 29, 1999

A special power of attorney cannot be the basis of a valid mortgage contract.

Guillermo Adriano v. Romulo Pangilinan
GR 137471, Jan. 16, 2002

FACTS: Petitioner entrusted and delivered his TCT and Residence Certificate (now known as "Community Tax Certificate") to Angelina Salvador, but only for the purpose of helping him find a money lender. No power of attorney was made giving her authority to act on his behalf in procuring the mortgage.

HELD: Not having executed a power of attorney in her favor, petitioner clearly did not authorize her to be his agent in procuring the mortgage. He only asked her to look for possible money lenders.

**Manuel B. Tan, et al. v.
Eduardo R. Gullas & Norma S. Gullas
GR 143978, Dec. 3, 2002**

FACTS: Following the stipulation in the Special Power of Attorney, petitioners contends they are entitled to a 3% commission for the sale of the land in question. Petitioners maintain that their commission should be based on the price at which the land was offered for sale, *i.e.*, P530 per square meter. *Issue:* How much commission are petitioners entitled to?

HELD: The actual purchase price for which the land was sold was only P200 per sq.m. Therefore, equity be based on this price. To rule otherwise would constitute unjust enrichment on the part of the petitioners as brokers.

Petitioners, as brokers, should be entitled to the commission whether or not the sale of the property subject matter of the contract was concluded three thru their efforts, although there was no dispute as to the role that petitioners played in the transaction. At the very least, petitioners set the sale in motion. They were not able to participate in its consummation only because they were prevented from doing so by the arts of private respondents.

**Naawan Community Rural Bank, Inc. v.
CA & Spouses Alfredo and Annabelle Lumo
GR 128573, Jan. 13, 2003**

A *special power of attorney* (SPA) may be executed in favor of an agent authorizing him to borrow money and use of subject lot as security.

Art. 1879. A special power to sell excludes the power to mortgage, and a special power to mortgage does not include the power to sell.

COMMENT:**(1) Power to SELL**

The power to sell carries with it the:

- (a) power to find a purchaser or to sell directly;
- (b) power to deliver the property;
- (c) power to make the usual representation and warranty;
- (d) power to execute the necessary transfer documents (like the execution of the *contract itself of sale*) (*Robinson, Fleming & Co. v. Cruz & Tan Chong Say*, 49 Phil. 42; 2 Am. Jur. 97-98);
- (e) power to fix the terms of the sale, including the time, place, mode of delivery, price of the goods, and the mode of payment unless there be set conditions stipulated by the principal (2 Am. Jur. 98-99);
- (f) power to sell only for CASH:

(In the absence of special authority, mere authority to sell does not give the agent authority to sell on credit. See Art. 1905 of the Civil Code, which reads:

“The commission agent cannot without the express or implied consent of the principal, sell on credit. Should he do so, the principal may demand from him payment in cash, but the commission agent shall be entitled to any interest or benefit which may result from such sale.”

- (g) power to receive the price, unless he was authorized only to solicit orders. (2 C.J. 605-607).

[**NOTE:** “Where payments are made over the counter of the principal’s store to a salesman accustomed to receive money there for his employer, authority to receive payment will be implied in favor of innocent persons, because the principal by his own act gives the agent apparent authority to receive payment. But if a salesman authorized to receive money over the counter only receives money elsewhere than in the shop, the payment is not good.” (See 2 C.J. 605-607).]

[**NOTE:** The power to sell DOES NOT carry with it the power:

- 1) to barter or to exchange;
- 2) to mortgage or to pledge. (*See Art. 1879 and 2 Am. Jur. 98*).J

(2) Power to MORTGAGE

The power to mortgage does not include the power:

- (a) to sell (*Art. 1879*);
- (b) or to execute a second mortgage (*Skaggs v. Murchison, 63 Tex. 348*);
- (c) to mortgage for the agent's personal benefit or for the benefit of any third person, unless contrary has been clearly indicated. (*2 C.J. 651*).

Ordinarily, the mortgage can be made only on the present property of the principal, and not on hereafter acquired property (acquired after the execution of the power of attorney) but the contrary can be stipulated upon. It is essential, however, that at the time of the execution of the mortgage itself, the principal must already be the owner; otherwise, the mortgage is VOID. (*Art. 2085 and See C.J. 651*).

(3) Jurisprudence

Bicol Savings and Loan Association v. CA, et al. GR 85302, Mar. 31, 1989

The pivotal issue is the validity of the extrajudicial foreclosure sale of the mortgaged property instituted by petitioner bank which, in turn, hinges on whether or not the agent-son exceeded the scope of his authority in agreeing to a stipulation in the mortgage deed that petitioner bank could extrajudicially foreclose the mortgaged property.

The sale proscribed by a special power to mortgage under Art. 1879 is a voluntary and independent contract, and not an auction sale resulting from extrajudicial foreclosure, which is precipitated by the default of a mortgagor. Absent that default, no foreclosure results. The stipulation granting an authority to extrajudicially foreclose a mortgage is an ancil-

lary stipulation supported by the same cause or consideration for the mortgage and forms an essential or inseparable part of that bilateral agreement. The power to foreclose is not an ordinary agency that contemplates exclusively the representation of the principal by the agent but is primarily an authority conferred upon the mortgagee for the latter's own protection. That power survives the death of the mortgagor. In fact, the right of the mortgagee bank to extrajudicially foreclose the mortgage after the death of the mortgagor, acting through his attorney-in-fact, did not depend on the authorization in the deed of mortgage executed by the latter.

The right existed independently of said stipulation and is clearly recognized in Sec. 7, Rule 86 of the Rules of Court, which grants to a mortgagee three (3) remedies that can be alternatively pursued in case the mortgagor dies, to wit: (1) to waive the mortgage and claim the entire debt from the estate of the mortgagor as an ordinary claim; (2) to foreclose the mortgage judicially and prove any deficiency as an ordinary claim; and (3) to rely on the mortgage exclusively, foreclosing the same at any time before it is barred by prescription, without right to file a claim for any deficiency. It matters not that the authority to extrajudicially foreclose was granted by an attorney-in-fact and not by the mortgagor personally. The stipulation in that regard, although ancillary, forms an essential part of the mortgage contract and is inseparable therefrom. No creditor will agree to enter into a mortgage contract without that stipulation intended for its protection. Petitioner bank, therefore, in effecting the extrajudicial foreclosure of the mortgaged property, merely availed of a right conferred by law. The auction sale that followed in the wake of that foreclosure was but a consequence thereof.

Art. 1880. A special power to compromise does not authorize submission to arbitration.

COMMENT:

(1) Special Power to Compromise

- (a) An agent authorized to compromise can do anything which the principal himself can do to effect a settlement (*See 2*

C.J. 652-653) unless there is a contrary legal provision, as in this Article.

- (b) A special power to submit to arbitration does not authorize the power to compromise. This is the logical inference that can be made from Art. 1880.

(2) Reason for the Article

Reason why a special power to *compromise* does *not* authorize submission to arbitration.

A principal may authorize his agent to compromise because of absolute confidence in the latter's judgment and discretion to protect the former's rights and obtain for him the best bargain in the transaction. If the transaction would be left in the hands of an arbitrator, said arbitrator may not enjoy the trust of the principal. A fundamental principle of agency shall have been violated, namely, that an agent must possess the trust and confidence of the principal. (*See 11 Manresa 471*).

(3) Special Power to Submit to Arbitration

When an agent is specifically empowered to submit a matter to arbitration, the arbitral award *binds* the principal, provided the agent acted within the scope of his authority. In the case of *Cox v. Fay*, 54 *Vt.* 446, it was held that if the principal had specifically designated who the arbitrators should be, the agent has no authority to submit the question to *other* arbitrators. However, when no designation had been made by the principal and on the contrary the agent was authorized to submit the controversy to *ANYONE*, it was held that the agent could agree to an arrangement for the appointment of *ADDITIONAL* arbitrators; moreover, it would be permissible for the agent to agree that an award could be validly made by *LESS* than the *FULL* number of the arbitrators selected. (*See Security Livestock Ins. Ass'n. v. Brigg*, 22 *Ill. A.* 107).

Art. 1881. The agent must act within the scope of his authority. He may do such acts as may be conducive to the accomplishment of the purpose of the agency.

COMMENT:**(1) Fundamental Principles of Agency**

There are two very important principles of a *true agency*:

- (a) The agent must act *within the scope of his authority*.
- (b) The agent must act in *behalf of his principal*.

[**NOTE:** It is therefore conceivable that an agent may act under the 2 conditions given, or under only one of them, or under neither. Thus, four instances may arise:

- 1) The agent acts *with authority* and in behalf of *the principal*.
- 2) The agent acts *with authority* but in behalf of *himself* (not the principal).
- 3) The “agent” acts *without authority* but in behalf of a “*principal*.”
- 4) The “agent” acts *without authority* and in his *own behalf* (not a “principal”).]

[**NOTE:** In (3) and (4), “agent” and “principal” are in quotation marks because they are NOT really such.]

(2) Effects**(a) WITH AUTHORITY:**

- 1) *In PRINCIPAL’S behalf* — **VALID** (principal is bound; agent not personally liable unless he bound himself). (*Art. 1897 and Macias & Co. v. Warner, Barnes and Co., 43 Phil. 155*).
- 2) *In AGENT’S behalf* — **APPLY** Art. 1883 (generally not binding on principal; agent and stranger are the only parties, except regarding things belonging to the principal). (*Smith, Bell & Co. v. Sotelo Matti, 44 Phil. 874*).

(b) WITHOUT AUTHORITY:

- 1) *In “PRINCIPAL’S” behalf* — **UNAUTHORIZED AND UNENFORCEABLE** (*Art. 1403, No. 1*) but may be

RATIFIED, in which case it may be validated from the very beginning. (Art. 1407).

- 2) In “AGENT’S” behalf — VALID, whether or not the subject matter belongs to the principal, provided that at the time delivery is to be made, the “agent” can transfer legally the ownership of the thing. Otherwise, he will be held liable for breach of warranty against eviction. Art. 1883 does NOT apply. (*Nat. Bank v. Agudelo*, 58 Phil. 655).

(3) Illustrative Examples

- (a) *With Authority and in Principal’s Behalf:*

P authorized *A* to sell his (*P*’s) car. *A* then sold the car in *P*’s name. The transaction is VALID. *A* assumes no personal liability. (See *Lorca v. Dineros*, L-10919, Feb. 28, 1958).

- (b) *With Authority but in Agent’s Behalf:*

P authorized *A* to sell his (*P*’s) car. *A* then sold the car in his (*A*’s) own name, without disclosing who the principal was. Ordinarily, the agent can only have recourse against the buyer, and the buyer can have recourse only against the agent under Art. 1883. HOWEVER, in this particular case, *since the car belonged to the principal*, *P* can have recourse against the buyer and the buyer can have recourse against *P*. (See exception in the second paragraph of Art. 1883.)

THE TRUE EXAMPLE IS GIVEN HEREUNDER:

If *P* authorized *A* to find for him (*P*) a singing engagement at the Manila Grand Opera House, and *A* acts in his own (*A*’s) behalf, that is, *A* wanted to sing, and he got the job, only *A* and the Opera House would be bound to each other. This example clearly illustrates the general rule referred to in the second paragraph of Art. 1883.

- (c) *Without Authority but in “Principal’s” Behalf:*

Without *P*’s authority, *A* sold *P*’s car to a buyer in *P*’s behalf. The transaction, insofar as *P* is concerned is

unauthorized, hence *unenforceable*. (Art. 1403, No. 1). *P* is therefore *not bound*, unless he ratifies the transaction. Without the necessary ratification, the buyer can have a claim only against the alleged agent *A*. The moment a ratification is made, *A* steps out of the picture, since he would *no longer* be personally liable, and now it is *P* who will have to deal with the buyer.

(d) *Without Authority and in “Agent’s” Behalf:*

A, without authority from *P*, and representing himself to be the owner of *P*’s car, sold it to a buyer. Here, *A* acted without authority. Moreover, he acted in his own behalf. It is clear that the transaction (sale) is valid, provided that at the time delivery is to be made, the “agent” can transfer legally the ownership of the thing. Otherwise, he will be held liable for breach of warranty against eviction. It is also clear that only *A* is liable to an innocent purchaser. Here, Art. 1883 does NOT apply because Art. 1883 presupposes AUTHORITY. (See *Nat. Bank v. Agudelo*, 58 *Phil.* 655).

(4) Authority Discussed

- (a) *Authority defined.* The right of the agent to effect the legal relations of his principal by the performance of acts effectuated in accordance with the principal’s manifestation of consent.
- (b) *Kinds of Authority:*
 - 1) express (here, the authority is clearly defined)
 - 2) implied (this includes necessary acts to accomplish the purpose)
 - 3) general (the agent’s discretion is COMPLETE)
 - 4) special (here, particular instructions are given)
 - 5) apparent (here, the “agent” or a third person was led by the principal’s conduct or words to believe that the “agent” was really authorized, when in fact he was *not*. The effect here is as if there really was authority).

(c) *Examples of Implied Authority:*

- 1) If an agent is authorized to collect a debt, he usually is also impliedly authorized to employ an attorney as counsel, and to bring suit for the enforcement of the payment. (*See 2 C.J. 633-643*).
- 2) If an agent is authorized “to exact the payments of the debt by *legal means*,” he has the right to institute a legal suit for its recovery. (*Germann and Col. v. Donaldson, Sim and Co., 1 Phil. 63*).
- 3) An agent or attorney-in-fact who is authorized to pay the debts of the principal and to employ an attorney to defend the interests of the latter is naturally impliedly empowered to pay the fees of the attorney for services rendered in the interest of said principal. Moreover, he is empowered to effect the payment of the fees by assignment to the attorney of the judgment awarded to his principal. (*See Mun. Council of Iloilo v. Evangelista, 55 Phil. 290*).

(**NOTE:** True, there can be *no* valid assignment of things in litigation in favor of the participating lawyers — Art. 1491, No. 5 — but after the litigation, there can be such an assignment.)

- 4) In the very nature of things an agent cannot sell hemp in a foreign (or even in our) country without making some kind of a contract, and if he has authority to sell, it would carry with it authority to make and enter into the usual and customary contract of sale. (*Robinson, Fleming and Co. v. Cruz and Tan Chong Say, 49 Phil. 42*).

(d) *No Implied Authority in the Following:*

- 1) An agent authorized to borrow necessary funds has *no* authority to pay his own personal debts therewith. (*Hodges v. Salas, 63 Phil. 567*).
- 2) An agent authorized to collect a debt has no right to make a novation of the contract and to release the sureties of the debtor. (*Villa v. Garcia, Bosque, 49 Phil. 126*).

- 3) An agent authorized to collect money belonging to his principal does *not* possess the implied authority to indorse the checks which had been received by him in payment. (*Insular Drug Co. v. Nat. Bank*, 58 Phil. 684).
- 4) An agent authorized to borrow is not impliedly authorized to pay the loan at maturity, nor is he allowed to give the money received to a third person. (2 C.J. 658).
- 5) Authority to collect does not carry with it authority to receive partial payment (*Heitsch v. Minneapolis Threshing Mach. Co.*, 150 N.W. 457), nor the authority to accept commercial paper as payment of the debt (2 Am. Jur. 135-136). It should be noted, however, that although receipt of a check is *unauthorized* still if the agent is able to collect the monetary equivalent, the payment should be considered GOOD, and the debt is therefore extinguished. (2 Am. Jur. 135-136).

[NOTE: If an agent is authorized to *conduct a business involving the acceptance of checks or notes* there is *naturally* an implied authority to accept and to indorse such commercial paper as will come to the agent in the course of the business. (2 C.J. 628-629).]

(5) Some Cases

Germann and Co. v. Donaldson Sim & Co.

1 Phil. 63

FACTS: Germann and Co. authorized its agent Kommerzell to direct and administer its commercial business, and, among others, “to collect sums of money and exact their payment by legal means.” with this authority, can the agent principal’s name, bring a court action for collection?

HELD: Yes. The collection of a claim is necessarily a *part of administration*, but even if it be regarded as an act of strict ownership, still the right to exact payment by legal means

carries with it the right to sue in court for collection. Indeed, it cannot be reasonably supposed that it was the intention of the principal to withhold from his agent a power so essential to the efficient management of the business entrusted to his control as that to sue for the collection of debts.

**Deen v. Pacific Commercial Co.
42 Phil. 738**

FACTS: The Pacific Commercial Co. thru Mr. Pond, its vice-president and general manager, wrote to its local manager in Cebu, Mr. Francisco, authorizing the latter *to look around for buyer of certain company land* and to submit the terms of the sale for approval by the Company. Francisco then wrote a real estate broker, Deen, authorizing him to sell the property. Later, Pond told Francisco that the land in question was *no longer for sale*. When Francisco conveyed this information to Deen, Deen said he had already found a buyer, and therefore, could not repudiate the transaction. When the Company persisted in refusing to sell the land, Deen sued for alleged commission fees which he could have earned had the sale been pushed thru. **Issue:** Did Francisco have authority to sell the land?

HELD: Francisco had no authority to sell. His only authority was to look for a buyer, and to present the terms of the proposed sale to the Company for its approval. Inasmuch as the act was not authorized, it follows that the Company *cannot* be held liable.

**Linan v. Puno, et al.
31 Phil. 259**

FACTS: Linan authorized in a public instrument a certain Puno “to administer the interest I possess within this municipality, purchase, sell, collect and pay, as well as sue and be sued before any authority, appear before the courts of justice and administrative officers in any proceeding or business concerning the good administration and advancement of my said interests.” Under this document, Puno sold a parcel of land belonging to Linan. Linan, however, said that he merely

granted Puno the right to administer, not the right to sell.
Issue: Did Puno have authority to sell the land?

HELD: Yes, in view of the precise words used in the document, which granted authority not only to administer, but also to sell. The clear words of the document should prevail, considering the fact that Puno presumably acted in good faith and in accordance with his power as he understood it.

Villa v. Garcia Bosque
49 Phil. 126

FACTS: Villa authorized Pirretas to sell her printing establishment and book store partly for cash and partly on credit, with two sureties for the buyer. The two sureties were France and Goullete. Subsequently, Pirretas left the Philippines but before doing so, he executed a document transferring to Figueras Hermanos *the authority to collect* the sums still due from the buyer. While acting as such agent, Figueras entered into an agreement with the buyer, relieving France and Goullette from all liabilities and sureties. When the buyer later on failed to pay, Villa sued the buyer and the two sureties.
Issue: Could the sureties still be liable despite their release by Figueras Hermanos?

HELD: Assuming that Pirretas could validly substitute Figueras Hermanos in his place, still the authority granted by him to Figueras Hermanos was merely to *collect*, not release the sureties. It follows that Figueras Hermanos could not discharge any of the debtors without payment, or to novate the contract, by releasing the sureties. In fact, the terms of the substitution clearly indicate the limited extent of the authority of Figueras Hermanos. Therefore, the sureties have *not* been relieved of their obligation, and are consequently still liable.

Katigbak v. Tai Hing Co.
52 Phil. 622

FACTS: In 1921, Po Tecsí authorized Gabino-Barretto Po Ejap to sell any land that “might belong” to him (Po Tecsí). In 1923, Gabino-Barretto sold his own land to Po Tecsí. In

1924, Gabino-Baretto sold the same land to Katigbak on the strength of the authority conferred on him in 1921. The sale was impugned on the theory that the power of attorney had been executed long before Po Tecsí became the owner of the land. *Issue*: Did Gabino-Baretto act within the scope of his authority.

HELD: Yes, in view of the words “might belong” (*pertenecen*) instead of the word “belong” (*pertenecen*). The use of the subjunctive mood indicates that Po Tecsí referred not only to the property he had at the time of the execution of the power, but also such as he might afterwards have during the time it was in force. (*See 2 C.J., p. 614*)

Veloso v. La Urbana
58 Phil. 681

FACTS: A forged a power of attorney in his favor, and on its alleged strength, he mortgaged land belonging to the purported makers of the power of attorney. He was then able to register the mortgages thus made. What is the effect of the mortgages and the registration thereof?

HELD: The mortgages and their registration are absolutely *null and void*, and cannot in any way affect the rights of the registered owners.

Yu Eng Yu v. A.C. Ransom Philippine Corp.
(C.A.) 40 O.G. Supp., Aug. 23, 1941, p. 65

FACTS: Without *P*'s authority, *A* sold the business establishment of *P* in *P*'s name in favor of a buyer. What right if any has the buyer? *HELD*: The buyer has no title to the property, since the sale was unauthorized and therefore unenforceable. His only remedy is to proceed against *A*.

Markham v. Jandon
41 N.Y. 235

FACTS: The plaintiff usually transacted with a broker thru the “*margin plan*” whereby the broker would extend credit to the plaintiff in buying stocks for him, but the stocks

were to be in possession of the broker. A short while after certain stocks had been purchased in behalf of the plaintiff, the broker notified the plaintiff that his (the plaintiff's) margin was *insufficient*, and that unless additional money would be deposited, he the broker, would sell the stocks even if by virtue of such sale, the plaintiff would lose. When the plaintiff failed to give the needed money, the broker sold the stocks. The plaintiff now sues the broker for damages. The broker offered to prove the existence of a *custom* of their local board of brokers authorizing the sale of stock once the margin is exhausted. *Issue*: Was the broker authorized to sell the stock?

HELD: No, the broker was not authorized to sell the stock. The transaction between the plaintiff and the broker amounts to a *pledge* of the stocks. And it is well-settled that although the pledgor defaults, the pledgee does *not* automatically become the owner of the property. Ownership is still with the pledgor. The pledgee must therefore comply with all the requirements of the law so that his claim can be satisfied. A custom not sanctioned by law cannot prevail over the law.

Keeler Elec. Co. v. Rodriguez
44 Phil. 1

Payment to an unauthorized "agent" does not extinguish one's obligation, for the payment is *not* valid. Payment to an authorized person is at the payor's risk. Indeed persons dealing with an assumed agent, whether the assumed agency be general or a special one, are bound at their peril, if they would hold the principal, to ascertain not only the fact of the agency, but also the nature and extent of the authority and in case either is controverted, the burden of proof is upon such persons to establish it.

Caram, Jr. v. Laureta
L-28740, Feb. 24, 1981

If agents, acting for a principal, purchased property in bad faith, the principal (under the rules of agency) must be presumed to have also acted in bad faith.

(6) Doctrine of Agency by Necessity

Strictly speaking, an agency can never be created by necessity. What is meant by the phrase “agency by necessity” is, however, this: that by virtue of the existence of an emergency, the authority of an agent is correspondingly enlarged in order to cope with the exigencies or the necessities of the moment. In the case of *Vandalia R. Co. v. Bryan*, 60 Ind. App. 233, five conditions were laid down for “authority of agency by necessity” (*agent ex necessitate*):

- (a) the real existence of an emergency;
- (b) inability of the agent to communicate with the principal;
- (c) the exercise of the additional authority for the principal’s own protection;
- (d) the adoption of fairly reasonable means, premises duly considered;
- (e) the ceasing of the authority the moment the emergency no longer demands the same.

Example:

If a bus conductor is seriously hurt, the driver is authorized to engage the services of a physician, in the company’s name, so that the conductor may survive. This is really for the best interest of all concerned. (*See Terre Haute v. McMurray*, 98 Ind. 358 for an analogous case).

(7) ‘Authority’ Distinguished from ‘Power’

While “authority” and “power” may be often used as synonymous terms, still there is a slight distinction in that authority may be considered the *cause*, while power is the *effect*. In other words, authority emanates from a principal, and is given to the agent, who thus becomes empowered. The agent who is thus authorized now possesses power.

(**NOTE:** Power may thus be *express, implied, or incidental*.)

[**NOTE:** A power of attorney or letter of attorney is authority given in writing. (1 *Mechem*, Sec. 35). The agent given the power of attorney may be referred to as an attorney in fact. (1 *Mechem*, Sec. 35).]

[**NOTE:** Attorneys-at-law are agents, being distinguished from agents generally by reason of the fact that their authority is of a special and limited character in most respects. (2 *Am. Jur.* 14). Therefore, notice to counsel of a party is notice to the latter, and the time to appeal from the dismissal of the client's complaint should be counted from the notice to said counsel, even if the client was not notified of the dismissal. (*Valeriano, et al. v. Kerr, et al.*, L-10657, May 16, 1958 and *Perez v. Araneta*, L-11728, May 16, 1958). But notice to the client being represented by counsel, is not notice in law. (*Visayan Surety & Ins. Co. v. Central Bank*, L-12139, Sept. 17, 1958).]

(8) ‘Authority’ Distinguished from ‘Instruction’

<i>AUTHORITY</i>	<i>INSTRUCTIONS</i>
<p>(a) Principal affects only third persons, because if the act is done outside the scope of the agent's authority, the principal is not bound.</p> <p>(b) Third persons must therefore verify or investigate the authority.</p> <p>(NOTE: If a person makes an inquiry, he is chargeable with knowledge of the agent's authority, and his ignorance of the authority will not be any excuse.)</p>	<p>(a) Concern only the principal and the agent.</p> <p>(b) Third persons do not have to investigate or verify the instructions.</p>

Art. 1882. The limits of the agent's authority shall not be considered exceeded should it have been performed in a manner more advantageous to the principal than that specified by him.

COMMENT:**(1) When Agent's Performance of Authority is Deemed Still Authorized**

This is justified because of the greater benefit that would accrue to the principal. "Advantageous," however, does not only refer to a financial gain, which may be offset by a moral or ethical loss.

(2) Example

If an agent was asked to sell on the installment plan an object for P100,000, but he is able to get P100,000 cash for the object, he is deemed not to have exceeded his authority.

(3) Sale at a Lower or Higher Price

The agent should not sell things received by him from his principal at a price less than that fixed by the latter. But there is NO prohibition against his selling the goods at a better price, if said price can be obtained. (*Tan Tiong Teck v. Com. de Valores y Bolsas*, 40 O.G. [6th S] p. 125, 69 Phil. 425). However, the conditions of the sale must remain unaltered, hence authorization to sell for cash does not carry with it authorization to sell on credit, even if by such device a higher price can be obtained. (*See Art. 1905*).

(4) Bar

An agent with general powers for administration, desirous of improving the financial condition of his principal's business, sold a piece of land belonging to his principal for double the price that appeared in an inventory prepared by the principal before leaving the place. Do you think the agent has exceeded his power? Why?

ANS.: Yes, the agent has exceeded his powers despite the fact that the price obtained was double the value of the property. The important fact is that he made a sale, a transaction which requires a *special* power of attorney. (*Art. 1878*). As a mere administrator, he had no right to alienate.

Art. 1883. If an agent acts in his own name, the principal has no right of action against the persons with whom the agent has contracted; neither have such persons against the principal.

In such case the agent is the one directly bound in favor of the person with whom he has contracted, as if the transaction were his own, except when the contract involves things belonging to the principal.

The provisions of this article shall be understood to be without prejudice to the actions between the principal and agent.

COMMENT:

(1) Agency With an Undisclosed Principal

This Article speaks of a case where the agent WAS *AUTHORIZED*, but instead of acting in behalf of the principal, he acts in his own behalf. Thus, Art. 1883 does not apply if the agent was *unauthorized* or he acts in excess 'of his authority.' (See *Nat. Bank v. Agudelo*, 58 *Phil.* 655).

(*NOTE:* Refer to Comments Nos. 1, 2, and 3 under Art. 1881.)

(2) Example of the General Rule

Jose asked Pedro to borrow money from Juan. Pedro did not disclose to Juan that he (Pedro) was borrowing in Jose's behalf; that is, Pedro borrowed in his own name. Can Juan ask Jose to pay the debt?

ANS.: No. Only Pedro has the duty to pay Juan.

Phil. Bank of Commerce v. Jose M. Aruego
L-25836-37, Jan. 31, 1981
102 Phil. 530

If an alleged agent signs a bill of exchange without indicating thereon that he was signing as an agent or representative of the Philippine Education Foundation Company (of which he was president), he is *personally* liable.

(3) Example of the Exception

A principal told his agent to sell his (the principal's) car for him (the principal). The agent sold it to a third party. The agent acted in his own name. Can the third party sue the principal in case the car has hidden defects?

ANS.: Yes. In this case, although the agent acted in his own name, still the sale involved a car belonging to the principal. Here we apply the exception stated in the second paragraph of Art. 1883. As a matter of fact, the sale is completely valid.

(4) When Agent Transacts Business in His Own Name

If an agent transacts business in his own name, it is not necessary for him to state who is the principal, and he is directly liable as if the business were for his own account, to the person with whom he transacts the same. (*Lim v. Ruiz y Rementeria*, 15 Phil. 367).

(5) When Authorized Agent Buys in His Own Name But Really in Behalf of His Principal

If an authorized agent buys in his own name but really in behalf of his principal, the seller has the option to look to EITHER for payment unless:

- (a) he trusted the agent exclusively;
- (b) or by the usage and understanding of business, the agent only is held;
- (c) or unless the special circumstances of the case reveal that only the agent was intended to be bound and the seller knew it, or was chargeable with knowledge of it. (*Wing Lee v. Bark "Monogabela"*, 44 Phil. 464).

(6) When Authority of Agent is Doubtful

If it cannot be determined whether or not the agent was authorized, or had disclosed a principal, the action must be directed against both the "agent" and the "principal." (*Beaumont v. Prieto*, 41 Phil. 670).

(7) Regarding “Things Belonging to the Principal”

This means that in the case of this exception, the agent's apparent representation yields to the principal's true representation; and that, in reality and in effect, the contract must be considered as entered into between the principal and the third person and consequently, if the obligations belong to the former, to him alone must also belong the rights arising from the contract. (*Sy-Juco and Viardo v. Sy-Juco*, 40 *Phil.* 634).

Examples:

- (a) If the agent buys with money belonging to the principal, was authorized to so buy but acted in his own name, the principal nevertheless has a right of action against the seller, and the seller has a right of action against the principal. (*See Sy-Juco and Viardo v. Sy-Juco*, *supra*).
- (b) The Philippine rule is that where merchandise is bought from an agent with an undisclosed principal, and without knowledge on the part of the buyer that the seller is merely an agent, the buyer takes title to the merchandise and the principal cannot maintain successfully an action against him for the recovery of the merchandise or for damages, but can only proceed against the agent. (*Awad v. Filma Mercantile Co.*, 49 *Phil.* 816).

(NOTE: In the above-mentioned case, the agent was authorized to sell; this is why the transaction is valid. Had the agent *not* been authorized, the whole transaction would have been *null and void*, considering the fact that he acted in his own name.)

[NOTE: The exception provided for in the second paragraph of Art. 1883 *cannot* be invoked if the contract of sale did *not* cover property of the supposed principal, but involved the property of a third person. (*See Lion Tek Goan v. Jose Azores*, 42 O.G. 2840).]

Chapter 2

OBLIGATIONS OF THE AGENT

Art. 1884. The agent is bound by his acceptance to carry out the agency and is liable for the damages which, through his non-performance, the principal may suffer.

He must also finish the business already begun on the death of the principal, should delay entail any danger.

COMMENT:

(1) Duty of Agent to Carry Out the Agency

An agent who does not carry out the agency is liable for damages. Upon the other hand, if he fulfills his duty, he is not personally liable unless he so binds himself.

Bank of the Phil. Islands v. Pineda GR 62441, Dec. 14, 1987

The agents of a disclosed principal the owner of a ship cannot be held liable for repairs made on the vessel to keep them in good running condition in order to earn revenue, if there is no showing that said agents exceeded their authority.

(2) Liability of Lawyer Who Fails to Perfect an Appeal

The mere fact that a lawyer fails to perfect an appeal of his client does not give rise to damages in the absence of showing that the decision which became final was unjust. (*Heridia v. Salinas*, 10 Phil. 157).

(3) Effect of Principal's Death

Angel was Pedro's agent. Angel was performing a business of the agency when suddenly Pedro died. Although as a rule,

the death of the principal extinguishes the agency, Angel is obliged to finish the business already begun if delay should entail any danger. (*Art. 1884, par. 2*).

(4) Agent Who Sells to Himself

An agent who has been authorized to sell some merchandise is not allowed to bind the principal by selling to himself (the agent) directly or indirectly. Hence, if an agent, through his own sub-agent, buys from the principal, the principal is not required to fill such orders unless said principal ratifies the sale after he has had full knowledge of the facts of the case. (*Barton v. Leyte Asphalt, 46 Phil. 938*).

Art. 1885. In case a person declines an agency, she is bound to observe the diligence of a good father of a family in the custody and preservation of the goods forwarded to him by the owner until the latter should appoint an agent. The owner shall as soon as practicable either appoint an agent or take charge of the goods.

COMMENT:

(1) Rule if a Person Declines the Agency

A person is of course free to refuse to be an agent; however, equity demands the rule set forth in the first sentence of this Article.

(2) Duty of Owner

Upon the other hand, the owner must also act as soon as *possible*:

- (a) by appointing an agent, or
- (b) by taking charge of the goods.

Art. 1886. Should there be a stipulation that the agent shall advance the necessary funds, he shall be bound to do so except when the principal is insolvent.

COMMENT:**Stipulation for Agent to Advance Necessary Funds***Example:*

Angel is Pedro's agent. Both agreed that Angel would advance the necessary funds, but later Pedro became insolvent. Is Angel still bound to furnish such necessary funds?

ANS.: No more, in view of the principal's insolvency.

Art. 1887. In the execution of the agency, the agent shall act in accordance with the instructions of the principal.

In default thereof, he shall do all that a good father of a family would do, as required by the nature of the business.

COMMENT:**(1) Agent's Duty to Follow Instruction**

- (a) Instruction, as we have already seen, differ from authority.
- (b) In commenting upon this article (*Art. 1887*) Dalloz, after laying down the admitted proposition that the acts of an agent beyond his limited powers are invalid, states three qualifications which would bind the principal:
 - 1) where the principal's acts have contributed to deceived a third person in good faith;
 - 2) where the limitations upon the power created by the principal could not have been known by a third person; and
 - 3) where the principal has placed in the hands of the agent instruments signed by him in blank. (*Jurisprudence Generale, Vol. 10, title "Mandata," Art. 142 — cited by the Supreme Court in Strong, et al. v. Gutierrez Repide, 6 Phil. 680*).

(2) Effect if Agent Follows Instruction

If an agent carrying out the orders of the principal carried out the instruction he has received from said principal,

he cannot be held responsible for the failure of his principal to accomplish the object of the agency unless the said agent exceeded his authority or has acted with negligence, deceit, or fraud. (*Gutierrez Hermanos v. Oria Hermanos*, 30 Phil. 491).

(3) Clarity of Instructions

It is the duty of the principal, if he desires an authority executed in a particular manner to make his terms so clear and unambiguous that they cannot reasonably be misconstrued. If he does this, it is the agent's duty to the principal to execute the authority strictly and faithfully; and third persons who know of the limitations, or who from the circumstances of the case ought to have known of them can claim no rights against the principal based upon their violation. (*1 Mechem on Agency*, Sec. 792).

(4) Different Interpretations Re Instructions

If on the other hand, the authority be couched in such uncertain terms as to be reasonably susceptible of two different meanings, and the agent in good faith and without negligence adopts one of them, the principal cannot be heard to assert, either as against the agent or against third persons who have, in like good faith and without negligence, relied upon the same construction, that he intended the authority to be executed in accordance with the other interpretation. If in such a case, the agent exercises his best judgment and an honest discretion, he fulfills his duty, and though a loss ensues, it cannot be cast upon the agent. (*Mechem on Agency*, Sec. 793).

(5) How Instructions Are to Be Construed

An instrument conferring authority is generally, it is said, to be construed by those having occasion to act in reference to it, as a "plain man acquainted with the object in view, and attending reasonably, to the language used, has in fact, construed it. He is not bound to take the opinion of an attorney concerning the meaning of a word not technical and apparently employed in a popular sense. (*1 Mechem on Agency*, Sec. 793).

(6) How Execution May Fail

The execution of the authority in a given case may fail, either:

- (a) because the agent has negligently failed to fully exercise his authority;
- (b) or because he has exceeded it. (*1 Mechem on Agency, Sec. 159*).

(7) Excessive Execution

If there has been a complete execution of the power and the excess can be distinguished and disregarded, the authorized portion may be given effect. (*1 Mechem on Agency, Sec. 159*).

Art. 1888. An agent shall not carry out an agency if its execution would manifestly result in loss or damages to the principal.

COMMENT:**(1) When Agency Should Not Be Carried Out**

- (a) The reason for the Article is because an agent should exercise due diligence.
- (b) Furthermore, the agent must presumably act for the benefit, and not to the detriment of the principal.
- (c) “Manifestly” means that the execution would damage ANY principal.

(2) Example

P instructed his agent *A* to charter a boat from Japan to Manila and to load the principal’s goods with the specific instructions to sail from Japan to Manila on Feb. 14, 2005, and to thereafter sell the goods upon arrival in Manila. The weather report on the date of the scheduled departure showed that a strong typhoon was directly going to cross the path of the boat. Considering the circumstances, it would be safe to

sail only after one week. In the meantime, the prices of the goods at Manila went down by 50%. *P* thus fell short of the profits he expected to realize. Would *A* be liable to *P*?

ANS.: No. *A* would not be liable to *P* because had *A* carried out the agency, it would have resulted in loss or damage to his principal (*P*).

Art. 1889. The agent shall be liable for damages if, there being a conflict between his interests and those of the principal he should prefer his own.

COMMENT:

(1) Rule if Agent Prefers His Own Interests

The Article applies whether the agency is onerous or gratuitous for here the law does not distinguish.

(2) Example

P owns a *Mercedes Benz* car, model 2005. He appoints *A* to sell the car. *A* also is an owner of a *Mercedes* car of the same model as *P*'s. *X* a third person, is interested in buying either *P*'s or *A*'s car for P12 million — an attractive price. If *A* sells his own car (and not that of *P*'s), *P* may sue *A* for damages for it is clear that *A* has preferred his own interest.

Art. 1890. If the agent has been empowered to borrow money, he may himself be the lender at the current rate of interest. If he has been authorized to lend money at interest, he cannot borrow it without the consent of the principal.

COMMENT:

(1) Authority to Borrow or Lend Money

Examples:

- (a) Angel was authorized to borrow money. May Angel lend his own money to the principal?

ANS.: Yes, at the current rate of interest. *Reason*
— Principal suffers no injury.

[**NOTE:** Justice J.B.L. Reyes has questioned the wisdom of Art. 1890. He says: "It is preferable that the agent be not permitted to occupy inconsistent positions, and not allow him to be lender and borrower at the same time. The temptation to insert terms *unfavorable* to the principal is too great, and lending money involves other considerations besides rate of interest. (*Observations on the new Civil Code, XVI Lawyer's Journal 138*).]

- (b) Angel has been authorized to lend money at interest. May Angel borrow the money for himself?

ANS.: No, unless the principal consents. *Reason for the law:* The agent may not be a good borrower or he may be insolvent or he may not be a good risk. There is danger here that the interests of the principal would be jeopardized.

(2) Benefit of Principal

The borrowing of the money must be for the benefit of the principal, and not for the agent's personal benefit.

(3) Prohibition to Purchase

It should be noted that under Art. 1491, agents cannot acquire by purchase, even at public or judicial auction, either in person or thru the mediation of another, the *property* whose administration or sale may have been entrusted to them, *unless* the consent of the principal has been given.

Art. 1891. Every agent is bound to render an account of his transactions and to deliver to the principal whatever he may have received by virtue of the agency, even though it may not be owing to the principal.

Every stipulation exempting the agent from the obligation to render an account shall be void.

COMMENT:

(1) Duty of Agent to account

Example of par. 1:

An overprice received by the agent for goods he was to sell at a certain price.

(**NOTE:** The Article does *not* apply to case, of *solutio indebiti* for in such cases, recovery can be had by the *payor against the agent himself*. Therefore, the agent meantime can keep what had been given to him by error.)

Domingo v. Domingo
42 SCRA 131

FACTS: An agent did not reveal to his principal that he (the agent) was able to obtain a secret profit from the transaction in the nature of a bonus, gratuity, or personal benefit. Does he still have the right to collect the commission that ordinarily should be due to him?

HELD: No more, on account of his breach of loyalty to the principal. The forfeiture of the commission will take place, even if the principal does not suffer any injury by reason of such breach of loyalty. It does not even matter that the agency was a gratuitous one, or that the principal obtained better results, or that usage or custom allows the receipt of such a bonus. Indeed, an agent has an absolute duty to make a full disclosure or accounting to his principal of all transactions and material facts that may have some relevance with the agency.

(2) Stipulation Exempting Agent from Duty to Account

Reason for par. 2:

Against public policy because it would be conducive to fraud.

(3) Duty to Deliver Funds

If nothing in the contract of agency provides otherwise, this Art. 1891 imposes on the agent the obligation to deliver to his principal all funds collected on his (the principal's) account. (*U.S. v. Kiene*, 7 Phil. 736). As a matter of fact, lawyers are required to render a prompt accounting for money or property received by them on behalf of their clients. Failure

to do this constitutes professional misconduct. While it is true that the lawyer may perhaps possess a lien on the money in his hands — money that had been collected on behalf of the clients — still this fact will not excuse him from the duty of accounting promptly for the funds received. (*In re Bamberger*, 49 *Phil.* 962).

(4) No Co-Ownership Over Funds Despite Right to Commission

Although the agent is entitled to receive a commission, this fact by itself would not make him a co-owner regarding the money that have been collected. Co-ownership is not established. The relationship of principal and agent subsists. If the agent subtracts from the money more than what he is entitled to obtain as his commission, it cannot be denied that he has committed estafa. (*U.S. v. Reyes*, 36 *Phil.* 791).

(5) Agent Should Not Profit for His Own Account

Neither an agent nor a trustee is allowed to make a profit for his own benefit as long as the agency exists or the trust relations continue. To hold otherwise would be to countenance an unlawful inducement. Thus, if an agent should conceal certain facts from his own principal, he should under no condition be permitted to profit thereby. A principal on the other hand is entitled to recover from the agent what may be due him (the principal) as a consequence of the agency. (*Ojinaga v. Estate of Perez*, 9 *Phil.* 185).

(6) Doctrines on the Duty to Account

- (a) Whoever administers another's affairs must render an account because of the *representative* relation and because of the *fiduciary* position. (*See Dorman v. Crooks State Bank*, 225 *N.W.* 661).
- (b) If an agent refuses to account when it is his duty to do so, the principal may at once terminate the agency and sue for the balance due. (2 *C.J.* 738-739). If the principal dies, the agency is extinguished, BUT the duty to account subsists, and can be demanded by the principal's heirs or legal representatives. (*See 11 Manresa* 513).

- (c) The principal, or his legal representative, has the right to pass upon the correctness of the *accounting*. (11 *Manresa* 513).
- (d) Corollary to his right to demand an accounting, a principal has the right to make a reasonable inspection of the books of account and memoranda, including the original entries. (2 *Am. Jur.* 227).
- (e) An agent, as a consequence of his duty to account, cannot dispute his principal's title to the property in his possession. (2 *C.J.* 744).

(7) Some Cases

United States v. Kiene 7 Phil. 736

FACTS: An insurance agent named Kiene refused count to his principal, the China Mutual Life Insurance Company, for approximately P1,500 which came to him in the course of the agency. Because he refused to turn over the amount and to account for them, he was prosecuted for estafa. His only defense was the allegation that no law compelled him to deliver the amount referred to.

HELD: He is guilty because the duty to turn over the fund is stated in Art. 1891 of the Civil Code.

United States v. Iguara 27 Phil. 619

FACTS: Iguara, an agent for Juana Montilla and Eugenio Veraguth had in his possession P2,498 belonging to the principals. At the time the accounts were settled, he executed the following instrument:

“We hold at the disposal of Eugenio Veraguth the sum of P2,498, the balance from Juana Montilla's sugar. Iloilo, June 26, 1911 Jose Iguara for Ramirez and Company.”

On Aug. 23, 1911, Veraguth demanded the return of the amount but the agent failed to do so. When Iguara was accused of estafa, he claimed no crime had been committed,

and that he was civilly liable because the contract referred to above was in the nature of a loan.

HELD: The contract was not a loan, otherwise the lender could not recover until after the expiration of a legal stipulated period. Indeed, the money in the possession of the agent but at the principal's disposal acquired the character of a deposit demendable at anytime. Moreover, Igpuara could not lawfully dispose of it without incurring criminal responsibility for appropriating or diverting to his own use another's property. Inasmuch as he has abused the confidence reposed in him by his misappropriation of the money, there is no doubt that he is guilty of estafa.

Ojinaga v. Estate of Perez
9 Phil. 185

FACTS: Ojinaga's properties were being administered by Perez. Perez rendered an accounting showing a profit of P1,700. He then turned the amount to Ojinaga who knew that the profits were much more, about P12,000. But Ojinaga accepted the accounting without any protest. When Ojinaga died, his heirs wanted the accounting set aside on the ground of fraud.

HELD: The accounting cannot be set aside on the ground of fraud, for although Ojinaga knew of the true amount of the profits, still, he approved the accounting report.

Severino v. Severino
44 Phil. 343

FACTS: An agent, Guillermo Severino, for his brother Melocio Severino, registered the latter's land in his (the agent's) own name, and was granted a Torrens Title therefor. Years after the decree became final, the estate of Melocio (now dead) sued for reconveyance of the land but Guillermo claimed ownership over it by virtue of the registration under his name. It was proved however that Guillermo was only the trustee, administrator, or agent of Melocio with respect to the land.

HELD: Reconveyance can be made. The relations were fiduciary in nature and the agent is estopped from acquiring or asserting a title adverse to that of his principal. True,

Guillermo is the owner insofar as third persons are concerned, but not insofar as his principal is concerned. The remedy of reconveyance does not mean the reopening of the decree of registration. That can no longer be done since the one-year period has already prescribed. But reconveyance can still be done. Surely, no reason of public policy demands that a person guilty of fraud or breach of trust be permitted to use his certificate of title as a shield against the consequences of his own wrong.

(To the same effect: *Consunji v. Tison*, 15 Phil. 81; *Uy Aloc v. Cho Jan Ling*, 19 Phil. 202 and *Sy-Juco & Viardo v. Sy-Juco*, 40 Phil. 634.)

Art. 1892. The agent may appoint a substitute if the principal has not prohibited him from doing so; but he shall be responsible for the acts of the substitute:

- (1) When he was not given the power to appoint one;
- (2) When he was given such power, but without designating the person, and the person appointed was notoriously incompetent or insolvent.

All acts of the substitute appointed against the prohibition of the principal shall be void.

COMMENT:

(1) Appointment of Substitute for the Agent

- (a) A is P's agent. In their contract of agency, nothing was mentioned as to whether or not A could appoint a substitute. A appointed S as his substitute. Is the appointment of the substitute valid?

ANS.: Yes, but A shall be responsible for the acts of the substitute. (*1st par.*, Art. 1892).

- (b) In problem (a), suppose the substitute violated the instructions of P, whom can P hold liable?

ANS.: P can hold A liable (Art. 1892) and P can also hold S liable. (Art. 1893).

- (c) *A* is *P*'s agent. *A* asked *P* for permission to appoint a substitute, but *A* did not mention who the substitute would be. *P* agreed. Now, the substitute violated *P*'s instructions as well as *A*'s instructions, causing damage to *P*. Can *P* hold *A* liable for the substitute's actuations, in case for example, the substitute is insolvent?

ANS.: It depends. If the substitute appointed by *A* was at the time of appointment notoriously incompetent or insolvent, then *P* can hold *A* liable, subsidiarily or even primarily. If the substitute at the time of appointment was neither notoriously incompetent or insolvent, then *P* cannot hold *A* liable, either primarily or subsidiarily. (*Art. 1892, No. 2*).

- (d) *A* is *P*'s agent. *A* was prohibited by *P* to appoint a substitute. Nevertheless *A* appointed *S* as substitute. *S* sold goods belonging to *P* to *B*, who was a purchaser in good faith. Is the sale valid?

ANS.: The sale is completely null and void. The law says that all acts of the substitute appointed against the prohibition of the principal shall be void. (*Last par., Art. 1892*).

(2) Soundness of the article

Is Art. 1892 sound?

ANS.: Yes, for while ordinarily the agent upon whom the principal has reposed confidence must do the act himself, still the principal need *not* fear prejudice for in some cases, he can still exact responsibility from his agent. (*11 Manresa 518-519*).

Art. 1893. In the cases mentioned in Nos. 1 and 2 of the preceding article, the principal may furthermore bring an action against the substitute with respect to the obligations which the latter has contracted under the substitution.

COMMENT:

(1) When the Principal Can Sue the Substitute

- (a) Under the premises given in the Article the principal can sue both the agent and the substitute.

- (b) This is one exception to Art. 1311 respecting the privity of contracts.

(2) Art. 1311 (Who Are Bound By Contracts)

Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not liable beyond the value of the property he received from the decedent.

If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting parties must have clearly and deliberately conferred a favor upon a third person.

Art. 1894. The responsibility of two or more agents, even though they have been appointed simultaneously, is not solidary, if solidarity has not been expressly stipulated.

COMMENT:

Joint Not Solidary Liability

- (a) The liability referred to here as well as in the next article is the liability of the agents towards the principal, and not that towards third parties.
- (b) The liability is indeed joint and personal, but only if each can act separately. But if it be essential that all agents act, and one is unable to do so, then that one is the **ONLY** agent liable.

Art. 1895. If solidarity has been agreed upon, each of the agents is responsible for the non-fulfillment of the agency, and for the fault or negligence of his fellow agents, except in the latter case when the fellow agents acted beyond the scope of their authority.

COMMENT:**When Solidarity Has Been Agreed Upon**

- (a) *Example: P* appointed *A* and *B* as agents. Solidarity between the agents was agreed upon. Thru *B*'s fault, the agency was not fulfilled. Can *P* sue *A* for damages?

ANS.: If *B* acted within the scope of his authority, *A*, being solidary agent, can be made responsible for the entire damages, without prejudice to his right later on to recover from the erring agent.

- (b) Example where one acts beyond the scope of his authority: two solidary agents were appointed to sell the Cadillac car of the principal. Unfortunately, one of them sold the Mercury automobile. Here, the innocent agent cannot be liable at all to the principal, even if solidarity had been agreed upon.

Art. 1896. The agent owes interest on the sums he has applied to his own use from the day on which he did so, and on those which he still owes after the extinguishment of the agency.

COMMENT:**Liability of the Agent for Interest**

- (a) Under the old Civil Code, after the word "agency," there was the clause "from the time he is put in default." Under the new Civil Code, said clause had been eliminated.
- (b) This Article is without prejudice to a criminal action that may be brought because of conversion.
- (c) On the other hand, there is no liability for interest on sums which have not been converted for the agent's own use (*De Borja v. Borja*, 58 Phil. 811), unless of course, at the expiration of the agency, the agent still owes the principal certain sums. (2nd part, Art. 1896).

Art. 1897. The agent who acts as such is not personally liable to the party with whom he contracts, unless he expressly binds himself or exceeds the limits of his authority without giving such party sufficient notice of his powers.

COMMENT:**(1) No Personal Liability for Agent**

- (a) *Reason for the law:* Said agent who acts as agent does not represent himself but the principal.
- (b) In case of acts by the agent in excess of authority, the principal cannot be bound unless he ratifies the act.
- (c) If an agent obligates himself personally, aside from acting in behalf of his principal, both are bound. (*Tuazon v. Orozco*, 5 Phil. 596).
- (d) If an executor or administrator of the estate of a deceased person, without proper court authority, makes a contract regarding said estate, he imposes upon himself a personal obligation. This is true even though in signing the contract, he has described himself as administrator or executor, with the intent to bind the estate. (*Pacific Commercial Co. v. Hernaez, et al.*, 51 Phil. 494).
- (e) Even if an agent has bound himself to pay the debt, this fact will not relieve from liability a principal for whose benefit the debt has been incurred. The further liability of the agent can be considered as a further security in favor of the creditor, and will not preclude or eliminate the liability of the principal. (*Tuazon v. Orozco, supra*).
- (f) It is manifest upon the simplest principles of jurisprudence that one who has intervened in the making of a contract as an agent cannot be permitted to intercept and appropriate the thing which the principal is bound to deliver. If he does this, this would make performance by the principal impossible. In any event, the agent must be prohibited to perform any positive act that could prevent fulfillment on the part of his principal. Good faith towards the other contracting party requires this much. (*National Bank v. Welch, Fairchild and Co.*, 44 Phil. 780).

(2) Proper Parties to the Suit

An action against a person who merely acted in behalf of another should be dismissed. The suit should be against the principal, not against the agent, except where the agent acts

in his own name or exceeds the limit of his agency. (*Lorca v. Dineros*, L-10919, Feb. 28, 1958; *Singh v. Dulce*, 49 Phil. 563 and *Macias and Co. v. Warner, Barnes & Co.*, 43 Phil. 155)

**Jovito R. Salonga v. Warner, Barnes
and Co., Ltd.
L-2246, Jan. 31, 1951**

FACTS: In 1946, Westchester Fire Insurance Co. of New York entered into a contract with Tina J. Gamboa, whereby said company insured one case of rayon yardage which said Gamboa shipped from San Francisco, California, on steamer "Clavis Victory," to Manila and consigned to Jovito Salonga, plaintiff herein. According to the contract of insurance, the insurance company undertook to pay to the sender or her consignee the damages that may be caused to the goods shipped subject to the condition that the liability of the company will be limited to the actual loss which the insured may suffer, not to exceed the sum of P2,000. When the shipped goods arrived in Manila, there was a shortage in the shipment amounting to P1,723.12. In Oct., plaintiff filed a claim for damages against the American President Lines, agents of the ship "Clavis Victory" demanding settlement; and when apparently no action was taken on his claims, plaintiff demanded payment thereof from Warner, Barnes and Co., Ltd. as agent of the Insurance Co. in the Philippines and his agent having refused to pay the claim, plaintiff instituted the present action. The defendant, among other defenses, claimed that it cannot be made responsible because it had no contractual relation with either the plaintiff or his consignor. Should the defendant pay?

HELD: The defendant is not obliged to pay. It is a well-known rule that a contractual obligation or liability, or an action *ex contractu*, must be founded upon a contract: oral or written, either express or implied. This is axiomatic. If there is no contract, there is no corresponding liability, and no cause of action may arise therefrom. The defendant did not take part, directly or indirectly, in the contract in question. The contract is purely bilateral, binding only upon Gamboa and the insurance company. In the case of *Morris and Co. v. Warner, Barnes and Co.*, 43 Phil. 155, it was held that even in the case of an agent who signs for his company, said agent, as long as he acts within the scope of

his authority, does not assume personal liability for a contract entered into by him in behalf of his principal. It was also held that in such a case only the principal was bound. In this case, this principle acquires added force and effect when we consider the fact that the defendant did not sign the contract as agent of the foreign insurance company.

(3) Authority to Sell All of the Principal's Property

A power of attorney allowing the agent to sell *all* the property of the principal is sufficient to validate the sale of any single parcel of land which may be included in said properties. (*Jimenez v. Rabat*, 38 *Phil.* 378).

(4) Authority to Agree on Certain Stipulations

If an agent is authorized generally to sell merchandise, he is also allowed to include in the contract of sale, the stipulation which are customary in the trade in such goods. (*Robinson, Fleming and Co. v. Cruz and Tan Chong Say*, 49 *Phil.* 42).

Art. 1898. If the agent contracts in the name of the principal, exceeding the scope of his authority, and the principal does not ratify the contract, it shall be void if the party with whom the agent contracted is aware of the limits of the powers granted by the principal. In this case, however, the agent is liable if he undertook to secure the principal's ratification.

COMMENT:

(1) Contracts Entered Into in Excess of Authority

- (a) This Article refers only to the liability of the agent towards the third person. It is clear that under the premises given, the principal is not at all bound, except of course if there is subsequent ratification by him.
- (b) Therefore "it shall be void" refers to the tie between the agent and the third party. Regarding the principal, other articles are applicable. (*See Arts. 1403, No. 1 and 1910, par. 2*).

(2) Example

An agent was authorized to sell his principal's car. The agent sold in the principal's name the principal's radio cabinet to a third person who knew that the agent was not so authorized. Give the status of the sale.

ANS.: Even as between the agent and the third person third person, such a sale is completely null and void. However, if the agent had promised to obtain the principal's ratification, said agent would be liable in case of failure to obtain such ratification. If ratification has been obtained, then the principal would be bound.

Art. 1899. If a duly authorized agent acts in accordance with the orders of the principal, the latter cannot set up the ignorance of the agent as to circumstances whereof he himself was, or ought to have been, aware.

COMMENT:**(1) Effect of Agent's Ignorance**

- (a) This article is based on equity, for after all the agent had complied with his duty.
- (b) It is the principal's fault should he have appointed an ignorant agent. Equity demands that the principal should be made responsible.

(2) Compliance With Authority and Instruction

Notice that under this Article, it is not enough for the agent to act within the scope of his authority. It is also imperative for such agent to have complied with the orders and instruction of the principal.

Art. 1900. So far as third persons are concerned, an act is deemed to have been performed within the scope of the agent's authority, if such act is within the terms of the power of attorney, as written, even if the agent has in fact exceeded the limits of his authority according to an understanding between the principal and the agent.

COMMENT:**(1) Act Performed Within Terms of Written Authority**

- (a) This is designed to protect the interest of third persons.
- (b) Notice that for this article to apply, the authority must be in writing.

PROBLEM

Question: The scope of the agent's authority is what appears in the written terms of the power of attorney. While third persons are bound to inquire into the extent or scope of the agent's authority, are they required to go beyond the terms of the written power of attorney?

Answer: No. Third persons cannot be adversely affected by an understanding between the principal and his agent as to the limits of the latter's authority. In the same way, third persons need not concern themselves with instructions given by the principal to his agent outside of the written power of attorney. (*Siredy Enterprises, Inc. v. CA & Conrado de Guzman*, GR 129039, Sept. 17, 2002).

(2) Example

P gave his agent *A* a power of attorney, wherein was written *A*'s right to sell 2 parcels of land belonging to *P*. *P* and *A* however had an understanding to the effect that *A* should only sell one parcel of land. *A* sold both. *P* did not ratify the contract. Is *P* bound by the sale of both parcels?

ANS.: Yes. While it is true that a third party deals with an agent at his (the third party's) own risk, and while it is the duty of the third party to investigate the extent of an agent's authority, nevertheless, in this case the power of attorney as written showed complete authorization. It is unfair to demand that the third person inquire further than the terms of said power of attorney as written. To hold otherwise would be to open the door to countless frauds and machinations.

Art. 1901. A third person cannot set up the fact that the agent has exceeded his powers, if the principal has ratified, or has signified his willingness to ratify the agent's acts.

COMMENT:**Effect of Ratification**

- (a) Ratification in effect grants authority to the agent.
- (b) Note that the ratification may be in the future.

Art. 1902. A third person with whom the agent wishes to contract on behalf of the principal may require the presentation of the power of attorney, or the instructions as regards the agency. Private or secret orders and instructions of the principal do not prejudice third persons who have relied upon the power of attorney or instructions shown them.

COMMENT:**(1) Private or Secret Orders**

Note that innocent third persons are not to be prejudiced.

(2) Case

Cruz v. CA
GR 85685, Sep. 11, 1991

FACTS: In its complaint Purefoods alleged that Lauro Cruz applied for a credit line, which was approved, and Lauro Cruz made various purchases. The unpaid account of Lauro Cruz, according to Purefoods, amounted to P55,246. The parties who signed the credit application card as applicants, however, are ME Cruz who signed over the printed words “Name of Signatory” and Marilou Cruz who signed over the printed words “Authorized Signature.” The application card indicated Mang Uro Store, as the Trade Name; and Lauro Cruz as owner and manager. Lauro Cruz contends that he did not sign any of the invoices attached to the complaint. The trial court ordered Lauro Cruz to pay Purefoods P55,246 as unpaid account plus interest. The Court of Appeals sustained the trial court.

HELD: The Supreme Court reversed the Court of Appeals’ decision and held that the trial court even without laying

the factual premises made a sweeping conclusion that it was Lauro Cruz who applied for a credit line with Purefoods. But as correctly pointed by Lauro Cruz, the documents themselves show that he did not sign any of them. The credit application card is a form prepared and supplied by Purefoods. There is no evidence, much less an allegation that it was Lauro who filled up the entries in said form. It is logical to presume that the parties who signed it made the entries.

Since on the face of the document, the owner-manager of the Mang Uro Store which is written on the column Trade Name is Lauro Cruz and not the parties signing the same, it was incumbent upon Purefoods to inquire into the relationship of the signatories to Lauro or satisfy itself as to their authority to act for or represent Lauro. Under the circumstances, Lauro had no participation and the two applicants could have acted without authority from him or as his duly authorized representatives. In either case, for the protection of its interest, Purefoods should have made the necessary inquiry verification as to the authority of the applicants and to find out from them whether Lauro is both the owner and manager or merely the owner or the manager, for that is what owner/manager in its form could signify.

Art. 1903. The commission agent shall be responsible for the goods received by him in the terms and conditions and as described in the consignment, unless upon receiving them he should make a written statement of the damage and deterioration suffered by the same.

COMMENT:

(1) 'Commission Agent' Defined

One in which the commission agent must be a merchant or broker, the agent having the option of acting in his own name or in that of the principal.

(2) Distinction Between a Commission Agent and a Broker

A commission agent is one engaged in the purchase and sale for a principal of personal property, which for this purpose, has to be placed in his possession and at his disposal.

He has a relation not only with his principal, and the buyers or sellers, but also with the property which constitutes the object of the transaction.

A broker, upon the other hand, maintains no relation with the thing which he purchases or sells. He is supposed to be merely a go-between, an intermediary between the seller and the buyer. As such, he does not have either the custody or the possession of the thing that he disposes of. His only function is, therefore, to bring the parties to the transaction. (*Pacific Commercial Co. v. Yatco*, 68 Phil. 398).

(3) Established Place of Business

It may be said that a commission agent is an agent, with an established place of business, allowed to have in his possession the goods of the principal.

(4) Presumption as to When the Damage to the Goods Occurred

This Article gives a presumption to the effect that the damage to the merchandise were suffered while in the possession and custody of the agent; such a presumption is only a disputable one however. (3 *Echavarri* 105).

Art. 1904. The commission agent who handles goods of the same kind and mark, which belong to different owners, shall distinguish them by countermarks, and designate the merchandise respectively belonging to each principal.

COMMENT:

Duty of Commission Agent to Place Countermarks

The reason for the Article is obvious.

Art. 1905. The commission agent cannot, without the express or implied consent of the principal, sell on credit. Should he do so, the principal may demand from him payment in cash, but the commission agent shall be entitled to any interest or benefit, which may result from such sale.

COMMENT:**(1) Sale by the Commission Agent on Credit (Not Cash)**

Example:

A was *P*'s commission agent who was asked to sell *P*'s car on cash. A sold it on credit. What are *P*'s rights?

ANS.: *P* may demand from A payment in cash. On the other hand, A shall be entitled to any interest or benefit which may result from such a sale on credit.

**Green Valley Poultry v. Intermediate
Appellate Court
L-49395, Dec. 26, 1984**

An agent who sells the goods on *credit* without the consent of the principal is liable for the price of the goods. However, the agent shall get the extra benefits derived from selling goods on credit.

(2) Untenable Defense of Agent

The commission agent is not allowed to escape the effects of this article by proving that the profits would have been less had the sale been made on a cash basis. This defense on the part of the agent is not tenable because if this were to be allowed, the way will be open for delay, fraud and bad faith. (*1 Malagarriaga 467*).

(3) Choices Given to the Principal

Two choices are given to the principal:

- (a) Require cash payment — If this is done, the principal should not be allowed to enrich himself at the agent's expense.
- (b) Ratify the sale on credit — here the principal will have both the risks and the advantages. (*See 3 Echavarri, p. 100*).

(4) Example

If an agent was authorized to sell a *Godin* electric acoustic guitar for P100,000 cash, but sells it on *credit* for P120,000,

the principal can demand from said agent the sum of *P100,000 cash*. However, should the agent eventually collect the entire P120,000, he can keep this entire sum of P120,000. In other words, he gets an ultimate personal gain of P20,000. This situation must not be confused with the case of an agent who, being authorized to sell for *P100,000 cash*, sells the property for *P120,000 cash*. Here, the entire P120,000 must be turned over to the principal — as already previously explained.

Art. 1906. Should the commission agent, with authority of the principal, sell on credit, he shall so inform the principal, with a statement of the names of the buyers. Should he fail to do so, the sale shall be deemed to have been made for cash insofar as the principal is concerned.

COMMENT:

(1) Duty of Agent to Inform the Principal

- (a) In this Article, an authorized sale on credit may be treated of as one on a cash basis.
- (b) This Article only talks of the relations between the commission agent and the principal; third parties should not be prejudiced.

(2) Reason for the Law

To prevent the commission agent from stating that a sale which was “in cash” in reality, was made on the credit basis. (*See 1 Malagarriaga 470*).

Art. 1907. Should the commission agent receive on a sale, in addition to the ordinary commission, another called a guarantee commission, he shall bear the risk of collection and shall pay the principal the proceeds the sale on the same terms agreed upon with the purchaser.

COMMENT:

(1) Guarantee Commission

- (a) The guarantee commission, also called a *del credere commission* is different from the ordinary commission.

(**NOTE:** An agent who receives a guarantee commission is called a *del credere* agent.)

- (b) The guarantee commission is given in return for the risks the agent will have to bear in the collection of credits.

(2) Example of the Purpose

If an agent receives a guarantee commission, and the third party does not pay, the agent will have to pay the principal just the same. Thus, an agent was authorized to sell on credit an *Ibañez* electric guitar for P40,000 with a 10% *ordinary commission* (P4,000). He was also paid a *guaranteed commission* of 5% (P2,000). His total profit would be, therefore, P6,000. However, every time the customer fails to pay an installment that is due, the agent himself pay said amount to the principal. Thus, the agent bears the risk. This is the reason for the “guarantee commission.”

(3) Applicability to Both Cash and Credit Sales

Does Art. 1907 include both cash and credit sales?

ANS.: Yes, since the law makes no distinction. Moreover, there are cash sales which may give a short term or period. (See 1 *Malagarriaga* 466-467).

(4) When Insolvency of Debtor Is Not a Defense

If the agent receives a guarantee commission, he cannot put up the defense that the debtor-third person possesses property. This is precisely the risk the commission agent assumed. This bother need not worry the principal. (See *Echavarri* 112).

Art. 1908. The commission agent who does not collect the credits of his principal at the time when they become due and demandable shall be liable for damages, unless he proves that he exercised due diligence for that purpose.

COMMENT:

(1) Failure of Agent to Collect Credits

- (a) This Article particularly applies to a case where there is no guarantee commission. But even if there be one,

should the agent not apply the proceeds of the sale on the same terms agreed upon by the purchaser, said agent is liable for interest in lieu of damages. This, it must be noted, can be monetary obligation.

- (b) Even if a commission agent can prove that he exercised due diligence on collecting the credits, he would still be responsible for non-payment on time in case he assumed the risks of collection by receiving a guarantee commission.

(2) When Agent is Not Liable in Case of Failure to Collect

If a commission agent without a guarantee commission should prove he exercised due diligence in the collection of the credit, and the credit is not collected for example, because of the fault of the third party, the agent is freed from responsibility. In such an eventuality, the debtor can be directly proceeded against by the principal. The principal need not fear in this case that the debtor can put up defenses which he (the debtor) could have set up against the agent. (*See 3 Echavarri 111*).

(3) Due Diligence of Agent

One way of showing due diligence is by making use at the proper time of the legal means to obtain payment.

Art. 1909. The agent is responsible not only for fraud, but also for negligence, which shall be judged with more or less rigor by the courts, according to whether the agency was or was not for a compensation.

COMMENT:

(1) Responsibility Not Only for Fraud But Also for Negligence

- (a) Whether the agency is gratuitous or not is important in considering the liability of the agent for negligence.
- (b) For fraud, the agent is of course always liable.

(2) Duty of Agent to Insure

If an agent is instructed to insure the goods under his custody, and he does not do so, he is responsible, but if no such obligation has been imposed by the principal, the agent cannot be held liable because the obligation to insure is not one of the duties required by the law to be performed by the agent. (*International Films [China] v. Lyric Film Exchange*, 63 Phil. 778).

(3) Some Decided Cases

**International Films (China) v.
Lyric Film Exchange
63 Phil. 778**

FACTS: The Lyric Film Exchange leased a film entitled “Monte Carlo Madness” from the International Films (China) thru the latter’s agent named Gabelman. After the film had been shown, the Exchange thru Vicente Albo, chief of its film department, asked the company where the film was to be returned. Gabelman replied that the film should be deposited in the vaults of the Exchange. Later the film was destroyed by accidental fire without fault on the part of the Exchange or its employees. The Exchange had NOT insured the film, but there was NO stipulation that it should do so. International Films (China) then sued the Exchange for damages.

HELD: Granting that Albo of the Exchange was a sub-agent of International Films insofar as the custody of the film was concerned, still Albo and the Exchange were *not* in any way negligent. The fact that the film was not insured against fire does not constitute fraud or negligence on the part of the defendant company because, as a sub-agent, it had received *no* instruction to that effect from its principal and the insurance of the film does *not* form a part of the obligation imposed upon it by law.

**Tan Tiong Teck v. La Comision de Valores Bol-
sas y Cua Oh and Co.
69 Phil. 425**

FACTS: A stock broker was ordered by his client, Tan Tiong Teck, to sell the former’s mining shares (10,000) for

at least P0.15 each on Jun. 15, 1957. Although the price prevailing that day was P0.17-1/2 for each share, the broker nevertheless still sold the shares for only P0.15 each. Is the broker liable for the difference?

HELD: Yes, for an agent must act with the prudence of a good father of a family, by trying to obtain the best possible price for the shares. The broker is, therefore, liable to his principal.

Nepomuceno, et al. v. Heredia
7 Phil. 563

FACTS: Nepomuceno instructed his agent Heredia to buy good real estate for P2,000, but unfortunately, although Heredia was careful, the land he purchased had a questionable title. Nepomuceno sued Heredia for the recovery of the P2,000.

HELD: The agent is *not* liable, for he had exercised reasonable care and diligence in the pursuit of the agency.

Gutierrez Hermanos v. Oria
Hermanos and Co.
30 Phil. 491

FACTS: Oria Hermanos authorized its agent Gutierrez Hermanos to insure against all war risks a stock of hemp in Catarman, Samar. The agent complied with the instructions, and had the goods insured with a London Company thru the latter's Philippine representative, Stevenson & Co. The hemp was eventually seized by insurgents, but the insurance company refused to pay on the ground of certain fraudulent concealments on the part of Oria Hermanos, the insured. When Oria Hermanos could not recover in court the amount of the insurance indemnity, it sued its agent for damages, including the amount of the insurance indemnity, the premiums paid and the expenses of litigation.

HELD: The agent should not be held liable, for it had faithfully complied with all the instructions that had been given to it. There was neither negligence nor deceit on the part of the agent.

Austria v. Court of Appeals
39 SCRA 527

FACTS: An agent who had been entrusted by her principal with a diamond pendant for sale was robbed of said pendant. Is said agent excused from the civil liability attendant to the loss of the pendant even if the robber is not yet convicted?

HELD: Yes, for it is sufficient that the fortuitous event (the robbery) took place without the agent's fault. Proof on this point can be arrived at by mere preponderance of evidence.

Caoile v. CA
44 SCAD 1040
1993

An agent who signed the receipt as a witness but never received the alleged amount is NOT LIABLE.

Chapter 3

OBLIGATIONS OF THE PRINCIPAL

Art. 1910. The principal must comply with all the obligations which the agent may have contracted within the scope of his authority.

As for any obligation wherein the agent has exceeded his power, the principal is not bound except when he ratifies it expressly or tacitly.

COMMENT:

(1) Principal's Duty to Comply With Agent's Commitments

Under Par. 1 — aside from acting within the scope of his authority, the agent must also act in the name of the principal, and not in his own name; otherwise, the principal is not bound except when the transaction concerns things belonging to the principal. (*See Art. 1883*).

(2) Ratification by Principal

If an agent misrepresents to a purchaser, and the principal accepts the benefits of such misrepresentation, he cannot at the same time deny responsibility for such misrepresentation. (*Gonzales & Gomez v. Haberer, 47 Phil. 380*).

(3) Case

Bedia v. White **GR 94050, Nov. 21, 1991**

FACTS: Bedia and White entered into a participation contract, which reads: "I/We, the above-mentioned company hereby agrees to participate in the 1980 Dallas State Fair to be held in Dallas, Texas on Oct. 3 to Oct. 19, 1980. I/We

request for a 15-square-meter booth space worth \$2,250 U.S. Dollars. I/We further understand that this participation contract shall be deemed non-cancelable after payment of the said downpayment, and that any intention on our part to cancel the same shall render whatever amount we have paid forfeited in favor of HONTIVEROS & ASSOCIATED PRODUCERS PHILIPPINE YIELDS, INC.

For the above consideration, I/We understand that Hontiveros and Associated Producers Phil. Yields, Inc. shall reserve said booth for our exclusive perusal; we also understand that the above cost includes overall exterior booth decoration and materials but does not include interior designs which will be per our specifications and expenses. Participant's Authorized Signature (Sgd) Emily White Participation Accepted by: (Sgd) Sylvia H. Bedia." White and her husband sued Bedia and Hontiveros & Associated Producers Phil. Yields, Inc. for damages caused by their fraudulent violation of their agreement. She averred that Bedia had approached her and persuaded her to take part in the State Texas Fair, and that she made a downpayment of \$500 to Bedia on the agreed display space. In due time, she enplaned for Dallas with her merchandise but was dismayed to learn later that the defendants had not paid for or registered any display space in her name, nor were they authorized by the State Fair Director to recruit participants. She said she incurred losses as a result for which the defendants should be held solidarily liable. Defendants denied White's allegation that they had deceived her. No display space was registered in her name as she was only supposed to share the spaced leased by Hontiveros. She was not allowed to display her goods in that space because she had not paid her balance of \$1,750 in violation of their contract. Bedia made the particular averment that she did not sign the participation contract on her own behalf but as an agent of Hontiveros and that she had later returned the advance payment of \$500 to White. The trial court dismissed the complaint against Hontiveros, but found Bedia liable for fraud and awarded White actual and moral damages. The Court of Appeals sustained the trial court.

ISSUE: In what capacity did Bedia enter into the participation contract with White? Both the trial and appellate courts held she was acting in her own personal behalf.

HELD: The Supreme Court reversed and set aside the decision of the Court of Appeals saying that Bedia acted as agent of Hontiveros and held that White acknowledged that Bedia was only acting for Hontiveros when it recruited her as a participant in the Texas State Fair and charged her a partial payment of \$500. This amount was to be forfeited to Hontiveros in case of cancellation by her of the agreement. The fact that the contract was typewritten on the letterhead stationery of Hontiveros bolsters this conclusion in the absence of any showing that said stationery had been illegally used by Bedia. Hontiveros itself has not repudiated Bedia's agency as it would have if she had really not signed in its name. In the answer it filed with Bedia, it did not deny the latter's allegation that she was only acting as its agent when she solicited White's participation. If White had any doubt about the capacity in which Bedia was acting, what she should have done was verify the matter with Hontiveros. She did not. Instead, she simply accepted Bedia's representation that she was an agent of Hontiveros and dealt with her as such. Hence, White cannot now hold Bedia liable for acts performed by her for and imputable to Hontiveros as her principal. Since Bedia was not acting beyond the scope of her authority when she entered into the Participation Contract on behalf of Hontiveros, it is the latter that should be held answerable for any obligation arising from the agreement. By moving to dismiss the complaint against Hontiveros, White virtually disarmed herself and forfeited whatever claim she might have proved against the latter under the contract signed for it by Bedia.

Art. 1911. Even when the agent has exceeded his authority, the principal is solidarily liable with the agent if the former allowed the latter to act as though he had full powers.

COMMENT:

(1) Liability of Principal Because of Estoppel

Reason for the law: The principal may be said to be in estoppel and therefore innocent third persons should not be prejudiced. It cannot be denied that here the principal failed to adopt the needed measures to prevent misrepresentation.

(2) Solidary Liability

This is an instance when solidarity is imposed by law. It would seem, however, that this Article is unjust for if the agent is considered innocent and acting within the scope of his authority, he should be exempted from liability. (*See Art. 1897*).

Art. 1912. The principal must advance to the agent, should the latter so request, the sums necessary for the execution of the agency.

Should the agent have advanced them, the principal must reimburse him therefor, even if the business or undertaking was not successful, provided the agent is free from all fault.

The reimbursement shall include interest on the sums advanced, from the day on which the advance was made.

COMMENT:**(1) Advancing of Necessary Funds**

- (a) Failure of the agency through no fault of the agent must be borne solely by the principal. It is unfair to hold this failure against an innocent agent.
- (b) Even if the agency be gratuitous, this Article will also apply; hence, the agent will still be entitled to reimbursement and interest. This is so because the reimbursement and interest spoken of in this Article do not refer to compensation or commission. (*See Fortis v. Gutierrez Hermanos, 6 Phil. 100*).

(2) Broker's Fee

A broker is entitled to a commission if the sale is effected, but not if there is no perfected transaction. (*See Perez v. Luzon Surety Co., 38 O.G. 1213*).

Art. 1913. The principal must also indemnify the agent for all the damages which the execution of the agency may have caused the latter, without fault or negligence on his part.

COMMENT:**Principal to Compensate Agent for Damages**

- (a) This Article is based on equity, and applies even if the agency be gratuitous, as a matter of fact, even more so.
- (b) Naturally, this Article can be made use of only if the agency exists, otherwise the Article cannot apply. In such a case, the supposed agent is not acting in behalf of a true principal, and the reason for the law would cease. (*Albaladejo y Cia v. Phil. Refining Co.*, 45 Phil. 556).

Art. 1914. The agent may retain in pledge the things which are the object of the agency until the principal effects the reimbursement and pays the indemnity set forth in the two preceding articles.

COMMENT:**Right of Agent to Retain by Way of Pledge**

The Article speaks of one kind of pledge by operation of law.

Art. 1915. If two or more persons have appointed an agent for a common transaction or undertaking, they shall be solidarily liable to the agent for all the consequences of the agency.

COMMENT:**(1) Solidary Liability of Principals**

Solidarity is the rule under this Article because of the common transaction. Thus, even if the agent have been appointed *separately*, the rule should apply in the interest of justice.

(2) Examples

- (a) W, X and Y employ agent A to sell land owned in common by the three, with A receiving a commission of P1,500,000. If A is successful, A can collect from *any*

of the three the amount of P1,500,000 because of their solidary liability. Of course, if *X* pays the P1,500,000, he can recover reimbursement of P500,000 each from *Y* and *W*.

- (b) *C*, *D* and *E* appoint *F* as their agent to sell their *separate* houses. The liability of *C*, *D* and *E* are merely *joint* and not solidary even if the appointment is made in one instrument. This is because this is NOT a *common* transaction or undertaking.

(3) Case

Constante Amor de Castro v. CA GR 115838, Jul. 18, 2002

The rule in Art. 1915 applies even when the appointments were made by the principals in separate acts, provided that they are for the same transaction. The solidarity arises from the common interest of the principals, and not from the act of constituting agency.

By virtue of this solidarity, the agent can recover from any principal the whole compensation and indemnity owing to him by the others. The parties, however, may, by express agreement, negate this solidary responsibility. The solidarity does not disappear by the mere partition effected by the principals after the accomplishment of the agency.

If the undertaking is one in which several are interested, but only some create the agency, only the latter are solidarily liable, without prejudice to the effects of *negotiorum gestio* with respect to the others. And if the power granted includes various transactions some of which are common and others are not, only those interested in each transaction shall be liable for it.

Art. 1916. When two persons contract with regard to the same thing, one of them with the agent and the other with the principal, and the two contracts are incompatible with each other, that of prior date shall be preferred, without prejudice to the provisions of Article 1544.

COMMENT:**QUESTION – (When Both Principal and Agent Contract with Respect to the Same Thing)**

On Jan. 31, 2000, A who owns a piece of agricultural land, gave a general power of attorney to B. On Feb. 20, 2005, A, without the knowledge of B, executed in favor of C a special power of attorney to sell said piece of land. On Feb. 25, 2005, B as attorney-in-fact of A, executed a deed of sale in favor of D. On the same date, Feb. 25, 2005, C, under the special power given by A, sold the same piece of land to E.

Assuming that the vendees have not yet registered their respective documents or have taken possession of the land, which of the two sales is valid and enforceable and who is responsible for damages, if any? Reasons.

ANS.: The sale by C in favor of E is valid and enforceable because C was specifically granted authority to sell. B, who only had a general power of attorney had NO right to sell, since selling ordinarily is *not* a mere act of administration. Moreover, under Art. 1878, a special power of attorney is needed to effectuate a sale. If anyone is liable for damages, it is certainly B who performed an unauthorized thing.

**Diosdado Sta. Romana v. Carlos Imperio, et al.
L-17280, Dec. 29, 1965**

FACTS: A principal authorized his brother as agent to sell certain parcels of land. The sale was made, with both the deed of sale and the authority of the agent being registered in the Registry of Property. Subsequently, the principal sold the same parcels of land to another buyer who managed to have the title given to him. Which buyer must prevail.

HELD: The buyer from the agent, in view of the registration in good faith in his name of the sale. Here, Art. 1544 regarding the double sale of property can be applied. Hence also, if said buyer sues for annulment of the transaction and seeks to recover its value, he will prevail in view of the breach of warranty against eviction. The value of the land must be returned, even if said value be greater or less than the price of the sale.

Art. 1917. In the case referred to in the preceding article, if the agent has acted in good faith, the principal shall be liable in damages to the third person whose contract must be rejected. If the agent acted in bad faith, he alone shall be responsible.

COMMENT:

Liability of Principal if Agent Acted in Good Faith or in Bad Faith

Note the liability of the principal for damages.

Art. 1918. The principal is not liable for the expenses incurred by the agent in the following cases:

(1) If the agent acted in contravention of the principal's instructions, unless the latter should wish to avail himself of the benefits derived from the contract;

(2) When the expenses were due to the fault of the agent;

(3) When the agent incurred them with knowledge that an unfavorable result would ensue, if the principal was not aware thereof;

(4) When it was stipulated that the expenses would be borne by the agent, or that the latter would be allowed only a certain sum.

COMMENT:

When Principal Is Not Liable for Agent's Expenses

- (a) Reason for Par. 1 — to punish the agent. Reason for the exception — this is implied ratification.
- (b) Reason for Par. 2 — this is self-evident.
- (c) Reason for Par. 3 — this is tantamount to bad faith and lack of due diligence.
- (d) Reason for Par. 4 — this stipulation would not contravene good morals or public policy, etc.

Chapter 4

MODES OF EXTINGUISHMENT OF AGENCY

Art. 1919. Agency is extinguished:

- (1) By its revocation;
- (2) By the withdrawal of the agent;
- (3) By the death, civil interdiction, insanity or insolvency of the principal or of the agent;
- (4) By the dissolution of the firm or corporation which entrusted or accepted the agency;
- (5) By the accomplishment of the object or purpose of the agency;
- (6) By the expiration of the period for which the agency was constituted.

COMMENT:

(1) Keyword for Extinguishment of the agency – EDWARD

- E — Expiration
- D — Death, etc.
- W — Withdrawal
- A — Accomplishment
- R — Revocation
- D — Dissolution

[OTHER CAUSES: Termination by mutual consent, novation, loss of subject matter of the agency (*11 Manresa 570-571*), outbreak of war if inconsistent with the agency. (*2 Am. Jur. 61*).]

(2) Death

Ordinarily, the death of the principal terminates the agency, even if a period had been stipulated and such period has not yet ended. (*See Gabin, et al. v. Villanueva, C.A., 5 O.G. 5749*). However, under Art. 1931, “anything done by the agent, *without knowledge* of the death of the principal or of any other cause which extinguishes the agency, is **VALID** and shall be fully effective with respect to third persons who may have contracted with him in good faith.” (*See Manuel Buason, et al. v. Mariano Panuyas, 105 Phil. 795*).

Manuel Buason, et al. v. Mariano Panuyas
105 Phil. 795

FACTS: Dayao authorized in 1930 his agent Bayuga to sell a particular parcel of land. This authority to sell was annotated on the original certificate of title of the registered land. Dayao died in 1934, and in 1939, his children sold the land to Buason. This sale was never registered. In 1944, Bayuga, who did *not* know of the death of Dayao, sold the same land to Panuyas, an innocent purchaser for value. This 1944 sale was duly registered. Buason now seeks to cancel the sale to Panuyas.

HELD: The sale will *not* be cancelled as Panuyas has a better right to the land. In case of double sale of land, he who first recorded the sale in *good faith* has a better right. While it is true that the death of Dayao in 1934 terminated the agent’s authority to sell the land, still under Art. 1738 of the old Civil Code, “anything done by the agent, without knowledge of the death of the principal or of any other cause which extinguishes the agency, is *valid* and shall be fully effective with respect to *third persons* who may have contracted with him in *good faith*.”

Hermosa v. Longara
L-5267, Oct. 27, 1953

FACTS: *P* authorized *A* to support the former’s grandson. *P* subsequently died. Is *A* still required to give support?

HELD: No, for two reasons. *P*’s death terminated *A*’s authority. Also, *P*’s obligation to give support, being a personal one, was extinguished on his death.

**Natividad Herrera, et al. v. Luy Kim Guan, et al.
L-17043, Jan. 31, 1961**

If an agent sells the lands of his principal *after* the latter's death, the sale will still be valid, if the agent did NOT know at the time of the sale that the principal was already dead.

(3) Dissolution

Note that the dissolution of the firm or corporation (whether it be the principal or the agent) ends the agency.

Art. 1920. The principal may revoke the agency at will, and compel the agent to return the document evidencing the agency. Such revocation may be express or implied.

COMMENT:

(1) Revocation by Principal or Agency

- (a) *Reason* — Agency is generally revocable at the will of the principal because the trust and confidence may have been lost. (*See Barretto v. Santa Marina, 26 Phil. 440*).
- (b) Revocation at will is proper:
 - 1) even if the agency is *onerous*;
 - 2) even if the period fixed has not yet expired. (*See Barretto v. Santa Marina, 26 Phil. 440*).

(2) When Agency Cannot Be Revoked at the Principal's Will

The agency cannot be revoked at will in the following instances:

- (a) When it is "coupled with an interest" (interest possessed by the agent not in the proceeds arising from the exercise of the power, but interest in the *subject matter of the power*). (*2 Am. Jur. 61-63 and Eulogio del Rosario, et al. v. Abad & Abad, 104 Phil. 648*).
- (b) In the cases mentioned under Art. 1927 —
 - 1) when a bilateral contract depends on the agency;

- 2) when the agency is the means of fulfilling an obligation already contracted;
 - 3) in the case of a partner appointed manager in the contract of partnership and his removal from the management is unjustifiable.
- (c) When there has been a WAIVER by the principal (however, the irrevocability of a power of attorney cannot affect one who is not a party thereto, it being obligatory only on the principal who created the agency.) (*New Manila Lumber Co. v. Republic*, 107 Phil. 824).
- (d) When the principal is obliged not to revoke. (Here, the principal can still revoke, but he can be held liable for damages, for breach of contract.)
- (e) When the revocation is done in *bad faith*. [Here, the principal can still revoke, but innocent third parties should *not* be prejudiced; moreover, the innocent agent can be entitled to damages from him. (*See Infante v. Cunanan*, 93 Phil. 691; *Danon v. Antonio Brimo & Co.*, 42 Phil. 133; *Reyes v. Mosqueda*, 53 O.G. 2158).]

(3) Agent Cannot Generally Recover Damages

Under the general rule, when revocation is proper, the agent cannot get damages because the principal is merely exercising a right.

(4) Kinds of Revocation

- (a) Express
- (b) Implied — as in the following:
 - 1) appointment of a new agent for the same business or transaction (*Art. 1923*) provided there is INCOMPATIBILITY. (*See Dy Buncio & Co. v. Ong Guan Can*, 60 Phil. 696).
 - 2) If the principal directly manages the business entrusted to the agent, dealing directly with third persons, in a way INCOMPATIBLE with the agency.

Art. 1921. If the agency has been entrusted for the purpose of contracting with specified persons, its revocation shall not prejudice the latter if they were not given notice thereof.

COMMENT:

Agency for Contracting With Specified Persons

- (a) So that innocent third parties may not be prejudiced, the principal who fails to give the notification can be held liable for damages. (*Rallos v. Yangco*, 20 Phil. 269).
- (b) No notice is required for persons who already know of the revocation for then the purpose of the notification shall have already been served.

Art. 1922. If the agent had general powers, revocation of the agency does not prejudice third person who acted in good faith and without knowledge of the revocation. Notice of the revocation in a newspaper of general circulation is a sufficient warning to third persons.

COMMENT:

Agency When Third Parties Are Not Specified

- (a) In this Article, as distinguished from the preceding one, the third persons have not been SPECIFIED.
- (b) Note the effect of a revocation in a newspaper of general circulation.

Art. 1923. The appointment of a new agent for the same business or transaction revokes the previous agency from the day on which notice thereof was given to the former agent, without prejudice to the provisions of the two preceding articles.

COMMENT:

Effect of Appointment of a New Agent

- (a) Appointment of a new agent revokes the first agency

only in case of incompatibility. (*See Dy Buncio & Co. v. Ong Guan Can*, 60 *Phil.* 696).

- (b) A special power revokes a general one. (*Art. 1926*).
- (c) If the first agent is not notified of the appointment of the second agent, it is understood that the first agency still exists. (*Garcia v. De Manzano*, 39 *Phil.* 577).

Art. 1924. The agency is revoked if the principal directly manages the business entrusted to the agent, dealing directly with third persons.

COMMENT:

(1) Effect if the Principal Directly Manages the Business

The rule applies only in case of incompatibility, because it may be that the only desire of the principal is for him and the agent to manage the business together. In case of true inconsistency, the agency is revoked, for there would no longer be any basis therefor. (*11 Manresa* 574).

(2) Case

**CMS Logging, Inc. v. CA & D.R. Aguinaldo Corp.
GR L-41420, Jul. 10, 1992**

The principal may revoke a contract of agency at will, and such revocation may be express or implied, and may be availed of even if the period fixed in the contract of agency has not yet expired. As the principal has this absolute right to revoke the agency, the agent cannot object thereto; neither may he claim damages arising from such revocation, unless it is shown that such was done in order to evade the payment of agent's commission.

In the case at bar, CMS appointed DRACOR as its agent for the sale of its logs to Japanese firms. Yet, during the existence of the contract of agency, DRACOR admitted that CMS sold its logs directly to several Japanese firms. This act constituted an implied revocation of the contract of agency

under Art. 1924 of the Civil Code. And since the contract of agency was revoked by CMS when it sold its logs to Japanese firms without the intervention of DRACOR, the latter is no longer entitled to its commission from the proceeds of such sale and is not entitled to retain whatever moneys it may have received as its commission for said transactions. Neither would DRACOR be entitled to collect damages from CMS, since damages are generally not awarded to the agent for the revocation of the agency, and the case at bar is not one falling under the exception mentioned, which is to evade the payment of the agent's commission.

Be it noted that the act of a contractor who, after executing powers of attorney in favor of another empowering the latter to collect whatever amounts may be due to him from the Government, and, thereafter, demanded and collected from the government the money the collection of which he entrusted to his attorney-in-fact, constituted revocation of the agency in favor of the attorney-in-fact.

Art. 1925. When two or more principals have granted a power of attorney for a common transaction, any one of them may revoke the same without the consent of the others.

COMMENT:

Revocation by One of Two or More Principals

The power to revoke here is a consequence of the solidary liability of co-principals.

Art. 1926. A general power of attorney is revoked by a special one granted to another agent, as regards the special matter involved in the latter.

COMMENT:

Rule When Special Power Is Granted to Another Agent

- (a) In this Article, two agents are involved.
- (b) A specific right naturally prevails over a general one.

Art. 1927. An agency cannot be revoked if a bilateral contract depends upon it, or if it is the means of fulfilling an obligation already contracted, or if a partner is appointed manager of a partnership in the contract of partnership and his removal from the management is unjustifiable.

COMMENT:

(1) When an Agency Cannot Be Revoked

This enumerates three instances of *irrevocability*:

- (a) If a bilateral contract depends upon the agency.

Example 1: P wanted to make A his surety so P made A his agent as a sort of inducement to safeguard him from eventual loss. Under American Law, this is referred to as an agency or authority necessary to effectuate a security; it is also an agency or authority coupled with an interest. (2 C.J. 530-531).

Example 2: A power to sell, where the property is delivered to the agent to dispose of it for the protection of himself and other creditors is an authority coupled with an interest, and therefore irrevocable, provided the interest is indicated in the power of attorney. (*Del Rosario v. Abad*, 104 Phil. 648).

Example 3: If the agency is only a clause or a part of a reciprocal contract. *Reasons:* The contract itself and, therefore, also the clause on the agency, cannot generally be revoked except thru mutual consent. (11 *Manresa* 572).

- (b) If the agency is the means of fulfilling an obligation already contracted.

Example: Sonia is indebted to Concepcion for the purchase of a diamond headband. But Sonia in the meantime has no money. So she appoints Concepcion as her agent to collect from Maria some money which Maria owes her (Sonia), which money in turn will be applied to the purchase price of the headband. It is clear that Sonia cannot revoke the agency here, unless she first pays Concepcion.

Bisaya Land Transportation Co., Inc. v. Sanchez
GR 74623, Aug. 31, 1987

FACTS: *S* and *B* entered into a shipping agency contract whereby *S* has been appointed as a shipping agent for *B*. Later, *B* opened its own branch office which, in effect, revoked the contract of agency.

HELD: The revocation of the contract of agency is not sanctioned by law because the agency is the means by which *S* could fulfill his obligation.

- (c) If a partner is appointed manager of a partnership in the contract of partnership, and his removal from the management is unjustifiable.

(2) Effect When “Interest” Terminates

An agency coupled with an interest cannot be terminated unilaterally by the principal, but revocation can be made AFTER the interest terminates. So if the Government allows the De la Rama Steamship Co. to manage the former's vessel for 2 years in order to pay the company for its help in acquiring the vessels, at the end of said two years, the Government may end the agency. (*De la Rama Steamship Co. v. Tan, et al.*, 99 Phil. 1034).

Art. 1928. The agent may withdraw from the agency by giving due notice to the principal. If the latter should suffer any damage by reason of the withdrawal, the agent must indemnify him therefor, unless the agent should base his withdrawal upon the impossibility of continuing the performance of the agency without grave detriment to himself.

COMMENT:

(1) Withdrawal by Agent

- (a) Just as a principal may revoke generally under Art. 1920, so also may an agent withdraw under Art. 1928.
- (b) Reasons of health can justify withdrawal by the agent. (*De la Rama v. Hidalgo*, 16 Phil. 450).

(2) Effect When Agent Sues Principal

When an agent files a complaint against the principal for a monetary claim in the former's favor, dignity and decorum will *not* ordinarily permit the continuation of the agency. Such a complaint is therefore equivalent to withdrawal of the agent from the agency. (*Valera v. Velasco*, 51 Phil. 695).

Art. 1929. The agent, even if he should withdraw from the agency for a valid reason, must continue to act until the principal has had reasonable opportunity to take the necessary steps to meet the situation.

COMMENT:**When a Withdrawn Agent Must Still Act**

Reason for the Article — to prevent damage to the principal.

Art. 1930. The agency shall remain in full force and effect even after the death of the principal, if it has been constituted in the common interest of the latter and of the agent, or in the interest of a third person who has accepted the stipulation in his favor.

COMMENT:**(1) When Agency Continues Even After Death of Principal**

This Article speaks of an agency:

- (a) coupled with a *common* interest;
- (b) coupled with the *interest* of a third person *who has accepted the stipulation in his favor*.

Example of COMMON interest:

Zenaida borrows from Jose, and as security entrusts to Jose a ring, which Jose can sell in case Zenaida fails to pay the debt at the time of maturity. Even if Zenaida dies, the agency of Jose would still remain. (*See Pasno v. Ravina, et al.*, 54 Phil. 378).

Example of Interest of a THIRD PERSON:

Melady sells his land to Bravo and appoints Bravo his agent in paying with the purchase price what Melady owes Arellano, a third person. Here even when Melady dies, the agency of Bravo continues to exist.

(2) Agency Coupled With an Interest

It is a well-settled general rule that if the authority of an agent is coupled with an interest, it is not revocable by the death, act, or condition of the principal, unless there is some agreement to the contrary between the parties. This is a well-recognized exception to the rule that the death of the principal revokes the authority of an agent appointed by him. (2 *Am. Jur.* 61-63). However, it must be noted that an agent whose agency is coupled with an interest cannot stand on a better ground than a partner appointed as manager in the articles of partnership insofar as revocability of authority or power is concerned. Inasmuch as a partner appointed as manager in the articles of partnership can be divested of his power if there is a just or lawful cause, it follows that an agent whose agency is coupled with an interest can also be stripped of his power of attorney, if there is a JUST CAUSE. (*Coleongco v. Claparols*, L-18616, Mar. 31, 1964).

(3) Nature of the Agent's Interest

In order that a power may be irrevocable because it is coupled with an interest, it is necessary that the interest shall be in the subject matter of the power and not in the proceeds which will arise from the exercise of the power. The person clothed with the power must derive under the instrument creating it, or from the nature of the relation, a present or future interest in the thing or subject itself on which the power is to be exercised, and not merely that which is produced by the exercise of the power. (2 *Am. Jur.* 61-63).

(4) Interest is Not the Share in the Profits or the Commission

- (a) A power has been held NOT to be coupled with an interest where the interest arises out of commission or out of the

proceeds of a transaction as where the agent's interest is merely his right to receive, by way of compensation, a certain percentage of the proceeds. (2 *C.J.* 532-533).

- (b) But a power to make a collection or sale out of the proceeds to pay an existing debt due to the agent from the principal is a power coupled with an interest, as is also an interest, as is also an authority to the agent to reimburse himself from such proceeds for advances made to the principal. It has also been held that authority to loan money and to collect the same and account for all over a given percent, which the agent is to retain as his compensation is authority coupled with an interest. (2 *C.J.* 532-533).

(5) The Entire Agreement to Be Construed

Whether an interest which will make the agency or power irrevocable exists in a particular case is to be determined from the entire agreement between the parties, and from the facts and circumstances attending the relation existing between the parties. The *terminology* used by the parties is *not* controlling; even though an agency or power is made in terms irrevocable, that fact will not prevent its revocation by the principal where the agency or power is *not* in fact, coupled with an interest. Nor will the fact of a stipulation in the instrument that the intention of the grantor of the power is that it shall be construed as a power of attorney coupled with an interest in the subject matter thereof prevent its revocation. (2 *Am. Jur.* 61-63).

Eulogio del Rosario, et al. v. Abad and Abad 104 Phil. 648

FACTS: In 1937, Tiburcio del Rosario borrowed from Primitivo Abad P2,000, with 12% interest payable in 1941. Tiburcio mortgaged the improvements of a parcel of land in favor of his creditor. On the same day that he obtained the loan, Tiburcio executed an "irrevocable special power of attorney coupled with an interest" in favor of Abad, the mortgagee, authorizing him among other things, to sell and convey the parcel of land, without however indicating in the document

the purpose of the agency to sell. In 1945, the mortgagor died, with the debt still unpaid. In 1947, Primitivo, acting as attorney-in-fact of Tiburcio, sold the land to his (Primitivo's) son in consideration of *P1 and the extinguishment* of the mortgage debt. The heirs of Tiburcio claim that the sale is not *valid* for it was made after Tiburcio's death, and they now desire to recover the possession and ownership of the land. Abad, however, counters that death did not extinguish the agency because by express provision of the power of attorney it was irrevocable and coupled with an interest.

HELD: The sale is not valid because the principal had already died when it was made. The agency was certainly not one coupled with an interest. The mere mention of the interest in the power of attorney is not *enough*. The power of attorney should have stated what precisely the interest consisted of. The mere fact that the improvements *on the land* had been mortgaged in favor of Abad, which fact, incidentally, *was not even mentioned* in the power of attorney, is *immaterial*. The mortgage of the improvements had *nothing* to do with the power of attorney. The proper remedy of Abad is to foreclose the mortgage, and not to avail himself of the power of attorney. As the agency was *not* coupled with an interest, it ended on Tiburcio's death, and the subsequent sale of the land cannot be considered valid.

Art. 1931. Anything done by the agent, without knowledge of the death of the principal or of any other cause which extinguishes the agency, is valid and shall be fully effective with respect to third persons who may have contracted with him in good faith.

COMMENT:

(1) Effect of Agent's Act Without Knowledge of the Termination of the Agency

Note that the law here requires the third persons to be in good faith. If in bad faith, they cannot be protected. (*See Buason v. Panuyas, 105 Phil. 795, cited under Art. 1919*).

(2) Rule in Case Business Was Already Begun

Under the second paragraph of Art. 1884, the agent “must also finish the business already begun on the death of the principal *should delay entail any danger.*”

Art. 1932. If the agent dies, his heirs must notify the principal thereof, and in the meantime adopt such measures as the circumstances may demand in the interest of the latter.

COMMENT:**(1) Death of the Agent**

If the heirs of the dead agent are unable to give notice, one good measure for them to do is to consign the object or property of the agency in court. In this way, they can still protect the interests of the principal, who trusted their predecessor in interest. The heir’s duty arises from what may be termed as *a presumed agency* or *tacit agency* or an agency *by operation of law*. (See *11 Manresa 588*).

(2) Effect of Agent’s Death in Case of Agency Coupled with an Interest

In an agency coupled with an interest, does the death of the agent terminate the agency?

ANS.: Generally, the agent’s death ends the agency for it should not be continued by one upon whom the principal has reposed no confidence (*See 11 Manresa 586-587*), but under American Law, when the agency is coupled with an interest, it has been held that the agent’s death does not terminate the agency; such a power may be subsequently exercised by his personal representative, at least insofar as may be essential to protect the interests of the estate of the agent. (*2 C.J. 551*).

TITLE XI

LOAN

(1) Introductory Comment

Title XI of the Civil Code begins the subject known in law courses as “credit transactions.” “Credit” in this connection refers to belief or trust by a person in another’s ability to comply with an obligation; and “credit transactions” refers to the contracts or agreements based on said trust or credit.

(2) Scope of Credit Transactions

The subject involves:

- (a) The PRINCIPAL contracts of *loan* (both *commodatum* and *mutuum*) and *deposit* (these are of course founded on “belief or “faith” or “trust”).
- (b) The ACCESSORY contracts [which generally depend on the existence of the aforementioned contracts and which tends to strengthen said “belief” or “trust” because of the security given:
 - 1) personal guaranty (*a person’s personal credit is involved as in guaranty proper and suretyship*)
 - 2) *real guaranty* (here the “belief” is strengthened with the use of *property* — if *real property*, the contracts of *real mortgage* and *antichresis*; if *personal property*, the contracts of *pledge* and *chattel mortgage*).
- (c) Preference and concurrence of credits.

GENERAL PROVISIONS

Art. 1933. By the contract of loan, one of the parties delivers to another, either something not consumable so that the latter may use the same for a certain time and return

it, in which case the contract is called a *commodatum*; or money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid, in which case the contract is simply called a loan or *mutuum*.

Commodatum is essentially gratuitous.

Simple loan may be gratuitous or with a stipulation to pay interest.

In *commodatum* the bailor retains the ownership of the thing loaned, while in simple loan, ownership passes to the borrower.

COMMENT:

(1) The Two Kinds of Loans

There are two kinds of loans:

- (a) *mutuum* or simple loan, and
- (b) *commodatum*.

(2) Loans Under the Old Law

Prior to the new Civil Code, there were two kinds of loans:

- (a) civil loans — governed by the old Civil Code; and
- (b) commercial loans — governed by the Code of Commerce. Under the new Civil Code this distinction has been abolished. (*Art. 2270*).

<i>MUTUUM</i>	<i>COMMODATUM</i>
a) equivalent amount to be returned (subject matter is fungible)	a) same thing to be returned (subject matter is non-fungible)
b) may be gratuitous or onerous (with interest)	b) essentially gratuitous (If there is compensation it

	ceases to be <i>commodatum</i> .)
c) ownership goes to borrower or bailee	c) ownership retained by lender or bailor
d) refers to personal property only	d) may involve real and personal property
e) referred to as loan for <i>consumption</i>	e) referred to as loan for <i>use or temporary possession</i>
f) borrower, because of his ownership, bears risks of loss	f) lender, because of his ownership, bears risk of loss
g) can be generally obliged to pay only at <i>end</i> of period	g) while generally obliged to return object at end of period, still in some cases the return can be demanded <i>even before</i> the end of the period
h) not personal in character	h) <i>personal</i> in character

(3) Distinctions Between *Mutuum* and *Commodatum*

(4) ‘Consumable’ and ‘Non-consumable’ Distinguished

- (a) *Consumable* – a movable which cannot be used in a manner appropriate to its nature without its being consumed. (Art. 418). *Example*: gasoline.
- (b) *Non-consumable* – a movable which can be used in a manner appropriate to its nature without its being consumed. (Art. 418). *Example*: a book.

(5) ‘Fungible’ and ‘Non-Fungible’ Distinguished

- (a) *Fungible* – if the intention is to allow a substitution of the thing given. (3 *Manresa* 58).
- (b) *Non-fungible* – if the intention is to compel a return of the identical thing given. (3 *Manresa* 58).

[NOTE: Whether a thing is consumable or not depends on the nature of the thing; whether it is fungible

or not depends on the *intention*. (3 *Manresa* 58). Hence, sugar is consumable and ordinarily fungible, but if the intention is merely to display the sugar for exhibition (*ad ostentationem*), then it is still consumable (nature) but *non-fungible (intention)*.]

(6) Meaning of ‘Bailment’

Etymological — It is derived from the French word *bailler*, meaning to *deliver*.

Real definition — The delivery of property by one person to another in trust for a specific purpose, with a contract, express or implied, that the first shall be faithfully executed and the property returned or duly accounted for when the special purpose is accomplished or kept until the bailor reclaims it. (3 *Ruling Case Law* 73).

(7) Parties in a Bailment

- (a) Bailor — the giver; and
- (b) Bailee — the recipient of the thing bailed.

(8) Consideration or Cause in a Bailment of Loan

Insofar as the borrower is concerned, the cause is the acquisition of the thing; insofar as the lender is concerned, it is the right to require the return of the same thing or its equivalent. If despite the issuance of a check to the prospective borrower, the money is *not* given, there is NO contract of loan. (*Monte de Piedad v. Javier, et al.*, C.A. 36 O.G. 2176).

(9) Definition of ‘Credit’ as Applied to ‘LOANS’

The ability to borrow money or thing by virtue of the confidence or trust reposed by a lender that the borrower will pay what he may promise (*People v. Concepcion*, 44 *Phil.* 126) is called “CREDIT” derived from the Latin “*credere*,” meaning “to trust.”

(10) ‘Loan’ Distinguished from ‘Rent’ or ‘Lease’ (*Tolentino v. Gonzales*, 50 Phil. 558)

<i>LOAN (Simple)</i>	<i>RENT OR LEASE</i>
(a) Lender loses his property for the borrower becomes the owner thereof.	(a) Owner of property does not lose his ownership; he merely loses control thereof in a limited way for the duration of the rent or lease.
(b) The relationship is one of lender and borrower (creditor and debtor).	(b) The relationship is one of lessor and lessee.

**In Re Guardianship of Tamboco, et al.
36 Phil. 939**

FACTS: Under the Code of Civil Procedure, the failure to return a thing deposited rendered the depositary liable to imprisonment, but this would not be the case if the contract is one of loan and not of deposit. Now then, one Plaza deposited with Chuatongco a sum of money, to be repaid with interest. The Court ordered the latter to deposit in the Postal Savings Bank in the name of the giver of the money. Chuatongco failed to comply with this and he was therefore ordered jailed. Was the arrest and imprisonment proper?

HELD: No, because this was a loan and not a deposit. Although it was not expressly agreed that Chuatongco could use the money, this can nevertheless be inferred from the fact that Chuatongco was obliged to pay interest.

**Government v. Phil. Sugar Estate Dev. Co.
38 Phil. 15**

FACTS: Under the Corporation Law, a sugar corporation cannot invest in a corporation dealing with real estate, but can grant a loan to the latter. If a corporation should do this, its franchise can be revoked. Now then, the Philippine Sugar Estate Dev. Co. delivered to the Tayabas Land Com-

pany about P300,000.00 which the government contended to be contribution of the sugar company to the land company, but which the sugar company alleged to be a mere loan. In the contract, no date was fixed for the return of the money; furthermore, there would be no interest or profit till after the principal had been paid.

HELD: The money was given as an investment and not as a loan. It is difficult to see how this contract can be considered a loan. There was no date fixed for the return to be made for the money. Furthermore, the sugar company was not to receive anything for the use of said sum until after the capital had been fully repaid, which is not consistent with the general idea of loan. It is not impossible to provide that the capital be repaid, but the usual method is to pay the interest first.

(11) ‘Loan’ Distinguished from ‘Discounting of a Paper’

To discount a paper is a mode of loaning money, with these distinctions:

- (a) In a discount, interest is deducted in advance, while in a loan, interest is taken at the expiration of a credit;
- (b) A discount is always on double-name paper; a loan is generally on single-name paper. (*People v. Concepcion*, 44 Phil. 126).

**Herrera v. Petrophil Corp.
GR 48349, Dec. 29, 1986**

The difference between a *discount* and a *loan* or *forbearance* is that the former does not have to be repaid.

(12) Loan Distinguished from Deposit

<i>LOAN</i>	<i>DEPOSIT</i>
(a) purpose — to grant its USE to borrower	(a) purpose — SAFEKEEPING by depositary (who generally cannot use)

(b) generally, the borrower pays only at <i>end</i> of period	(b) the return of deposited things can be demanded by the depositor at any time
(c) relationship is that of lender (creditor) and borrower (debtor)	(c) relationship is that of depositor and depositary
(d) there can be compensation of credits	(d) NO compensation of things deposited with each other (except by mutual agreement).

[**NOTE:** An agent who uses for his own ends money or property of the principal is a depositary or trustee of said funds and would be liable in case of failure to return. He cannot claim that only a “loan” was involved for this would require the principal’s consent. (*U.S. v. Iguara*, 27 *Phil.* 619).]

(13) ‘Loan’ Distinguished from ‘Irregular Deposit’

<i>LOAN</i>	<i>IRREGULAR DEPOSIT</i>
(a) borrower can use and will return only at end of period generally	(a) depositary can also use (as distinguished from a case of a regular deposit where depositary cannot generally use)
(b) lender has <i>no preference</i> over other creditors	(b) irregular depositor has <i>preference</i>
(c) essential cause is NECESSITY of borrower	(c) essential use is the special benefit for depositor (as his money is being safeguarded)

(11 *Manresa* 664; *Rogers v. Smith, Bell and Co.*, 10 *Phil.* 319 and *Compania Agricola de Ultramar v. Nepomuceno*, 55 *Phil.* 283).

(14) ‘Loan’ Distinguished from ‘Sale’

<i>LOAN</i>	<i>SALE</i>
(a) <i>real</i> contract	(a) <i>consensual</i> contract
(b) <i>Generally unilateral</i> because only borrower has obligations	(b) bilateral and reciprocal

[**NOTE:** If property is “sold” but the real intent is only to give the object as *security* for a debt — as when the “price” is comparatively small — there really is a contract of LOAN, with an “equitable mortgage.” (See *Jayme v. Salvador*, 55 Phil. 540).]

(15) Form of Interest

Herrera v. Petrophil Corp.
GR 48349, Dec. 29, 1986

A *loan* must be in the form of money or something circulating as money. It must be repayable absolutely and in all events.

(16) Escalation Clause

Insular Bank of Asia and America v. Salazar
GR 82082, Mar. 25, 1988

Escalation clauses are valid stipulations in commercial contracts to maintain fiscal stability and to retain the value of money in long-term contracts. However, the enforceability of such stipulations are subject to certain conditions.

The escalation clause is a valid provision in a loan agreement provided that (1) the increased rate imposed by the lender does not exceed the ceiling fixed by law or the monetary board; (2) the increase is made effective not earlier

than the effectivity of the law or regulation authorizing such increase; and (3) the remaining maturities of the loans are more than 730 days as of the effectivity of the law or regulation authorizing such an increase.

Almeda v. CA
70 SCAD 248, 256 SCRA 292
1996

Central Bank (Bangko Sentral) Circ. 905 (lifting the ceiling on interest rates) could not be properly invoked to justify the escalation clauses requiring that the increase be “within the limits allowed by law,” such circular not being a grant of specific authority.

Art. 1934. An accepted promise to deliver something by way of commodatum or simple loan is binding upon the parties, but the commodatum or simple loan itself shall not be perfected until the delivery of the object of the contract.

COMMENT:

(1) Nature of the Contract of Loan

Commodatum and loan are real contracts. They are perfected by the delivery of the object loaned. On the other hand, consensual contracts are perfected by mere consent. (*Art. 1316, Civil Code*).

(2) Need for Delivery

To effect either a *commodatum* or a *mutuum*, a delivery, either real or constructive, is essential. This is so because unless there is delivery, the borrower in commodatum (for example) cannot exercise due diligence over the thing loaned. (*11 Manresa 507-508*).

(3) Consent of the Parties

The borrower and the lender must of course consent either personally or through an authorized agent, as in every obligation founded upon a contract. However, the necessary

acceptance need not be actual but may be implied from circumstances. (3 *RCL* 81).

(4) Consensual Contract of Future Loans

Aside from the real contracts of *commodatum* and loan, there can also be a *consensual* contract created by an accepted promise to deliver something by way of *commodatum* or simple loan.

Example: A promised to lend P1,000,000 to B. The promise was accepted by B. This contract (consensual) is already binding upon the parties so that if A does not fulfill his promise, B has the right to demand compliance thereof. But note here that the real contract of loan does not yet exist.

Chapter 1

COMMODATUM

Section 1

NATURE OF COMMODATUM

Art. 1935. The bailee in commodatum acquires the use of the thing loaned but not its fruits; if any compensation is to be paid by him who acquires the use, the contract ceases to be a commodatum.

COMMENT

(1) ‘Commodatum’ Defined

Commodatum is a *real, principal*, essentially *gratuitous*, and *personal* contract where one of the parties (called the bailor or lender) delivers to another (called the bailee or borrower) a non-consumable object, so that the latter may USE the same for a certain period and later *return* it. (See Arts. 1933 and 1935).

The term is derived from the Latin “*commodum*” (usefulness) or “*commodo*” (particular usefulness to a borrower). (See 11 Manresa 514).

(2) Features or Characteristics of Commodatum as a Contract

- (a) *real* (because perfected by delivery)
- (b) *principal* (because it can stand alone by itself)
- (c) *gratuitous* (otherwise, the contract is one of lease)
- (d) *personal in nature* (because of the trust). (See Art. 1939).

(3) What Bailee (Borrower) in Commodatum Acquires

Commodatum gives the right to the use (*jus utendi*) and not the right to the fruits (*jus fruendi*); otherwise, the contract may be one of usufruct. But of course a stipulation that the bailee may make use of the fruits of the thing loaned is valid. (*Art. 1940*). In such a case, however, the right to get the fruits is merely incidental and not the main cause of the contract.

(4) Spanish Terms

Bailor in commodatum (lender) is called *comodatario* in Spanish, bailee in *commodatum* (borrower) is termed *comodante*.

Art. 1936. Consumable goods may be the subject of commodatum if the purpose of the contract is not the consumption of the object, as when it is merely for exhibition.

COMMENT:**(1) Subject Matter of Commodatum**

Usually, only non-consumable goods may be the object of a commodatum for the thing itself should not be consumed and must be returned, but when a jar of vinegar is given merely for exhibition, the thing itself is not consumed. It is only used *ad ostentationem*. Note that the vinegar in this case is non-fungible, for the same vinegar must be returned.

(2) Counterpart in the Contract of Lease

Note that this provision has a counterpart in the contract of lease, except when they are merely to be exhibited or when they are accessory to an industrial establishment. (*Art. 1645*).

Art. 1937. Movable or immovable property may be the object of commodatum.

COMMENT:**(1) Properties That May Be the Object of Commodatum**

- (a) immovable property
- (b) movable property

(2) Example of Commodatum Involving Land

A borrowed *B*'s land so that he can erect thereon a small *barong-barong* to be used for the time that *A* works in *B*'s province. If there is no rental this is a case of commodatum, but if rental is paid, this would be a lease.

NOTE: In one case a person asked his brother's permission to erect on the latter's land a house. The Supreme Court said that this was not a *commodatum* since no time for the use of land was specified. And this was so, even if the parties had denominated the contract as commodatum, for contracts must be interpreted by their constitutive elements as defined and denominated by law, and not by the name given by the parties. (*Mina v. Pascual*, 25 Phil. 540). However, under the Civil Code the contract may be regarded as a particular kind of commodatum — namely a *PRECARIUM*. (See Art. 1947, Code).

Art. 1938. The bailor in commodatum need not be the owner of the thing loaned.

COMMENT:**Bailor (Lender) Need Not Be the Owner**

Reason for the law: The contract of commodatum does not transfer ownership. All that is required is that the bailor has the right to the use of the property which he is lending, and that he be allowed to alienate this right to use. Hence, in lease for example, a lessee may become a sub-lessor, unless he has been expressly prohibited to do so in the contract of lease. (Art. 1650, Civil Code).

Mercado and Ebora v. Aguilar
(C.A.) 45 O.G. 5th S. 118, Jun. 30, 1947

FACTS: Mercado, the occupant of a stall in the Batangas market, allowed Aguilar to occupy the same gratuitously with the promise of Aguilar to return it upon demand. Aguilar claims that Mercado has no right to demand because Mercado, being a mere lessee of the Batangas municipality had no right to cede its occupancy in commodatum.

HELD: Mercado had the right to give it in commodatum. If a lessee, by a contract of a sub-lease, may transfer to another the enjoyment of the thing leased for a consideration, there is no reason why he should be unable to cede gratuitously its use to the *commodatory*. Aguilar should return the stall.

Art. 1939. Commodatum is purely personal in character. Consequently:

(1) The death of either the bailor or the bailee extinguishes the contract;

(2) The bailee can neither lend nor lease the object of the contract to a third person. However, the members of the bailee's household may make use of the thing loaned, unless there is a stipulation to the contrary, or unless the nature of the thing forbids such use.

COMMENT:

(1) Personal Nature of Commodatum

Under the old Civil Code, the obligations and rights arising from the commodatum descended to the heirs of both contracting parties unless the loan was made in consideration of the person of the borrower. (*Art. 1742, old Civil Code*). The new Civil Code changes this rule by considering commodatum as purely *personal*. (*Art. 1939, new Civil Code*). This is so even if commodatum is a *real contract* (*Arts. 1316 and 1934*) and constitutes an exception to the rule that all rights acquired by virtue of an obligation are transmissible. (*Art. 1178, Civil Code*).

(2) Example of the First Paragraph

A loaned to B the former's car by way of *commodatum*. If either A or B dies, the contract is extinguished.

(**NOTE:** If there are two or more borrowers, the death of one does not extinguish the *commodatum* as to the other, unless there is stipulation to the contrary.)

(3) Example of the Second Paragraph

A loaned to B a home theatre component by way of *commodatum*. B cannot lend or lease this to a friend. But the children of B in his household may use the same unless there is a stipulation to the contrary. But said component cannot be used as a chair, because the nature of the thing forbids such use.

Art. 1940. A stipulation that the bailee may make use of the fruits of the thing loaned is valid.

COMMENT:**(1) Does Bailee Have Right to Use the Fruits?**

- (a) As a rule, the bailee is not entitled to the fruits, otherwise the contract may be one of usufruct. It should be noted that the right to use is distinct from the right to enjoy the fruits, since under the law fruits should as a rule pertain to the owner of the thing producing the fruits. (*Art. 441, Civil Code*).
- (b) However, to stipulate that the bailee makes use of the fruits would not destroy the essence of a *commodatum*, for liberality is still the actual cause or consideration of the contract.

(2) Example

A is the bailee in *commodatum* of B's land. Incidentally, they may stipulate that A can get some lanzones from a lanzones tree on the land. Unless there is such a stipulation, A would not be entitled to the lanzones.

Section 2

OBLIGATIONS OF THE BAILEE

Art. 1941. The bailee is obliged to pay for the ordinary expenses for the use and preservation of the thing loaned.

COMMENT:

(1) Duty of Borrower to Pay Ordinary Expenses

Reason for the law: The bailee is supposed to return the identical thing (*Art. 1933*), so he is obliged to take care of the thing with, as a rule, the diligence of a good father of a family. (*Art. 1163*). It follows necessarily that ordinary expenses for the use and preservation of the thing loaned must be borne the bailee.

(2) Examples

- (a) A borrowed an automatic *Rolls Royce* automobile. He repays for the gasoline, motor oil, and expenses of greasing and spraying. He cannot ask reimbursement for these. (*Art. 1941*).
- (b) A borrowed a horse for a journey. If the horse is exhausted, rest must be given to the horse; otherwise, if A continues the journey with a tired horse, he should be responsible for the consequences of his folly. (*3 R.C.L. 111 and Higman Camody, 112 Ala. 267*).

[**NOTE:** The rule is different in the case of extraordinary expenses. (*See Art. 1949*).]

Art. 1942. The bailee is liable for the loss of the thing, even if it should be through a fortuitous event:

- (1) If he devotes the thing to any purpose different from that for which it has been loaned;
- (2) If he keeps it longer than the period stipulated, or after the accomplishment of the use for which *commodatum* has been constituted;

(3) If the thing loaned has been delivered with appraisal of its value, unless there is a stipulation exempting the bailee from responsibility in case of a fortuitous event;

(4) If he lends or leases the thing to a third person, who is not a member of his household;

(5) If, being able to save either the thing borrowed or his own thing, he chose to save the latter.

COMMENT:

(1) Liability for Loss Due to a Fortuitous Event

As a rule, a debtor of a thing is not responsible for its loss thru a fortuitous event. This Article gives the exceptions in a case of *commodatum*.

(2) Reason for the Law

- (a) *Paragraph 1* — This amounts to bad faith or abuse of generosity considering the fact that *commodatum* is gratuitous.
- (b) *Paragraph 2* — He is guilty of a certain kind of default (*mora*).
- (c) *Paragraph 3* — Evidently, the giving of the value was made to hold the bailee liable for after all this is not a sale, and neither is ownership transferred in *commodatum*.

(*Exception* — when there is a stipulation to the contrary. It may *in a sense* be said that the appraisal converts the *commodatum* into a *mutuum*.)

- (d) *Paragraph 4* — This is prohibited by the law for it amounts to a violation of the personal character of a *commodatum*.
- (e) *Paragraph 5* — This amounts to an act of ingratitude and to a failure to exercise due diligence, considering the fact that *commodatum* is gratuitous.

(3) Misuse or Abuse

A misuse or abuse of the property is ordinarily a conversion for which the bailee is generally held responsible, to the full extent of the loss. (*Fros v. Plumb*, 16 Am. Rep. 18).

Art. 1943. The bailee does not answer for the deterioration of the thing loaned due only to the use thereof and without his fault.

COMMENT:**Non-liability for Deterioration Without Fault**

The reason for the Article is obvious.

Art. 1944. The bailee cannot retain the thing loaned on the ground that the bailor owes him something, even though it may be by reason of expenses. However, the bailee has a right of retention for damages mentioned in Article 1951.

COMMENT:**(1) Generally, Borrower Cannot Retain**

Example:

A is indebted to B for P500,000. B later borrowed A's car but refused to return it on the ground that A owed him some money. B has no right to do this. This is so even if A had borrowed after B had borrowed the car.

(2) Reason for the Law

Bailment implies a trust that as soon as the time has expired, or the purpose accomplished, the bailed property must be restored to the bailor. (*Cobb v. Wallace*, 5 Cold [Tenn.] 539.)

Art. 1945. When there are two or more bailees to whom a thing is loaned in the same contract, they are liable solidarily.

COMMENT:**Solidary Liability of Bailees**

This is one more instance when solidary liability is imposed by law.

Section 3**OBLIGATIONS OF THE BAILOR**

Art. 1946. The bailor cannot demand the return of the thing loaned till after the expiration of the period stipulated, or after the accomplishment of the use for which the commodatum has been constituted. However, if in the meantime, he should have urgent need of the thing, he may demand its return or temporary use.

In case of temporary use by the bailor, the contract of commodatum is suspended while the thing is in the possession of the bailor.

COMMENT:**(1) Generally, Bailor Cannot Demand Immediate Return**

A *commodatum* is for a certain time. (*Art. 1933*). This is the reason for the first sentence, first paragraph of Art. 1946. This is based on equitable grounds for otherwise, the bailee may not be able to make proper use of the thing borrowed.

(2) Reason for Second Sentence, First Paragraph (Urgent Necessity)

A bailor usually lends his property because he does not need it. Hence, the reason for the exception. NOTE that the return may be only temporary, but it can also be permanent. This is so because the law uses "its return (meaning permanent) or temporary use." "Or temporary use" was a phrase added by the Code Commission. The gratuitous use by the borrower must yield the necessity of the lender. This follows naturally from the gratuitous nature of a *commodatum*. (*Art. 1948*).

(3) Suspension of the Contract

Note that the contract is suspended when the lender has temporary use and possession of the object.

Art. 1947. The bailor may demand the thing at will, and the contractual relation is called a *precarium*, in the following cases:

(1) If neither the duration of the contract nor the use to which the thing loaned should be devoted, has been stipulated; or

(2) If the use of the thing is merely tolerated by the owner.

COMMENT:

Precarium

- (a) *Precarium* is a special form of *commodatum*. In a true commodatum, the possession of the borrower is more secure.
- (b) The possession of the borrower in *precarium* is precarious, that is, dependent on the lender's will, hence the name *precarium*.
- (c) The two kinds of precarium are given in the Article.

Art. 1948. The bailor may demand the immediate return of the thing if the bailee commits any act of ingratitude specified in Article 765.

COMMENT:

(1) Effect of Commission of Act of Ingratitude

The bailor can demand IMMEDIATE RETURN.

(2) Grounds of Ingratitude

Article 765 provides:

“The donation may also be revoked at the instance of the donor, by reason of ingratitude in the following cases:

“(1) If the donee should commit some offense against the person, the honor or the property of the donor, or of his wife or children under his parental authority;

“(2) If the donee imputes to the donor any criminal offense, or any act involving moral turpitude, even though he should prove it, unless the crime or the act has been committed against the donee himself, his wife or children under his authority;

“(3) If he unduly refuses him support when the donee is legally or morally bound to give support to the donor.”

Art. 1949. The bailor shall refund the extraordinary expenses during the contract for the preservation of the thing loaned, provided the bailee brings the same to the knowledge of the bailor before incurring them, except when they are so urgent that the reply to the notification cannot be awaited without danger.

If the extraordinary expenses arise on the occasion of the actual use of the thing by the bailee, even though he acted without fault, they shall be borne equally by both the bailor and the bailee, unless there is a stipulation to the contrary.

COMMENT:

(1) Extraordinary Expenses

- (a) As a rule, the extraordinary expenses should be paid by the bailor because it is he who profits by said expenses; otherwise, the thing borrowed would be destroyed.
- (b) Generally, notice is required because the bailor should be given discretion as to what he wants to do with his own property.

(2) Reason for the Second Paragraph (Actual Use by Bailee)

This is an equitable solution. The bailee pays one half because of the benefit derived from the use of the thing loaned to him, and the bailor pays the other half because he is the

owner and the thing will be returned to him. (*Report of the Code Commission, p. 151*).

(3) Example

A borrowed a motorbike from B. While A was riding on it, he met an accident which greatly damaged the bike. A was not at fault for he was driving carefully. Both A and B should share equally in the extraordinary expenses unless there is a stipulation to the contrary.

Art. 1950. If, for the purpose of making use of the thing, the bailee incurs expenses other than those referred to in Articles 1941 and 1949, he is not entitled to reimbursement. (n)

COMMENT:

Other Expenses

Example: The borrower of a car buys an *extra jack* to be used as a reserve on a trip. Here, he is not entitled to reimbursement.

Art. 1951. The bailor who, knowing the flaws of the thing loaned, does not advise the bailee of the same, shall be liable to the latter for the damages which he may suffer by reason thereof.

COMMENT:

(1) When Bailor Knows Flaws

Example:

A lent B a Fisher & Paykel, the electric connections of which were defective. If although he knows said defect, A does not inform B thereof, A will be liable in case B is injured by reason thereof.

(2) Reason for the Law

When a person lends, he ought to confer a benefit, and not to do a mischief. If he does not reveal the flaws, he is liable for his bad faith. (*Gagnon v. Dana, 39 Atl. 982*).

[NOTE: But the obligation of a gratuitous lender goes no further than this, and he cannot therefore be made liable for not communicating anything which he did not know, whether he ought to have known it or not. (Gagnon v. Dana, supra).]

(3) Right of Retention

For the damages spoken of in this Article, the bailee has the right of retention until paid of said damages. (*Art. 1944, Civil Code*).

(4) Nature of the Flaws

It is evident that the flaws referred to in this Article are *hidden defects, not obvious ones*.

Art. 1952. The bailor cannot exempt himself from the payment of expenses or damages by abandoning the thing to the bailee.

COMMENT:

(1) Effect of Bailor's Abandonment or Giving of the Object

Example:

For extraordinary expenses on *A's* car, *B* the borrower spent P125,000. *A* cannot exempt himself from payment thereof by just giving *B* the thing borrowed.

(2) Reason for the Law

The value of the thing borrowed might be less than the value of the expenses or damages.

Chapter 2

SIMPLE LOAN OR MUTUUM

Art. 1953. A person who receives a loan of money or any other fungible thing acquires the ownership thereof, and is bound to pay to the creditor an equal amount of the same kind and quality.

COMMENT:

(1) Ownership Passes in Mutuum

Ownership passes to the borrower, but, of course, he must pay later.

Republic v. Jose Grijaldo **L-20240, Dec. 31, 1965**

FACTS: In 1943, Jose Grijaldo borrowed money from a bank, evidenced by five promissory notes, and secured by a chattel mortgage on the standing crops on his land. During the war, the crops were destroyed as a result of enemy action.
Issue: Must the borrower still pay?

HELD: Yes, for his obligation was to pay a *generic* thing — money representing the loan with interest. The chattel mortgage on the crops simply stood as security for the fulfillment of his obligations, and therefore, the loss of the crops did NOT extinguish his obligation to pay, because the account can still be paid from sources other than said mortgaged crops.

Carlos Gelano, et al. v. Court of Appeals **and Insular Sawmill, Inc.** **L-39060, Feb. 24, 1981**

If a husband incurs debts which redound to the benefit of the conjugal partnership, who is liable?

HELD: The conjugal partnership is liable under Art. 161, par. 1, of the Civil Code [now Art. 121, last par., Family Code]. It is wrong to say that the conjugal partnership is liable jointly and severally, for the conjugal partnership is a *single entity*.

Bonnevie v. Court of Appeals
GR 49101, Oct. 24, 1983

(1) A contract of loan is *consensual* (author believes it to be a real contract — a borrower of money who has not yet been given the money is not yet a borrower; he is only a would-be borrower).

(2) If a loan (money is given only some time after the execution of a mortgage, the mortgage is still *valid*. After all, the promissory note is only *evidentiary* of the debt. The late execution of the promissory note does not mean that the mortgage had no consideration.

(2) Similarity to Abnormal Usufruct

Mutuum is similar to an abnormal usufruct.

(3) Bank Accounts

Fixed, savings, and current deposits of money in banks and similar institutions shall be governed by the provisions concerning simple loans. (*Art. 1980 and Gullas v. Phil. National Bank, 62 Phil. 519*).

(4) Effect of Mutual Error

Rural Bank of Caloocan v. Court of Appeals
L-32116, Apr. 21, 1981

Thru fraud committed by a third party (the Valencia Spouses), Maxima Castro found herself indebted to a Rural Bank for a *total* debt of P6,000 (P3,000 was what she intended to borrow; the Valencias added another P3,000 for themselves, with Castro signing the promissory note as co-maker). For how much is Castro liable?

HELD: Only for P3,000 plus interest. The extra P3,000 can be annulled insofar as Castro is concerned, not because of fraud (neither party — the Bank nor Castro — had committed fraud), but because of *mutual error* caused by the fraud attributable to the Valencias. The mortgage over Castro's lot is *reduced* insofar as it exceeds Castro's personal loan.

(5) 'Behest' Loans

**Presidential Ad Hoc Fact-Finding Committee on Behest Loans v. Hon. Aniano A. Desierto
(Recovery of Ill-Gotten Wealth)**

GR 130340, 114 SCRA 707

Oct. 25, 1999

The "behest" nature of the loans could not be reasonably known by a mere eye examination of the mortgage contracts.

Behest loans are part of the ill-gotten wealth which former President Ferdinand E. Marcos and his cronies accumulated and which the Government thru the Presidential Commission on Good Government (PCGG) seeks to recover.

Art. 1954. A contract whereby one person transfers the ownership of non-fungible things to another with the obligation on the part of the latter to give things of the same kind, quantity, and quality be considered a barter.

COMMENT:

(1) Barter of Non-Consumable Things

Here, the word *non-fungible* does not really mean non-fungible but *non-consumable*. *Reason*: If the thing were really non-fungible, the identical thing must be returned. Here, an equivalent thing is returned.

(2) Example

A got a fountain pen from B and he (A) became the owner thereof, with the obligation of giving another pen of

the same kind and quality. This shall be considered a barter. It is not a *commodatum* nor a *mutuum*.

Art. 1955. The obligation of a person who borrows money shall be governed by the provisions of Articles 1249 and 1250 of this Code.

If what was loaned is a fungible thing other than money, the debtor owes another thing of the same kind, quantity and quality, even if it should change in value. In case it is impossible to deliver the same kind, its value at the time of the perfection of the loan shall be paid.

COMMENT:

(1) Liability of Borrower of Money

- (a) Liability is governed by Arts. 1249 and 1250.
- (b) Art. 1249. The payment of debts in money shall be made in the currency stipulated, and if it is not possible to deliver such currency, then in the currency which is legal tender in the Philippines.

The delivery of promissory notes payable to order, or bills of exchange or other mercantile documents shall produce the effect of payment only when they have been cashed, or when through the fault of the creditor they have been impaired.

In the meantime, the action derived from the original obligation shall be held in abeyance.

- (c) Art. 1250. In case an extraordinary inflation or deflation of the currency stipulated should supervene, the value of the currency at the time of the establishment of the obligation shall be the basis of payment, unless there is an agreement to the contrary.

(2) Example of Second Paragraph (Loan of Things Other Than Money)

A borrowed from B five sacks of rice. At the time the loan was perfected, each sack cost P1,800. Even if at the

time of payment the price would change, five sacks of the same kind and quality of rice should be returned. However, if it is impossible to deliver the same kind, P1,800 should be paid. Note that the value at the time of PERFECTION (not payment) applies.

Art. 1956. No interest shall be due unless it has been expressly stipulated in writing.

COMMENT:

(1) Formality for Interest (for Use of the Money)

The interest must be stipulated in WRITING.

(2) Example

A borrowed P1,000,000 from B. No mention was made of interest. No interest can be charged. But if interest had been stipulated upon, but no rate was mentioned, then it is 12% per annum provided of course that the agreement as to interest was made in writing.

(3) Kinds of Interest

Interest may be paid either as *compensation* for the use of the money (monetary interests) or as *damages* (compensatory interest). Art. 1956 refers to interest for use of the money.

(4) How Interest Arises

The right to interest arises only by virtue of a contract or by virtue of damages for delay or failure to pay principal on which interest is demanded. (*Barretto v. Santa Marina*, 37 Phil. 568).

(5) When Interest Earns Interest

Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point. (*Art. 2212, Civil Code*).

(6) Interest by Way of Damages

- (a) Part of a contract said: "The first installment (payable in 3 months) shall have no interest." But debtor was in default. Should he pay interest for damages?

HELD: Yes, not interest for compensation but interest for damages. "The trial court appears to have considered that this stipulation deprived the plaintiff of the right to interest after default, and no interest whatever was allowed by him upon this installment. This was error. The stipulation that this installment should draw no interest was made in the expectation that the obligation would be paid upon the date stipulated. After default occurred the defendant became liable for interest as *damages* regardless of the statement that his installment should draw no interest. This statement in the contract was evidently intended merely to govern the rights of the parties with respect to interest for the three-month period between the making of the contract and the date when the installment was to become due. With respect to the plaintiff's right to interest after default, the situation is to be treated precisely as if nothing had been said about interest at all." (*Zobel v. City of Manila*, 47 *Phil.* 169).

- (b) In contracts for the payment of a sum of money, the measure of damages for delay is limited to the interest provided for by law. The deprivation of an opportunity for making money, which might have proved beneficial or might have been ruinous is of too uncertain a character to be weighed in the even balances of the law. (*Lopez v. Del Rosario*, 44 *Phil.* 98).
- (c) Art. 2209 — If the obligation consists in the payment of a sum of money, and the debtor incurs in delay, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six per cent per annum. (The rate NOW is 12% *per annum*.)

(7) Consolidation

Part of the contract reads: "The five latter installments shall draw interest at the rate of five per cent per annum, payable to the creditors upon the date when they shall respectively fall due." Debtor was in default. How will interest be computed?

HELD: Interest must be allowed thereon at the contract rate of 5% per annum from the date of the contract; and the interest that had accrued up to the date of the filing of the complaint must be consolidated as to that date with the capital, after which the whole shall bear interest at the contract rate of five per cent per annum until paid. Where interest is contracted for at a given rate, the contract of obligation to pay interest is not merged in the judgment but remains in full force until the debt is paid. The circumstances that the rate stipulated was less than the lawful rate does not alter the case. (*Zobel v. City of Manila, supra*).

(8) Municipal Corporations Are Liable for Interest

A municipal corporation does *not* enjoy immunity from liability for interest when assessed as damages for the non-payment of a debt, to the same extent as the national government. (*Zobel v. City of Manila, supra*).

(9) Interest During the Moratorium Laws

Interest ran during the moratorium laws. If debtors had wanted to avoid liability for all the interest falling due during the time that the moratorium laws were in effect, they could have renounced the benefits of the said laws and paid the debts, or in the very least paid the interest as they accrued. (*Warner, Barnes & Co. v. Yasay, et al., L-12984, Jul. 26, 1960*). What the moratorium laws suspended was the running of the period of prescription of actions. (*Republic v. Grijaldo, L-20240, Dec. 31, 1965*). Interest during the war years however can be eliminated if the creditors were enemies of the Japanese, for their payment to them could *not* have been made. (*Ibid.*)

(10) Computations for Compensatory Damages

As already stated, this is interest not imposed for the *use* of the money, but to serve as *penalty or damages* for the breach of contractual obligations. This kind of interest need not be stipulated in writing, for the law gives the rate (6% per annum) in the absence of *agreement as to the penalty*. (*Art. 2209, Civil Code*). In the following examples, legal interest was computed at 6% *per annum*. Note however that today the legal rate is 12% per annum. The examples must, therefore, be amended correspondingly.

Examples:

- (a) *B* borrowed from *C* P1,000,000 for one year. No interest was agreed upon in writing. At the end of one year, *C* demanded payment, but *B* was unable or refused to pay. After two more years, *B* was ready to pay. In addition to the principal sum of P1,000,000, how much interest, if any, must *B* pay?

ANS.: B is not liable for interest for the *use* of the money (since this was not stipulated in writing) BUT he is liable for interest in view of his *default*, as a punishment or penalty by way of damages for his breach of the contract. Please note that there is default after a *demand* is made (either judicially or extra-judicially). (*Art. 1169, Civil Code*). The interest here given as penalty is 6% per annum — since there was no stipulation as to the penalty. (*Art. 2209, Civil Code*). *B* has been in default for two years (counted from the demand). Hence, he is liable for interest (6%) for two years: 6% of P1,000,000 = P60,000 per year, P60,000 times 2 (years) = P120,000. This is the interest that he must pay. (*Ibid.*)

- (b) *B* borrowed from *C* P1,000,000 for two (2) years. It was agreed *in writing* that interest would be 6% per annum. At the end of two years, *C* made an extrajudicial demand, but *B* was unable or refused to pay. At the end of three (3) MORE years, *B* was ready to pay. How much all in all must *B* pay?

ANS.: Here *B* must pay:

- 1) the principal (P1,000,000)
- 2) interest for the use of the money (6% per year — for a total of 5 years, since from the time he borrowed up to the time of payment, 5 years have elapsed).
- 3) interest as penalty for the default (6% per year for a period of three [3] years — since he has been in *default* for 3 years).

Computation:

1)	Principal	—	P1,000,000	
2)	Moratory interest	—	P300,000	(P60,000 a year times 5 years)
3)	Compensatory	—	P 180,000	(P60,000 a year times 3 years)
			<hr/>	
			P1,480,000	(Total sum to be paid.)

[**NOTE:** In the problem given, no interest is charged on the *accrued interest* — interest that has accumulated up to the time demand is made because here the demand was only *extrajudicial*. If the demand had been *judicial*, there would have been an *additional* interest on the accrued interest. The law says that “interest *due* shall earn legal interest from the time it is *judicially* demanded, although the obligation may be silent upon this point.” (*Art. 2212, Civil Code*).]

Example:

B borrowed from *C* P1,000,000 for two (2) years. It was agreed in writing that interest would be 6% per annum. At the end of two years, *C* made a JUDICIAL demand (a court action was instituted). At the end of three (3) MORE years, *B* was ready to pay. How much all must *B* pay?

ANS.: <i>B</i> must pay:		
1) the principal	— P1,000,000	(P60,000 a year use for 6 years use of the money) (P60,000 a year of default) (at the time <i>judicial</i> demand, interest for two years was already due P20,000. The <i>accrued</i> interest itself earns interest from judicial demand to payment.
2) moratory interest	— P 300,000	
3) compensatory	— P 180,000	
4) additional compensatory interest on the interest due or accrued	— P 21,600	
Total Sum	P1,501,600	P120,000 x 6% = P7,200 a year. P7,200 times 3 years = P21,600).

(11) Some Cases

**Nakpil and Sons, et al. v. CA
GR 47861, Resolution on Motion
for Reconsideration**

FACTS: In a decision of the Supreme Court, finding the architect and the contractor liable for gross negligene (equivalent to bad faith) in effecting the plans and construction of a building, imposed upon defendants a solidary indemnity in favor of the plaintiff. The court added that “upon failure to pay on such finality, twelve percent (12%) interest *per annum* shall be imposed upon aforementioned amounts from finality until paid.” On motion for reconsideration, the defendants alleged that the interest of 12% *per annum* imposed on the total amount of the monetary award contravenes the law, since there is neither loan nor forbearance. Denying the motion for reconsideration, the Supreme Court —

HELD: It is true that in the instant case, there is neither a loan or a forbearance, but then no interest is actually being imposed provided the sums referred to in the judgment are paid upon the finality of the judgment. It is delay in the payment of such final judgment that will cause the imposition of interest. The rate of interest is imposed on the total sum, from the filing of the complaint until paid; in other words, as part of the judgment for damages.

**Monzon, et al. v. IAC and Theo H. Davies
& Co., Far East Ltd.
GR 72828, Jan. 31, 1989**

Eliminating the interest on the various damages from the date of the filing of the suit is clearly an unwarranted act. It must be borne in mind that interest begins to accrue upon demand, extrajudicial or judicial. A complaint is a judicial demand.

**Antonio Tan v. CA & Cultural Center
of the Phils.
GR 116285, Oct. 19, 2001**

The stipulated 14% p.a. interest charge until full payment of the loan constitutes the monetary interest on the note and is allowed under Art. 1956.

In the case at bar, the stipulated 2% per month penalty is in the form of a penalty charge which is separate and distinct from the monetary interest on the principal of the loan.

Art. 1957. Contracts and stipulations, under any cloak or device whatever, intended to circumvent the laws against usury shall be void. The borrower may recover in accordance with the laws on usury.

COMMENT:

(1) Usury Law Should Not Be Circumvented

The Article is self-explanatory.

(2) What Constitutes Usury**Herrera v. Petrophil Corp.
GR 48349, Dec. 29, 1986**

To constitute usury, there must be a loan or forbearance. And something must be exacted for the use of money in excess of and in addition to interest allowed by law.

Thus, the elements of usury are: (1) a loan express or implied; (2) understanding between the parties that the money lent shall or may be returned; (3) for such loan a greater rate of interest that is allowed by law shall be paid or agreed to be paid as the case may be; and (4) corrupt intent to take more than the legal rate for the use of money. Unless these four things concur in every transaction, no case of usury can be declared.

(3) Repeal of Usury Law

Central Bank (Bangko Sentral) Circular 905 has repealed the Usury Law. Today, there is no more maximum rate of interest. The rate will just depend on the mutual agreement of the parties.

**Liam Law v. Olympic Sawmill Co.
and Elin Lee Chi
L-30771, May 28, 1984**

For sometime now, usury has been legally non-existent. Interest can now be charged as lender and borrower may agree upon.

Art. 1958. In the determination of the interest, if it is payable in kind, its value shall be appraised at the current price of the products or goods at the time and place of payment.

COMMENT:**Determination of Interest if in Kind**

Value should be at *time* and *place* of PAYMENT.

Art. 1959. Without prejudice to the provisions of Article 2212, interest due and unpaid shall not earn interest. However, the contracting parties may by stipulation capitalize the interest due and unpaid, which as added principal, shall earn new interest.

COMMENT:**(1) When Accrued Interest Earns Interest**

The general rule is that accrued interest (interest due and unpaid) will not bear interest, BUT

- (a) if there is agreement to this effect (*Art. 1959*), or
- (b) if there is judicial demand. (*Art. 2212*).

THEN such accrued interest will bear interest at the legal rate (*Art. 2212*) unless, a different rate is stipulated. (*Hodges v. Regalado, 69 Phil. 588*).

(2) Compound Interest

Compound interest is interest on accrued interest. It is valid to charge compound interest, but there must be a written agreement to this effect; otherwise said compound interest should not be charged (*Nolan v. Majinay, 12 Phil. 560*) unless it be the interest charged upon judicial demand. (*Art. 2212*).

(3) Usury Law Not Violated

The interest on accrued or capitalized interest is not considered interest on the original principal, and should not be considered usurious, if, when added to the original interest, the sum should exceed the rates allowed by the Usury Law. (*Villareal v. Alayda, 46 Phil. 277*). In that case, the

original principal was P30,000 which had earned P3,600 at 12% interest for one year. The parties added the P3,600 to the original P30,000, and thus constituted thereon a new principal debt. The debtor did not want to pay on the ground that the contract was usurious.

HELD: There is nothing illegal here. As a matter of fact, the Supreme Court in a subsequent case held: "It is well settled in this jurisdiction that when there is an express agreement to charge interest on interest, such fact should not be taken into consideration in determining whether or not the stipulated interest exceeds the limit prescribed by the Usury Law." (*Gov't. v. Conde*, 61 Phil. 714 and *Gov't. v. Vaca & Calderon*, 64 Phil. 6).

(4) When Compound Interest Cannot Be Demanded

Notice, however, that the agreement on compound interest must be expressly made. In one case the following words were used: "Interest, to be computed upon the still unpaid capital of the loan, shall be paid monthly, at the end of each month." Does this allow compound interest?

HELD: No. The language which we have quoted above does not justify the charging of interest upon interest, so far as interest on the capital is concerned. The provision quoted merely requires the debtor to pay interest monthly at the end of each month, such interest be computed upon the capital of the loan not yet paid. Clearly this provision does not justify the charging of compound interest upon the interest accruing upon the capital monthly. (*Co Unjieng v. Mabalacat Sugar Co.*, 54 Phil. 976).

(5) Reason Why Compound Interests Are Not Allowed Except in the Cases Provided for by Law

Debts would accumulate with a rapidity beyond all ordinary calculation and endurance. It would tend also to inflame the avarice and harden the heart of the creditor. Some allowance must be made for the indolence of mankind. (15 RCL 36).

(6) Case

**Antonio Tan v. CA & Cultural
Center of the Phils.
GR 116285, Oct. 19, 2001**

FACTS: Petitioner avers that there is no legal basis for the imposition of interest on the penalty charge for the reason that the law only allows imposition of interest on monetary interest but not the charging of interest on penalty. He claims that since there is no law that allows imposition of interest on penalties, the penalties should not bear interest. *Issue:* May interest on penalties be validly imposed?

HELD: Penalty clauses can be in the form of penalty or compensatory interest. The compounding of the penalty or compensatory interest is sanctioned by and allowed pursuant to the abovequoted provision of Art. 1959 of the new Civil Code considering that:

1. There is an express stipulation in the promissory note permitting the compounding of interest; and
2. Art. 2212 of the new Civil Code provides that “[i]nterest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point.”

Art. 1960. If the borrower pays interest when there has been no stipulation therefor, the provisions of this Code concerning *solutio indebiti*, or natural obligations, shall be applied as the case may be.

COMMENT:

Payment of Interest When There is No Stipulation

- (a) A borrower borrowed money. No interest was stipulated. If by mistake he pays, then this will be a question of *undue payment* or *solutio indebiti*. We should then apply the rules on the subject.
- (b) If a borrower borrows money and orally agrees to pay legal interest at 10% *per annum*, there is really no ob-

ligation to pay since the interest was not agreed upon in writing. If he nevertheless pays because he considers it his moral obligation to pay said interest, he cannot recover the interest that he has given voluntarily. This will now be a *natural* obligation, and the provisions on said subject should apply.

Art. 1961. Usurious contracts shall be governed by the Usury Law and other special laws, so far as they are not inconsistent with this Code.

COMMENT:

(1) Usury Law

Act 2655 as amended is our Usury Law, and was enacted on Feb. 24, 1916. The law was passed to curb usury, since the taking of excessive interest for the loan of money has been regarded with abhorrence from the earliest times. (*U.S. v. Constantino*, 39 *Phil.* 552).

(2) Rules on Construction

Since the Usury Law is penal in nature, it should be construed strictly. (*Dickerman v. Pay*, 7 *Am. Rep.* 156). Like other laws, prospective effect should be given to it, where such construction may be permitted. Laws adopted after the execution of a contract, changing or altering the rate of interest, cannot apply to such a contract without violating the provision of the Constitution which prohibits the adoption of a law impairing the obligations of a contract. (*U.S. v. Conde*, 42 *Phil.* 766).

(3) Criminal Liability

A lender and a borrower agreed that the rate of interest on an unsecured loan would be higher than 14% *per annum*. But actually, the lender only received the lawful rate. Is the lender guilty of usury by the mere fact that he agreed to charge a usurious rate?

HELD: Yes. Under Sec. 3 of the Usury Law, the prohibition is deemed to comprehend not only the taking or receiv-

ing of a higher rate of interest than 14% *per annum* if such loan is not secured in the manner provided in said section, but also the act of agreeing on such rate of interest. To this extent it differs from Sec. 2, under which a mere agreement to pay usurious interest is not criminal. (*People v. Bernarte*, C.A. 36 O.G. 2720).

(4) When Usury Law Does Not Apply

- (a) A contract for the lease of property is not a *loan*; hence, the rental paid is not governed by the Usury Law. (*Tolentino v. Gonzales*, 50 Phil. 58).
- (b) The increase of the price of a thing sold on credit over its cash sale price is not interest within the purview of the Usury Law, if the sale is made in good faith and not as a mere pretext to cover a usurious loan. (*Manila Trading v. Tamaraw*, 47 Phil. 513). Such price is the *selling price* for a sale made on the installment plan.

(5) Compound Interest

In one case, it was held that an express agreement to charge compound interest is not to be taken into consideration in determining whether or not the stipulated interest exceed the limit prescribed by the Usury Law. (*Gov't. v. Conde*, 61 Phil. 714). This was changed by a subsequent case which held that charging compound interest violates the Usury Law when the sums charged as such added to the stipulated interest exceeds the average rate of interest that may legally be charged for a loan. (*Hodges v. Salas*, 63 Phil. 567). In a still later case, the Supreme Court reverted to the ruling in the *Conde* Case. (*Gov't v. Vaca and Calderon*, 64 Phil. 6).

(6) Advance Interest

Charging interest in advance is permissible provided said interest does not correspond to interest for more than one year. (*Hodges v. Salas*, 63 Phil. 567).

(7) How Much Interest Can Debtor Recover

If a debtor has paid usurious interest, how much can he get back from his creditor?

ANS.:

- (a) Under Art. 1961, in case of conflict between the new Civil Code and the Usury Law, the new Civil Code applies, and therefore, the interest in excess of 12% or 14% may be recovered, with interest. (*Art. 1413*). However, in the case of *Angel Jose Warehousing v. Chelda Enterprises & David Syjuico, L-25704, Apr. 24, 1968*, the Supreme Court, ruled that the ENTIRE interest can be recovered by the debtor, for such a stipulation is VOID (thus, it is as if there is NO STIPULATION as to interest). On the other hand, the principal contract of loan by itself is valid, hence this may be recovered by the creditor. In case of demand, and if the debtor is in default, said principal debt earns interest from the date of the demand. This interest is not by way of compensation but by way of damages.

**Sanchez v. Buenviaje
GR 57314, Nov. 29, 1983**

Under the Usury Law (now repealed), the lender at usurious rates can still recover the principal (not the interest). Justice Ramon Aquino (later to become Chief Justice) consents because there should be no unjust enrichment by the borrower. Justice Makasiar (later to become Chief Justice) dissents on the theory that the usurer has committed a crime and must therefore be penalized by barring him from the recovery of his capital.

- (b) Under Arts. 1175 and 1957, the Usury Law prevails; and under Sec. 6 of said Usury Law (*Act 2655*), the person paying the usurious interest “may recover the *whole* interest, commission, premiums, penalties, surcharges paid and delivered” as long as the action for recovery is instituted within two years after such payment and the delivery (that is, all interest paid within the last two years prior to litigation may be recovered).

(**NOTE:** It should be noted that under both theories, *legal interest on the interest* may also be recovered.)

(**NOTE:** As has already been said, as of today, the Usury Law no longer exists.)

(8) Lawful Interest Rates

Interest rates are now fixed from time to time by the Monetary Board.

(9) Central Bank Circular 416

Pilipinas Bank v. CA
43 SCAD 990
1993

Circular No. 416, fixing the rate of interest at 12% p.a., deals with:

- (1) loans;
- (2) forbearance of any money, goods or credit; and
- (3) judgments.

(10) Cases

Almeda v. CA
70 SCAD 248
1996

While the Usury Law ceiling on interest rates was lifted by Central Bank (Bangko Sentral) Circular 905, nothing in the said circular could possibly be read as granting *carte blanche* authority to lenders to raise interest rate to levels which would either enslave their borrowers or lead to a hemorrhaging of their assets. At any rate, galloping increases in interest rate unilaterally imposed by a bank on a customer's loan, over the latter's vehement protests, are arbitrary. An increase in interest rates from 18% to 68% is excessive and unconscionable.

Where the escalation clause of the credit agreement in the instant case required that the same be made "within the limits allowed by law," it obviously referred specifically to legislative enactments not administrative circulars. Escalation clauses are not basically wrong or legally objectionable so long as they are not solely potestative but based on reasonable and valid grounds.

[**NOTE:** Any increase in the rate of interest made pursuant to an escalation clause must be the result of an agreement between the parties. (*PNB v. CA*, 72 SCAD 366, 258 SCRA 549).] Escalation clauses are valid stipulations in commercial contracts to maintain fiscal stability and to retain the value of money in long-term contracts. (*Florendo v. CA*, 77 SCAD 429, 265 SCRA 678 [1996]).]

[**NOTE:**

Sec. 1 of Central Bank (Bangko Sentral) Circ. 905, Series of 1982, expressly removed the interest ceilings prescribed by the Usury Law. Interest can now be charged as lender and borrower may agree upon. (*People v. Dizon*, 73 SCAD 532, 260 SCRA 851 [1996]). The unilateral determination and imposition of increased interest rates by respondent bank is obviously violative of the principle of mutuality of contracts. (*Ibid.*)]

**Spouses Puerto v. Court of Appeals
GR 138210, Jun. 13, 2002**

Contracts and stipulations, under any cloak or device whatever, intended to circumvent the laws against usury shall be void. The parties then must restore what each had received from the other.

[**NOTE:** The maximum rate of interest on a loan are forbearance of money secured by a mortgage upon real estate the title to which is duly registered, shall be 12% *per annum*. (Sec. 2, *The Usury Law* [PD 116, amending Act 2655]). All covenants and stipulations contained in conveyances, mortgages, and other contracts or evidences of debts, whereupon or whereby there shall be stipulated, charged, demanded, reserved, secured, taken or received, directly or indirectly, secured, taken or received, directly or indirectly, a higher rate or greater sum or value for the loan than is hereinbefore allowed, shall be void. (Sec. 7, *Id.*, cited in *Sps. Puerto vs. CA*, *supra*).]

TITLE XII

DEPOSIT

Chapter 1

DEPOSIT IN GENERAL AND ITS DIFFERENT KINDS

Art. 1962. A deposit is constituted from the moment a person receives a thing belonging to another, with the obligation of safely keeping it and of returning the same. If the safekeeping of the thing delivered is not the principal purpose of the contract, there is no deposit but some other contract.

COMMENT:

(1) Provisions in the Code of Commerce

The provisions on commercial deposits found in the Code of Commerce have been repealed. (*Art. 2270, [2], Civil Code*).

(2) When Contract of Deposit is Perfected

A deposit, being a real contract, is perfected by delivery (*Art. 1316, Civil Code*), but an agreement to constitute a deposit is merely consensual, and is therefore binding upon mere consent. (*Art. 1963, Civil Code*).

(3) Purposes of the Contract

The principal purpose of a deposit is the safekeeping of the thing delivered (*Art. 1962*), but this does not mean that the depositary can never use it. He can, in two instances:

- (a) with the express permission of the depositor;

- (b) when the preservation of the thing deposited requires its use, it must be used but only for that purpose. (*Art. 1977, Civil Code*).

Of course, if safekeeping is not the principal purpose, there is no deposit but some other contract (*Art. 1962*), like one of lease or commodatum.

(4) Kinds of Deposits

- (a) Judicial (sequestration) — When an attachment or seizure of property in litigation is ordered. (*Art. 2005, Civil Code*).
- (b) Extrajudicial —
 - 1) voluntary — made by the will of the depositor. (*Art. 1968, Civil Code*).
 - 2) necessary —
 - a) made in compliance with a legal obligation. (*Art. 1966, Civil Code*).
 - b) on the occasion of a calamity. (*Art. 1996, Civil Code*).
 - c) made by travelers in hotels or inns. (*Art. 1998, Civil Code*).
 - d) made by travelers with common carrier. (*Art. 1736, Civil Code*).

(5) Characteristics of the Contract of Deposit

- (a) It is a *real* contract perfected by delivery. (*Art. 1316, Civil Code*). [Nonetheless, there can be consensual contract to make or to constitute a deposit. (*Art. 1963, Civil Code*).
- (b) The principal *purpose* is the safekeeping of the thing delivered. (*Art. 1962*). [Thus, if the safekeeping is merely *secondary*, the contract is *not* a deposit but some other contract like one of lease or *commodatum*. (*Ibid.*).]
- (c) The depositary cannot *use* the thing deposited except:
 - 1) with the express permission of the depositor; or

- 2) when the preservation of the thing deposited requires its use [but then it must be used only for that purpose. (*Art. 1977, Civil Code*).]
- (d) Only *movable* things can be the object of a deposit. (*Art. 1966, Civil Code*).
- (e) It is a *gratuitous* contract, except when there is an agreement to the contrary or unless the depositary is engaged in the business of storing goods. (*Art. 1965, Civil Code*).
- (f) The contract is either *unilateral* or *bilateral*, according to whether it is gratuitous or compensated (onerous).

(6) ‘Deposit’ Distinguished from ‘Sale’ and ‘Barter’

<i>DEPOSIT</i>	<i>SALE AND BARTER</i>
(a) ownership is not transferred	(a) ownership is transferred upon delivery
(b) real contract	(b) consensual (perfected by mere consent)
(c) generally gratuitous	(c) always onerous

(7) ‘Deposit’ and ‘Commodatum’ Distinguished

<i>DEPOSIT</i>	<i>COMMODATUM</i>
(a) may be gratuitous	(a) essentially and always gratuitous
(b) principal purpose is safe-keeping	(b) principal purpose is use

(8) ‘Deposit’ Distinguished from ‘Agency’

<i>DEPOSIT</i>	<i>AGENCY</i>
(a) purpose is safekeeping	(a) purpose is the representation by the agent of the principal’s affairs

(b) the custody of the things is the principal and essential reason for deposit	(b) the custody here of the things is merely an incidental or accessory obligation of the agent
(c) generally gratuitous. (Art. 1965, Civil Code).	(c) generally onerous or for a compensation

(9) Balance of a Commission Account

NOTE, however, that the balance of a commission account remaining in the possession of the agent at the principal's disposal acquires at once the character of a deposit which the former must return or restore to the latter at any time it is demanded. The agent *cannot* lawfully dispose of it *without* incurring criminal responsibility for appropriating or diverting to his own use another's property. It could only become his as a loan, if so expressly agreed by its owner who would then be obligated not to demand it until the expiration of the legal or stipulated period for the loan. (*U.S. v. Iguara*, 7 Phil. 619).

(10) Advance Partial Payment in Sales

A so-called *deposit* of an advance payment in the case of a sale is not the *deposit* contemplated under Art. 1962. It is *advance payment*, and ownership is transferred to the seller once given. (*Cruz v. Aud.-Gen.*, L-12233, May 30, 1959).

Art. 1963. An agreement to constitute a deposit is binding, but the deposit itself is not perfected until the delivery of the thing.

COMMENT:

(1) Consensual Contract to Constitute a Deposit

A deposit is a real contract and is not perfected until the delivery of the object of the obligation. (Art. 1316, Civil Code). Where there has been no delivery, there is merely an agreement to deposit, a personal obligation *to do*. Hence, it has been truly said that a contract of future deposit is merely consensual. Such contract is, however, binding.

(2) Necessity of an Agreement

It should be noted, however, that an offer to constitute a deposit in the future is binding only when said offer is accepted. Note that the law uses the term *agreement*. Without said agreement, there is no contract at all whether real or consensual. This doctrine is, however, applicable merely to voluntary deposits.

Art. 1964. A deposit may be constituted judicially or extrajudicially.

COMMENT:

Distinctions Between ‘Judicial’ and ‘Extrajudicial’ Deposits

<i>EXTRAJUDICIAL</i>		<i>JUDICIAL</i>
(1) the will of the parties	ORIGIN	(1) the will of the court
(2) there is a contract	STATUS	(2) no contract
(3) custody and safe-keeping of the thing for the benefit of the depositor	PURPOSE	(3) to guarantee the right of the plaintiff in case of a favorable judgment
(4) gratuitous, as a rule	CAUSE	(4) onerous
(5) always movable property	SUBJECT MATTER	(5) either movable or immovable property, but generally, immovable
(6) in behalf of the depositor	IN WHOSE BEHALF IT IS HELD	(6) in behalf of the winner

Art. 1965. A deposit is a gratuitous contract, except when there is an agreement to the contrary, or unless the depositary is engaged in the business of storing goods.

COMMENT:

(1) Compensation in a Deposit

Generally, deposit is GRATUITOUS.

Exceptions:

- (a) when there is a contrary agreement;
- (b) when the depositary is engaged in the business of storing goods.

(2) Problem

A deposited his goods with B. Compensation was agreed upon, but the rate was not fixed. How much should be given?

ANS.: In such a case (because there was no stipulation as to how much should be paid), the compensation should be fixed according to the current rates in the place where the deposit was constituted. If the goods were delivered in one place but actually deposited in another place, the rate of compensation shall be that of the place where the things were delivered, because that would be the place where the contract was perfected. (8 *Echavarri* 180).

(3) When Contract Is Really One of Loan

When the thing delivered can be used by the depositary and he is obliged to pay interest for said use, it follows that the contract cannot be considered a deposit but a loan or mutuum. Notice here that we cannot consider this an onerous deposit for in the problem presented, it is the *depositary* who pays interest or remuneration. (*Aquino v. Dealá*, 63 *Phil.* 582).

Art. 1966. Only movable things may be the object of a deposit.

COMMENT:**(1) Why Only Movable Things May Be the Object of a Deposit**

The object of a deposit is the safekeeping of a thing, for without such safekeeping it may be lost or it may disappear or be stolen. This will not happen in real property (unless of course what is meant by loss is *destruction*). Hence, only movable things may be the object of a deposit.

(2) Services of a Watchman

A watchman's services may, of course, be *leased* to guard real estates.

(3) Sequestration or Attachment of Real Properties

Real properties, particularly those involved in court cases, may be attached or sequestered. An annotation of *lis pendens* pending litigation) may be made in the Register of Property.

Art. 1967. An extrajudicial deposit is either voluntary or necessary.

COMMENT:**Kinds of Extrajudicial Deposit**

- (a) Voluntary — as when there is mutual consent.
- (b) Necessary — when there is a deposit because of a calamity (*depositum miserabile*).

Chapter 2

VOLUNTARY DEPOSIT

Section 1

GENERAL PROVISIONS

Art. 1968. A voluntary deposit is that wherein the delivery is made by the will of the depositor. A deposit may also be made by two or more persons each of whom believes himself entitled to the thing deposited with a third person, who shall deliver it in a proper case to the one to whom it belongs.

COMMENT:

(1) ‘Voluntary Deposit’ Defined

A voluntary deposit is that wherein the delivery of the object is made by the will of the depositor.

(2) Reason for the First Sentence

To emphasize the difference of a voluntary deposit from the necessary deposit, it is obvious that this complete freedom of action is absent in the latter.

(3) Depositor Need Not Be the Owner

Generally, the depositor must be the owner. The second sentence admits the validity of a deposit which has not been made by the true owner. As a matter of fact, the law provides that the “depository cannot demand that the depositor prove his ownership of the thing deposited.” (*Art. 1984, 1st par., Civil Code*). After all, a depositor does not transfer ownership over the subject matter.

(4) 'Interpleader' Defined

Whenever conflicting claims upon the same subject matter are or may be made against a person who claims no interest whatever in the subject matter, or an interest which in whole or in part is not disputed by the claimants, he may bring an action to compel them to interplead and litigate their several claims among themselves. (*Sec. 1, Rule 63, Revised Rules of Court*).

(5) Example of Interpleader

A and *B* each claiming to be the sole owner of a bicycle, deposited the same with *C*. *C* should later on deliver it to the one to whom it belongs. The action which would settle the conflicting claims would be in the nature of an interpleader.

Art. 1969. A contract of deposit may be entered into orally or in writing.

COMMENT:**Form of the Contract of Deposit**

- (a) oral
- (b) written

NOTE: In either case, however, there must be a DELIVERY.

Art. 1970. If a person having capacity to contract accepts a deposit made by one who is incapacitated, the former shall be subject to all the obligations of a depositary, and may be compelled to return the thing by the guardian, or administrator, of the person who made the deposit, or by the latter himself if he could acquire capacity.

COMMENT:**(1) Rule When Depositor Is Incapacitated***Example:*

A accepted a deposit from *B*, an insane individual. As long as *B* is insane, he cannot by himself compel the return

of the thing. He must act through his guardian or administrator. Should *B* be of sound mind again, he can by himself compel the return of what has been deposited.

(2) Capacity of Depositary

The depositary himself must be *sui juris* capacitated to enter into binding contracts. He is subject to all the obligations of a depositary. The law says that “persons who are capable cannot allege the incapacity of those with whom they contracted.” (*Art. 1379, Civil Code*).

(3) Validity of the Contract Entered Into

The contract entered into under Art. 1970 is a *voidable one*.

Art. 1971. If the deposit has been made by a capacitate person with another who is not, the depositor shall only have an action to recover the thing deposited while it is still in the possession of the depositary, or to compel the latter to pay him the amount by which he may have enriched or benefited himself with the thing or its price. However, if a third person who acquired the thing acted in bad faith, the depositor may bring an action against him for its recovery.

COMMENT:

(1) Rule if Depositary Is Incapacitated

Example:

A deposited something with *B*, who is insane. *B* in turn disposed of it in favor of *C*. Can A go against *C*?

ANS.: Yes, if *C* acted in bad faith. But if *C* acted in good faith, A's only recourse would be to compel *B* to give him (A) the amount by which he (*B*) might be enriched or benefited himself.

(2) Remedy of Depositor

What is the nature of the action of a depositor who has deposited something still in the possession of an insane depositary?

ANS.: His *is* an owner's action to recover or vindicate a thing. The insane depositary, because of the insanity, does not incur the obligations of a depositary.

(3) Validity of the Contract Entered Into

The contract entered into under Art. 1971 is a voidable one, in view of the incapacity of one of the contracting parties.

Section 2**OBLIGATIONS OF THE DEPOSITARY**

Art. 1972. The depositary is obliged to keep the thing safely and to return it, when required, to the depositor, or to his heirs and successor or to the person who may have been designated in the contract. His responsibility, with regard to the safekeeping and the loss of the thing, shall be governed by the provisions of Title I of this Book.

If the deposit is gratuitous, this fact shall be taken into account in determining the degree of care that the depositary must observe.

COMMENT:**(1) Principal Obligations of the Depositary**

The safekeeping and the return of the thing, when required, are the two principal obligations of the depositary.

NOTE: Title I of Book IV refers to obligations and contracts. (*Arts. 1156-1304*).

(2) Duty of Safekeeping

- (a) If the contract does not state the diligence which is to be observed in the performance, that of a good father of a family shall be required. (*Art. 1175, par. 2*).

- (b) The depositary is responsible if the loss occurs through his fault (*Art. 1172*), but as a rule, not if the loss is through a fortuitous event. (*Art. 1174*).

(3) Effect if Deposit Is Gratuitous or Onerous

Paragraph 2 — More care is required if the deposit is for a compensation than if it is gratuitous. But even if gratuitous, care must still be exercised. (*11 Manresa 666*).

Examples:

A fire destroyed something deposited. It was proved that the fire was neither intentional nor caused by the *fault* of the depositary, who as a matter of fact had even attempted to save the goods.

HELD: Depositary is not liable. (*La Sociedad Dalisay v. De los Reyes, 55 Phil. 452*).

The depositary who was in charge of some cattle failed to prove that the loss occurred either without fault on his part or by reason of *caso fortuito*.

HELD: He is liable. (*Palacio v. Sudario, 7 Phil. 275*).

(4) Owner Bears Loss

In case of non-fault on the part of the depositary, the depositor-owner bears the loss because of the maxim "*res perit domino*." (*Rizares v. Hernaez, 40 Phil. 981*).

(5) Duty of Owner of Rice Mill

The owner of a rice mill who, in accordance with customs prevailing in the trade, receives palay and converts the same into rice, and sells the products for his own benefit has the obligation to account for said palay to the owner, at the price prevailing at the time demand is made. (*Baron v. David, 51 Phil. 1*).

(6) Guardian as Such, is Not Depositary

A guardian is not the depositary of the ward's properties. (*Phil. Trust Co. v. Ballesteros, L-8261, April 20, 1956*).

Art. 1973. Unless there is a stipulation to the contrary, the depositary cannot deposit the thing with a third person. If deposit with a third person is allowed, the depositary is liable for the loss if he deposited the thing with a person who is manifestly careless or unfit. The depositary is responsible for the negligence of his employees.

COMMENT:

(1) Deposit With a Third Person

(a) *Examples:*

A deposited a car with B. B then deposited the same car with C. Is this allowed? *ANS.:* No, unless there is a stipulation that such deposit can be done.

(b) *Another example:*

A deposited a car with B. A allowed B to deposit the car with a third person. B then deposited the car with C. If thru C's carelessness, the car is destroyed, would B be liable to A?

ANS.: Yes, provided that C is a person manifestly careless or unfit; otherwise, no. However, had C been an employee of B, B is no doubt liable, whether C was manifestly careless or not, for under the law the depositary is responsible for the negligence of his employees.

(2) Reason of the First Sentence of the Article

The depositary is, as a rule, not allowed to deposit the thing with a third person because a deposit is founded on the fact that the depositor has precisely chosen a particular depositary by virtue of the latter's qualifications, and because of the trust and confidence reposed on him by the depositor.

[*NOTE:* This is similar to the agent's liability for the acts of a substitute. (*Art. 1898, Civil Code*).]

Art. 1974. The depositary may change the way of the deposit if under the circumstances he may reasonably presume that the depositor would consent to the change

if he knew of the facts of the situation. However, before the depositary may make such change, he shall notify the depositor thereof and wait for his decision, unless delay would cause danger.

COMMENT:

(1) When Depositary may Change the Way of the Deposit

Example:

A deposited a car with B in garage No. 1. If B builds garage No. 2, which is better than the first, B may put the car in garage No. 2. However, B should first notify A and wait for the latter's decision, unless delay would cause danger.

(2) Reason for the Law

This is in accordance with the rule that generally, the depositary must take care of the thing with the diligence of a good father of a family.

Art. 1975. The depositary holding certificates, bonds, securities or instruments which earn interest shall be bound to collect the latter when it becomes due, and to take such steps as may be necessary in order that the securities may preserve their value and the rights corresponding to them according to law.

The above provision shall not apply to contracts for the rent of safety deposit boxes.

COMMENT:

(1) Duty of Depositary to Collect Interest on Intangible Properties

Example:

A deposits with B a negotiable promissory note bearing interest, which interest is due every six months. When that day comes, B should collect the interest. This is logically essential in the exercise of due diligence by the depositary in taking good care of the thing deposited.

(2) Duty to Collect the Capital Also

Under this Article, the depositary is obliged to collect, when due, not only the interest, but also the capital itself, and to return whatever may have been received or collected, to the depositor. (*Espeo de Hinojosa, 480-481*). Naturally, this would not be the case should there be a contrary agreement. (*3 Malagarriaga 315*).

(3) Reason for the Second Paragraph

Here, the renter of the box is supposed to have control over the box and the contents thereof, and the real owner of said boxes should therefore not have the duty imposed in the first paragraph. As a matter of fact, this is really a lease of a thing (the box) and not a contract of deposit.

Art. 1976. Unless there is a stipulation to the contrary, the depositary may commingle grain or other articles of the same kind and quality, in which case the various depositors shall own or have a proportionate interest in the mass.

COMMENT:**(1) Right of Depositary to Commingle**

- (a) A received from B a deposit of 4 cavans of rice; and from C, a deposit of 7 cavans of the same kind of rice. A can commingle the 11 cavans and B and C would be the Co-owners of the mixture in the proportion of 4 to 7. This can be done unless there is a stipulation to the contrary.
- (b) This provision is particularly applicable to a warehouseman, who may commingle goods if authorized by agreement or by custom. (*Sec. 25, Warehouse Receipts Law*).

(2) Reason for the Proportional Co-ownership

This is so from the necessity of the case because as soon as the goods are intermingled, each person's portion loses its identity and can no longer be distinguished or separated from the common mass. He becomes a tenant in common (co-own-

ers), not only while his (actual) grain is in the common store, but as long as any grain is so stored, and if the owner of the warehouse puts his own grain into the mass, he becomes, as to such grain a tenant, in common of the entire body of grain with other owners. (*Drudge v. Loiter*, 18 Ind. App. 694).

(**NOTE:** The rule stated in Art. 1976 is similar to the provision on commixtion.)

Art. 1977. The depositary cannot make use of the thing deposited without the express permission of the depositor.

Otherwise, he shall be liable for damages.

However, when the preservation of the thing deposited requires its use, it must be used but only for that purpose.

COMMENT:

Generally, Depositary Cannot Use

- (a) Generally, the use of the thing is not allowed the depositary.
- (b) *Example of paragraph 3:* A radio-phonograph set must occasionally be used so that it may function properly. This use for preservation is implicitly granted, in view of the nature of the thing deposited.

Art. 1978. When the depositary has permission to use the thing deposited, the contract loses the concept of a deposit and becomes a loan or *commodatum*, except where safekeeping is still the principal purpose of the contract.

The permission shall not be presumed, and its existence must be proved.

COMMENT:

(1) When Depositary Has Permission to Use

A deposited a sum of money with *B* who later was authorized to use the same. The contract becomes one of loan. (*Gavierrez v. Tavera*, 1 Phil. 71).

(2) Irregular Deposit

A deposited 5 kilos of sugar with B. B was authorized to use the sugar, but safekeeping was still the principal purpose of the contract. This is still a deposit but an irregular one, hence it is called an *irregular deposit*.

[**NOTE:** The *deposit irregular* was in the Spanish laws before the old Civil Code, but was abolished in the old Civil Code. This abolition was criticized by Manresa. (11 Manresa 696-697). The new Civil Code restores it. Like *mutuum*, an irregular deposit is concerned with *consumable* things which are given by weight, number, or measure, but *unlike mutuum*, it is demandable at the will of the depositor, for whose benefit the deposit has been constituted.]

(3) Presumption

The law creates the presumption that in a deposit, the permission to use is not presumed, except when such use is needed for preservation. Therefore, a person who alleges that permission or authority to use the thing deposited has been given, has the burden of proving his allegation. (*Par. 3, Art. 1978*).

Baron v. David 51 Phil. 1

FACTS: Pablo David was the owner of a rice mill in Pampanga. Silvestra and Guillermo Baron delivered around 2,000 cavans of palay to him, with the understanding that he (David) was free to convert them into rice, and dispose of them at his pleasure. After sometime, the rice mill was burned, including its contents of around 360 cavans of palay. This action was brought to recover the value of said cavans.

HELD: The owner of the rice mill who in conformity with customs prevailing in the trade receives palay and converts it into rice, selling the product for his own benefit, must account for the palay to the owner at the price prevailing at the time demand is made. The destruction of the rice mill with its contents by fire after the palay thus deposited had been milled and marketed, does not affect the liability of the millers. Even supposing that the palay had been delivered in

the character of a deposit, subject to future sale or withdrawal at the plaintiff's election, nevertheless, if it was understood that the defendant might mill the palay and he has in fact appropriated it to his own use, he is, of course, bound to account for its value, because under the law such a *deposit* loses the concept of deposit and becomes a loan. By appropriating the thing, the bailee becomes responsible for its value. The defendant should be liable for the whole quantity delivered, without deducting the 360 that were burned.

(4) Deposit of Palay

Delgado v. Bonnevie and Arandez 23 Phil. 308

FACTS: Palay was deposited so that it would be threshed into rice. Is this a deposit or a hire of services?

HELD: While the deposit of palay was converted into a hire of services, yet, after the object of the hiring (conversion into rice) has been fulfilled, the rice continued to be a deposit in the possession of the thresher for them to return to the plaintiff-owner upon demand.

(5) When Deposit of Money Is Really a Loan

- (a) Where money, consisting of coins of legal tender, is deposited with a person, and the latter is authorized by the depositor to use and dispose of the same, the agreement thus entered into between the *depositor* and the *depository* is not a contract of deposit but a loan. (*Javellana v. Lion, et al.*, 11 Phil. 141).
- (b) Evidence showing that *interest* had been offered as compensation for the use of money *deposited* leads one to the conclusion that the contracts, although denominated by the parties as *deposit* is really one of loan. (*Co Agricola v. Nepomuceno*, 55 Phil. 283).

(6) No Prescription of Demand for Return

Can the right to demand the return of the thing deposited prescribe?

ANS.: Things received on deposit do not prescribe, for the depositary cannot claim that ownership of the thing deposited was transferred to him, but simply the custody thereof. The possession of the depositary, as such, is *not adverse* to that of the depositor. (*Delgado v. Bonnevie, supra*). The Civil Code states that possession, in order to ripen into prescription, must among other things be in the *concept of an owner*, public, peaceful, and uninterrupted. (*Art. 1118, Civil Code*). *Adverse possession* can, of course, give rise to prescription.

Art. 1979. The depositary is liable for the loss of the thing through a fortuitous event:

- (1) If it is so stipulated;
- (2) If he uses the thing without the depositor's permission;
- (3) If he delays its return;
- (4) If he allows others to use it, even though he himself may have been authorized to use the same.

COMMENT:

Liability for Fortuitous Event

Generally, the depositary is not liable for fortuitous events. The Article gives the four (4) exceptions.

Art. 1980. Fixed, savings, and current deposits of money in banks and similar institutions shall be governed by the provisions concerning simple loan.

COMMENT:

(1) Bank Deposits

- (a) A bank can compensate a debtor's debt with a debtor's deposit because insofar as the deposit is concerned, the relationship between them is that of debtor and creditor, not depositary and depositor. (*Gullas v. Phil. Nat'l. Bank, 62 Phil. 619*).

(**NOTE:** In a true deposit, Art. 1287 prohibits compensation.)

**Philippine Deposit Insurance Corp. v.
CA, Abad, et al.
GR 126911, Apr. 20, 2003**

FACTS: The Monetary Board (MB) of the Central Bank (now Bangko Sentral) closed the Manila Banking Corp. (MBC) on May 22, 1987 (a Friday) under MB Resolution 505. Said Resolution prohibited MBC to do business and placed its assets and affairs under receivership. On May 25, 1987 (a Monday), respondent was at MBC at 9 am for the purpose of preterminating 71 of his “Golden Time Deposits” (GTD) certificates with an aggregate value of P1,115,889.96. He redeposited the same into new GTDs in denominations of P40,000 or less.

The Philippine Deposit Insurance Corp. (PDIC) refused to pay deposits because it said transactions were not made “in the usual course of business,” as understood in its Charter. It said that respondent might have learned of the MB Resolution, hence, he acted in bad faith. PDIC theorizes that after MBC had exhausted its cash and could no longer sustain further withdrawal transactions, it instead issue new GTDs as “payment” for respondent’s preterminated GTDs.

HELD: The PDIC Charter provides that the term “deposit” means the unpaid balance of money or its equivalent received by a bank in the usual course of business and for which it has given or is obliged to give credit to a commercial, checking, savings time, and thrift account or which is evidenced by its certificate of deposit. (*Sec. 3, RA 3591*).

The Supreme Court, in the instant case, rejected PDIC’s argument, opining respondent should be given the benefit of doubt that he was not aware the MB Resolution had been passed, given the necessity of confidentiality of placing a banking institution under receivership. Appointment of a receiver may be made by the MB without notice and hearing, but its action is subject to judicial

review to ensure protection of the banking institution. One can just imagine the dire consequences of prior hearing: Bank runs would be the order of the day, resulting in panic and hysteria. In the process, fortunes may be wiped out and disillusionment will run the gamut of the entire banking community.

- (b) A depositor is disputably *presumed* to be the owner of the funds standing in his name in a bank deposit. (*Fulton Iron Works v. China Banking Corporation*, 55 Phil. 208).
- (c) If a depositor incurs an overdraft, the same *cannot* be charged against an account placed under his name, that has a notation that it is held in trust for another. (*Fulton Iron Works v. China Banking Corporation*, 55 Phil. 208).
- (d) If a trustee of some funds in a bank withdraws them and misappropriates the same, the bank cannot be liable if it acted in good faith. (7 C.J. 644).
- (e) Current and savings deposits are loans to a bank because it can use the same. (*Tian Tiong Tick v. American Apothecaries*, 38 O.G. 889).

Rural Bank of Caloocan v. Court of Appeals
L-32116, Apr. 21, 1981

A bank must exercise the highest order of care and prudence in dealing with would-be borrowers since it is engaged in a business affected with public interest. The consent of alleged co-makers or guarantors must be strictly ascertained to prevent adverse effects on our banking system.

Ong Sip v. Prudential Bank and Trust Co.
GR 27328, May 30, 1983

A postdated check cannot at all be regarded as a check. A bank cannot therefore deduct from a client's checking (current) account postdated checks which have been issued by the depositor (at least not until the date indicated on the check).

Gonzales v. Philippine National Bank
GR 33320, May 30, 1983

Because the Philippine National Bank has a charter all its own, it is not an ordinary corporation, and is not therefore governed by the Corporation Law. Thus, a stockholder cannot inspect its books, otherwise its charter would be violated. Only the Central Bank (Bangko Sentral) can inspect.

(2) Distressed Banks

Serrano v. Central Bank
L-30511, Feb. 14, 1980

The recovery of time deposits from a distressed bank as well as damages should be in the Court of First Instance (now Regional Trial Court) in an ordinary action, not a petition for *mandamus* and prohibition. Bank deposits are really loans, and failure to return the same is failure to pay an obligation as a debtor, not a breach of trust (for there is no trust, constructive or otherwise). Incidentally the Central Bank (Bangko Sentral) has no obligation to pay the deposits in an insolvent bank.

Concurring (J. Ramon Aquino): The depositor's remedy is to file his claim in the liquidation proceeding of the Bank.

(3) Exemption from Payment of Interest

The Overseas Bank of Manila v. Court of Appeals
L-49353, Jun. 11, 1981

Banks are not required to pay interest on deposits for the period during which they are not allowed to operate by the Central Bank (Bangko Sentral). This is demanded by fairness. However, interests that had accrued prior to the suspension should be paid by the bank, for after all, it had made use them of the money deposited.

(4) The Bouncing Checks Law**BATAS PAMBANSA BLG. 22****AN ACT PENALIZING THE MAKING OR DRAWING AND ISSUANCE OF A CHECK WITHOUT SUFFICIENT FUNDS OR CREDIT AND FOR OTHER PURPOSES.**

Be it enacted by the Batasang Pambansa in session assembled:

SECTION 1. *Checks without sufficient funds.* — Any person who makes or draws and issues any check to apply on account or for value, knowing at the time of issue that he does not have sufficient funds in or credit with the drawee bank for the payment of such check in full upon its presentment, which check is subsequently dishonored by the drawee bank for insufficiency of funds or credit or would have been dishonored for the same reason had not the drawer, without any valid reason, ordered the bank to stop payment, shall be punished by imprisonment of not less than thirty days but not more than one (1) year or by a fine of not less than but not more than double the amount of the check which fine shall in no case exceed Two Hundred Thousand Pesos, or both such fine and imprisonment at the discretion of the court.

The same penalty shall be imposed upon any person who, having sufficient funds in or credit with the drawee bank when he makes or draws and issues a check, shall fail to keep sufficient funds or to maintain a credit to cover the full amount of the check if presented within a period of ninety (90) days from the date appearing thereon, for which reason it is dishonored by the drawee bank.

Where the check is drawn by a corporation, company or entity, the person or persons who actually signed the check in behalf of such drawer shall be liable under this Act.

SEC. 2. *Evidence of knowledge of insufficient funds.* — The making, drawing and issuance of a check payment of which is refused by the drawee because of insufficient funds in or credit with such bank, when presented within ninety (90) days from the date of the check, shall be *prima facie* evidence of knowledge of such

insufficiency of funds or credit unless such maker or drawer pays the holder thereof the amount due thereon, or makes arrangements for payment in full by the drawee of such check within five (5) banking days after receiving notice that such check has not been paid by the drawee.

SEC. 3. *Duty of drawee; rules of evidence.* — It shall be the duty of the drawee of any check, when refusing to pay the same to the holder thereof upon presentment, to cause to be written, printed, or stamped in plain language thereon, or attached thereto, the reason for drawee's dishonor or refusal to pay the same: *Provided*, That where there are no sufficient funds in or credit with such drawee bank, such fact shall always be explicitly stated in the notice of dishonor or refusal. In all prosecutions under this Act, the introduction in evidence of any unpaid and dishonored check, having the drawee's refusal to pay stamped or written thereon, or attached thereto, with the reason therefor as aforesaid, shall be *prima facie* evidence of the making or issuance of said check, and the due presentment to the drawee for payment and the dishonor thereof, and that the same was properly dishonored for the reason written, stamped or attached by the drawee on such dishonored check.

Notwithstanding receipt of an order to stop payment, the drawee shall state in the notice that there were no sufficient funds in or credit with such bank for the payment in full of such check, if such be the fact.

SEC. 4. *Credit construed.* — The word "credit" as used herein shall be construed to mean an arrangement or understanding with the bank for the payment of such check.

SEC. 5. *Liability under the Revised Penal Code.* — Prosecution under this Act shall be without prejudice to any liability for violation of any provision of the Revised Penal Code.

SEC. 6. *Separability clause.* — If any separable provision of this Act be declared unconstitutional, the remaining provisions shall continue to be in force.

SEC. 7. *Effectivity.* — This Act shall take effect fifteen days after publication in the Official Gazette.

Approved, April 3, 1979.

A.M. 00-11-01-SC

RE: AMENDMENT TO THE RULE ON SUMMARY PROCEDURE OF CRIMINAL CASES TO INCLUDE WITHIN ITS COVERAGE VIOLATIONS OF B.P. BLG. 22, OTHERWISE KNOWN AS THE BOUNCING CHECKS LAW

Section 1 of the Revised Rules on Summary Procedure (Resolution of the Court *En Banc* dated October 15, 1991), is amended as follows:

“Section 1. *Scope.* This rule shall govern the summary procedure in the Metropolitan Trial Courts, the Municipal Trial Courts in Cities, and Municipal Circuit Trial Courts in the following cases falling within their jurisdiction:

A. Civil Cases:

x x x

B. Criminal Cases:

x x x

4. *Violations of Bata Pambansa Bilang 22* (Bouncing Checks Law):

5. All other criminal cases where the penalty prescribed by law for the offense charged is imprisonment not exceeding six months, or a fine not exceeding one thousand pesos (P1,000.00), or both irrespective of other imposable penalties, accessory or otherwise, or of the civil liability arising therefrom: *Provided, however,* That in offenses involving damage to property through criminal negligence, this Rule shall govern where the imposable fine does not exceed ten thousand pesos (P10,000.00).

This Rule shall not apply to a civil case where the plaintiff's cause of action is pleaded in the same complaint with another cause of action subject to the ordinary procedure; nor to a criminal case where the offense charged is necessarily related to another criminal case subject to the ordinary procedure.”

The amendment shall take effect on April 15, 2003 following its publication in a newspaper of general circulation not later than March 30, 2003.

**Elvira Yu Oh v. CA & People of the Phils.
GR 125297, Jun. 6, 2003**

FACTS: As understood by the trial court itself, Joaquin Novales III, General Manager of complainant Solid Gold International Traders, Inc., a company engaged in jewelry trading, knew of the non-availability of sufficient funds when appellant issued the subject checks to him.

HELD: There is no violation of BP 22 if complainant was told by the drawer that he has no sufficient funds in the bank. (*Eastern Assurance & Surety Corp. v. CA*, 322 SCRA 73 [2000]).

[NOTE: The term “closed accounts” is within the meaning of the phrase “does not have sufficient fund in or credit with the drawee bank.” (*Oh v. CA*, *supra*).]

[NOTE: RA 7691, which took effect on Jun. 15, 1994, amended BP 129 (“the Judiciary Reorganization Act”), and vested on the Metropolitan, Municipal and Municipal Circuit Trial Courts jurisdiction to try cases punishable by imprisonment of not more than 6 years. (*Sec. 2, RA 7691*). (*Oh v. CA*, *supra*).]

Art. 1981. When the thing deposited is delivered closed and sealed, the depositary must return it in the same condition, and he shall be liable for damages should the seal or lock be broken through his fault.

Fault on the part of the depositary is presumed, unless there is proof to the contrary.

As regards the value of the thing deposited, the statement of the depositor shall be accepted, when the forcible opening is imputable to the depositary, should there be no proof to the contrary. However, the courts may pass upon the credibility of the depositor with respect to the value claimed by him.

When the seal or lock is broken, with or without the depositary’s fault, he shall keep the secret of the deposit.

COMMENT:

The Depositary Must Keep the Secret of the Deposit

When the thing deposited is delivered closed and sealed,

the depositary must return it in the same condition, and he shall be liable for damages should the seal or lock be broken through his fault. When the seal or lock is broken, with or without the depositary's fault, he shall keep the secret of the deposit. (*Art. 1981, pars. 1 and 4*). If the seal or lock is broken through the depositary's fault, the presumption is that the fault is on the part of the depositary, unless there is proof to the contrary. (*Art. 1981, par. 2*).

As regards the *value* of the thing deposited, the *statement of the depositor shall be accepted*, when the *forcible opening* is imputable to the *depositary*, should there be no proof to the contrary. However, the courts may pass upon the *credibility* of the depositor with respect to the value claimed by him. (*Art. 1981, par. 3*).

When it becomes necessary to open a locked box or receptacle, the depositary is *presumed authorized to do so*, if the *key* has been delivered to him; or when the *instructions* of the depositor as regards the deposit cannot be executed without opening the box or receptacle. (*Art. 1982*).

Example:

A instructed B to take insurance on the thing deposited. C, the agent of the Insurance Company, insurer, asks B to give him opportunity to examine the thing deposited to appraise its insurable value, and also to estimate the risks the Company would assume, so that he may decide the rate of premium to be imposed. Since the thing deposited is in a box, may B open the box?

ANS.: Yes, B may open the box or receptacle for this is the only possible way by means of which B may follow the instruction of A. (*Ibid.*)

Art. 1982. When it becomes necessary to open a locked box or receptacle, the depositary is presumed authorized to do so, if the key has been delivered to him; or when the instructions of the depositor as regards the deposit cannot be executed without opening the box or receptacle.

COMMENT:**Necessity of Opening Locked Box**

(See Comments under the preceding Article.)

Art. 1983. The thing deposited shall be returned with all its products, accessories and accessions.

Should the deposit consists of money, the provisions relative to agents in Article 1896 shall be applied to the depositary.

COMMENT:**Return of the Thing Deposited**

- (a) The Article is self-explanatory.
- (b) If a property owner whose property has been judicially attached sells the same but fails to deliver the money to the attorney of the creditors, and instead deposits the sum in court, he is guilty neither of estafa nor of malversation. (*U.S. v. Rastrollo*, 1 Phil. 22).
- (c) If a sale fails to materialize because of circumstances beyond control, any earnest money given by way of deposit or advance payment must be returned. (*Litton, et al. v. Luzon Surety Co., Inc., et al.*, 90 Phil. 783).
- (d) Art. 1896 provides: "The agent owes interest on the sums he has applied to his own use from the day on which he did so, and on those which he still owes after the extinguishment of the agency."

Art. 1984. The depositary cannot demand that the depositor prove his ownership of the thing deposited.

Nevertheless, should he discover that the thing has been stolen and who its true owner is, he must advise the latter of the deposit.

If the owner, in spite of such information, does not claim it within the period of one month the depositary shall be relieved of all responsibility by returning the thing deposited to the depositor.

If the depositary has reasonable grounds to believe that the thing has not been lawfully acquired by the depositor; the former may return the same.

COMMENT:

Depositary Cannot Demand Proof of Ownership

- (a) Difference between paragraphs 2 and 4:

In paragraph 2, the depositary knows who the owner of the stolen property is; in paragraph 4, he does not.

- (b) Note that the law uses the word *stolen*; hence, if lost, the provisions appertaining to stolen property should not apply. The law must be construed strictly. (*11 Manresa 689*).

Art. 1985. When there are two or more depositors, if they are not solidary, and the thing admits of division, each one cannot demand more than his share.

When there is solidarity or the thing does not admit of division, the provisions of Articles 1212 and 1214 shall govern. However, if there is a stipulation that the thing should be returned to one of the depositors, the depositary shall return it only to the person designated.

COMMENT:

Two or More Depositors

- (a) *Example of Paragraph 1:*

If A and B deposit 1,000 sacks of rice, A can demand only 500 sacks.

- (b) If A and B deposited a car, the depositary can return to either, in the absence of a contrary stipulation. (*See Arts. 1212 and 1214, Civil Code*).

Art. 1986. If the depositor should lose his capacity to contract after having made the deposit, the thing cannot be returned except to the persons who may have the administration of his property and rights.

COMMENT:**Rule if Depositor Becomes Insane**

If the depositary returns to a depositor who is NOW insane, the depositary is discharged from his obligation only if the insane depositor has *kept* the thing delivered or insofar as delivery has been beneficial to such insane depositor. (*See Art. 1241, Civil Code*).

Art. 1987. If at the time the deposit was made a place was designated for the return of the thing, the depositary must take the thing deposited to such place; but the expenses for transportation shall be borne by the depositor.

If no place has been designated for the return, it shall be made where the thing deposited may be, even if it should not be the same place where the deposit was made, provided that there was no malice on the part of the depositary.

COMMENT:**(1) Example of Paragraph 1**

Liwayway deposits in Manila a car but stipulates that delivery must be in Daet. The depositary must take the car to Daet, but expenses will be charged to Liwayway.

(2) Example of Paragraph 2

Liwayway deposits a car with Bella in Manila. Bella later on resided in Cavite, bringing the car along with her. In the absence of stipulation, the car must be returned in Cavite, provided there was *no malice* on the part of Bella.

Art. 1988. The thing deposited must be returned to the depositor upon demand, even though a specified period or time for such return may have been fixed.

This provision shall not apply when the thing is judicially attached while in the depositary's possession, or should he have been notified of the opposition of a third person to the return or the removal of the thing deposited. In these cases the depositary must immediately inform the depositor of the attachment or opposition.

COMMENT:**(1) When Deposit Must Be Returned**

As a rule, the thing deposited should be returned at the will of the depositor. This is true whether a period has been stipulated or not.

Reason: The term is for the sole benefit of the depositor and he may therefore demand that the thing be returned notwithstanding the non-expiration of the term. It is submitted, however, that when a time has been stipulated, and the deposit is for a compensation, the term in this case would be for the benefit of both depositor and depositary. In this case, while the depositor may still demand the thing at will, he should pay the depositary the corresponding indemnity, unless of course a breach of confidence on the part of the depositary makes it imperative for the depositor to immediately demand the return of the thing.

[**NOTE:** It has been held that when there is *no* fixed period for the return, withdrawal can be made at any time without necessity of a judicial order. (*Aboitiz v. Oquinen*a, 39 *Phil.* 926).]

(2) Exceptions to the General Rule

- (a) When the thing is judicially attached while in the depositary's possession. *Reason:* The property will be subject to judicial orders.
- (b) Should the depositary have been notified of the opposition of a third person to the return or the removal of the thing deposited. *Reason:* The oppositor may claim to be the owner.

(3) Liability for Damages

Should the depositary return the thing despite the attachment or the opposition, he should respond for damages. He should therefore not return in these two cases. The law clearly gives him his course of action, namely, to inform the depositor of the opposition or of the attachment. Of course, should the opposition or the attachment be later withdrawn or discharged, the

depository should now return the subject matter of the deposit upon demand therefor by the depositor.

Art. 1989. Unless the deposit is for a valuable consideration, the depository who may have justifiable reasons for not keeping the thing deposited may, even before the time designated, return it to the depositor; and if the latter should refuse to receive it, the depository may secure its consignment from the court.

COMMENT:

(1) Justifiable Reason for Returning

(a) *Example:*

A gratuitously deposited with *B* a car. *B* is later on appointed minister to a foreign city. It is clear in this case that *B* may return the car to *A*, even before the time designated. The depository *B* in the problem has justifiable reason for not keeping the thing deposited.

[**NOTE:** Other just causes include serious danger to the property, or an unbearably long time of deposit. The cause must be real, not imaginary. (*11 Manresa 699*).]

(b) In (a), suppose *A* refuses to receive the car, what should *B* do?

ANS.: *B* may secure its consignment from the court.

[Consignment is the act of depositing the things due at the disposal of judicial authority. (*Art. 1258, par. 1, Civil Code*).]

(2) Problem

A deposited with *B* a car. *B* is to be paid for the deposit. If *B* has to leave the Philippines for medical treatment abroad, is he allowed to return the car to *A* even before the expiration of the term specified?

ANS.: Although apparently, the depository is not granted that right inasmuch as the deposit has been made for a com-

pensation, it is believed that the depositary in a case like this will be allowed to return the car provided that a proportional reduction in the compensation is made; for otherwise, if it is really imperative for *B* to go abroad, who will take care of the car? The law must not be construed to effect an absurdity.

Art. 1990. If the depositary by *force majeure* or government order loses the thing and receives money or another thing in its place, he shall deliver the sum or other thing to the depositor.

COMMENT:

Loss Thru *Force Majeure* or Government Order

A deposited with *B* a car. Because of an emergency need for cars, the government took the car away from *B* giving him P200,000 therefor. This P200,000 must be given by *B* in turn to *A*. *B* shall not be held responsible for the non-return of the car, but it is also clear that he should not unjustly enrich himself at *A*'s expense, hence the duty to return the P200,000.

[*NOTE: A* is entitled not only to P200,000, but also to any other right of action given to *B*. (*11 Manresa 700-701*.)]

Art. 1991. The depositor's heir who in good faith may have sold the thing which he did not know was deposited, shall only be bound to return the price he may have received or to assign his right of action against the buyer in case the price has not been paid him.

COMMENT:

Sale by Heir

(a) "Depositor's" should read "Depositary's". This is a typographical error. Proofs:

- 1) The old Civil Code, in Spanish, reads as follows:
"El heredero del depositario..."
- 2) The provision is under Section 2 which deals with
"obligations of the *depositary*."

(b) *Example:*

A deposited a car with B. Later B died. C, the son of B, not knowing that the car had been merely deposited with his father, sold the car to D, in the belief that he (C) had inherited the same from his (C's) father. What will be C's liability?

ANS.: It depends:

- 1) If C has already been paid by D, then C should return to A the price received.
- 2) If D still owes the purchase price, then C should *assign* his right to be paid to A.

Notice that in (b) the heir was in good faith. Had he been in bad faith, he would have been liable for damages.

Section 3

OBLIGATIONS OF THE DEPOSITOR

Art. 1992. If the deposit is gratuitous, the depositor is obliged to reimburse the depositary for the expenses he may have incurred for the preservation of the thing deposited.

COMMENT:

Duty of Depositor to Reimburse

- (a) Art. 1992 does not apply when the deposit is onerous, for in such a case, the depositary is obliged to spend, without the right of reimbursement, for the necessary expenses for preservation. He has no right to seek reimbursement because said expenses are deemed included in the compensation. There can, however, be a contrary stipulation.
- (b) Note that in Art. 1992, the law talks merely of necessary expenses and not the useful ones or those for mere luxury or pleasure or ostentation.

Art. 1993. The depositor shall reimburse the depositary for any loss arising from the character of the thing deposited, unless at the time of the constitution of the deposit

the former was not aware of, or was not expected to know the dangerous character of the thing, or unless he notified the depositary of the same, or the latter was aware of it without advice from the depositor.

COMMENT:

(1) Reimbursement Because of Loss

As a rule, if the depositary suffers because of the character of the thing deposited, the depositor should be responsible for the loss sustained by the depositary.

Example:

A car containing a small bomb inside the machine was deposited with a depositary. Should an explosion occur and he suffers loss therefrom, the depositor must reimburse him for said loss.

(2) Exceptions

- (a) If at the time the deposit was made, the depositor was not aware of, or was not expected to know the dangerous character of the thing.

Example:

In the example in No. (1), the bomb may have been placed by an assassin while the car was still in the depositor's possession.

- (b) If at the time the deposit was made, the depositor knew of the danger BUT he notified the depositary of the same. *Reason:* Here, the depositary may be said to have assumed the risk.
- (c) If at the time the deposit was made, the depositary was aware of the danger, even though he had not been notified by the depositor. *Reason:* There is also an assumption of risk here.

Art. 1994. The depositary may retain the thing in pledge until the full payment of what may be due him by reason of the deposit.

COMMENT:**(1) Right of Retention by Depositary***Example:*

A deposited with B a car. If the deposit is gratuitous, B may nevertheless retain the car in pledge until, for example, he has been reimbursed the necessary expenses he had incurred for its preservation. If the deposit is for a compensation, and the compensation has not yet been paid, he may nevertheless still retain the car in pledge.

(2) Pledge by Operation of Law

Art. 1994 gives an example of a pledge created by operation of law. As a matter of fact, the thing deposited but now pledged may even be sold after the requirements and formalities in the case of sales of things pledged have been complied with. If, for example, the thing is sold for P1,000, although the debt is only P200, the balance of P800 must be returned to the depositor. (*See Art. 2121, Civil Code*).

(3) Query

Under Art. 1994, suppose the depositary voluntarily returns the thing deposited to the depositor even if the latter has not yet fully paid him (depositary) what may be due him (depositary), may the depositary still bring an action to recover said fees, compensation, or expenses from the depositor?

ANS.: Yes. In this case, the depositary has only lost the right of retention by way of pledge, but surely not the right to recover what may be due him.

Art. 1995. A deposit is extinguished:

(1) Upon the loss or destruction of the thing deposited;

(2) In case of a gratuitous deposit, upon the death of either the depositor or the depositary.

COMMENT:**(1) Extinguishment of Deposit**

Example:

A deposited a car with B. If the car is destroyed by a fortuitous event, the deposit is extinguished.

(2) Effect of Death

The death of either the depositor or the depositary extinguishes the deposit if it is gratuitous, but the thing deposited must of course be returned. When the law says “extinguished” it really means that the depositary need not be a depositary any longer.

(3) Query

Suppose the deposit is for a compensation, does the death of either the depositor or the depositary extinguish the deposit?

ANS.: No, unless the deposit is terminated by the heirs of the depositor. This is different from the rule in gratuitous deposits which are personal in nature.

(4) Other Grounds

Art. 1995 is not exclusive. There are other grounds for extinguishment of a deposit — like the expiration of the term, or demand at the will of the depositor, or termination of the purpose of the deposit or fulfillment of the resolutory condition, or mutual withdrawal from the contract.

Chapter 3

NECESSARY DEPOSIT

Art. 1996. A deposit is necessary:

(1) When it is made in compliance with a legal obligation;

(2) When it takes place on the occasion of any calamity, such as fire, storm, flood, pillage, shipwreck, or other similar events.

COMMENT:

(1) Example of Necessary Deposit Made in Compliance With a Legal Obligation

A borrowed P100,000 from B, and as security thereof, pledged his diamond ring. If B uses the ring without the authority of A, A may ask that the ring be judicially or extrajudicially deposited. (*Art. 2104, Civil Code*).

[**NOTE:** Art. 2104 — “The creditor cannot use the thing pledged, without the authority of the owner, and if he should do so, or should misuse the thing in any other way, the owner may ask that it be judicially or extrajudicially deposited. When the preservation of the thing pledged requires its use, it must be used by the creditor but only for that purpose.”]

[**NOTE:** Other examples of necessary deposits in compliance with a legal obligation:

- (a) cash deposits to be made by certain officers or officials;
- (b) deposits to be made by those who desire to use fire arms.]

(2) Example of a Necessary Deposit Made on the Occasion of a Calamity

In a fire, Jose saves Pedro’s car. Jose is in possession of the car; Jose is supposed to be its depositary. Deposits made

on the occasion of a calamity have been fittingly termed *depositos miserables*.

(3) Two Other Kinds of Necessary Deposits

- (a) That made by travellers in hotels or inns. (*See Art. 1998, Civil Code*).
- (b) That made with common carriers.

Art. 1997. The deposit referred to in No. 1 of the preceding article shall be governed by the provisions of the law establishing it, and in case of its deficiency, by the rules on voluntary deposit.

The deposit mentioned in No. 2 of the preceding article shall be regulated by the provisions concerning voluntary deposit and by Article 2168.

COMMENT:

(1) Governing Rules for Deposits Made in Compliance with a Legal Obligation

- (a) Firstly, the law creating said deposits.
- (b) Suppletorily, the rule on voluntary deposits.

(2) Rules Governing Deposits Made Because of a Calamity

- (a) Firstly, the rules on Voluntary Deposits.
- (b) Also, Art. 2168 of the Civil Code.

(3) Art. 2168

“When during a fire, flood, storm, or other calamity, property is saved from destruction by another person without the knowledge of the owner, the latter is bound to pay the former just compensation.”

(**NOTE:** Art. 2168 establishes a quasi-contract.)

Art. 1998. The deposit of effects made by travellers in hotels or inns shall also be regarded as necessary. The keepers of hotels or inns shall be responsible for them as depositaries, provided that notice was given to them, or to their employees, of the effects brought by the guests and that, on the part of the latter, they take the precautions which said hotel-keepers or their substitutes advised relative to the care and vigilance of their effects.

COMMENT:

(1) Example of Liability of Hotel or Inn-keepers

A traveller spent a night in a Makati hotel. A hotel servant maliciously destroyed the cellular phone of the traveller. Is the hotel-keeper liable?

ANS.: Yes, provided that he had previously been informed about the cellular phone, and provided furthermore that the traveller followed any precaution that may have been given by the hotel-keeper or his substitutes regarding the care and vigilance of said property.

(2) ‘Innkeeper’ Defined

The keeper of an inn for the lodging of travellers and passengers for a reasonable compensation. He is distinguished from the proprietor of other public houses of entertainment in that he publicly holds out his place as one where all transient persons who choose to come will be received as guests. (*Holstein v. Phillips*, 146 N.C. 366).

(3) ‘Occasional Entertainment’ Defined

The occasional entertainment of travellers does not of itself make one an innkeeper. (*Holstein v. Phillips*, *supra*).

(4) ‘Travellers’ Defined

The word *travellers* refers to transient and was certainly not meant to include ordinary or regular boarders in any apartment, house, inn, or hotel. Distance travelled is immaterial.

Notice furthermore that the law sometimes uses the term *guests* instead of *travellers*. For purposes of the provisions on this kind of necessary deposit, the two terms are synonymous. (*Holstein v. Phillips, supra*).

(5) Reasons for the Liability of the Hotels or Inns

- (a) It is a good policy to encourage travel;
- (b) Travellers and strangers must of necessity trust in the honesty and vigilance of the innkeeper and those in his employ;
- (c) The opportunity and temptation to connive with evil-disposed persons and to afford facilities in stealing the goods of those in his house;
- (d) The innkeeper is as a rule better able to protect himself against loss than the guest who is practically helpless to enforce his rights. (*Holstein v. Phillips, supra*).

(6) When Liability Begins

Liability or responsibility by the hotel or innkeeper commences as soon as there is an evident intention on the part of the travellers to avail himself of the accommodations of the hotel or inn. It does not matter whether compensation has already been paid or not, or whether the guest has already partaken of food and drink or not.

(7) Meaning of Effects

All kinds of personal property, like jewelry, fountain pens, cash.

(8) Nature of Precautions to Be Given to the Guests

They may be given directly or orally to the guests, or they may be typed, mimeographed or printed on posters which are usually set up and posted both in the lobby as well as in the individual rooms. Note however that “the hotel-keeper cannot free himself from responsibility by posting notices to the effect that he is not liable for the articles brought by the guest.” (*Art. 2003, 1st sentence, Civil Code*).

Art. 1999. The hotel-keeper is liable for the vehicles, animals and articles which have been introduced or placed in the annexes of the hotel.

COMMENT:

Liability Extends to Objects in Annexes

The Article is self-explanatory.

Art. 2000. The responsibility referred to in the two preceding articles shall include the loss of, or injury to the personal property of the guests caused by the servants or employees of the keepers of hotels or inns as well as by strangers; but not that which may proceed from any *force majeure*. The fact that the travellers are constrained to rely on the vigilance of the keeper of the hotels or inns shall be considered in determining the degree of care required of him.

COMMENT:

(1) Rules for Liability

- (a) As a rule, the master is responsible for the acts of servants or employees of the hotel provided of course that notice has been given and the proper precautions taken.
- (b) The master is also liable for the acts of strangers, like malicious mischief or theft.

(2) Non-Liability for Force Majeure

The master should be exempted in case:

- (a) there has, for example, been robbery by intimidation of persons, or
- (b) a fortuitous event, like flood.

(3) Problem

A was guest in B's hotel. C, a drunkard, entered the hotel and destroyed A's personal belongings despite the fact that A had given proper notice and had followed all precautions. Will B be liable?

ANS.: Yes. This is an act of a stranger, not considered a *force majeure* under this provision of the law. The management should have taken the necessary steps to prevent the occurrence of things like this.

Art. 2001. The act of a thief or robber, who has entered the hotel is not deemed *force majeure*, unless it is done with the use of arms or through an irresistible force.

COMMENT:

(1) Robbery Through Force Upon Things

Example:

In the middle of the night, A went up the fire escape, slowly raised a guest's window, went inside the room, and stole the guest's shoes. Is the hotel-keeper liable?

ANS.: Yes. He should have seen to it that no thief could enter the building without being noticed, for example, by a watchman. This is a case of robbery with force upon things.

(2) Query

The bell boy of a hotel, at the point of a gun, asked the watchman of a hotel's safe to open it for him. The bell boy then run away taking with him some jewelries deposited in said safe by the guests. Will the hotel-keeper be liable?

ANS.: Yes. It is true that here the robbery was committed with use of arms, but then the bell boy was the servant of the hotel-keeper. The latter will be liable, not because of Art. 2001 which evidently refers to a stranger, but because of Art. 2000.

(3) Reason for Art. 2001

The innkeeper is bound to keep his house safe from the intrusion of thieves, day and night, and if they are allowed to gain access to the house, and specially without the use of such force as will show its marks upon the house, it is fairly presumable that the innkeeper is at fault.

Art. 2002. The hotel-keeper is not liable for compensation if the loss is due to the acts of the guest, his family, servants or visitors, or if the loss arises from the character of the things brought into the hotel.

COMMENT:

(1) Instances When Hotel-Keeper Is Not Liable

Since the law does not distinguish what kind of acts are referred to, it may be inferred that the acts mentioned in the Article be either the result of a voluntary malicious act or simply of negligence.

(2) Examples

- (a) Act of the guest himself — when turning on his radio, he may have forgotten to attach the transformer.
- (b) Acts of visitors of the guest — *A* while entertaining *B* in his room suddenly noticed that *B* was hurling his (*A*'s) radio into the street, or that *C*, another visitor had just departed taking away with him *A*'s shoes.
- (c) Acts of the guest's own servant — the servant may have appropriated the thing for himself. (Do not confuse this with the acts of the hotel-keeper's servant.)

Art. 2003. The hotel-keeper cannot free himself from responsibility by posting notices to the effect that he is not liable for the articles brought by the guest. Any stipulation between the hotel-keeper and the guest whereby the responsibility of the former as set forth in Articles 1998 to 2001 is suppressed or diminished shall be void.

COMMENT:

Effect of Notices Negating Liability

Example:

A is a guest in *B*'s hotel. In the lobby, there was a notice that *B* would not be liable in any way for the loss of *A*'s effects. Subsequently, a bell boy stole *A*'s watch. *B* will still be liable.

Art. 2004. The hotel-keeper has a right to retain the things brought into the hotel by the guest, as a security for credits on account of lodging, and supplies usually furnish to the guests.

COMMENT:

(1) Right of Retention Given to Hotel-Keeper

Example:

A was a transient in B's hotel. A left without settling his account but forgot one valise in the hotel. B can retain said valise as security for the payment of A's account.

(2) Right to Sell

Has the hotel owner the right to sell the valise? In other words, is there a right of retention here by way of pledge?

According to a member of the Code Commission, this right of retention is in the nature of a pledge created by operation of law, and thus the hotel-keeper is allowed the power of sale under Arts. 2121 and 2122 of the new Civil Code. (*VI Capistrano, Civil Code of the Phil., p. 402*).

(3) Why the Right to Retain Is Given

This is given to compensate the innkeeper for the extraordinary liabilities imposed upon him by the law. (*Singer Manufacturing Co. v. Millar, 52 Minn. 516*).

(4) When Lien or Retention Does Not Exist

It does not exist when the debtor is not a guest of the hotel, as understood by the term *traveller*. (*Elliot v. Martin, 105 Mich. 506*).

Chapter 4

SEQUESTRATION OR JUDICIAL DEPOSIT

Art. 2005. A judicial deposit or sequestration takes place when an attachment or seizure of property in litigation is ordered.

COMMENT:

Nature of Garnishment or Judicial Deposit

The garnishment of property to satisfy a writ of execution “operates as an attachment and fastens upon the property a lien which the property is brought under the jurisdiction of the court issuing the writ. It is brought into *custodia legis*, under the sole control of such court. Property is in the custody of the court when it has been seized by an officer either under a writ of attachment on *mesne* process or under a writ of execution. A court which has control of such property, exercises exclusive jurisdiction over same. No court, except one having supervisory control or superior jurisdiction in the premises has a right to interfere with and change that possession. (*National Power Corporation v. De Veyra, et al.*, L-16763).

Art. 2006. Movable as well as immovable property may be the object of sequestration.

COMMENT:

Object of Judicial Sequestration

- (a) movables
- (b) immovables

Art. 2007. The depositary of property or objects sequestrated cannot be relieved of his responsibility until the controversy which gave rise thereto has come to an end, unless the court so orders.

COMMENT:

(1) When Depositary Can Be Relieved of Liability

Only when the controversy ends, unless the Court orders otherwise.

(2) When Properties Cease to Be in Custodia Legis

When the insolvency proceedings of a partnership terminated because the assignee in insolvency has *returned* the remaining assets to the firm, said properties cease to be in *custodia legis*. (*Ng Cho Cio, et al. v. Ng Diong & Hodges, L-14832, Jan. 28, 1961*).

Art. 2008. The depositary of property sequestrated is bound to comply, with respect to the same, with all the obligations of a good father of a family.

COMMENT:

To Exercise Diligence of a Good Father

The Article is self-explanatory.

Art. 2009. As to matters not provided for in this Code, judicial sequestration shall be governed by the Rules of Court.

COMMENT:

Suppletory Rules in Rules of Court

The Civil Code prevails in case of conflict.

TITLE XIII

ALEATORY CONTRACTS

GENERAL PROVISIONS

Art. 2010. By an aleatory contract, one of the parties or both reciprocally bind themselves to give or to do something in consideration of what the other shall give or do upon the happening of an event which is uncertain, or which is to occur at an indeterminate time.

COMMENT:

(1) Element of Risk

In an aleatory contract, the element of *risk* is present.

(2) Kinds of Aleatory Contracts

(a) *UNCERTAINTY OF EVENT* –

Examples:

- 1) gambling (sale of sweepstakes ticket) (*Santiago v. Millar*, 68 Phil. 39; *Rubis v. Phil. Charity Sweepstakes*, 68 Phil. 515); a bank account with 2 joint owners and with a provision that the survivor takes the whole or balance on the death of the other (*Rivera v. People's Bank and Trust Co.*, 73 Phil. 546); a transaction speculating on the value of certain currency. (*Rono v. Gomez*, L-1927, May 31, 1949).
- 2) insurance. (*Arts. 2011 and 2012*).

Malayan Insurance Co., Inc. v. Arnaldo **GR 67835, Oct. 12, 1987**

Fire insurance is an aleatory contract. By such insurance, the insured in effect wagers that

his house will be burned, with the insurer assuring him against the loss, for a fee. If the house does burn, the insured, while losing his house, wins the wager. The price is the recompense to be given by the insurer to make good the loss the insured has sustained.

(b) *UNCERTAINTY OF TIME OF CERTAIN EVENT* –

Example: life annuity (Arts. 2021 et seq.)

(3) Distinction Between an Aleatory Contract and a Contract with a Suspensive Condition

ALEATORY CONTRACT	CONTRACT WITH A SUSPENSIVE CONDITION
Whether or not the event happens, the contract remains; only the effects and extent of profit and losses are determined	If condition does not happen, the obligation <i>never</i> becomes effective

(See 12 Manresa, p. 12 and 3 Castan 311).

Chapter 1

INSURANCE

Art. 2011. The contract of insurance is governed by special laws. Matters not expressly provided for in such special laws shall be regulated by this Code.

COMMENT:

(1) Principal Law on Insurance

The principal law on insurance is the *Insurance Code*, as amended. In case of inconsistency between the Insurance Law, being special, prevails with the exception of special articles like Art. 2012 of the Civil Code which is mandatory in character.

**Acme Shoe Rubber and Plastic Corporation
v. Court of Appeals
L-56718, Jan. 17, 1985**

(1) An insurance policy is automatically cancelled upon failure to pay the premium before the stipulated date.

(2) Republic Act 3540 which became effective on Oct. 1963 does not have retroactive effect. Thus, the insurance company was justified in applying the payment made by the insured on Jan. 8, 1964 to the premium for 1963-64.

**Mayer Steel Pipe Corp. & Hongkong
Government Supplies Dept. v. CA, South Sea
Surety & Insurance Co., Inc. & Charter
Insurance Corp.
GR 124050, Jun. 19, 1997
83 SCAD 881**

An *insurance contract* is a contract whereby one party, for a consideration known as the premium, agrees to indem-

nify another for loss or damage which he may suffer from a specified peril.

An “all-risks” insurance policy covers all kinds of losses other than those due to willful and fraudulent acts of the insured. Thus, when private respondents issued the “all-risks” policies to petitioner Mayer, they bound themselves to indemnify the latter in case of loss or damage to the goods insured. Such obligation prescribes in 10 years, in accordance with Art. 1144 of the Civil Code.

(2) Deficiency in the Insurance Law

In case of deficiency in the Insurance Code, the Civil Code applies. (*Enriquez v. Sun Life Assur. Co.*, 41 Phil. 269). If even the Civil Code is deficient, the general principles on insurance will apply. (*See Grecio v. Sun Life Assur. Co.*, 48 Phil. 53).

Association of Baptist for World Evangelism, Inc. v. Fieldman’s Insurance GR 28772, Sep. 21, 1983

A car, insured against burglary or theft, was driven by a gasoline station attendant for a *joy ride* without the owner’s consent. The car was parked at the gasoline station. If during the joyride, the car is damaged, can the owner recover on its insurance policy?

HELD: Yes, because the unauthorized joyride was really “theft” of the car, within the meaning of the insurance policy.

(3) Beneficiary Is Not the Donee in a Donation

The beneficiary in a contract of insurance is not the donee spoken of in the law on donations. (*Del Val v. Del Val*, 29 Phil. 534).

(4) Rule if Beneficiary Is a Compulsory Heir

If a compulsory heir is a beneficiary, the indemnity which he may have received is not collationable. (*Del Val v. Del Val*, *supra*).

(5) Who Collects the Insurance Indemnity?

- (a) *General rule* — The beneficiary, no matter what or whose funds were used in the payment of the premiums. This is because a beneficiary has a *vested right* to the indemnity, unless the insured reserves the right to change the beneficiary. (*Del Val v. Del Val*, 29 Phil. 634 and *Grecio v. Sun Life Assur. Co. of Canada*, 48 Phil. 63).
- (b) *Exception* — When the beneficiary is also the insured or his own estate and the premiums were paid from conjugal funds, the indemnity will *not* belong to him or to his estate. It belongs to the *conjugal partnership*. (*Bank of the P.I. v. Posadas*, 56 Phil. 215).

(6) Problem

Z during his marriage to Y obtained a life insurance policy for P1 million payable to his own estate. Premiums thereon were paid from his SALARY as teacher. While the policy was in effect, Z died survived by Y and 2 children, A and B. How would you generally apportion the proceeds of the policy?

ANS.: Since the premiums came from the husband's salary, they are conjugal (*Art. 117, Family Code*); therefore, the insurance indemnity is also conjugal. (*Bank of the P.I. v. Posadas*, 56 Phil. 215). Half of it must belong to the widow Y as her share of the conjugal assets; the other half forms part of the deceased's estate and should now be divided among his heirs, namely Y, A and B. If he died intestate, the division will be *equal*, for under the law of intestacy, the share of the surviving spouse is the same as the share of each of the legitimate children. (*Art. 996, Civil Code*).

(7) Effect of Predecease of the Beneficiary

If the beneficiary predeceases the insured, and the insured later dies, who gets the insurance indemnity?

ANS.: The heirs of the *beneficiary*, and *not* the heirs of the insured. This is because generally, the beneficiary has a vested right to the indemnity. (*See Grecio v. Sun Life Assur. Co. of Canada*, 48 Phil. 53). The rules on testamentary succession cannot apply here, for the insurance indemnity does

not partake of a donation. Therefore, it cannot be considered as an advance of the inheritance. For the same reason, it is *not* subject to collation. (*See Del Val v. Del Val, supra*).

[**NOTE:** The rule in the United States, however, is different. There, it has been held that if the beneficiary predeceases the insured, the proceeds of the indemnity must go, not to the estate of the beneficiary, but to the estate of the insured. (*McKinney v. Depoy, N.S. {2nd} 250*).]

(8) Accident Insurance

Although a life insurance is, generally speaking, distinct and different from an accident insurance, still when one of the risks insured against in the latter is the death of the insured by accident, such accident insurance may also be regarded as a life insurance. (*Gallardo v. Morales, L-12189, Apr. 29, 1960*).

(9) Measure of the Vested Interest of Insurance Beneficiary

The vested interest or right of the beneficiaries in a life insurance policy should be measured on its *full face value*, and not on its cash surrender value. The reason is clear. In case of death of the insured, said beneficiaries are paid on the basis of its face value, and in case the insured should discontinue paying premiums, the beneficiaries may continue paying them, and they are entitled to automatic extended terms or paid-up insurance options, etc. (*Delfin Nario & Alejandra Santos-Nario v. Phil. American Life Insurance Co., L-22796, Jun. 26, 1967*).

(10) Act of Surrendering an Insurance Policy is an Act of Disposition or Alienation

If a wife insures herself for P500,000 and designates her husband and minor child as *irrevocable beneficiaries*, her act of obtaining a loan on said policy and her subsequent act of surrendering the policy because the loan was not granted are acts of disposition or alienation of her husband's and her minor child's property rights, and are not *merely acts of management or administration*. To be valid, the act of surrendering must be with the husband's consent (insofar as his P250,000 is concerned), and with the court's consent (insofar as the minor

child's share of P250,000 is concerned). In the interest of the minor child, the parent needs *judicial appointment as guardian* and *judicial approval* for the *act of disposition*, in addition to *judicial approval* for the act of alienation or encumbrance. (*Nario v. Phil-Am Life*, L-22796, Jun. 26, 1967).

Art. 2012. Any person who is forbidden from receiving any donation under Article 739 cannot be named beneficiary of a life insurance policy by the person who cannot make any donation to him, according to said article.

COMMENT:

(1) Disqualified Donees Cannot Be Beneficiaries

- (a) If a concubine is made the beneficiary, it is believed that the insurance contract will still remain valid, but the indemnity must go to the legal heirs and not to the concubine, for evidently what is prohibited under this article is the naming of the *improper* beneficiary.
- (b) Art. 739 provides: "The following donations shall be void:
 - 1) Those made between persons who were guilty of adultery or concubinage at the time of the donation;
 - 2) Those made between persons found guilty of the same criminal offense, in consideration thereof;
 - 3) Those made to a public officer or his wife, descendants and ascendants, by reason of his office.

In the case referred to in No. 1, the action for declaration of nullity may be brought by the spouse of the donor or donee, and the guilt of the donor and donee may be proved by preponderance of evidence in the same action."

(2) No Retroactive Effect of the Article

This Article does not have any retroactive effect, and will not therefore apply to contracts perfected *before* the effectivity date of the new Civil Code. (*Southern Luzon Employees Association v. Gulpeo*, L-6114, Oct. 30, 1954).

Chapter 2

GAMBLING

Art. 2013. A game of chance is that which depends more on chance or hazard than on skill or ability. For the purposes of the following articles, in case of doubt a game is deemed to be one of chance.

COMMENT:

(1) Game of Chance Defined

The first sentence defines a game of chance.

(2) Rule in Case of Doubt

Note that in case of doubt, the presumption is that the game is one of CHANCE.

(3) Examples of Games of Chance

- (a) In a lottery, there is the element of chance. (*Valhalla Hotel v. Larmona*, 44 Phil. 233). Generally, a guessing contest partakes of the nature of a lottery. (*El Debate v. Topacio*, 44 Phil. 294).

Under the Revised Penal Code, some forms of *gambling include monte, jueteng* or any other form of lottery, policy, banking or percentage. (Art. 195, No. [1], Revised Penal Code). Note that the law makes gambling a crime because “the social scourge of gambling must be stamped out.” (*People v. Gorostiza*, 43 O.G. No. 6, p. 2007). Even betting on the results of a sports game is prohibited.

(4) Some Forms of Legal Gambling

The Jai Alai, horse-racing on certain days, the sweepstakes and lotteries (lotto) held by the government, cockfighting on certain days, mahjong at certain hours.

Art. 2014. No action can be maintained by the winner for the collection of what he has won in a game of chance. But any loser in a game of chance may recover his loss from the winner with legal interest on the time he paid the amount lost, and subsidiarily from the operator or manager of the gambling house.

COMMENT:

(1) No Court Action by Winner

The law discourages gambling, hence the provisions of Art. 2014.

(2) Promissory Note Issued Because of Gambling

A promissory note issued because of a gambling debt will not produce any effect in the hands of the winner, but if indorsed in favor of an innocent third party, recovery can be had from the indorser who will be in estoppel. (*Rodriguez v. Martinez*, 5 Phil. 67; see *Palma v. Canizares*, 1 Phil. 602).

(3) Money Lent to a Gambler

If I lend money to a person, and he later gambles and loses it, I can still recover from him the amount of the loan even if the gambling took place at my home. This is because the loan is NOT the result of gambling. (*Vasquez v. Florence*, 5 Phil. 183). Similarly, if a gambler borrows from me to pay a winner, I can still recover from him, for I did *not* win the money by gambling.

(4) Instance Where Article is Not Applicable

**Ban v. IAC
GR 66272, Oct. 17, 1986**

FACTS: A organized *mahjong* sessions for recreation in which B was a constant participant. On several occasions B borrowed from A various amounts to pay off his mahjong losses, promising to pay the same on demand. A sued B to recover the amounts borrowed. B alleged that the alleged

indebtedness was a gambling debt, and therefore A cannot legally collect it.

HELD: Art. 2014 does not apply to a case where the maintainer of a gambling house sues a gambler to recover money which the latter had borrowed from the former to pay off gambling debts incurred in favor of others. Even if plaintiff is admittedly the operator of the gambling joint, his alleged subsidiary liability cannot arise absent a direct suit against those primarily liable for defendant's losses, namely, the *mahjong* winners, and absent furthermore said winners' proven liability to pay.

Art. 2015. If cheating or deceit is committed by the winner, he, and subsidiarily the operator or manager of the game bring house, shall pay by way of exemplary damages, not less than the equivalent of the sum lost, in addition to the latter amount. If both the winner and the loser have perpetrated fraud, no action for recovery can be brought by either.

COMMENT:

Effect of Cheating

According to the Code Commission, "it is provided that exemplary damages should be paid in the above case in order that cheating in a game of chance may be properly discouraged and punished." (*Report of the Code Commission*, p. 153).

Art. 2016. If the loser refuses or neglects to bring an action to recover what has been lost, his or her creditors, spouse, descendants or other persons entitled to be supported by the loser may institute the action. The sum thereby obtained shall be applied to the creditors' claims, or to the support of the spouse or relatives, as the case may be.

COMMENT:

Rule if Loser Does Not Bring the Action to Recover

Note the persons who may subsidiarily bring the action.

With respect to creditors, recovery is only to the extent of the credit.

Art. 2017. The provisions of Articles 2014 and 2016 apply when two or more persons bet in a game of chance, although they take no active part in the game itself.

COMMENT:

Bets Made by Game Watchers

This Article may refer to “side-bets” among the spectators in a gambling game.

Art. 2018. If a contract which purports to be for the delivery of goods, securities or shares of stock is entered into with the intention that the difference between the price stipulated and the exchange or market price at the time of the pretended delivery shall be paid by the loser to the winner, the transaction is null and void. The loser may recover what he has paid.

COMMENT:

Where the Transactions Partake of Gambling and Thus Void

If a certain share of stock is sold today in the Philippine Stock Exchange for P19 per share and it is agreed between X and Y that X will deliver to Y 10 days from now (or on Feb. 14) 1,000 shares of said stock at the price prevailing on said date, *i.e.*, on Feb. 14, and on that the date the price is already P23 per share (or a gain of P4 per share or P4,000 for the 1,000 shares), it is understood that X has gained P4,000 and this amount should be given by Y to X. If, upon the other hand, instead of a gain, the price decreases, *e.g.*, by P3 on Feb. 14, it is understood that X has lost P3 a share or a total of P3,000, which amount X must give to Y. Both transactions partake of gambling and are regarded as null and void. (*Dr. Edgardo C. Paras, Economics for Lawyers, Rex Book Store, 1993, pp. 203-204*).

Art. 2019. Betting on the result of sports, athletic competitions, or games of skills may be prohibited by local ordinances.

COMMENT:

(1) Prohibition on Betting

Note that local ordinances may prohibit BETTING on the result of:

- (a) sports
- (b) athletic competitions
- (c) games of skill

(2) Beauty Contest, Oratorical Contest

It would seem that in these contests, there can be prohibition on betting. What the law does not include, it excludes.

(3) Revised Penal Code

The Revised Penal Code (*Art. 195*) expressly prohibits betting on the results of sports contest. (*See PD 1602*).

Art. 2020. The loser in any game which is not one of chance, when there is no local ordinance which prohibits betting therein, is under obligation to pay his loss, unless the amount thereof is excessive under the circumstances. In the latter case, the court shall reduce the loss to the proper sum.

COMMENT:

Chess is definitely not a game of chance.

Chapter 3

LIFE ANNUITY

Art. 2021. The aleatory contract of life annuity binds the debtor to pay an annual pension or income during the life of one or more determinate persons in consideration of a capital consisting of money or other property, whose ownership is transferred to him at once with the burden of the income.

COMMENT:

(1) Example of Life Annuity

Jose gave Mariano a parcel of land with the condition that the latter will give Jose an annual pension or income as long as Jose lives. Jose is both the *annuitant* (giver of the capital) and the beneficiary. Ownership of the land is immediately transferred to Mariano with the burden of the pension.

(2) Life Annuity Distinguished from Life Insurance

Life annuity differs from life insurance in that the annual income is not payment of interest on the capital given, but as the consideration for the transfer of the ownership of the capital. (*12 Manresa 62*).

Art. 2022. The annuity may be constituted upon the life of the person who gives the capital, upon that of a third person, or upon the lives of various persons, all of whom must be living at the time the annuity is established.

It may also be constituted in favor of the person or persons upon whose life or lives the contract is entered into, or in favor of another or other persons.

COMMENT:**(1) Upon Whose Life the Annuity May Be Constituted**

- (a) the life of the annuitant
- (b) the life of a third person
- (c) the lives of various persons

(2) Who May Be the Beneficiary

- (a) the person or persons upon whose life or lives the contract is entered into
- (b) another person or persons

Art. 2023. Life annuity shall be void if constituted upon the life of a person who was already dead at the time the contract was entered into, or who was at that time suffering from an illness which caused his death within twenty days following said date.

COMMENT:**When the Contract of Life Annuity Is Void**

The Article gives us two instances when the contract is VOID.

Art. 2024. The lack of payment of the income due does not authorize the recipient of the life annuity to demand the reimbursement of the capital or to retake possession of the property alienated, unless there is a stipulation to the contrary. He shall have only a right judicially to claim the payment of the income on arrears and to require a security for the future income, unless there is a stipulation to the contrary.

COMMENT:**Effect if the Income Due Is Not Paid**

- (a) Note that if the income is not paid, the recipient *cannot* demand reimbursement of the property, unless there is a stipulation to the contrary.

- (b) The only rights are to *judicially claim the payment* of the income in *arrears* AND to acquire a *security* of the future income (unless there is a stipulation to the contrary).

Art. 2025. The income corresponding to the year in which the person enjoying it dies shall be paid in proportion to the days during which he lived; if the income should be paid by installments in advance, the whole amount of the installment which began to run during his life shall be paid.

COMMENT:

Effect if Beneficiary Dies

The Article is self-explanatory.

Art. 2026. He who constitutes an annuity by gratuitous title upon his property, may provide at the time the annuity is established that the same shall not be subject to execution or attachment on account of the obligations of the recipient of the annuity. If the annuity was constituted in fraud of creditors, the latter may ask for the execution or attachment of the property.

COMMENT:

Attachment of the Annuity

Note that the annuity cannot be attached by *creditors of the recipient* if there be a stipulation to this effect, but the *creditors of the person who constituted the annuity* may ask for the attachment if made in fraud of their rights.

Art. 2027. No annuity shall be claimed without first proving the existence of the person upon whose life the annuity is constituted.

COMMENT:

Proof of Existence of Person Upon Whose Life the Annuity Has Been Constituted

The reason for the Article is obvious. If the person referred to does not exist, the contract is VOID.

TITLE XIV

COMPROMISES OR ARBITRATIONS

Chapter 1

COMPROMISES

Art. 2028. A compromise is a contract whereby the parties, by making reciprocal concessions, avoid a litigation or put an end to one already commenced.

COMMENT:

(1) Essence of Compromise

According to the Code Commission, the element of “reciprocal concessions” is the very heart and life of every compromise. (*Report of the Code Commission, p. 164*).

(2) Definition of Compromise

The Article defines the contract of compromise.

(3) Characteristics

- (a) Consensual
- (b) Reciprocal
- (c) Nominate
- (d) Onerous
- (e) Accessory (in the sense that a prior conflict is presupposed)
- (f) Once accepted, it is binding on the parties, provided there is no vitiated consent. (*McCarthy v. Barber Steam-*

ship Lines, 45 Phil. 488). And this is true *even if* the compromise turns out to be unsatisfactory to either or both of the parties. (*Castro v. Castro, 97 Phil. 705*).

- (g) It is the settlement of a *controversy principally*, and is, but merely incidentally, the settlement of a claim. (*McCarthy v. Barber Steamship Lines, 45 Phil. 488*).

Kaisahan v. Sarmiento
L-47853, Nov. 16, 1984

A compromise entered into by the officers of a labor union must be authorized by the union members, and must be produced in court.

(4) Kinds

- (a) Judicial — (to end a pending litigation)
- (b) Extrajudicial — (to prevent a litigation from arising). (*Ybleon v. Sison, 58 Phil. 290*).

(5) When Agreement Is Not Really a Compromise

Merced v. Roman Catholic Archbishop
L-24614, Aug. 17, 1967

FACTS: The lessees of a parcel of land (for an indefinite period) were occupying the premises for several years. One day, they were given notice to vacate, whereupon they went to court to have it fix the period of the lease and to have the lessees' rights determined insofar as the improvements are concerned. A so-called "compromise agreement" was reached whereby the court was given discretion to fix the term, but the attorney who signed in behalf of the lessees had *not* been so authorized.

ISSUE: Does the agreement bind the lessees?

HELD: Yes. It is immaterial that the attorney was unauthorized for what he signed in their behalf was NOT really a compromise. There were no reciprocal concessions given,

and what was agreed upon is merely what the law provides. Upon the other hand, a true compromise requires the grant of reciprocal concessions.

(6) Cases

**Landoil Resources Corp., et al.
v. Hon. Tensuan, et al.
GR 77733, Dec. 20, 1988**

Jurisprudence in a long line of decisions has established without question that compromise agreements reached by the parties in a case and filed before either the Court of Appeals or the Supreme Court, have been approved and/or sustained by this Court. Thus, it has been held that a compromise may supersede all agreements and proceedings that had previously taken place and may constitute a final and definite settlement of the controversies by and between the parties. From the time a compromise is validly entered into, it becomes the source of the rights and obligations of the parties thereto, the purpose of a compromise being precisely to replace and terminate controverted claims.

**Reformist Union of R.B. Liner, Inc. v. NLRC
GR 120482, Jan. 27, 1997
78 SCAD 377**

FACTS: An agreement was entered into by R.B. Liner, Inc. and its union (Reformist Union) in the nature of a compromise agreement, *i.e.*, “an agreement between two or more persons, who, for preventing or putting an end to a lawsuit adjust their difficulties by mutual consent in the manner which they agree on, and which everyone of them prefers to the hope of gaining, balanced by the danger of losing.” In said agreement, each party made concessions in favor of the other to avoid a protracted litigation.

HELD: While the Supreme Court does not abandon the rule that “unfair labor practice acts are beyond and outside the sphere of compromises,” the agreement herein was voluntarily entered into and represents a reasonable settlement, thus, it binds the parties.

Art. 2029. The court shall endeavor to persuade the litigants in a civil case to agree upon some fair compromise.

COMMENT:

(1) Duty of the Court to Persuade Litigants to Compromise

The reason for this duty is obvious: litigation must, if possible, be avoided or minimized.

(2) Right of Attorney to Compromise for His Client

The Rules of Court require a “special authority” before a attorney can compromise in behalf of his client. The authority may be in writing, or may be oral, but in case of an *oral* authority the same must be duly established by evidence other than the self-serving assertion of counsel himself that such authority had been given to him orally. (*Home Insurance Co. v. United States Lines, Co., et al.*, L-25693, Nov. 15, 1967).

(3) The Case of Richard Gordon

**Richard J. Gordon v. CA
GR 134900, Sep. 1, 1998**

In open court during the hearing, a civil settlement has been encouraged for a dignified exit of an achiever and smooth assumption of a successor, for a settlement still accords with Arts. 2028 and 2029 of the Civil Code.

Art. 2028 provides: “A compromise is a contract whereby the parties, by making reciprocal concessions, avoid a litigation or put an end to one already commenced.” Art. 2029 states: “The court shall endeavor to persuade the litigants in a civil case to agree upon some fair compromise.”

Art. 2030. Every civil action or proceeding shall be suspended:

(1) If willingness to discuss a possible compromise is expressed by one or both parties; or

(2) If it appears that one of the parties, before the commencement of the action or proceeding, offered to discuss a possible compromise but the other party refused the offer.

The duration and terms of the suspension of the civil action or proceeding and similar matters shall be governed by such provisions of the rules of court as the Supreme Court shall promulgate. Said rules of court shall likewise provide for the appointment and duties of amicable compounders.

COMMENT:

(1) Suspension of Civil Action or Proceeding

Under the Revised Rules of Court, this Article on *suspension* is reproduced substantially.

(2) Motion to Dismiss

The Revised Rules of Court mentions as one of the grounds to dismiss — the fact that no attempt has been made to arrive at a compromise. (*Rev. Rules of Court, Rule 16*). In cases where the law allows a compromise, the fact that an attempt to arrive at one has been made — should be stated in the complaint — otherwise, the complaint can be dismissed. Of course, if no compromise is allowed by law (as in the case of *future* support), the condition precedent does not apply.

(3) Postponements

While postponements must be discouraged, still they can be allowed when the parties are trying to reach an amicable settlement. (*PNB v. De la Cruz, L-1002, Apr. 16, 1958*).

(4) Offers to Arbitrate Not Included

This Article does *not* include offers to arbitrate. It refers only to a compromise, upon terms that the court can ascertain and determine if they are reasonable. A compromise could dispense with a trial; but an arbitration would merely prolong the case, since the arbiter's decision would remain appealable. (*Vaswani v. P. Tarochand Bros., L-15800, Dec. 29, 1960*).

Art. 2031. The courts may mitigate the damages to be paid by the losing party who has shown a sincere desire for compromise.

COMMENT:

Mitigation of Damages

The Article is self-explanatory.

Art. 2032. The court's approval is necessary in compromises entered into by guardians, parents, absentee's representatives, and administrators or executors of decedents' estates.

COMMENT:

(1) When Court Approval is Essential

The Article is self-explanatory.

(2) Other Rules

- (a) An agent needs a special power to compromise. (*Art. 1878, Civil Code*).
- (b) If an attorney is not authorized by the client, he cannot compromise his client's claim (*Monte de Piedad v. Rodrigo, 56 Phil. 310 and Sec. 23, Rule 138, Revised Rules of Court*), unless the client fails to repudiate promptly the act after knowing of it, in which case the client will be in estoppel. (*Rivero v. Rivero, 59 Phil. 15*).
- (c) While under Art. 225 of the Family Code the widow is the legal administratrix of the property pertaining to the children under parental authority, said article does *not* give her authority as legal administratrix to compromise their claims for indemnity arising from their father's death "for a compromise has always been deemed equivalent to an alienation (*transigere est alienare*), and is an act of strict ownership that goes beyond mere administration." (*Visaya, et al. v. Suguitan, et al., L-8300, Nov. 18, 1955 and People v. Verano, L-15805, Feb. 28, 1961*).

Art. 2033. Juridical persons may compromise only in the form and with the requisites which may be necessary to alienate their property.

COMMENT:

Rules for Compromise Entered Into by Juridical Persons

- (a) A corporation may compromise thru authority granted by the Board of Directors. The *form* and the *requisites* for alienation of property must be observed.
- (b) The Municipal Council can also compromise provided that the legal requirements for the alienation of property are complied with, and provided further that the provincial governor approves the compromise. (*Municipality of San Joaquin v. Bishop of Jaro*, 36 Phil. 577).

Art. 2034. There may be a compromise upon the civil liability arising from an offense, but such compromise shall not extinguish the public action for the imposition of the legal penalty.

COMMENT:

(1) Generally, No Compromise on Criminal Aspect

If a crime has been committed, there can be a compromise on the civil liability but *not* generally on the criminal liability, because the social and public interest demands the punishment of the offender. (*U.S. v. Leano*, 6 Phil. 368 and *U.S. v. Mendozana*, 2 Phil. 353 and *U.S. v. Heery*, 25 Phil. 600).

(2) When Compromise Is Allowed

In some crimes, there can be a sort of compromise as in the case of crimes against chastity and violations of the Internal Revenue Code. Thus, the Commissioner of Internal Revenue may enter into a contract of compromise regarding *civil* and *criminal* liability arising under the Internal Revenue Code or any other law administered by the Bureau of Internal Revenue. (*Koppel Phil. v. Collector*, L-1977, Sept. 21, 1950).

However, in a *civil case*, the compromise must be entered into *before* or *during* litigation, never after final judgment. (*Rovero v. Amparo*, 91 Phil. 228). The compromise *during* litigation may even be in the form of a “confession of judgment.”

Republic v. Marcelo B. Garay
L-21416, Dec. 31, 1965

FACTS: The Government sued Garay for alleged income tax deficiency. Garay filed a pleading (which was ALSO signed by the counsel for the Commissioner of Internal Revenue), entitled “confession of judgment.” The Commissioner, in turn, signified his willingness to allow the payment of the deficiency in installments. The trial judge then rendered a decision requiring the defendant to pay in accordance with the “confession of judgment.” The Government filed a motion requesting that the decision be amended to include surcharges and interests, for which allegedly Garay had become liable in view of his admission of tax deficiency. The court amended the decision by requiring legal interest but refused to include the surcharge. The Government appealed the case.

HELD: The lower court’s decision should be affirmed for the “confession of judgment,” under the fact stated, partook of the nature of a compromise. In consideration of Garay’s admission of delinquency and the Commissioner’s willingness to allow payment on installments, both parties had agreed to put an end to the litigation, through the rendition of a judgment incorporating said stipulations. The decision appealed from is one based on a compromise agreement.

Dasalla, Sr. v. CFI
GR 51461, Apr. 26, 1991

FACTS: For the death of his son who died when the passenger jeepney driven and owned by Sumangil featured in an accident, Dasalla sued Sumangil for damages. Sumangil in his answer prayed for the dismissal of the complaint, claiming that his civil obligation to Dasalla was already settled.

The trial court dismissed the complaint on the ground that the obligation had been fully paid as shown by the “Simumpaang Salaysay” executed by Dasalla.

ISSUE: Whether the “Sinumpaang Salaysay” which was made the basis of the dismissal of the complaint is contrary to law, public order, public policy, morals or good customs, or prejudicial to a third person with a right recognized by law.

HELD: There is no law which prohibits a person who has incurred damages by reason of the act of another from waiving whatever rights he may have against the latter. If the act causing damage to another also constitutes a crime, the civil liability arising from the criminal act may also be validly waived. What is not allowed in this jurisdiction is to compromise or waive the criminal aspect of a case. The reason or principle underlying the difference between rights which may be waived and rights which may not be waived are personal, while those rights which may not be waived involve public interest which may be affected. In a compromise or a waiver of the civil aspect of the case, the restriction imposed by law is that it must be entered into before or during litigation, never after final judgment. A compromise on the civil aspect of a case is valid even if it turns out to be unsatisfactory to either or both of the parties. Express condonation by the offended party has the effect of waiving civil liability with regard to the interest of the injured party. For, civil liability arising from an offense is extinguished in the same manner as other obligations, in accordance with the provisions of the civil law. It is true that the minimum amount of compensatory damages for death that may be awarded to plaintiff at the time of the death of his son is P12,000. However, for reasons stated in the “*Sinumpaang Salaysay*,” plaintiff voluntarily released defendant from his civil obligations. Said affidavit executed by plaintiff, releasing the defendant from additional civil liability arising from the death of the former’s son, is legal. It is not contrary to law, morals, good customs, public policy or public order. Consequently, he can no longer institute a complaint to recover damages arising from the same incident subject of the affidavit. A party to the settlement cannot be allowed to renege on his undertaking therein after receiving the benefits thereof as long as the parties entered into the settlement voluntarily and intelligently, the courts are bound to respect the agreement.

(3) Compromise in Criminal Tax Cases

In *criminal case*, the compromise entered into between the taxpayer and the Commissioner must be made PRIOR to the filing of the information in court (payment may of course be made later). *Before* the compromise reaches the office of the Fiscal (now Prosecutor), the Fiscal's (Prosecutor's) consent is *not* required after it reaches the office of the Fiscal (Prosecutor), but PRIOR to the filing of the information in court, the consent of Fiscal (Prosecutor) is required. AFTER the filing of the information in court, there can be no COMPROMISE, with or without the consent of the Fiscal (Prosecutor). (*People v. Magdaluyo*, L-16236, Apr. 20, 1961). Unlike the Commissioner of Internal Revenue, the Commissioner of Customs is today NOT authorized to compromise. (*People v. Ignacio Desiderio*, L-20805, Nov. 29, 1965).

Art. 2035. No compromise upon the following questions:

- (1) The civil status of persons;**
- (2) The validity of a marriage or a legal separation;**
- (3) Any ground for legal separation;**
- (4) Future support;**
- (5) The jurisdiction of courts;**
- (6) Future legitime.**

COMMENT:

(1) Questions on Which There Can Be No Valid Compromise

The Article mentions 6 instances or questions where a compromise is VOID.

(2) Status

**Tan, et al. v. Republic
L-27713, Feb. 10, 1981**

Civil status of the parents, and the filiation of the children cannot be ordered recorded in the Civil Registry in mere summary proceedings.

(3) Recognition of Illegitimate Child

Recognition of an illegitimate child is *not* prohibited. And if a child has already been recognized, and there is *no* dispute concerning his status, his share in the inheritance proceedings may be the subject of compromise. (*Lajom v. Viola*, 73 Phil. 563).

(4) Support

Future conventional (not legal) support may be the subject of compromise, for conventional support is after all based on a contract.

(5) Jurisdiction of Courts

The “jurisdiction” of a court refers to the power of a court to hear and determine a case. To ascertain whether jurisdiction is present or not, the provisions of the law and the Constitution, not the Rules of Court, should be inquired into. (*See Auyong Hian v. Court of Tax Appeals*, L-25181, Jan. 11, 1967). Jurisdiction of courts over the subject matter *cannot* be considered by the parties. (*Nepomuceno v. Carlos*, 9 Phil. 194). Upon the other hand, parties cannot deprive a court of its jurisdiction. (*Molina v. De la Riva*, 6 Phil. 12 and *International Harvester Co. v. Hamburg American Line*, 42 Phil. 845).

**One Heart Sporting Club, Inc.
v. The Court of Appeals
GR 53790, Oct. 23, 1981**

After voluntarily submitting a cause and encountering an adverse decision on the merits, it is too late for the loser to question the jurisdiction or power of the court. It is an “undesirable practice” to accept a judgment only if it is favorable and to attack it for lack of jurisdiction when adverse.

**Solidum v. Sta. Maria
Administrative Case 1858, Dec. 26, 1984**

Civil liability may be compromised, but not the criminal offense.

Art. 2036. A compromise comprises only those objects which are definitely stated therein, or which by necessary implication from its terms should be deemed to have been included in the same.

A general renunciation of rights is understood to refer only to those that are connected with the dispute which was the subject of the compromise.

COMMENT:

(1) What a Compromise Can Deal With

- (a) those objects *definitely* stated therein
- (b) those included *implicitly* — according to the terms stated

(2) Effect of General Renunciation of Rights

Even if the renunciation is GENERAL it is understood to refer only to rights connected with the DISPUTE involved, and *not to other rights*.

(3) Strict Construction of a Compromise Agreement

A compromise must be strictly construed (*Ferrer v. Ignacio*, 39 Phil. 446); and can include only those expressly or impliedly included therein. (Art. 2036). Therefore, just because a lessee renounces possession does not mean that she waives her right of redemption granted by another agreement. (*Vitug Dimatulac v. Coronel*, 40 Phil. 686). Where a compromise agreement is onerous, the doubt should be settled in favor of the greatest reciprocity of interest. (*Rodriguez, et al. v. Belgica, et al.*, L-10801, Feb. 28, 1961).

**International Hotel Corp., et al. v.
Hon. Elias Asuncion
L-39669, Mar. 10, 1975**

A court cannot include in a compromise judgment terms which have not been agreed upon between the parties except if the same are required by law or by the Rules to be included or are necessary consequences of the stipulations. This grave abuse of discretion can be corrected by *certiorari*.

Art. 2037. A compromise has upon the parties the effect and authority of *res judicata*; but there shall be no execution except in compliance with a judicial compromise.

COMMENT:

(1) Res Judicata Effect of a Compromise

A compromise, being a contract, has the effect of *res judicata* only if there has been no vitiated consent. (*Sajona v. Sheriff*, L-5603, Aug. 24, 1954). And, therefore, it is not exactly the same as the *res judicata* referred to in the law of procedure. Generally, however, the compromise binds the parties even without judicial approval. (*Meneses v. De la Rosa*, 77 Phil. 34). However, if there is no judicial approval, it can be enforced only by a court litigation, *not by execution*. (Art. 2037; *Salazar v. Jarabe*, 91 Phil. 596). Incidentally, a compromise or amicable settlement before a court of justice, even if reduced to writing is NOT VALID unless signed by the parties. (*Simeon O. Cruz, et al. v. Court of Agrarian Relations, et al.*, L-121131-32, Dec. 29, 1965).

**Cruz, et al. v. IAC, et al.
GR 72806, Jan. 9, 1989**

It is hornbook knowledge that a judgment on compromise has the effect of *res judicata* on the parties and should not be disturbed except for vices of consent or forgery.

To challenge the same, a party must move in the trial court to set aside the said judgment and also to annul the compromise agreement itself, before he can appeal from that judgment.

(2) Judicial Compromise

If a compromise is approved by the court, a stipulation therein is considered a court order, and if not complied with, the non-performance may be considered contempt of court. (*Marquez v. Marquez*, 73 Phil. 74). Indeed, a compromise agreement submitted by the parties to the court for approval with the request that judgment be rendered in accordance

therewith, and accordingly approved by the court and incorporated into its decision, is not merely a contract which may be enforced by ordinary action for specific performance, but is part and parcel of the judgment and may, therefore, be enforced as such, by writ of execution. (*Tria v. Lirag*, L-13994, Apr. 29, 1961). In fact, even if judicially approved, a writ of execution is *necessary* for the enforcement of a judicial compromise. (*Ibid.* and *Adriano Amante v. Court of Agrarian Relations & Sergio Pama*, L-21283, Oct. 22, 1966). If the compromise agreement or the court itself fails to state when the stipulations in the compromise are supposed to be fulfilled, the court *may fix the period*, thus giving full force to the agreement. (*Alano v. Cortes*, L-15276, Nov. 28, 1960; *See Art. 1197 of the Civil Code*).

**Republic v. Court of Appeals
L-47381 and L-47420, Jan. 31, 1985**

When there is a compromise agreement that is submitted to a court, a decision may be rendered based on said compromise.

**Federis v. Sunga
L-34893, Jan. 17, 1985**

One may consent by estoppel to a judicial compromise. And by virtue of such consent, he cannot generally subsequently appeal the judicial compromise to a higher court.

(3) Judgment Generally Not Appealable

A judgment on compromise is not generally appealable and may therefore be immediately executory, unless a motion is filed to set aside the error on the ground of vitiated consent, in which case an appeal may be taken from a court order denying the motion to set aside the compromise. (*Masters Tours and Travel Corp. v. Court of Appeals*, 219 SCRA 321 [1993]). The reason for the rule is that when both parties enter into an agreement to end a pending litigation and request that a decision be rendered approving said agreement, it is only natural to presume that such action constitutes an *implicit*, as

undeniable as an express, *waiver* of the right to appeal against the decision. For a party to reserve under the circumstances, the right to appeal against said decision, is to adopt an attitude of bad faith which courts cannot countenance. (*Serrano, et al. v. Reyes, et al.*, L-16163, Dec. 29, 1960). To be entitled to appeal from a judgment approving a compromise, a party must move, not only to set aside said judgment, but also to annul or set aside, the compromise itself, on the ground of fraud, mistake, or duress, vitiating his consent to said compromise. (*Ibid.*) The claim that a judgment based on a compromise is *not* a decision in contemplation of law simply because it does not contain any finding of fact or law is *untenable*, for the reason that, when a compromise agreement is approved by a court, and the same is embodied in a decision the theory is that the court merely *adopts* the statement of facts and of law reached therein, thereby doing nothing except to impress its approval. (*Pedro Manioque, et al. v. Ceferino F. Cayco, et al.*, L-17059, Nov. 29, 1965).

(4) Judgment by Wage Administration Service

A *judgment* rendered by the Wage Administration Service, without an agreement to arbitrate, is *not* a judgment at all that can be enforced thru a writ of execution. It is nothing more than a finding that the claim is meritorious and justifies the filing of a complaint in court. (*Cabrero v. Talamán*, L-11924, May 16, 1968, applying Sec. 14 of the Services Code of Rules and Regulations, and Sec. 9, to implement Rep. Act 602 and *Gomez v. North Camarines Lumber Co.*, L-11945, Aug. 18, 1958). An order of the WAS investigator dismissing the claim “without prejudice” does *not* bar a subsequent action filed in court for the same. (*Winch v. Kiener Co., Ltd.*, L-11884, Oct. 27, 1958).

(5) When Judgment on Compromise Is Void

A judgment based upon a compromise entered into by an attorney without specific authority from the client is null and void. Such judgment may be impugned, and its execution restrained in any proceeding by the party against whom it is sought to be enforced. (*Jacinto v. Montesa*, L-23098, Feb. 28, 1967).

(6) Effect of a Judicial Compromise on Persons Not Original Parties

**Rodriguez v. Alikpala
L-38314, Jun. 25, 1974**

FACTS: To put an end to a court action, a motion for a judgment on compromise was filed. In the compromise agreement, third parties were sureties. All the parties to the compromise, including the sureties (who were not original parties to the case) asked for the approval of the compromise. Later a judgment based on such compromise was rendered. When the defendants failed to comply with its provisions, a motion for execution was filed, and granted, against the defendants and the sureties. The sureties now complain, alleging that the writ of execution cannot be issued against their properties because they were *not* parties to the case. Can the writ be issued against their properties?

HELD: Yes, because they had joined the others in asking for a judgment on compromise, and they are therefore now in estoppel.

**Bobis v. Provincial Sheriff of Camarines Norte
GR 29838, Mar. 18, 1983**

If a writ of execution is issued to enforce a judgment based on a compromise, the writ cannot be enforced against a person who although a party to the case, was not a party to the compromise agreement, and who in fact had been absolved from liability.

Art. 2038. A compromise in which there is mistake, fraud, violence, intimidation, undue influence, or falsity of documents, is subject to the provisions of Article 1330 of this Code.

However, one of the parties cannot set up a mistake of fact as against the other if the latter, by virtue of the compromise has withdrawn from a litigation already commenced.

COMMENT:**(1) Effect of Compromise Where There is Vitiating Consent**

- (a) Any of the *vices of consent* referred to in the Article may cause the annulment of the compromise.
- (b) The alleged vitiated consent must be proved. (*Rojas, et al. v. Rumbaoa, C.A., 58 O.G. 2605*).
- (c) Mere inadequacy of cause is not equivalent to vitiated consent. (*Andino v. Stanvac, C.A., 54 O.G. 8251*).
- (d) If a party consents to a compromise because of an erroneous report submitted to the court, his error is ground to set aside the compromise, even if the compromise was approved by the court. (*Saminiada v. Mata, 92 Phil. 426*).
- (e) The presence of invalid stipulations in a compromise agreement does not render void the whole agreement, where such invalid stipulations are independent of the rest of the terms of the agreement and can easily be separated therefrom without doing violence to the manifest intention of the parties. (*Velayo v. Court of Appeals, et al., 107 Phil. 587*).

(2) Modification of a Judgment on Compromise

If a court renders a judgment on compromise, it generally cannot modify the compromise unless the parties consent or unless there is a hearing to determine the presence or absence of vitiated consent. (*Ybleon v. Sison, 59 Phil. 281*).

Art. 2039. When the parties compromise generally on all differences which they might have with each other, the discovery of documents referring to one or more but not to all of the questions settled shall not itself be a cause for annulment or rescission of the compromise, unless said documents have been concealed by one of the parties.

But the compromise may be annulled or rescinded if it refers only to one thing to which one of the parties has no right, as shown by the newly-discovered documents.

COMMENT:**Effect of Discovery of Documents Referring to Matters Compromised Upon**

- (a) The first paragraph refers to a compromise on ALL differences; the second, to a compromise on one thing. The effect of the discovery of the documents is set forth in the Article.
- (b) *Reason for the first paragraph* — This is a compromise on the WHOLE, not on specific things.

Art. 2040. If after a litigation has been decided by a final judgment, a compromise should be agreed upon, either or both parties being unaware of the existence of the final judgment, the compromise may be rescinded.

Ignorance of a judgment which may be revoked or set aside is not a valid ground for attacking a compromise.

COMMENT:**(1) Compromise Entered Into in Ignorance of a Final Judgment**

A compromise in a case like this may be RESCINDED. The ignorance of the judgment may have been on the part of one party or on the part of both parties.

(2) Reason for Allowing a Rescission

Here, there was no more need for the compromise in view of the existence of the final judgments. (*See Rovero v. Amparo, et al., 91 Phil. 228*).

(3) Effect of Appeal

If a judgment is rendered but appealed, there can in the meantime be a compromise. (*Artayo v. Azaña, 62 Phil. 425*).

Art. 2041. If one of the parties fails or refuses to abide by the compromise, the other party may either enforce the compromise or regard it as rescinded and insist upon his original demand.

COMMENT:**(1) Effect if Compromise Agreement Is Not Fulfilled**

A and B had a controversy, settled eventually by a compromise. If B fails to carry out the terms thereof, A can have a choice:

- (a) enforce the compromise;

City of Zamboanga v. Mandi
GR 86760, Apr. 30, 1991

FACTS: On Feb. 11, 1982, Zamboanga City lodged a complaint for eminent domain against Julian over the latter's lot. The expropriation was intended to expand the Pasonanca Park. The trial court gave the city authority to take possession of the property upon payment of just compensation fixed at P0.18 per square meter, or P10,428. The Court of Appeals affirmed the judgment. On Feb. 12, 1987, Julian filed a notice of appeal to the Supreme Court. On Mar. 16, 1987, Julian wrote the OIC Mayor, stating, *inter alia*, that pending appeal, they were accepting the offer of the City to buy the lot at P3.00 per square meter. The Sangguniang Panglunsod adopted a resolution on May 13, 1987 authorizing the OIC Mayor to enter into a compromise agreement for the acquisition of the lot for P3.00 per square meter subject to the approval of the Supreme Court. On Jun. 4, 1987, the Agreement was signed. On the same date, the parties filed with the Supreme Court a motion to approve compromise agreement. On Jan. 6, 1988, notwithstanding the non-approval yet of the compromise agreement by the Supreme Court, the Sangguniang Panglunsod authorized the OIC Mayor to sign for and on behalf of the City the Deed of Sale covering the acquisition by the City of the lot at P3.00 per square meter. The resolution did not impose any condition of prior approval by the Supreme Court. And so it was that pursuant to the authorization granted, the Deed was signed by the parties on Jan. 11, 1988 for and in consideration of P170,595 at P3.00 per square meter. On Feb. 4, 1988, the City received a

copy of the Entry of Judgment of the Appellate Court showing that it had become final and executory on Feb. 21, 1987. Significantly, the Entry of Judgment was made only on Jan. 26, 1988. On Mar. 21, 1988, on the ground that the City was reneging on the Compromise Agreement, Julian instituted before the RTC a petition for *mandamus* praying that the City be made to comply with the agreement “particularly to pay Julian P170,595 for the purchases of the lot.” The Judge issued the writ, approved the sale entered into between the parties as a result of the Compromise Agreement, and ordered the City to pay P170,595 for the property at P3.00 per square meter. The judge relied on the ruling that a final judgment may be novated by the subsequent agreement of the parties.

HELD: The Supreme Court found the writ of *mandamus* properly issued and dismissed the City’s petition and held that it is true that in its resolution of May 13, 1987, the City had authorized the execution of the Compromise Agreement and the Deed of Sale “subject to the approval of the Supreme Court.” However, the subsequent acts of the parties clearly show that the City was no longer insisting on the suspensive condition. Thus, with the Judge’s decision “immediately after the filing of notice of appeal to the Supreme Court, the OIC Mayor negotiated for the purchase of the subject at P3.00 per square meter “to prevent a lengthy litigation at the Supreme Court and where respondent City also paying the same price of P3.00 to other adjoining lot owners.” Julian thereupon accepted the City’s offer. Further, the subsequent Sangguniang Panglunsod resolution did away with that condition. To cap it all, the Deed was signed by the parties fully cognizant that such approval had not been obtained. By virtue of the settlement thus arrived at, Julian abandoned his appeal to the Supreme Court and withdrew from a pending litigation. All these developments transpired before the entry of the Appellate Court. Judgment was made on Jan. 26, 1988. To all intents and purposes, new rights and obligations as between the parties had been created of their own volition. There was an *animus novandi* and an obvious intent

to supersede the previous agreement in the Eminent Domain case. With this the decision must be deemed to have been novated by the parties themselves, with the result that the original decision had lost force and effect. The finality of the appellate court decision which was unknown to the parties at the time of settlement, neither produced any legal effect since the appeal had effectively been withdrawn. There was no longer any lower court decision that could be the subject of an appeal. The City maintains that it was not aware of the abandonment of the appeal for which reason it entered into the compromise. This is not accurate since it was made known that the dismissal of the appeal was being made as a reciprocal concession for the settlement. Besides, under Art. 2038 of the Civil Code, "one of the parties can not set up mistake of fact against the other if the latter, by virtue of the compromise has withdrawn from a litigation already commenced." It may be conceded that the City was unaware that the judgment in the Eminent Domain case had attained finality. Ignorance of a judgment is not a valid ground for attacking a compromise. The course of action should have been an action for rescission which has not been availed of here. Art. 2040 of the Civil Code explicitly provided: "If after a litigation has been decided by a final judgment, a compromise should be agreed upon, either or both parties being unaware of the existence of the final judgment, the compromise may be rescinded." Ignorance of a judgment which may be revoked or set aside is not a valid ground for attacking a compromise. Julian was well within his right in seeking the enforcement of the compromise through a petition for *mandamus* on the strength of Art. 2041 of the Civil Code, providing that: "If one of the parties fails or refuses to abide by the compromise, the other party may either enforce the compromise or regard it as rescinded and insist upon his original demand."

- (b) or rescind it and insist on his original demand.

In either case, damages may be recovered if there should be additional injury caused by failure to abide by the terms of the compromise.

**Barreras, et al. v. Hon. Garcia, et al.
L-44715-16, Jan. 26, 1989**

While the approval of the compromise agreement by the court dismisses the case, or considers it closed, the law, however, anticipates situations wherein the parties refuse to comply with the terms of a compromise agreement.

Clearly, therefore, when a party fails or refuses to abide by the compromise, the other party may either enforce the compromise by a writ of execution, or regard it as rescinded and insist upon his original demand. Non-fulfillment of the terms of the compromise justifies execution.

(2) No Necessity for Judicial Rescission

Under this Article, there is no necessity for a judicial declaration of rescission, for the party aggrieved may “regard” the compromise agreement as already “rescinded.” (*Leonor v. Sycip, L-14220, Apr. 29, 1961*).

(3) No Rescission After Benefits are Enjoyed

**Republic v. Sandiganbayan
49 SCAD 45
1993**

The Court has consistently ruled that a party to a compromise cannot ask for a rescission after it has enjoyed its benefits.

Chapter 2

ARBITRATIONS

Art. 2042. The same persons who may enter into a compromise may submit their controversies to one or more arbitrators for decision.

COMMENT:

(1) ‘Arbitration’ Defined

Arbitration is the process whereby by mutual agreement a third party decides a dispute between two persons.

Mindanao Portland Cement Corp. v. McDonough **L-23390, Apr. 24, 1967**

FACTS: In a contract, there was a provision requiring arbitration in case of certain disputes concerning materials, plans, etc. After a particular dispute, one party went to court to compel the other to submit the matter to arbitrators. *Issue:* May the court decide the dispute on the merits?

HELD: No. All it can do, in this summary proceeding to enforce the arbitration proviso, is to determine whether or not the parties should really go to the arbitrators. Arguments on the merits must not be addressed to the court, but to the arbitrators.

Bengson v. Chan **L-27283, Jul. 29, 1977**

FACTS: In a contract for the construction of a condominium building, it was expressly agreed that should there be any dispute, a board of arbitrators must first be resorted to before

taking any judicial action. The owner went to court because the building was not finished on time, but there was no prior resort to arbitration. *Issue*: Will the case now be dismissed?

HELD: No, the case will not be dismissed, although there was no prior resort to arbitration. This is so because under the arbitration law, in a case like this, what the court should do is to refer the matter to the arbitrators who are supposed to be selected by the parties.

Allied Banking Corp. v. CA & BPI
GR 123871, Aug. 31, 1998

FACTS: By participating in the clearing operations of the Philippine Clearing House Corporation (PCHC), petitioner agreed to submit disputes of this nature to arbitration.

ISSUE: Can PCHC invoke the jurisdiction of the trial courts without a prior recourse to the PCHC Arbitration Committee?

HELD: No. Having given its free and voluntary consent to the arbitration clause, petitioner cannot unilaterally take it back according to its whim. In the world of commerce, especially in the field of banking, the promised word is crucial. Once given, it may no longer be broken. Arbitration as an alternative method of dispute resolution is encouraged by the Supreme Court. Aside from unclogging judicial dockets, it also hastens solutions especially of commercial disputes.

LM Power Engineering Corp. v.
Capitol Industrial Construction Groups, Inc.
GR L-141833, Mar. 26, 2003

FACTS: In a dispute involving electrical work at the Third Part of Zamboanga, petitioner took over some of the work contracted to petitioner. Allegedly, the latter failed to finish it because of inability to procure materials. Upon completion of its task under the contract, petitioner killed respondent in an amount contested for its accuracy by respondent. The latter also took refuge in the termination clause of the contract. That clause allowed it to set-off the cost of the work

that petitioner had failed to undertake — due to termination or takeover — against the amount it owed the latter.

Because of the dispute, petitioner filed a complaint with the Regional Trial Court (RTC) for collection of the amount representing alleged balance due it under the contract. Instead of filing an answer, respondent filed a motion to dismiss, alleging the complaint was premature because there was no prior recourse to arbitration. The RTC denied the motion and after trial, it directed respondent to pay petitioner the amount of the claim.

Petitioner claims there is no conflict regarding interpretation or implementation of the agreement. Without having to resort to prior arbitration, it is entitled to collect the value of services rendered thru an ordinary action for collection of a sum of money from respondent. Upon the other hand, respondent contends there is need for prior arbitration as provided in the agreement. *Issue:* Whether or not certain provisions of the agreement could be applied to the facts owing to parties' incongruent position regarding the dispute.

HELD: The instant case involves technical discrepancies that are better left to an arbitral body that has expertise in those areas. In any event, the inclusion of an arbitration clause in a contract does not *ipso facto* divest the courts of jurisdiction to pass upon the findings of arbitral bodies, because awards are still judicially reviewable under certain conditions. And because there was no prior referral to arbitration, the Supreme Court affirmed the decision of the Court of Appeals directing the parties to refer their dispute for arbitration in accordance with their contract.

Be that as it may, alternative dispute resolution (ADR) methods — like arbitration, mediation, negotiation, and conciliation — are encouraged by the Supreme Court. By enabling parties to resolve their disputes amicably, they provide solutions that are less consuming, less tedious, less confrontational, and more productive of goodwill and lasting relationship.

(2) Distinguished from ‘Compromise’

In arbitration, a third party gives the solution; in compromise, the decision is arrived at by the parties concerned.

(3) Special Law on Arbitration

Rep. Act 876 provides for arbitration.

Art. 2043. The provisions of the preceding Chapter upon compromises shall also be applicable to arbitrations.

COMMENT:**Applicability of Provisions on Compromise**

The Article is self-explanatory.

Art. 2044. Any stipulation that the arbitrators' award or decision shall be final, is valid, without prejudice to Articles 2038, 2039, and 2040.

COMMENT:**(1) Finality of Arbitral Award**

The arbitrator's decision is FINAL except:

- (a) if there is vitiated consent;
- (b) or if the parties had previously agreed that to be binding it must be accepted by them, and they have not accepted.
(*See Cassels v. Reid, 9 Phil. 580*).

(2) Stipulation on Arbitration Before Judicial Suit

It is permissible to agree that in case of dispute, the matter will first be submitted to arbitration before the case is brought to court. (*Chong v. Assurance Corp., 8 Phil. 339*). However, if the arbitration is NOT clearly made a condition precedent, the court action can proceed. (*Vega v. San Carlos Milling Co., 51 Phil. 911*).

[**NOTE:** The law recognizes the validity, enforceability, and irrevocability of arbitration agreements. (See Sec. 2, RA 876, otherwise known as "The Arbitration Law"). Art. 2044 of the Civil Code likewise allows the parties to an arbitration agreement to stipulate that the arbitral award shall be final, without prejudice to Arts. 2038-2040.]

[NOTE Further:

The Philippines is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, Jun. 10, 1958), otherwise known as the *New York Convention*. (Arthur P. Autea, “*International Commercial Arbitration: The Philippine Experience*,” *Philippine Law Journal*, Vol. 77, No. 2, Dec. 2002, p. 143).]

(3) Cases

**National Union Five Insurance Co. of Pittsburg
v. Stolt-Nielsen Phils., Inc.
184 SCRA 682 (1990)**

Arbitration, as an alternative mode of settling disputes, has long been recognized and accepted in our jurisdiction. (Chap. 2, Title XIV, Book IV, *Civil Code*). Republic Act 876 (*The Arbitration Law*) also expressly authorizes arbitration of domestic disputes.

Foreign arbitration as a system of settling commercial disputes of an international character was likewise recognized when the Philippines adhered to the United Nations “Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958,” under the May 10, 1965 Resolution 71 of the Philippine Senate, giving reciprocal recognition and allowing enforcement of international agreements between parties of different nationalities within a contracting state.

**Santos v. Northwest Orient Airlines
210 SCRA 256
(1992)**

The Philippines being a signatory to the New York Convention, the same has the force and effect of law.

The New York Convention actually refers to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, Jun. 10, 1958).

(4) Some Observations

“In *all* international commercial arbitration cases,” it has been observed that “parties always agree, either in their

arbitration agreements or in their agreed arbitration rules, that the award to be rendered by the arbitrator shall be final and binding.” (*Arthur P. Autea, “International Commercial Arbitration: The Philippine Experience,” Philippine Law Journal, Vol. 77, No. 2, Dec. 2002, p. 145*). In fact, both the Philippine Civil Code (*Art. 2044*) and the UNCITRAL Arbitration Rules (*Art. 32[2]*), respectively, recognize the validity of any stipulation that the arbitrator’s award or decision “shall be final” and “binding on the parties.” with the latter “undertak[ing] to carry out the award without delay.”

Lamentably, however, “losing parties not only appeal but also assail the factual findings (*See Sec. 24, The Arbitration Law*) and appreciation of evidence by the arbitrator “in the hope of re-litigating anew what the arbitrator had already settled. (*Autea, “Int’l Comm’l Arbitration: The Phil. Experience,” supra*).

Question of Fact and of Law Re Arbitral Awards
Asset Privatization Trust v. Court of Appeals
300 SCRA 579
(1998)

As a rule, the award of an arbitrator cannot be set aside for mere errors of judgment either as to the law or as to the facts. Courts are without power to amend or overrule merely because of disagreement with matters of law or facts determined by the arbitrators. They will not review the findings of law and fact contained in an award, and will not undertake to substitute their judgment for that of the arbitrators, since any other rule would make an award the commencement, not the end, of litigation.

Errors of law and fact, or an erroneous decision of matters submitted to the judgment of the arbitrators, are insufficient to invalidate an award fairly and honestly made. Judicial review of an arbitration is, thus, more limited than judicial review of a trial. Nonetheless, the arbitrator’s award is not absolute and without exceptions. The arbitrators cannot resolve issues beyond the scope of the submission agreement. Parties to such an agreement are bound by the arbitrators’ award only to the extent and in the manner prescribed by the contract and only if the award is rendered in conformity thereto.

(5) The Matter of ‘Filing Fee’**Sun Insurance Office, Ltd. (SIOL) v. Asuncion
170 SCRA 274
(1989)**

It is not simply the filing of the complaint or appropriate initiatory pleading but the payment of the prescribed docket fee, that vests a trial court with jurisdiction over the subject matter or nature of the action.

[NOTE: At any time within one month after the award is made, any party to the controversy which was arbitrated may apply to the court having jurisdiction for an order confirming the award. (Sec. 23, The Arbitration Law).]

(6) Court to Decide All Motions, Petitions, or Applications Within 10 Days After Hearing

The court shall decide all motions, petitions, or applications filed under the provisions of the Arbitration Law, within 10 days after such motions, petitions, or applications have been heard by it. (*Sec. 6, The Arbitration Law*)

[NOTE: “While some Philippine courts are able to see thru the dilatory tactics of the losing party, and eventually uphold the enforcement of the foreign arbitral award, the sad part is that they are unable to resolve the dilatory issues within the 10-day period under Sec. 6 of the Arbitration Law. Sec. 6 is honored more in the breach than in the observance. It is probably not an exaggeration to state that it is hardly observed at all. But if Sec. 6 were to be consciously observed by Philippine courts, the delay that losing parties may interpose will be short-lived and will not succeed in frustrating the enforcement of foreign arbitral awards.” (A.P. Autea, “Int’l Comm’l Arbitration: The Phil. Experience,” supra, p. 149).]

**Puromines, Inc. v. CA
220 SCRA 281
(1993)**

Since there obtains a written provision for arbitration as well as failure on respondent’s part to comply therewith, the

court rightly ordered the parties to proceed to their arbitration in accordance with the terms of their agreement. (*Sec. 6, The Arbitration Law [RA 876]*).

Respondent's arguments touching upon the merits of the dispute are improperly raised. They should be addressed to the arbitrators. The duty of the court in this case is not to resolve the merits of the parties' claims but only to determine if they should proceed to arbitration or not. (*Mindanao Portland Cement Corp. v. McDonough Construction Co. of Florida, 19 SCRA 808 [1987]*).

(7) Inclusion of Third Parties as Additional Parties to Defeat an Arbitration Clause

**Toyota Motor Phils. Corp. v. CA
216 SCRA 236
(1992)**

The contention that the arbitration clause has become dysfunctional because of the presence of third parties is untenable. (*See the following cases: Associate Bank v. CA, 233 SCRA 137 [1994]; Allied Banking Corp. v. CA, 294 SCRA 803 [1998]; and Home Bankers Savings & Trust Co. v. CA, 318 SCRA 558 [1999]*).

[NOTE: In the cases of *Associate Bank v. CA*, *supra* and *Allied Banking Corp. vs. CA*, *supra*, the Supreme Court dismissed a third party complaint and directed the parties therein to arbitrate, regardless of the related principal action that was then pending in court. (*Cited in A.P. Autea, "Int'l Comm'l Arbitration: The Phil. Experience," supra, p. 155.*) In *Home Bankers Savings & Trust Co.*, *supra*, it was held: "Arbitration, as an alternative method of dispute resolution is encouraged. Aside from unclogging judicial dockets, it also hastens solutions especially of commercial disputes. The Court looks with favor upon such amicable arrangements and will only interfere with great reluctance to anticipate or nullify the action of the arbitrator." (*Cited in A.P. Autea, "Int'l Comm'l Arbitration: The Phil. Experience," op. cit., p. 154.*)]

(8) The Del Monte Case

The relatively recent case of *Del Monte Corp.-USA v. CA* (351 SCRA 373 [2001]), according to an acknowledged authority on international arbitration practice, “gave rise to a new problem in international commercial arbitration — the inclusion of *third parties as additional parties to defeat an arbitration clause.*” (A.P. Autea, “*Int’l Comm’l Arbitration: The Phil. Experience,*” *supra*, p. 149). He “summits that the decision of the Supreme Court in the Del Monte case threatens to radically depart from establish jurisprudence in the subject of arbitration consistently observed by the precedent cases [earlier alluded to in] *Associated Bank v. CA*, *Allied Banking Corp. v. CA*, and *Home Bankers Savings & Trust Co. v. CA*,” and [which all spr[un]g from the landmark case of *Toyota Motor Phils. Corp. v. CA*. (*Ibid.*, p. 155). He adds that “[w]ith the Del Monte decision, the pronouncement [earlier quoted] in *Home Bankers Savings & Trust Co. v. CA*, inevitably fades into history.” (*Ibid.*, p. 154).

Del Monte Corp.-USA v. CA
351 SCRA 373
(2001)

FACTS: Under a distributorship agreement, Del Monte Corp.-USA (“Del Monte”) appointed Montebueno Marketing, Inc. (“Montebueno”) as sole and exclusive distributor of the former’s products in the Philippines.

The agreement provided for the following arbitration clause *re* governing law and arbitration:

“This Agreement shall be governed by the laws of the State of California and/or, if applicable, the United States of America. All disputes arising out of or relating in this agreement or the parties’ relationship, including the termination thereof, shall be resolved by arbitration in the City of San Francisco, State of California, under the Rules of American Arbitration Association.

“The arbitration panel shall consist of three members, one of whom shall be selected by [Del Monte], one of whom shall be selected by [Montebueno], and third

of whom shall be selected by the other two members and shall have relevant experience in the industry. The parties further agree that neither shall commence any litigation against the other arising out of this Agreement or the termination thereof as to any matter not subject to arbitration or with respect to any arbitration proceeding or award, except in a court located in the State of California. Each party consents to jurisdiction over it by and exclusive venue in such a court.”

Montebueno, et al., filed a complaint against Del Monte, et al., for violation of Arts. 20, 21 and 23 of the Civil Code. The former alleged that the latter’s products continued to be brought into the country by parallel importers despite the appointment of Montebueno as sole and exclusive distributor of Del Monte products thereby causing them (Montebueno, et al.) great embarrassment and substantial damage. Del Monte, et al. filed a “Motion to Suspend Proceedings” invoking the arbitration clause in the distributorship agreement and Sec. 7 of the Arbitration Law (RA 876) *re* stay of civil action.

The trial court deferred consideration of the motion rationalizing that “the grounds alleged therein do not constitute [grounds for] the suspension of the proceedings as this action is for damages with prayer for the issuance of [a] Writ of Preliminary Attachment and not on the distributorship agreement.” Subsequently, however, the trial court issued an order denying the motion based on the ground that it “will not serve the ends of justice and to allow said suspension will only delay the determination of the issues, frustrate the quest of the parties for a judicious determination of their respective claims, and/or deprive and delay their rights to seek redress.” But in so disposing, the trial court had occasion to contravene the doctrine laid down in *Puromines, Inc. v. Court of Appeals* (220 SCRA 281 [1993]), where it was ruled: “Since there obtains a written provision for arbitration as well as failure on respondent’s part to comply therewith, the court rightly ordered the parties to proceed to their arbitration in accordance with the terms of their agreement. (Sec. 6, RA 876). Respondent’s arguments touching upon the merits of the dispute are improperly raised. They should be addressed to the arbitrators. The duty of the court in this case is not to

resolve the merits of the parties' claims but only to determine if they should proceed to arbitration or not." (*Ibid.*, citing *Mindanao Portland Cement Corp. v. McDonough Construction Co. of Florida*, GR L-23390, 19 SCRA 808 [1967]).

On appeal, the Court of Appeals (CA) affirmed the trial court on the ground that the alleged damaging acts required the interpretation of Art. 21 of the Civil Code and that in determining whether Del Monte, et al. had violated said provision would require a full blown trial. Del Monte filed a Motion for Reconsideration but the motion was denied. Thereupon, Del Monte filed a petition for *certiorari* with the Supreme Court, and which the latter denied on Feb. 7, 2001. In affirming the CA, the highest tribunal also directed the trial court to proceed with the hearing of the case.

In holding that the arbitration clause in the distributorship agreement only applied to the parties thereto, the Supreme Court opined that only parties to the Agreement, *i.e.*, petitioners [Del Monte Corp.-USA (DMC-USA)] and its Managing Director for Export Sales Paul E. Derby, Jr. and private respondents [Montebueno marketing, Inc.] and its Managing Director Lily Sy are bound by the Agreement and its arbitration clause as they are the only signatories thereto. Petitioners Daniel Collins and Luis Hidalgo, and private respondent [Salvosa Foods, Inc.], not parties to the Agreement cannot even be considered assigns or heirs of the parties, are not bound by the Agreement and the arbitration clause therein.

Consequently, referral to arbitration in the State of California pursuant to the arbitration clause and the suspension of the proceedings in Civil Case 2637-MN pending the return of the arbitral award could be called for but only as to petitioners DMC-USA and P.E. Derby, Jr., and private respondents Montebueno and L. Sy, and not as to the other parties in this case. This is consistent with the case of *Heirs of Augusto L. Salas, Jr. v. Laperal Realty Corp.* (320 SCRA 610 [1990]), which superseded that of *Toyota Motor Phils. Corp. v. Court of Appeals* (216 SCRA 236 [1992]).

In *Toyota, Motor Phils. Corp. v. CA* (*supra*), "the contention that the arbitration clause has become dysfunctional because of the presence of third parties is centenable [con-

sidering that] contracts are respected as the law between the contracting parties [and] as such, the parties are thereby expected to abide with good faith in their contractual commitments.” However, in *Salas, Jr. vs. Laperal Realty Corp.* (*supra*), only parties to the agreement, their assigns or heirs have the right to arbitrate or could be compelled to arbitrate. In recognizing the right of the contracting parties to arbitrate or to compel arbitration, the splitting of the proceedings to arbitration as to some of the parties on one hand and trial for the others upon the other hand, or the suspension of trial pending arbitration between some of the parties, should not be allowed as it would, in effect, result in multiplicity of suits, duplicitous procedure and unnecessary delay.

Accordingly, the object of arbitration is to allow the expeditious determination of a dispute. Dearly, the issue before this Court could be speedily and efficiently resolved in its entirety if simultaneous arbitration proceedings and trial, or suspension of trial pending arbitration are allowed. The interest of justice would only be served if the trial court hears and adjudicates the case in a single albeit complete proceedings.

Del Monte, et al. filed a Motion for Reconsideration but which was denied by the Supreme Court in a Resolution dated Jul. 18, 2001. Held the Court: “The inclusion of third parties to defeat the arbitration clause presupposes bad faith. And bad faith is never presumed. In the instant case, it is not alleged nor even hinted at that the inclusion of third parties was specifically and intentionally done to negate the effect of the arbitration clause. Consequently, the pronouncement of the Court in *Salas, Jr. v. Laperal Realty Corp.* (*supra*) that only parties to the agreement, their assigns or heirs have the right to arbitrate, or could be compelled to arbitrate, must be adopted.”

[NOTE: “With the declaration of the Supreme Court in *Del Monte Corp.-USA v. CA* (351 SCRA 373 [2001]) that “the case of *A.L. Salas, Jr. v. Laperal Realty Corp.* (320 SCRA 610 [1999]) superseded that of *Toyota Motor Phils. Corp. v. CA* (216 SCRA 236 [1992]), the *Del Monte Case* (*supra*) needs to be revisited. The *Salas case* (*supra*) which was rendered by

a division (of the Court), cannot overturn the doctrine laid down in (the) *Toyota case (supra)*, which was rendered by another division, without running afoul with the mandatory provision under Art. VII, Sec. 4(3) of the 1987 Phil. Const., which reads that cases or matters heard by a division shall be divided or resolved with the concurrence of a majority of the Members who actually took part in the deliberations on the issues in the case and voted thereon, and in no case, without the concurrence of at least three of such Members. When the required number is not obtained, the case shall be decided *en banc*. *Provided*, That no doctrine or principle of law laid down by the court in a decision rendered *en banc* or in division may be modified or reversed except by the court sitting *en banc*. The case of *Republic v. Delos Angeles (159 SCRA 264 [1988])*, declared this constitutional provision as mandatory.” (A.P. Autea, “*International Commercial Arbitration: The Philippine Experience*,” *Philippine Law Journal*, Vol. 77, No. 2, Dec. 2002, p. 156).].

Art. 2045. Any clause giving one of the parties power to choose more arbitrators than the other is void and of no effect.

COMMENT:

Equal Number of Arbitrators

The Article explains itself.

Art. 2046. The appointment of arbitrators and the procedure of arbitration shall be governed by the provisions of such rules of court as the Supreme Court shall promulgate.

COMMENT:

Authority of the Supreme Court to Promulgate Rules on Arbitration

The Article is self-explanatory.

TITLE XV

GUARANTY

Chapter 1

NATURE AND EXTENT OF GUARANTY

INTRODUCTORY COMMENT:

(1) Guaranty in the Broad Sense

Guaranty may be:

- (a) personal guaranty;
- (b) or real guaranty.

(2) Personal Guaranty

This may be in the form of:

- (a) guaranty (properly so-called or guaranty in the strict sense)
- (b) suretyship (one where the surety binds himself solidarily, not subsidiarily, with the principal debtor).

(3) Real Guaranty

Here, the guaranty is PROPERTY —

- (a) if *real* property — the guaranty may be in the form of:
 - 1) a real mortgage;
 - 2) antichresis.
- (b) if *personal* property — the guaranty may be in the form of:

- 1) pledge;
- 2) chattel mortgage.

**San Miguel Corporation
v. National Labor Relations Commission
GR 58630, Nov. 25, 1983**

A cash bond to bail out an employee is not a loan (for ownership is not transferred) but money *entrusted* to the employee.

Art. 2047. By guaranty a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so.

If a person binds himself solidarily with the principal debtor, the provisions of Section 4, Chapter 3, Title I of this Book shall be observed. In such case the contract is called a suretyship.

COMMENT:

(1) Guaranty in the Strict Sense

This Article refers to guaranty properly so-called, or guaranty in the strict sense. The first paragraph defines this contract of guaranty. The parties thereto are the *guarantor* and the *creditor*. Strictly speaking, the contract between the debtor and the guarantors is called the *contract of indemnity*.

(2) Characteristics of the Contract of Guaranty

- (a) It is a contract between the *guarantor* and the *creditor*.

**Vizconde v. IAC
GR 74231, Apr. 10, 1987**

FACTS: PAG and CJV were charged with and convicted of estafa. The people's evidence — a receipt — reads:

“Received from *MJL* one diamond ring, which I agree to sell for P85,000 on commission basis and pay

her in the following manner: P85,000 — post dated check. It is understood that in the event the above postdated check is dishonored on its due date, the total payment of the above item, shall become immediately due and demandable without awaiting further demand.

“I guarantee that the above check will be sufficiently funded on the due date.

(SGD) PAG I guarantee jointly and severally.” (SGD) CJV

HELD: The joint and several undertaking assumed by *CJV* in a separate writing below the main body of the receipt merely guaranteed the civil obligation of *PAG* to pay *MJL* the value of the ring in the event *PAG* failed to return the article. It cannot be construed as assuming any criminal responsibility consequent upon the failure of *PAG* to return the ring or deliver its value.

When a person acts merely as a guarantor of the obligation assumed by another to a third person for the return of such third person's right or the delivery of its value, whatever liability was incurred by the principal obligor for defaulting on such obligation, that of the guarantor consequent upon such default is merely civil, not criminal. It is error therefore, to convict the guarantor of estafa.

- (b) Generally, there must be a meeting of the minds between said parties. (*PNB v. Garcia*, 47 Phil. 662; *Texas [Phil.] Co. v. Alonzo*, 73 Phil. 90). In general, therefore, the creditor must *notify* the guarantor that the former is *accepting* the guaranty, unless the guaranty is not merely an offer but a *direct and unconditional one*. In such a case, all that is required is for the creditor to act upon the promise; no prior notice is needed to indicate his acceptance. (*Visayas Surety and Insurance Corporation v. Laperal*, 69 Phil. 688). *Reason:* In a sense, the contract may be said to be *unilateral*. (*Ibid.*)
- (c) It is consensual, nominate, accessory, unilateral (in that only the guarantor is obligated to the creditor and *not vice versa*). (*See Texas [Phil.] Co. v. Alonzo*, 73 Phil. 90).

- (d) As to form, the contract of guaranty is governed by the Statute of Frauds, being a special promise to answer for the debt, default, or miscarriage of another.” (See Art. 1403, No. 2). Hence, an oral promise of guaranty is not enforceable. (See *Nolasco Brothers, Inc. v. Villarino, CA 17616-R, Aug. 8, 1958*).

(3) Guarantor Distinguished from Surety

<i>GUARANTOR</i>	<i>SURETY</i>
(a) subsidiary liability	(a) primary liability
(b) pays if debtor CANNOT	(b) pays if debtor DOES NOT
(c) insurer of the debtor’s solvency	(c) insurer of the debt

(*Machetti v. Hospicio de San Jose, 43 Phil. 297 and Higgins v. Sellner, 41 Phil. 142*).

(4) Surety Distinguished from a Solidary Debtor

A surety is almost the same as a solidary debtor, except that the latter is himself a principal debtor. In all applicable provisions, the provisions of this Title also apply to a surety. (*Manila Surety and Fidelity Co. v. Batu Construction & Co., et al., 53 O.G. 8836*).

(5) Procedure for Enforcement of Surety’s Liability

The procedure for the enforcement of the surety’s liability under a bond for delivery of personal property is described in Sec. 8, Rule 58 and Sec. 20, Rule 57 of the Revised Rules of Court. (*Luneta Motor Co. v. Antonio Menendez, L-16880, Apr. 30, 1963*). In this *Luneta Motor Co. case*, the Court had occasion to state that in order to recover on a replevin (recovery of personal property) bond, the following requisites must be complied with:

- (a) application for damages must be filed before trial or before entry of trial judgment;
- (b) due notice must be given the other party and his surety; and

- (c) there must be a proper hearing, and the award of damages, if any, must be included in the final judgment. (*See also Alliance Surety Co., Inc. v. Piccio, L-9950, Jul. 31, 1959*).

(6) ‘Guarantor’ Distinguished from the ‘Debtor’

A guarantor is a person distinct from the debtor. While the guarantor is subsidiarily liable, the debtor is principally liable.

(7) Instance When a Suretyship is Deemed a Continuing One

Ongkiko v. BPI Express Card Corp. 486 SCRA 206 (2006)

FACTS: By executing an undertaking, petitioner solidarily obliged himself to pay respondent all the liabilities incurred under the credit card account, whether under the principal, renewal, or extension card issued, regardless of the charges or novation in the terms and conditions in the issuance and use of the credit card. *Issue:* Whether or not the surety is bound by the liabilities of the principal until it has been fully paid.

HELD: Yes, for under the circumstances, the suretyship agreement is a continuing one. Thus, in a similar case, the Supreme Court exhorted prospective sureties to exercise caution in signing treaty undertakings prepared by credit card companies, and to read carefully the terms and conditions of the agreement. (*See Molino v. Security Diners International Corp., 363 SCRA 358 [2001]*).

Art. 2048. A guaranty is gratuitous, unless there is a stipulation to the contrary.

COMMENT:

(1) Gratuitous Character

Generally, the contract of guaranty is GRATUITOUS, but there can be a contrary stipulation.

(2) Relation Between an ‘Accommodation Party’ and the ‘Accommodated Party’

**Tomas Ang v. Associated Bank and Antonio
Ang Eng Liong
GR 146511, Sep. 5, 2007**

The relationship is one of *principal* and *surety* — the accommodation party being the surety. Altho, a contract of suretyship is in essence accessory or collateral to a valid principal obligation, the surety’s liability to the creditor is immediate primary, and absolute — he is directly and equally-bound with the principal.

Art. 2049. A married woman may guarantee an obligation without the husband’s consent, but shall not thereby bind the conjugal partnership, except in cases provided by law.

COMMENT:**Married Woman as Guarantor**

Generally, a wife-guarantor responds with her paraphernal property.

Art. 2050. If a guaranty is entered into without the knowledge or consent, or against the will of the principal debtor, the provisions of Articles 1236 and 1237 shall apply.

COMMENT:**(1) Guaranty Entered Into Without Debtor’s Knowledge, Consent, or Against the Latter’s Will**

A guarantor can recover from the debtor what the former had to pay the creditor, even if the guaranty was without the debtor’s consent or against his will, but the recovery will only be to the extent that the debtor had been benefited. (*See Arts. 1236 and 1237 and De Guzman v. Santos, 68 Phil. 371.*)

(2) Cross-References

- (a) Art. 1236. The creditor is not bound to accept payment or performance by a third person who has no interest

in the fulfillment of the obligation, unless there is a stipulation to the contrary.

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

- (b) Art. 1237. Whoever pays on behalf of the debtor without the knowledge or against the will of the latter, cannot compel the creditor to subrogate him in his rights, such as those arising from a mortgage, guaranty, or penalty.

Art. 2051. A guaranty may be conventional, legal or judicial, gratuitous, or by onerous title.

It may also be constituted, not only in favor of the principal debtor, but also in favor of the other guarantor, with the latter's consent, or without his knowledge, or even over his objection.

COMMENT:

(1) Guaranty Classified According to Manner of Creation

According to manner of creation, guaranty may be:

- (a) conventional (by agreement);
- (b) legal (required by law);
- (c) judicial (required by the court as when an attachment is to be lifted).

(2) Sub-Guaranty

A sub-guaranty may be created. This is to guarantee an obligation of a guarantor.

Art. 2052. A guaranty cannot exist without a valid obligation.

Nevertheless, a guaranty may be constituted to guarantee the performance of a voidable or an unenforceable contract. It may also guarantee a natural obligation.

COMMENT:**(1) Can a Guaranty Exist Even Without a Valid Principal Obligation**

A guaranty is merely an *accessory* contract, so if the principal obligation is void, the guaranty is also void. (*De la Rosa v. De Borja*, 53 *Phil.* 990). However, by express provision of the second paragraph, a guaranty can be valid even if the principal obligation is:

- (a) voidable;
- (b) unenforceable;
- (c) natural.

(2) Consideration

The consideration of the guaranty is the same as the consideration of the principal obligation. As long as the principal debtor receives some benefit, this is all right even if the guarantor himself has NOT received any benefit. (*Phil. Guaranty Co. v. Dinio*, 54 *O.G.* 5331).

**Willex Plastic Industries Corp. v.
CA & International Corporate Bank
GR 103066, Apr. 25, 1996**

FACTS: Inter-Resin Industrial (IRI) and Willex Plastic Industries Corp. (WPIC) executed a “continuing guaranty” in favor of Investment & Underwriting Corp. of the Phils. (IUCP), jointly and severally guaranteeing payment of sums obtained and to be obtained from IRI from IUCP. For failure of IRI and WPIC to pay what IUCP had paid to Manilabank under IUCP and IRI’s “continuing surety agreements,” IUCP, thru its successor Atrium Capital Corp. (ACC), filed a case against them before the Manila RTC.

The trial court ordered IRI and WPIC to jointly and severally pay Interbank (successor of ACC) the amount of their indebtedness, plus, interest, liquidated the damages, attorney’s fees, and litigation expenses. The Court of Appeals (CA) affirmed the trial court’s ruling and denied the motion for reconsideration filed by WPIC. On appeal, the Supreme Court affirmed the CA’s decision.

HELD: WPIC, as guarantee, is bound by the same consideration that makes the contract effective between principal parties thereto. In this case, the “continuing guaranty” would cover sums obtained and/or to be obtained by IRI from Interbank. Hence, the contract of suretyship in this case has both retrospective and prospective application. Furthermore, since the “continuing guaranty” embodies an express remuneration of the right of excussion, WPIC can be proceeded against without first exhausting all the properties of IRI.

Art. 2053. A guaranty may also be given as security for future debts, the amount of which is not yet known; there can be no claim against the guarantor until the debt is liquidated. A conditional obligation may also be secured.

COMMENT:

(1) Guaranty for Present and Future Debts

There can be a guaranty for:

- (a) *present* debts;
- (b) *future* debts (even if the amount is *not* yet known). (*Art. 2053*). Therefore, a bond posted to secure additional credit that the principal debtor had applied for is not void just because the said bond was signed and filed before the additional credit was extended by the creditor. (*Naric v. Fodas, et al., L-11517, Apr. 30, 1958*).

(2) Liquidated Debt

A debt is already considered *liquidated* under this article when it is for a *price fixed* in a contract for the delivery of future goods and the seller is now ready to deliver said goods within the period stipulated. (*Smith, Bell & Co. v. Nat. Bank, 42 Phil. 733*).

(3) Continuing Surety Agreements Are Quite Commonplace in Present Day Commercial Practice

**South City Homes, Inc., Fortune Motors
(Phils.), Palawan Lumber Manufacturing
Corp. v. BA Finance Corp.
GR 135462, Dec. 7, 2001**

FACTS: Petitioners assert that the suretyship agreement they signed is void because there was no principal obligation at the time of signing as the principal obligation was signed 6 mos. later.

HELD: The law allows a suretyship agreement to secure future loans even if the amount is not yet known. (*See Art. 2053, Civil Code.*)

Of course, a surety is not bound under any particular principal obligation until that principal obligation is born. But there is no theoretical or doctrinal difficulty inherent in saying that the suretyship agreement itself is valid and binding even before the principal obligation intended to be secured thereby is born, any more than there would be in saying that obligations which are subject to a condition precedent are valid and binding before the occurrence of the condition precedent.

Comprehensive or continuing surety agreements are, in fact, quite commonplace in present-day financial and commercial practice. A bank or financing company which anticipates entering into a series of credit transactions with a particular company, commonly requires the projected principal debtor to execute a continuing surety agreement along with its sureties. By executing such an agreement, the principal places itself in a position to enter into the projected series of transactions with its creditor. With such suretyship agreement, there would be no need to execute a separate surety contract or bond for each financing or credit accommodation extended to the principal debtor.

Art. 2054. A guarantor may bind himself for less, but not for more than the principal debtor, both as regards the amount and the onerous nature of the conditions.

Should he have bound himself for more, his obligations shall be reduced to the limits of that of the debtor.

COMMENT:**(1) Obligation of Guarantor May Be Less, But Not More Than Obligation of Principal Debtor***Example:*

A borrowed from B P10 million. No mortgage was constituted. C guaranteed to B the payment of A's debt, and to show his sincerity, C even mortgaged his land in favor of B. If A cannot pay, and C cannot pay, may B foreclose the mortgage on C's land?

ANS.: No. The obligation of C being merely accessory to A's debt, it should not be more onerous than the latter. If the principal debt is not secured by a mortgage, the guaranty should also not be secured by a mortgage; otherwise, this would be making the guarantor's liability more onerous than that of the principal debtor.

[**NOTE:** A person, however, without becoming a guarantor, may secure or guarantee another's debt by mortgaging his (the former's) own property. Thus, under the last paragraph of Art. 2085, "Third persons who are *not* parties to the principal obligation may *secure* the latter by *pledging* or *mortgaging* their own property." It is, of course, understood that one who mortgages his property to guarantee another's debt *without expressly assuming personal liability* for such debt, CANNOT be compelled to pay the deficiency remaining after the mortgage has been foreclosed. (*Phil. Trust Co. v. Echaus Tan Siua*, 52 Phil. 582 and *Parsons Hardware Co., Inc. v. Acosta*, CA-GR 194344-R, May 5, 1939).]

Art. 2054 can also apply to surety. (*Hospicio de San Jose v. Fidelity & Surety Co.*, 62 Phil. 926 and *Uy Isabelo v. Yandoc*, CA-GR 8801-R, Jun. 20, 1956).

Pacific Banking Corp. v. IAC
GR 72275, Nov. 13, 1991

FACTS: Celia Regala obtained from Pacific Banking Corp. a Pacificard Credit Card under the terms and conditions issued by the bank. On the same date, Roberto Regala, Jr., spouse of Celia, executed a "Guarantor's undertaking" in favor of the bank, which provides: "I/We, the undersigned,

hereby agree, jointly and severally with Celia Syjuco Regala to pay the Pacific Banking Corporation upon demand any and all indebtedness, obligations, charges, or liabilities due and incurred by said Celia Syjuco Regala with the use of the Pacificcard or renewal thereof issued in his favor by the Pacific Banking Corporation. Any changes of or Novation in the terms and conditions in connection with the issuance or use of said Pacificcard, or any extension of time to pay such obligations, charges or liabilities shall not in any manner release me/us from the responsibility hereunder, it being understood that the undertaking is a continuing one and shall subsist and bind me/us until all the liabilities of the said Celia Syjuco Regala have been fully satisfied or paid.” Celia as such Pacificcard holder, had purchased goods or services on credit under her Pacificcard, for which Pacific Bank advanced the cost amounting to P92,803.98 at the time of the filing of complaint. In view of Celia’s failure to settle her account, demand was sent to her and to Roberto Regala under his “guarantor’s” undertaking. Later, Pacific sued both Celia and Roberto. The trial court rendered judgment against both Celia and Roberto who were ordered jointly and severally to pay the bank P92,803.98 with interest at 14% per annum from the time of demand until the principal is fully paid plus 15% of the principal obligation as attorney’s fees. The Court of Appeals modified the trial court’s decision. Roberto was made liable only to the extent of the monthly credit limit granted to Celia, *i.e.*, at P2,000 a month and only for advances made during the one-year period of the card’s effectivity counted from Oct. 29, 1975 to Oct. 29, 1976.

HELD: The Supreme Court set aside the decision of the Court of Appeals and reinstated that of the trial court and held that the undertaking signed by Roberto Regala, Jr., although denominated “Guarantor’s Undertaking” was in substance a contract of surety. As a surety he bound himself jointly and severally with the debtor Celia Regala “to pay the Pacific Banking Corporation upon demand, any and all indebtedness, obligations, charges or liabilities due and incurred by said Celia Syjuco Regala with the use of Pacificcard or renewals thereof issued in her favor by Pacific Banking Corporation.” This undertaking was also provided as a condition in the issuance of the Pacificcard to Celia. Under Art. 2054 of the Civil

Code, “a guarantor may bind himself for less, but not for more than the principal debtor, both as regards the amount and the onerous nature of the conditions.” The credit limit granted to Celia Regala was P2,000 per month and that Celia Regala succeeded in using the card beyond the original period of its effectivity, Oct. 29, 1979. However, Roberto’s liability should not be limited to that even. As surety of his wife, he expressly bound himself up to the extent of the debtor’s indebtedness, likewise expressly waiving any discharge in case of any change or novation in the terms and conditions in connection with the issuance of the Pacificard credit card. Roberto in fact made his commitment as a surety a continuing one, binding upon himself until all the liabilities of Celia have been fully paid.

(2) Problems

- (a) A borrowed from B P1 million. Can C act as surety and guarantee the payment and limit his liability to merely P300,000?

ANS.: Yes, the guarantor or the surety can bind himself for less than the principal debtor.

- (b) In case (a), suppose A can pay only P900,000, can B get anything from C?

ANS.: Yes, B can still get P100,000 from C. Out of the P1 million debt, P700,000 was unsecured; P300,000 was secured (by the suretyship). It follows that, applying the rule of application of payments, the payment of the P900,000 should first be applied to the unsecured debt of P700,000, and the remaining P200,000 should be applied to the secured debt. This is so because the unsecured debt is clearly more onerous than the secured one. It follows that since only P200,000 of the secured debt has been paid, the creditor can still claim from the surety the amount of P100,000.

[NOTE: This does not contradict the statement that the guarantor of the surety may bind himself for less than the principal debt. After all, in the problem presented the surety bound himself to pay up to P300,000. Had the principal debtor been completely insolvent, the creditor could only ask for P300,000 from the surety.

The Supreme Court has repeatedly stated that: "Where in a bond the debtor and surety have bound themselves solidarily, but limiting the liability of the surety to a lesser amount than that due from the principal debtor, any such payment as the latter may have on account of such obligation, must be applied first to the unsecured portion of the debt, for, as regards the principal debtor, the obligation is more onerous as to the amount not secured." (*Hongkong and Shanghai Banking Corporation v. Aldanese*, 48 Phil. 990).]

(3) Rule if a Person Has Two Debts

When a person has two debts, one as a sole debtor, and another as solidary co-debtor, his more onerous obligation to which first payment is to be applied, is the debt as sole debtor. (8 *Manresa* 290).

Commonwealth of the Phil. v. Far Eastern Surety and Insurance Co. 83 Phil. 305

FACTS: The Far Eastern Surety & Insurance Co., Inc. bound itself to pay jointly and severally with the principal debtor the sum of P10,000.00 although the debt was really P11,230. The principal debtor was able to pay P10,000 only. When sued, the Far Eastern Surety claimed that inasmuch as the P10,000 had been fully satisfied, the surety cannot now be held liable for the balance. It alleged that as surety it had agreed to guarantee the payment of merely P10,000. **Issue:** Is said surety liable for the balance?

HELD: Yes, since in a case like this, we have to apply the rule on the application of payments. The P10,000 already given should first be applied to the unsecured portion and the balance to the secured debt.

(4) Rule if Debt is Increased

If the indebtedness is increased without the guarantor's consent, he is completely released from the obligation as guarantor or surety. (*Nat. Bank v. Veraguth*, 50 Phil. 253).

(5) Liability of Guarantor for Interest

If a guarantor upon demand fails to pay, he can be held liable for interest, even if in thus paying, the liability becomes *more* than that in the principal obligation. The increased liability is not because of the contract but because of the default and the necessity of judicial collection. It should be noted, however, that the interest runs from the time the complaint is filed, *not* from the time the debt becomes due and demandable. (*Tagana v. Aldanese*, 43 Phil. 582 and *Plaridel Surety & Insur. Co. v. P.I. Galang Machinery Co.*, 53 O.G. 1449).

(6) Effect of a Penalty Clause

If a surety bond has a penalty clause (in case of a violation of a condition), said penalty may be demanded in the proper case even if its value is MORE than the amount of the principal debt. (*General Insurance & Surety Corp. v. Republic*, L-13873, Jan. 31, 1963).

Art. 2055. A guaranty is not presumed; it must be express and cannot extend to more than what is stipulated therein.

If it be simple or indefinite, it shall comprise not only the principal obligation, but also all its accessories, including the judicial costs, provided with respect to the latter, that the guarantor shall only be liable for those cost incurred after he has been judicially required to pay.

COMMENT:**(1) Form of the Contract**

To be enforceable, the contract of guaranty (between the guarantor and the creditor) must be in *writing*, since this is “a special promise to answer for the debt, default, or miscarriage of another.” (Art. 1403, *Civil Code*). Hence, an *oral* guaranty is *unenforceable*. (*Nolasco Brothers, Inc. v. Villarino*, CA-GR 17616-R, Aug. 8, 1958).

(NOTE: Even if oral, however, the defense may be WAIVED by the guarantor, since it is well known that the defense of the Statute of Frauds is *waivable*.)

Be it noted therefore that the guaranty must be EXPRESS (it is *not* presumed).

**PNB v. CA, Luzon Surety Co., et al.
GR 33174, Jul. 4, 1991**

FACTS: On Aug. 6, 1955, Estanislao Depusoy, doing business under the name of E.E. Depusoy Construction and the Director of Public Works, entered into a building contract for the construction of the GSIS building, Depusoy to furnish all materials, labor, plans and supplies needed in the construction. Depusoy applied for credit accommodation with the PNB. This was approved subject to the conditions that he would assign all payments to be received from the Bureau of Public Works of the GSIS to the Bank, furnish a surety bond, and the surety to deposit P10,000 to the PNB. The total accommodations granted to Depusoy was P100,000. This was later extended by another P10,000 and P25,000, but in no case should the loan exceed P100,000. In compliance with the conditions, Depusoy executed a Deed of Assignment of all money to be received by him from the GSIS. Luzon thereafter executed two surety bonds, one for P40,000 and the other for P60,000. Under the credit accommodation, Depusoy received on Jan. 14, 1957, P50,000 from the bank which he promised to pay in installments on the dates therein indicated. On Jan. 17, 1957, he received another P50,000 under the same conditions. Under the arrangement, all payments made by GSIS were payable to the PNB. The checks, however, were not sent directly to the PNB. Depusoy received them. In turn, he delivered the checks to the bank. PNB then applied the money thus received, first, to the checks, and the balance to the current account of Depusoy with the bank. A total of P1,309,461 was paid by the GSIS to the bank for the account of Depusoy. Of this amount P246,408 was paid for the importation of construction materials and P1,063,408 was received by the Loans and Discounts Department of the Bank. Depusoy defaulted in his building contract with the Public Works Bureau. In 1957, the Bureau rescinded its contract with Depusoy. No further amounts were thereafter paid by the GSIS to the bank. Depusoy's loan remained unpaid, including interest, amounting to P100,000. The PNB then sued Depusoy

and Luzon. The trial court dismissed the case against Luzon, saying that the surety bonds it issued guaranteed only the faithful performance of the deed of assignments, and nothing else. That the bonds were extended by letters did not change their conditions. The Court of Appeals affirmed the trial court's decision with the modification that Depusoy shall pay 10% interest on the amount of the judgment.

HELD: The Supreme Court affirmed the Court of Appeals' decision and explained that the 10% interest should be considered as and for attorney's fees. The Court held that the bonds executed by Luzon were to guarantee the faithful performance of Depusoy of his obligation under the Deed of Assignment and not to guarantee the payment of the loans or the debt of Depusoy to the bank to the extent of P100,000. The language of the bonds is clear. It leaves no room for interpretation. Even if there had been any doubt on the terms and conditions of the surety agreement, the doubt should be resolved in favor of the surety. As concretely put in Art. 2055 of the Civil Code, a guaranty is not presumed, it must be expressed and cannot extend to more than what is stipulated therein.

(2) Kinds of Guaranty According to Period or Condition

- (a) with a term (express or implied);
- (b) with a condition (suspensive or resolutory);
- (c) simple or indefinite (no period specified; no amount fixed) — here all the consequences provided for in the second paragraph of Art. 2055 are *enforceable*.

National Marketing Corporation v. Gabino Marquez, et al. L-25553, Jan. 31, 1969

FACTS: Gabino Marquez owed the Namarco a certain amount of money for the purchase of a tractor and a rice thresher. The Plaridel Surety and Insurance Co. signed the contract as surety, binding itself solidarily with Marquez and waiving any prior demand on the debtor. When Marquez failed to pay, Namarco sued the surety

more than 10 years after the maturity date, although from time to time written extrajudicial demands for payments had been made. The surety was asked to pay not only the original amount but also the interests thereon. Previous to the suit against the surety, the surety had not been informed of the demand against Marquez. The surety thus alleges three defenses, namely:

- (a) that the action has prescribed,
- (b) that it had not been informed of the demand against Marquez, and
- (c) that assuming it was liable for the principal debt, there should *not* be any liability for the interest.

HELD:

- (a) The action has not prescribed because under Art. 1115 of the Civil Code, one way of interrupting the prescription of actions is by a written extrajudicial demand by the creditor.
- (b) The surety had waived in the contract any notification of demand on the debtor, and even if it had not so waived, still it had bound itself *solidarily*.
- (c) The surety is liable not only for the principal debt but also for the interest because under Art. 2055, par. 2 of the Civil Code — if the guaranty be simple or indefinite, it shall comprise not only the principal obligation but *also all its accessories*, including judicial costs, provided with respect to the latter, that the guarantor shall only be liable for those costs incurred after he had been judicially required to pay.

(3) Strictly Construed

A guaranty is strictly construed against the creditor and in favor of the guarantor or surety.

Examples:

- (a) If the surety makes himself liable only if the creditor informs him of the debtor's default within a certain

period, and notification is *not* done, the surety is not liable. (*Santos v. Mejia*, 94 Phil. 211).

- (b) If a surety guarantees that the debtor will “render an accounting,” and the debtor really does so, but does not deliver the money supposed to be given to the creditor, the surety is *not liable* for he did not guarantee the delivery of the money. (*Uy Aloo v. Cho Jan Ling*, 27 Phil. 247).
- (c) If a surety guarantees a “delivery of a firearm upon demand,” he does *not* necessarily guarantee that the firearm will be produced for inspection. (*Gov’t. v. Herrero*, 38 Phil. 410).
- (d) A surety is liable only for the obligations of the debtor stipulated upon, not for prior obligations, unless this retroactive effect had been clearly agreed upon. (*Bank of the Phil. Islands v. Forester*, 49 Phil. 843).
- (e) If a surety binds itself only for a *limited* period, it can *not* be held liable generally beyond said time limit. (*Santos v. Media*, 94 Phil. 211).
- (f) A guarantor is *not* liable for *past* defaults of the debtor. *Reason*: a guaranty has only a *prospective*, not retroactive effect, unless the contract clearly indicates a contrary intent. (*Bueno contra Ambrosio*, 87 Phil. 225). Thus, also, a guaranty generally secures only the debts contracted *AFTER* the guaranty takes effect. (*El Vencedor v. Canlas*, 44 Phil. 699). This is a consequence of the statutory directive that a guaranty is not presumed, but must be express and cannot extend to more than what is stipulated. (*See Traders Insurance & Surety Co., Inc. v. Dy Eng Giok*, L-9073, Nov. 17, 1958).

Art. 2056. One who is obliged to furnish a guarantor shall present a person who possesses integrity, capacity to bind himself, and sufficient property to answer for the obligation which he guarantees. The guarantor shall be subject to the jurisdiction of the court of the place where this obligation is to be complied with.

COMMENT:**(1) Qualification of Guarantor**

- (a) integrity (at time of perfection);
- (b) capacity to bind (at time of perfection);
- (c) sufficient property (at time of perfection; excluding his own properties that may be out of reach, or which are under litigation).

(NOTE: The creditor can naturally WAIVE the requirements, for right in general is waivable.)

(2) Proper Court

The court of the place of performance (*loci solutionis*) has jurisdiction over the guarantor.

Art. 2057. If the guarantor should be convicted in first instance of a crime involving dishonesty or should become insolvent, the creditor may demand another who has all the qualifications required in the preceding article. The case is excepted where the creditor has required and stipulated that a specified person should be the guarantor.

COMMENT:**(1) Effect of Conviction of a Crime Involving Dishonesty**

- (a) The creditor may demand a substitute guarantor
- (b) Exception — when the guarantor had been selected by the creditor
- (c) The law says “first instance” *not* “court of first instance.”

(2) Subsequent Loss of Integrity or Insolvency

Subsequent loss of integrity or insolvency generally does *not* end the guaranty; creditor is given right to demand SUBSTITUTION OF GUARANTOR. This right may be waived. (*See Estate of Hemady v. Luzon Surety & Ins. Co., 53 O.G. 2786*).

(3) Liability of Heirs if the Guarantor Dies

If a guarantor dies, his heirs are still liable, to the extent of the value of the inheritance because the obligation is *not* purely personal, and is therefore transmissible. It is not personal because all the guarantor is interested in is the *recovery of the money*, regardless of its giver. (*Estate of Hemady v. Luzon Surety & Ins. Co.*, 53 O.G. 2786).

[**NOTE:** An action against a guarantor who dies during pendency of the same, being one for the recovery of money or debt, should be dismissed, but may be instituted in the proceeding for the settlement of his estate. (*Villegas v. Zapanta and Zorilla*, L-11056, Dec. 26, 1958). Even if the action had not yet been commenced, same may be filed in the proceedings, as a claim against the estate. (*Estate of Hemady v. Luzon Surety & Ins. Co.*, 53 O.G. 2786).]

Chapter 2

EFFECTS OF GUARANTY

Section 1

EFFECTS OF GUARANTY BETWEEN THE GUARANTOR AND THE CREDITOR

INTRODUCTORY COMMENT:

In general, the effects between the guarantor and the creditor are the following:

- (1) The guarantor is entitled to the benefit of excussion (benefit of exhaustion) of the debtor's properties except in the cases mentioned under Art. 2059, and provided that the guarantor follows Art. 2060.
- (2) A compromise between the creditor and the principal debtor benefits but does not prejudice the guarantor. (*Art. 2063, Civil Code*).
- (3) If there should be several guarantors, they are in general entitled to the benefit of division (*pro-rata* liability). (*See Art. 2065, Civil Code*).

Art. 2058. The guarantor cannot be compelled to pay the creditor unless the latter has exhausted all the property of the debtor, and has resorted to all the legal remedies against the debtor.

COMMENT:

(1) Benefit of Excussion

Generally, a guarantor has the right to demand exhaustion of the debtor's assets (BENEFIT OF EXCUSSION OR EXHAUSTION OR SIMPLY EXCUSSION) provided:

- (a) he sets it up as defense before judgment is rendered against himself (guarantor) (*See Saavedra v. Price, 68 Phil. 699*);
- (b) he has not pledged nor mortgaged his own property to the creditor for the satisfaction of the principal obligation for clearly, a mortgagor is *not* entitled to the benefit of exhaustion (*Southern Motors, Inc. v. Barbosa, 99 Phil. 263*);
- (c) he does not fall in the cases enumerated in Art. 2059 (*See Jaucian v. Querol, 38 Phil. 707*);
- (d) he complies with Art. 2060. (*See Garcia v. Lianco, C.A., 50 O.G. 1145*).

(2) Bar Question

What do you understand by *excussion*?

ANS.: By *excussion* is meant the right of the guarantor to have all the properties of the debtor and all legal remedies against him first exhausted before he can be compelled to pay the creditor. (*See Art. 2058*).

[**NOTE:** A mortgagor is NOT entitled to the benefit of *excussion* of the property of the principal debtor. (*Saavedra v. Price, 68 Phil. 699 and Southern Motors, Inc. v. Barbosa, 99 Phil. 263*).]

(3) Duty of Creditor

If a creditor wants to hold the guarantor liable, he (the creditor) must do the following:

- (a) exhaust all the property of the debtor (*Art. 2058*) unless the guarantor is not entitled to such benefit under Art. 2059;
- (b) resort to all the legal remedies against the debtor (*Art. 2058*) (This includes *SUIT* against the debtor.) (*See Wise and Co., Inc. v. Tanglao, 63 Phil. 372*);
- (c) prove that the debtor is still unable to pay (*See Wise and Co., Inc. v. Tanglao, 63 Phil. 372*);

[NOTE: Just because the debtor has been declared insolvent in insolvency proceeding this does *not* mean that the debtor cannot pay, for part of the debtor's assets may still be available to the creditor. One good way of proving inability to pay is to prove an UNSATISFIED writ of execution that has been returned. (See *Machetti v. Hospicio de San Jose*, 43 Phil. 297).]

- (d) notify the guarantor of the debtor's inability to pay, otherwise if the guarantor is prejudiced by lack of notice, he cannot be made to pay, unless of course there is a WAIVER on the part of the guarantor. (*Roces Hermanos, Inc. v. China Insurance and Surety Co., Inc.*, Aug. 9, 1941 issue of the *Official Gazette*, p. 1257).

(4) Query

Suppose the guarantor has already been sued, will a writ of execution be rendered against him?

ANS.: Not necessarily, for it is essential to sue first the debtor and exhaust his assets. (*Southern Motors, Inc. v. Barbosa*, 99 Phil. 263).

Art. 2059. This excussion shall not take place:

- (1) If the guarantor has expressly renounced it;**
- (2) If he has bound himself solidarily with the debtor;**
- (3) In case of insolvency of the debtor;**
- (4) When he has absconded, or cannot be sued within the Philippines unless he has left a manager or representative;**
- (5) If it may be presumed that an execution on the property of the principal debtor would not result in the satisfaction of the obligation.**

COMMENT:

- (1) When Guarantor Is Not Entitled to Benefit of Excussion**

Keyword for the instances when the guarantor is not entitled to the BENEFIT OF EXCUSSION (*BAR*).

R — renounce

U — useless because execution will not be satisfied

S — solidarily bound

I — insolvency of debtor

A — absconded, etc.

(2) Additional Instances When Guarantor Is NOT Entitled to the Benefit of Excussion

- (a) if the guaranty is in a judicial bond (*Art. 2084*)
- (b) if Art. 2060 is not complied with
- (c) if the principal debt is a natural, voidable, or unenforceable obligation. (*See Art. 2062*, where there can still be guaranty but generally the principal debtor would not be liable.)

(3) Re Paragraph 4 of the Article (Absconding Debtor)

- (a) “He” refers to the principal debtor.
- (b) If there are still assets in the Philippines belonging to the absconding debtor, said assets may be attached. (*Rule 57, Revised Rules of Court*).

Art. 2060. In order that the guarantor may make use of the benefit of excussion, he must set it up against the creditor upon the latter’s demand for payment from him, and point out to the creditor available property of the debtor within Philippine territory, sufficient to cover the amount of the debt.

COMMENT:

Requisites Before Guarantor Can Make Use of Excussion

- (a) Guarantor must set it up when the creditor demands payment.

[NOTE: The demand can be made only AFTER a judgment has been rendered against the principal debtor.

Just because the guarantor was sued at the same time as the debtor this does not mean that the creditor has already made the demand on the guarantor. (*Vda. de Syquia v. Jacinto*, 60 Phil. 861).]

- (b) Guarantor must point out AVAILABLE (not things in litigation or encumbered ones) property of debtor WITHIN the Philippines. (Art. 2060). (*Ruling Case Law*, 3045-3046).

Art. 2061. The guarantor having fulfilled all the conditions required in the preceding article, the creditor who is negligent in exhausting the property pointed out shall suffer the loss, to the extent of said property, for the insolvency of the debtor resulting from such negligence.

COMMENT:

Effect of Creditor's Negligence

The Article says that the negligent creditor suffers the loss to the extent of the value of the property pointed out by the guarantor but *not exhausted* by the creditor.

Art. 2062. In every action by the creditor, which must be against the principal debtor alone, except in the cases mentioned in Article 2059, the former shall ask the court to notify the guarantor of the action. The guarantor may appear so that he may, if he so desire, set up such defenses as are granted him by law. The benefit of excussion mentioned in Article 2058 shall always be unimpaired, even if judgment should be rendered against the principal debtor and the guarantor in case of appearance by the latter.

COMMENT:

(1) Generally Suit Must Be Against Principal Debtor Alone

As expressly worded in the Article, the creditor must *generally* sue ONLY the principal debtor (except, of course, when the guarantor is *not* entitled to the benefit of excussion).

The Article applies, however, only to cases accruing *after* the effectivity of the new Civil Code. Under the *old law*, suit could be filed against BOTH, but even then, the judgment must specify that the guarantor's liability was only *SUBSIDIARY generally*. (*De Leon v. Ching Leng*, L-7122, Jan. 29, 1959).

It is clear therefore that no writ of execution could issue against the guarantor's properties, unless the principal debtor was unable to pay. (*Ibid.*; see *Arroyo v. Jungsay*, 34 Phil. 589).

(2) Suit by the Creditor to Recover the Debt

While the guarantor **MUST** be notified he does **NOT** have to appear for the law uses the phrase "may appear."

(3) Reason for Notifying Guarantor

To enable him to put up defense he may desire to offer. (*See Garcia v. Lianco, C.A., 50 O.G. 1145*).

(4) Obligatory Nature of the Notification

The notification of the guarantor in this article is **OBLIGATORY**. (*See Garcia v. Lianco, et al., C.A., 50 O.G. 1145*).

Art. 2063. A compromise between the creditor and the principal debtor benefits the guarantor but does not prejudice him. That which is entered into between the guarantor and the creditor benefits but does not prejudice the principal debtor.

COMMENT:

(1) Effect of Compromise Between Creditor and Principal Debtor

The guarantor **BENEFITS**, but is **NOT PREJUDICED**.

(2) Effect of Compromise Between the Guarantor and the Creditor

The debtor **BENEFITS**, but is **NOT PREJUDICED**.

Art. 2064. The guarantor of a guarantor shall enjoy the benefit of excussion, both with respect to the guarantor and to the principal debtor.

COMMENT:

Sub-Guarantor Enjoys Excussion

The Article explains itself.

Art. 2065. Should there be several guarantors of only one debtor and for the same debt, the obligation to answer for the same is divided among all. The creditor cannot claim from the guarantors except the shares which they are respectively bound to pay, unless solidarity has been expressly stipulated.

The benefit of division against the co-guarantors ceases in the same cases and for the same reasons as the benefit of excussion against the principal debtor.

COMMENT:

(1) Benefit of Division

(a) This Article speaks of the BENEFIT OF DIVISION.

(b) *Example:*

If 5 guarantors are liable for a total of P1,000,000, each will be held responsible for only P200,000 provided the benefit of division exists.

(2) When the Benefit of Division Ceases

The same instances when the benefit of *excussion* ceases.

Section 2

**EFFECTS OF GUARANTY BETWEEN THE
DEBTOR AND THE GUARANTOR**

Art. 2066. The guarantor who pays for a debtor must be indemnified by the latter.

The indemnity comprises:

- (1) The total amount of the debt;**
- (2) The legal interests thereon from the time the payment was made known to the debtor, even though it did not earn interest for the creditor;**
- (3) The expenses incurred by the guarantor after having notified the debtor that payment had been demanded of him;**
- (4) Damages, if they are due.**

COMMENT:

(1) Indemnity to Be Paid By the Debtor for Whom the Guarantor Has Paid

Keyword — TIED:

T — total amount of debt

I — interest (legal)

E — expenses

D — damages, if due

(2) Guaranty as a Strict Indemnity

Since a guaranty is a *strict indemnity*, he can recover only what was paid plus losses and damages, including costs and interest. (*Tagawa v. Aldanese and Union Guarantee Co.*, 43 Phil. 852; *Saenz v. Yap Chuan*, 16 Phil. 76 and *Perez v. Barcia*, 52 Phil. 197).

Art. 2067. The guarantor who pays is subrogated by virtue thereof to all the rights which the creditor had against the debtor.

If the guarantor has compromised with the creditor, he cannot demand of the debtor more than what he has really paid.

COMMENT:**(1) Right of Guarantor to Subrogation**

- (a) Subrogation transfers to the person subrogated, the credit with all the rights thereto appertaining, either against the debtor or against third persons, be they guarantors or possessors of mortgages, subject to stipulation in a conventional subrogation. (*Art. 1212*).
- (b) This Article deals with the benefit of *subrogation*. This results by *operation of law* from the act of payment and there is no necessity for the guarantor to ask the creditor to expressly assign his rights of action. (*Manresa*). The right is not contractual; it is based on natural justice. (*Somes v. Molina, 9 Phil. 653*).
- (c) *Purpose*: To enable the guarantor to enforce the indemnity given in the preceding article.
- (d) It is believed that Art. 2067 may be availed of only by a guarantor who became such with the *knowledge and consent* of the principal debtor. (*See Arts. 1237 and 2050*). Now then, as long as consent to the guaranty was obtained, the right of subrogation is absolute even if the debtor refuses the subrogation. (*See Somes v. Molina, 9 Phil. 653*).

Urrutia and Co. v. Moreno and Reyes
28 Phil. 260

FACTS: The creditor sued both the principal debtor and the surety. The property of the principal debtor was sold under execution, and the surety paid the judgment shortly afterwards. The surety now wanted to redeem the properties of the debtor which had been sold. The surety alleged the right of subrogation.

HELD: The surety did not have the right to redeem. While he was subrogated to the rights of the *creditor*, he was not subrogated to the rights of the *debtor*.

Art. 2068. If the guarantor should pay without notifying the debtor, the latter may enforce against him all the defenses which he could have set up against the creditor at the time the payment was made.

COMMENT:**(1) Effect if Guarantor Pays Without Notifying Debtor**

The effect is set forth in the Article.

(2) Reason for the Article

The liability of the guarantor being merely subsidiary, he should really wait till after the debtor has tried to comply. The guarantor should *not*, thru his own fault or negligence, be allowed to jeopardize the rights of the debtor. By paying the debt without first notifying the debtor, the guarantor deprives the debtor of the opportunity to set up defenses against the creditor. (*Manresa*).

Art. 2069. If the debt was for a period and the guarantor paid it before it became due, he cannot demand reimbursement of the debtor until the expiration of the period unless the payment has been ratified by the debtor.

COMMENT:**(1) Payment By Guarantor Before Debt Becomes Due**

The effect is indicated in this Article.

(2) Reason for the Article

There was no need for the advance payment. (*Manresa*).

(3) Ratification By the Debtor

Ratification by the debtor may be express or implied.

Art. 2070. If the guarantor has paid without notifying the debtor, and the latter not being aware of the payment, repeats the payment, the former has no remedy whatever against the debtor, but only against the creditor. Nevertheless, in case of a gratuitous guaranty, if the guarantor was prevented by a fortuitous event from advising the debtor of the payment, and the creditor becomes insolvent, the debtor shall reimburse the guarantor for the amount paid.

COMMENT:**(1) Payment By Both the Guarantor and the Debtor**

Examples:

- (a) A owes B P100,000 with C as guarantor. C paid the P100,000 to B when the debt fell due, but C did this without first notifying A. Not being aware of the payment by C, A repeated the payment. Can C recover from A?

ANS.: No. C cannot recover from A. C has no remedy whatever against A, the debtor. C's only remedy is to recover from B, the creditor. (*1st sentence, Art. 2070*).

- (b) Suppose in example (a), the guaranty was gratuitous, and suppose the only reason C was not able to notify A was because of a fortuitous event, what are C's rights?

ANS.: C must still recover from B. But if B, the creditor is insolvent, then A, the debtor, shall reimburse C, the guarantor, for the amount paid. This is therefore a different case from that presented in example (a), because in said example, even if B, the creditor, is insolvent A does not have to reimburse C, the guarantor, because under the facts of the case, C is clearly at fault for having no justifiable reason for not advising the debtor of the payment.

(2) Gratuitous Guaranty

Note that the second sentence of Art. 2070 is applicable only in case of a gratuitous guaranty. It is clear that it should not be applied if the guaranty is onerous or for a compensation. The law favors a gratuitous guarantor because he receives nothing extra for his efforts and obligations, and it would be rather unfair if under the premises given, he cannot recover from the principal debtor, who should not indeed unjustly enrich himself at the expense of another.

(3) Comment of Manresa

The object of Art. 2070 is to prevent the guarantor from impairing the rights of the principal debtor. The latter should,

therefore, not be denied the right to pay his creditor, if he has not been previously notified of the payment made by the guarantor, and consequently, payment by the debtor under such circumstances should produce the same effect as if no payment had been made by the guarantor. As to the liability of the creditor to return to the guarantor what that latter has paid, no sound principle of law can be invoked against it. No one should be allowed to enrich himself unduly to the prejudice of another. (*Manresa, vol. 12*).

(4) Applicable Only When Debtor Had Not Previously Authorized the Guarantor to Pay

It is believed that the preceding comments (Nos. 1 to 3) on the article apply only when the debtor had *not* previously authorized the guarantor to pay. For in such a case, the debtor must now inquire from the guarantor whether or not the latter has already paid.

Art. 2071. The guarantor, even before having paid, may proceed against the principal debtor:

- (1) When he is sued for the payment;**
- (2) In case of insolvency of the principal debtor;**
- (3) When the debtor has bound himself to relieve him from the guaranty within a specified period, and this period has expired;**
- (4) When the debt has become demandable, by reason of the expiration of the period for payment;**
- (5) After the lapse of ten years, when the principal obligation has no fixed period for its maturity, unless it be of such nature that it cannot be extinguished except within a period longer than ten years;**
- (6) If there are reasonable grounds to fear that the principal debtor intends to abscond;**
- (7) If the principal debtor is in imminent danger of becoming insolvent.**

In all these cases, the action of the guarantor is to obtain release from the guaranty, or to demand a security that shall protect him from any proceedings by the creditor and from the danger of insolvency of the debtor.

COMMENT:

(1) Rights of Guarantor Before Payment

It should be noted that Art. 2071 differs from Art. 2066. Art. 2071 refers to the rights of the guarantor before payment, whereas Art. 2066 refers to his rights after payment. Art. 2071 does not give the guarantor the right to obtain a money judgment in his favor, for the simple reason that he has not yet paid, whereas in Art. 2066, a money judgment would be proper since in this case, there has already been a payment. Art. 2071 is of the nature of a preliminary remedy, whereas Art. 2066 is a substantive right. Art. 2066 gives a right of action, which without the provisions of the other might be worthless. (*Kuenzle & Streiff v. Tan Sunco*, 16 Phil. 670 and *Perez v. Baria*, 52 Phil. 197). In Art. 2071, the guarantor has either of two rights:

- (a) to obtain *release* from the guaranty;
- (b) to demand security.

(2) Problems

- (a) A borrowed P900,000 from B. C is the guarantor. The debt has already fallen due, for the term has already expired. Is C allowed to bring an action against A even before C had paid B?

ANS.: Yes. (Art. 2071, par. 4). The purpose is to obtain *release* from the guaranty, or to demand a *security* that shall protect him from any proceedings by the creditor and from the danger of insolvency of the debtor. (Art. 2071, 1st par.). The purpose is certainly *not* to recover money, since the guarantor has not yet paid. (*Kuenzle and Streiff v. Tan Sunco*, 16 Phil. 670). If a trial judge should render a money judgment for the guarantor in

a case like this, it is clear that such a judgment would be erroneous.

There would be no reason for it. And, furthermore, such a money judgment is *not* among the remedies enumerated in this provision of the law. (*Perez v. Barcia*, 62 Phil. 197).

- (b) In problem (a), suppose the guarantor wins in this action, and suppose, for example, he obtains a *security* from the principal debtor, would this be proper?

ANS.: Yes, this would be proper for such a remedy is one of those enumerated. And, therefore, a judgment on this point is proper, BUT he ought *not* to be allowed to realize on said judgment to *the point of actual collection* of the same until he (the guarantor) has satisfied or caused to be satisfied the obligation the payment of which he assumed. Otherwise, a great opportunity for collusion and improper practices between the guarantor and the principal debtor would be offered which might result in injury and prejudice to the creditor who holds the claim against them. (*Kuenzle and Streiff v. Tan Sunco*, *supra*).

(3) How Guarantor or Surety Can Enforce the Rights Under the Article

It being evident that the purpose of this article is to give the guarantor or surety a remedy in anticipation of the payment of the debt, which debt being one he could be called upon to pay at any time, it remains only to say, in this connection, that the only procedure known under our present practice to enforce that right is by action. (*Kuenzle and Streiff v. Tan Sunco*, *supra*). Of course, this action may be in the form of a cross-claim against his co-defendant, the debtor. (*Pan Asiatic Commercial Co., Inc. v. World Wide Insurance & Surety Co., Inc.*, CA-GR 12083-R, Jun. 30, 1956).

(4) Problem

The creditor failed to make a demand upon the principal debtor although the debt was already due. The guarantor, afraid that the principal debtor might sooner or later become

insolvent, brought an action against the creditor to compel said creditor to make the demand upon the principal debtor. Will the action prosper?

ANS.: No, the action will not prosper because the remedy of the fearful guarantor should be against the principal debtor in accordance with Art. 2071. (*Banco Español v. Donaldson Sim & Co.*, 6 Phil. 418).

**Mercantile Insurance Co., Inc. v. Felipe
Ysmael, Jr., and Co., Inc.
L-43862, Jan. 13, 1989**

The principal debtors, defendants-appellants herein, are simultaneously the same persons who executed the Indemnity Agreement. The position occupied by them is that of a principal debtor and indemnitor at the same time, and their liability being joint and several with the plaintiff-appellee's, the Philippine National Bank may proceed against either for fulfillment of the obligation as covered by the surety bonds. There is, therefore, no principle of guaranty involved and, therefore, the provisions of Art. 2071 does not apply. Otherwise stated, there is more need for the plaintiff-appellee to exhaust all the properties of the principal debtor before it may proceed against defendants-appellants.

The trial court did not err in ordering defendants-appellants to pay jointly and severally the plaintiff the sum of P100,000 plus 15% as attorney's fees.

(5) The Nature of the Remedies

The remedies provided for under Art. 2071 are alternative remedies in favor of the guarantor *at his election* and the guarantor who brings an action under this article must choose the remedy and apply for it specifically. (*Tuason v. Machuca*, 46 Phil. 561).

(6) Applicability of the Article to Sureties

Art. 2071, despite its use of the term "guarantor" can apply also to a "surety." (*Atok Finance Corp. v. CA*, 41 SCAD 450 [1993]). The reference in Art. 2047 to the provisions of

Sec. 4, Ch. 3, Title I, Book IV of the new Civil Code, on *solidary obligations*, does not mean that suretyship, which is a solidary obligation, is withdrawn from the applicable provisions governing *guaranty*. (*Manila Surety and Fidelity Co., Inc. v. Batu Construction & Co.*, L-9353, May 21, 1967, 53 O.G. 8836).

(7) When Surety's Action Is Not Premature

If an indemnity bond executed by a debtor in favor of the surety provides that "said indemnity shall be paid to the company as soon as it becomes liable for the payment of any amount under the bond, whether or not it shall have paid such sum or sums of money, or any part thereof," it *cannot* be said that the surety's action against the debtor is premature just because the debtor has *not* yet been made actually liable in view of a pending case. The fact that the creditor has actually filed an action in court demanding payment from the surety under the bond it has posted is more than enough to entitle the surety to enforce the indemnity agreement executed by the debtor. (*Manila Surety and Fidelity Co., Inc. v. Cruz*, L-10414, Apr. 18, 1958 and *Alto Surety and Ins. Co. v. Aguilar*, L-5626, Mar. 16, 1954).

The Cosmopolitan Insurance Co., Inc. v.

Angel B. Reyes

L-20199, Nov. 23, 1965

FACTS: Angel B. Reyes, who owed the government some money from the payment of his income tax entered into an agreement with the Cosmopolitan Insurance Co., Inc., whereby the latter was to file a bond in favor of the Commissioner of Internal Revenue to secure payment of the tax by Reyes. The Company then filed the bond. In consideration of the bond, Reyes signed an indemnity agreement whereby he bound himself to *indemnify* the Company, upon its demand, even BEFORE the surety shall have paid the Government. Because of Reyes' failure to pay the tax, the Company became liable on its bond. Prior to payment to the Government, the Company sought indemnity from Reyes. Reyes countered that the provision in the contract requiring him to pay even before the Company has paid the tax is void because it is contrary to law and public policy.

HELD: The agreement is valid and does *not* in any way militate against the public good; neither is it contrary to the policy of the law. Therefore, in accordance with the indemnity agreement, the surety may demand from Reyes, even before paying to the Commissioner of Internal Revenue. (*See also Security Bank v. Globe Assurance*, 58 O.G. 3708, Apr. 30, 1962).

Art. 2072. If one, at the request of another, becomes a guarantor for the debt of a third person who is not present, the guarantor who satisfies the debt may sue either the person so requesting or the debtor for reimbursement.

COMMENT:

Guarantor Who Becomes One At the Request of an Absent Debtor

Note that the guarantor who pays can sue for reimbursement:

- (a) either the person who made the request, or
- (b) the debtor.

Section 3

**EFFECTS OF GUARANTY AS BETWEEN
CO-GUARANTORS**

Art. 2073. When there are two or more guarantors of the same debtor and for the same debt, the one among them who has paid may demand of each of the others the share which is proportionally owing from him.

If any of the guarantors should be insolvent, his share shall be borne by the others, including the payer, in the same proportion.

The provisions of this article shall not be applicable, unless the payment has been made in virtue of a judicial demand or unless the principal debtor is insolvent.

COMMENT:**(1) Right of Guarantor Who Pays**

This Article is applicable only when there has been *payment*. If there has been no payment by way of the guarantors, this Article cannot be applied. Furthermore, this payment must have been made:

- (a) in virtue of a judicial demand;
- (b) or because the principal debtor is insolvent.

(2) Example of Par. 1

A, B, and C are D's guarantors. D was insolvent, and A had to pay the whole debt. Later, A can demand from B and C 1/3 of the debt from each. This is so because A's share is supposed to be also 1/3. Of course, each of them can later demand proportional reimbursement from the principal debtor.

(3) Example of Par. 2

A, B, and C are D's guarantors of a debt of P300,000 in favor of E. Since D was insolvent, A paid P300,000 to E. Under par. 1, he can therefore demand P100,000 each from B and C. But B is insolvent. How much can A demand from C?

ANS.: P150,000. A cannot demand the extra P100,000 (share of B) from C because in that way, C would have a greater burden. The law provides that the insolvent guarantor's share (B) must be borne by the others (including the payer A) proportionally.

(4) Distinguished from Benefit of Division

This Article should not be confused with the article giving as a rule to several guarantors the *benefit of division* (Art. 2065) for in said article, there has been no payment as yet. Moreover, in Art. 2073, the payment must have been made

because *of judicial proceedings* or because the principal debtor was insolvent. (*Cacho v. Valles*, 45 Phil. 107).

Art. 2074. In the case of the preceding article, the co-guarantors may set up against the one who paid, the same defenses which would have pertained to the principal debtor against the creditor, and which are not purely personal to the debtor.

COMMENT:

Right of Co-Guarantors Against the Guarantors Who Paid

The Article gives the co-guarantors the SAME defenses which would have pertained to the principal debtor. EXCEPTION: defenses purely personal to the debtor (like fraud or force).

Art. 2075. A sub-guarantor, in case of the insolvency of the guarantor for whom he bound himself, is responsible to the co-guarantors in the same terms as the guarantor.

COMMENT:

Liability of Sub-Guarantors to Co-Guarantors

The Article is self-explanatory.

Note that the Article applies if the guarantor is INSOLVENT.

Chapter 3

EXTINGUISHMENT OF GUARANTY

Art. 2076. The obligation of the guarantor is extinguished at the same time as that of the debtor, and for the same causes as all other obligations.

COMMENT:

(1) Two Causes for Extinguishment of the Guaranty

- (a) *direct* (when the guaranty itself is extinguished, independently of the principal obligation)
- (b) *indirect* (when the principal obligation ends, the accessory obligation of guaranty naturally ends). (*Manresa*). (See *Shannon v. Phil. Lumber & Trans. Co.*, 61 Phil. 876).

(2) Effect of Novation

- (a) If a contract is novated without the guarantor's consent, the guaranty ends. (*Barretto v. Albo*, 62 Phil. 593; *Nat'l. Bank v. Veraguth*, 50 Phil. 253).
- (b) Therefore, a novation where the debtor is *substituted* or where the credit is increased, releases the guarantor who did not consent thereto. (*Barretto v. Albo*, 62 Phil. 593; *Nat. Bank v. Veraguth*, 50 Phil. 253).

[**NOTE:** Consent, however, on the part of the guarantor may be given expressly or *implicitly* before or after the novation. (*NARIC v. Guillioso, et al.*, {C.A.} 53 O.G. 4151).]

[**NOTE:** If the interest rates are increased without the guarantor's consent, he is *not* liable for the increase, but is liable still for the principal obligation and the

original rate of interest. (*Bank of the P.I. v. Albaladejo y Cia*, 53 Phil. 141).]

Capitol Insurance v. Ronquillo Trading
GR 36488, Jul. 25, 1983

If a surety contract expires, the principal is no longer bound to pay the premiums. This is true even if there is a pending lawsuit involving a liability that arose while the surety agreement was still subsisting.

Art. 2077. If the creditor voluntarily accepts immovable or other property in payment of the debt, even if he should afterwards lose the same through eviction, the guarantor is released.

COMMENT:

Effect of *Dacion En Pago*

- (a) Note that the *dacion en pago* here refers to both IMMOVABLE or OTHER (personal) PROPERTY.
- (b) Eviction revives the principal obligation, but NOT the guaranty, for the creditor here took the *risk*.

Art. 2078. A release made by the creditor in favor of one of the guarantors, without the consent of the others, benefits all to the extent of the share of the guarantor to whom it has been granted.

COMMENT:

Release by Creditor in Favor of One of the Guarantors

Example: A, B, C, and D are co-guarantors for P1,000,000. A is released with the consent of B, C, and D. B, C, and D will each be responsible for P333,33 1/3. If A is released without the consent of B, C, and D, then B, C, and D will each be responsible for only P250,000. This is the clear intention of the law. There is an opinion which says that the remaining

P750,000 should be divided among the 4 of them, making *B*, *C*, and *D* liable for only P187,500 each. This clearly is wrong because what was released was only P250,000. Even if *B*, *C*, and *D* will each give, the total under this second opinion would be only P562,500. This cannot have been the intention of the law. (*See Comments of Manresa*).

Art. 2079. An extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty. The mere failure on the part of the creditor to demand payment after the debt has become due does not of itself constitute any extension of time referred to herein.

COMMENT:

(1) Effect of Extension Granted By the Creditor

Example:

A owed *B* P10 million payable in 10 years. *C* was the guarantor. *B* extended without the consent of *C* the period to 12 years. The obligation of *C* as guarantor is extinguished.

(2) Comment of Manresa

The object of the provision is to avoid prejudice to the guarantor. If the payment is delayed on account of the extension, the principal debtor may become insolvent and the guarantor's right to reimbursement would be rendered useless. (*Vol. 12*).

**Philippine General Ins. Co. v. Mutuc
L-19632, Nov. 13, 1974**

FACTS: In a surety bond, the sureties bound themselves to be liable in case of *extension* or *renewal* of the bond, *without the necessity* of executing another indemnity agreement for the purpose and without the necessity of their being *notified* of such extension or renewal. Is the agreement valid?

HELD: Yes, the agreement is valid; there is nothing in it that militates against the law, good customs, good morals, public order, or public policy.

(3) Failure of Creditor to Demand Payment

- (a) The reason for the second sentence is that, after all, the guarantor would not be prejudiced since his recourse would be to avail himself of the right granted under Art. 2071 (*Banco Español v. Donaldson Sim & Co.*, 5 Phil. 418).
- (b) Deferring the filing of the action does not imply a change in the efficacy of the contract or liability of any kind on the part of the debtor. It is merely — without demonstration or proof to the contrary — respite, courtesy, leniency, passivity, inaction. It does *not* constitute novation, because this must be express. The receipt of interest stipulated in the same contract after the obligation has become due does not constitute novation, it being merely a compliance with the obligation itself. It would however be different, if the interest has been paid in advance, covering a definite period, because in that case, his action would be barred during said period by his own act, which would have created a new term of the obligation, and a tacit extension of time. (*Banco Español v. Donaldson Sim & Co.*, 5 Phil. 418).

**General Insurance and Surety Corp. v. Republic
L-13873, Jan. 31, 1963**

FACTS: On May 15, 1954, the Central Luzon Educational Foundation, Inc. and the General Insurance Surety Corp. posted in favor of the Department of Education a bond required by said Department. The Foundation was operating the Sison and Aruego College of Urduyeta, Pangasinan. The bond in the amount of P10,000 was posted "to guarantee the adequate and efficient administration of said school or college, and the observance of all regulations ... and compliance with all obligations including the payment of the salaries of all its teachers and employees, past, present, and future..." It appeared that on the date of the execution of the bond, the Foundation was indebted to two of its teachers for salaries, to wit: Remedios Laoag, for the sum of P695.64 and H.B. Arandia, for the sum of P820.00, or

a total of P1,515.64. On Feb. 4, 1955, Remedios Laoag and the Foundation agreed that the latter would pay the former's salaries, which were then already due, on Mar. 1, 1955. When the demand for said amount was refused the Solicitor General in behalf of the Republic of the Philippines, filed a complaint for the forfeiture of the bond. The Surety, however, maintained that it was already released from the obligations under the bond, inasmuch as Remedios Laoag extended the time to Mar. 1, 1965. In support of this proposition, the Surety cited Art. 2079. It also contended that it cannot be made to answer for more than the unpaid salaries of H.B. Arandia, which it claimed, amounted to only P820, because of Art. 2054, which provides that "a guarantor may bind himself for less, but not for more than the principal debtor both as regards the amount, and the onerous nature of the conditions. Should he have bound himself for more, his obligations shall be reduced to the limits of that of the latter." *Issues:* (a) Was the guaranty extinguished by the extension granted by Remedios Laoag? (b) Was the surety liable for the whole amount of the bond?

HELD: (a) Art. 2079 is not applicable because the supposed extension of time was granted, not by the Department of Education or by the Government but by the teachers. As already stated, the creditors of the bond were not the teachers, but the Department of Education or the government. (b) The Surety is liable for the whole amount of the bond. The penal nature of the bond suffices to dispose of this claim. The conditions for the bond having been violated, the Surety must answer for the penalty.

**The Commissioner of Immigration v.
Asian Surety and Insurance Co., Inc.
L-22552, Jan. 30, 1969**

FACTS: The Asian Surety and Insurance Co. executed a bond in the sum of P7,000 to guarantee that a certain Chinese student admitted temporarily to the Philippines "would actually depart from the Philippines on or about Apr. 7, 1958, OR within such period as in his

discretion, the Immigration Commissioner or his authorized representative may properly allow.” The departure was *not* made on Apr. 7, 1958 because the Bureau of Immigration extended several times the temporary stay of the Chinese without notifying the surety company. The last extension expired in Nov. 1960 (the end of the first semester of the school year 1960-1961). Because the surety company did not know of this extension and its date of expiration, it was not able to effectuate the Chinese’s departure from the Philippines. Sometime later (on Jun. 13, 1961), deportation proceedings were instituted against the Chinese; on the same day, a warrant of arrest was issued against him, and the surety bond was declared forfeited. Three days later (Jun. 16, 1961), the surety company surrendered the Chinese. The company then sought the lifting of the order of confiscation, alleging that the only reason it could not comply with the bond was because of the extensions granted by the Immigration Commissioner — extensions *not* made known to the company. *Issue*: Should the bond be forfeited?

HELD: Yes, the bond should be forfeited because of the following reasons:

- (1) The surety company was *not* able to comply with the duty to effectuate the departure of the Chinese on or before the expiration date of the last extension. While it is true that the extensions were made by the Commissioner of Immigration, still these were allowed by the terms of the bond (the said Commissioner being allowed to grant a *period* for such departure).
- (2) The non-notification of the extensions to the surety company is not *important*. *Reason*: the company could have made the proper inquiries. This step was *not* done, so the company cannot blame any one except itself.
- (3) The rule that a surety bond should be construed strictly in favor of the surety (rule of *strictissimi juris*) does *not apply to compensated surety* (sureties which receive compensation, and organized for

the purpose of assuming classified risks in large numbers — as distinguished from *gratuitous* or *accommodation sureties*, who should be protected against unjust financial impoverishment). (See *Pastoral v. Mutual Security Insurance Corporation*, L-20469, Aug. 31, 1965 and *Pacific Tobacco Co. v. Lorenzana*, 102 Phil. 234).

- (4) The surety companies must be strictly dealt with to reduce the problem of overstaying aliens.

Concurring opinion of Justice A. Dizon (with whom Justice J.B.L. Reyes concurs):

Art. 2079 of the Civil Code, an extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty. BUT this provision *does not apply* to the instant case because under the terms of the bond, the surety had agreed that the Chinese would depart from the Philippines on or before Apr. 7, 1958 OR within such period as, in his discretion, the Commissioner of Immigration or his authorized representative may properly allow.” This amounts to company’s consent to all the extensions granted to the Chinese.

(4) Problems

- (a) A borrowed money from B, payable in installments, with C as the guarantor. The contract provided that upon the failure to pay one installment, the whole unpaid balance *automatically became due* (*acceleration clause*).

A failed to pay one installment on time, but was granted extension by B, without C’s consent. *Issue*: Is C released?

HELD: Yes, inasmuch as the extension here referred really to the whole amount of the indebtedness. (*Radio Corporation of the Phil. v. Roa*, 62 Phil. 211).

- (b) Suppose in problem (a), there was *no* “balance automatically due” clause, and suppose the creditor had granted an extension for merely one installment without the consent of the guarantor, does this release the guarantor?

HELD: There is a release insofar as that particular installment is concerned, but not insofar as the other installments are concerned. It is well settled that where a guarantor is liable for different payments such as installments of rent, or upon a series of promissory notes, an extension of time as to one or more will not affect the liability of the guarantor for the others. (*Basque*, 49 *Phil.* 126).

(5) Neglect of Creditor to Collect

The neglect of a creditor to sue or to attempt to collect a debt after it falls due does not discharge the guarantors from their liability notwithstanding the fact that the principal became insolvent, subsequent to the maturity of the debt. (*Bank of the P.I. v. Albadejo*, 53 *Phil.* 141).

Art. 2080. The guarantors, even though they be solidary, are released from their obligation whenever by some act of the creditor they cannot be subrogated to the rights, mortgages, and preferences of the latter.

COMMENT:

(1) When Guarantors Are Released Because of an Act of the Creditor That Prevents Subrogation

The Article releases the guarantors — *even if* they be solidary.

(2) Reason for the Article

It is possible that the guarantor became one only because of the presence of rights, mortgages, and preferences of the creditor — to all of which he expected to be subrogated.

(3) Meaning of “Act”

“Act” should also include “inaction.”

Examples:

- (a) Of “act” — when the creditor remits a mortgage or a pledge.

- (b) “Inaction” — when the creditor fails to *register* a mortgage.

(4) When Guarantor is at Fault

If there can be no subrogation because of the guarantor’s *fault*, he cannot avail himself of this Article; hence, he is still bound as guarantor. (*Manila Trading and Supply Co. v. Jordana*, [C.A.] 37 O.G. 2722).

(5) When Guarantor Can Make Use of the Article

The guarantor can make use of this Article only during the proceeding against him for payment, not *before* (*Municipality of Gasan v. Marasigan*, 63 Phil. 510), nor *after* rendition of judgment. (See *Molina v. De la Riva*, 8 Phil. 569).

(6) Art. 2080 Does Not Apply in a Contract of Suretyship

**Ang v. Associated Bank
GR 146511, Sep. 5, 2007**

Contrary to petitioner’s adamant stand, Art. 2080 of the new Civil Code is inapplicable in a contract of suretyship. Art. 2047 of the Code states that if a person binds himself solidarily with the principal debtor, the provisions of Sec. 4, Chap. 3, Title I, Book IV of the Civil Code must be observed. Accordingly, Arts. 1207 up to 1222 thereof (on joint and solidary obligations) shall govern the relationship of petitioner with the respondent bank. (*Associated Bank [now known as United Overseas Bank Philippines]*).

Art. 2081. The guarantor may set up against the creditor all the defenses which pertain to the principal debtor and are inherent in the debt; but not those that are purely personal to the debtor.

COMMENT:

Defenses Available to the Guarantor

- (a) defenses *inherent in the principal obligation*. (Art. 2081).

Examples: Prescription, *res judicata*, payment, illegality of cause. (*Chinese Chamber of Commerce v. Pua Te Ching*, 16 Phil. 406).

- (b) defenses *ordinarily* personal to the principal debtor, but which are *inherent in the debt*. (Art. 2081).

Example: Vitiated consent (or intimidation, etc.). (*Chinese Chamber of Commerce v. Pua Te Ching*, 16 Phil. 406).

- (c) defenses of the guarantor himself.

Examples:

- 1) vitiating consent on his part
- 2) *compensation* between debtor and creditor
- 3) *remission* of the principal obligation or of the guaranty
- 4) *merger* of the person of debtor and creditor

(NOTE: Reason for the last 3 examples: extinguishment of the principal obligation extinguishes the guaranty.)

Chapter 4

LEGAL AND JUDICIAL BONDS

Art. 2082. The bondsman who is to be offered in virtue of a provision of law or of a judicial order shall have the qualifications prescribed in Article 2056 and in special laws.

COMMENT:

(1) Qualification of a Bondsman

See Rule 114, Sec. 9, Revised Rules of Court.

(2) The Bond

- (a) A bond merely stands as a guaranty (solidary guaranty) for a principal obligation, which exists independently of said bond, the latter being merely an accessory obligation. (*Valencia v. RFC, et al., L-10749, Apr. 25, 1958*).
- (b) A bond being for the benefit of the creditor (in some cases, the government), it follows that the creditor can legally waive a bond requirement. This may be done for example by extending the principal contract once or twice, despite the expiration of the bond originally set up. (*Board of Liquidators v. Floro, et al., L-15155, Dec. 29, 1960*).
- (c) If a bond is given to *suspend* the execution of a final decree, the object is impossible, hence the bond is void. The surety company would therefore incur no obligation under such a bond. (*Republic Savings Bank v. Far Eastern Surety, L-14959, Aug. 31, 1960*).

Singson v. Babida
L-30096, Sept. 27, 1977

Surety bonds should be signed not only by the sureties but also by the principal obligors (the defendants in a case,

for example). If not signed by the latter the surety bonds are void, there being no principal obligation (which is of course the cause or consideration of such surety bonds).

(3) Right to Be Heard

A bondsman or surety must be given an opportunity to be heard; otherwise, the writ of execution issued is void. (*Luzon Surety Co. v. Guerrero*, 17 SCRA 400 [1966] and *Luzon Surety Co. v. Beson, et al.*, L-26865-66, Jan. 30, 1970). Even when execution is proper, the party against whom it is directed is still entitled to a hearing if he wants to show subsequent facts that would make the execution unjust (*Luzon Surety Co. v. Beson, et al.*, L-26865-66, Jan. 30, 1970 and *Abellana v. Dosdos*, 13 SCRA 244 [1965].) (See, however, *Sy Bang v. Mendez, Sr.*, 226 SCRA 770 [1993].), where the rules do not require a hearing on the approval of the bond, provided that the Judge is satisfied with the solvency of the surety.)

Art. 2083. If the person bound to give a bond in the cases of the preceding article, should not be able to do so, a pledge or mortgage considered sufficient to cover his obligation shall be admitted in lieu thereof.

COMMENT:

Rule if the Bond Is Not Given

Note that instead of the bond, *a pledge or a mortgage* may be made.

Art. 2084. A judicial bondsman cannot demand the exhaustion of the property of the principal debtor.

A sub-surety in the same case, cannot demand the exhaustion of the property of the debtor or of the surety.

COMMENT:

(1) No Right to Excussion

A judicial bondsman, being a surety, is not entitled to the benefit of excussion granted a guarantor. The benefit is also denied a sub-surety.

(2) Liability of Surety if Creditor Was Negligent in Collecting

A surety is still liable even if the creditor was negligent in collecting from the debtor. As stated in American Jurisprudence, "the contract of suretyship is *not* that the *obligee* will see that the *principal* pays the debt or fulfills the contract, but that the *surety* will see that the principal pay or perform." (50 *Am. Jur.* 904 and *Judge Advocate General v. Court of Appeals & Alto Surety Co.*, L-10671, Oct. 23, 1958).

(3) Effect of Violation by Creditor of Terms of the Surety Agreement

A violation by the creditor of the terms of the surety agreement entitles the surety to be released therefrom. (*Associated Ins. & Surety Co. v. Bacolod Murcia Milling Co.*, L-12334, May 22, 1959). However, where an assurance company has profited in the issuance of the bond by the receipt of the premium paid, it cannot later go back and assail the validity of the bond which it had furnished for a premium on the mere allegation or ground that the release of a prisoner was unauthorized under the provisions of law. (*People v. Enriquez, et al.*, L-13006, Feb. 29, 1960).

(4) Bond Filed for Aliens Stay

If a surety bond filed for an alien stay in the country is forfeited because of violation of its conditions, its subsequent *unauthorized cancellation* thru *mistakes* or *fraud* does *not* relieve the surety. A bond surrendered thru mistake or fraud may, therefore, be considered as a valid and subsisting instrument. (*Far Eastern Surety and Ins. Co. v. Court of Appeals*, L-12019, Oct. 16, 1958).

(5) Rule When Performance is Rendered Impossible

Even when a surety's performance of the bond is rendered impossible by an act of God, or of the obligee, or of the law, it is the surety's duty to inform the court of the happening of the event so that it may take action or decree in the discharge of the surety. Thus, if the surety took no such steps,

it is equally chargeable with negligence in this connection. (*People v. Otiak Omal & Luzon Surety Co., Inc.*, L-14457, Jun. 30, 1961.)

(6) Obligation of Surety to Keep the Accused Under His Surveillance

It is well settled that surety is the jailer of the accused, and is responsible for the latter's custody. Therefore, it is not merely his right but his obligation to keep the accused at all times under his surveillance. (*People v. Tuising*, 61 Phil. 404). A trial court has no authority to relieve the bonding company from a part of its liability under the bail bond by ordering a mere trial confiscation of the bond, where the body of its principal has not been surrendered to the court despite several extensions of time granted said company to produce him. For it is the bonding company's responsibility to produce the accused before the court whenever required. Failure to do so is indisputably complete breach of the guaranty. (*People v. Gantang Kasim and Luzon Surety Co.*, L-12624, May 25, 1960). However, if three days after the *forfeiture* of the bond, the accused immediately submitted to the jurisdiction of the court giving *weighty* reasons for his failure to appear, the amount to be forfeited really may be reduced to a certain degree. (*People v. Cruz & Globe Assurance*, L-15214-15, Oct. 26, 1960).

**People v. Ignacio Sanchez, et al.
L-34222, Jan. 24, 1974**

FACTS: The defendant in a criminal case was convicted, but did not appear for execution of the judgment. He was ordered arrested, and his appeal bond was ordered confiscated. When the surety caught the accused, the surety asked that judgment on the bond be reduced. May this be done?

HELD: Yes, and the reduction would generally depend on the discretion of the judge.

**House v. De La Costa
68 Phil. 742**

FACTS: A brought an action for the recovery of a sum of money from B. In the meantime, a certain property of B

was attached. *B* obtained a discharge of the attachment by offering bondsman *C*. *C* undertook to guarantee the return of the property to the cost should *B* lose the case. Pending the case, *A* bought said property from *B*. *A* won the case but *B* failed to pay. Hence, *A* brought this action against *C* for the liability under the bond. Is *C* liable?

HELD: C is no longer liable. It is true, *C* guaranteed the return of the property but then he cannot do so now because *A* himself has already bought said property. *A*'s own act has made performance by the surety impossible.

(7) Special Act on Performance Bonds

Act 3688, regulating PERFORMANCE BONDS, when speaking of the place where the action on the bond must be brought, simply deals with VENUE which is a procedural, not a jurisdictional, matter. (*Navarro v. Aguila*, 66 Phil. 604). In case of inconsistency, the provision of Act 3688 must be deemed repealed by those of Com. Act 103, insofar as they deal with the settlement of "all questions, matters, controversies, or disputes arising between and or affecting employers and employees or laborers." (*Phil. Surety and Ins. Co. v. Tiburcio*, L-12766, May 25, 1960).

TITLE XVI

PLEDGE, MORTGAGE AND ANTICHRESIS

Chapter 1

PROVISIONS COMMON TO PLEDGE AND MORTGAGE

Art. 2085. The following requisites are essential to the contracts of pledge and mortgage:

(1) That they be constituted to secure the fulfillment of a principal obligation;

(2) That the pledgor or mortgagor be the absolute owner of the thing pledged or mortgaged;

(3) That the persons constituting the pledge or mortgage have the free disposal of their property, and in the absence thereof, that they be legally authorized for the purpose.

Third persons who are not parties to the principal obligation may secure the latter by pledging or mortgaging their own property.

COMMENT:

(1) Consideration of Pledge or Mortgage

Pledges and mortgages are accessory contracts; therefore, their consideration is the same as the consideration of the principal obligation. (*China Banking Corp. v. Lichauco*, 46 Phil. 460). If the principal contract is void, so also is the pledge given as security therefor.

(2) Ownership

- (a) The pledgor or the mortgagor must be the *owner*, otherwise the pledge or mortgage is VOID. (*National Bank v. Palma Gil*, 55 Phil. 639). Future property therefore cannot be mortgaged or pledged because of the lack of ownership. (*Dilag v. Heirs of Resurreccion*, 76 Phil. 650).
- (b) An agent cannot therefore pledge or mortgage in *his own name* the property of the principal, otherwise the contract is VOID. BUT the agent can do so, *in the name of the principal*, for here the real pledgor or mortgagor is the principal. Hence, if the *agent* is properly authorized, the contract is VALID. (See *Arenas v. Raymundo*, 19 Phil. 46).
- (c) The pledgor or mortgagor need *not* be the debtor or borrower; thus, one who *owns* property can pledge or mortgage it to secure *another's debt*. Note here that pledgor or mortgagor is the OWNER of the property.
- (d) If a forger pledges or mortgages another's property, the pledge or mortgage is VOID, unless the land concerned was *already* registered in the *forger's* name, in which case innocent third parties should not be prejudiced. (See *Veloso v. La Urbana*, 58 Phil. 681; *Lopez v. Seva*, 69 Phil. 311 and *De Lara v. Ayroso*, 95 Phil. 185).

(3) Nullity of Pledge or Mortgage

Even if the pledge or mortgage is VOID the principal obligation (loan) may still be VALID. Therefore, the debt may still be recovered in an ordinary action. (See *Lozano v. Tan Suico*, 23 Phil. 16 and *Julian v. Lutero*, 49 Phil. 703).

(4) Liability of Mortgagor for Another's Debt

One who mortgages his property to guaranty another's debt, *without expressly assuming personal liability for such debt*, CANNOT be compelled to pay the deficiency remaining after the mortgage has been foreclosed. (*Phil. Trust Co. v. Echaus Tan Siua*, 52 Phil. 852).

(5) Essential Requisites for Pledge and Mortgage

<i>PLEDGE</i>	<i>MORTGAGE</i>
(a) accessory contract — made to secure fulfillment of a principal obligation	(a) same as in pledge
(b) pledgor must be absolute owner of property pledged	(b) mortgagor must be absolute owner of property mortgaged
(c) pledgor must have free disposal or be authorized	(c) mortgagor must have free disposal or be authorized
(d) thing pledged may be alienated when principal becomes due for payment to the creditor. (<i>Art. 2087</i>).	(d) mortgaged property may be alienated when principal obligation becomes due for payment to the creditor. (<i>Art. 2087</i>).
(e) thing pledged must be placed in the possession of the creditor, or of a third person by common agreement. (<i>Art. 2093</i>).	

(6) Case

**Guillermo Adriano v. Romulo Pangilinan
GR 137471, Jan. 16, 2002**

FACTS: Petitioners contends that because he did not give his consent to the real estate mortgage (his signature having been forged), then the mortgage is void and produces no force and effect.

Not only was it proven in the trial court that the signature of the mortgagor had been forged, but also that somebody else — an impostor — had pretended to be the former when the mortgagee made an ocular inspection of the subject

property. The Court of Appeals, for its part, faulted petitioner for entrusting to Angelina Salvador the TCT covering the property. Without his knowledge or consent, however, she caused or abetted an impostor's execution of the real estate mortgage. Petitioner had been negligent in entrusting and delivering his TCT 337942 to his "distant relative" Salvador, who undertook to find a money lender. In the present case, the mortgagor was an impostor, not the registered owner.

ISSUE: Was petitioner negligent in entrusting and delivering his TCT to a relative who was supposed to help him find a money lender, and if so, was such negligence sufficient to deprive him of his property?

HELD: To be able to address the issue, it is crucial to determine whether herein respondent was an "innocent mortgagee for value." The answer is no, because he failed to observe due diligence in the grant of the loan and in the execution of the real estate mortgage. (*GSIS v. CA, 287 SCRA 204 [1998]*) for which he must bear the consequences of his negligence.

For instance, respondent's testimony negated his assertion that he exercised due diligence in ascertaining the identity of the alleged mortgagor when he made an ocular inspection of the mortgaged property. And since he knew that the property was being leased, respondent should have made inquiries about the rights of the actual possessors; he could have easily verified from the lessees whether the claimed owner was, indeed, their lessor.

Petitioner's act of entrusting and delivering his TCT and Residence Certificate (now known as "Community Tax Certificate") to Salvador was only for the purpose of helping him find a money lender. Not having executed a power of attorney in his favor, he clearly did not authorize her to be his agent in procuring the mortgage. He only asked her to look for possible money lenders. (*See Art. 1878, Civil Code*).

As between petitioner and respondent, the failure of the latter to verify essential facts was the immediate cause of his predicament. If he were an ordinary individual without any expertise or experience in mortgages and real estate dealings, his failure to verify essential facts would probably have

been understandable. However, he has been in the mortgage business for seven years. Assuming that both parties were negligent, respondent should bear the loss. His superior knowledge of the matter should have made him more cautious before releasing the loan and accepting the identity of the mortgagor. (*See Uy vs. CA, 246 SCRA 703 [1993]*).

Given the particular circumstances of this case, the negligence of petitioner is not enough to offset the fault of respondent himself in granting the loan. The former should not made to suffer for respondent's failure to verify the identity of the mortgagor and the actual status of the subject property before agreeing to the real estate mortgage. Respondent's own negligence was the primary, immediate, and overriding reason that put him in his present predicament.

To summarize, both law and equity favor petitioner. Three (3) reasons are adduced, to wit:

1. The relevant legal provision, Art. 2085, requires that the mortgagor be the absolute owner of the thing mortgaged. Here, the mortgagor was an impostor who executed the contract without the knowledge and consent of the owner.
2. Equity dictates that a loss brought about by the concurrent negligence of two persons shall be borne by one who was in the immediate, primary, and overriding position to prevent it. Herein respondent, who is engaged in the business of lending money secured by real estate mortgages, could have easily avoided the loss by simply exercising due diligence in ascertaining the identity of the impostor who claimed to be the owner of the property being mortgaged.
3. Equity merely supplements, not supplements, the law. The former cannot contravene or take the place of the latter.

In any event, respondent is not precluded from availing himself of proper remedies against Salvador and her cohorts.

[NOTA BENE: A Torrens certificate serves as evidence of an indefeasible title to the property in favor

of the person whose name appears therein. The Torrens system does not create or vest title. It only confirms and records title already existing and vested. IT does not protect a usurper from the true owner. It cannot be a shield for the commission of fraud. It does not permit one to enrich himself at the expense of another. (*Adriano v. Pangilinan, supra*).]

(7) A DST is not an Imposition on the Document Itself but on the Privilege to Enter Into a Taxable Transaction of Pledge

**Michel J. Lhuillier Pawnshop, Inc. v. Commissioner of Internal Revenue
501 SCRA 450 (2006)**

FACTS: The law is clear and needs no further interpretation. No law on legal hermeneutics could change the fact that the entries contained in a pawnshop ticket spell out a *contract of pledge*, and that the exercise of the privilege to conclude such a contract is taxable under Sec. 195 of the National Internal Revenue Code (NIRC).

Sec. 195 of the NIRC imposes DST on every pledge regardless of whether the same is “conventional pledge” governed by the new Civil Code *or* one that is governed by the provisions of Presidential Decree (PD) 114.

It should be pointed out that the NIRC provisions on the Documentary Stamp Tax (DST) has been amended by RA No. 9243. Among the highlights thereof were the amendments to Sec. 199 thereof, which incorporated 12 more categories of documents in addition to the initial categories exempted from DST. *Expression unius est exclusio alterius*. The omission of pawnshop tickets only means that it is not among the documents exempted from the DST.

ISSUES: (1) When we say that a DST on pledge is an excise tax on the exercise of a right to transfer obligations, rights, or properties incident thereto, does it mean an imposition on the document itself?; (2) Are all pledges subject to DST?; and (3) Are “good faith” and “honest belief” that one is subject to tax on the basis of previous interpretation of

government agencies tasked to implement the tax law, sufficient justifications to delete the imposition of surcharges and interests?

HELD: (1) No. It is not an imposition on the document itself but on the privilege to enter into a taxable transaction. Pledge is among the privileges the exercise of which is subject to the DST. Thus, for purposes of taxation, the same pawn ticket is proof of an exercise of a taxable privilege of concluding a contract of pledge. Moreso, it is the exercise of the privilege to enter into an accessory contract of pledge, as distinguished from a contract of loan; (2) Sec. 195 of the NIRC unqualifiedly subjects all pledges to the DST, unless there is a law exempting them in clear and categorical language. For one who claims an exemption from tax payments rests the burden of justifying the exemption by words too plain to be mistaken and too categorical to be misinterpreted and (3) Yes, and such is the settled rule.

[NOTE: Pawnshops are not included in the term “lending investors” for the purpose of imposing the 5% percentage tax. (*CIR v. Trustworthy Pawnshop, Inc.*, 488 SCRA 538 [2006]).]

Art. 2086. The provisions of Article 2052 are applicable to a pledge or mortgage.

COMMENT:

Applicability of Art. 2052 (Guaranty of Voidable, Etc., Obligations)

- (a) Even if the principal debt is voidable, unenforceable, or merely natural, the pledge or mortgage is valid.
- (b) If the principal obligation is void, the pledge or mortgage is also void.
- (c) Art. 2052. “A guaranty cannot exist without a valid obligation.

Nevertheless, a guaranty may be constituted to guarantee the performance of a voidable or an unenforceable contract. It may also guarantee a natural obligation.”

Art. 2087. It is also of the essence of these contracts that when the principal obligation becomes due, the things in which the pledge or mortgage consists may be alienated for the payment to the creditor.

COMMENT:

(1) Right to Have the Property Alienated So That the Debt May Be Paid

This Article does not mean that the creditor automatically become the owner, if at the time the debt falls due, the debt is still unpaid. It only means that the property pledged or mortgaged may be sold (to anybody, including the creditor) so that from the proceeds of such alienation the debt might be paid. (*See Villarama v. Crisostomo*, [C.A.] 54 O.G. 6894 and *El Hogar Filipino v. Paredes*, 45 Phil. 178). If a loan from the GSIS is obtained by *installments*, but the debtor-mortgagor signed a promissory note for every release (of the money), providing that the loan shall earn interest, said money released *immediately* earns interest, *even if* the entire loan had not yet been given. Insurance on the property mortgaged, by express stipulation of the GSIS contract, is also chargeable against the debtor. If under the terms of the contract, there can be an extrajudicial foreclosure upon non-fulfillment on its condition, said stipulation can be given effect. (*Jose C. Zulueta v. Hon. Andres Reyes, et al.*, L-21807, May 29, 1967).

(2) Violations of Conditions May Authorize Immediate Foreclosure

As a rule, the mortgage can be foreclosed only when the debt remains unpaid at the time it is due, but the violation of certain conditions in the mortgage may authorize immediate foreclosure. (*Gov't. of the P.I. v. Espejo*, 57 Phil. 496). Hence, if a mortgage contract prohibits the mortgagor to execute a lease or a second mortgage on the property without the written consent of the mortgagee, a violation of this condition would make the mortgage debt due and demandable, and would entitle the mortgagee immediately to bring an action for the foreclosure of the mortgage. (*Vasquez v. Jocson & Araneta*, 62 Phil. 537). Regarding the stipulations that may be agreed

upon, would it be lawful to stipulate in a mortgage of real property that the property can be sold at a public auction without judicial proceeding in case the mortgage debt is not paid within the time stipulated?

ANS.: Yes. (*Lopez & Javelona v. El Hogar Filipino*, 47 *Phil.* 247). As a matter of fact, the extrajudicial foreclosure of mortgages is authorized by Act 3135, passed on Mar. 6, 1924. The silence of the Rules of Court as to extrajudicial foreclosure of mortgage on real property does not operate to blot out such a remedy. The right to extrajudicial foreclosure when so stipulated in a mortgage is established by substantive law. (*II Moran, Comments on the Rules of Court*, p. 234). The Supreme Court has even declared that the power of the mortgagee to sell the mortgaged property to satisfy his credit survives after the death of the mortgagor. Property which is however in *custodia legis*, cannot be extrajudicially foreclosed, because this is not provided for in Act 3135. (*Pasno v. Ravina*, 54 *Phil.* 378).

(3) Price

Just because the price is considered inadequate this does not mean that the foreclosure sale should be cancelled. It would be otherwise if the price were *shocking*. (See *Bank of P.I. v. Green*, 52 *Phil.* 249). It has been held that the price of P8,375 at the public auction for property assessed at P19,140 is not so shocking to the conscience as to warrant the cancellation of a sale which was carried out with the formalities of the law, especially where the mortgagor had been given ample opportunity, to sell the property at a higher price. (*Go Letting & Sons, etc. v. Leyte Land Transportation Co., et al.*, L-8887, May 28, 1958).

El Hogar Filipino v. Phil. Nat'l. Bank **64 Phil. 582**

FACTS: Property was mortgaged to the El Hogar Filipino. With the consent of the mortgagee, it was mortgaged for the second time to the Philippine National Bank (PNB) (junior mortgagee). When the mortgage was foreclosed, the proceeds realized were just enough to pay off the first mortgage. Has the PNB still a lien on the property?

HELD: No more. The security in favor of the PNB, as second creditor and mortgagee, was extinguished. Its only right under the mortgage, aside from the right to repurchase, would have been to apply to the payment of its credit the excess of the proceeds of the sale after the payment of that of the El Hogar Filipino, such being the effect of the subordination of its mortgage to that of the latter. However, there was no excess and so the mortgage in favor of the PNB was extinguished because it cannot be enforced by said bank beyond the total value of the mortgaged land. Consequently, the land passed to the purchaser (at the foreclosure sale) free from the mortgage in favor of the PNB. The bank's claim that the second mortgage in its favor stands to the prejudice of the purchaser is untenable particularly because, as the purchaser in this case is the first mortgagee itself (El Hogar Filipino), the result, inverting the legal effects of two mortgages would practically be to convert the second mortgage into a first mortgage, and the first mortgage into second mortgage.

(*NOTE:* Although there is no more mortgage in favor of the PNB, this does not mean that the debtor should not pay his debt any more in favor of the PNB.)

Solomon and Lachica v. Dantes
63 Phil. 522

FACTS: A's debt in B's favor is secured by a mortgage. Does this existence of the mortgage prevent B from maintaining a personal action for the recovery of the debt from A?

HELD: No, B can bring such personal action for the recovery of the debt covered by the mortgage.

Lopez v. Director of Lands
47 Phil. 23

FACTS: A was indebted to B. As a security, A's land was mortgaged in favor of B. A did not pay his taxes, and so the land was sold at a tax sale to C. Does C have to respect the mortgage in B's favor?

HELD: Yes. The tax title issued under the procedure adopted in the City of Manila for the recovery of delinquent

taxes, conveys only such title as was vested in the delinquent taxpayer. Such sale cannot affect the rights of other lien holders unless by the procedure adopted, they had been given an opportunity to defend their rights.

[NOTE: Although as a rule, there is an implied warranty against eviction, this does not render liable a sheriff auctioneer, mortgagee, pledgee, or other person professing to sell by virtue of authority in fact or law, for the sale of a thing in which a third person has a legal or equitable interest (Last paragraph, Art. 1547). Note also that “if the property is sold for non-payment of taxes due and not made known to the vendee before the sale, the vendor is liable for eviction.” (Art. 1551).]

Art. 2088. The creditor cannot appropriate the things given by way of pledge or mortgage, or dispose of them. Any stipulation to the contrary is null and void.

COMMENT:

(1) *Pactum Commissorium*

- (a) A borrowed from B a sum of money. A offered his house by way of a mortgage. It was expressly stipulated in the contract that upon non-payment of the debt on time, the house would belong to B. Is the stipulation valid?

ANS.: No, such a stipulation (*pacto comisorio*) is null and void. “This forfeiture clause has traditionally not been allowed because it is contrary to good morals and public policy.” (*Report of the Code Commission, p. 156; See Perez v. Cortez, 35 Phil. 211 and Tan Chun Tic v. West Coast Life Ins. Co., 54 Phil. 361*).

- (b) It is true that a debtor, instead of paying in cash, can just alienate in favor of his creditor property to satisfy the debt (dation in payment) but it would be illegal for the debtor to previously authorize the creditor to appropriate the property pledged or mortgaged as the latter’s own in payment of the debt. It is true that the property may be alienated in favor of anybody in order that the debt may be paid, as long as the formalities of the law

are complied with, and it is true that even the creditor himself may get the property but he cannot become the owner automatically just because the debtor does not pay his debt. To provide for automatic ownership would be to stipulate a *pactum commissorium*. In one case, the Supreme Court held: "The stipulation in the mortgage that the land covered thereby shall become the property of the mortgagee upon failure to pay the debt within the period agreed upon, constitutes a *pactum commissorium* and is therefore null and void." (*Tan Chun Tic v. West Coast Life*, 54 Phil. 361). Similarly, a stipulation that in case of non-payment, the mortgaged property would be considered full payment "without further action in court," is null and void, being "*pactum commissorium*." (*Reyes v. Nebrija*, 98 Phil. 639).

(2) Cases

Warner, Barnes and Co. v. Buenaflor and Macoy (C.A.) 36 O.G. 3290

FACTS: A pledged his property in favor of B to secure a loan. It was expressly stipulated in the contract that the pledgee could purchase the things pledged at the current purchase price if the debt was not paid on time. Is this a valid stipulation?

HELD: Yes. What is prohibited by Art. 2088, dealing with *pacto comisorio*, is the automatic appropriation by the creditor or pledgee in payment of the loan at the expiration of the period agreed upon. The reason for the prohibition is that the amount of the loan is ordinarily much less than the real value of the things pledged. Where there is express authorization of the pledgee to purchase the things pledged at the current market price, the contract would not come within the prohibition.

[NOTE: If a mortgagor promises to sell the property to the mortgagee upon default, this is merely a personal obligation, and does *not* bind the land. Hence, he can still sell the land to a stranger BUT he would be liable for damages. (*Guerrero v. Yñigo & Court of Appeals*, 96 Phil. 37).]

Ranjo v. Salmon
15 Phil. 436

The creditor is not allowed to appropriate to himself the thing held as pledge or under mortgage, nor can he dispose of the same as owner. He is merely entitled, after the principal obligation becomes due, to move for the sale of the things pledged, in order to collect the amount of the claim from the proceeds.

Dalay v. Aquiatin and Maximo
47 Phil. 951

FACTS: A document contained this clause: "If I cannot pay the aforesaid amount when the date agreed upon comes, the same shall be paid with the lands given, as security..." The issue is: does this partake of the nature of *pacto comisorio* and therefore in violation of Art. 2088?

HELD: Two things are prohibited under Art. 2088: (1) the appropriation by the creditor of the things given by way of pledge or mortgage; and (2) the disposition thereof by the creditor. The stipulation quoted does not authorize either one or the other. Clearly, it does not authorize the creditor to dispose of the properties mortgaged. Neither does it authorize him to appropriate the same. What it says is merely a promise to pay the debt with such properties, if at its maturity, the debt remains unsatisfied. It is merely a promise made by the debtor to assign the property given as security in payment of the debt, a promise accepted by the herein creditor. There is no doubt that under the law, a debtor may make an assignment of his properties in payment of debt. (*Art. 1255, Civil Code*). And the assignment is not made unlawful by the fact that the said properties are mortgaged, because the title thereto remains in the debtor; nor is a promise to make such an assignment in violation of the law. Therefore, Art. 2088 is not applicable to the stipulation in question.

[NOTE: "We disagree to such holding of the court. While it is true that in form said stipulation may not be considered a *pactum commissorium*, it is nonetheless true that it has the same effect which *pactum commissorium* produces.

Furthermore, it places the debtor at a great disadvantage. In case the property is mortgaged for an amount very much lower than its real value, the creditor would have the benefit of acquiring the same at a very low price. Upon the other hand, if the property mortgaged is sold and the proceeds of the sale are more than the amount of the loan, the claim of the creditor is paid, and the balance of the sale is given to the debtors." (*Ventura, Land Registration and Mortgages*, p. 368).]

Furthermore, is this not tantamount to a forfeiture? For, suppose the lands are worth, let us say, 4 times the mortgage debt, should the creditor be allowed to get the entire lands for himself? If so, is this not forfeiture (of 3/4 of the value of the land) speaking of which the Code Commission says: "This forfeiture clause has traditionally been outlawed, because it is contrary to good morals and public policy." (*Report of the Code Commission*, p. 156). Moreover, the new Civil Code presumes in certain cases a contract with *pacto de retro*, to be an equitable mortgage precisely for the purpose of preventing an indirect violation of Art. 2088, which prohibits a *pacto comisorio*. If we are to hold that the creditor in the problem presented would be entitled to the whole land, what then would be the use of introducing reforms in the "*pacto de retro* problems"? If it is claimed, however, that the creditor would not be entitled to the whole land, what then is the meaning of the clause — "If I cannot pay the aforesaid amount when the date agreed upon comes, the same shall be paid with the lands given as security"? Suppose, the debtor does not want to pay with the land, cannot under the premises given, the court compel him to do so? And if this is done, is this not practically countenancing a forfeiture?

It is true that the law allows an assignment in favor of creditor for the payment of a debt but this assignment is made only afterwards, not at the time the obligation is constituted. If, however, the clause is construed to mean that the land will be responsible for the payment of the debt, that is, if the land is worth four times the debt, the creditor should return 3/4 of the value of the price, this construction in our opinion would be legal for in this case there would be no unwarranted forfeiture.

**A. Francisco Realty & Development Corp. v.
CA & Sps. Romulo S.A. Javillonar
and Erlinda P. Javillonar
GR 125055, Oct. 30, 1998**

FACTS: Petitioner granted a loan to respondent spouses, in consideration of which the latter executed a promissory note, a deed of mortgage, and an undated deed of sale of the mortgaged property in favor of petitioner as mortgagee. As respondent spouses failed to pay the interest, petitioner registered the sale of the land in its favor and a new transfer certificate of title was issued in its name. Respondent spouses likewise failed to pay the principal loan. When respondent spouses refused to vacate the property, petitioner filed an action for possession before the trial court.

The trial court rendered a decision in favor of petitioner but, upon appeal, was reversed by the Court of Appeals (CA). On appeal, the Supreme Court affirmed with modification the CA's decision.

HELD: The stipulations in the promissory notes providing that, upon failure of respondent spouses to pay interest, ownership of the property would be automatically transferred to petitioner and the deed of sale in its favor would be registered in its name constitute in substance *pactum commissorium*, which is prohibited under Art. 2088. The subject transaction being void, the registration of the deed of sale, by virtue of which petitioner was able to obtain a certificate of title covering the subject lot, must also be declared void.

(3) Mortgagee Cannot Sell During Existence of Principal Obligation

Is a mortgagee allowed during the existence of the principal debt, to sell the property mortgaged to him?

ANS.: No, because this would certainly be an act of disposition. The answer would be the same even if the contract allows the sale, for in such a case, said stipulation would be null and void.

(4) Case**Hechanova v. Adil
GR 49940, Sep. 25, 1986**

A deed of mortgage which contains a stipulation that in case the mortgagor fails to pay the debt secured by the mortgage, the mortgagee shall become the owner of the property is null and void.

Art. 2089. A pledge or mortgage is indivisible, even though the debt may be divided among the successors in interest of the debtor or of the creditor.

Therefore, the debtor's heir who has paid a part of the debt cannot ask for the proportionate extinguishment of the pledge or mortgage as long as the debt is not completely satisfied.

Neither can the creditor's heir who received his share of the debt return the pledge or cancel the mortgage, to the prejudice of the other heirs who have not been paid.

From these provisions is excepted the case in which, there being several things given in mortgage or pledge, each one of them guarantees only a determinate portion of the credit.

The debtor, in this case, shall have a right to the extinguishment of the pledge or mortgage as the portion of the debt for which each thing is specially answerable is satisfied.

COMMENT:**(1) Indivisibility of a Pledge or Mortgage***Examples:*

- (a) A borrowed P1 million from B, secured by a mortgage on A's land. A died leaving children X and Y. X paid P50,000 to B. Can X ask for the proportionate extinguishment of the mortgage?

ANS.: No (*Par. 2, Art. 2089*), but of course the debt is now only *half*. Indeed, a mortgage is *indivisible*, but the principal obligation may be divisible.

- (b) A borrowed P1 million from B, secured by a mortgage on A's land. B died leaving two children, R and T. A paid R P500,000. Is R allowed to cancel the mortgage?

ANS.: No. (*Par. 3, Art. 2089*).

(2) Example of the Exception

A borrowed P1 Million from B, secured by the pledge of a ring for a debt of P200,000; and by a mortgage on A's land, for the balance of P800,000. If A pays P200,000, can he demand the return of the ring?

ANS.: Yes, because in this case the ring guaranteed only P200,000. (*Pars. 3 and 4, Art. 2089*).

(3) Mortgage on Both a House and Its Lot

If a mortgage is constituted on a house and its lot, both should be sold TOGETHER at the foreclosure, and not separately. (*Bisayas, et al. v. Lee, et al., [C.A.] 53 O.G. 1518*). Similarly, if the mortgage is on two lots, the mortgagee can demand the sale of *either* or *both*. This is because the mortgage is INDIVISIBLE. (*Aquino v. Macondray and Co., 97 Phil. 731*).

(4) Non-Applicability to Third Persons

The indivisibility of a mortgage *does not* apply to third persons. (*Nat. Bank v. Agudelo, 58 Phil. 655*).

Art. 2090. The indivisibility of a pledge or mortgage is not affected by the fact that the debtors are not solidarily liable.

COMMENT:

(1) Indivisibility Applies Even if Debtors Are Not Solidary

The Article explains itself.

(2) Case**Ong v. IAC
GR 74073, Sep. 13, 1991**

FACTS: Madrigal Shipping Co., Inc. was granted a P2,094,000-loan by Solidbank payable on or before Jul. 27, 1978, at 10% interest per annum. As security, Madrigal pledged in favor of the bank a barge and a tugboat. Madrigal failed to pay its obligation to Solidbank. When the bank was to sell the pledged properties, it found out that the tugboat and the barge had surreptitiously been taken from Pasig River, where they were moored and towed to the North Harbor, without the knowledge and consent of the bank. Meanwhile, Ong bought the barge which was subject of the pledge from Ocampo, a successful bidder in a public auction by virtue of a writ of execution issued by the National Labor Relations Commission, in a labor case. The Bank then sued Ong for replevin with damages before the Regional Trial Court. The trial court ordered the seizure of the barge upon posting of a bond in the sum of P1,000,000. Thereafter, the court ordered Ong to put up a counterbond of P400,000 executed in favor of Solidbank; otherwise, the latter's motion to release the property subject of replevin will be granted. The Court of Appeals sustained the trial court.

ISSUE: Whether the contract of pledge entered into by and between Solidbank and Madrigal is binding on Ong. Ong rely heavily on the fact that the contract of pledge by and between Solidbank and Madrigal was not recorded under Sections 804 and 809 of the Tariff and Customs Code and argue that it is not binding on third persons, like Ong.

HELD: The Supreme Court affirmed the appellate court's decision and held that all the requisites for a valid pledge has been complied with. The pledge agreement is a public agreement, the same having been notarized. The pledge was delivered to Solidbank which had it moored at the Pasig River where it was guarded by a security guard. Madrigal, owner of the barge, pledged the vessel and tugboat to securing its obligation to the bank in the amount of P2,094,000. No payment was made by Madrigal as pledgor. Therefore, Solidbank has

the right to it until it is paid. Solidbank is obviously a lawful and rightful possessor of the personal property pledged.

Art. 2091. The contract of pledge or mortgage may secure all kinds of obligations, be they pure or subject to a suspensive or resolutive condition.

COMMENT:

The Kinds of Obligations Which a Pledge or a Mortgage May Secure

The Article is self-explanatory.

Art. 2092. A promise to constitute a pledge or mortgage gives rise only to a personal action between the contracting parties, without prejudice to the criminal responsibility incurred by him who defrauds another, by offering in pledge or mortgage as unencumbered, things which he knew were subject to some burden, or by misrepresenting himself to be the owner of the same.

COMMENT:

(1) A Promise to Constitute a Pledge or Mortgage

A borrowed 10 million from B. A promised to execute a mortgage to guarantee this debt. The promise was accepted. Suppose A has not yet constituted the mortgage, can we say that there already exists a mortgage here?

ANS.: No, there is no mortgage as yet — no real right has been created. What exists, however, is a personal right of B to demand the constitution of the mortgage. Thus in one case, inasmuch as the debtor had made a promise to constitute a pledge and inasmuch as the promise had been accepted by the creditor-bank, it was held that the bank could have, under Art. 2082, compelled the fulfillment of the agreement. (*See Mitsui Bussan Kaisha v. Hongkong & Shanghai Bank*, 36 Phil. 27).

(2) Judicial Declaration of Lien Is Sufficient

It has been held that though there is nothing wrong in requiring the debtor to execute the mortgage, still in certain cases a judicial declaration of the existence of the lien would be sufficient. For “a court of equity never requires an unnecessary thing, and in this case, all the rights of the creditor will be adequately protected by declaring that the indebtedness recognized by the debtor, constitutes a lien in the nature of a mortgage upon the *Hacienda Salvacion*, it appearing that the registration of the whole has been effected. It is a maxim of jurisprudence that equity regards that as done which ought to be done, and in obedience to this precept, as between the parties to this record, the property must be considered to be subject to the same lien, as if the mortgage which had been agreed to be made had been actually executed. (*Laplana v. Garchitorena Chereau*, 48 Phil. 163).

(3) Double Remedies

Is it inconsistent to ask in one action that: (a) the mortgage be constituted; or (b) the indebtedness be paid?

HELD: No, they are not inconsistent. (*Laplana v. Garchitorena Chereau*, *supra*).

(4) Estafa

Any person who, pretending to be the owner of any real property, shall convey, sell, encumber, or mortgage the same shall be guilty of estafa. (*Art. 316, par. 1, Revised Penal Code*). This crime has 3 constituent elements:

- (1) the property should be real property, for otherwise, the crime might be theft or another crime, but not estafa;
- (2) the offender must have pretended to be the owner, that is, he should not have been in good faith; otherwise, deceit or fraud would not be present; and
- (3) the fictitious owner must have executed some acts of ownership to the prejudice of the true owner.

(5) Another Instance of Estafa

Any person who, knowing that real property is encumbered, shall dispose of the same as unencumbered, is also guilty of estafa. (*Art. 316, par. 2, Revised Penal Code*). It is essential in a case like this that fraud or deceit be practiced upon the vendee at the time of the sale. (*People v. Mariano, 40 O.G. [45] No. 8, p. 91*).

(6) Ownership Not a Necessary Element of Estafa

The Supreme Court in *Hernandez v. Court of Appeals*, 228 SCRA 429 (1993), held that ownership is not a necessary element of the crime of estafa.

Chapter 2

PLEDGE

Art. 2093. In addition to the requisites prescribed in Article 2085, it is necessary, in order to constitute the contract of pledge, that the thing pledged be placed in the possession of the creditor, or of a third person by common agreement.

COMMENT:

(1) Thing Pledged Must Be in Possession of the Creditor or a Third Person By Common Agreement

This requisite is most essential and is characteristic of a pledge without which the contract cannot be regarded as entered into because precisely in this delivery lies the security of the pledge. (*Manresa*). Indeed, if Art. 2093 is not complied with, the pledge is VOID. (*El Banco Español-Filipino v. Peterson*, 7 Phil. 409). Until the delivery of the thing, the whole rests in an executory contract, however strong may be the engagement to deliver it, and the “pledgee” acquires no right of property in the thing. (*U.S. v. Terrel*, 2 Phil. 222). Hence, if a pledgee fails or neglects to take this property into his possession, he is presumed to have waived the right granted him by the contract. (*U.S. v. Terrel*, *supra*). Furthermore, mere taking of possession is insufficient to continue the pledge. The pledgee must continue in said possession. (*Pacific Commercial Co. v. National Bank*, 49 Phil. 237). Furthermore, mere symbolical delivery is insufficient. There must be actual possession — actual delivery of possession. (*Betita v. Ganzon*, 49 Phil. 87).

(2) Effectivity Against Third Persons

A pledgee shall not take effect against third persons if a description of the thing pledged and the date of the pledge do not appear in a public instrument. (*Art. 2096*).

(3) Symbolic Delivery

Although we have seen that symbolic delivery is not sufficient, still if the pledgee, before the pledge, had the thing already in his possession, then the requirement of the law has been satisfied. For then, said pledgee would be in actual possession. The same thing may be said in case the thing pledged is in the possession of a third person by common agreement. (*See Art. 2093*).

(4) Example

In one case, *A* pledged to *B* the goods found in a warehouse formerly rented by *A*. By common consent, it was agreed that *C*, a depositary, would take charge of the goods in the warehouse. Has the contract of pledge been perfected in this case?

HELD: Yes, since *C* became the depositary by common agreement. (*Banco Espanol-Filipino v. Peterson, et al.*, 7 Phil. 409).

Betita v. Ganzon **49 Phil. 87**

FACTS: Buhayan pledged to Betita 4 carabaos which Buhayan owned but which were actually in the possession of Jacinto. Betita never took possession of the carabaos. Furthermore, nothing in the contract stated that Jacinto was by common consent made the depositary in Betita's behalf. Has a pledge been lawfully constituted here?

HELD: No. The delivery of possession of the property pledged requires actual possession and a mere symbolic delivery is insufficient.

Art. 2094. All movables which are within commerce may be pledged, provided they are susceptible of possession.

COMMENT:

What May Be Pledged

- (a) Only *movables* can be pledged (including incorporeal rights — *See Art. 2095*).

- (b) Real property cannot be pledged. A pledge cannot include a lien on real property. (*Pac. Com. Co. v. Phil. Nat'l. Bank*, 49 Phil. 236).
- (c) Certificates of stock or of stock dividends, under the Corporation Code, are quasi-negotiable instruments in the sense that they may be given in pledge to secure an obligation.

Pac. Com. Co. v. Phil. Nat'l. Bank
49 Phil. 236

FACTS: The Gulf Plantation Co., to secure a loan not exceeding P165,000, constituted a pledge in favor of the Philippine National Bank. The document was prepared on the customary blank form of pledge. It was entered into on Aug. 24, 1918, and endorsed on Feb. 24, 1921 by the Register of Deeds with the words "received this 24th day of Feb. 1921, at 9:30 A.M." The property was never placed in the possession of the bank. Furthermore, the property consisted of some bales of hemp, and the rest were all real properties consisting of buildings and lands.

HELD: The pledge is not valid for failure to deliver possession, but even granting its validity, it can only refer to the personal property and not to the real property.

The Manila Banking Corp. v. Teodoro, et al.
GR 53955, Jan. 13, 1989

In case of doubt as to whether a transaction is a *pledge* or a *dation in payment*, the presumption is in favor of a pledge, the latter being the lesser transmission of rights and interests.

Art. 2095. Incorporeal rights, evidenced by negotiable instruments, bills of lading, shares of stock, bonds, warehouse receipts and similar documents may also be pledged. The instrument proving the right pledged shall be delivered to the creditor, and if negotiable, must be indorsed.

COMMENT:**(1) Pledge of Incorporeal Rights**

- (a) The instrument proving the right pledged must be **DELIVERED**.
- (b) If negotiable, said instrument must be **ENDORSED**.

(2) Pledge Certificate

A pledge certificate by itself is *not* a negotiable instrument, and therefore even if delivered and endorsed to an assignee, he would have *no* right to redeem the property, unless the creditor-pledgee consents. (*Concepcion v. Agencia Empeños de A. Aguirre*, [C.A.] 63 O.G. 1431).

Art. 2096. A pledge shall not take effect against third persons if a description of the thing pledged and the date of the pledge do not appear in a public instrument.

COMMENT:**(1) Effectivity of Pledge Against Third Persons**

- (a) A *public instrument* must be made.
- (b) The instrument must contain the **DESCRIPTION** of the thing pledged and the **DATE** of the pledge.

(2) Reason for the Law

A debtor in bad faith may attempt to conceal his property by simulating a pledge thereof with an accomplice. Art. 2096 is, of course, *mandatory* in character.

(3) Mere Delivery Not Sufficient

To affect third persons, mere delivery of possession is insufficient. "This provision (*Art. 2096*) has been interpreted in the sense that for the contract to affect third persons, it must appear in a public instrument in addition to delivery of the thing pledged." (*Bachrach Motor Co. v. Lacson Ledesma*, 64 *Phil.* 681).

(4) Assignee Under the Insolvency Law

An assignee of a person under the Insolvency Law is a third person within the meaning of Art. 2096 of the Civil Code. This is because the assignee insofar as the collection of credits is concerned, is the representative of the creditors and not of the bankrupt. Furthermore, when goods or merchandise have been pledged to secure the payment of a debt of a particular creditor, the other creditors of the pledgor are “third persons” with relation to the pledge contract and pledgor and pledgee. (*Te Pate v. Ingersoll*, 43 Phil. 394).

(5) Problem

A is indebted to B, so A pledges his diamond ring to B. The ring is delivered to B, but in the public instrument executed, there is no description of the ring, and the date of the pledge does not appear. If A sells the ring to C, does C have to respect the pledge in favor of B?

ANS.: No. C does not have to respect the pledge since as to him, the pledge is not effective and valid. (*Art. 2096*).

(6) Effect if No Public Instrument Is Made

When the contract of pledge is not recorded in a public instrument, it is void as against third persons; the buyer of the thing pledged is a third person within the meaning of the article. The fact that the person claiming as pledgee has taken actual physical possession of the thing sold will not prevent the pledge from being declared void insofar as the innocent stranger is concerned. (*Tec Bi and Co. v. Chartered Bank of India, Australia and China*, 16 O.G. 908; *Ocejo, Perez and Co. v. International Bank*, 37 Phil. 631).

Art. 2097. With the consent of the pledgee, the thing pledged may be alienated by the pledgor or owner, subject to the pledge. The ownership of the thing pledged is transmitted to the vendee or transferee as soon as the pledgee consents to the alienation, but the latter shall continue in possession.

COMMENT:**Pledgor May Alienate Thing Pledged***Example:*

A pledged his diamond ring with B. A may sell the ring provided that B consents. The sale is, however, subject to the pledge, that is, the pledge would bind third persons if Art. 2096 has been followed. If C buys the ring, the ownership of the ring is transferred to him, as soon as B consents to the sale but B shall continue to be in possession of the ring.

Art. 2098. The contract of pledge gives a right to the creditor to retain the thing in his possession or in that of a third person to whom it has been delivered, until the debt is paid.

COMMENT:**(1) Creditor's Right to Retain***Example:*

A owes B P1 million. As security, A pledged his diamond ring with B. B has the right to retain the ring until the P1 Million debt is paid.

(2) Rule Under the Old Law

Under the old Civil Code, the second paragraph of the equivalent article (1866, old Civil Code) granted the creditor the right to retain the property pledged as guaranty for any other obligation of the debtor. But said second paragraph has been eliminated. "It is thought that said provision was unjust. If the creditor wants the original pledge to apply also to the new claim, he should so demand at the time the later obligation is entered into. It cannot be fairly presumed that the debtor consented to the new pledge." (*Report of the Code Commission, p. 156*)

Example: A borrowed P1 million from B. As security, A pledged his diamond ring. Later, A borrowed P200,000. When the first debt fell due, A paid the P1 million and demanded

the return of the ring. But *B* wants to retain the ring until he has been paid the remaining debt of P200,000. *Issue*: Has *B* the right to retain the ring?

ANS.: Under the old Civil Code, *yes*; but under the new Civil Code, *no*.

(3) No Double Pledge

Property which has been lawfully pledged to a creditor cannot be pledged to another as long as the first one subsists. (*Mission de San Vicente v. Reyes*, 19 Phil. 524). This is so, for otherwise, how can the thing pledged be delivered to the second creditor? It must be noted that if the first pledgee or creditor gives up the possession of the property pledged, such pledge is thereby extinguished notwithstanding the continuation of the principal obligation guaranteed by the pledge. (See Art. 2110, Civil Code).

Art. 2099. The creditor shall take care of the thing pledged with the diligence of a good father of a family; he has a right to the reimbursement of the expenses made for its preservation, and is liable for its loss or deterioration, in conformity with the provisions of this Code.

COMMENT:

Duty of Pledgee to Take Care of Thing Pledged

- (a) When the possession of property belonging to a debtor is delivered to a creditor simply as a guaranty for the payment of a debt, the title does not pass to the temporary possessor, who has no right to damage or to destroy, and is liable for any injury he may cause. (*Bonjoc v. Cuison*, 13 Phil. 301). But the pledgee should not be held responsible for fortuitous events except if there is a contrary stipulation, or when the nature of the obligation requires the assumption of risk. (Art. 1174, Civil Code).
- (b) If the pledgee has exercised all the care and diligence which the law requires of her, she cannot be held responsible for the theft of the jewelry pledged with her. Had

the theft occurred as a result of her fault or negligence, she would have been liable. (*San Jose and Carlos v. Ruiz*, 71 Phil. 541).

Cruz and Serrano v. Chua A.H. Lee
54 Phil. 10

FACTS: Cornelio Cruz pledged valuable jewelry to the Monte de Piedad which gave him 2 pawn tickets. These two pawn tickets were in turn pledged by him to Chua A. H. Lee. The tickets could be renewed from time to time upon payment of the proper interest. Lee renewed them once, but did not continue as time passed. Eventually, the tickets lost their value. *Issue:* Is Lee responsible for the loss of the value of the tickets?

HELD: Yes. The principal question requiring decision in the case before us is one of law, namely, whether a person who takes a pawn ticket in pledge is bound to renew the ticket from time to time, by the payment of interest, or premium, as required by the pawnbroker, until the rights of the pledgor are finally foreclosed. It must be borne in mind that the ordinary pawn ticket is a document by virtue of which the property in the thing pledged passes from hand to hand by mere delivery of the ticket, and the contract of pledge is therefore absolvable to bearer. It results that one who takes a pawn ticket in pledge acquires domination over the pledge; and it is the holder who must renew the pledge if it is to be kept alive. The law (*Art. 2099*) contemplates that the pledgee may have to undergo expenses in order to prevent the pledge from being lost; and these expenses the pledgee is entitled to recover from the pledgor. From this, it follows that where the pledge is lost by a failure like this — failure of the pledgee to renew the loan — he is liable for the resulting damage. Nor, in this case, was the duty of the pledgee destroyed by the fact that the pledgee had obtained a judgment for the debt of the pledgor which was secured by the pledge. The duty to use the diligence of a good father of the family in caring for the pledge subsists as long as the pledged article remains in the power of the pledgee.

Art. 2100. The pledgee cannot deposit the thing pledged with a third person, unless there is a stipulation authorizing him to do so.

The pledgee is responsible for the acts of his agents or employees with respect to the thing pledged.

COMMENT:

(1) Pledgee Cannot Deposit the Thing Pledged

Generally, the pledgee cannot deposit the thing pledged with a third person. Exception — if there is a stipulation authorizing such deposit.

(2) Responsibility of Pledgee for Subordinates' Acts

The second paragraph stresses the master and servant rule.

Art. 2101. The pledgor has the same responsibility as a bailor in commodatum in the case under article 1951.

COMMENT:

Same Responsibility as a Bailor in Commodatum

Art. 1951. The bailor who, knowing the flaws of the thing loaned, does not advise the bailee of the same, shall be liable to the latter for the damages which he may suffer by reason thereof.

Art. 2102. If the pledge earns or produces fruits, income, dividends, or interests, the creditor shall compensate what he receives with those which are owing him; but if none are owing him, or insofar as the amount may exceed that which is due, he shall apply it to the principal. Unless there is a stipulation to the contrary, the pledge shall extend to the interest and earnings of the right pledged.

In case of a pledge of animals, their offspring shall pertain to the pledgor or owner of the animals pledged, but shall be subject to the pledge, if there is no stipulation to the contrary.

COMMENT:**Rules if Pledge Produces Fruits or Interests**

- (a) Fruits and interests may *compensate* for those to which the pledgee himself is entitled or may be applied to the principal.
- (b) Generally, the pledge extends to *offspring* of animals, but there can be a contrary stipulation.

Art. 2103. Unless the thing pledged is expropriated, the debtor continues to be the owner thereof.

Nevertheless, the creditor may bring the actions which pertain to the owner of the thing pledged in order to recover it from, or defend it against a third person.

COMMENT:**(1) Ownership Retained By Pledgor**

Generally, the pledgor continues to be the owner. Exception — when the object is expropriated.

(2) Exercise By Pledgee of Rights of Owner

Despite ownership by the pledgor, the pledgee may exercise certain rights of the owner.

Art. 2104. The creditor cannot use the thing pledged, without the authority of the owner, and if he should do so, or should misuse the thing in any other way, the owner may ask that it be judicially or extrajudicially deposited. When the preservation of the thing pledged requires its use, it must be used by the creditor but only for that purpose.

COMMENT:**Use By Creditor of Thing Deposited**

- (a) The Article explains itself.

- (b) The deposit referred to here is an instance of a *necessary deposit*. That is made in compliance with a legal obligation.

Art. 2105. The debtor cannot ask for the return of the thing pledged against the will of the creditor, unless and until he has paid the debt and its interest, with expenses in a proper case.

COMMENT:

When Debtor Can Demand the Return of Thing Pledged

- (a) When he has PAID the *debt, interest, and expenses* in the proper case — the debtor may demand the return of the thing pledged.
- (b) In an obligation *with a term*, there can be *no* demand of the property pledged till after the term had arrived. The prescriptive period for recovery of the property begins from the time the debt is *extinguished* by payment and a *demand* for the return of the property is made. (*Sarmiento v. Javellana*, 43 Phil. 880).

Art. 2106. If through the negligence or willful act of the pledgee, the thing pledged is in danger of being lost or impaired, the pledgor may require that it be deposited with a third person.

COMMENT:

When Pledgor May Require That the Object Be Deposited With a Third Person

The Article explains itself.

Art. 2107. If there are reasonable grounds to fear the destruction or impairment of the thing pledged, without the fault of the pledgee, the pledgor may demand the return of the thing, upon offering another thing in pledge, provided the latter is of the same kind as the former and not of

inferior quality, and without prejudice to the right of the pledgee under the provisions of the following article.

The pledgee is bound to advise the pledgor, without delay, of any danger to the thing pledged.

COMMENT:

When Destruction or Impairment Is Feared, Without the Fault of the Pledgee

This Article is applicable if the danger arises without fault or negligence on the part of the pledgee. Two remedies are granted, one for the pledgor, the other, for the pledgee.

- (a) For the pledgor — demand the return but there must be a substitute.
- (b) For the pledgee — he may cause the same to be sold at a public sale. The pledge continues on the proceeds. (*Art. 2108*).

(**NOTE:** The pledgee's right is superior to that of the pledgor. The law says the pledgor is given the right "without prejudice to the right of the pledgee.")

Art. 2108. If, without the fault of the pledgee, there is danger of destruction, impairment, or diminution in value of the thing pledged, he may cause the same to be sold at a public sale. The proceeds of the auction shall be a security for the principal obligation in the same manner as the thing originally pledged.

COMMENT:

Destruction, Impairment, or Diminution in Value of the Thing Pledged

- (a) *Example:* A pledged canned goods with B. Because the goods were in danger of deterioration, B sold them for P20,000. Who owns the P20,000?

ANS.: A owns the P20,000, but B shall keep the money as security in the same manner as the canned goods originally pledged.

- (b) Note that the sale under this Article must be a “*public sale*.” Note also that here the pledgee is *without fault*.

Art. 2109. If the creditor is deceived on the substance or quality of the thing pledged, he may either claim another thing in its stead, or demand immediate payment of the principal obligation.

COMMENT:

Rule if Creditor Is Deceived on the Substance or Quality of the Thing Pledged

The Article explains itself.

Art. 2110. If the thing pledged is returned by the pledgee to the pledgor or owner, the pledge is extinguished. Any stipulation to the contrary shall be void.

If subsequent to the perfection of the pledge, the thing is in the possession of the pledgor or owner, there is a *prima facie* presumption that the same has been returned by the pledgee. This same presumption exists if the thing pledged is in the possession of a third person who has received it from the pledgor or owner after the constitution of the pledge.

COMMENT:

(1) Return of Thing Pledged

A pledged with B a diamond ring to secure a loan of P100,000. It was agreed that after a week, B would return the ring although the debt would be paid only after one year. It was also agreed that although A would once more be in possession of the ring, the pledge would continue. After a week, B, as stipulated, returned the ring. Has the pledge been extinguished?

ANS.: Yes. (*Par. 1, Art. 2110*). The stipulation about the continuation of the pledge is VOID.

(2) When Thing Pledged Is Found in the Possession of the Pledgor or Owner

A pledged with *B* a *Mont Blanc-Meisterstuck* fountain pen. A week later, the pen was found in *A*'s possession. There is presumption here that *B* has returned the fountain pen and that therefore the pledge has been extinguished. May this presumption be rebutted?

ANS.: Yes, since the presumption is merely *prima facie*. For example, *B* may have returned the pen and asked that it be substituted; or a stranger may have stolen the pen, and given it to *A*. (*1st sentence, 2nd paragraph, Art. 2110*).

Art. 2111. A statement in writing by the pledgee that he renounces or abandons the pledge is sufficient to extinguish the pledge. For this purpose, neither the acceptance by the pledgor or owner, nor the return of the thing pledged is necessary, the pledgee becoming a depositary.

COMMENT:**(1) When Pledgee Renounces or Abandons the Pledge**

Example:

A pledged with *B* his diamond ring. *B* took possession of the ring. Later, although the principal obligation had not been paid, *B* wrote on a private document that he was renouncing the pledge. *A* did not accept this renunciation, and the ring remained in *B*'s possession. Has the pledge been extinguished.

ANS.: Yes. *B* in this case is no longer a pledgee, but a depositary, with the rights and obligations of a depositary. (*Art. 2111*).

(2) Form Needed — Statement in Writing

Notice that renunciation or the abandonment must be in writing. An oral waiver is not sufficient. But if the pledgee orally renounces the pledge, and returns the thing pledged to the pledgor, the pledge is thereby extinguished, not because of Art. 2111, but because of Art. 2110, first paragraph.

Art. 2112. The creditor to whom the credit has not been satisfied in due time, may proceed before a Notary Public to the sale of the thing pledged. This sale shall be made at a public auction, and with notification to the debtor and the owner of the thing pledged in a proper case, stating the amount for which the public sale is to be held. If at the first auction the thing is not sold, a second one with the same formalities shall be held; and if at the second auction there is no sale either, the creditor may appropriate the thing pledged. In this case he shall be obliged to give an acquittance for his entire claim.

COMMENT:

(1) Right of Creditor to Sell if Credit is Not Satisfied

Under Art. 2087, the law says that it is of the essence of the contract of pledge that when the principal obligation becomes due, the things in which the pledge consists may be alienated for the payment to the creditor.

(2) Formalities Required

- (a) The debt is already due.
- (b) There must be the intervention of a notary public.
- (c) There must be a public auction (if at the first, it is not sold, a second auction must be held with the same formalities).
- (d) Notice to debtor or owner stating the amount due, that is, the amount for which the public sale is to be held.

(3) Questions

- (a) Suppose at the first auction, the thing pledged is not sold, is the pledgee allowed to appropriate the thing for himself.

ANS.: No, because there must be a second auction.

- (b) Suppose at the second auction, the thing pledged is not sold, may the pledgee now appropriate the thing for himself?

ANS.: Yes. In this case, he shall be obliged to give an acquittance for his entire claim?

If he believes that the pledged thing is worth much more than the principal debt, should the pledgee give the excess?

ANS.: No. It is his right to get the whole value of the thing. (*Contrast with the rule in case it was sold.*) (Art. 2115). If the value happens to be less and the pledgee appropriates the thing for himself, is he entitled to any deficiency judgment?

ANS.: No. He is obliged to cancel the entire obligation. After all, why did he accept a pledge of something worth less than the principal obligation?

(4) Rule Under the Old Law

Art. 1859 of the old Civil Code (Art. 2088 of the new Civil Code) prohibits the creditor from appropriating to himself the things pledged or mortgaged, and from disposing of them; but this does not mean that a stipulation is prohibited whereby the creditor is authorized in case of non-payment within the term fixed by the parties to sell the thing mortgaged at public auction, or to adjudicate to himself the same, in case of failure of said sale, nor is there any reason whatever to prevent it; on the contrary, Art. 1872 (*now Art. 2112 of the new Civil Code*) expressly authorized this procedure in connection with pledge, even if it may not have been expressly stipulated. (*Resol. of the General Director of Registries of Jul. 12, 1901, 92 Jur. Civil 103*). This power to sell does not imply an appropriation thereof, but is merely a derivative of the authority granted the contracting parties. This is not against the law, since what the law prohibits is only the acquisition by the creditor of the property mortgaged, merely by reason of the non-payment of the debt, and the above-stated stipulation simply authorizes him to sell it with the aforesaid conditions, which authorization is inherent in ownership and is not against morals and public order. (*Decision of the Supreme Court of Spain on Oct. 21, 1902, 94 Jur. Civil 364*). Hence, a stipulation in a mortgage conferring a power of sale upon the mortgagee in default of payment is valid. (*El Hogar Filipino v. Paredes, 45 Phil. 178*).

(**NOTE:** Act 3135 allows the extrajudicial foreclosure of mortgages, but the procedure set forth therein must be followed. The creditor himself is *not* authorized to conduct the sale for the law itself provides that the sale shall be under the direction of the sheriff of the province, the justice or auxiliary justice of the peace of the municipality. The *El Hogar case* was decided prior to the passage of Act 3135. This Act is still in force.)

(5) Rule When Pledgee Is Expressly Authorized to Sell Upon Default

If in the contract of pledge, the pledgee is *authorized to sell upon default*, the requirements in this Article (Art. 2112) must be complied with; if the conditions of the sale are set forth already in the contract, Art. 2112 does *not* have to be observed. (See *Tan Chun Tic v. West Coast Life Ins. Co.*, 54 Phil. 361).

Art. 2113. At the public auction, the pledgor or owner may bid. He shall, moreover, have a better right if he should offer the same terms as the highest bidder.

The pledgee may also bid, but his offer shall not be valid if he is the only bidder.

COMMENT:

Right of Pledgor and Pledgee to Bid at the Public Auction

Example: A pledged his diamond ring with B. The debt was not paid on time, and a public auction took place. Can A bid? Can B bid?

ANS.: Yes, A can bid. Furthermore, he shall have a better right if he should offer the same terms as the highest bidder. *Reason for the preference:* after all, the thing belongs to him. Yes, B may also bid but his offer shall not be valid if he is the only bidder.

Art. 2114. All bids at the public auction shall offer to pay the purchase price at once. If any other bid is accepted, the pledgee is deemed to have received the purchase price, as far as the pledgor or owner is concerned.

COMMENT:**Nature of the Bids at the Public Auction**

The bids must be for CASH — for said bids “shall offer to pay the purchase price AT ONCE.” Even if a purchase on *installment* is accepted by the pledgee, the sale is still for cash — insofar as the pledgor or owner is concerned?

Art. 2115. The sale of the thing pledged shall extinguish the principal obligation, whether or not the proceeds of the sale are equal to the amount of the principal obligation, interest and expenses in a proper case. If the price of the sale is more than said amount, the debtor shall not be entitled to the excess, unless it is otherwise agreed. If the price of the sale is less, neither shall the creditor be entitled to recover the deficiency, notwithstanding any stipulation to the contrary.

COMMENT:**Rules if the Price At the Sale Is More or Less Than the Debt**

- (a) If the price at sale is MORE — excess goes to the creditor, unless the contrary is *provided*. (This is rather *unfair*, because the pledgor is the OWNER.)
- (b) If the price is LESS — creditor does NOT get the deficiency. A *contrary* stipulation is VOID.

Manila Surety and Fidelity Co., Inc. v. Velayo
L-21069, Oct. 26, 1967

FACTS: A debtor pledged to his surety piece jewelry to indemnify the latter in case it (the surety would be obliged to pay the creditors. The surety paid P2,800 to the creditors. To recover the amount, it at a public auction the jewels, but unfortunately received only P235. *Issue:* May the surety recover the deficiency from the debtor?

HELD: There can be no more recovery of deficiency, by express provision of Art. 2115. *Reason:* The surety (pledgee)

decided to avail himself of the remedy of foreclosure. Had he sued on the principal obligation (the P2,800), he could have recovered the deficiency.

Art. 2116. After the public auction, the pledgee shall promptly advise the pledgor or owner of the result thereof.

COMMENT:

Duty of Pledgee to Advise Pledgor or Owner of the Result of the Public Auction

The Article explains itself.

Art. 2117. Any third person who has any right in or to the thing pledged may satisfy the principal obligation as soon as the latter becomes due and demandable.

COMMENT:

Right of a Third Person to Pay the Debt

Example: A promised to give B a particular diamond ring if B should pass the bar. But because A needed money, he pledged the ring with C to secure a loan. When the debt becomes due and demandable, B, if he passed the bar, may pay the debt to C and thus get the diamond ring. C cannot refuse payment by B because B has a right in the thing pledged.

Art. 2118. If a credit which has been pledged becomes due before it is redeemed, the pledgee may collect and receive the amount due. He shall apply the same to the payment of his claim, and deliver the surplus, should there be any, to the pledgor.

COMMENT:

Pledge of a Credit That Later on Becomes Due

Example: A borrowed from B P100,000. This was secured by a negotiable promissory note made by X in favor of A to

the amount of P180,000. The negotiable promissory note was endorsed by *A* in *B*'s favor. If the note becomes due before it is redeemed, *B* can collect and receive the P180,000 from *X*, *B* should get P100,000 and deliver the surplus of P80,000 to *A*.

Art. 2119. If two or more things are pledged, the pledgee may choose which he will cause to be sold, unless there is a stipulation to the contrary. He may demand the sale of only as many of the things as are necessary for the payment of the debt.

COMMENT:

Rule if Two or More Things Are Pledged

The Article explains itself. Note, however, that there can be a stipulation to the contrary.

Art. 2120. If a third party secures an obligation by pledging his own movable property under the provisions of own movable property under the provisions of Article 2085 he shall have the same rights as a guarantor under articles 2066 to 2070, and Articles 2077 to 2081. He is not prejudiced by any waiver of defense by the principal obligor.

COMMENT:

Rule if a Third Person Pledges His Own Property to Secure the Debt of Another

The Article is self-explanatory.

Art. 2121. Pledges created by operation of law, such as those referred to in Articles 546, 1731, and 1994, are governed by the foregoing articles on the possession, care and sale of the thing as well as on the termination of the pledge. However, after payment of the debt and expenses, the remainder of the price of the sale shall be delivered to the obligor.

COMMENT:**(1) Pledges Created by Operation of Law**

- (a) This Article speaking of “pledges created by operation of law” refers to the *right of retention*.
- (b) Note that in this *legal* pledge, the remainder of the price shall be given to the *debtor*. This rule is different from that in Art. 2115.

(2) Samples

- (a) Art. 546 — refers to necessary and useful expenses
- (b) Art. 1731 — to work on a movable
- (c) Art. 1994 — refers to a depositary
- (d) Art. 1914 — (also legal pledge) — refers to the right of an *agent* to retain
- (e) Art. 2004 — (also a legal pledge) refers to the right of a hotel-keeper

(3) Query

If the property retained is real property, is this still a PLEDGE by operation of law?

Art. 2122. A thing under a pledge by operation of law may be sold only after demand of the amount for which the thing is retained. The public auction shall take place within one month after such demand. If, without just grounds, the creditor does not cause the public sale to be held within such period, the debtor may require the return of the thing.

COMMENT:**If Sale of Thing Pledged By Operation of Law**

Note that there is only ONE public auction here.

Art. 2123. With regard to pawnshops and other establishments, which are engaged in making loans secured by pledges, the special laws and regulations concerning them shall be observed, and subsidiarily, the provisions of this Title.

COMMENT:

Special Laws on Pawnshops, Etc.

The Article is self-explanatory.

Chapter 3

MORTGAGE

Art. 2124. Only the following property may be the object of a contract of mortgage:

- (1) Immovables;**
- (2) Alienable real rights in accordance with the laws, imposed upon immovables.**

Nevertheless, movables may be the object of a chattel mortgage.

COMMENT:

(1) ‘Real Mortgage’ Defined

It is a contract in which the debtor guarantees to the creditor the fulfillment of a principal obligation, subjecting for the faithful compliance therewith a real property in case of non-fulfillment of said obligation at the time stipulated. (12 *Manresa*, p. 460).

(2) Etymological Definition

Mortgage is derived from two French words, “mort” and “gage.” These are equivalent to the Latin terms *mortuum uadium*. The word “mort” means “dead” and the term “gage” means “pledge.” Thus, literally, a mortgage is a dead or unproductive pledge. (*Sturpe v. Kopp*, 201, No. 412, 99 S.W. 1703).

(3) Characteristics of a Real Mortgage

- (a) It is a real right.
- (b) It is an accessory contract.
- (c) It is indivisible.

- (d) It is inseparable.
- (e) It is real property.
- (f) It is a limitation on ownership.
- (g) It can secure all kinds of obligations.
- (h) The property cannot be appropriated.
- (i) The mortgage is a lien.

(4) Real Right

A mortgage binds a purchaser who knows of its existence or if the mortgage was registered. (*McCullough v. Veloso*, 46 *Phil.* 1).

(5) Accessory

If the principal obligation is VOID, the mortgage is also VOID. (*Reyes v. Gonzales*, [C.A.] 45 *O.G. No. 2*, p. 831). But if a mortgage is void because it was *not* made by the owner of the property, the principal contract of loan may still be valid. (*Nat. Bank v. Rocha*, 55 *Phil.* 496).

(6) Indivisible

A and B mortgaged their land in C's favor. While the mortgage debt was pending, A and B partitioned the land between them, and A paid his share of the debt. Is the mortgage on A's share of the land extinguished?

HELD: No, because a mortgage is indivisible. (*Grooves v. Senteel*, 153 *U.S.* 465 and See Art. 123, *Mortgage Law*).

(7) Inseparable

The mortgage adheres to the property, regardless of who its owner may subsequently be. (*McCullough v. Veloso*, 46 *Phil.* 1; Art. 105, *Mortgage Law*; Art. 126, *Civil Code*).

(8) Real Property

A mortgage on real property is *by itself* real property also. (Art. 415, *par. 10*, *Civil Code*).

(9) Limitation on Ownership

A mortgage *encumbers*, but does not *end* ownership; it may thus be foreclosed. (*McCullough v. Veloso*, 46 *Phil.* 1).

(10) Kinds of Real Mortgages

- (a) *Voluntary or Conventional* — created by the parties. (*Art. 138, Mortgage Law*).
- (b) *Legal Mortgage* — one required by law to guarantee performance. (*Art. 169, Mortgage Law*).
- (c) *Equitable Mortgage* — one which reveals an intent to make the property a security, even if the contract lacks the proper formalities of a real estate mortgage. (*See 41 C.J. 303*).

(11) ‘Real Mortgage’ Distinguished from ‘Pledge’

<i>REAL MORTGAGE</i>	<i>PLEDGE</i>
(a) constituted on real property. (<i>Art. 2124</i>).	(a) constituted on personal property. (<i>Art. 2094</i>).
(b) as a rule, mortgagor retains the property. (<i>Legaspi & Salcedo v. Celestial, supra</i>).	(b) pledgor must deliver the property to the creditor, or, by common consent, to a third person. (<i>Art. 2093</i>).
(c) not valid against third persons if not registered. (<i>Art. 2125</i>).	(c) not valid against third persons unless a description of the thing pledged and the date of the pledge appear in a public instrument. (<i>Art. 2096</i>).

(12) ‘Real Mortgage’ Distinguished from ‘Sale A Retro’

<i>REAL MORTGAGE</i>	<i>A RETRO SALE</i>
(a) made as security	(a) not security
(b) no transfer of ownership	(b) transfers ownership provided there is delivery

(c) no transfer of possession, generally	(c) generally, there is transfer of possession
(d) indivisible	(d) redemption can be partial. (<i>See Arts. 1612 and 1613</i>)
(e) applies only to real property	(e) applies to real or personal property

(13) ‘Real Mortgage’ Distinguished from ‘Chattel Mortgage’

<i>REAL MORTGAGE</i>	<i>CHATTEL MORTGAGE</i>
(a) constituted on immovables	(a) on movables
(b) may guarantee <i>future</i> obligations	(b) <i>cannot</i> guarantee <i>future</i> obligations

(14) Non-Possession By Mortgagee of the Property Mortgaged

A mortgagee usually does NOT possess the land mortgaged; however, even if he does possess it, say, by agreement, he cannot acquire the property by prescription, for his possession is *not* in the concept of an owner. (*Daoare v. Aglutay, et al., CA, L-16114-R, Oct. 20, 1956*). And even if the obligation is not paid at maturity, the mortgagee cannot appropriate the property for himself. Any stipulation to the contrary is prohibited. (*Rosa Naval, et al. v. Genaro Homeres, CA, L-19482-R, May 30, 1959*).

(15) Mortgages Given to Secure Future Advancements

**Mojica v. CA
GR 94247, Sep. 11, 1991**

FACTS: The real estate mortgage expressly stipulates that it serves as guaranty “for the payment of the loan of P20,000

and such other loans or other advances already obtained or still to be obtained by the mortgagors as makers.”

HELD: Mortgages given to secure future advancements are valid and legal contracts. The amounts named as consideration in said contract do not limit the amount for which the mortgage may stand as security if from the four corners of the instrument the intent to secure future and other indebtedness can be gathered. Where the annotation on the back of a certificate of title about a first mortgage states “that the mortgage secured the payment of a certain sum of money plus interest plus other obligations arising thereunder” there is no necessity for any notation of the later loans on the mortgagors’ title. It is incumbent upon any subsequent mortgagee or encumbrancee of the property in question to examine the books and records of the bank, as first mortgage, regarding the credit standing of the debtors.

(16) Some Cases

Prudencio v. CA GR 34539, Jul. 14, 1986

The mortgage cannot be separated from the promissory note for it is the latter which is the basis of determining whether the mortgage should be cancelled. Without the promissory note which determines the amount of indebtedness there would be no basis for the mortgage.

Prudential Bank v. Panis GR 50008, Aug. 31, 1987

FACTS: In 1971, FAM secured a loan from BANK. To secure its payment, FAM executed in favor of BANK a real estate mortgage over a 2-storey, semi-concrete building. The property conveyed by way of mortgage includes the right of occupancy on the lot where the mortgaged building is erected. The BANK knew that FAM had already filed a sales application patent over the lot. The mortgage was registered under the provision of Act 3344. In May, 1973, FAM secured an additional loan from BANK. To secure its payment, FAM executed in favor of the BANK another deed of real estate

mortgage over the same properties previously mortgaged. In Apr. 1973, the Secretary of Agriculture issued the same patent over the land, the possessory rights over which were mortgaged to BANK. When FAM failed to pay the debt, the deeds of mortgage were foreclosed extrajudicially. The BANK bought the property as the highest bidder. The trial court declared as void the deeds of real estate mortgage in favor of BANK.

ISSUE: May a valid real estate mortgage be constituted on the building erected on the land belonging to another?

HELD: On petition for *certiorari*, the Supreme Court modified the trial court's judgment by declaring the mortgage for the first loan valid, but ruling that the mortgage for the additional loan void, without prejudice to any appropriate action, the Government may take against FAM. While it is true that mortgage of land necessarily includes, in the absence of stipulation of the improvements thereon, buildings, still a building by itself may be mortgaged apart from the land on which it has been built. Such a mortgage would still be a real estate mortgage, for the building would still be considered immovable property even if dealt with separately and apart from the land. In the same manner, possessory rights over said properties before title is vested on the grantee, may be validly transferred or conveyed as in a deed of mortgage.

The original mortgage was executed before the issuance of the final patent and before the government was divested of its title to the land, an event which takes effect only on the issuance of the sales patent and its subsequent registration in the Office of the Register of Deeds. Hence, the mortgage executed by FAM on his own building erected on the land belonging to the government is to all intents and purposes a valid mortgage. The restrictions expressly mentioned on FAM's title (Secs. 121, 122 and 124, Public Land Act) refer to land already acquired under the Public Land Act, or any improvement thereon. Hence, they have no application to the assailed mortgage which was executed before such eventuality. Likewise, Section 2 of Republic Act 730, also a restriction appearing on the face of FAM's title has no application, despite its reference to encumbrance or alienation before the patent is issued because it refers specifically to encumbrance or alienation on the land itself and does not mention

anything regarding the improvements existing thereof. But it is a different matter, as regards the second mortgage for additional loan, which mortgage was executed after the issuance of the sales patent and of the original certificate of title. This falls squarely under the prohibitions stated in Sections 121, 122 and 124 of the Public Land Act and Section 2 of Republic Act 730, and is, therefore, void.

Pari delicto may not be invoked to defeat the policy of the State. Neither may the doctrine of estoppel validate a void contract. As between parties to a contract, validity cannot be given to it by estoppel if it is prohibited by law or is against public policy. No citizen is competent to barter away what public policy by law seeks to preserve. This pronouncement covers only the previous transaction already alluded to and does not pass upon any new contract between the parties. It should not preclude new contracts that may be entered into between BANK and FAM that are in accordance with the requirements of law. But any new transaction would be subject to whatever steps the government may take for the reversion of the land in its favor.

Serfino v. CA
GR 40868, Sep. 15, 1987

FACTS: A parcel of land patented in the name of Casamayor was sold for Nemesia Baltazar. Nemesia sold the same lot to Lopez Sugar Central. In 1956, the land was sold at public auction by the Provincial Treasurer for tax delinquency. Notice of the public auction was sent to Casamayor but none to Nemesia or the Lopez Sugar Central. The land was sold to Serfino as the highest bidder. After the transfer certificate of title had been issued in the name of Serfino, he declared the property in his name, continuously paid the taxes and introduced improvements thereon. Under these circumstances, the PNB extended a loan to Serfino secured by the land in question on the strength of the title in the name of Serfino and after a spot investigation by one of the fact inspectors who made a report of his investigation. After the execution of a real estate mortgage in favor of the PNB duly annotated on Serfino's certificate of title, the bank loaned Serfino P5,000. The Bank relied on the certificate of title, the genuineness of which is not in issue.

In a suit filed by the Lopez Sugar Central, the trial court declared the tax sale void for lack of notice of the same to the actual owner, and ordered the cancellation of Serfino's title, but declared the mortgage valid and ordered Lopez Sugar Central to pay the PNB the amount secured by the mortgage. The Court of Appeals modified the judgment by nullifying the mortgage in favor of the PNB and exempted Lopez Sugar Central from paying the PNB, the amount of the mortgage loan.

HELD: The mortgagee bank had every right to rely on the transfer certificate of title as it was a sufficient evidence of ownership of the mortgagor. At the time the mortgage was executed, it has no way of knowing the existence of another genuine title covering the same land in question. The fact that the public auction sale of the disputed property was not valid (for lack of notice of the auction sale to the actual owner) can not in anyway be attributed to the mortgagee's (PNB's) fault. The PNB is entitled to the payment of the mortgage loan.

Danao v. CA
GR 48276, Sep. 30, 1987

For non-payment of a note secured by mortgage, the creditor has a single cause of action against the debtor. This single cause of action consists in the recovery of the credit with execution of the security. The creditor in his action may make two demands, the payment of the debt and the foreclosure of the mortgage. But both demands arise from the same cause, the non-payment of the debt and for that reason, they constitute a single cause of action. Though the debt and the mortgage constitute separate agreements, the latter is subsidiary to the former and both refer to one and the same obligation.

A mortgage creditor may elect to waive his security and bring, instead, an ordinary action to recover the indebtedness with the right to execute a judgment on all the properties of the debtor, including the subject matter of the mortgage, subject to the qualification that if he fails in the remedy by him elected, he cannot pursue further the remedy he has waived. He may institute against the mortgage debtor a personal ac-

tion for debt or a real action to foreclose the mortgage. He may pursue either of the two remedies, but not both.

(17) A Mortgage Is An Accessory Contract

This is because the consideration of which is the same for the principal contract without which it cannot exist as an independent contract. (*Ganzon, et al. v. Hon. Inserto, et al.*, 208 *Phil.* 630 [1983]).

**Philippine National Bank v. CA, Spouses Antonio
So Hu & Soledad del Rosario and Spouses
Mateo Cruz & Carlita Ronquillo
GR 126908, Jan. 16, 2003**

FACTS: PNB's application for foreclosure, filed on Jul. 15, 1985, was based on the Spouses Cruz's third mortgage deed. However, Spouses So Hu had already paid on Mar. 18, 1983 the principal obligation secured by the third mortgage.

HELD: Foreclosure is only valid where the debtor is in default in the payment of his obligation. In the instant case, PNB foreclosed the third mortgage even when the obligation, the Third Loan, secured by the mortgage has been completely paid prior to the foreclosure.

Obviously, the property could no longer be foreclosed to satisfy an extinguished obligation. Since the full amount of the Third Loan was paid as early as Mar. 18, 1983, extinguishing the loan obligation under the principal contract, the mortgage obligation under the accessory contract has likewise been extinguished.

(18) Ship Mortgage

**Nordic Asia, Ltd. (now known as DNC Limited)
& Bankers Trust Co. v. CA, et al.
GR 111159, Jun. 30, 2003**

FACTS: Petitioners Nordic Asia Ltd. and Bankers Trust Co. loaned \$5.3 Million to Sextant Maritime, S.A. to buy a vessel, the M/V Fylyppa. As security for payment of the loan,

the borrower mortgaged the vessel and when it could not pay, petitioners instituted extrajudicial foreclosure proceedings under Sec. 14 of PD 1521, otherwise known as the Ship Mortgage Decree of 1978.

As part of said proceedings, petitioners filed with the Pasay RTC a petition for issuance of an arrest order against the vessel. At the same time, crew members, herein respondents, filed a case against the vessel for collection of their unpaid wages, overtime pay, allowances, and other benefits due them with the Manila RTC. Both trial courts (Pasay and Manila) issued warrants against the vessel.

Petitioners subsequently filed a motion to intervene with the Manila RTC solely for the purpose of opposing the claim of crew members. Petitioners averred that by reason of their mortgage lien, they are so situated as to be adversely affected by the collection case. Notwithstanding respondents' opposition, the motion was granted. *Issue*: Can the mortgagee of a vessel intervene in a case filed by crew members of the vessel for collection of their unpaid wages?

HELD: No, intervention is improper. Since petitioners did not own the vessel, but merely held a mortgage lien over it, whatever judgment rendered in the collection case against the vessel would not be of such direct and immediate character that petitioners would either gain or lose by direct legal operation and effect of judgment of the Manila RTC.

Requirements for intervention are the following:

1. It must be shown that movant has legal interest in the matter of litigation. Interest which entitles a person to intervene in a suit between other parties must be in the matter of litigation and of such direct and immediate character that intervenor will either gain or lose by direct legal operation and effect of judgment. Otherwise, if persons not parties to the action were allowed to intervene, proceedings would become unnecessarily complicated, expressive, and interminable — and this would be against the policy of the law. The words, “an interest in the subject,” mean a direct interest in the cause of action as pleaded, one that would put intervenor in a legal position to litigate a fact alleged in the

complaint without establishment of which plaintiff could not recover.

2. Consideration must be given as to whether adjudication of rights of original parties may be delayed or prejudiced, or whether or not intervenor's rights may be protected in separate proceedings.

Art. 2125. In addition to the requisites stated in Article 2085, it is indispensable, in order that a mortgage may be validly constituted, that the document in which it appears be recorded in the Registry of Property. If the instrument is not recorded, the mortgage is nevertheless binding between the parties.

The persons in whose favor the law establishes a mortgage have no other right than to demand the execution and the recording of the document in which the mortgage is formalized.

COMMENT:

(1) Questions Re an Unrecorded Mortgage

Is an unrecorded mortgage?

- (a) effective against innocent third parties?
- (b) effective, valid, and binding between the parties themselves?

ANS.:

- (i) Under the old and new Civil Code, an unrecorded mortgage is not effective against innocent third parties.
- (ii) Under Art. 1875 of the old Civil Code, an unrecorded mortgage was not effective, valid, and binding even between the contracting parties themselves. (*Art. 1875, old Civil Code; Julian v. Lutero, 49 Phil. 703*). But an unrecorded mortgage on land, which were not registered either under the Torrens system or under the Spanish Mortgage Law, was valid, binding, and effective between the parties. (*Matute v.*

Banzali, 62 Phil. 256). Under the new Civil Code, however, even if the mortgage is not recorded, the mortgage (whether land is registered under the Torrens System, Spanish Mortgage Law, or not at all registered is nevertheless binding between the parties. (Art. 2125, new Civil Code).

Reyes v. De Leon
GR 22331, Jun. 6, 1967

FACTS: The owner of a house sold it *a retro* at a very low price with the stipulation that if not paid or redeemed at the time stipulated, the right to redeem would be forfeited and ownership would automatically pass to the buyer. The period was later extended. During this period, the owner mortgaged the property to another person. This mortgagee recorded the mortgage under Act 3344. The buyer *a retro* brought this action for consolidation of the *a retro* transaction. But the mortgagee intervened stating that his right should prevail.

HELD: The intervenor should prevail. The 1st transaction is actually an equitable mortgage in view of the grossly inadequate price and the *pactum commissorium* (as the automatic transfer of ownership). As between the 2 mortgages, the latter one should prevail, for it was recorded, while the equitable mortgage was not. Be it noted that the second mortgagee was a mortgagee in good faith.

Tan v. Valdehueza
L-38745, Aug. 5, 1975

Even if not registered in the Registry of Property, a mortgage is valid between the parties and the mortgagee has the right to foreclose the mortgage, as long as no innocent third parties are involved.

(2) Comment of the Code Commission

“An additional provision is made that if the instrument of mortgage is not recorded, the mortgage is nevertheless

binding between the parties.” (*Report of the Code Commission*, p. 159).

(3) Effect of a Signed Mortgage

Once a mortgage has been signed in due form, the mortgagee is entitled to its registration as a matter of right. By executing the mortgage, the mortgagor is understood to have given his consent to its registration, and he cannot be permitted to revoke it unilaterally. The validity and fulfillment of contracts cannot be left to the will of one of the contracting parties. (*Gonzales v. Basa, et al.*, 73 Phil. 704). And the legal presumption of sufficient cause or consideration supporting a contract, even if such cause is not stated therein, cannot be overcome by a simple assertion of lack of consideration. (*Samanilla v. Cajucum, et al.*, L-13683, Mar. 31, 1960).

(4) Rule in Case of Legal Mortgages

In case of legal mortgages (where the law establishes a mortgage in favor of certain persons) the persons entitled have no other right than to demand the execution and the recording of the document in which the mortgage is formalized. This is in conformity with the rule established under the law on Form of Contracts which reads: “If the law requires a document of some other special form, the contracting parties may compel each other to observe that form, once the contract had been perfected. This right when exercised simultaneously with the action upon the contract is valid and enforceable.”

(5) Effect of Registration

A mortgage, whether registered or not is binding between the parties, registration being necessary only to make the same valid against third persons. In other words, registration only operates as a notice of the mortgage to others, but neither adds to its validity nor convert an invalid mortgage into a valid one between the parties. If the purpose of registration is merely to give notice, the question regarding the effect or invalidity of instrument, are expected to be decided AFTER, not *before* registration. It must follow as a necessary consequence that registration must first be allowed and the validity

or the effect litigated afterwards. (*Samanilla v. Cajucum, et al.*, L-13683, Mar. 31, 1960).

Art. 2126. The mortgage directly and immediately subjects the property upon which it is imposed, whoever the possessor may be to the fulfillment of the obligation for whose security it was constituted.

COMMENT:

(1) Meaning of Property Being Subjected to the Mortgage

The Article simply means that a mortgage is a real right following the property. Therefore, if a mortgagor sells the property, the buyer must respect the mortgage (if registered, or if he knows of its existence).

(2) Non-Responsibility of Buyer for the Deficiency

If in the above example, the creditor forecloses the mortgage, the buyer will not be responsible for the *deficiency, if any*, for the encumbrance is only on the property itself. The exception of course would be in the case of *novation*, where all the parties consent to the buyer's assumption of personal liability. (*See McCullough and Co., Inc. v. Veloso and Serna*, 46 Phil. 1).

(3) Applicability of the Article Even if the Mortgagor Is Not the Principal Debtor

Art. 2126 applies even if the mortgagor is NOT the principal debtor. (He, for example, mortgaged the property to guarantee another's debt.) (*Lack v. Alonzo*, 14 Phil. 630).

(4) Transfer of Property to Another

If a mortgagor, *without* the creditor's consent, transfers the *property and the debt* to another, the mortgagor would still be personally liable, for the attempted novation here would not be valid in view of the lack of consent on the part of the creditor. On the other hand, the mortgage on the property

can still be foreclosed upon, in view of the real nature of a mortgage. (*See Angelo v. Dir. of Lands*, 49 Phil. 838 and *McCullough & Co., Inc. v. Veloso & Serna*, 46 Phil. 1).

Art. 2127. The mortgage extends to the natural accessions, to the improvements, growing fruits, and the rents or income not yet received when the obligation becomes due, and to the amount of the indemnity granted or owing to the proprietor from the insurers of the property mortgaged, or in virtue of expropriation for public use, with the declarations, amplifications and limitations established by law, whether the estate remains in the possession of the mortgagor, or it passes into the hands of a third person.

**Ganzon v. Judge Sancho
GR 56450, Jul. 25, 1983**

A mortgage lien is considered inseparable from the property inasmuch as it is a right *in rem*.

If the mortgage be replaced by a surety bond, the lien would be converted into a right *in personam*. Naturally, the mortgagee's rights under the mortgage would be diminished.

COMMENT:

(1) Objects to Which a Mortgage Extends

Example:

A mortgage on the land includes *present* and *future* houses thereon, unless the houses are exempted by express stipulation. (*See Bischoff v. Pomar & Cia General de Tabacos*, 12 Phil. 690; *Berkenkotter v. Cu Unjieng*, 61 Phil. 663).

(2) Some Doctrines

- (a) "Growing fruits" naturally should exclude those already harvested before the obligation falls due. (*See Afable v. Belando*, 55 Phil. 64).
- (b) If equipment on a mortgaged land is temporarily removed, the mortgage continues on said equipment. (*Serra v. Nat'l. Bank*, 45 Phil. 907).

- (c) Land, with an old house, was mortgaged. Later, the house was replaced by a new and more expensive one. In the absence of a contrary stipulation, the new house is covered by the mortgage. (*Phil. Sugar Estate Dev. Co. v. Campos*, 36 *Phil.* 85).
- (d) Under the old Code, a mortgage lien on the fruits of the land may be defeated by the *superior* lien given to the person who advanced credit for the seeds and expenses of cultivation and harvesting. (*Par. 11, Art. 2241; Serra v. Nat'l. Bank*, 45 *Phil.* 907). It would seem, however, from Arts. 2246 and 2247 of the new Civil Code that now, the preference has ceased, and the credit will have to be apportioned *pro rata*.

(3) Fruits of the Land Mortgaged

Fruits, already gathered, of the land mortgaged should NOT be applied to the payment of the principal obligation, unless there is a stipulation to this effect. (*Araniego, et al. v. Bernardino, et al.*, C.A., L-20192-R, May 30, 1959). Note, however, that under the Article, the mortgage extends to GROWING FRUITS.

Art. 2128. The mortgage credit may be alienated or assigned to a third person, in whole or in part, with the formalities required by law.

COMMENT:

(1) Alienation of the Mortgage Credit

The mortgage credit (the right of the mortgagee) may be alienated or assigned, in whole or in part. This is because the mortgagee is the owner of said right.

(2) Effect if Alienation of the Mortgage Credit Is Not Registered

Even if the alienation is *not* registered, it would still be valid as between the parties. Registration is needed only to affect third parties. (*Lopez v. Alvarez*, 9 *Phil.* 28).

Art. 2129. The creditor may claim from a third person in possession of the mortgaged property, the payment of the part of the credit secured by the property which said third person possesses, in the terms and with the formalities which the law establishes.

COMMENT:

(1) Right of Creditor to Go Against Possessor of Property Mortgaged

This means that the mortgage creditor can demand from any possessor of the mortgaged property the credit insofar as it can be obtained from the property itself. Of course, a *prior* demand must have been made on the debtor, and said debtor failed to pay. (*See McCullough & Co. v. Veloso & Serna*, 46 *Phil.* 1).

(2) Example

Marcial mortgaged his land to Rodrigo to obtain a debt of P100,000. Marcial then sold the land to Alfredo. When the debt falls due, Rodrigo may demand payment from Marcial; and if Marcial fails to pay, Rodrigo may now demand from Alfredo. If Alfredo does not pay, the mortgage may be foreclosed. Of course, if there is a deficiency, Alfredo cannot be held liable for such deficiency, in the absence of a contrary stipulation. (*See Bank of the P.I. v. Concepcion & Hijos, Inc.*, 53 *Phil.* 806).

Fernandez v. Aninias
57 Phil. 737

FACTS: Adecendent in his lifetime had mortgaged his land in favor of Y. The estate was then distributed among the heirs, one of which was W, who received for his part the land subject to the mortgage. If Y decides to foreclose, does he have to bring the action against the executor and other heirs also, or against W alone?

HELD: Against W alone, because it was he to whom said mortgaged property had been allotted.

Art. 2130. A stipulation forbidding the owner from alienating the immovable mortgaged shall be void.

COMMENT:

(1) Stipulation Forbidding Owner to Alienate

The Article explains itself.

(2) Reason for the Law

“Such a prohibition would be contrary to the public good, inasmuch as the transmission of property should not be unduly impeded.” (*Report of the Code Commission, p. 58*).

(3) Bar Question

May the parties to a mortgage of a house and lot validly stipulate that during the period of mortgage, the mortgagor may not sell the mortgaged property? Reason.

ANS.: No, for such a stipulation is void under Art. 2130 of the Civil Code, being contrary to public policy.

(4) Stipulation Requiring Prior Consent of Mortgagee

A stipulation wherein the mortgagor is required to get the consent of the mortgagee before subsequently mortgaging the property is valid and binding when the land is registered under the Torrens system. But if the property was originally registered under the Spanish Mortgage Law, then such a stipulation is not valid and may be disregarded by the mortgagor. (*Philippine Industrial Co. v. El Hogar Filipino, 43 Phil. 336*).

**Bonnevie v. Court of Appeals
GR 49101, Oct. 24, 1983**

FACTS: A mortgagor sold his mortgaged lot to a buyer without the consent of the mortgagee (the contract required said consent). The buyer assumed the mortgage, also without the mortgagee’s knowledge and consent. If later, both the mortgagor and the buyer offer to redeem the property by paying the debt, whose offer must the mortgagee accept?

HELD: The offer of the mortgagor, not the offer of the buyer whose purchase and whose assumption of mortgage had not been authorized by the mortgagee.

(5) Second Mortgage

If the making of a second mortgage, except with the written consent of the mortgagee is prohibited, and the contract states the penalty for such a violation, namely, "the violation gives the mortgagee the right to immediately foreclose the mortgage," the violation does not give the first mortgagee the right to treat the second mortgage as null and void. (*Sim Janco v. Bank of the Phil.*).

Art. 2131. The form, extent and consequences of a mortgage, both as to its constitution, modification and extinguishment, and as to other matters not included in this Chapter, shall be governed by the provisions of the Mortgage Law and of the Land Registration Law.

COMMENT:

(1) What Special Laws Govern

The Article explains itself.

(2) Upset Price

A stipulation in a contract which fixes a *tipo* or *upset price*, at which the property will be sold at a foreclosure proceedings is *null* and *void*. This stipulation violates Sec. 3, Rule 70 of the Rules of Court (now Rule 68) which provides that the property mortgaged should be sold to the highest bidder. Hence, even if the contract contains such a stipulation, the sale of the property must take place, and the property should be awarded to the highest bidder. (*Bank of the Philippines v. Yulo*, 31 Phil. 472).

(3) Insurance

The mortgagee and the mortgagor both have insurable interest in the property, and therefore they may insure the

same. (*See San Miguel Brewery v. Law Union & Rock Ins. Co.*, 40 Phil. 647).

(4) ‘Equity of Redemption’ Distinguished from ‘Right of Redemption’

- (a) *Equity of redemption* — This is the right of the mortgagor to redeem the mortgaged property after his default in the performance of the conditions of the mortgage but *before* the sale of the mortgaged property.

[**NOTE:** Under the Rules of Court, the mortgagor may exercise his equity of redemption at any time before the judicial sale is confirmed by the court. (*Raymundo v. Sunico*, 25 Phil. 365)].

- (b) *Right of redemption* — This is the right of the mortgagor to purchase the property within a certain period *after* it was sold for the purpose of paying the mortgage debt.

Rosales v. Yboa
GR 42282, Feb. 28, 1983

(1) If a mortgage on real property is foreclosed but the buyer at the auction sale does not pay the real property taxes during the period of redemption, how will this affect the mortgage redemption? The non-payment of the realty taxes will *not* affect the validity of the mortgage redemption.

(2) The interest on the amount for redemption is computed from the *date of registration* of the sale of the property at the foreclosure proceedings, and not from the date of the sale itself.

IFC Service Leasing and Acceptance
Corporation v. Venancio Nera
L-21720, Jan. 30, 1967

FACTS: A mortgagee (the IFC Service Leasing and Acceptance Corporation) filed with the Sheriff's office a verified petition for the extrajudicial foreclosure of the mortgage. On Oct. 27, 1961, after notice and publication,

the property (consisting of a house and lot) was sold to the Corporation as highest bidder (for P28,451.77.) One year later (Oct. 27, 1962), the period of redemption having expired (Oct. 27, 1962), the ownership of the property was consolidated in the name of the Corporation, to which a new title (Transfer Certificate of Title 65575) was issued. If the mortgagee now wants to obtain possession of the property, does it have to institute a regular action for its recovery, or is it enough to ask for a writ of possession?

HELD: It is enough to ask for a writ of possession. Sec. 35 of Rule 39 of the Revised Rules of Court expressly states that “if no redemption be made within 12 months after the sale, the purchaser, or his assignee, is entitled to a *conveyance* and *possession* of the property. The *possession* of the property shall be given to the purchaser or last redemptioner by the same officer unless a third party is actually holding the property adversely to the judgment debtor.” In fact, there is no law in this jurisdiction whereby the purchaser at the sheriff’s sale of *real property* is obliged to bring a separate and independent suit for possession after the one-year period of redemption has expired and after he had obtained the sheriff’s certificate of title. (*Tan Soo Huat v. Ongwico*, 63 Phil. 746). The case of *Luna v. Encarnacion*, 91 Phil. 531, does *not* apply because said case involved the extrajudicial foreclosure of a *chattel mortgage*. Moreover, if under Sec. 7 of Act 3135 (as amended by Act 4118), the court has the power, on the *ex parte* application of the purchaser, to issue a writ of possession *during the period of redemption*, there is no reason why it should not also have the *same power* after the expiration of that period, especially where, as in this case, a new title has already been issued in the name of the purchaser.

Lonzame v. Amores
L-53620, Jan. 31, 1985

(1) If as a result of a mortgage, the real estate is sold at a public auction, there can be no redemption of the property after the sale has been *confirmed* by the

court. And such confirmation retroacts to the date of the auction sale.

(2) After the confirmation, the previous owners lose any right they may have had over the property, which rights are in turn vested on the purchaser of the property.

**Concha, et al. v. Hon. Divinagracia
L-27042, Sep. 30, 1981**

Co-possessors of a parcel that is mortgaged must be made parties to foreclosure proceedings; otherwise, they cannot be deprived of possession of that portion of the land actually possessed by them.

**Pedro Dimasacat and Ernesto Robles
v. The Court of Appeals, et al.
L-26575, Feb. 27, 1969**

FACTS: Rafael O. Lagdameo mortgaged with the Philippine National Bank contiguous parcels of land with an approximate area of 7,236 square meters situated in Quezon Province.

Later, Lagdameo sold to Ernesto Robles 250 square meters (undivided), and to Pedro Dimasacat 381 square meters (also undivided) of the parcels of land involved. The two sales were not *registered*. Upon Lagdameo's failure to pay, the PNB foreclosed the mortgage. Within the one-year period of redemption, however, Robles and Dimasacat wanted to redeem the ENTIRE lot (7,236 square meters) from the Bank, in view of their fear that Lagdameo had no money with which to effectuate the redemption. Because of the PNB's refusal, the two buyers sued both the PNB and Lagdameo. In the meantime, Lagdameo was able to redeem the entire lot, without prejudiced however, to the pending suit that had been brought by the two buyers.

ISSUES:

- (a) Could the two buyer (Robles and Dimasacat) redeem the *entire* lot?

- (b) Now that Lagdameo has redeemed the property, what are the rights of Robles and Dimasacat?

HELD:

- (a) The two buyers could redeem only the shares they had bought from Lagdameo, not the entire lot. (*See in this connection Magno v. Viola, 61 Phil. 80*).
- (b) Since Lagdameo has already redeemed the entire lot (the sales in favor of Robles and Dimasacat) the three (Lagdameo, Robles, and Dimasacat) should be considered as CO-OWNERS, to the extent of their respective shares, without prejudice to the right to effectuate a physical partition eventually.

Gorospe v. Santos
L-30079, Jan. 30, 1976

FACTS: A mortgage of registered land was extrajudicially foreclosed on Mar. 10, 1960 when the property was purchased at the public auction by a buyer, but the certificate of sale was registered only on Oct. 20, 1960. From what moment does the one-year period of redemption start — from the sale, or from the registration of the sale?

HELD: The one-year redemption period must be counted from the time of the *registration of the sale*, in order that delinquent registered owners or notice produced by the act of registration.

Development Bank of the Philippines
v. Mirang
L-29130, Aug. 8, 1975

If a mortgagor desires to redeem his property after the same has been sold at public auction (extrajudicial foreclosure) he should pay the *amount of the loan* at the time such sale was made, and not just the price at which the property was sold. This is because, if the property be sold at less than

the amount of the indebtedness, the mortgagee is entitled to recover the deficiency. Be it noted that a mortgage is a security, not the satisfaction by itself of an obligation. What is extinguished by foreclosure is indeed not the loan (for here, there was only partial performance), but only the mortgage lien. Thus under the law, in the absence of a provision in Act 3135 prohibiting recovery of the deficiency after an extrajudicial foreclosure of a real estate mortgage, the mortgagee is as of right, entitled to recover the deficiency.

**In Re Petition for the Cancellation
of Encumbrances Appearing in Transfer
Certificates of Title Nicanor T. Santos,
petitioner
L-27358, Feb. 20, 1981**

The CFI (now RTC), acting as a land registration court, CANNOT in summary proceedings under Sec. 112 of the Land Registration Law cancel encumbrances on TCTs (like an attachment lien and the first mortgage, both of which are alleged to have prescribed). There should be adversary proceedings in an ordinary civil action. If in this case there had *previously* been such an ordinary civil action, summary proceedings under Sec. 112 can be allowed.

**Bonnevie v. Court of Appeals
GR 49101, Oct. 24, 1983**

Act 3135 (re extrajudicial foreclosure of a mortgage) requires publication of the notice once a week for three consecutive weeks. This does not require a period of three full weeks.

Thus, a publication on Jun. 30, Jul. 7, and Jul. 14 satisfies the requirement although only 14 days have actually elapsed from the first to the third publication.

Gravina v. CA
220 SCRA 178
1993

Section 3 of Act 3135 (Mortgage Law) requires only the posting of the notices of sale in three public places and publication of the same in a newspaper of general circulation.

Hi-Yield Realty, Inc. v. CA, etc.
GR 138978, Sep. 12, 2002

FACTS: In compliance with an order, petitioner submitted to the trial court a detailed computation of the total redemption price as of Mar. 17, 1994. Private respondent received his copy on Mar. 24, 1994. Private respondent received his copy on Mar. 24, 1994 and, therefore, had until Apr. 8, 1994 to pay the redemption price in full. He, however, failed to pay it by that date. Instead, on Apr. 8, 1994, private respondent filed an “Urgent Motion for Extension of Time” with the trial court asking for an extra time of 45 days within which to pay the redemption price. He reasoned out that his debtor to augment his cash on hand and that he was then waiting for a bank loan for P150,000. Private respondent simply did not have sufficient money to tender; he experienced difficulty in raising the money to redeem the foreclosed property. *Issue:* Is financial hardship a ground to extend the period of redemption?

HELD: No. While respondent may have elicited the sympathy of the trial court, the Supreme Court, on its part, ruled that it cannot, however, be blind to the rights of petitioner. For it was serious error to make the final redemption of the foreclosed property dependent on the financial condition of private respondent.

After all, the opportunity to redeem the subject property was never denied to private respondent. His timely formal offer thru judicial action to re-

deem was likewise recognized. But that is where it ends. Every succeeding motion or petition cannot be sanctioned and granted, especially if frivolous or unreasonable — filed by him because this would manifestly and unreasonably delay the final resolution of ownership of the subject property.

The Supreme Court said it “cannot be clearer on this point: as a result of the trial court’s grant of a 45-day extended period to redeem almost 9 years have elapsed with both parties’ claims over the property dangling in limbo, to the serious impairment of petitioner’s rights,” thus, it “cannot help but call the trial court’s attention to the prejudice it has unwittingly caused the petitioner. It was really all too simple. The trial court should have seen, as, in fact, it had already initially seen, that the 45-day extension sought by private respondent on Apr. 8, 1994 was just a play to cover up his lack of funds to redeem the foreclosed property.”

(5) Redemption Price When DBP Is Mortgagee

Development Bank of the Phils. v. West Negros College, Inc. GR 152359, Oct. 28, 2002

FACTS: Redemption of properties mortgaged with the Development Bank of the Philippines (DBP) and foreclosed either judicially or extrajudicially is governed by special laws which provide for payment of all amount owed by debtor. This special protection given to DBP is not accorded to judgment creditors in ordinary civil actions. *Issues:* (1) How much should a mortgagor pay to redeem a real property mortgaged to and subsequently foreclosed by DBP?; and (2) Must he pay the bank the entire amount he owed the latter on date of sale with interest on total indebtedness at agreed rate on the obligation, or is it enough for purposes of redemption that he reimburse the amount of purchase with 1% monthly interest thereon, including other expenses defrayed by purchases at the extrajudicial sale?

HELD: (1) Where real property is mortgaged to and foreclosed judicially or extrajudicially by DBP, the right of redemption may be exercised only by paying to DBP all the amount owed by borrower on date of sale, with interest on total indebtedness at rate agreed upon in the obligation from said date unless bidder has taken material possession of the property or unless this has been delivered to him, in which case proceeds of the property shall compensate interest. This rule applies whether the foreclosed property is sold to DBP or another person at public auction, provided, of course, the property was mortgaged to DBP.

(2) Where property is sold to persons other than mortgagee, the procedure is for DBP in case of redemption to return to bidder the amount it received from him as a result of the auction sale with corresponding interest by the debtor.

The foregoing rule is embodied consistently in the charter of DBP (RA 2081) and its predecessor agencies — Agricultural and Industrial Bank (AIB) (RA 459) and Rehabilitation Finance Corp. (RFC) (RA 85).

Chapter 4

ANTICHRESIS

Art. 2132. By the contract of antichresis the creditor acquires the right to receive the fruits of an immovable of his debtor, with the obligation to apply them to the payment of the interest, if owing, and thereafter to the principal of his credit.

COMMENT:

(1) ‘Antichresis’ Defined

The Article defines “antichresis.”

(2) Characteristics

- (a) Antichresis is an *accessory* contract and gives a *real right*. (*Santa Rosa v. Noble, 35 O.G. 2724*).
- (b) It is a *formal* contract because it must be in *writing*; otherwise, it is VOID. (*Art. 2134*).

(3) Distinguished from ‘Pledge’ and ‘Mortgage’

- (a) It differs from a *pledge* because the latter refers only to personal property, whereas antichresis deals only with immovable property.
- (b) It differs from *mortgage* because in the latter, there is NO RIGHT to the FRUITS.

[**NOTE:** While the creditor in antichresis is entitled to the fruits, still the fruits must be applied to the interest, if owing. (*Art. 2132*).]

[**NOTE:** In both antichresis and mortgage, the property *may or may not* be delivered to the creditor.

In *general*, however, in *mortgage*, the property is NOT DELIVERED whereas in *antichresis*, the property is DELIVERED.]

(4) Problem

A borrower obtained a loan, delivered the property as security so that the creditor may use the fruits. But *no interest* was mentioned; and it was *not stated* that the fruits would be applied to the interest first and then to the principal. What kind of a contract is this?

ANS.: This is a real mortgage, not an antichresis. (*Salcedo v. Celestila*, 66 *Phil.* 372). What characterizes a contract of antichresis is that the creditor acquires the right to receive the fruits of the property of his debtor, with the obligation to apply them to the payment of interest, if any is due, and then to the principal of his credit — and when such a covenant is not made in the contract, the contract cannot be an antichresis. (*Alojada v. Lim Siongco*, 51 *Phil.* 339; see *Adrid, et al. v. Morga, et al.*, L-13299, *Jul.* 25, 1960, where the Court held that the mere taking of land products in lieu of the receipt of interest originally stipulated upon does not necessarily convert the contract into one of an antichresis in view of the lack of provision in the contract specifically authorizing the receipt of the fruits.)

(5) Jurisprudence

Samonte v. CA **GR 44841, Jan. 27, 1986**

The claim that an instrument of antichresis had been executed by the parties' predecessors-in-interest in the latter part of 1930, based on testimonial evidence, cannot be considered legally sufficient. On or about 1930, an express contract of antichresis would have been unusual.

Ramirez v. CA **GR 38185, Sep. 24, 1986**

An antichretic creditor cannot acquired by prescription the land surrendered to him by the debtor. The creditor is

not a possessor in the concept of owner but a mere holder placed in possession of the land by the owner. Hence, their possession cannot serve as a title for acquiring dominion.

Art. 2133. The actual market value of the fruits at the time of the application thereof to the interest and principal shall be the measure of such application.

COMMENT:

(1) Use of “Actual Market Value”

“The foregoing rule will forestall the use of antichresis for purposes of USURY.” (*Report of the Code Commission, p. 158*).

(2) Interest Must Not Be Usurious

The interest in antichresis must not violate the Usury law. (*Santa Rosa v. Noble, 35 O.G. 2724; see Art. 2138*).

Art. 2134. The amount of the principal and of the interest shall be specified in writing; otherwise, the contract of antichresis shall be void.

COMMENT:

(1) Form

The amount of the PRINCIPAL and the INTEREST must be in WRITING. This is *mandatory*; therefore, if not in writing, the contract of antichresis is VOID.

(2) Principal Obligation

Even if the antichresis is VOID, the principal obligation may still be VALID.

Art. 2135. The creditor, unless there is a stipulation to the contrary, is obliged to pay the taxes the charges upon the estate.

He is also bound to bear the expenses necessary for the preservation and repair.

The sums spent for the purposes stated in this article shall be deducted from the fruits.

COMMENT:

(1) Obligations of the Creditor

- (a) To pay the taxes and charges upon the estate — unless there is a contrary stipulation.
- (b) To pay expenses for necessary repairs.

(2) Effects if Creditor Does Not Pay the Proper Taxes

If the creditor does not pay the taxes, the debtor is prejudiced; hence, the creditor is liable for damages. (*Rosales v. Tanseco, et al.*, 90 Phil. 496).

(3) Rule if the Fruit Are Insufficient

Since the first paragraph provides for responsibility on the part of the creditor, it follows that he has to pay for the taxes and charges, even if the fruits be *insufficient*. This duty is implied also from the second paragraph of Art. 2136. However, insofar as they can be deducted from the fruits, it is as if the debtor is really paying for such taxes and necessary repairs.

Art. 2136. The debtor cannot reacquire the enjoyment of the immovable without first having totally paid what he owes the creditor.

But the latter, in order to exempt himself from the obligations imposed upon him by the preceding article, may always compel the debtor to enter again upon the enjoyment of the property, except when there is a stipulation to the contrary.

COMMENT:

(1) When Debtor Can Reacquire the Enjoyment of the Immovable

After he has paid TOTALLY what he owes the creditor.

(2) What Creditor Can Do to Exempt Himself from the Payment of Taxes and Necessary Repairs

He can avail himself of the *second* paragraph of the Article.

(3) Reimbursement in Favor of Creditor

An antichretic creditor is entitled to be reimbursed for his expenses for machinery and other improvements on the land, and for the sums paid as land taxes. (*Magdangal v. Lichauco*, 51 Phil. 894). Said reimbursement may of course come from the fruits.

Art. 2137. The creditor does not acquire the ownership of the real estate for non-payment of the debt within the period agreed upon.

Every stipulation to the contrary shall be void. But the creditor may petition the court for the payment of the debt or the sale of the real property. In this case, the Rules of Court on the foreclosure of mortgages shall apply.

COMMENT:

Prohibition Against Pactum Commissorium Applicable

- (a) The evils of *pactum commissorium* may arise in the contract of antichresis — hence, the prohibition.
- (b) The parties may validly agree on an *extrajudicial* foreclosure. (*El Hogar Filipino v. Paredes*, 45 Phil. 178).

Art. 2138. The contracting parties may stipulate that the interest upon the debt be compensated with the fruits of the property which is the object of the antichresis, provided that if the value of the fruits should exceed the amount of interest allowed by the laws against usury, the excess shall be applied to the principal.

COMMENT:**Usurious Rates Prohibited**

In case of excessive interest, the excess shall be applied to the principal.

Art. 2139. The last paragraph of Article 2085, and Articles 2089 to 2091 are applicable to this contract.

COMMENT:**Applicability of Other Articles**

- (a) Art. 2085. The following requisites are essential to the contracts of pledge and mortgage:
- 1) That they be constituted to secure the fulfillment of the principal obligation;
 - 2) That the pledgor or mortgagor be the absolute owner of the thing pledged or mortgaged;
 - 3) That the persons constituting the pledge or mortgage have the free disposal of their property, and in the absence thereof, that they be legally authorized for the purposes.

Third persons who are not parties to the principal obligation may secure the latter by pledging or mortgaging their own property.

- (b) Art. 2089. A pledge or mortgage is indivisible, even though the debt may be divided among the successors in interest of the debtor of the creditor.

Therefore, the debtor's heir who has paid a part of the debt cannot ask for the proportionate extinguishments of the pledge or mortgage as long as the debt is not completely satisfied.

Neither can the creditor's heir who received his share of the debt return the pledge or cancel the mortgage, to the prejudice of the other heirs who have not been paid.

From these provisions is excepted the case in which, there being several things given in mortgage or pledge each one of them guarantees only a determinate portion of the credit.

The debtor, in this case, shall have a right to the extinguishments of the pledge or mortgage as the portion of the debt for which each thing is specially answerable is satisfied.

- (c) Art. 2090. The indivisibility of a pledge or mortgage is not affected by the fact that the debtors are not solidarily liable.
- (d) Art. 2091. The contract of pledge or mortgage may secure all kinds of obligations, be they pure or subject to a suspensive or resolutive condition.

Chapter 5

CHATTEL MORTGAGE

Art. 2140. By a chattel mortgage, personal property is recorded in the Chattel Mortgage Register as a security for the performance of an obligation. If the movable, instead of being recorded, is delivered to the creditor or a third person, the contract is a pledge and not a chattel mortgage.

COMMENT:

(1) Requisites for the Form of a Chattel Mortgage

(a) *Validity between the Parties:*

The personal property must be RECORDED or REGISTERED in the Chattel Mortgage Register. (*Art. 2140*).

(NOTE: Registration in the Day Book is NOT enough; it must be in the Chattel Mortgage Register. (*See Associated Insurance and Surety Co., Inc. v. Lim Ang, et al. [C.A.] 52 O.G. 5218; BUT SEE ALSO Salcedo v. Lim Ang, et al., 54 O.G. 5153.*)

[NOTE: To be valid between the parties, is *recording or registration* in the Chattel Mortgage Register required? According to one school of thought, YES because of the wording of Art. 2140; according to another school, NO, for after all Sec. 4 of the Chattel Mortgage Law states that the recording or registration is only for effectivity as against *third persons*, and there is nothing incompatible between this Sec. 4 and Art. 2140 UNLESS the latter (*Art. 2140*) will be regarded as a DEFINITION. (*See Standard Oil Co. v. Jaramillo, 44 Phil. 630*). The author is inclined to answer that the registration is required even for validity between the parties because of the *express*

wording of Art. 2140 and because such article may be regarded as the DEFINITION of a Chattel Mortgage.]

(b) *Validity as against Third Persons:*

The same as (a). Moreover, the registration must be accompanied by an affidavit of good faith. (*Secs. 4 and 5, Chattel Mortgage Law, Act No. 5108*). A mortgage constituted on a car, in order to affect third persons should be registered not only in the Chattel Mortgage Registry but also in the Motor Vehicles Office as required by Sec. 5(e) of the Revised Motor Vehicles Law. (*Borlough v. Fortune Enterprises, Inc., L-9451, Mar. 29, 1957 and Aleman, et al. v. De Catera, et al., L-13693-94, Mar. 5, 1961*). Thus, as between a chattel mortgagee, whose mortgage is not recorded in the MVO, and an innocent purchaser for value of a car who registers the car in his name, it is obvious that the latter is entitled to preference. (*Montano v. Lim Ang, L-13057, Feb. 27, 1963*).

(2) Definition

A chattel mortgage is an accessory contract by virtue of which personal property is recorded in the Chattel Mortgage Register as a security for the performance of an obligation. (*Art. 2140*).

[**NOTE:** Under the old law, it was considered a conditional sale. The Code Commission considered the old definition defective. (*Report of the Code Commission, p. 158*).]

(3) When Mortgage Must Be Registered in Two Registries

If under the Chattel Mortgage Law, the mortgage must be registered in two registries (as when the mortgagor resides in one province, but the property is in *another*), the registration must be in BOTH; otherwise, the chattel mortgage is VOID. (*See Malonzo v. Luneta Motor Co., et al., C.A., 52 O.G. 5566*).

(4) House as the Subject Matter of a Chattel Mortgage

May a house constructed on rented land be the subject of a chattel mortgage? State your reasons. (BAR).

ANS.: Generally no, because the house is real property. (*Art. 415, Civil Code and Leung Yee v. Strong Machinery Co., 37 Phil. 644*). This is so even if the house belongs to a person other than the owner of the land.

However, in the following instances there may be such a chattel mortgage:

- (a) If the parties to the contract agree and no third persons are prejudiced. (*Evangelista v. Abad, [C.A.] 36 O.G. 291, Tomines v. San Juan, [C.A.] 45 O.G. 2935*). This is really because one who has so agreed is ESTOPPED from denying the existence of the chattel mortgage.

[NOTE: Insofar as third persons are concerned, the chattel mortgage on the building even if registered is VOID. (*Leung Yee v. Strong Machinery Co., 37 Phil. 644; Evangelista v. Alto Surety and Ins. Co., Inc., L-11139, Apr. 23, 1958*).]

- (b) If what is mortgaged is a house intended to be demolished or removed — for here, what are really mortgaged are the MATERIALS thereof, hence, mere personal property. (*3 Manresa, p. 19*).

Navarro v. Pineda
L-18456, Nov. 30, 1963

FACTS: Pineda executed a chattel mortgage on his 2-story residential house erected on a lot belonging to another, to secure an indebtedness. The debt was not paid on the date due, hence, the plaintiff sought to foreclose the chattel mortgage on the house. Pineda argued however that since only movables can be the subject of a chattel mortgage (*Sec. 1, Act 3952*), the mortgage in question which is the basis of the present action, cannot give rise to an action for foreclosure, because it is a nullity. He cited Art. 415, which classifies a house as immovable property whether the owner of the land is or is not the owner of the building. He further invoked the ruling in the case of *Lopez v. Oroza (L-10817-8, Feb. 8, 1958)* which held that “a building is an immovable property, irrespective of whether or not said structure

and the land on which it is adhered to belong to the same owner.” (See *Leung Yee v. Strong Machinery Co.*, 37 Phil. 644).

HELD: The house in question was treated as personal property by the parties to the contract themselves. Hence, as to them, the chattel mortgage is VALID. Besides, the Court, speaking of the size of the house, said “The house was small and made of light material, *sawali*, and wooden posts; and built on the land of another.”

[NOTE: The Court distinguished this case from previous ones. In the *Iya* case (*Associated Insurance v. Iya*, L-10837, May 30, 1958), the Court said that the house was build of strong materials, permanently adhered on the owner’s own land. In the *Lopez* case, the building was a theater. In said cases, *third persons* assailed the validity of the mortgage; in this *Navarro* case, it was a party attacking it.]

(5) If Executed by a Wife

If the wife alone, without the prior consent or authority of the husband, enters into a contract of chattel mortgage respecting conjugal property, said contract is of doubtful validity. (*Serra v. Rodriguez*, 56 SCRA 538).

(6) Cases

Servicewide Specialists, Inc. v. CA 70 SCAD 529, 256 SCRA 649 1996

Where the Chattel Mortgage does not authorize the mortgagee to apply previous payments for the car to the insurance, the mortgagee has to send notice to the mortgagor it is decides to convert any of the installments made by the latter for the renewal of the insurance.

Development Bank of the Phils. v. CA & Emerald Resort Hotel Corp. GR 125838, Jun. 10, 2003

FACTS: DBP complied with the mandatory *posting* of the notices of the auction sale of the personal properties.

There was no postponement of the auction sale of the personal properties and the foreclosure took place as scheduled.

HELD: Under the Chattel Mortgage Law (*Act 1508, as amended*), the only requirement is posting of the notice of auction sale. Thus, the extrajudicial foreclosure of the chattel mortgage in the instant case suffers from no procedural infirmity.

Art. 2141. The provisions of this Code on pledge, insofar as they are not in conflict with the Chattel Mortgage Law, shall be applicable to chattel mortgages.

COMMENT:

(1) Applicability of the Provisions on Pledge

In case of conflict between the Chattel Mortgage Law and the Civil Code provisions on pledge, the former must prevail. The latter will have suppletory effect.

(2) Deficiency Judgments

Where the proceeds from the sale of mortgaged property (chattel mortgage) do *not* fully satisfy the secured debt, is the mortgagee entitled to recover the deficiency from the mortgagor? State the rule, and the exception, if any. (*BAR*).

ANS.:

- (a) Generally YES, the mortgagee is entitled to recover the deficiency from the mortgagor.

REASON: Although the Chattel Mortgage Law contains no provision on this point, still previous court decision have held that there can be a recovery. The Chattel Mortgage Law therefore *read in the light of these decisions*, allows such a recovery. Therefore, the new Civil Code provisions on pledge prohibiting recovery do NOT apply. (*Ablaza v. Ignacio, L-11460, May 23, 1958*).

- (b) An exception to the aforementioned rule may be found in *Art. 1484*, which speaks of a chattel mortgage as se-

curity for the purchase of *personal property payable in installments*. Here, no deficiency judgment can be asked. Any agreement to the contrary shall be VOID.

(3) No Registry of Buildings

There is no legal compulsion to register, as notice to third persons, transactions over buildings that do not belong to the owners of the lands on which they stand. There is no registry of buildings in this jurisdiction apart from the land. (*Manalansan v. Manalang, et al.*, L-13646, Jul. 26, 1960).

(4) No Necessity of Very Detailed Description of the Chattel Mortgage

Very detailed descriptions of a chattel mortgage are not required. All that is needed is a description which would enable both parties and strangers, after reasonable inquiry and investigation to identify the property mortgaged. (*Saldaña v. Guaranty Co., et al.*, L-13194, Jan. 29, 1960).

(5) Ownership of Rentals Accrued During Period of Redemption

Tumalad v. Vicencio
41 SCRA 143

FACTS: Under Sec. 6 of Act 3135 as amended, after the auction sale of the property involved in a chattel mortgage, the debtor-mortgagor has a period of one year within which to redeem the property sold at the extrajudicial foreclosure sale. During this period, if the property should produce rentals, who is entitled to them?

HELD: They should go to the debtor-mortgagor, because it is the latter who as owner of the property is entitled to said rents. This is so even if the rentals had been collected by the purchaser.

(6) Chattel Mortgagee Preferred Over Judgment Creditor of Mortgagor

**Northern Motors, Inc. v. Hon. Jorge Coquia
L-40018, Aug. 29, 1975**

FACTS: As security for the payment of installments of a number of taxicabs, the Manila Yellow Taxicab Company executed chattel mortgages on the vehicles in favor of the seller, Northern Motors. In the meantime, a judgment creditor (the Tropical Commercial Co.) of the taxicab company was able thru the sheriff to levy on the vehicles. Northern Motors, being the chattel mortgagee, filed a third-party claim with the sheriff, alleging it has preferential rights over the vehicles. *Issue:* Who has a preferential lien over the vehicles — the chattel mortgagee or the judgment creditor who has levied on the cars?

HELD: The chattel mortgagee (Northern Motors) has the preferential lien. As long as the mortgage debt is not yet paid, the judgment creditor of the mortgagor can only levy on the debtor's equity or right of redemption. Unless the purchaser at the levy-on-execution sale pays the mortgage debt, he cannot obtain possession over the properties, nor can he obtain delivery thereof. The levy by the sheriff is therefore wrong in taking possession of the vehicles. Because the chattel mortgages were registered, we can say that the mortgagee (Northern Motors) has the symbolical possession of the taxes. Thus, the chattel mortgagee's lien *can* be asserted in the *same case* where a judgment has been rendered resulting in the levy of the mortgaged property, instead of ventilating its lien in an independent action. (*Note:* The decision of Mar. 21, 1975, which did not prohibit the sheriff from going ahead with the execution sale, was reconsidered and set aside.)

(7) When a Third Person Becomes Solidarily Bound With Debtor

A third person who constitutes chattel mortgage on his own property as security to another's obligation not solely by reason thereof becomes solidarily bound with principal debtor. (*Cerna v. Court of Appeals*, 220 SCRA 517 [1993].)

TITLE XVII

EXTRA-CONTRACTUAL OBLIGATIONS

Chapter 1

QUASI-CONTRACTS

Art. 2142. Certain lawful, voluntary and unilateral acts give rise to the juridical relation of quasi-contract to the end that no one shall be unjustly enriched or benefited at the expense of another.

COMMENT:

(1) Definition of ‘Quasi-Contracts’

Quasi-contracts are lawful, voluntary, and unilateral acts which generally require a person to reimburse or compensate another in accordance with the principle that no one shall be unjustly enriched or benefited at the expense of another. (*See Art. 2142*).

Union Insurance Society of Canton v. CA 73 SCAD 163 1996

To order private respondent to pay petitioner the value of the vessels is one without legal basis and could result in unjust enrichment of petitioner. For it is error to make private respondent pay petitioner the value of three vessels or to order the return of the vessels to petitioner without the sale first being rescinded.

**MC Engineering v. CA
GR 104047, Apr. 3, 2002**

Every person who thru an act or performance by another, or by any other means, acquires or comes into possession of something at the expense of the latter without just or legal ground, shall return the same to him. (*Art. 22, Civil Code*).

Two (2) conditions must generally concur before the rule on *unjust enrichment* can apply, namely: (1) a person is unjustly benefited; and (2) such benefit is derived at another's expense or damage.

(2) Bases for Quasi-Contracts

- (a) no one must unjustly enrich himself at another's expense
- (b) if one benefits, he must reimburse
- (c) justice and equity

(3) Examples of Quasi-Contracts

- (a) *negotiorum gestio*
- (b) *solutio indebiti*

(4) Example of a Situation When There is No Quasi-Contract

A person who makes constructions on another's property by virtue of a contract entered into between him and the *lessee* (NOT the *lessor-owner*) of the property cannot, despite the lessee's insolvency, recover the value of said constructions from the lessor-owner on the ground of "undue enrichment" on the part of such lessor-owner. This is NOT a quasi-contract. *Firstly*, the construction was not a "purely voluntary act" or a "unilateral act" on the part of the builder, for he had constructed them in compliance with a *bilateral* obligation he had undertaken with the *lessee*. *Secondly*, having become privy to the *lessee's* rights under the lease contract, his rights as *builder* will be governed by the provisions of said lease contract, under whose terms, the improvements made on the property would be given to the lessor. *Thirdly*, if ever there was enrichment on the part of the lessor-owner, it was *not* "undue." For the

builder can blame no one except himself. What he should have done at the beginning was to obtain a bond from the lessee. He did not. Now that the lessee cannot pay, he should not be allowed to proceed against the lessor. (*Lao Chit v. Security Bank and Trust Co., et al.*, L-11028, Apr. 17, 1959).

(5) Case Where There Was No Unjust Enrichment

**Permanent Concrete Products v.
Donato Teodoro, et al.
L-29766, Nov. 29, 1968**

FACTS: Clementina Vda. de Guison hired Teodoro and Associates to construct a building for her for the lump sum of P44,000. The contractor explicitly agreed in the written contract between them that “all of the labor and materials shall be supplied by me.” During the construction, hollow blocks were supplied by a company, the Permanent Concrete Products, Inc. When no payment was received, the supplier sued both Guison (as owner) and Teodoro (as contractor) for the purchase price. Teodoro alleges, among other things, that it should be the owner who should pay for the hollow blocks since the same redounded to her benefit, otherwise she would be unjustly enriched at the expense of the supplier. *Issue:* Who should pay for the hollow blocks?

HELD: The contractor, Teodoro, must pay for in the contract he expressly assumed the cost of all materials. While the owner got the benefit of the hollow blocks, it does not necessarily follow that she was enriched at the expense of the Permanent Concrete Products, Inc. After all, she paid the P44,000 agreed upon as the lump sum.

Art. 2143. The provisions for quasi-contracts in this Chapter do no exclude other quasi-contracts which may come within the purview of the preceding article.

COMMENT:

Enumeration in the Civil Code Not Exclusive

The Article explains itself.

Section 1
NEGOTIORUM GESTIO

Art. 2144. Whoever voluntarily takes charge of the agency or management of the business or property of another, without any power from the latter, is obliged to continue the same until the termination of the affair and its incidents, or to require the person concerned to substitute him, if the owner is in a position to do so. This juridical relation does not arise in either of these instances:

(1) When the property or business is not neglected or abandoned;

(2) If in fact the manager has been tacitly authorized by the owner.

In the first case, the provisions of Articles 1317, 1403, No. 1 and 1404 regarding unauthorized contracts shall govern.

In the second case, the rules on agency in Title X of this Book shall be applicable.

COMMENT:

(1) Essential Requisites for “Negotiorum Gestio”

- (a) no meeting of the minds
- (b) taking charge of another’s business or property
- (c) the property or business must have been ABANDONED OR NEGLECTED (otherwise, the rule on unauthorized contracts would apply)
- (d) the officious manager must NOT have been expressly or implicitly authorized (otherwise, the rules on AGENCY would apply)
- (e) the officious manager (gestor) must have VOLUNTARILY taken charge (that is, there must be no vitiated consent, such as error in thinking that he owned the property or the business). (*TS, Nov. 26, 1926*).

(2) Examples

- (a) If an attorney *in fact* continues to manage the principal's estate after the principal's death, the former agent becomes a gestor. (*Julian, et al. v. De Antonio [C.A.] 2 O.G. 966, Oct. 14, 1943*).
- (b) If a co-ownership is illegally partitioned, the possessors become *gestors* with the duty to render an accounting. (*De Gala v. De Gala & Alabastro, 60 Phil. 311*).

Art. 2145. The officious manager shall perform his duties with the diligence of a good father of a family, and pay the damages which through his fault or negligence may be suffered by the owner of the property or business under management.

The courts may, however, increase or moderate the indemnity according to the circumstances of each case.

COMMENT:**Diligence Required of the Officious Manager**

- (a) Diligence of a good father of the family.
- (b) Hence a gestor is liable for the acts or negligence of his employees. (*MRR Co. v. Compania Transatlantica, 38 Phil. 875*).
- (c) Note the liability for damages, which however, in certain cases, may be mitigated.

Art. 2146. If the officious manager delegates to another person all or some of his duties, he shall be liable for the acts of the delegate, without prejudice to the direct obligation of the latter toward the owner of the business.

The responsibility of two or more officious managers shall be solidary, unless the management was assumed to save the thing or business from imminent danger.

COMMENT:**(1) Delegation of Duties of Officious Manager**

The first paragraph is self-explanatory.

(2) Solidary Liability of the Gestors

Note the *solidary liability* of two or more gestors. Note also the exception.

Art. 2147. The officious manager shall be liable for any fortuitous event:

- (1) If he undertakes risky operations which the owner was not accustomed to embark upon;**
- (2) If he has preferred his own interest to that of the owner;**
- (3) If he fails to return the property or business after demand by the owner;**
- (4) If he assumed the management in bad faith.**

COMMENT:**Liability for Fortuitous Events**

The Article explains itself.

Art. 2148. Except when the management was assumed to save the property or business from imminent danger, the officious manager shall be liable for fortuitous events:

- (1) If he is manifestly unfit to carry on the management;**
- (2) If by his intervention he prevented a more competent person from taking up the management.**

COMMENT:**Other Instances of Liability for Fortuitous Events**

The Articles explain itself.

Art. 2149. The ratification of the management by the owner of the business produces the effects of an express agency, even if the business may not have been successful.

COMMENT:**Effect of Ratification By the Owner of the Business**

- (a) Note that ratification produces the effects of an EXPRESS AGENCY.
- (b) This is *true* even if the business is not *successful*.

Art. 2150. Although the officious management may not have been expressly ratified, the owner of the property or business who enjoys the advantages of the same shall be liable for obligations incurred in his interest, and shall reimburse the officious manager for the necessary and useful expenses and for the damages which the latter may have suffered in the performance of his duties.

The same obligation shall be incumbent upon him when the management had for its purpose the prevention of an imminent and manifest loss, although no benefit may have been derived.

COMMENT:**(1) Specific Liabilities of the Owner Even if There Is No Ratification**

- (a) Liability *for obligation incurred in his interest*.
- (b) Liability *for necessary and useful expenses and for damages*.

(2) Rule if the Owner Is a Minor

Even if the *owner* is a minor, he is still liable under the article for he should not be unjustly enriched at another's expense. (*Rotea v. Delupio*, 67 Phil. 330).

Art. 2151. Even though the owner did not derive any benefit and there has been no imminent and manifest danger to the property or business, the owner is liable as under the first paragraph of the preceding article, provided:

- (1) The officious manager has acted in good faith, and
- (2) The property or business is intact, ready to be returned to the owner.

COMMENT:**Liability Even if No Benefit or Danger**

Note that here the owner is liable even if there had been NO benefit to him, for after all the gestor acted with an *honest* intent.

Art. 2152. The officious manager is personally liable for contracts which he has entered into with third persons, even though he acted in the name of the owner, and there shall be no right of action between the owner and third persons. These provisions shall not apply:

(1) If the owner has expressly or tacitly ratified the management, or

(2) When the contract refers to things pertaining to the owner of the business.

COMMENT:**Personal Liability of the Officious Manager Towards Third Persons**

The Article explains itself.

Art. 2153. The management is extinguished:

(1) When the owner repudiates it or puts an end thereto;

(2) When the officious manager withdraws from the management, subject to the provisions of Article 2144;

(3) By the death, civil interdiction, insanity or insolvency of the owner or the officious manager.

COMMENT:**Cause for the Extinguishment of the Officious Management**

(a) The causes are enumerated in the Article.

- (b) Note the effect of DICI (death, insanity, civil interdiction, or insolvency) of EITHER the OWNER or the OFFICIOUS MANAGER.

Section 2

SOLUTIO INDEBITI

Art. 2154. If something is received when there is no right to demand it, and it was unduly delivered through mistake, the obligation to return it arises.

COMMENT:

(1) ‘Solutio Indebiti’ Defined

Solutio indebiti is the quasi-contract that arises when a person is obliged to return whatever was received by him through error or mistake or received by him although there was NO RIGHT to demand it.

(2) Requisites for Solutio Indebiti

- (a) Receipt (not mere acknowledgment) of something. (*Art. 2154*).
- (b) There was no right to demand it (because the giver had no obligation). (*Hoskyn & Co., Inc. v. Goodyear Tire & Rubber Export Co., CA., 40 O.G. No. 15 [IIs], p. 245*).
- (c) The undue delivery was because of mistake (either of FACT [*Hoskyn and Co. v. Goodyear, Ibid.*], or of law, which may be doubtful or difficult). (*Art. 2155*).

[NOTE: When the payment was not by mistake or voluntary, but was made because of the coercive process of the writ of execution, *solutio indebiti* does NOT apply. (*Manila Surety & Fidelity Co., Inc. v. Lim, L-9343, Dec. 29, 1959*).]

(3) Examples of Solutio Indebiti

- (a) Erroneous payment of interest *not due*. (The interest must be returned.) (*Velez v. Balzarza, 73 Phil. 630*).

- (b) Erroneous payment of rental *not* called for in *view* of the expiration of the lease contract. (*Yanson v. Sing, C.A., 38 O.G. 2438*).
- (c) Taxes erroneously given. (*Aquiñena and Co. v. Muertequi, 32 Phil. 261*).

Puyat and Sons v. Sarmiento
L-17447, Apr. 30, 1963

FACTS: Plaintiff held an action for the refund of retail dealer's taxes paid by it WITHOUT PROTEST to the City of Manila. May such a tax (which should *not* have been paid at all) be recovered although *no* protest had been made?

HELD: Yes. The taxes collected from the plaintiff by the City of Manila were paid through error or mistake. This is manifest from the reply of the defendant that the sales of manufactured products at the factory site are *not* taxable either under the Wholesaler's Ordinance or under the Retailer's Ordinance. This makes the act of payment under the category of *solutio indebiti*. Being such a case, protest is *not* requires as a *conditio sine qua non* for its application.

[NOTE: Payment by a joint co-debtor for the benefit of another co-debtor or co-surety is NOT *solutio indebiti* but a payment by a person interested in the fulfillment of the obligation under Art. 1236. (*Monte de Piedad v. Rodrigo, 63 Phil. 312*).]

Art. 2155. Payment by reason of a mistake in the construction or application of a doubtful or difficult question of law may come within the scope of the preceding article.

COMMENT:

Payment Because of Doubtful or Difficult Question of Law

Are there questions of law which are NOT difficult or doubtful? It would seem that all are hard and susceptible or

both liberal and strict interpretations. Please note, however, that under the law, payment because of “doubtful or difficult question of law” may lead to *solutio indebiti* because of the mistake committed.

**Globe Mackay Cable and Radio Corp., et al.
v. NLRC, et al.
GR 74156, Jun. 29, 1988**

FACTS: Globe Mackay used to compute and pay its monthly cost-of-living allowance (COLA) on the basis of 30 days a month ever since the law mandated the payment of COLA. Upon the effectivity of Wage Order 6, which increased the COLA by P3 a day, starting Oct. 3, 1984, the company complied. However, in computing said allowance, management multiplied the P3 additional COLA by 22 days, which is the number of working days a month in the company. This was a departure from the company’s long-standing practice of multiplying the daily COLA by 30 days.

The union objected to management’s unilateral act of using this new multiplier as it clearly diminishes the monthly allowance accruing to each employee. It is the union’s position that what the company did was tantamount to a unilateral withdrawal of benefits which is supposedly contrary to law. The union raised this issue in the grievance system. A series of grievance proceedings proved futile.

The union filed a complaint against the company and its president and vice-president who were sought to be held personally liable for alleged illegal deduction, underpayment, unpaid allowance, supposed violations of Wage Order 6. The arbiter decided in favor of management, saying there are 22 working days, and “*to compel the respondent company to use 30 days in a month to compute the allowance and retain 22 days for vacation and sick leave, overtime pay and other benefits is inconsistent and palpably unjust...*” The arbiter likewise held that since the president and vice-president acted in their corporate capacity, they could not be impleaded, much less held personally liable.

The union appealed to the National Labor Relations Commission (NLRC), which reversed the arbiter and ruled that

the company was indeed guilty of illegal deduction based on the following considerations: *First*, the NLRC held that the P3 daily COLA under Wage Order 6 should be computed and paid based on 30 days instead of 22, since employees paid on monthly basis are entitled to COLA on Saturdays, Sundays, and legal holidays “*even if unworked.*” *Second*, the NLRC pointed out that the full allowance enjoyed by the employees before the CBA constituted a voluntary employer practice which supposedly can not be unilaterally withdrawn. *Third*, the NLRC deemed it proper that the president and the vice-president were impleaded.

Management raised the case to the Supreme Court. The court reversed the NLRC and reinstated the arbiter’s ruling. The court called attention to the uniform provisions in Wage Orders 2, 3, 5, and 6 which declared that “*all covered employees shall be entitled to their daily living allowance during the days that they are paid their basic wage even if unworked.*” It was therefore clarified that “*... the payment of COLA is mandated only for the days that the employees are paid their basic wage.*”

HELD: Petitioner corporation can not be faulted for erroneous application of the law. Payment may be said to have been made by reason of a mistake in the construction or application of “doubtful or difficult question of law.” (*Art. 2155 of the Civil Code, in relation to Art. 2154*). Since it is a past error that is being corrected, no vested right may be said to have arisen nor any diminution of benefit under Article 100 of the Labor Code, may be said to have resulted by virtue of the correction.

Art. 2156. If the payer was in doubt whether the debt was due, he may recover if he proves that it was not due.

COMMENT:

Payment Made Because of Doubt

The Article explains itself.

Art. 2157. The responsibility of two or more payees, when there has been payment of what is not due, is solidary.

COMMENT:**Solidary Liability of the Payees**

In general, obligations are *joint*. Art. 2157 gives one of the *exceptions*.

Art. 2158. When the property delivered or money paid belongs to a third person, the payee shall comply with the provisions of Article 1984.

COMMENT:**Rule When Property Belongs to a Third Person**

- (a) The Article explains itself.
- (b) Art. 1984. The depositary cannot demand that the depositor prove his ownership of the thing deposited.

Nevertheless, should he discover that the thing has been stolen and who its true owner is, he must advise the latter of the deposit.

If the owner in spite of such information, does not claim it within the period of one month, the depositary shall be relieved of all responsibility by returning the thing deposited to the depositor.

If the depositary has reasonable grounds to believe that the thing has not been lawfully acquired by the depositor, the former may return the same.

Art. 2159. Whoever in bad faith accepts an undue payment, shall pay legal interest if a sum of money is involved, or shall be liable for fruits received or which should have been received if the thing produces fruits.

He shall furthermore be answerable for any loss or impairment of the thing from any cause, and for damages to the person who delivered the thing, until it is recovered.

COMMENT:**Rule if Payee Is in Bad Faith**

- (a) Payee is liable for *interests* or *fruits* and for *fortuitous events* (damages).
- (b) Reason — The payee here assumes all risks having acted fraudulently, though of course the damages may be mitigated under Art. 2215, No. 4. (*Report of the Code Commission, p. 161*).

Art. 2160. He who in good faith accepts an undue payment of a thing certain and determinate shall only be responsible for the impairment or loss of the same or its accessories and accessions insofar as he has thereby been benefited. If he has alienated it, she shall return the price or assign the action to collect the sum.

COMMENT:

Liability of a Payee in Good Faith

- (a) In case of impairment or loss, liability is only to the extent of *benefit*.
- (b) In case of alienation, price is to be *reimbursed*, or in case of credit, the same should be *assigned*.

Art. 2161. As regards the reimbursement for improvements and expenses incurred by him who unduly received the thing, the provisions of Title V of Book II shall govern.

COMMENT:

Reimbursement for Improvement and Expenses

- (a) The Article is self-explanatory.
- (b) The rules for possessors in *good faith* or *bad faith* are applicable.

Art. 2162. He shall be exempt from the obligation to restore who, believing in good faith that the payment was being made of a legitimate and subsisting claim, destroyed the document, or allowed the action to prescribe, or gave up the pledges, or cancelled the guaranties for his right. He who

paid unduly may proceed only against the true debtor or the guarantors with regard to whom the action is still effective.

COMMENT:

Right of a Payee Who Destroys the Evidences or Proofs of His Right

Example:

Jose is indebted to Liwayway for P1,000,000. The debt is evidenced by a promissory note. Jose's brother, Ricardo, thinking that it was he who was the true debtor paid the P1,000,000 to Liwayway. The latter thinking in good faith that Ricardo was the true debtor received the P1,000,000. She then destroyed the promissory note. If it should turn out later that the payment by Ricardo was a mistake, is Liwayway obliged to return the P1,000,000 to Ricardo?

ANS.: No, she will not be so obliged, by express provision of the instant article. The remedy of Ricardo will be to get reimbursement from Jose, the true debtor.

Art. 2163. It is presumed that there was a mistake in the payment if something which had never been due or had already been paid was delivered; but he from whom the return is claimed may prove that the delivery was made out of liberality or for any other just cause.

COMMENT:

When Mistake Is Presumed

The Article explains itself.

Section 3

OTHER QUASI-CONTRACTS

(New, except Articles 2164 and 2165.)

Art. 2164. When, without the knowledge of the person obliged to give support, it is given by a stranger, the latter shall have a right to claim the same from the former, unless it appears that he gave it out of piety and without intention of being repaid.

COMMENT:**Support Given by a Stranger**

- (a) Here, the support was given **WITHOUT** the knowledge of the person obliged to give support.
- (b) Before a wife's relatives who give support to the wife can recover from the husband, the husband should first be given a chance to support the wife. (*See Ramirez & De Marcaida v. Redfern, 49 Phil. 849*).

Art. 2165. When funeral expenses are borne by a third person, without the knowledge of those relatives who were obliged to give support to the deceased, said relatives shall reimburse the third person, should the latter claim reimbursement.

COMMENT:**Funeral Expenses Borne By a Third Person**

The Article is self-explanatory.

Art. 2166. When the person obliged to support an orphan, or an insane or other indigent person unjustly refuses to give support to the latter, any third person may furnish support to the needy individual, with right of reimbursement from the person obliged to give support. The provisions of this article apply when the father or mother of a child under eighteen years of age unjustly refuses to support him.

COMMENT:**Rule if Support is Unjustly Refused**

Under this Article, as distinguished from Art. 2164, "the obligor *unduly refuses* to support the persons referred to therein. The law creates a promise of reimbursement on the part of the person obliged to furnish support, in spite of the deliberate disregard of his legal and moral duty. The new provision is demanded by justice and public policy." (*Report of the Code Com., pp. 70-71*).

Art. 2167. When through an accident or other cause a person is injured or becomes seriously ill, and he is treated or helped while he is not in a condition to give consent to a contract, he shall be liable to pay for the services of the physician or other person aiding him, unless the service has been rendered out of pure generosity.

COMMENT:

Services Rendered By a Physician or Other Persons

“The law also creates a promise on behalf of the sick or injured person, who, on account of his physical condition, cannot express his desire to be treated, and his promise to pay. It is presumed that the patient would request the services if he were able to do so, and would promise to pay.” (*Report of the Code Commission, p. 71*).

Art. 2168. When during a fire, flood, storm, or other calamity, property is saved from destruction by another person without the knowledge of the owner, the latter is bound to pay the former just compensation.

COMMENT:

Rule When Property Is Saved During a Calamity

The Article explains itself but note that here PROPERTY (*not* persons) is saved.

Art. 2169. When the government, upon the failure of any person to comply with health or safety regulations concerning property, undertakes to do the necessary work, even over his objection, he shall be liable to pay the expenses.

COMMENT:

Rule When Government Undertakes Necessary Work

“The law creates a promise on the part of the neglectful or recalcitrant individual. The common welfare requires that a quasi-contract be imposed upon him.” (*Report of the Code Commission, p. 71*).

Art. 2170. When by accident or other fortuitous event, movable separately pertaining to two or more persons are commingled or confused, the rules on co-ownership shall be applicable.

COMMENT:

Rule When Movables are Commingled or Confused

The Article explains itself.

Art. 2171. The rights and obligations of the finder of lost personal property shall be governed by Articles 719 and 720.

COMMENT:

When Lost Personal Property is Found

- (a) Art. 719. Whoever finds a movable, which is not treasure, must return it to its previous possessor. If the latter is unknown, the finder shall immediately deposit it with the mayor of the city or municipality where the finding has taken place.

The finding shall be publicly announced by the mayor for two consecutive weeks in the way he deems best.

If the movable cannot be kept without deterioration, or without expenses which considerably diminish its value it shall be sold at public auction eight days after the publication.

Six months from the publication having elapsed without the owner having appeared, the thing found, or its value, shall be awarded to the finder. The finder and the owner shall be obliged, as the case may be to reimburse the expenses.

- (b) Art. 720. If the owner should appear in time, he shall be obliged to pay, as a reward to the finder, one-tenth of the sum or of the price of the thing found.

Art. 2172. The right of every possessor in good faith to reimbursement for necessary and useful expenses is governed by Article 546.

COMMENT:

Reimbursement for Necessary and Useful Expenses

Art. 546. Necessary expenses shall be refunded to every possessor; but only the possessor in good faith may retain the thing until he has been reimbursed therefor.

Useful expenses shall be refunded only to the possessor in good faith with the same right of retention, the person who has defeated him in the possession having the option of refunding the amount of the expenses or of paying the increase in value which the thing may have acquired by reason thereof.

Art. 2173. When a third person, without the knowledge of the debtor, pays the debt, the rights of the former are governed by Articles 1236 and 1237.

COMMENT:

Payment Made By a Third Person

- (a) Art. 1236. The creditor is not bound to accept payment or performance by a third person who has no interest in the fulfillment of the obligation, unless there is a stipulation to the contrary.

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

- (b) Art. 1237. Whoever pays on behalf of the debtor without the knowledge or against the will of the latter, cannot compel the creditor to subrogate him in his rights, such as those arising from a mortgage, guaranty, or penalty.

Art. 2174. When in a small community a majority of the inhabitants of age decide upon a measure for protection

against lawlessness, fire, flood, storm or other calamity, any one who objects to the plan and refuses to contribute to the expenses but is benefited by the project as executed shall be liable to pay his share of said expenses.

COMMENT:

Measure for Protection Decided Upon By a Community

“It is unjust for the person receiving the benefit of the method of protection to refuse to pay his share of the expense. The law therefore makes a promise for him to contribute to the plan.” (*Report of the Code Commission, p. 71*).

Art. 2175. Any person who is constrained to pay the taxes of another shall be entitled to reimbursement from the latter.

COMMENT:

When Someone is Constrained to Pay Another's Taxes

- (a) “This situation frequently arises when the possessor of land, under a contract of lease or otherwise, has to pay the taxes to prevent a seizure of the property by the government, the owner having become delinquent in the payment of the land tax.” (*Report of the Code Commission, p. 72*).
- (b) The payment by a person other than the delinquent taxpayer of the overdue taxes on a parcel of land which had been forfeited by the Government for delinquency in the payment of said taxes, MERELY SUBROGATES the payor into the rights of the Government as *creditor* for said delinquent taxes. (*See Art. 1236*). The payor does not thereby acquire the rights of the landowner to the property. (*Villorta v. Cutamona Vda. de Cuyno, et al., L-20682, May 19, 1966*).

Chapter 2

QUASI-DELICTS

Art. 2176. Whoever by act or omission causes damage to another, there being fault or negligence, is obliged to pay for the damage done. Such fault or negligence, if there is no pre-existing contractual relation between the parties, is called a quasi-delict and is governed by the provision of this Chapter.

COMMENT:

(1) Requisites for a Quasi-Delict (Culpa Aquiliana)

- (a) Act or omission.
- (b) Presence of fault or negligence (lack of due care).

[**NOTE:** In the absence of fault or negligence, there can be NO award for damages. Mere suspicion or speculation without proof cannot be the basis of such an award. (*Rebullida v. Estrella, C.A., L-15256-R, Jun. 24, 1959*).]

LRT v. Navidad **GR 145804, Feb. 6, 2003**

ISSUE: Once fault is established, can an employer be made liable on the basis of the presumption *juris tantum* that the employer failed to exercise *diligentissimi patris familias* in the selection and supervision of its employees?

HELD: Yes. The premise for the employer's liability is negligence or fault on the part of the employee. The liability is primary and can only be negated by showing due diligence in the selection and supervision of the employee, a factual matter that must be shown.

Absent such a showing, one might ask further, how then must the liability of the common carrier, on the one hand, and independent contractor, upon the other hand, be described? It would be *solidary*.

- (c) Damage to another.
- (d) Causal connection between the fault or negligence and the damage.

Phoenix Construction, Inc. v. IAC
GR 65295, Mar. 10, 1987

Courts distinguish between the active “cause” of the harm and the existing “conditions” upon which the cause operated. If the defendant has created only a passive static condition which made the damage possible, the defendant is said not to be liable. But so far as the fact of causation is concerned, in the sense of necessary antecedents which have played an important part in producing results, it is quite impossible to distinguish between active forces and passive situations, particularly since, as is invariably the case, the latter are the result of the other active forces which have gone before.

Example:

The defendant who spills gasoline about the premises creates “a condition; but the act may be culpable because of the danger of fire. When a spark ignites the gasoline, the condition has gone quite as much as to bring about the fire as the spark. Since that is the very risk which the defendant has created, the defendant will not escape responsibility. Even the lapse of a considerable time during which the “condition” remains static will not necessarily affect liability: one who digs a trench on the highway may still be liable to another who falls into it a month afterward.

“Cause” and “condition” still find occasional mention in the decisions. But the distinction is now almost entirely discredited. So far as it has any validity at all, it must refer to the type of case where the forces set in operation by the defendant have come to rest in a position of apparent safety, and some new force intervenes.

But even in such cases, it is not the distinction between “cause” and “condition” which is important, but the nature of the risk and the character of the intervening cause.

- (e) No pre-existing contractual relation. (*12 Manresa 613-614; Algara v. Sandejas, 27 Phil. 284*). Indeed, quasi-delict or *culpa aquiliana* is an independent source of obligation between two persons not so formerly bound by juridical tie. (*Batangas Laguna Tayabas Co., Inc., et al. v. Court of Appeals, et al., L-33138-39, Jun. 27, 1975*). Of course, it has been ruled that tort liability can exist even if there are already contractual relations (*Air France v. Carrascoso, L-21438, Sep. 28, 1966*), BUT this should be interpreted to mean that the tort liability itself does not arise because of the contract, but because of some other fact.

[**NOTE:** The person responsible (tortfeasor) is liable even if he does not know the identity of the victim. (*Gilchrist v. Cuddy, 29 Phil. 542*).]

Teague v. Fernandez
51 SCRA 181

If an ordinance requires certain building to provide two stairways, failure to comply with the same constitutes an act of negligence. Even if another agency had intervened, the negligent entity would still be liable if the occurrence of the accident, in the manner in which it happened, was the very thing sought to be prevented by the statute or ordinance.

People’s Bank and Trust Co. v.
Dahican Lumber Co.
L-17500, May 16, 1967

FACTS: A person induced another to violate the latter’s contract with a third person. Is the inducer liable for the commission of a tort (quasi-delict)?

HELD: Yes, because a quasi-delict or tort can arise because of *negligence* OR *fault*. In this case, we have

more or less the tort referred to as “interference with contractual relations.”

Penullar v. Philippine National Bank
GR 32762, Jan. 27, 1983

If one of two innocent parties has to suffer thru the act of a third person, he who made possible the injury (or was negligent) should bear the loss.

Prima Malipol v. Lily Lim Tan, et al.
L-27730, Jan. 21, 1974

FACTS: Defendants were not able to file their answer in civil case against them for a quasi-delict because of the error or negligence of their original counsel. Are said defendants bound by said error or negligence?

HELD: Yes. Clients are generally bound by the error or negligence of their counsel, who failed to file their ANSWER to the complaint within the time given by the Rules. Thus, the order of the trial court declaring in default is proper.

People v. Capillas
L-38756, Nov. 13, 1984

In delicts and quasi-delicts, not only actual damages may be recovered but also moral and exemplary damages.

Phoenix Construction, Inc. v. IAC
GR 65295, Mar. 10, 1987

Our law on quasi-delicts seeks to reduce the risks and burdens of living in society and to allocate them among the members of society.

Valenzuela v. CA
68 SCAD 113
1996

The liability of an employer for the negligence of his employee is not based on the principal of *respondent*

superior but that of *pater familias*. Where no allegations were made as to whether or not the company took the steps necessary to determine or ascertain the driving proficiency and history of its employee to whom it gave full and unlimited use of a company car, said company, based on the principle of *bonus pater familias*, ought to be jointly and severally liable with the former for the injuries caused to third persons.

Once evidence is introduced showing that the employer exercised the required amount of care in selecting its employees, half of the employer’s burden is overcome, but the question of diligent supervision depends on the circumstances of employment. Ordinarily, evidence demonstrating that the employer has exercised diligent supervision of its employee during the performance of the latter’s assigned tasks would be enough to relieve him of the liability imposed by Art. 2180 in relation to Art. 2176 of the Civil Code.

(2) ‘Culpa Aquiliana’ Distinguished from ‘Culpa Contractual’ and ‘Culpa Criminal’

<i>CULPA CONTRACTUAL</i>	<i>CULPA AQUILIANA</i>	<i>CULPA CRIMINAL</i>
(a) Negligence is merely incidental to the performance of an obligation already existing because of a contract. (<i>Rakes v. Atlantic Gulf & Pacific Co.</i> , 7 Phil. 395).	(a) Negligence here is direct substantive, independent. (<i>Rakes v. Atlantic Gulf & Pacific</i> , 7 Phil. 395).	(a) Negligence here is direct, substantive, independent of a contract.
(b) There is a pre-existing obligation (a contract, either express or implied). (<i>Rakes Case</i>)	(b) No pre-existing obligation (except of course the duty to be careful in all human actuations). (<i>Rakes Case</i>).	(b) No pre-existing obligation (except the duty never to harm others.)

<p>(c) Proof needed — preponderance of evidence. (<i>Barredo v. Garcia</i>, 73 Phil. 607).</p>	<p>(c) Proof needed — preponderance of evidence. (<i>Barredo v. Garcia</i>, 73 Phil. 607).</p>	<p>(c) Proof needed in a crime — proof of guilt beyond reasonable doubt. (<i>Barredo v. Garcia</i>, 73 Phil. 607).</p>
<p>(d) Defense of “good father of a family” in the selection and supervision of employees is not a proper complete defense in <i>culpa contractual</i> (though this may MITIGATE damages.) [<i>Cangco v. MRR</i>, 38 Phil. 769 and <i>De Guia v. Merlco</i>, 40 Phil. 769]. Here we follow the rule of RESPONDEAT SUPERIOR or COMMAND RESPONSIBILITY or the MASTER AND SERVANT RULE.)</p>	<p>(d) Defense of “good father, etc.,” is a proper and complete defense (insofar as employers or guardians are concerned) in <i>culpa aquiliana</i>. (<i>Cangco and De Guia Cases</i>).</p>	<p>(d) This is not a proper defense in <i>culpa criminal</i>. Here the employee’s guilt is <i>automatically</i> the employer’s civil guilt, if the former is insolvent. (See <i>M. Luisa Martinez v. Barredo</i>).</p>
<p>(e) As long as it is proved that there was a <i>contract and that it</i> was not carried out, it is presumed that the debtor is at fault, and it is <i>his duty</i> to prove that there was no negligence in carrying out the terms of the contract. (<i>Cangco Case</i>; 8 <i>Manresa</i> 71).</p>	<p>(e) Ordinarily, the victim has to prove the negligence of the defendant. This is because his action is based on alleged negligence on the part of the defendant. (<i>Cangco Case</i>; 8 <i>Manresa</i> 71).</p>	<p>(e) Accused is presumed innocent until the contrary is proved, so prosecution has the burden of proving the negligence of the accused.</p>

**Syquia, et al. v. CA and Manila
Memorial Park Cemetery, Inc.
GR 98695, Jan. 27, 1993**

In the case at bar, it has been established that the Syquias and the Manila Memorial Park Cemetery, Inc., entered into a contract entitled “Deed of Sale and Certificate of Perpetual Care.” That agreement governed the relations of the parties and defined their respective rights and obligations.

Hence, has there been actual negligence on the part of the Manila Memorial Park Cemetery, Inc., it would be held liable not for a *quasi-delict* or *culpa aquiliana*, but for *culpa contractual*.

(3) Necessity of Proving Negligence

Negligence must be proved in a suit on a quasi-delict, so that the plaintiff may recover. However, since negligence may in some cases be hard to prove, we may apply the doctrine of *RES IPSA LOQUITUR* (the thing speaks for itself). This means that in certain instances, the presence of facts or circumstances surrounding the injury *clearly indicate negligence on the part of the defendant* — as when the defendants was on the WRONG side of the street. (See *U.S. v. Crame*, 30 Phil. 2). The presumption is however rebuttable. (See *U.S. v. Bonifacio*, 34 Phil. 65).

**Bernabe Africa, et al. v. Caltex, et al.
L-12986, Mar. 31, 1966**

FACTS: A fire broke out at a Caltex service station. It started while gasoline was being hosed from a tank trunk into the underground storage, right at the opening of the receiving tank where the nozzle of the hose had been inserted. The fire destroyed several houses. Caltex and the station manager were sued. **Issue:** Without proof as to the cause and origin of the fire, would the doctrine of *res ipsa loquitur* apply such that the defendants can be presumed negligent?

HELD: Yes, for the gasoline station was under the care of the defendant, who gave no explanation at all regarding the fire. It is fair to reasonably infer that the incident happened because of their want of care.

Republic v. Luzon Stevedoring Corporation
L-21749, Sep. 29, 1967

FACTS: A barge belonging to the Luzon Stevedoring Company rammed against one of the wooden supports of the old Nagtahan Bridge (a stationary object). What presumption arises?

HELD: There arises the presumption that the barge was negligent (doctrine of *res ipsa loquitor*, meaning the thing speaks for itself). This is evident because the bridge (at that time) was an immovable, stationary object, adequately provided with openings for the passage of watercraft). The doctrine can indeed be applied, for in the ordinary course of events, such a ramming would not occur if proper care is used.

NIA, et al. v. IAC, et al.
GR 73919, Sep. 18, 1992

On the issue of negligence, plaintiffs thru the testimonies of Andres Ventura, Florentino Ventura, and Prudencio Martin showed that the NIA constructed irrigation canals on the landholding[s] of the plaintiffs by scraping away the surface of the landholding[s] to raise the embankment of the canal. As a result of the said construction, in 1967, the landholdings of the plaintiffs were inundated with water. Although it cannot be denied that the irrigation canal of the NIA is a boon to the plaintiffs, the delay of almost 7 years in installing the safety measures such as the check gates, drainage[s], ditches, and paddy drains has caused substantial damage to the annual harvest of the plaintiffs. In fact, Engineer Carlitos, witness for the defendant declared that these improvements were made only after the settlement of the claim of Mrs. Virginia Tecson, which was sometime in 1976 or 1977, while the irrigation canal was constructed in 1976.

The testimonies of the plaintiffs essentially corroborated by a disinterested witness in the person of Barangay Captain Prudencio Martin, proved that the landholdings of the complainants were inundated when the NIA irrigation canal was constructed without safety devices thereby reducing their annual harvest of 30 cavans per hectare (portions flooded). The failure, therefore, of the NIA to provide the

necessary safeguards to prevent the inundation of plaintiffs' land-holding[s] is the proximate cause of the damages to the poor farmers.

Upon the other hand, the defendant maintains that the cause of inundation of plaintiffs' landholdings was the check gate of the Cinco-cinco creek, known as Tombo check gate. However, evidence showed that this check gate existed long before the NIA irrigation canal was constructed and there were no complaints from the plaintiffs until the canal of the NIA was built. The uncontested testimony of barrio captain Prudencio Martin that the former name of the sitio where the plaintiffs' landholdings were located was "Hilerang Duhat" but was changed to Sitio Dagat-dagatan because of the inundation was not without justification.

**Leah Alesna Reyes, et al. v.
Sisters of Mercy Hospital, et al.
GR 130547, Oct. 3, 2000**

FACTS: Petitioner's husband died while undergoing treatment for typhoid fever at respondent hospital. Petitioner, thus, filed a complaint for negligence and damages against respondents on account of the wrongful administration of the drug chloromycetis. The trial court rendered a decision in favor of respondents, which was affirmed by the Court of Appeals (CA). On appeal, the Supreme Court affirmed the CA.

HELD: Respondents were not guilty of medical malpractice as they were able to establish thru expert testimony that the physicians who attended to petitioner's husband exercised the necessary care, within the reasonable average merit among ordinarily good physicians, in treating him under circumstances pertaining at that time.

Further, the doctrine of *res ipsa loquitur* does not apply in a suit against a physician or surgeon which involves the merit of diagnosis or a scientific treatment. It is generally restricted to situations in malpractice cases where a layman is able to say, as a matter of common knowledge and observation, that the consequences of professional care were not as such as would ordinarily have followed if due care had been exercised. (*Ramos v. CA*, 321 SCRA 584 [1999]).

(4) Damnum Absque Injuria

This means that “although there was physical damage, there was *no legal injury*.” Hence, if a carefully driven car hurts a pedestrian because lightning temporarily blinded the driver, the pedestrian *cannot* recover damages, for legally while he has been DAMAGED, there was NO INJURY or NO FAULT in view of the fortuitous event. (*See Board of Liquidators v. Kalaw, GR 18805, Aug. 14, 1967*, where the Court ruled that while the National Coconut Corporation was not able to deliver the copra it had promised to deliver, and therefore caused damage to the buyers, still nobody can legally be blamed because the non-delivery was caused by typhoon. This is a case of *damnum absque injuria*.)

**Farolan v. Solmac Marketing Corp.
GR 83589, Mar. 13, 1991**

FACTS: Farolan was then the Acting Commissioner of Customs, while Parayno was then the Acting Chief, Customs Intelligence and Investigation Division. They were sued in their official capacities as officers in the government. Nevertheless, they were both held personally liable for the awarded damages “since the detention of the goods by defendants (Farolan and Parayno) was irregular and devoid of legal basis, hence, not done in the regular performance of official duty.” Solmac Marketing was the assignee and owner of an importation of Clojus Recycling Plastic Products of 202,204 kilograms of what is technically known as polypropylene film, valued at US\$69,250.05. The importation, consisting of 17 containers, arrived in December 1981. Upon application for entry, the Bureau of Customs asked Solmac for its authority from any government agency to import the goods described in the Bill of Lading. Solmac presented a Board of Investment Authority for polypropylene film scrap. However, upon examination of the shipment by the National Institute of Science and Technology, it turned out that the fibers of the importation were oriented in such a way that the materials were stronger than OPP film scrap. The Clojus shipment was not OPP film scrap, as declared by Solmac to the Bureau of Customs and BOI Governor Bautista, but oriented polypropylene the importa-

tion of which is restricted, if not prohibited, under Letter of Instruction 658-B. Considering the shipment was different from what had been authorized by the BOI and by law, Parayno and Farolan withheld the release of the importation. Parayno wrote the BOI asking for the latter's advice on whether or not the importation may be released. Thereafter, Solmac filed the action for *mandamus* and injunction with the trial court, which ordered Farolan and Parayno to release the importation. Solmac appealed only insofar as the denial of the award of damages is concerned. Parayno and Farolan did not appeal. The Court of Appeals ordered Farolan and Parayno solidarily liable in their personal capacity to pay Solmac temperate damages in the sum of P100,000, exemplary damages in the sum of the P100,000 and P50,000 as attorney's fees and expenses of litigation.

HELD: The Supreme Court set aside and annulled the decision of the Court of Appeals, and held that there is no convincing proof showing the alleged bad faith of Farolan and Parayno. On the contrary, the evidence bolstered their claim of good faith. *First*, there was the report of the NIST that, contrary to what Solmac claimed, the importation was not OPP film scraps but oriented polypropylene, a plastic product of stronger material, whose importation to the Philippines was restricted, if not prohibited. It was on the strength of this finding that they withheld release of the importation for being contrary to law. *Second*, on many occasions, the Bureau of Customs sought the advice of the BOI on whether the subject importation might be released. *Third*, up to the time of the trial there was no clear-cut policy on the part of the BOI regarding the entry into the Philippines of oriented polypropylene. Even the highest officers of the BOI were not in agreement as to what proper course to take on the subject of the various importations of Oriented Polypropylene (OPP) and Polypropylene (PP) withheld by the Bureau of Customs. The conflicting recommendations of the BOI prompted petitioners to seek final clarification from the former with regard of its policy on the importations. The confusion over the disposition of the importation obviates bad faith. When a public officer takes his oath of office, he binds himself to perform the duties of his office faithfully and to use reasonable skill and diligence, and to act primarily for the benefit of

the public. Thus, in the discharge of his duties, he is to use that prudence, caution, and attention which careful men use in the management of their affairs. That petitioners acted in good faith in not immediately releasing the imported goods is supported by substantial evidence, independent of the presumption of good faith, which was not successfully rebutted. Here, prudence dictated that petitioners first obtain from the BOI the latter's definite guidelines regarding the disposition of the various importations of oriented polypropylene and polypropylene then being withheld at the Bureau of Customs. These cellophane film products were competing with locally manufactured polypropylene and oriented polypropylene as raw materials which were then already sufficient to meet local demands. Hence, their importation were restricted, if not prohibited. Thus, petitioners could not be said to have acted in bad faith in not immediately releasing the imported goods without obtaining the necessary clarificatory guidelines from the BOI. As public officers, petitioners had the duty to see to it that the law they were tasked to implement, *i.e.*, LOI 658-B, was faithfully complied with. But even if petitioners committed a mistake in withholding the release of the importation because it was composed of film scraps, nonetheless, it is the duty of the Court to see it that public officers are not hampered in the performance of their duties or in making decisions for fear of personal liability for damages due to honest mistake. Whatever damages they may have caused as a result of such an erroneous interpretation, if any at all, is in the nature of a *damnum absque injuria*.

(5) Last Clear Chance

The doctrine of "last clear chance" is to the effect that even if the injured party was *originally* at fault (as when he was on the wrong side of a street) still if the person who finally caused the accident had the "last clear opportunity" to avoid striking him, *he who could have prevented the injury is still liable if he did not take advantage of such opportunity or chance*.

Other names for the doctrine of "last clear chance" include "doctrine of discovered peril"; "doctrine of supervening negligence"; "the humanitarian doctrine."

In the case of *Ong v. Metropolitan Water District* (104 Phil. 398), the Court applying 38 Am. Jur. 900, said that according to third doctrine “the negligence of the plaintiff does not preclude (or prevent) a recovery for the negligence of the defendant where it appears that the defendant by exercising reasonable care and prudence *might have avoided* injurious consequences to the plaintiff notwithstanding the plaintiff’s negligence.”

Ong v. Metropolitan Water District
104 Phil. 398

FACTS: A visitor was drowned in a swimming resort due to his own negligence and despite measures on the part of the resort authorities to save him. Is the resort liable?

HELD: No, the resort is NOT liable. While it is duty bound to provide for safety measures, still it is *not* an absolute insurer of the safety of its customers or visitors. The doctrine of “last clear chance” cannot apply if the:

- (a) negligence of the plaintiff is *concurrent* with the negligence of the defendant;
- (b) party charged is required to act *instantaneously*;
- (c) injury *cannot* be avoided *despite* the application at all times of all the means to avoid the injury (after the peril is or should have been discovered), at least in all instances where the previous negligence of the party charged *can not* be said to have contributed to the injury at all.

Picart v. Smith
37 Phil. 809

FACTS: A person driving an automobile on a bridge saw a man on horseback riding towards him but on the wrong side of the bridge. The driver sounded his horn several times; the horse-rider made no move to go to the correct side; the driver continued in his original direction until it was too late to avoid a collision. Is the auto driver liable?

HELD: Yes, for although the horse-rider was originally at fault, it was the auto driver who had the last clear chance to

avoid the injury by merely swerving, while still some distance away, to the other part of the bridge. “Where both parties are guilty of negligence, but the negligent act of one succeeds that of the other by an appreciable interval of time, the one who has the last reasonable opportunity to avoid the impending harm and fails to do so, is chargeable with the consequences, without reference to the prior negligence of the other party.” That is the doctrine known as the “last clear chance.”

[**NOTE:** The contributory negligence of the victim may of course be considered as a circumstance to *mitigate* the other’s liability. (*Del Prado v. Manila Electric Co.*, 53 Phil. 906).]

Phoenix Construction, Inc. v. IAC
GR 65295, Mar. 10, 1987

The *last clear chance doctrine* of the common law was imported into our jurisdiction, but it is a matter for debate whether, or to what extent, it has found its way into the Civil Code of the Philippines. The historical function of that doctrine in the common law was to mitigate the harshness of another common law doctrine or rule — that of *contributory negligence*.

The common-law rule of contributory negligence prevented any recovery at all by the plaintiff who was also negligent, even if the plaintiff’s negligence was relatively minor as compared with the wrongful act or omission of the defendant. The common-law notion of last clear chance permitted courts to grant recovery to a plaintiff who had also been negligent, provided, that the defendant had the last clear chance to avoid the casualty and failed to do so. It is difficult to see what role, if any, the common-law last clear chance doctrine has to play in a jurisdiction where the common-law concept of contributory negligence as an absolute bar to recovery by the plaintiffs, has itself been rejected, as it has been in Art. 2179.

In a civil law jurisdiction like ours, there is no general concept of “last clear chance” that may be extracted from its common-law matrix and used as a general rule in negligence cases. Under Art. 2179, the task of a court, in technical terms, is to determine whose negligence — the plaintiff’s or defend-

ant's — was the legal or proximate cause of the injury. The task is not simply or even primarily an exercise in chronology or physics, as one may imply by the use of terms like "last" or "intervening." The relative location in the *continuum* of time of the plaintiff's and the defendant's negligent acts or omissions, is only one of the relevant factors that may be taken into account. Of more fundamental importance are the nature of the negligent act or omission of each party and the character and gravity of the risks created by such act or omission for the rest of the community.

(6) Tort Liability May Still Exist Despite Presence of Contractual Relations

**Air France v. Carrascoso
L-21438, Sep. 28, 1966**

FACTS: An airplane passenger despite his first class ticket, was illegally ousted from his first-class accommodation, and was compelled to take a seat in the tourist compartment. *Issue:* May he recover damages from the carrier on the ground of tort?

HELD: Yes, because although the relation between a passenger and a carrier is contractual both in origin and nature, the act that breaks the contract may also be a tort.

[*NOTE:* It would seem here that the Court has in a sense modified somehow Art. 2176 which defines "quasi-delict," for under said *article*, it is important that "there is no pre-existing contractual relation between the parties." Be it noted however that in this case, the Court referred to the liability as one arising from *tort*, and not one arising from a *contract*.]

**Julian C. Singson and Ramona del Castillo v.
Bank of the Philippine Islands
and Santiago Freixas
L-24837, Jun. 27, 1968**

FACTS: Because of a *mistake* committed by a clerk in the Bank of the Philippine Islands, the current or checking account of Julian Singson was frozen by said Bank, and the depositor's checks were dishonored. Singson complained. When

the Bank realized it had committed a mistake, it apologized to Singson, and restored the checking account. Singson, however, sued for damages. It was alleged by the Bank that there would be no liability for the negligence or quasi-delict in view of the existence of contractual relations between the Bank and Singson; that moreover, the Bank had immediately corrected its error. *Issue*: Can Singson recover?

HELD: Yes, damages may be recovered by Singson, despite the existence of contractual relations because the act that breaks the contract may also be a tort or a quasi-delict, as in this case. However, considering the rectification immediately made by the Bank, an award of *nominal damages* — the amount of which need not be proved — in the amount of P1,000 in addition of attorney's fees in the sum of P500, will suffice to vindicate plaintiff's rights. (See Arts. 2208 and 2221, *Civil Code*).

(7) Non-Liability

Ng v. Republic L-31935, Jan. 24, 1980

If a person's registered name is "Baby Ng (Ng Kong Ding)" he cannot be said to have violated the Anti-Alias Law, for the registered name already contains the supposed alias.

(8) An Unregistered Deed of Sale

Equitable Leasing Corp v. Lucita Suyom, et al. GR 143360, Sep. 5, 2002

ISSUE: Can the petitioner, a registered owner of a motor vehicle be held liable for the acts of the driver employed by its former lessee who has become the owner of that vehicle by virtue of an unregistered Deed of Sale?

HELD: Yes. In an action based on *quasi-delict*, the registered owner of a motor vehicle is solidarily liable for injuries and damages caused by the negligence of the driver, in spite of the fact that the vehicle may have already been the subject of an unregistered Deed of Sale in favor of another person.

Unless registered with the Land Transportation Office (LTO), the sale, while valid and binding between the parties, does not affect third parties, especially the victims of accidents involving the said transport equipment.

Art. 2177. Responsibility for fault or negligence under the preceding article is entirely separate and distinct from the civil liability arising from negligence under the Penal Code. But the plaintiff cannot recover damages twice for the same act or omission of the defendant.

COMMENT:

(1) Culpa Aquiliana Distinguished From Civil Liability Arising From a Crime

See Table under the preceding Article.

(2) Effect of Acquittal in a Criminal Case

Acquittal from an accusation of criminal negligence whether on reasonable doubt or not, shall *not* be a bar to a subsequent civil action. (*Report of the Code Com., p. 62 and Chan v. Yatco, L-11163, Apr. 30, 1958*). (*Reason: The evidence in the criminal case may not be sufficient for a conviction, but sufficient for a civil liability, where mere preponderance of evidence is sufficient. Moreover, the basis of liability is different in the two cases: in a criminal case, the liability is subsidiary to the criminal case, the liability is subsidiary to the criminal punishment; in a case of culpa aquiliana, the liability is primary. (TS, Nov. 22, 1940 and See Calo, et al. v. Peggy, L-10756, Mar. 29, 1958].*) However, under the Revised Rules of Court, the civil action must have been RESERVED, otherwise the civil case will NOT prosper. (*Rule 111*).

**Marcia v. Court of Appeals
GR 34529, Jan. 27, 1983**

If in a criminal case for reckless imprudence resulting in physical injuries, the accused is acquitted because he was not negligent and the incident was a “pure accident,” a separate civil action should be dismissed.

[**NOTE:** Here, the court said that Art. 33 of the Civil Code speaks only of intentional or malicious acts. It forgot that Art. 2177 read together with Art. 2176 provides for an independent civil action for negligent acts. However, the conclusions reached by the court may be justified on the ground that there was also no negligence in this present case.]

(3) Query

If a hurt pedestrian files a criminal case against the driver of a common carrier, is he allowed *at the same time* (or at any stage during the pendency of the *criminal* case) to bring a civil action based on *culpa aquiliana*?

ANS.: It would seem that the correct answer to this problem is YES provided that a RESERVATION to bring the civil case had been set up in the criminal case. (*See Rule 111, Revised Rules of Court*). In other words, in a case like this it is *not essential* to first terminate the criminal case before the civil case of quasi-delict is brought. Indeed, the civil liability that may arise from *culpa aquiliana* was never intended by the law to be merged in the criminal action. The criminal prosecution is not a condition precedent to the enforcement of the civil right. (*Batangas, Laguna, Tayabas Bus Co., Inc., et al. v. Court of Appeals, et al., L-33138-9, Jun. 27, 1975*).

**Batangas, Laguna, Tayabas, Bus Co., Inc. v.
Court of Appeals, et al.
L-33138-39, Jun. 27, 1975**

FACTS: As a result of the recklessness of a driver (Ilagan) of a bus of BLTB Company in overtaking a cargo truck, the bus crashed into an automobile coming from the opposite direction, resulting to death and physical injuries to the passengers of the automobile. A criminal case was brought, but during its pendency, a civil case based on *culpa aquiliana* under Art. 2177 of the Civil Code was filed. **Issue:** Can the civil action of *culpa aquiliana* proceed independently of the pending criminal case, or must the judgment in the criminal case be first awaited before proceeding with the civil case?

HELD: The civil case of *culpa aquiliana* can proceed independently of the pending criminal case. This is expressly allowed under Art. 2176 and Art. 2177 of the Civil Code, be-

cause *culpa aquiliana* is an independent source of obligations. The case of *Corpus v. Paje*, L-26737, Jul. 31, 1969 does not apply because the statement therein that no independent civil action lies in a case of *culpa aquiliana* or reckless imprudence (because Art. 33 of the Civil Code does not mention reckless imprudence) is *really not doctrinal in character*, lacking as it does, one vote to make it an expression of the court opinion.

[**NOTE:** In fact, while it is true that Art. 33 makes no mention of negligence, Art. 2177 refers to negligence or *culpa aquiliana* and makes the suit an independent civil action.]

(4) Rule under the 1985 Rule of Court, as Amended in 1988

While Art. 2177 gives an independent civil action, still the Revised Rules of Court required that if a criminal case be instituted first, the independent civil action is also automatically instituted unless there is an *express* reservation or waiver. (*Rule 111*). If, on the other hand, the civil case of *culpa aquiliana* is *first* brought, the subsequent institution of the criminal case will NOT SUSPEND the civil action — otherwise, it cannot then be called *independent*. Moreover, the very institution of the civil case ahead of the criminal action satisfied the requirement of “reservation.”

**Garcia v. Florido
L-35095, Aug. 31, 1973**

FACTS: After a vehicular accident, the victims were brought to the hospital for treatment. In the meantime, the police authorities filed a criminal case of reckless imprudence resulting in physical injuries, WITHOUT making a reservation as to the civil aspect. When the victims became well enough to go to court, they decided to file a *civil case* despite the pendency of the criminal case.

ISSUE: Should the civil case be allowed, despite the pendency of the criminal proceedings?

HELD: Yes, for while it is true that a reservation should have been made under Rule 111 of the Revised Rules of Court (through such rule has been assailed by SOME in this respect as virtually eliminating or amending the “substantive” right

of allowing an “independent civil action,” as ordained by the Civil Code) *still the Rule does not state when the reservation is supposed to be made*. Here, the victims had no chance to make the reservation (for they were still at the hospital); moreover, the *trial has not even begun*. It is therefore not yet too late to make the reservation; in fact, the actual filing of the civil case, though at this stage, is even better than the making of the reservation.

**Crispin Abellana and Francisco Abellana v.
Hon. Geronimo R. Maraue
and Geronimo Companer, et al.
L-27760, May 29, 1974**

FACTS: Francisco Abellana was driving a cargo truck when he hit a motorized pedicab. Four of the passengers of the pedicab were injured. He was accused in the City Court of Ozamis for his reckless imprudence (no reservation was made as to any civil action that might be instituted); he was convicted. He then appealed to the Court of First Instance (Regional Trial Court). During the pendency of the appeal (and in fact, before trial in the CFI [RTC]) the victims decided to make a waiver re claim for damages in the criminal case, and RESERVATION with respect to the civil aspects. The victims then in another Branch of the CFI (RTC) allowed the FILING of the civil case. The accused objected to the allowance on the theory that in the City Court (original court), no *reservation* had been made, thus the civil aspect should be deemed included in the criminal suit, conformably with Rule 111 of the Revised Rules of Court. The CFI (RTC) maintained that the civil case should be allowed, because with the appeal the judgment of the City Court had become *vacated* (said court was then not a court of record) and in the CFI (RTC) the case was to be tried anew (trial *de novo*). This ruling of the CFI (RTC) was elevated to the Supreme Court on *certiorari*.

ISSUE: May a civil case still be brought despite the appeal in the criminal case?

HELD: Yes, for three reasons.

- (a) *Firstly*, with the appeal, the original judgment of conviction was VACATED; there will be a trial *de novo* in

the CFI. A trial that has not even began, therefore, a reservation can still be made and a civil action can still be allowed.

- (b) *Secondly*, to say that the civil action is barred because no reservation (pursuant to Rule 111) had been made in the City Court when the criminal suit was filed is to present a grave constitutional question, namely, can the Supreme Court, in Rule 111 amend or restrict a SUBSTANTIVE right granted by the Civil Code? This cannot be done. The apparent *literal* import of the Rule cannot prevail. A judge “is not to fall prey,” as admonished by Justice Frankfurter, “to the vice of literalness.”
- (c) *Thirdly*, it would be UNFAIR, under the circumstances if the victims would not be allowed to recover any civil liability, considering the damage done to them.

Escueta v. Fandialan
L-39675, Nov. 29, 1974

ISSUE: One of the questions presented in this case was — when a criminal case is filed, is there a need of making a reservation if it is desired to sue later on an independent civil action?

HELD: There is NO NEED, because the civil case is one considered as an “independent civil action.”

[*NOTE:* How about Rule 111, Revised Rules of Court, which *requires the reservation*, even if an independent civil action is involved?]

(5) No Double Recovery

Padua, et al. v. Robles, et al.
L-40486, Aug. 29, 1975

FACTS: Because of the recklessness of a taxi-driver, a boy (Padua) was killed. A criminal case was instituted against Punzalan, the taxi-driver. At the same time, a civil action for damages was filed against both the *driver* and the *owner of the taxi* (Robles). The two cases were raffled off to the same

judge for decision. In the civil case, the taxi-cab owner (company) was not made to pay anything (ostensibly because it was able to prove due diligence in the selection and supervision of employees) but the taxi-driver, who was found negligent, was held liable for damages (P12,000 for actual damages, P5,000 for moral and exemplary damages, and P10,000 for attorney's fees). In the criminal case, the judge convicted the taxi-driver, but with reference to his civil liability, the court did not fix any sum, stating only that the "civil liability of the accused is already determined and assessed in the civil case." When the judgment in the civil case became final and executory, the parents of the victim sought its execution, but the writ issued against the driver was returned unsatisfied because of his insolvency. The parents now sued the employer to enforce his *subsidiary* liability under the Revised Penal Code because of the driver's conviction. Robles, the employer pleaded *res judicata*. *Issue*: Can the employer still be held liable?

HELD: Yes, the employer can still be held liable because the judgment in the criminal case, in talking of the driver's civil liability, made reference to the decision in the civil case, relative to the driver's financial accountability. It is this amount for which the employer is subsidiarily liable under Art. 103 of the Revised Penal Code. Further, there is no *res judicata* because the responsibility of an employer in *culpa aquiliana* (the civil case) is different from his liability in *culpa criminal* (the subsidiary civil liability in the criminal case). The only limitation is that while it is possible that in both cases the employer can be held liable, actual recovery for damages can be availed of only once.

(6) Dec. 1, 2000 Amended Rules

**Avelino Casupanan & Roberto Capitulo v.
Mario Llavore Laroya
GR 145391, Aug. 26, 2002**

FACTS: The petition premises the legal controversy in this wise: "In a certain vehicular accident involving two parties, each one of them may think and believe that the accident was caused by the fault of the other. The first party, believing himself to be the aggrieved party, opted to file a criminal

case for reckless imprudence against the second party. Upon the other hand, the *second party*, together with the operator, believing themselves to be the real aggrieved parties, opted in turn to file a civil case for quasi-delict against the *first party* who is the very private complainant in the criminal case.”

ISSUE: Whether or not an accused in a pending criminal case for reckless imprudence can validly file, simultaneously and independently, a separate civil action for quasi-delict against private complainant in the criminal case.

HELD: Par. 6, Sec. 1 of the present Rule III of the Rules of Court was incorporated in the Dec. 1, 2000 Amended Rules precisely to address the issue. Under this provision, the accused is barred from filing a counterclaim, cross-claim, or third-party complaint in the criminal case. However, the same provision states that “any cause of action which could have been the subject (of the counterclaim, cross-claim, or third party complaint) may be litigated in a separate civil action.” The present Rule III mandates the accused to file his counterclaim in a separate civil action which shall proceed independently of the criminal action, even as the civil action of the offended party is litigated in the criminal action.

The accused can file a civil action for *quasi-delict* for the same act or omission he is accused of in the criminal case. This is expressly allowed in par. 6, Sec. 1 of the present Rule III which states that the counterclaim of the accused “may be litigated in a separate civil action.” This is only fair for two (2) reasons:

1. The accused is prohibited from setting up any counterclaim in the civil aspect that is deemed instituted in the criminal case. The accused is, therefore, forced to litigate separately his counterclaim against the offended party. If the accused does not file a separate civil action for quasi-delict, the prescriptive period may set in since the period continues to run until the civil action for *quasi-delict* is filed.
2. The accused, who is presumed innocent, has a right to invoke Art. 2177, in the same way that the offended party can avail of this remedy which is independent of the criminal action. To disallow the accused from filing a separate civil action for *quasi-delict*, while refusing

to recognize his counterclaim in the criminal case, is to deny him due process of law, access to the courts, and equal protection of the law.

The civil action based on *quasi-delict* filed separately, is, thus, proper.

[NOTE: More than half-a-century has passed since the Civil Code introduced the concept of a civil action separate and independent from the criminal action although arising from the same act or omission. The Supreme Court, however, has yet to encounter a case of conflicting and irreconcilable decisions of trial courts, one hearing the criminal case and the other the civil action for quasi-delict. The fear of conflicting and irreconcilable decisions may be more apparent than real. In any event, there are sufficient remedies under the Rules of Court to deal with such remote possibilities. (*Avelino Casupanan & Roberto Capitulo v. Marioi Llavore Laroya, supra*).]

[NOTE: The Revised Rules on Criminal Procedure took effect on December 1, 2000 while the Municipal Circuit Trial Court (MCTC) in the *Casupanan & Capitulo case (supra)* issued the order of dismissal on Dec. 28, 1999 or before the amendment of the rules. The Revised Rules on Criminal Procedure must be given retroactive effect considering the well-settled rule that “statutes regulating the procedure of the court will be construed as applicable to actions pending and undetermined at the time of their passage. Procedural laws are retroactive in that sense and to that extent.” (*People v. Arrojado, 350 SCRA 679 [2001], citing Ocampo v. CA, 180 SCRA 27 [1989], Alday v. Camilon, 120 SCRA 521 [1983], and People v. Sumilong, 77 Phil. 764 [1946]*).]

Art. 2178. The provisions of Articles 1172 to 1174 are also applicable to a quasi-delict.

COMMENT:

(1) Applicability of Some Provisions on Negligence

- (a) *Art. 1172* — Responsibility arising from negligence in the performance of every kind of obligation is also demand-

able, but such liability may be regulated by the courts, according to the circumstances.

- (b) *Art. 1173* — The fault or negligence of the obligor consists in the omission of that diligence which is required by the nature of the obligation and corresponds with the circumstances of the persons, of the time and of the place. When negligence shows bad faith, the provisions of articles 1171 and 2201, paragraph 2 shall apply.

If the law or contract does not state the diligence which is to be observed in the performance, that which is expected of a good father of a family shall be required.

- (c) *Art. 1174* — Except in cases expressly specified by the law, or when it is otherwise declared by stipulation, or when the nature of the obligation requires the assumption of risk, no person shall be responsible for those events which could not be foreseen, or which, though foreseen were inevitable.

(2) Cases

Ronquillo, et al. v. Singson (C.A.) L-22612-R, Apr. 22, 1959

FACTS: A man ordered a ten-year-old boy, Jose Ronquillo, to climb a high and rather slippery santol tree, with a promise to give him part of the fruits. The boy was killed in the act of climbing. Is the person who ordered him liable?

HELD: Yes, in view of his negligent act in making the order. He did not take due care to avoid a reasonably foreseeable injury to the 10-year-old boy. The tree was a treacherous one, a veritable trap. His act was clearly a departure from the standard of conduct required of a prudent man. He should have desisted from making the order. Since he failed to appreciate the predictable danger and aggravated such negligence by offering part of the fruits as a reward, it is clear that he should be made to respond in damages for the actionable wrong committed by him.

**Vda. de Imperial, et al. v. Herald Lumber Co.
L-14088-89, L-14112, Sep. 30, 1961**

Undertaking an airplane or helicopter flight *without* sufficient fuel is a clear case of negligence. Moreover, the piloting of a helicopter by an *unlicensed* individual violates Civil Aviation Regulations.

Art. 2179. When the plaintiff's own negligence was the immediate and proximate cause of his injury, he cannot recover damages. But if his negligence was only contributory, the immediate and proximate cause of the injury being the defendant's lack of due care, the plaintiff may recover damages, but the courts shall mitigate the damages to be awarded.

COMMENT:

(1) Effect of Sole Cause of Injury is a Person's Own Negligence

It is understood that if the *sole* cause is the plaintiff's own fault, there can be no recovery. (*TS, May 31, 1932*).

(2) Effect of Contributory Negligence of Plaintiff

- (a) If this was the PROXIMATE cause of the accident, there can be no recovery. (*Taylor v. Manila Electric Co., 16 Phil. 8*).
- (b) If the PROXIMATE cause was still the negligence of the defendant, the plaintiff can still recover damages, BUT the amount of damages will be mitigated due to his contributory negligence. (*Art. 2179*). Thus, if he contributes to the aggravation of the injury, damages in his favor will be reduced. (*Rakes v. Atlantic Gulf and Pacific Co., 7 Phil. 359; Bernal v. House, 54 Phil. 327 and Del Rosario v. Manila Electric Co., 57 Phil. 478*).

[NOTE: The courts have held that in CRIMES committed thru reckless imprudence, the defense of contributory negligence does NOT apply. One cannot allege the negligence of another to evade the effects of his own negli-

gence. (*People v. Orbeta*, 43 O.G. 3175; *People v. Quiñones*, 44 O.G. 1520 and *People v. Cabusao, C.A., L-20191-R, Sep. 7, 1958*).]

(3) Proximate Cause

It is that adequate and efficient cause which in the natural order of events, and under the particular circumstances surrounding the case, would naturally produce the event. (3 *Bouvier's Law Dictionary* 434).

Saturnino Bayasen v. Court of Appeals **L-25785, Feb. 28, 1981**

While being driven at a moderate speed, a passenger jeep skidded and fell into a precipice. It was proved that the proximate cause of the tragedy was the skidding of the rear wheels of the jeep. Is the driver guilty of negligence?

HELD: No, for there was no negligence. Cars may skid on greasy or slippery roads without the driver's fault. Skidding means partial or complete loss of control of the car under circumstances not necessarily implying negligence. It may occur without fault.

Phoenix Construction, Inc. v. IAC **GR 65295, Mar. 10, 1987**

If the intervening cause is one which in ordinary human experience is reasonably to be anticipated, or one which the defendant has reason to anticipate under the particular circumstances, the defendant may be negligent, among other reasons, because of failure to guard against it; or the defendant may be negligent only for that reason.

Example:

One who sets a fire may be required to foresee that an ordinary, usual and customary wind arising later will spread it beyond the defendant's own property, and therefore to take precautions to prevent that event. The person who leaves combustible or explosive material exposed in a public place may foresee the risk of fire from some independent source. In all of these cases there is an intervening cause combin-

ing with the defendant's conduct to produce the result, and in each case the defendant's negligence consists in failure to protect the plaintiff against that very risk.

The defendant cannot be relieved from liability by the fact that the risk or a substantial and important part of the risk, to which the defendant has subjected the plaintiff has indeed come to pass. Foreseeable intervening forces are within the scope of the original risk, and hence of the defendant's agreed negligence. The courts are quite, generally, agreed the intervening causes which fall fairly in this category will not supersede defendant's responsibility. A defendant will be required to anticipate the usual weather of the vicinity, including all ordinary forces of nature such as usual wind or rain, or snow or frost or fog or even lightning. One who leaves an obstruction on the road or a railroad track should foresee that a vehicle or a train will run into it.

The risk created by the defendant may include the intervention of the foreseeable negligence of others. The standard of reasonable conduct may require the defendant to protect the plaintiff against "that occasional negligence which is one of the ordinary incidents of human life, and therefore to be anticipated."

Example:

A defendant who blocks the sidewalk and forces the plaintiff to walk in a street where the plaintiff will be exposed to the risks of heavy traffic becomes liable when the plaintiff is run down by a car, even though the car is negligently driven. One who parks an automobile on the highway without lights at night is not relieved of responsibility when another negligently drives into it.

**Phoenix Construction, Inc. v. IAC
GR 65295, Mar. 10, 1987**

FACTS: At about 1:30 a.m., *LD* was on his way home from a cocktails-and-dinner meeting with his boss. During the cocktails, *LD* had taken a "shot or two" of liquor. *LD* was driving his car and had just crossed the intersection, not far from his home when his headlights suddenly failed. He

switched his headlights on “bright” and thereupon he saw a Ford dump truck looming some 2-1/2 meters away from his car. The dump truck, owned by Phoenix Construction, Inc. was parked on the right hand side of the street (*i.e.*, on the right hand side of a person facing in the same direction toward which *LD*’s car was proceeding), facing the oncoming traffic. The dump truck was parked askew (not parallel to the street curb) in such manner as to stick out onto the street, partly blocking the way of oncoming traffic. There were no lights nor any so-called “early warning” reflector devices set anywhere near the dump truck, front or rear. *LD* tried to avoid a collision by swerving his car to the left but it was too late and his car smashed into the dump truck. *LD* suffered physical injuries including some permanent facial scars, a “nervous breakdown” and loss of two gold bridge dentures.

LD sued Phoenix and its driver claiming that the legal and proximate cause of his injuries was the negligent manner in which phoenix’s driver had parked the dump truck. Phoenix and its driver countered that the proximate cause of *LD*’s injuries was his own recklessness in driving fast at the time of the accident, while under the influence of liquor, without his headlights on and without a curfew pass. Phoenix also sought to establish that it had exercised due care in the selection and supervision of the driver. The trial court rendered judgment in favor of *LD*. The Court of Appeals affirmed the decision but modified the award of damages.

On petition for review, the Supreme Court found that *LD* was negligent the night of the accident. He was hurrying home that night and driving faster than he should have been. Worse, he extinguished his headlights at or near the intersection, as he approached his residence, and thus did not see the dump truck that was parked askew and sticking out onto the road lane. Nevertheless, the Supreme Court agreed with the trial court and the appellate court that the legal and proximate cause of the accident and of *LD*’s injuries was the wrongful and negligent manner in which the truck was parked. The Supreme Court —

HELD: There was a reasonable relationship between the dump truck driver’s negligence on the one hand and the accident and *LD*’s injuries on the other hand. The collision of

LD's car with the dump truck was a natural and foreseeable consequence of the truck driver's negligence. The truck driver's negligence far from being a "passive and static condition" was an indispensable and efficient cause. The collision between the dump truck and *LD's* car would in all probability not have occurred had the dump truck not been parked askew without any warning lights or reflector devices. The improper parking of the dump truck created an unreasonable risk of injury for anyone driving and for having so created this risk the truck driver must be held responsible. *LD's* negligence, although later in point of time than the truck driver's negligence, and therefore closer to the accident, was not an efficient intervening or independent cause. What Phoenix and its driver describe as an "intervening cause" was no more than a foreseeable consequence of the risk created by the negligent manner in which the truck driver had parked the dump truck. *LD's* negligence was not of an independent and overpowering nature as to cut, as it were, the chain of causation in fact between the improper parking of the dump truck and the accident, nor to sever the *juris vinculum* of liability. *LD's* negligence was "only contributory." The immediate and proximate cause of the injury remained the truck driver's "lack of due care." Hence, *LD* may recover damages though such damages are subject to mitigation by the Courts.

The *last clear chance* doctrine of the common law, imported into our jurisdiction, has no role to play in a jurisdiction where the common law concept of contributory negligence as an absolute bar to recovery by the plaintiffs has itself been rejected in Art. 2179. Our law on quasi-delicts seeks to reduce the risks and burdens of living in society and to allocate them among the members of society. The truck driver's proven negligence creates a presumption of negligence on the part of his employer in supervising its employees properly and adequately.

(4) Examples of Proximate Cause

- (a) If a passenger boxes a bus driver who subsequently loses control of the vehicle, the act of the passenger is the proximate cause.
- (b) If the Meralco leaves an exposed live wire, and subsequent electrocution follows because somebody touches

the wire, the negligence of the Meralco is the proximate cause. (*TS, Feb. 24, 1928*).

- (c) If somebody neglects to cover his ditch (filled with hot water) and a child carelessly falls into it, the negligence is the proximate cause, though the contributory negligence of the child would reduce the amount of recoverable damages. (*Bernal and Enverso v. House & Tacloban Electric and Ice Plant, 54 Phil. 327*).
- (d) If the damaged vehicle was driven by a reckless driver who made the vehicle travel at a very high rate of speed and on the wrong side of the road, it is clear that this negligence was the proximate cause of the collision. (*Tuason v. Luzon Stevedoring Co., et al., L-13514, Jan. 28, 1961*).

(5) Case

Metro Manila Transit Corp. & Apolinario Ajoc v. CA, etc. GR 141089, Aug. 1, 2002

FACTS: Petitioners were found liable for the death of Florentina Sabalburo by the trial court in a vehicular accident involving a passenger bus owned by petitioner. Metro Manila Transit Corp. (MMTC) and driven by petitioner Apolinario Ajoc. Accordingly, petitioners were ordered to pay damages to private respondents.

Petitioners reasonably appealed to the Court of Appeals (CA), insisting that the accident was solely the fault of the victim since she suddenly crossed a very busy street with complete disregard for her safety and in violation of traffic rules and regulations designed to protect pedestrians. The CA affirmed the trial court's decisions. Petitioners then moved for reconsideration, but the CA denied their motion in its resolution of Dec. 10, 1999. Hence, the present petition.

ISSUE: Whether or not Art. 2179 as an exception to Art. 2176 is applicable in the instant case.

HELD: Records support private respondents' claim that the MMTC bus was being driven carelessly. As found by the

trial court and affirmed by the CA, the victim and her companions were standing on the island of Andrew Ave., waiting for the traffic light to change so they could cross. Upon seeing the red light, the victim and her companions started to cross. It was then when petitioner Ajoc, who was trying to beat the red light, hit the victim. As the court *a quo* noted, Ajoc's claim that "he failed to see the victim and her companions proves his recklessness and lack of caution in driving his vehicle."

Findings of fact of the trial court, especially when affirmed by the CA, are binding and conclusive on the Supreme Court. (*Austria v. CA*, 327 SCRA 668 [2000]). Moreso, as in the case at bar, where petitioners have not adequately shown that the courts below overlooked or disregarded certain facts or circumstances of such import as would have altered the outcome of the case. Contrary to petitioners' insistence, the applicable law in this case is Art. 2176 and not Art. 2179.

Art. 2180. The obligation imposed by Article 2176 is demandable not only for one's own act or omissions, but also for those of persons for whom one is responsible.

The father, and, in case of his death or incapacity, the mother, are responsible for the damages caused by the minor children who live in their company.

Guardians are liable for damages caused by the minors or incapacitated persons who are under their authority and live in their company.

The owners and managers of an establishment or enterprises are likewise responsible for damages caused by their employees in the service of the branches in which the latter are employed or on the occasion of their functions.

Employers shall be liable for the damages caused by their employees and household helpers acting within the scope of their assigned tasks, even though the former are not engaged in any business or industry.

The State is responsible in like manner when it acts through a special agent; but not when the damage has been caused by the official to whom the task done properly per-

tains, in which case what is provided in article 2176 shall be applicable.

Lastly, teachers or heads of establishments of arts and trades shall be liable for damages caused by their pupils and students or apprentices, so long as they remain in their custody.

The responsibility treated of in this article shall cease when the person herein mentioned prove that they observed all the diligence of a good father of a family to prevent damage.

COMMENT:

(1) Liability for the Acts and Omissions of Another

This Article deals with liability for the acts and omissions of another.

(2) Reason for the Liability

Negligence in supervision. (*See Bahia v. Litonjua*, 30 Phil. 624).

[**NOTE:** This negligence is PRESUMED but may be rebutted by proof of diligence. (*See last paragraph, Art. 2180*).]

(3) Solidarily Liability

The person responsible for the act (like the minor), and the person exercising supervision (like the parents) are solidarily liable. (*Art. 2194; Araneta, et al. v. Arreglado, et al.*, 104 Phil. 529). Indeed, the liability of the guardian or master is primary and direct, NOT subsidiary. (*Barredo v. Soriano*, 73 Phil. 607).

[**NOTE:** The mother is liable only if the father is dead or incapacitated, hence, if the father is alive and all right, the mother should not be joined as party defendant. (*Romano, et al. v. Pariñas, et al.*, 101 Phil. 140).]

[**NOTE:** If a minor child negligently operates the family car, the head of the family and owner of the car can be sued for liability. (*Gutierrez v. Gutierrez*, 56 Phil. 177).]

Maria Teresa Cuadra v. Alfonso Monfort
L-24101, Sep. 30, 1970

FACTS: While playing inside a shooyard, a 13-year-old girl playfully tossed as a joke a girl's headband at her 12-year-old girl classmate. The latter, who was surprised by the act, turned around only to have her eyes hit. One eye eventually became blind after unsuccessful surgical operations thereon. The victim then sued the culprit's father for damages. Is the defendant liable.

HELD: No, the culprit's father is *not* liable, for he could *not* have prevented the damage in any way. The child was at school, where she ought to be under the supervision of the school authorities.

(DISSENTING OPINION of Justice Antonio Barredo:

The culprit's father should be held liable for *no proof* was presented that he even warned the child *not* to play dangerous jokes on her classmates; the burden of proof of non-negligence must be on the part of the culprit's parents or guardians.)

[**NOTE:** In the said case, no suit was brought against the school authorities, the teacher in charge, or the school itself.]

Libi, et al. v. IAC, et al.
GR 70890, Sep. 18, 1992

The civil liability of parents for *quasi-delicts* of their minor children, as contemplated in Art. 2180 of the Civil Code, is primary and not subsidiary. In fact, if we apply Art. 2194 of said code which provides for solidary liability of joint tortfeasors, the persons responsible for the act or omission, in this case, the minor and the father and, in case of his death or incapacity, the mother, are solidarily liable. Accordingly, such parental liability is primary and not subsidiary; hence, the last paragraph of Art. 2180 provides that "[t]he responsibility treated of in this article shall cease when the persons herein mentioned prove that they observed all the diligence of a good father of a family to prevent damage." To hold that the civil liability under Art. 2180 would apply only to *quasi-delicts* and not to criminal offenses would result in

the absurdity that in an act involving mere diligence, the parents would be liable but not where the damage is caused with criminal intent. The liability of the parents for felonies committed by their minor children is likewise primary, not subsidiary. (*See Art. 101 of the Revised Penal Code*). It bears stressing, however, that the Revised Penal Code provides for subsidiary liability only for persons causing damages under the compulsion of irresistible force or under the impulse of an uncontrollable fear; innkeepers, tavernkeepers, and proprietors of establishments; employers, teachers, persons, and corporations engaged in industry; and principals, accomplices, and accessories for the unpaid civil liability of their co-accused in the other classes.

Under the foregoing considerations, therefore, it is hereby ruled that the parents are and should be held primarily liable for the civil liability arising from criminal offenses committed by their minor children under their legal authority or control, or who live in their company, unless it is proven that the former acted with the diligence of a good father of a family to prevent such damages. In the case at bar, whether the death of the hapless Julie Ann Gotiong was caused by a felony or a *quasi-delict* committed by Wendell Libi, respondent court did not err in holding petitioners liable for damages arising therefrom. Subject to the preceding modifications relied upon by it, therefore, and on the bases of the legal imperatives herein explained, the Court is conjoined in its findings that said petitioners failed to duly exercise the requisite *diligentissimi patris familias* to prevent such damages.

(4) Owners and Managers

**Phil. Rabbit Bus Lines, Inc., et al. v.
Phil. Am. Forwarders, Inc., et al.
L-25142, Mar. 25, 1975**

FACTS: An action for damages was brought against the Phil. Am. Forwarders, Inc. because of the alleged negligence of the driver. Included as defendants were the corporation, and a certain Balingit, the manager of the corporation. A motion was filed to dismiss the case against the manager Balingit

on the ground that while indeed he was the *manager*, he was also a mere *employee* of the company. Now then, under the fourth paragraph of Art. 2180, the law speaks of “owners and managers” as being liable. *Issue*: Should Balingit be released from the complaint?

HELD: Yes, because the term ‘manager’ in Art. 2180 (fourth paragraph) is used in the sense of employer, not employee. Hence, there is no cause of action against Balingit.

(5) Employers

- (a) In paragraph 5, note that the employers can be liable even if “not engaged in any business or industry.” If a complaint, therefore, makes *no* reference to such business or industry, there is still a *cause of action*, and the complaint should NOT be dismissed. (*Ortaliz v. Echarri*, 101 Phil. 947).
- (b) It should be noted, too, that paragraph 5 refers to “employees and household helpers,” *not* to strangers. So if a stranger should drive another’s car without the latter’s consent, the owner is NOT liable, even if he is engaged in an industry. (*Duquillo v. Bayot*, 67 Phil. 131).
- (c) One who hires an “independent contractor” but controls the latter’s work, is responsible also for the latter’s negligence. (*See Cuison v. Norton and Harrison Co.*, 55 Phil. 18).
- (d) The registered owner of a public utility vehicle continues to be its owner if he leases it to another *without* the permission of the Public Service Commission. Therefore, even if the driver of the *lessee is negligent*, the registered owner can still be held liable. (*Timbol v. Osias, et al.*, 96 Phil. 989; *Montoya v. Ignacio*, L-5868, Dec. 29, 1953). Indeed, to exempt from liability the owner of a public vehicle who operates it under the “boundary system” on the ground that he merely leases it to the driver would not only be to abet a flagrant violation of the Public Service Law but also to place the riding public at the mercy of reckless and irresponsible drivers: “reckless” because the measure of their earnings would depend

largely upon the number of trips they make and hence, the speed at which they drive; and “irresponsible” because most, if not all of them, are in no position to pay damages they might cause. (*Magboo v. Bernardo*, L-16790, Apr. 30, 1963).

Vinluan v. Court of Appeals
L-21477-81, Apr. 29, 1966

FACTS: A passenger of a bus was hurt because of the negligence of the driver of the bus as well as the negligence of the driver of another vehicle. Who should be liable?

HELD: According to the court, four persons are liable: the owner of the bus, the driver of the bus, the owner of the other vehicle, and the driver of said other vehicle — and their liability is SOLIDARY — notwithstanding the fact that the liability of the bus company is predicated on a CONTRACT, while the liability of the owner and driver of the other vehicle is based on a QUASI-DELICT. (*Observation:* The bus driver can be excused on the basis of *culpa contractual* for the contract of common carriage was *not* with him, but with the bus company; nonetheless, he can be held liable on the basis of *culpa aquiliana*, there being no pre-existing contract between him and the passenger. Note also that the owner of the *other* vehicle can be excused if he can prove due diligence in the selection and supervision of his driver, under Art. 2180, last paragraph, *unless* at the time of the collision, said owner was also in his vehicle, in which case, notwithstanding due care in selection and supervision, he would still be liable, if he could have, by use of diligence prevented the misfortune. (*See Art. 2184*).

Ramos v. Pepsi-Cola
L-22533, Feb. 9, 1967

FACTS: A driver of Pepsi-Cola is admittedly negligent in a vehicular collision. Suit was brought by the other car owner against both the driver and Pepsi-Cola. But Pepsi-Cola was able to prove diligence in selection

(*no culpa in eligiendo*) and supervision (*no culpa in vigilando*) of the driver. For instance, it was proved that Pepsi-Cola had carefully previously examined the erring driver as to his qualifications, record of service, and experience. Is Pepsi-Cola still liable?

HELD: No, otherwise it would have been liable solidarily with the driver. In Philippine torts, we do *not* follow the doctrine of *respondeat superior* (where the negligence of the servant is the negligence of the master). Instead, we follow the rule of *bonus pater familias* (good father of a family). The negligence of the employer here indicated in the last paragraph of Art. 2180, is *only presumptive*; it can therefore be rebutted, as in this case.

**Bernardo Jocson and Maria D. Jocson v.
Redencion Glorioso
L-22686, Jan. 30, 1968**

FACTS: For the death of a three-year-old boy who was run over by a passenger jeepney, two actions were filed by the parents: the first, against the owner and the driver for *culpa aquiliana*, and the other, against the driver for homicide through reckless imprudence, the criminal action having been instituted while the civil case was pending trial. The civil case was dismissed; but the criminal case resulted in a conviction for homicide through reckless imprudence. Aside from the prison sentence imposed, the driver was also ordered to indemnify the heirs of the deceased the sum of P6,000 with subsidiary imprisonment in case of insolvency. A writ for the execution of the civil liability was returned unsatisfied due to the insolvency of the accused. The parents of the victim then sued the owner of the jeepney, pursuant to Art. 103 of the Revised Penal Code. The owner claims that the previous dismissal of the *culpa aquiliana* case should now prevent the application of the subsidiary liability of an owner under the Revised Penal Code. Is this claim correct?

HELD: The claim is *not* correct. After all, the *culpa aquiliana* case had a different cause of action from this case involving the subsidiary liability of an employer

for an employee's criminal act. In other words, we have the controlling rule that once there is a conviction for a felony, final in character, the employer, according to the plain and explicit command of Art. 103 of the Revised Penal Code, is subsidiarily liable, if it be shown that commission thereof was in the discharge of the duties of such employee.

Malipol v. Tan
L-27730, Jan. 21, 1974
54 SCRA 202
(1974)

FACTS: Labsan, a driver of a gasoline tanker used in the business of his employer, Tan, hit a pedestrian, causing the latter's death. In the civil action filed by the heirs of the victim against both Labsan and Tan, no allegation was made that a crime had been committed. The trial court found the driver reckless, and so it held *Tan primarily* liable on the basis of a quasi-delict, without prejudice to the right of Tan to demand reimbursement from the driver. *Issue:* Is the imposition of primary liability on Tan proper?

HELD: Yes, the imposition of *primary* liability on an employer in the case of a quasi-delict is proper in the absence of an allegation that a crime had been committed in which latter case, the liability of the employer would only be subsidiary.

[*NOTE:* In a quasi-delict, *both* employer and employee are *solidarily* liable, unless employer is able to prove due diligence in the selection and supervision of employees. Here Tan did not present any such defense since he was declared in default.]

St. Francis High School v. CA
GR 82465, Feb. 25, 1991

FACTS: Ferdinand Castillo, a freshman student at the St. Francis High School wanted to join a school picnic at the beach. Ferdinand's parents, because of short notice, did not allow their son to join but merely allowed him to bring food to the teachers for the picnic, with

the directive that he should go back home after doing so. However, because of the persuasion of the teachers, Ferdinand went on with them to the beach. During the picnic and while the students, including Ferdinand, were in the water, one of the female teachers was apparently drowning. Some of the students, including Ferdinand, came to her rescue, but in the process, it was Ferdinand himself who drowned. Ferdinand's parents sued the school and the teachers for damages allegedly incurred from the death of their 13-year-old son. Contending that the death of their son was due to the failure of defendants to exercise the proper diligence of a good father of the family in preventing their son's drowning, they (Ferdinand's parents) prayed for actual moral and exemplary damages, attorney's fees and expenses for litigation. The trial court found in favor of plaintiffs and against the teachers, ordering all of them to pay plaintiffs P30,000 as actual damages, P20,000 as moral damages, P15,000 as attorney's fees and to pay the costs. However, the court dismissed the case against the school. The Court of Appeals (CA) ruled that the school and the teachers are guilty of negligence and liable for Ferdinand's death.

ISSUES:

(1) Whether there was negligence attributable to the defendants which will warrant the award of damages to the plaintiffs.

(2) Whether or not Art. 2180, in relation to Art. 2176 of the new Civil Code, is applicable to the case at bar.

(3) Whether the award of exemplary and moral damages is proper under the circumstances of the case.

HELD: The Supreme Court set aside the decision of the Court of Appeals insofar as the school and teachers are concerned, but the portion of the said decision dismissing their counterclaim there being no merit, is affirmed. It then held that if at all petitioners are liable for negligence, this is because of their own negligence or the negligence of people under them. Here, petitioners are neither guilty of their own negligence or guilty of

the negligence of those under them. Hence, they cannot be said that they are guilty at all of any negligence. Consequently, they cannot be held liable for damages of any kind. At the outset, Ferdinand's parents allowed him to join the excursion. The fact that his father gave him money to buy food for the picnic even without knowing where it will be held, is a sign of consent for Ferdinand to join the same. The CA committed an error in applying Art. 2180 of the Civil Code in rendering the school liable for the death of Ferdinand. In the case at bar, the teachers/petitioners were not in the actual performance of their assigned tasks. The incident happened not within the school premises, not on a school day and most importantly while the teachers and students were holding a purely private affair, a picnic. The incident happened while some members of the class of the school were having a picnic at the beach. This picnic had no permit from the school head or its principal because this picnic was not a school sanctioned activity, neither is it considered as an extra-curricular activity. Mere knowledge by petitioner/principal of the planning of the picnic by the students and planning of the picnic by the students and their teachers does not in any way show acquiescence or consent to the holding of the same. The application, therefore, of Article 2180 has no basis in law and neither is it supported by any jurisprudence. If we were to affirm the findings of the appellate court on this score, employers will forever be exposed to the risk and danger of being hailed to court to answer for the misdeeds or omissions of the employees even if such act or omission be committed while they were not in the performance of their duties. No negligence could be attributable to the teachers to warrant the award of damages to Ferdinand's parents. The class adviser of the class where Ferdinand belonged did her best and exercised diligence of a good father of a family to prevent any untoward incident or damages to all the students who joined the picnic. In fact, she invited the P.E. instructors and scout masters who have knowledge in first aid application and swimming. Moreover, the petitioners brought life savers in case of emergency. Petitioners did all what is humanly

possible to save the child. No moral or exemplary damages may be awarded in favor of Ferdinand's parents. The case does not fall under any of the grounds to grant moral damages. Petitioners are not guilty of any fault or negligence. Hence, no moral damages can be assessed against them. While it is true that Ferdinand's parents did give their consent to their son to join the picnic, this does not mean that petitioners were already relieved of their duty to observe the required diligence of a good father of a family in ensuring the safety of the children. But here, petitioners were able to prove that they had exercised that required diligence. Hence, the claim for moral or exemplary damages becomes baseless.

**Figuracion Vda. de Maglana, et al. v.
Judge Francisco Z. Consolacion &
Afisco Insurance Corp.
GR 60506, Aug. 6, 1992**

The liability of AFISCO based on the insurance contract is direct, but not solidary with that of Destrajo which is based on Art. 2180 of the Civil Code. As such, petitioners have the option either to claim the P15,000 from AFISCO and the balance from Destrajo or enforce the entire judgment from Destrajo, subject to reimbursement from AFISCO to the extent of the insurance coverage.

While the petition seeks a definitive ruling only on the nature of AFISCO's liability, this Court noticed that the lower court erred in the computation of the probable loss of income. Using the formula: $\frac{2}{3}$ of $(80-56) \times P12,000$, it awarded P28,800. Upon recomputation, the correct amount is P192,000. Being a "plain error," this Court opt to correct the same. (*Sec. 7, Rule 51, Rules of Court*). Furthermore, in accordance with prevailing jurisprudence, the *death indemnity* is hereby increased to P50,000.

**Go v. IAC
GR 68138, May 13, 1991**

FACTS: Floerto Jazmin, an American citizen and retired employee of the U.S. Federal Government, had

been a visitor in the Philippines since 1972 residing in Mangatarem, Pangasinan. As a *pensionado* of the U.S. Government, he received annuity checks in the amounts of \$67 for disability and \$620 for retirement through the Mangatarem Post Office. On Aug. 22, 1975, Agustin Go, as branch manager of Solidbank in Baguio City, allowed a person named "Floerto Jazmin" to open Savings Account No. BG5206 by depositing two U.S. treasury checks in the amounts of \$1810 and \$910 respectively equivalent to the total amount of P20,565.69 both payable to the order of Floerto Jazmin of Mangatarem, Pangasinan and drawn on the First National City Bank, Manila. The Savings Account was opened in the ordinary course of business. The bank, thru Go, required the depositor to fill up the information sheet for new accounts to reflect his personal circumstances. The depositor indicated therein that he was Floerto Jazmin with mailing address at Mangatarem, that he was a Filipino citizen and a security officer of the US army; that he was married to Milagros Bautista; and that his initial deposit was P3,565. He wrote CSA 138134 under remarks or instructions and left blank the spaces under telephone number, residence certificate, passport, bank and trade performance as to who introduced him to the bank. The depositor's signature specimens were also taken. Thereafter, the deposited checks were sent to the drawee bank for clearance. Inasmuch as Solidbank did not receive any word from the drawee bank, after three (3) weeks it allowed the depositor to withdraw the amount indicated in the checks. On Jun. 29, 1976, or more than a year later, the two dollar checks were returned with notation that the amounts were altered. So Go reported the matter to the Philippine Constabulary in Baguio City. On Aug. 3, 1976, Jazmin received radio messages requiring him to appear before the PC headquarters in Benguet for investigation regarding the complaint filed by Go against him for estafa. Initially, Jazmin was investigated by the constabulary officers in Lingayen, and later in La Trinidad. Eventually, the investigators found that the person named "Floerto Jazmin" who made the deposit and withdrawal with Solidbank was an impostor. Floerto

Jazmin's name was used by a syndicate to encash the checks. On Sep. 23, 1976, Jazmin sued Agustin Go and the Solidbank for moral and exemplary damages in the amount of P90,000 plus attorney's fees. The trial court ordered Go and CBTC to pay Jazmin P6,000 as moral damages, P3,000 as exemplary damages and P1,000 as attorney's fees. The appellate court disallowed the moral and exemplary damages and granted nominal damages.

HELD: The Supreme Court affirmed the decision of the Court of Appeals and held that here, the damages in the form of mental anguish, moral shock and social humiliation were suffered by Jazmin only after the filing of Go's complaint with the PC. It was only then that he had to bear the inconvenience of traveling to Benguet and Lingayen for the investigation as it was only then that he was subjected to embarrassment for being a suspect in the unauthorized alteration of the treasury checks. Hence, it is understandable why Go appears to have overlooked the factors antecedent to the filing of the complaint to the Constabulary authorities and to have to put undue emphasis on the appellate court's statement that "denouncing a crime is not negligence." Although there should be no penalty on the right to litigate and error alone in the filing of a case be it before the courts or the proper police authorities, is not a ground for moral damages, under the peculiar circumstances of this case, Jazmin is entitled to an award of damages. It would be unjust to overlook the fact that Go's negligence was the root of all the inconvenience and embarrassment experienced by Jazmin, albeit they happened after the filing of the complaint with the Constabulary authorities. Go's negligence in fact led to the swindling of his employer. Had Go exercised the diligence expected of him as a bank officer he would have noticed the disparity between the payee's name and address on the treasury checks involved and the name of the depositor appearing in the bank's records. The situation would have been different if the treasury checks were tampered with only as to their amounts because the alteration would have been unnoticeable and hard to detect as the herein altered check bearing the amount

of \$913 shows. But the error in the name and address of the payee was patent and could not have escaped the trained eyes of bank officers and employees. Hence, the bank thru its employees was grossly negligent in handling the business transaction herein.

In crimes and *quasi-delicts*, the defendant shall be liable for all damages which are the natural and probable consequences of the act or omission complained of. It is not necessary that such damages have been foreseen or could have reasonably been foreseen by the defendant. As Go's negligence was the root of the complained inconvenience and embarrassment, Go is liable to Jazmin for damages. Under the 5th paragraph of Art. 2180 of the Civil Code, "employers shall be liable for the damages caused by their employees acting within the scope of their assigned tasks. Pursuant to this provision, the bank is responsible for the acts of its employee, unless there is proof that it exercised the diligence of a good father of a family to prevent the damage. Hence, the burden of proof lies upon the bank and it cannot disclaim liability in view of its own failure to prove not only that it exercised due diligence to prevent damage but that it was not negligent in the selection and supervision of its employees.

**George Mckee & Ararelo Koh Mckee v.
IAC, Jaime Tayag & Rosalinda Manalo
GR 68102, Jul. 16, 1992**

In the case at bar, as employers of the truck driver, the private respondents are, under Art. 2180 of the Civil Code, directly and primarily liable for the resulting damages. The presumption that they are negligent flows from the negligence of their employee. That presumption, however, is only *juris tantum*, not *juris et de jure*. Their only possible defense is that they exercised all the diligence of a good father of a family to prevent the damage.

The diligence of a good father referred to means that diligence in the selection and supervision of employees. The answers of the private respondents in Civil Cases Nos. 4477 and 4478 did not interpose this defense. Neither did they attempt to prove it.

**San Miguel Corp. v. Heirs of Sabiano
Inguito & Julius Ouano
GR 141716, Jul. 4, 2002**

FACTS: San Miguel Corp. (SMC) entered into a Time Charter Party Agreement with Julius Ouano, doing business under the name and style J. Ouano Marine Services. Under the terms of the agreement, SMC chartered the M/V Doña Roberta owned by Julius Ouano for a period of two years, from Jul. 1, 1989 to May 31, 1991, for the purpose of transporting SMC's beverage products from its Mandaue City plant to various points in Visayas and Mindanao.

On Nov. 11, 1990, during the term of the charter, SMC issued sailing orders to the Master of the M/V Doña Roberta, Capt. Sabiano Inguito. In accordance thereto, Inguito obtained the necessary sailing clearance from the Philippine Coast Guard. Loading of the cargo on the M/V Doña Roberta was completed at 8:30 p.m. of Nov. 11, 1990. However, the vessel did not leave Mandaue City until 6 a.m. of the following day, Nov. 12, 1990. Meanwhile at 4 a.m. of Nov. 12, 1990, typhoon Ruping was spotted moving in the general direction of Eastern Visayas. At 7 a.m., Nov. 12, 1990, one hour after the M/V Doña Roberta departed from Mandaue City, SMC Radio Operator Rogelio P. Moreno contacted Inguito thru radio and advised him to take shelter. The latter replied that the ship will proceed since the typhoon was far away anyway. At 2 p.m. that same day, while the vessel was two kms. Abeam Boljoon Pt., Moreno again communicated with Inguito and advised him to take shelter. The captain responded that the ship can manage. Hearing this, Moreno immediately tried to get in touch with Rico Ouano to tell him that Inguito did not heed their advice. Rico was out of his office, however, so Moreno left the message with the secretary.

Again Moreno contacted Inguito at 4 p.m. of Nov. 12, 1990. By then the vessel was already 9.5 miles southeast of Balicasag Island heading towards Sulauan Pt. Moreno reiterated the advice and pointed out it will be difficult to take shelter after passing Balicasag Island as the ship

was approaching an open sea. Still, the captain refused to heed his advice. At 8 p.m., the vessel was 38 miles southeast of Balicasag Island, and Westsouth winds were now prevailing. At 10 p.m., the M/V Doña Roberta was 25 miles approaching Sulauan Pt. Moments later, power went out in Moreno's office and resumed at 11:40 p.m. He immediately made a series of calls to the M/V Doña Roberta but he failed to get in touch with anyone in the vessel.

At 1:15 a.m., Nov. 13, 1990, Inguito called Moreno over the radio and requested him to contact Rico, son of Julius Ouano, because a helicopter is needed to provide rescue. The vessel was about 20 miles west of Sulauan Pt. Upon being told by SMC's radio operator, Rico turned on his radio and read the distress signal from Inguito. When he talked to the captain, the latter requested for a helicopter to provide rescue. Rico talked to the Chief Engineer who informed him that the crew can no longer stop the water from coming into the vessel because the crew members were feeling dizzy from petroleum fumes. At 2:30 a.m. of Nov. 13, 1990, M/V Doña Roberta sank. Out of the 25 officers and crew on board the vessel, only 5 survived. On Nov. 24, 1990, shipowner Julius Ouano, in lieu of the captain who perished in the sea tragedy, filed a Marine Protest. Heirs of the deceased captain and crew, as well as survivors of the ill-fated M/V Doña Roberta filed a complaint for tort against SMC and Julius Ouano at the RTC of Lapu-Lapu City, Br. 27. Julius Ouano filed an answer with crossclaim, alleging that the proximate cause of the loss of the vessel and its officers and crew was the fault and negligence of SMC, which had complete control and disposal of the vessel as charterer and which issued the sailing order for its departure despite being forewarned of the impending typhoon. Thus, he prayed that SMC indemnify him for the cost of the vessel and the unrealized rentals and earnings thereof.

SMC countered that it was Ouano who had the control, supervision, and responsibilities over the vessel's navigation. This notwithstanding, and despite knowledge of the incoming typhoon, Ouano never bothered to initiate contact with his vessel. Contrary to his allegation,

SMC argued that the proximate cause of the sinking was Ouano's breach of his obligation to provide SMC with a seaworthy vessel duly manned by competent crew members. SMC interposed counterclaims against Ouano for the value of the cargo lost in the sea tragedy. After trial, the court *a quo* rendered judgment finding that the proximate cause of the loss of the M/V Doña Roberta was attributable to SMC. Both SMC and Ouano appealed to the Court of Appeals (CA). SMC argued that as mere charterer, it did not have control of the vessel and that the proximate cause of the loss of the vessel and its cargo was the negligence of the ship captain. For his part, Ouano complained of the reduced damages awarded to him by the trial court. On Dec. 10, 1998, the CA modified the decision appealed from, declaring defendant-appellants SMC and Julian C. Ouano jointly and severally liable to plaintiff-appellees, except to the heirs of Inguito. SMC and Ouano filed separate motions for reconsideration, which were denied by the CA for lack of merit.

ISSUE: Under Arts. 1176 and 2180, owners and managers are responsible for damages caused by negligence of a servant or an employee, the master or employer is presumed to be negligent either in the selection or in the supervision of that employee. May this presumption be overcome? If so, how?

HELD: Yes. This presumption may be overcome only by satisfactorily showing that the employer exercised the care and diligence of a good father of a family in the selection and supervision of its employee. (*Pestaño v. Sumayang*, 346 SCRA 870 [2000]).

In the instant case, the Supreme Court does not find the SMC liable for the losses incurred. The contention that it was the issuance of the sailing order by SMC which was the proximate cause of the sinking is untenable.

The fact that there was an approaching typhoon is of no moment. It appears that for one previous occasion, SMC issued a sailing order to the captain of the M/V Doña Roberta, but the vessel cancelled its voyage due to a typhoon. Likewise, it appears from the records that

SMC issued the sailing order on Nov. 12, 1990, before the typhoon, “Ruping” was first spotted at 4 a.m. of Nov. 12, 1990. Consequently, Ouano should answer for the loss of lives and damages suffered by heirs of the officers and crew members who perished on board the M/V Doña Roberta, except Capt. Inguito. The award of damages granted by the CA is affirmed only against Ouano, who should also indemnify SMC for the cost of the lost cargo, in the total amount of P10,278,542.40.

‘Charter Party’ Distinguished from ‘Affreightment’

A *charter party* is a contract by virtue of which the owner or agent of a vessel binds himself to transport merchandise or persons for a fixed price. It has also been defined as a contract by virtue of which the owner or the agent of the vessel leases for a certain price the whole or a portion of the vessel for the transportation of goods or persons from one port to another. (*SMC v. Heirs of S. Inguito & J. Ouano, supra.*)

It may either be a: (1) bareboat or demise charter or (2) contract of affreightment. Under a demise or bareboat charter, the charterer mans the vessel with his own people and becomes, in effect, the owner of the ship for the voyage or service stipulated, subject to liability for damages caused by negligence. (*Caltex [Phils.], Inc. v. Sulpicio Lines, Inc., 315 SCRA 709 [1999]*).

In a *contract of affreightment*, upon the other hand, the owner of the vessel leases part or all of its space to haul goods for others. It is a contract for special service to be rendered by the owner of the vessel. Under such contract the ship owner retains the possession, command and navigation of the ship, the charterer or freighter merely having use of the space in the vessel in return for his payment of the charter hire. (*National Food Authority v. CA, 311 SCRA 700 [1999]*). Otherwise put, a contract of affreightment is one by which the owner of a ship or other vessel lets the whole or part of her to a merchant or other person for the conveyance of goods, on a particular voyage, in consideration of the payment of freight. (*SMC v. Heirs of Inguito & Ouano, supra.*)

A contract of affreightment may be either time charter, wherein the leased vessel is leased to the charter for a fixed period of time, or voyage charter, wherein the ship is leased for a single voyage. In both cases, the charterer provides for the hire of the vessel only, either for a determinate period of time or for a simple or consecutive voyage, the ship owner to supply the ship's store, pay for the wages of the master of the crew, and defray the expenses for the maintenance of the ship. (*Ibid.*)

If the charter is a contract of affreightment, which leaves the general owners in possession of the ship as owner for the voyage, the rights and responsibilities of ownership rest on the owner. The charterer is free from liability to third persons in respect of the ship. (*Caltex [Phils.], Inc. v. Sulpicio Lines, Inc., supra.*).

'Emergency Rule'

**George Mckee, et al. v.
IAC, et al.
GR 68102, Jul. 16, 1992**

Under what is known as *the emergency rule*, one who suddenly finds himself in a place of danger, and is required to act without time to consider the best means that may be adopted to avoid the impending danger, is not guilty of negligence, if he fails to adopt what subsequently and upon reflection may appear to have been a better method, unless the emergency in which he finds himself is brought about by his own negligence.

'Labor-Only' Contracting

**Napocor v. CA
GR 119121, Aug. 14, 1998**

FACTS: A vehicle owned by a company and driven by a driver supplied by the "labor-only" contractor figured in an accident and both were sued by the heirs of the victims. Petitioner Napocor insists that the responsibilities of the employer contemplated in a "labor-only" contract should

be restricted to the workers and cannot be expanded to cover liabilities for damages to third persons resulting from the employee's tortious acts under Art. 2180 of the Civil Code that provides that employers are liable for the damages caused by their employees and household helpers acting within the scope of their assigned tasks. Petitioner theorizes that its liability is limited only to compliance with the substantive labor provisions on working conditions, rest periods, wages — and does not extend to liabilities suffered by third persons.

HELD: Napocor's position is incorrect since the action brought by the heirs of the victims of the vehicular accident was premised on the recovery of damages as a result of a quasi-delict against both Napocor and Phesco. Hence, it is the Civil Code and not the Labor Code that is the applicable law. The present controversy is not a labor dispute on conditions of employment between an employee and an employer. It is a claim for damages for injury caused by the negligent acts of an employee and his employer.

Under the factual milieu of the case, respondent Phesco, Inc. was engaged in "labor-only" contracting *vis-à-vis* petitioner Napocor and as such, it is considered merely an agent of the latter. Hence, Napocor is deemed liable. "Labor-only" contracting, as defined under Sec. 9(b), Rule VII, Book III of the Omnibus Rules Implementing the Labor Code, is prohibited and the person acting as contractor shall be considered merely as an agent or intermediary of the employer who shall be responsible to the workers in the same manner and extent as if the latter were directly employed by him. Nonetheless, petitioner Napocor could have disclaimed liability had it raised the defense of due diligence in the selection or supervision of respondent Phesco and the truck driver. In the same Art. 2180 of the Civil Code, the responsibility of the employer ceases when it can prove that it observed all the diligence of a good father of a family to prevent damages. For unknown reasons, however, petitioner Napocor did not invoke said defense. By opting not to present any evidence that it exercised

due diligence in the supervision of the activities of respondent Phesco and the driver, it foreclosed its right to interpose the same on appeal in conformity with the rule that points of laws, theories, issues of facts, and arguments not raised in lower court cannot be raised for the first time on appeal.

**FGU Insurance Corp. v. CA, Filcar
Transport, Inc. & Fortune Insurance Corp.
GR 118889, Mar. 23, 1998**

ISSUE: For damages suffered by a third party, may an action based on *quasi-delict* prosper against Filcar, a rent-a-car company, and, consequently, its insurer, for fault or negligence of the car lessee in driving the rented vehicle?

HELD: No. Filcar being engaged in a rent-a-car business was only the owner of the car leased to Dahl-Jensen. As such, there was no *vinculum juris* between then employer and employee. Filcar cannot in any way be responsible for the negligent act of Dahl-Jensen, the former not being an employer of the latter.

(6) Liability of Teachers and Heads of Establishment (of Arts and Trades)

**Palisoc v. Brillantes
41 SCRA 548**

FACTS: During recess-time, one student of a technical, (trade, vocational) school fatally injured another at the school's laboratory room. Are the president of the school and the instructor concerned liable for the death of the student?

HELD: Yes, they are liable under the provisions of Art. 2180 of the Civil Code. The clause used in said article "so long as they remain in their custody" does not necessarily refer to the custody over students boarding in dormitories of the school (as erroneously referred to in a previous case) but to the protective and supervisory custody that the school and its heads or teachers exercise over the pupils and students

for as long as they are at attendance in school and includes recess-time. To avoid liability, the school officials concerned should have proved “that they observed all the diligence of a good father of a family to prevent damage.” Said school officials and teachers incidentally are liable even if the students or pupils are no longer minors.

Magtibay v. Garcia
GR 28971, Jan. 28, 1983

While a school is obliged to afford its students a fair opportunity to complete the courses they seek to pursue, this opportunity is forfeited if the students commit a serious breach of discipline. Courts should not review the discretion of university authorities in failing students for disciplinary reasons or academic deficiencies. The requisite academic standard must be maintained.

Pasco v. CFI
GR 54357, Apr. 25, 1987

FACTS: Reynaldo, together with two companions, while walking inside the campus of Araneta University, after attending classes in said University, was accosted and mauled by a group of Muslim students led by Teng. The Muslim group were also students of the Araneta University. Reynaldo was stabbed by Teng and as a consequence, he was hospitalized and he underwent surgery to save his life. In a suit by Reynaldo against Teng for damages, the Araneta University was impleaded as a party defendant based on Art. 2180. The trial court, on motion of Araneta University, dismissed the complaint as to said defendant.

ISSUE: Is the provision of the penultimate par. of Art. 2180 which states that “teachers or heads of establishment of arts and trades shall be liable for damages caused by their pupils and students or apprentices, so long as they remain in their custody” — equally applicable to academic institutions?

HELD: The answer is in the negative. The provision concerned speaks only of “teachers or heads.”

(7) Liability of the State

A State's liability has two aspects:

- (a) Its public or government aspects (here it is liable for the tortious acts of *special agents only*.)
- (b) Its private or business aspects (as when it engages in private enterprises — here it is liable as an ORDINARY EMPLOYER). (*See Palma v. Garciano, et al., L-7240, May 16, 1956*).

**MMTC & Apolinario Ajoc v. CA, Etc.
GR 141089, Aug. 1, 2002**

FACTS: Petitioner MMTC contends that the Court of Appeals (CA) erred in finding it solidarily liable for damages with its driver/employee, Ajoc, pursuant to Art. 2180. It argues that Ajoc's act in bringing the victim to a hospital reflects MMTC's diligence in the selection and supervision of its drivers, particularly with regard to safety measures. Hence, having exercised the diligence of a good father of a family in the selection and supervision of its employees to prevent damage, MMTC should not be held vicariously liable.

HELD: The claim that Ajoc's act of bringing the victim to the nearest medical facility shows adequate supervision by MMTC over its employees deserves but scant consideration. For one, the act was after the fact of negligence on Ajoc's part. For another, evidence on record shows that Ajoc's act was neither voluntary nor spontaneous; he had to be prevailed upon by the victim's companions to render assistance to his victim.

Suffice it to say, owners of public utilities fall within the scope of Art. 2180. MMTC is a public utility, organized and owned by the government for public transport service. Hence, its liability to private respondents, for the negligent and reckless acts of its driver, Ajoc, under Art. 2180 is both manifest and clear.

**Victor Orquiola & Honorata Orquiola v. CA, Etc.
GR 141463, Aug. 6, 2002**

FACTS: Petitioner-spouses purchased the subject land in 1964 from Mariano Lising. The spouses acquired the land in question without knowledge of any defect in the title of Lising. Shortly afterwards, they built their conjugal home on said land. It was only in 1998, when the sheriff of Quezon City tried to execute the judgment in Civil Case Q-12918, that they had notice to private respondent's adverse claim.

ISSUE: Can the institution of Civil Case Q-12918 serve as notice of such adverse claim to petitioners?

HELD: No. It cannot since petitioner-spouses were not impleaded therein as parties. As builders in good faith and innocent purchases for value, petitioners have rights over the subject property and, hence, are proper parties in interest in any case thereon. (*Sec. 2, Rule 3, Rules of Court*). Consequently, private respondents should have impleaded them in Civil Case Q-12918. Since they failed to do so, petitioners cannot be reached by the decision in said case. No man shall be affected by any proceeding to which he is a stranger, and strangers to a case are not bound by any judgment rendered by the court.

In the same manner, a writ of execution can be issued only against a party and not against one who did not have his day in court. Only real parties in interest in an action are bound by the judgment therein and by writs of execution and demolition issued pursuant thereto. Thus, spouses Victor and Honorata Orquiola have valid and meritorious cause to resist the demolition of their house on their titled lot, which is tantamount to a deprivation of property without due process of law.

(8) Special Agent

- (a) This is a government employee who commits a tort while performing a job or act foreign to his usual duties. (*See Merritt v. Government, 34 Phil. 311*).

In *Republic v. Palacio* (L-20322, May 29, 1968), the Supreme Court held that the State is liable only for torts caused by its special agents *pecially commissioned* to carry out the acts of which the torts arise, and which acts are OUTSIDE of the REGULAR DUTIES of said special agents.

- (b) Hence, when the damage has been caused by the official upon whom properly devolved the doing of the act performed, the State (both central and local governments) is NOT liable. Where therefore the plaintiff's father was run over by a truck driven by a chauffeur of the provincial government of a province, and at the time of the accident, he was driving a vehicle in compliance with his duties as such, his employer is NOT liable for the plaintiff's claim. The chauffeur alone is liable. (*Palafox v. Ilocos Norte, et al.*, L-10659, Jan. 31, 1958). The same principle applies to a chauffeur of the Philippine General Hospital (*Merritt v. Gov't.*, 34 Phil. 311), or to any employee of a branch of the government performing his usual duties. (*Rosell v. Aud.-Gen.*, 81 Phil. 453).

[**NOTE:** In the case of *Palma v. Garciano, et al.*, it was held that if a governor and a mayor file criminal charges which are groundless, their acts cannot have borne the approval of the province and the municipality; hence, these political subdivisions cannot be liable. Moreover, the prosecution of crimes is NOT corporate but governmental or political in character. In the discharge of functions of this nature, municipal corporations are *not* liable for the acts of its officers, except if and when, and only to the extent that, they have acted by authority of law and in conformity with the requirement thereof.]

Republic v. Palacio
L-20322, May 29, 1968

FACTS: Ildefonso Ortiz filed a complaint against a government entity (the Irrigation Service Unit) alleging that said entity had induced the Handong Irrigation Association to occupy and possess the land of Ortiz. As a consequence of the complaint, the funds of the entity

(deposited at the Philippine National Bank) was garnished. There was no proof, however, that the State had specifically commissioned the entity to make the tortious inducement.

ISSUES:

- (a) Is the government here liable, for the acts of the Irrigation Service Unit?
- (b) Assuming that there is liability may there be a levy of execution against the funds deposited by the entity with the PNB?

HELD:

- (a) The government is not liable for no authorization was ever given to its alleged “special agent.” If there had been such authorization, there would have been liability for then the acts authorized are NOT REGULARLY performed by the entity.
- (b) Assuming that there is liability, the Court’s power ends with the promulgation of the judgment. Execution cannot issue on a judgment against the State. After all, the State should be regarded as free to determine whether or not it will honor the judgment by payment. The presumption of course is that the State will honor and respect the judgment, and this can be done when Congress, recognizing the finality of the judgment, enacts a legislative measure providing for the satisfaction of the judgment.

(9) Defense

- (a) If an employee (or ward or minor child, etc.) is found negligent, it is *presumed* that the employer (or person in charge) was negligent in selecting and/or supervising him for it is *hard* for the victim to prove the negligence of such employer. It is impossible for the victim to have observed the conduct of all employers, etc. who are potential tortfeasors. (*See Campo, et al. v. Comarote & Gemilga, L-9147, Nov. 29, 1956*).
- (b) In *Campo v. Camarote and Gemilga (supra)*, it was held that the mere fact that the driver was a professional

one does *not* show sufficient diligence on the part of the employer. The employer should not have been satisfied with the mere possession by his driver of a professional driver's license; he had the duty to examine thoroughly the qualifications, experience, and record of the driver.

- (c) Even if the employer can prove the diligence in the selection and supervision of the employee, still if he *ratifies* the wrongful acts, or take *no* steps to avert further damage, he (the employer) would still be liable. (*See Maxion v. Manila Railroad Co.*, 44 Phil. 597).

(10) Penal Provisions in Case of Crimes

Art. 365, par. 3 of the Revised Penal Code simply means that if there is only damage to property, the amount fixed therein shall be imposed, but if there are also physical injuries there should be an additional penalty for the latter. The information cannot be split into two; one for physical injuries and another for the damage to property, for both the injuries, and the damage committed were caused by one single act of the defendant and constituted what may be called a complex crime of physical injuries and damage to property. It is clear that the fine fixed by the law in this case is beyond the jurisdiction of the municipal court and within that of the Court of First Instance (now Regional Trial Court). (*People v. Villanueva*, L-15014, Apr. 29, 1961).

(11) Failure of Doctor to Follow Medical Procedure Is a Clear Indicia of Negligence

Erlinda Ramos v. Court of Appeals GR 124354, Apr. 11, 2002

FACTS: Private respondents De Los Santos Medical Center (DLSMC), Dr. Orlino Hosaka, and Dr. Perfecta Gutierrez — were held civilly liable for petitioner Erlinda Ramos' comatose condition after she delivered herself to them for their professional care and management.

The Philippine College of Surgeon (PSC) filed its petition-in-intervention contending in the main that the court erred in holding private respondent Dr. Hosaka liable under the

Captain-of-the-Ship doctrine. For the intervenor, said doctrine had long been abandoned in the United States in recognition of the developments in modern medical and hospital practice.

For his part, Dr. Hosaka mainly contends that the court erred in finding him negligent as a surgeon by applying the *Captain-of-the-Ship doctrine*. Dr. Hosaka argues that the trend in U.S. jurisprudence has been to reject said doctrine in light of developments in medical practice. He points out that anesthesiology and surgery are two distinct and specialized fields in medicine and as a surgeon, he is not deemed to have control over the acts of Dr. Gutierrez. As anesthesiologist, Dr. Gutierrez is a specialist in her field and has acquired skills and knowledge in the course of her training which Dr. Hosaka, as a surgeon, does not possess. He states further that current American jurisprudence on the matter recognizes that the trend towards specialization in medicine has created situations where surgeons do not always have the right to control all personnel within the operating room, especially a fellow specialist.

Dr. Gutierrez maintains that the court erred in finding her negligent and in holding that it was the faulty intubation which was the proximate cause of Erlinda's comatose condition. The following objective facts allegedly negate a finding of negligence on her part:

1. That the outcome of the procedure was a comatose patient and not a dead one;
2. That the patient had a cardiac arrest; and
3. That the patient was revived from that cardiac arrest.

In effect, Dr. Gutierrez, insists that, contrary to the finding of the court, the intubation she performed on Erlinda was successful. The instruments used in the administration of anesthesia, including the endotracheal tube, were all under the exclusive control of private respondents Dr. Gutierrez and Dr. Hosaka.

Meanwhile, the hospital, DLSMC, argues that it cannot be deemed liable for the resulting injury to petitioner Erlinda. DLSMC contends that applying the four-fold test in determining whether such a relationship exists between

it and respondent doctors, it (DLSMC) cannot be considered an employer of respondent doctors. The four-fold test in determining whether an employer-employee relationship exists between the parties are the following:

1. selection and engagement of services;
2. payment of wages;
3. power to hire and fire; and
4. power to control not only the end to be achieved, but the means to be used in reaching such an end.

On the *1st test*, DLSMC maintains that a hospital does not hire or engage the services of a consultant, but rather, accredits the latter and grants him or her the privilege of maintaining a clinic and/or admitting patients in the hospital upon a showing by the consultant that he or she possess the necessary qualifications, such as accreditation by the appropriate board (diplomate), evidence of fellowship and references.

On the *2nd test*, it is not the hospital but the patient who pays the consultant's fee for services rendered by the latter.

On the *3rd test*, a hospital does not dismiss a consultant; instead, the latter may lose his or her accreditation or privileges granted by the hospital.

On the *4th and last test*, DLSMC argues that when a doctor refers a patient for admission in a hospital, it is the doctor who prescribes the treatment to be given to said patient. The hospital's obligation is limited to providing the patient with the preferred room accommodation, the nutritional diet and medications prescribed by the doctor, the equipment and facilities necessary for the patient's treatment, as well as the services of the hospital staff who perform the ministerial tasks of ensuring that the doctor's orders are carried out strictly.

Issues: (1) Whether or not Dr. Hosaka (surgeon) is liable for negligence; (2) Whether or not Dr. Gutierrez (anesthesiologist) is liable for negligence; and (3) Whether or not the hospital (DLSMC) is liable for any act of negligence committed by their visiting consultant-surgeon and anesthesiologist.

HELD: (1) That there is a trend in American jurisprudence to do away with the Captain-of-the-Ship doctrine does not mean that the Supreme Court will *ipso facto* follow said trend. Due regard for the peculiar factual circumstances obtaining in this case justify the application of the Captain-of-the-Ship doctrine. From the facts on record, it can be logically inferred that Dr. Hosaka exercised a certain degree of, at the very least, supervision over the procedure then being performed on Erlinda. Thus:

a. It was Dr. Hosaka who recommended to petitioner the services of Dr. Gutierrez. In effect, he represented to petitioner that Dr. Gutierrez possessed the necessary competence and skills. Drs. Hosaka and Gutierrez had worked together since 1977. Whenever Dr. Hosaka performed a surgery, he would always engage the services of Dr. Gutierrez to administer the anesthesia on his patient.

b. Dr. Hosaka himself admitted that he was the attending physician of Erlinda. When Erlinda showed signs of cyanosis, it was Dr. Hosaka who gave instructions to call for another anesthesiologist and cardiologist to help resuscitate Erlinda.

c. It is conceded that in performing their responsibilities to the patient, Dr. Hosaka and Gutierrez worked as a team. Their work cannot be placed in separate watertight compartments because their duties intersect with each other.

The duties of Dr. Hosaka and those of Dr. Gutierrez in the treatment of petitioner Erlinda are, therefore, not a clearcut as respondents claim them to be. On the contrary, it is quite apparent that they have a common responsibility to treat the patient, which responsibility necessitates that they call each other's attention to the condition of the patient while the other physician is performing the necessary medical procedures.

It is important to point out that Dr. Hosaka was remiss in his duty of attending to petitioner Erlinda promptly, for he arrived more than 3 hrs. late for the scheduled operation. In reckless disregard for his patient's well-being, Dr. Hosaka scheduled two procedures on the same day, just 30 minutes apart from each other, at different hospitals. When the first

procedure (protoscopy) at the Sta. Teresita Hospital did not proceed on time, Erlinda was kept in a state of uncertainty at the DLSCMC. The long period that Dr. Hosaka made Erlinda wait for him cause anxiety that adversely affected the administration of anesthesia on her. A patient's anxiety usually causes the outpouring of adrenaline which, in turn, results in high blood pressure or disturbances in the heart rhythm. Dr. Hosaka's irresponsible conduct of arriving very late for the scheduled operation of petitioner Erlinda is violative, not only of his duty as a physician "to serve the interest of his patients with the greatest solicitude, giving them always his best talent and skill," but also of Art. 19 of the Civil Code which requires a person, in the performance of his duties, to act with justice and give everyone his due.

(2) It was the faulty intubation on Erlinda that caused her comatose condition. There is no question that Erlinda became comatose after Dr. Gutierrez performed a medical procedure on her. Even the counsel of Dr. Gutierrez admitted to the fact during the oral arguments.

The cyanosis (bluish discoloration of the skin or mucous membranes caused by lack of oxygen or abnormal hemoglobin in the blood) and enlargement of the stomach of Erlinda indicate that the endotracheal tube was improperly inserted into the esophagus instead of the trachea. Consequently, oxygen was delivered not to the lungs but to the gastrointestinal tract. This conclusion is supported by the fact that Erlinda was placed in trendelenburg position. This indicates that there was a decrease of blood supply to the patient's brain. The brain was, thus, temporarily deprived of oxygen supply causing Erlinda to go into coma.

The injury occurred by petitioner Erlinda does not normally happen absent any negligence in the administration of anesthesia and in the use of an endotracheal tube. In *Voss v. Bridwell* (364 P2d 955 [1961]), the Kansas Supreme Court applied the doctrine of *res ipsa loquitur*, reasoning that the injury to the patient therein was one which does not ordinarily take place in the absence of negligence in the administration of an anesthetic, and in the use and employment of an endotracheal tube. The court went to say: "Ordinarily, a person being put under anesthesia is not rendered decerebrate as a

consequence of administering such anesthesia in the absence of negligence.”

(3) Respondent hospital’s position on this issue is meritorious. There is no employer-employee relationship between DLSMC and Drs. Gutierrez and Hosaka which would hold DLSMC solidarily liable for the injury suffered by petitioner Erlinda under Art. 2180 of the Civil Code. Moreover, the contract between the consultant in respondent hospital and his patient is separate and distinct from the contract between respondent hospital and said patient.

No evidence was adduced to show that the injury suffered by petitioner Erlinda was due to failure on the part of the respondent DLSMC to provide for hospital facilities and staff necessary for her treatment.

Apropos to the award of damages to petitioner in view of the supervening event of the former’s death, the amount representing actual (P1,325,000), moral and exemplary damages, attorney’s fees, and costs of suit should be awarded to petitioner.

Art. 2181. Whoever pays for the damages caused by his dependents or employees may recover from the latter what he has paid or delivered in satisfaction of the claim.

COMMENT:

Right of Person (Who Pays) to Get Reimbursement

Reason for the Article: After all, the person who actually caused the injury should be made to answer for his fault.

**Sarkies Tours Phil. v.
Intermediate Appellate Court
GR 63723, Sep. 2, 1983**

If as a result of an accident a tour operator and the owner of the boat used for the tour are sued, the tour operator has a right of action against the boat owner for reimbursement. The principle embodied in Art. 2181 of the Civil Code may be applied in favor of the tour operator.

Art. 2182. If the minor or insane person causing damage has no parents or guardian, the minor or insane person shall be answerable with his own property in an action against him where a guardian *ad litem* shall be appointed.

COMMENT:

When a Minor or an Insane Person Is Answerable With His Own Property

The Article explains itself.

Art. 2183. The possessor of an animal or whoever may make use of the same is responsible for the damage which it may cause, although it may escape or be lost. This responsibility shall cease only in case the damage should come from *force majeure* or from the fault of the person who have suffered damage.

COMMENT:

Damages Caused By Animals

Defenses:

- (a) *force majeure* — as when the tooting of a car horn frightens a horse, who thereby injures and kills a person. (*Derifas v. Escano*, [C.A.] 40 O.G. [Supp. 12] 526).
- (b) *fault of the person injured*

[**NOTE:** The law does *not* mention diligence of the possessor of the animal as a defense.]

Art. 2184. In motor vehicle mishaps, the owner is solidarily liable with his driver, if the former, who was in the vehicle, could have, by the use of due diligence, prevented the misfortune. It is disputably presumed that a driver was negligent, if he had been found guilty of reckless driving or violating traffic regulations at least twice within the next preceding two months.

If the owner was not in the motor vehicle, the provisions of Article 2180 are applicable

COMMENT:**(1) Liability of Owner of a Motor Vehicle**

Note the difference in the owner's responsibility when he *was* in the vehicle, or *was not*. In a sense, the owner is compelled to be an intelligent "back-seat driver."

(2) Case

**Marcial T. Caedo, et al. v.
Yu Khe Thai, et al.
L-20392, Dec. 18, 1968**

FACTS: Marcial T. Caedo and the members of his family were injured when their Mercury car was hit on Highway 54 by a Cadillac car owned by Yu Khe Thai, and driven by the latter's driver, Rafael Bernardo. According to the facts, the accident was due to Bernardo's trying to overtake a *carretela* in front of the Cadillac. There was therefore no question about Bernardo's negligence. Now then, would the owner Yu Khe Thai be held solidarily liable inasmuch as he was in the car at the time of the collision? (It was proved that the driver had been driving for over 20 years, and had no record of an accident; at the time of the collision, he was driving at moderate speed).

HELD: Under the facts given, the owner had no negligence either in employing the driver, or in supervising the driver at or before the time of the accident. Hence, he is *not liable at all*, much less solidarily liable. It is true that under Art. 2184 of the Civil Code, "In motor vehicle mishaps, the owner is solidarily liable with his driver if the former, *who was in the vehicle*, could have, by the *use of due diligence*, prevented the misfortune. It is disputably presumed that a driver was negligent, if he had been found guilty of reckless driving or violating traffic regulations at least twice within the preceding two months."

The basis of the master's liability in civil law is *not respondeat superior* but rather, the relationship of *pater familias*. The theory is that ultimately the negligence of the servant, if known to the master and susceptible of timely

correction by him, reflects his own negligence if he fails to correct it in order to prevent injury or damage. There is no such negligence here as the imputed negligence is necessarily subjective — depending invariably on the car-driving ability of the master himself. As a matter of fact, many *car owners* precisely hire *drivers* since the former for one reason or another cannot drive their cars themselves. Hence, the care or vigilance demanded of them cannot be uniform; each case must stand on its own.

Art. 2185. Unless there is proof to the contrary, it is presumed that a person driving a motor vehicle has been negligent if at the time of the mishap, he was violating any traffic regulation.

COMMENT:

Presumption of Driver's Negligence

The presumption arises if *at the time of the mishap*, he was VIOLATING *any* traffic regulation.

**Mikee v. IAC
GR 68102, Jul. 16, 1992**

Under Art. 2185 of the Civil Code, a person driving a vehicle is presumed negligent if at the time of the mishap, he was violating any traffic regulation.

Art. 2186. Every owner of a motor vehicle shall file with the proper government office a bond executed by a government controlled corporation or office, to answer for damages to third persons. The amount of the bond and other terms shall be fixed by the competent public official.

COMMENT:

Duty of Owner of Motor Vehicle to File a Bond

- (a) For the present, the “proper government office” would seem to be the Land Transportation Commission (formerly the Motor Vehicles’ Office).

- (b) The GSIS may be called upon to take charge of the “bonding.”
- (c) One big problem is whether or not motor vehicle already insured *privately* against third party liability (damages to third persons) would still be covered by the Article. Perhaps an amendment can better reveal the Congressional intent.

Art. 2187. Manufacturers and processors of foodstuffs, drinks, toilet articles and similar goods shall be liable for death or injuries caused by any noxious or harmful substances used, although no contractual relation exists between them and the consumers.

COMMENT:

Liability of Manufacturers

Note that liability exists even in the *absence* of contractual relations.

Art. 2188. There is *prima facie* presumption of negligence on the part of the defendant if the death or injury results from his possession of dangerous weapons or substances, such as firearms and poison, except when the possession or use thereof is indispensable in his occupation or business.

COMMENT:

Presumption of Negligence Because of the Possession of Dangerous Weapons or Substances

Note the exception indicated in the law.

Art. 2189. Provinces, cities and municipalities shall be liable for damages for the death of, or injuries suffered by any person by reason of the defective condition of roads, streets, bridges, public buildings, and other public works, under their control or supervision.

COMMENT:**Liability of Municipal Subdivisions Because of Defective Roads, Bridges, Etc.**

- (a) The liability is for the DEATH or INJURIES suffered by a *person* (it would seem that damages to *property* would not come under this Article).
- (b) If a pedestrian falls into a manhole in a city street (Manila), the Supreme Court has ruled that the City Government would be liable under this Article despite the fact that under the Revised Charter of Manila, the City incurs no liability. While the Charter of Manila is a special law insofar as *territory* is involved, still this Article is a special provision insofar as *defective condition of streets, etc.* is concerned. (*City of Manila v. Genero N. Teotico*, L-23052, Jan. 29, 1968).

Guilatco v. City of Dagupan and CA
GR 61516, Mar. 21, 1989

The liability of public corporations for damages arising from injuries suffered by pedestrians from the defective condition of roads extends to the fact that it is not even necessary for such defective road or street to belong to the province, city, or municipality for liability to attach. Art. 2189 only requires that either control or supervision is exercised over the defective road or street.

Art. 2190. The proprietor of a building or structure is responsible for the damages resulting from its total or partial collapse, if it should be due to the lack of necessary repairs.

COMMENT:**Liability of Proprietor if a Building or Structure Collapses**

The Article is self-explanatory.

Art. 2191. Proprietors shall also be responsible for damages caused:

(1) By the explosion of machinery which has not been taken care of with due diligence, and the inflammation of explosive substances which have not been kept in a safe and adequate place;

(2) By excessive smoke, which may be harmful to persons or property;

(3) By the falling of trees situated at or near highways, or lanes, if not caused by *force majeure*;

(4) By emanations from tubes, canals, sewers or deposits of infectious matter, constructed without precautions suitable to the place.

COMMENT:

Other Liabilities of Proprietors of Buildings or Structure

- (a) The Article enumerates four instances.
- (b) *Injunction* is an available remedy here because the damage may be irreparable. (See *Bengzon v. Prov. of Pangasinan*, 62 Phil. 816 and *Ollendorf v. Abrahamson*, 38 Phil. 585).

**Austin Hardware Co., Inc. & All-Steel Products,
Inc. v. The Court of Appeals, et al.
L-41754, Feb. 27, 1976**

FACTS: A hardware business and a factory for the manufacture of steel products located at No. 115 L.K. Santos St., San Juan, Rizal, was ordered stopped by the Mayor, pursuant to a municipal council resolution finding same to be nuisances in a residential zone, causing both noise and air pollution. May the permit for the same be validly revoked?

HELD: Yes. The power to license carries with it the power to revoke it, either for cause or upon a change of policy

and legislation. Moreover, the permit violated the existing ordinances.

Art. 2192. If damages referred to in the two preceding articles should be the result of any defect in the construction mentioned in Article 1723, the third person suffering damages may proceed only against the engineer or architect or contractor in accordance with said article, within the period therein fixed.

COMMENT:

Rule if the Cause Is a Construction Defect

The Article explains itself.

Art. 2193. The head of a family that lives in a building or a part thereof, is responsible for damages caused by things thrown or falling from the same.

COMMENT:

Responsibility for Thrown or Fallen Things

The Article can apply to the lessee of a house who converts same into a hotel. (*See Dingcong v. Kanaan*, 72 Phil. 14). Note the liability of the head of the family.

Art. 2194. The responsibility of two or more persons who are liable for a quasi-delict is solidary.

COMMENT:

(1) Solidary Liability of Tort-Feasors

Although all those responsible for a quasi-delict are called joint tortfeasors, their liability is SOLIDARY. (*See Worcester v. Ocampo*, 22 Phil. 42).

(2) Cases

Metro Manila Transit Corp. v. CA
42 SCAD 538
1993

Where the injury is due to the concurrent negligence of the drivers of the colliding vehicles, the drivers and owners of said vehicles shall be primarily, directly and solidarily liable for damages and it is immaterial that one action is based on *quasi-delict* and the other on *culpa contractual*.

Light Rail Transit Authority & Rodolfo
Roman v. Marjorie Navidad, Heirs of the
late Nicanor Navidad & Prudent
Security Agency
GR 145804, Feb. 6, 2003

ISSUE: Can a contractual obligation be breached by tort?

HELD: Yes, and when the same act or omission causes the injury, one resulting in *culpa contractual* and the other *culpa acquiliana*, Art. 2194 can well apply. (*Air France v. Carrascoso*, 124 Phil. 722).

In fine, a liability for tort may arise even under a contract, where tort is that which breaches the contract. (*PSBA v. CA*, 205 SCRA 729). Stated differently, when an act which constitutes a breach of contract would have itself constituted the source of a quasi-delict liability and no contract existed between the parties, the contract can be said to have been breached by tort, thereby allowing the rules on tort to apply. (*Cangco v. Manila Railroad*, 38 Phil. 768 and *Manila Railroad v. Compania Transatlantica*, 38 Phil. 875).

TITLE XVIII

DAMAGES

(New, except Arts. 2200, 2201, 2209, and 2212.)

Introductory Comment:

The fundamental principle of the law on damages is that one injured by a breach of a contract or by a wrongful or negligent act or omission shall have a fair and just compensation, commensurate with the loss sustained as a consequence of the defendant's act. Hence, actual pecuniary compensation is the general rule, whether the action is based on a contract or in tort, except where the circumstances warrant the allowance of other kinds of damages. (*See Western Union Teleg Co. v. Green, 153 Tenn. 69*). In general, the damages awarded should be equal to, and precisely commensurate with the injury sustained. However, rules of law respecting the recovery of damages are framed with reference to just rights of BOTH PARTIES, not merely what may be right for an injured person to receive, but also what is just to compel the other party to pay, to accord just compensation for the injury. (*Kennings v. Kline, 158 Ind. 602*).

Zulueta v. Pan American World Airways, Inc. 43 SCRA 397

FACTS: Zulueta and his wife were passengers of a Pan American airplane. At a stop-over, Zulueta was ill-treated and was left at the airport. Is he entitled to recover damages?

HELD: Yes. Passengers should be treated by the employees of an airplane carrier with kindness and courtesy, and should be protected against indignities, abuses, and injurious language from such employees. In case of breach of contract, the airline company should be held liable for damages. Be it

noted further that the contract of common air carriage generates a relation attended with a public duty.

Air France v. CA and Morales
GR 76093, Mar. 21, 1989

Mere refusal to accede to the passenger's wishes does not necessarily translate into damages in the absence of bad faith.

Tiu v. Court of Appeals
46 SCAD 408, 228 SCRA 51
1993

An adverse result of a suit in law does not mean that the same is wrongful as to justify assessment of damages against the actor.

Chapter 1

GENERAL PROVISIONS

Art. 2195. The provisions of this Title shall be respectively applicable to all obligations mentioned in Article 1157.

COMMENT:

Applicability to All Kinds of Legal Obligations

Art. 1157. Obligations arise from:

- (1) Law;
- (2) Contracts;
- (3) Quasi-contracts;
- (4) Acts or omissions punishable by law; and
- (5) Quasi-delicts.

Art. 2196. The rules under this Title are without prejudice to special provisions on damages formulated elsewhere in this Code. Compensation for workmen and other employees in case of death, injury or illness is regulated by special laws. Rules governing damages laid down in other laws shall be observed insofar as they are not in conflict with this Code.

COMMENT:

(1) Special Provisions and Laws

It is to be observed that in case of conflict between the Civil Code and the Special Laws, it is the Civil Code that *prevails* insofar as *damages* are concerned — EXCEPT in the case of compensation for workmen and other employees.

(2) Indemnity in Workmen's Compensation Cases

**Milagros F. Vda. de Forteza v. Workmen's
Compensation Commission and the Philippine
Charity Sweepstakes Office
L-21718, Jun. 29, 1968**

FACTS: Amadeo R. Forteza worked as watchman in the Philippine Charity Sweepstakes Office (PCSO) from Jul. 1, 1950 up to Jan. 17, 1955. He was more than 60 years old, and was suffering from hypertension when he entered the service of the office. On Jan. 17, 1955, he died of cerebral hemorrhage due to said hypertension. It was proved that he had to work at nighttime, was exposed to colds, lacked proper sleep and rest, and had to go up and down a 3-story building (without elevator) to check out the premises. Is his death compensable?

HELD: Yes, his death is compensable. It is the rule in Workmen's Compensation cases that it *need* not be proven that his employment was the sole cause of the death or injury suffered by the employee. It is enough — to entitle him or his heirs to compensation benefits under the law — that there be a showing that his employment (as in this case) had contributed to the acceleration of his death or ailment. Moreover, the law *presumes* that such death is compensable, unless the employer clearly establishes that it was *not* caused or aggravated by the employment. (*See Niara v. Workmen's Compensation Commission, L-18066, Oct. 30, 1962*).

**Ysmael Maritime Corp. v. Avelino
GR 43674, Jun. 30, 1987**

FACTS: *RGL* was a licensed second mate on board a vessel owned by *YMC* when the same ran aground and sank. *RGL* perished as a result. *FL* and *CG*, the parents of *RGL*, sued *YMC* in the Court of First Instance (Regional Trial Court) for damages. *YMC* invoked the rule in *Robles v. Yap Wing, 41 SCRA 267*, that all claims for death or injuries by employees against employers are exclusively cognizable by the Workmen's Compensation Commission (WCC) regardless

of the causes of said death or injuries. *CG* admitted that he had previously filed a claim for death benefits with the WCC and had received the compensation payable to them under the Workmen's Compensation Act (WCA). The trial court denied *YMC's* motion to dismiss.

ISSUE: Is the compensation remedy under the WCA (now under the Labor Code) for work-connected death or injuries sustained by an employee exclusive of the other remedies available under the Civil Code?

HELD: The rule in *Robles v. Yap Wing* no longer controls. In *Floresca v. Philex*, 136 Phil. 141, involving a complaint for damages for the death of five miners in a cave-in, the Supreme Court was confronted with three divergent opinions on the exclusivity rule.

One view is that the injured employee or his heirs, in case of death, may initiate an action to recover damages (not compensation under the Workmen's Compensation Act) with the regular courts on the basis of negligence of the employer pursuant to the Civil Code. *Another view*, as enunciated in the *Robles case*, is that the remedy of an employee for work-connected injury or accident is exclusive in accordance with Sec. 5 of the WCA. A *third view* is that the action is selective and the employee or his heirs have a choice of availing themselves of the benefits under the Workmen's Compensation Act or of suing in the regular courts under the Civil Code for higher damages from the employer by reason of his negligence. But once the election has been exercised, the employee or his heirs are no longer free to opt for the other remedy, *i.e.*, the employee cannot pursue both actions simultaneously. The view was adopted by the majority in the *Floresca case*, reiterating as main authority its earlier decision in *Pacana v. Cebu Autobus*, 32 SCRA 442. In so doing, the Court rejected the doctrine of exclusivity of the rights as remedies granted by the WCA as laid down in the *Robles case*.

Claimants cannot be allowed to maintain their action to recover additional damages against the employer if the former had previously filed a claim for death benefits with the WCC and had received the compensation payable to them under the WCA. If they had not only opted to recover under

the Act but they had also been duly paid, at the very least, a sense of fair play would demand that if a person entitled to a choice of remedies made a first election and accepted the benefits thereof, he should no longer be allowed to exercise the second option. If one had staked his fortunes on a particular remedy, he is precluded from pursuing the alternate course, at least until the prior claim is rejected by the WCC.

(3) Dismissal of Action

**Enrique A. Defante v. Hon. Antonio
E. Rodriguez, et al.
L-28380, Feb. 27, 1976**

If an action for damages is sought to be dismissed by plaintiff-appellant or his heirs when the case is already on *appeal*, may the dismissal be granted despite the appeal? Yes, since the parties involved are no longer interested in prosecuting the appeal.

Art. 2197. Damages may be:

- (1) Actual or compensatory;**
- (2) Moral;**
- (3) Nominal;**
- (4) Temperate or moderate;**
- (5) Liquidated; or**
- (6) Exemplary or corrective.**

COMMENT:

(1) Damages Distinguished from Injury

Damages (from the Latin "*damnum*" or "*demo*" — to take away) refers to the harm done and what may be recovered (*See Hale on Damages, 2nd Ed., p. 1*); *injury* refers to the wrongful or unlawful or tortious act. The former is the measure of recovery, the latter is the legal wrong to be redressed. There may be damages without injury, and an injury without damages. (*15 Am. Jur., p. 388*).

(2) Damage Without Injury

There can be “damage without injury” (*damnum absque injuria*) (or physical hurt or injury without legal wrong). The principle was mentioned in, among other cases, *De la Rama Steamship Co., Inc. v. Judge Tan and the NDC* (99 Phil. 1034). In that case, the government exercised a *contractual right* to cancel an agency, although by such cancellation, the agent would suffer damages.

Similarly, one who complies with a government-promulgated rule cannot be held liable for damages that may because by other person. (*Janda v. Lepanto Cons. Mining Co., L-6930, May 25, 1956*).

(3) Some Rules on Waiver

- (a) Although the right to recover civil liability whether arising from an offense or otherwise is waivable, still, where the waiver thereof was made in behalf of the minor heirs by a person who is not their judicial guardian, such waiver is ineffective if it lacks judicial approval. (*People v. Verano, L-15805, Feb. 28, 1961*).
- (b) Waiver of the right to recover upon the civil liability of an accused employee arising from a crime, made in favor of his employer, embraces also the civil liability of the accused himself, since the law makes his employer subsidiarily liable for the civil obligation and in default of the person criminally *liable, responsible for the civil liability*. (*Ibid.*). (QUERY: Should extinction of the *subsidiary* obligation result also in extinction of the *principal* obligation?)

(4) Liability of Fiscal (now Prosecutor)

Lim v. De Leon
L-22554, Aug. 29, 1975

A Fiscal (now Prosecutor) who orders the seizure of property alleged to be involved in the crime of robbery without a search warrant is liable (except in the case of a citizen's

arrest) for actual damages (including attorney's fees), moral damages, and exemplary damages. There is nothing in the law (RA 732) which gives to provincial fiscals the power to issue warrants, much less to order the seizure without warrant, of personal property alleged to be the *corpus delicti* of a crime.

(5) Damages in Voidable Contracts

**Development Bank of the Phil.
v. Court of Appeals
L-28774, Feb. 28, 1980, 96 SCRA 342**

A person *not* obliged *principally* or subsidiarily in a contract *may nevertheless ask* for its annulment (with damages in the proper cases) if he is prejudiced in his rights regarding one of the contracting parties. (*See Banez v. Court of Appeals, L-30351, Sep. 11, 1974, 59 SCRA 16, 21*).

Art. 2198. The principles of the general law on damages are hereby adopted insofar as they are not inconsistent with this Code.

COMMENT:

Adoption of the Principles of the General Law on Damages

It is clear that in case of conflict, it is the Civil Code that prevails.

Chapter 2

ACTUAL OR COMPENSATORY DAMAGES

Art. 2199. Except as provided by law or by stipulation, one is entitled to an adequate compensation only for such pecuniary loss suffered by him as he has duly proved. Such compensation is referred to as actual or compensatory damages.

COMMENT:

(1) 'Actual or Compensatory Damages' Defined

Actual or compensatory damages are those recoverable because of pecuniary loss (in business, trade, property, profession, job, or occupation). (*Algarra v. Sandejas*, 27 Phil. 284). They include:

- (a) the value of the loss suffered (*daño emergente*);
- (b) profits which were not obtained or realized (*lucro cesante*). (*Art. 2199*; 8 *Manresa* 100).

NOTE: Recovery cannot be had for the death of an unborn (aborted) child. This is *not* to say that the parents are not entitled to collect any damages at all. But all such damages must be those inflicted *directly* upon them, as distinguished from the injury or violation of the rights of the deceased, his right to life, and physical integrity. Because the parents cannot expect either help, support, or service from an unborn child, they would normally be limited to *moral damages* for the illegal arrest of the normal development of the *spos hominis* that was the foetus, *i.e.*, on account of distress and anguish attendant to its loss, and the disappointment of their parental expectations (*Art. 2217*), as well as to *exemplary damages*, if the circumstances should warrant them. (*Art. 2230*). (*Geluz v. Court of Appeals, et al.*, L-16439, Jul. 20, 1961).

Bert Osmeña and Associates v. Court of Appeals
GR 56545, Jan. 28, 1983

Because of a breach of contract on the part of the sellers, the buyers were not able to construct the house they had intended to build (at a certain estimated cost). Can they recover said cost from the delinquent party?

HELD: No, they are not entitled to be awarded said estimated costs because after all they did not lose this amount. The amount was an expense, not expected income that had been lost.

Radio Communications of the Philippines, Inc. v.
Court of Appeals
L-55194, Feb. 26, 1981

In transmitting a telegraphic message, the RCPI erroneously transmitted “no truck available” instead of “truck available,” causing damage to a freight company the Yabut Freight Express. The RCPI was held liable:

- (1) for both *actual damages* (*damnum emergens*) and *compensatory damages* (*lucrum cessans* or unrealized profit).
- (2) for *exemplary damages* — because of the gross negligence or wanton misconduct here.
- (3) attorney’s fees and expenses of litigation (which may be reduced if found unreasonable)
- (4) temperate or moderate damages — for injury to one’s business standing.

Ramos v. CA,
GR 124354, Apr. 11, 2002

The Court rules on actual or compensatory damages generally assume that at the time of litigation, the injury suffered as a consequence of an act of negligence, has been completed and that the cost can be liquidated.

These provisions, however, neglect to take into account those situations, as in the case at bar, where the resulting injury might be continuing and possible future

complications directly arising from injury, while certain to occur, are difficult to predict.

[NOTE: To be able to recover actual or compensatory damages, the amount of loss must be proven with a reasonable degree of certainty, based on competent proof and on the best evidence obtainable by the injured party. (*MOF Co. v. Enriquez*, GR 149280, May 9, 2002).]

(2) Necessity of Pleading

To be recoverable, actual damages must be pleaded or prayed for. However, when a prayer mentions only exemplary damages, moral damages, and attorney's fees and "such further relief... as this Honorable Court may deem just and equitable," the phrase "such further relief" may include "actual damages" if and when they are proved. (*Heirs of Justiva v. Court of Appeals*, L-16396, Jan. 31, 1963).

(3) Necessity of Proof

- (a) Actual damages must *be proved as a general rule* (*Tomassi v. Villa-Abrille*, L-7047, Aug. 21, 1958) and the amount of damages must possess at least some degree of certainty. (*Chua Teck Hee v. Phil. Publishing Co.*, 34 Phil. 447).

[NOTE: It is not necessary to prove exactly how much the loss is; it is enough that LOSS is proved; and if the amount the court awards is fair and reasonable, this will be allowed. (*Tan Ti v. Alvear*, 26 Phil. 506; *Hicks v. Manila Motel*, 28 Phil. 235; *Pedret v. Ponce Enrile*, (C.A.) 53 O.G. 2809). In *Republic v. Tayengco, et al.*, L-23766, Apr. 27, 1967, it was held that in expropriation, the owners of the lands involved can recover interest from the date the expropriator takes possession of the parcels concerned until payment or deposit in court is made.]

Inhelder Corporation v. Court of Appeals GR 52358, May 30, 1983

Judges and Justices must be careful not to award exorbitant damages. There must be balanced restraint and measured objectivity.

[**NOTE:** If there is NO proof of loss (*Sanz v. Lavin Brothers*, 6 *Phil.* 299) or if the proof is flimsy and unsubstantial, no damages will be given (*Heredia v. Salinas*, 10 *Phil.* 157). The Court cannot rely on its own speculations as to the fact and amount of damages, but must depend on actual proof that damage had been suffered and actual proof of the amount. (*Suntay Tanjangco v. Jovellanos*, L-12332, *Jun.* 30, 1960). The Court in awarding damages, must point out *specific* acts which afford a basis for measuring compensatory or actual damages had been suffered. (*Malonzo v. Galang, et al.*, L-13851, *Jul.* 27, 1960). However, if there was proof, but it is not *clear* or satisfactory, the appellate court may remand the case to the lower court for *new trial*. (*Brodeck v. Larsen*, 8 *Phil.* 425; *Roroqui v. Maiquez, et al.*, {C.A.} 37 O.G. 1191). In no instance may the judge give *more* than the damages proved in court. (*Marker v. Garcia*, 5 *Phil.* 557). Just because the complaint filed by the plaintiffs against the defendant is “clearly unfounded,” this does *not* necessarily mean, in the absence of specific facts proving damages, that said defendants really suffered actual damages over and above attorney’s fees and costs. A mere relief by the Court that the sum of P500 must have been what they had actually suffered clearly should *not* be countenanced. (*Malonzo v. Galang, et al.*, L-13851, *Jul.* 27, 1960). Similarly, an alleged but *unproved* claim of damages in the amount of P10,000 simply because a party had been made a defendant in an unfounded “easement” case cannot be allowed. Indeed, the Court cannot rely on its own speculations as to the fact and amount of damages alleged to have been suffered. (*Tanjangco v. Jovellanos, et al.*, L-12332, *Jun.* 30, 1960; see *Basilan Lumber Co. v. Cagayan Timber Export Co., et al.*, L-15908, *Jun.* 30, 1961).]

[**NOTE:** If there be an award for compensatory damages, there can be *no* grant of nominal damages. The reason is that the purpose of nominal damages is to vindicate or recognize a right that has been violated, in order to preclude further cost thereon, and “not for the purpose of indemnifying the plaintiff for any loss suffered by him.” (*Medina, et al. v. Cresencia, et al.*, L-8194, *Jul.* 11, 1956).]

[**NOTE:** The damages given must be based on the evidence given and *not* on the personal knowledge of the court. (*Villaroman v. Lastrella*, [C.A.] L-136-R, Feb. 11, 1947 and *Romualdez v. Ysmael and Co.*, [C.A.] 53 O.G. 8858). Neither must the damages be *remote* or *speculation* (*Tomassi v. Villa Abrille*, L-7047, Aug. 21, 1958 and *Standard Oil Co. v. Castro*, 54 Phil. 716), nor must the claim be delayed unreasonably. (*Strong v. INAEC*, 40 O.G. [18th, S] p. 269). In *Kairuz v. Pacio and Pacio* (L-14506, Jul. 25, 1960), it was held that a person who *unjustifiably withholds* from another the latter's motor engine used for the hauling of logs should *not* be held liable for speculative and contingent damages (in the form of *possible rentals*). Instead, the withholder must be held responsible for its return (or payment of its value) plus *legal interest* thereon from the date of demand. In the case of *Ventanilla v. Centeno*, L-14333, Jan. 28, 1961, the Supreme Court held that even if an attorney fails to perfect an appeal in a civil case from an adverse judgment in a lower court, he should not be held liable for the "damages that could have been recovered" since these damages are *highly speculative*. In *Rizal Surety and Insurance Co., Inc. v. MRR Co.*, L-22409, Apr. 27, 1967, the Court ruled that a provisional claim filed by a consignee BEFORE knowledge of any actual shortage or damage with respect to cargo consigned to her is a *speculative* claim. In *Delfin v. Court of Agrarian Relations*, L-23348, Mar. 14, 1967, the Court decreed that damages, such as those awarded to an illegally dispossessed tenant, should *not* be given the basis of guesswork or speculation.]

- (b) In the following cases, actual damages need NOT be proved:
- 1) In case liquidated damages had been previously agreed upon. (*Art. 2216*).
 - 2) In case of damages other than actual. (*Art. 2216*).
 - 3) In case loss is presumed as when a child (minor) or a spouse dies. (*Manzanares v. Moreta*, 38 Phil. 821).
 - 4) In case of forfeiture of bonds in favor of the government for the purpose of promoting public interest

or policy (like a bond for the temporary stay of an alien). (*Far Eastern Surety & Ins. Co. v. Court of Appeals*, L-12019, Oct. 16, 1958).

**Radio Communications of the Philippines,
Inc. (RCPI) v. Lantin
L-59311, Jan. 31, 1985**

If because of a breach in a lease contract, there is an award of *compensatory* damages, this award may be ordered executed pending *appeal*, but *not* an award for moral or exemplary damages. The award for moral or exemplary damages cannot be regarded as fixed or definite until there is a final judgment. Otherwise stated, their grant is dependent on the outcome of the main case.

Art. 2200. Indemnification for damages shall comprehend not only the value of the loss suffered, but also that of the profits which the obligee failed to obtain.

COMMENT:

(1) Two Kinds of Actual Damages

There are two kinds of actual or compensatory damages:

- (a) losses suffered (*damno vitando* or *daño emergente*)
- (b) unrealized profits (*lucro captando* or *lucro cesante* or *lucrum cessans*). (*Angeles v. Lerma*, [C.A.] 45 O.G. No. 6, p. 2589).

[**NOTE** that “*lucrum cessans*” is also a basis for indemnification. Hence, if there exists a *basis* for a *reasonable expectation* that profits would have continued had there been no breach of contract, indemnification for damages based on such expected profits is proper. (*General Enterprises v. Lianga Bay Logging Co.*, L-18487, Aug. 31, 1964).]

**St. Louis Realty Corporation v. Court of Appeals
L-46061, Nov. 14, 1984**

If a person’s house is used as advertising material without the consent of the owner, and without apologizing

to him, he is entitled to an award of actual and moral damages.

BA Finance Corp. v. CA
GR 61464, May 28, 1988

The court cannot sustain the award of unrealized profits if the same have not been proved or justified before the trial court, and the basis of the alleged unearned profits is too speculative and conjectural to show actual damages for a future period.

Batong Buhay Gold Mines, Inc. v. CA
GR 45048, Jan. 7, 1987

Damages by way of unrealized profits (*lucro cesante*) may not be awarded in the absence of supporting evidence or merely on the basis of pure assumption, speculation or conjecture. Speculative damages cannot be recovered.

Aguilar v. Chan
GR 28688, Oct. 9, 1986

Where the actual damages suffered by plaintiff exceeded the amount awarded her by the lower court, but plaintiff did not appeal, the appellate court cannot award her more than the amount awarded by the lower court.

(2) Examples of Daño Emergente

- (a) destruction of things. (*19 Scaevola 557*).
- (b) fines or penalties that had to be paid. (*19 Scaevola 557*).
- (c) medical and hospitalization expenses. (*See Araneta, et al. v. Arreglado, et al., 104 Phil. 529*).

[NOTE: If the injured party claims actual damages because a jaw injury prevented him from going to school for one year, will not be given said damages because damages due to a lost school year and the resulting reduction in the victim's earning capacity are manifestly

speculative, and may not exist at all. (*Araneta, et al. v. Arreglado, et al.*, 104 Phil. 529). In one case, however, where the victim's mental capacity was so reduced that according to a psychiatrist, he could no longer finish his studies as a medical student; had become a misfit for any kind of work; and unable to walk around without someone helping him, compensatory damages amounting to P25,000 were awarded by the Court. (*Carriaga, et al. v. Laguna-Tayabas Bus Co., et al.*, L-11037, Dec. 29, 1960).]

- (d) rents and agricultural products *not* received in an agricultural lease. (*J.M. Tuason, Inc. v. Santiago, et al.*, L-5079, Jul. 31, 1956).

(3) Examples of Lucro Cesante

- (a) profits that could have been earned had there been no interruption in the plaintiff's business as evidenced by the reduced receipts of the enterprise. (*See Algarra v. Sandejas*, 27 Phil. 284; *Tan Ti v. Alvear*, 26 Phil. 566).
- (b) profits because of a proposed *future re-sale* of the property being purchased — if the existence of a contract there was known to the delinquent seller. (*See Enriquez de la Cavoda v. Diaz*, 37 Phil. 982).
- (c) interest on rentals that were not paid. (Here, the interest undeniably forms profits which could have been realized had the rents been given.) (*See J.M. Tuason, Inc. v. Santiago, et al.*, L-5079, Jul. 31, 1956).

Art. 2201. In contracts and quasi-contracts, the damages for which the obligor who acted in good faith is liable shall be those that are the natural and probable consequences of the breach of the obligation, and which the parties have foreseen or could have reasonably foreseen at the time the obligation was constituted.

In case of fraud, bad faith, malice or wanton attitude, the obligor shall be responsible for all damages which may be reasonably attributed to the non-performance of the obligation.

COMMENT:**(1) Liability of Debtor in Contracts and Quasi-Contracts****(a) if in GOOD FAITH —**

It is *essential* that the damages be:

- 1) the NATURAL and PROBABLE consequences of the breach of the obligation;
- 2) those which the parties FORESAW or COULD HAVE REASONABLY FORESEEN at the time the obligation was *constituted*.

(b) if in BAD FAITH

It is ENOUGH that the damages may be REASONABLY ATTRIBUTED to the non-performance of the obligation. (Relation of cause and effect is enough.)

[**NOTE:** There is no necessity of the damage being a natural or probable consequence, and there is no necessity of foreseeing or foreseeability. (*See 8 Manresa 103-104*).]

[**NOTE:** The fundamental difference between the first paragraph and the second paragraph in Art. 2201 is this: in the first, there was *mere carelessness*; in the second, there was *deliberate or wanton wrongdoing* (*Verzesa v. Baytan, et al., L-14092, Apr. 29, 1960*). Mere carelessness or negligence of a bus driver in a collision with a train would make his liability fall under the first paragraph. (*Carriaga, et al. v. Laguna, Tayabas Bus Co., et al., L-11037, Dec. 29, 1960*).]

(2) Examples of Reasonably Foreseen or Foreseeable Damages in Contracts**(a) ORDINARY DAMAGES** (generally inherent in a breach of *typical contract*)

- 1) Value of the use of the land if same is withheld, computed for the duration of the withholding. (*Daywalt v. Corporacion de P.P. Agustinos Recoletos, 39 Phil. 587*).

- 2) Difference in the value of goods at the time of *stipulated* delivery and the time of *actual* delivery (common carriers). (*Uy Chaco v. Admiral Line*, 46 Phil. 418).
- 3) Cost of completing or repairing a defective building (in the case of building contracts). (*Marker v. Garcia*, 5 Phil. 551).
- 4) The income which an injured bus passenger could have earned (had he finished his medical course and passed the corresponding board examinations) must be deemed within the category of “natural and probable consequences which parties should have foreseen by the parties at the moment said passenger boarded the bus. (*Carriaga, et al. v. Laguna, Tayabas Bus. Co., et al.*, L-111037, Dec. 29, 1960).
- 5) Salary for the entire period agreed upon in an employment contract in case the employer breaks it without *just* cause MINUS income actually earned or could have been earned during the unexpired period. (*Lemoine v. Alkan*, 33 Phil. 162; *see Sotelo v. Behn, Meyer & Co.*, 57 Phil. 775; *Berbari v. General Oil Co.*, 43 Phil. 414 and *Logan v. Phil. Acetylene Co.*, 33 Phil. 177).

[**NOTE:** The breach is generally indivisible, and therefore action may be brought AT ONCE for both *present* and *future salaries*, without waiting for the stipulated end of the contract. Failure to sue for all damages by suing only for the damages already accrued will BAR future suits on the same point. (*Hicks v. Manila Hotel*, 78 Phil. 325 and *Garcia v. Hotel de Francia*, 42 Phil. 660).]

[**NOTE:** The employer has the *duty* to prove the earnings made or which could have been earned during the unexpired period. (*Hicks v. Manila Hotel*, *supra*; *Garcia v. Hotel de Francia*, *supra*).]

- (b) **SPECIAL DAMAGES** (Those which exist because of *special* circumstances and for which a debtor in GOOD

FAITH can be held liable only if he had been *previously informed* of such circumstances.)

Example: If a carrier fails to deliver a movie film intended for showing at a fiesta, it *cannot* be held liable for the *extraordinary* profits realizable at a fiesta showing, if it had *not* been told that the film had to be delivered in time for said fiesta. (*Mendoza v. PAL*, 90 Phil. 836).

[**NOTE:** If a debtor is in BAD faith, special damages can be assessed against him even if he had NO knowledge of the special circumstances. It is enough that the damage be *reasonably attributed* to the non-performance of obligation. (8 *Manresa* 103).]

Art. 2202. In crimes and quasi-delicts, the defendant shall be liable for all damages which are the natural and probable consequences of the act or omission complained of. It is not necessary that such damages have been foreseen or could have reasonably been foreseen by the defendant.

COMMENT:

(1) Damages in Crimes and Quasi-Delicts

- (a) Note here that as distinguished from the rule in the preceding article, it “is *not* necessary that such damages have been foreseen or could have reasonably been foreseen by the defendant.”
- (b) The Article applies to CRIMES and QUASI-DELICTS.

**Maranan v. Perez
L-22272, Jun. 26, 1967**

If a taxi driver should kill his passenger, the civil liability of the *offender* is based on his having committed a *crime*. On the basis of *contracts*, it is the taxicab owner-operator who should be held liable for damages, *not* the driver-killer, for said driver is *not* a party to the contract of carriage.

People v. Salig
L-53568, Oct. 31, 1984

During their appeal in a criminal case where they were convicted, one of the accused died. The estate of the person who died, can be held solidarily liable with others in case of a final judgment of conviction. [**NOTE:** Justice Serafin Cuevas *dissents* because under Art. 89 of the Revised Penal Code, the pecuniary liability of the deceased was extinguished because of his death before final judgment.]

(2) What Victim Must Prove in a Tort or Quasi-Delict Suit

In a tort action the alleged victim must prove:

- (a) a causal connection between the tort and the injury;
- (b) the amount and extent of the injury.

(3) Unfair Competition

If unfair competition deprives the victims of certain profits, the person liable must respond if the two things stated above are proved. Liability may, however, be *reduced* if loss was suffered by the plaintiff not only because of the unfair competition but also because of his fault, *e.g.*, inferior quality or service. (*Castro, et al. v. Ice and Cold Storage Industries, et al.*, L-10147, Dec. 27, 1958).

(4) Concealment of an Existing Marriage

Concealment of an existing marriage from a girl whom a man intends to seduce can make a man liable for damages. Thus, if on account of his concealment, the woman lives with him and bears a child, and relinquishes her employment to attend to a litigation filed to obtain support for her child — he must be held liable for all the consequent damages. This concealment of the marriage in fact is NOT mere negligence, but actual fraud (*dolo*) practiced upon the girl. While the liability may be considered *extra-contractual* in nature, still under the old Civil Code as well as, it is believed, the new Civil Code, said liability is equivalent to that of a contractual

debtor in *bad faith*. (*Silva, et al. v. Peralta, et al.*, L-13114, Aug. 29, 1961). Should the man be also held liable for *moral* damages? YES. It is true that no moral damages are generally allowable as a consequence of sexual relations outside of wedlock, but in the instant case it appears that after the girl had filed the action for support the man *avoided* the service of summons and then exercised improper pressure upon her to make her withdraw the suit. When she refused, the man and his lawful wife even filed an action against her, thus calling to her employer's attention the fact that she was an unwed mother. These are deliberate maneuvers causing her anguish and physical suffering in which she got sick as a result. As this injury was inflicted after the new Civil Code became operative, it constitutes a justification for the award of moral damages. (*Ledesma Silva, et al. v. Peralta, L-13114, Aug. 29, 1961*).

Budiong v. Judge Apalisok
GR 60151, Jun. 24, 1983

Even if there is no specific allegation of damages in the complaint or information, civil liability may still be claimed in the criminal case.

Brinas v. People
GR 50309, Nov. 25, 1983

Even if a separate civil case is brought because of an accident, the Court in the criminal case can still impose civil liability (arising from the commission of a crime). In the civil case, if it is the employer who is sued, it will be an obligation arising from *culpa contractual* (not one arising from the commission of the criminal act).

People v. Castañeda
GR 49781, Jun. 24, 1983

If the accused in a criminal case is acquitted on reasonable doubt, a civil action for damages may still be instituted.

Art. 2203. The party suffering loss or injury must exercise the diligence of a good father of a family to minimize the damages resulting from the act or omission in question.

COMMENT:**(1) Victim Must Minimize the Damage**

Prudent men must minimize the damage done to them by others. Thus, one prevented from entering a particular hacienda must complain to the proper officials in time. (*Del Castelvi v. Compania Gen. de Tabacos*, 49 Phil. 998). One ousted from a job must try to seek other employment. (*Lemoine v. Alkan*, 33 Phil. 162).

(2) Burden of Proof

The person sued has the burden of proving that the victim could have mitigated the damage. (*Lemoine v. Alkan*, *supra*).

(3) Plastic Surgery Which Could Have Been Performed in the Philippines

A victim cannot recover the cost of plastic surgery in the United States if it is proved that the operation could have been completely performed in the Philippines by local practitioners. (*Araneta, et al. v. Arreglado, et al.*, 104 Phil. 529).

(4) Case

**Abelardo Lim & Esmadito Gumalan v.
CA & Donato H. Gonzales
GR 125817, Jan. 16, 2002**

FACTS: Private respondent left his passenger jeepney by the roadside at the mercy of the elements.

HELD: Art. 2203 exhorts parties suffering from loss or injury to exercise the diligence of a good father of a family to minimize the damages resulting from the act or omission in question. One who is injured then by the wrongful or negligent act of another should exercise reasonable care and diligence to minimize the resulting damage. Anyway, he can recover from the wrong doer's money lost in reasonable efforts to preserve the property injured and for injuries incurred in attempting to prevent damages to it.

Art. 2204. In crimes, the damages to be adjudicated may be respectively increased or lessened according to the aggravating or mitigating circumstances.

COMMENT:

Effect of Aggravating or Mitigating Circumstances

The Article explains itself.

Art. 2205. Damages may be recovered:

(1) For loss or impairment of earning capacity in cases of temporary or permanent personal injury;

(2) For injury to the plaintiff's business standing or commercial credit.

COMMENT:

Damages to Earning Capacity and to Business

- (a) The Article is self-explanatory.
- (b) Lameness is a permanent personal injury. (*Marcelo v. Veloso*, 11 Phil. 287). If a dancer's leg is amputated, it is clear that recovery is proper. (*Julio v. Manila Railroad Co.*, 58 Phil. 176).

**Consolidated Plywood Industries, Inc. & Henry Lee v. CA, Willie Kho & Alfred C.H. Kho
GR 101706, Sep. 23, 1992**

While it is the Court's belief that petitioner is entitled to an award for moral damages, the award granted by the trial court in the amount of P200,000 is excessive. It should be stated here that the hauling agreement between the petitioners and the private respondent had no fixed date of termination; it was a verbal agreement where the private respondents bound themselves until the loan with Equitable Bank in the personal account of petitioners had been fully paid. There was substantial compliance by the private respondents of their obligations in the contract for about a year. The record showed

that the remaining balance owing to the bank was only P30,000 which was not due until one year and 6 months after the breach by the private respondents, or on Sep. 4, 1980. However, the trial court found that private respondents acted with bad faith when it surreptitiously pulled out their hauler trucks from petitioner's jobsite before the termination of the contract.

The trial court held that the act of defendants in suddenly and surreptitiously withdrawing its hauler trucks from the jobsite and abandoning its obligation of hauling the logs is indubitably a wanton violation of its obligation, under the contract, a neglect to perform its obligation in bad faith more particularly in its stipulation to liquidate the cash advance obtained from Equitable Bank, for the law would not permit said defendants to enrich themselves at the expense of the plaintiffs. Thus, an award of P50,000 for moral damages is sufficient.

**Francisco, et al. v.
Ferrer, Jr., et al.
GR 142029, Feb. 28, 2001**

FACTS: A couple engaged to be married had ordered a 3-layered cake from a bakeshop to be delivered at 5 p.m. of the wedding day itself. On the wedding day, the now newly-married couple arrived at the country club (venue-reception of the wedding) at around 6 p.m., but the wedding cake was nowhere to be found. At 10 p.m., the wedding cake finally arrived, but by then rejected because of the lateness of the hour. One other reason for its rejection: what arrived was only a 2-layered cake and not a 3-layered one as originally agreed upon. The bakeshop owner was sued for breach of contract, with the complaints alleging personal embarrassments, mental anguish, serious anxiety, and sleepless nights. *Issue:* To recover moral damages, is it enough that one suffered sleepless nights, mental anguish, serious anxiety, social embarrassment, or besmirched reputation?

HELD: No. To recover moral damages, it must be proven that the guilty party acted in bad faith. In the

instant case, no such bad faith existed. The bakeshop owner was quick to apologize and offered to repair whatever damage was done. Note that the bakeshop owner sent a letter of apology accompanied by a P5,000 check for the harm done, but which was unacceptable to the couple who considered the amount offered as inadequate. Nevertheless, while not liable for moral damages, the bakeshop owner must pay nominal damages in the amount of P10,000 for prevarication when confronted with failure to deliver the cake on time, this, in addition to paying the cost of the cake in the sum of P3,175 and attorney's fees of P10,000.

Art. 2206. The amount of damages for death caused by a crime or quasi-delict shall be at least three thousand pesos, even though there may have been mitigating circumstances. In addition:

(1) The defendant shall be liable for the loss of the earning capacity of the deceased, and the indemnity shall be paid to the heirs of the latter; such indemnity shall in every case be assessed and awarded by the court, unless the deceased on account of permanent physical disability not caused by the defendant, had no earning capacity at the time of his death;

(2) If the deceased was obliged to give support according to the provisions of Article 291, the recipient who is not an heir called to the decedent's inheritance by the law of testate or intestate succession, may demand support from the person causing the death, for a period not exceeding five years, the exact duration to be fixed by the court;

(3) The spouse, legitimate and illegitimate descendants and ascendants of the deceased may demand moral damages for mental anguish by reason of the death of the deceased.

COMMENT:

(1) Damages for Death — Reason for Awarding Damages

- (a) "Human life has heretofore been very cheap, in law and the practice thereunder. Before the passage of Common-

wealth Act 284, in Jun. 1938, the practice was to allow P1,000 to the heirs of the deceased in case of death caused by a crime. Later, by virtue of that special law, a minimum of P2,000 was fixed, but the courts usually award only the minimum, without taking the trouble to inquire into the earning capacity of the victim, and regardless of aggravating circumstances.” (*Report of the Code Com.*, p. 34).

- (b) Note that under Art. 2206, the minimum to be given is P3,000, but this does not mean that the court should stop after awarding that amount, because the life of a captain of industry, scientist, inventor, a great writer or statesman, is materially more valuable to the family and community than that of an ordinary man. Moreover, exemplary damages may be justified by aggravating circumstances. The earning capacity of the deceased, his obligation to support dependents, and the moral damages suffered by his kin must also be considered. (*Report of the Code Com.*, p. 35). It is clear from Art. 2206 that P3,000 is the *minimum* award. Hence, a greater sum can be given. (*Nita Lira v. Gonzalo Mercado, et al. and Gonzalo Mercado, et al. v. Ramon Ura, et al.*, L-13358, L-13328, L-13329, Sept. 29, 1961).
- (c) In fact in many decisions, the appellate courts awarded P6,000, then P12,000, and now, P50,000, as damages. The Court gave as its reason the great rise in prices and declining purchasing power of the peso. Independently of its financial capacity, a common carrier, if liable for the death of a passenger or of a pedestrian, must be made to pay the minimum amount. But if its financial capacity enables it to pay more, said greater sum should be given. It is here where financial capacity is material and significant.
- (d) Cases

Mckee, et al. v. IAC, et al.
GR 68102, Jul. 16, 1992

In light of recent decisions of the Supreme Court, the indemnity for death is now P50,000.

(2) Factors Which May Be Considered in Determining the Amount

- (a) life expectancy (considering the state of health and habit of the deceased; mortality tables are inconclusive evidence) and consequent loss of earning capacity.

**Monzon, et al. v. IAC and Theo H.
Davies and Co., Far East Ltd.
GR 72828, Jan. 31, 1989**

Life expectancy fluctuates with several factors but it is for that very reason that a generally accepted formula has been established by this Court in a long line of cases.

It would be most unfair and illogical for a court to reduce the compensation due for the loss of the earning capacity of a deceased by discarding the well-established formula by taking a pessimistic and depressed view of every situation instead of an average standard. For as a man grows older, and gains more experience, his income generally increases, with each passing year.

**Smith Bell Dodwell Shipping Agency Corp. v.
Catalino Borja and International Towage
& Transport Corp.
GR 143008, Jun. 10, 2002**

FACTS: Petitioner contends that respondent Borja died nine years after the incident and, hence, his life expectancy of 80 years should yield to the reality that he was only 59 when he actually died.

ISSUE: Is this contention correct?

HELD: No. The Court uses the American Experience/Expectancy Table of Morality or the Actuarial Combined Experience Table of Mortality, which consistently pegs the life span of the average Filipino at 80 years, from which it extrapolates the estimated income to be earned by the deceased had he not been killed. (*People v. Villanueva*, 302 SCRA 380 [1999]).

The owner or the person in possession and control of a vessel is liable for all natural and proximate damages

caused to persons and property by reason of negligence in its management or navigation. Negligence is conducted that creates undue risk of harm to another. It is failure to observe that degree of care, precaution, and vigilance that circumstances justly demand — whereby that other person suffers injury. (*Jarco Marketing Corp. v. CA*, 321 SCRA 375 [1999]; *Bulitan v. COA*, 300 SCRA 445 [1998]; and *Valenzuela v. CA*, 253 SCRA 303 [1996]). Petitioner's vessel was carrying chemical cargo — alkyl benzene and methyl methacrylate monomer. While knowing that their vessel was carrying dangerous inflammable chemicals, its officers and crew failed to take all the necessary precautions to prevent an accident. Petitioner was, therefore, negligent and held liable for damages and loss of respondent Borja's income.

As a result of the fire and the explosions during the unloading of the chemicals from petitioner's vessel, respondent Borja suffered damages and injuries, thus:

1. chemical burns of the face and arms;
2. inhalation of fumes from burning chemicals;
3. exposure to the elements while floating in sea water for about 3 hours;
4. homonymous *hemianopsia* or blurring of the right eye which was of possible toxic origin; and
5. cerebral infract with neo-vascularization, left occipital region with right sided headache and the blurring of vision of right eye.

Respondent Borja's demise earlier than the estimated life span is of no moment. For purposes of determining loss of earning capacity, life expectancy remains at 80. Otherwise, the computation of loss of earning capacity will never become final, being always subject to the eventuality of the victim's death. The computation should not change even if Borja lived beyond 80 years. Fair is fair.

- (b) pecuniary loss, loss of support and service.

- (c) moral and mental suffering. (*Alcantara, et al. v. Surro, et al.*, 93 Phil. 472).

[**NOTE:** The minimum award (actual) for the debt of a person does NOT cover the case of an *unborn foetus*, because it is NOT endowed with juridical personality. (*Geluz v. C.A. and Lazo, L-16439, Jul. 20, 1961*). However, under *certain* circumstances, *moral* damages may be awarded.]

Villa-Rey Transit v. Bello
L-18957, Apr. 23, 1963

FACTS: The Villa-Rey Transit, Inc. committed a breach of contract when it failed to comply with its obligation of bringing safely the passenger, Felipe Tejada, to his place of destination. **Issue:** How much damages may Tejada's heirs recover?

HELD: Had not Tejada met this fatal accident on Jul. 17, 1961, he would have continued to serve in the government for some 27 years until his retirement with a compensation of P6,000. As consequential damages, the heirs having been deprived of the earning capacity of their husband and father, respectively, they are entitled to P3,300 a year for at least 17 years the average life of a Filipino being between 50 and 60 years (17 years because he could have died at the age of 50 only). For failure of the transportation company to exercise due diligence in employing a careful and prudent driver, the amount of P2,000 as exemplary damages is hereby awarded. And for the agony, mental anguish and sorrow suffered by the heirs because of the sudden death of Tejada and the mutilated and gory condition of the body, the amount of P5,000 is awarded as moral damages. (*See Art. 2234; Velayo v. Shell Co., 100 Phil. 187; Singson v. Aragon and Lerza, 92 Phil. 514; Estopa v. Piansay, L-14733, Sep. 30, 1962 and Yutuk v. Manila Electric Co., L-13106, May 31, 1961*).

Davila v. Phil. Air Lines
49 SCRA 497

At the age of 30, one's normal life expectancy is 33-1/3 years more. This is the formula adopted by the

Supreme Court in *Villa-Rey Transit v. Court of Appeals*, 31 SCRA 511, based on the American Expectancy Table of mortality. Earning capacity under Art. 2206(1) means gross earning LESS the necessary living expenses of the deceased.

Budiong v. Judge Apalisok
GR 60161, Jun. 24, 1983

After the accused has pleaded guilty in a criminal case, the judge must set the case for hearing so that the offended party's evidence on the civil liability may be received. And this is true even if the accused has already filed an application for probation.

Dangwa Transportation v. CA
GR 95582, Oct. 7, 1991

The amount recoverable by the heirs of a victim, a tort is not the loss of the entire earnings, but rather the loss of that portion of the earnings which the beneficiary would have received. In other words, only net earnings, not gross earnings, are to be considered, that is, the total of the earnings less expenses necessary in the creation of such earnings or income and minus living and other incidental expenses.

The deductible living and other expenses of the deceased may fairly and reasonably be fixed at P500 a month or P6,000 a year. In adjudicating the actual or compensatory damages, the appellate court found that the deceased was 48 years old, in good health with a remaining productive life expectancy of 12 years and then earning P24,000 a year. Using the gross annual income as the basis, and multiplying the same by 12 years, it accordingly awarded P288,000. Applying the aforesaid rule on computation based on the net earnings, said award must be rectified and reduced to P216,000. However, in accordance with prevailing jurisprudence, the death indemnity is hereby increased to P50,000.

**Metro Manila Transit Corp. (MMTC),
et al. v. CA & Spouses Rodolfo V. Rosales
and Lily R. Rosales
GR 116617, Nov. 16, 1998**

FACTS: Pedro Musa, a bus driver of MMTC, was found guilty by the trial court of reckless imprudence resulting in homicide for the death of Liza Rosalie Rosales. Liza Rosalie's parents filed an independent civil action for damages against MMTC, Musa, MMTC Actg., Gen. Mgr. Conrado Tolentino, the GSIS, and Feliciano Celebrado, an MMTC dispatcher. The trial court found MMTC and Musa guilty of negligence and ordered them to pay damages and attorney's fees. The Court of Appeals (CA) affirmed the trial court's decision, but deleted the award of actual damages and awarded instead death indemnity. On appeal, the Supreme Court set aside the CA's decision.

HELD: Both MMTC and Musa, respectively, are liable for negligence for the death of Liza Rosalie. The responsibility of employers for the negligence of their employees is primary, *i.e.*, the injured party may recover from the employers directly, regardless of the solvency of their employees. Employees may be relieved of responsibility for the negligent act of their employees within the scope of their assigned tasks only if they can show that they observed all the diligence of a good father of a family to prevent damage. For this purpose, they have the burden of proving that they have indeed exercised such diligence, both in the selection of employee who committed the *quasi-delict* and in the supervision of the performance of his duties.

In addition to the death indemnity, the heirs of Liza Rosalie are awarded moral damages, exemplary damages, attorney's fees, and compensation for loss of earning capacity. Compensation for loss of earning capacity was awarded because Liza Rosalie's parents had adduced proof that the victim was a good student, a promising artist, and an obedient child. Such form of damages, computed in accordance with the formula laid down in decided cases, may use as basis for the victim's projected

gross annual income the minimum wage for workers in the non-agricultural sector at the time of her death.

(3) Moral Damages

- (a) If the victim *dies* because of a CRIME, QUASI-DELICT (*Art. 2206*), or BREACH OF CONTRACT BY COMMON CARRIER (*Art. 1764 read together with Art. 2206*), moral damages may be recovered by:

- 1) the spouse (legitimate);
- 2) *legitimate* descendants and ascendants;
- 3) illegitimate descendants and ascendants [*Art. 2206; Necesito, etc. v. Paras, et al.*, 104 *Phil.* 75 — where the court said that moral damages may be recovered here as an EXCEPTION to the general rule against moral damages in breach of contract under *Art. 2220*. Indeed, once the heirs are able to prove that they are entitled to the actual damages of at least P3,000, it becomes the duty of the court to award *moral* damages to the claimants in an amount commensurate with their mental anguish. (*Mercado v. Lira*, L-13328-29, *Sept. 29, 1961*).]

[**NOTE:** In the case of *Tamayo v. Aquino* (Nos. L-12634, L-12720, *May 29, 1959*), the Court apparently *forgot* the ruling in the case of *Necesito v. Paras* (*supra*), when it denied *moral damages* for the heirs of a *passenger* who *died* as a result of *culpa contractual*. The Court obviously *forgot* to consider *Art. 1764 read together with Art. 2206*. However, the error was obviously corrected in later cases which correctly granted moral damages in case of *death*. One such case is *Mercado v. Lira*, L-13328-29, *Sep. 29, 1961*).]

[**NOTE:** In ordinary breaches of contract, moral damages may be recovered only if the defendant acted fraudulently or in *bad faith*. (*Art. 2220*).]

[**NOTE:** In *Heirs of Gervacio Gonzales v. Alegarbes, et al.*, 99 *Phil.* 213, it was held that Arts. 2206 (No. 3) and 2217, do NOT grant brothers and

sisters of the deceased who left a *child* a right to recover moral damages arising out of or from the death of the deceased caused by the wrongful or tortuous act of the defendant. (See Art. 2219, last paragraph, which excludes brothers, and sisters, if a descendant is present).]

- (b) If the victim does not die, but merely suffers physical injuries, may *moral* damages be recovered?

ANS.: Yes, but only in the following instances:

- 1) if caused by a crime. (*Art. 2219, No. 1*).
- 2) if caused by a quasi-delict. (*Art. 2219, No. 2*).
- 3) if caused by a breach of contract BUT ONLY if the defendant acted *fraudulently* or in *bad faith* (*Art. 2220*) or in case of wanton and deliberately injurious conduct on the part of the carrier. (*LTB v. Cornista, L-22193, May 29, 1964*). Thus, if a passenger is merely *injured* due to the negligence of a *common carrier* there is no *right* to recover moral damages, unless the common carrier acted *fraudulently* or in *bad faith*. (*Art. 2220*). This is DIFFERENT from a case of death. (*Necesito, et al. v. Paras, et al., supra*). Indeed, *proof* of fraud, malice, or bad faith must be given if only physical injuries were sustained. The mere bursting of a tire while a passenger bus was overspeeding *cannot* be considered evidence of fraud, malice, or bad faith. (*Lira v. Mercado, L-13328, Sept. 29, 1961 and Consolidated Plywood Industries, Inc. & Henry Lee v. CA, Willie Kho & Alfred C. H. Kho, GR 101706, Sep. 23, 1992*).

(4) Right of Recovery Not Affected By Testimony

People v. Santiago Manos L-27791, Dec. 24, 1970

FACTS: A son was convicted for having killed his father. May he be required to indemnify the victim's heirs (the defendant's mother, brothers, and sisters) even if they had testified in his favor?

HELD: Yes, for they have *suffered*, even if their natural impulses compelled them to seek exoneration of the guilty son.

(5) Liability for Reckless Imprudence

**People v. Eutiquia Carmen, et al.
GR 137268, Mar. 26, 2001**

FACTS: Accused-appellants, none of whom was a medical practitioner, belonged to a religious group engaged in faith-healing. Upon advise of one of the accused-appellants, the parents of the victim agreed to subject their child, who had earlier suffered from a nervous breakdown, to a “treatment,” but which, resulted in the child’s death. Charged with and later convicted of murder by the trial court, the Supreme Court modified the accused-appellants’ judgment upon appeal.

HELD: Accused-appellants can only be made liable for reckless imprudence resulting in homicide as qualifying circumstance of treachery cannot be appreciated absent an intent to kill.

As to the their civil liability, accused-appellants should pay the heirs of the victim an indemnity in the amount of P50,000 and moral damages also in the amount of P50,000. (*Arts. 2206[3] and 2219[1], Civil Code*). (*See People v. Silva, 321 SCRA 647 [1999]*). (*See also People v. Silvestre, 307 SCRA 60 [1999]*). In addition, they should pay exemplary damages in the amount of P30,000 in view of accused-appellants’ gross negligence in attempting to “cure” the victim without a license to practice medicine and to give an example or correction for the public good. (*Arts. 2229 and 2231*). (*See People v. Medroso, Jr., 62 SCRA 245 [1975]*).

Art. 2207. 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 or injury.

COMMENT:

(1) Effect if Property Was Insured

- (a) According to American jurisprudence, the fact that the plaintiff has been indemnified by an insurance company cannot lessen the damages to be paid by the defendant. Such rule gives more damages than those actually suffered by the plaintiff, and the defendant, if also sued by the insurance company for reimbursement, would have to pay in many cases twice the damages he has caused. The proposed article would seem to be a better judgment of the rights of the three parties. (*Report of the Code Commission, p. 73*).
- (b) The principle enunciated in this article can apply even to cases that accrued prior to the effectivity of this article and the new Civil Code — otherwise, the general principle against unjust enrichment would be violated. (*Africa v. Caltex, L-12986, Mar. 21, 1966*). Hence, the amount of insurance recovered shall be deducted from the total liability of the defendant. (*Ibid.*)

(2) Meaning of “Authorized Driver” in Car Insurance

**CCC Insurance Corp. v. Court of Appeals
and Carlos F. Robes
L-25920, Jan. 30, 1970**

FACTS: A car insured against loss or damage was being driven by a driver, who was *licensed*, WITHOUT an examination (he was illiterate). The car was subsequently damaged in an accident, but the insurance company refused to pay on the ground that the driver was *not* an “authorized driver.” Is the insurance company liable?

HELD: Yes, the insurance company is liable for under Sec. 24 of the Revised Motor Vehicles Law, Act 3992, as amended by Republic Acts 587, 1204, and 2363, an examination or

demonstration of the applicant's ability to operate a motor vehicle *may* (only) be required in the discretion of the Chief, Motor Vehicles Office. Sec. 26 even allows a *non-examination*. Whether discretion on the part of the government official was abused or not is a matter of legislative policy. The issuance of the license is proof that the driver was entitled to drive. Besides, insurance contracts must be construed liberally in favor of the insured and strictly against the insurer.

(3) Subrogation of Insurer

**Fireman's Fund Insurance Co., et al. v.
Jamila and Co., Inc.
L-27427, Apr. 7, 1976**

FACTS: Firestone Corporation had its properties insured by Fireman's Fund Insurance Co. Some of said properties were lost allegedly because of the acts of its own employees, who were in connivance with security guards from the Jamila agency. These security guards were supposed to safeguard the Firestone properties, and under the contract, Jamila assumed responsibility for the guards' actuations. The First Quezon City Insurance guaranteed this obligation of Jamila. The losses of Firestone Corporation were paid by Fireman's Fund Insurance Company as insurer. Does Fireman's Fund Insurance Company have a cause of action against Jamila and the First Quezon City Insurance Company, so that the money paid may be reimbursed? Can there be subrogation even without Jamila's consent?

HELD: Yes, it has a valid cause of action, under Art. 2207, Civil Code. Said article states that the insurer who has paid shall be subrogated in the place of the injured party in the latter's rights against the offender or violator of a contractual commitment. This is an instance when the consent of the debtor is not required for the subrogation in favor of the Fireman's Fund Insurance Company.

Art. 2208. In the absence of stipulation, attorney's fees and expenses of litigation, other than judicial costs, cannot be recovered except:

(1) When exemplary damages are awarded;

(2) When the defendant's act or omission has compelled the plaintiff to litigate with third persons or to incur expenses to protect his interest;

(3) In criminal cases of malicious prosecution against the plaintiff;

(4) In case of a clearly unfounded civil action or proceeding against the plaintiff;

(5) Where the defendant acted in gross and evident bad faith in refusing to satisfy the plaintiffs plainly valid, just and demandable claim;

(6) In actions for illegal support;

(7) In actions for the recovery of wages of household helpers, laborers and skilled workers;

(8) In actions for indemnity under workmen's compensation and employer's liability laws;

(9) In a separate civil action to recover civil liability arising from a crime;

(10) When at least double judicial costs are awarded;

(11) In any other case where the court deems it just and equitable that attorney's fees and expenses of litigation should be recovered.

In all cases, the attorney's fees and expenses of litigation must be reasonable.

COMMENT:

(1) Concept of Attorney's Fees As Damages

The attorney's fees referred to in this article do not refer to the duty of a client to pay his *own* attorney. Such payment generally involves only the client and his attorney. The fees stated in the article apply rather to instances when a client may recover from the *other party* the fees which the former may pay the former's attorney. (*See Tan Ti v. Alvear*, 26 Phil. 566).

**Luz G. Cristobal v. Employees’
Compensation Commission
L-49280, Feb. 26, 1981**

While a pauper litigant is exempt from the payment of legal fees and from filing an appeal bond, a printed record on appeal, and a printed brief, he is not exempted from the payment of attorney’s fees. An award of attorney’s fees whether in favor of or against a litigant in “*forma pauperis*” is thus proper.

**Borcena, et al. v. IAC
GR 70099, Jan. 7, 1987**

The Supreme Court has invariably fixed counsel fees on a *quantum meruit* basis whenever the fees stipulated appear excessive, unconscionable, or unreasonable, because a lawyer is primarily a court officer charged with the duty of assisting the court in administering impartial justice between the parties. Hence, the fees should be subject to judicial control. Sound public policy demands that courts disregard stipulations for counsel fees, whenever they appear to be a source of speculative profit at the expense of the debtor or mortgagor.

In determining the compensation of an attorney, the following circumstances should be considered: the amount and character of the services rendered; the responsibility imposed; the amount of money or the value of the property affected by the controversy, or involved in the employment; the skill and experience called for in the performance of the service; the professional standing of the attorney; the results secured; and whether or not the fee is contingent or absolute, it being a recognized rule that an attorney may properly charge a much larger fee when it is to be contingent than when it is not.

**Sun Insurance Office, Ltd. v. CA & Nerissa Lim
GR 92383, Jul. 17, 1992**

FACTS: Petitioner issued a personal accident policy to Felix Lim, Jr. with a face value of P200,000. Two months later, he was shot dead with a bullet wound in his head. As beneficiary, his wife Nerissa Lim sought payment on the policy but her claim was rejected. The petitioner agreed that

there was no suicide. It argued, however, that there was no accident either.

HELD: The petitioner is liable to the private respondent in the sum of P200,000 representing the face value of the insurance contract, with interest at the legal rate from the date of the filing of the complaint until the full amount is paid, but modified with the deletion of all awards for damages, including attorney's fees, except the costs of the suit.

In order that a person may be made liable to the payment of moral damages, the law requires that his act be wrongful. The adverse result of an action does not *per se* make the act wrongful and subject the act or to the payment of moral damages. The law could not have meant to impose a penalty on the right to litigate; such right is so precious that moral damages may not be charged on those who may exercise it erroneously. For these, the law taxes costs. If a party wins, he cannot, as a rule, recover attorney's fees and litigation expenses, since it is not the fact of winning alone that entitles him to recover such damages of the exceptional circumstances enumerated in Art. 2208. Otherwise, every time a defendant wins, automatically the plaintiff must pay attorney's fees thereby putting a premium on the right to litigate, which should not be so. For those expenses, the law deems the award of costs as sufficient.

(2) Generally Not Part of Damages

Generally, attorney's fees, as understood in this article are not a proper element of damage, for it is NOT sound public policy to place a penalty on the right to litigate. To compel the defeated party to pay the fees of counsel for his successful opponent would throw wide the door of temptation to the opposing party and his counsel to swell the fees to undue proportions. (*Tan Ti v. Alvear*, 26 Phil. 566). Thus, no right to such fees can accrue merely because of an adverse decision. Otherwise stated, if a party loses in court, this does not mean necessarily that the court will compel him to award attorney's fees (as damages) to the winning party. (*Ramos v. Ramos*, 61 SCRA 284). This is precisely the rationale for taxing costs in certain cases against the losing party. The payment of said costs is deemed a sufficient sanction. How-

ever, under the new Civil Code, it may truly be said that in *certain cases*, attorney's fees are an element of recoverable damages, whether they be in writing or not stipulated at all. (*Santiago v. Dimayuga*, L-17883, Dec. 30, 1961). The appellate court may fix attorney's fees even when the trial court did not award attorney's fees, and even when no appeal on this point was interposed before the appellate tribunal. (*Medenilla v. Kayanan*, 40 SCRA 154).

Salao v. Salao
L-26699, Mar. 16, 1976

FACTS: Plaintiffs lost in a reconveyance case although they presented 15 witnesses in a protracted five (5)-year case, and fought vigorously. They honestly thought that their action could prosper because they believed (albeit erroneously) that the property involved had been acquired by the funds of the common ancestor of plaintiffs and defendants. Should said plaintiffs be held liable for *moral damages* and *attorney's fees*?

HELD: No, they should not be assessed moral damages and attorney's fees. Although their causes of action turned out to be unfounded, still, the pertinacity and vigor with which they pressed their claim indicate sincerity and good faith. Thus, the action was not manifestly frivolous. With respect to attorney's fees, while the case was unfounded (*Art. 2208[4], Civil Code*), still there was the element of good faith, and, therefore, neither attorney's fees or litigation expenses should be awarded. (*See Rizal Surety and Insurance Co., Inc. v. Court of Appeals*, L-23729, May 16, 1967).

Public Estates Authority v. Elpidio S. Uy
GR 147933-34, Dec. 12, 2001

FACTS: Anent petitioner's claim for attorney's fees, suffice it to state that it was represented by the Government Corporate Counsel in the proceedings before the Construction Industry Arbitration Commission.

HELD: Attorney's fees are *in the nature of actual damages, which must be duly proved*. Petitioner failed to show with convincing evidence that it incurred attorney's fees.

(3) Given to Party, Not to Counsel

The Court's award of attorney's fees is an indemnity to the party and NOT to counsel, and the fact that the contract between the client and his counsel was on a CONTINGENT basis does not affect the client's right to counsel fees. A litigant who improvidently stipulates higher counsel fees than those to which he is lawfully entitled, does NOT for that reason earn the right for a larger indemnity, but by parity of reasoning, he should NOT be deprived of counsel fees if by law he is entitled to recover. (*Necesito, et al. v. Paras, et al.*, 104 Phil. 75).

Tiu Po v. Bautista
L-55514, Mar. 17, 1981

A claim for attorney's fees which arises out of the filing of a complaint partakes of the nature of a compulsory counterclaim. Therefore, if it is not pleaded or prayed for in the answer to the complaint, it is barred.

What has been said above applies also to all damages claimed to have been suffered by the defendant as a consequence of the action filed against him.

Quirante and Cruz v. IAC, et al.
GR 73886, Jan. 31, 1989

Attorney's fees as an item of damages provided for under Art. 2208 of the Civil Code is an award made in favor of the litigant, not of his counsel. And the litigant, not his counsel, is the judgment creditor who may enforce the judgment for attorney's fees by execution.

What is being claimed in this case as attorney's fees by petitioners is, however, different. Herein, the petitioners' claims are based on an alleged contract for professional services, with them as the creditors and the private respondents as the debtors.

(4) Express Stipulation

- (a) Note that aside from the eleven instances enumerated, attorney's fees and expenses of litigation may be recov-

ered also should there be an *express stipulation to that effect*. (*Introductory paragraph, Art. 2208*). However, if despite an express stipulation for attorney's fees, there is an implied WAIVER thereof (as when instead of demanding specific fulfillment of an obligation — with attorney's fees in compelling such fulfillment — there is a demand for cancellation of a contract), attorney's fees cannot be recovered. (*Luneta Motor Co. v. Baguio Bus Co., L-15157, Jun. 30, 1960*).

- (b) If the parties agree on attorney's fees based on a certain percentage of the amount of the principal obligation, the stipulation is valid. (*Luneta Motor v. Mora Limlengco, 73 Phil. 80*).
- (c) Where the contract does not expressly stipulate that a fixed sum by way of attorney's fees shall be paid by defendant in case of collection even if the same is subsequently settled by compromise, it is just and fair to reduce the amount of counsel's fees in the court's discretionary power, where the case is partially or fully settled out of court. (*Santiago v. Dimayuga, L-17833, Dec. 30, 1961*).
- (d) Be it noted, however, that an agreement whereby a *non-lawyer* will be given part of the attorney's fees, is condemned by legal ethics, is immoral and cannot be justified. (*PAFLU v. Binalbagan Isabel a Sugar Co., 42 SCRA 302*).

Kapol v. Masa
L-50473, Jan. 21, 1985

(1) When exemplary damages are recovered, there can be an award of attorney's fees.

(2) Exemplary damages may be awarded even if not expressly prayed for in the complaint and even if not proved.

(3) Moral damages may be proved by documentary evidence even without testimonial proof.

(5) Paragraph 2 (Defendant's Act or Omission)

If the litigation was caused not by the defendant's failure to pay but by the plaintiff's *exorbitant* charge, the plaintiff cannot get attorney's fees. (*Cachero v. Manila Yellow Taxicab Co.*, 101 Phil. 523 and *Globe Assurance Co. v. Arcache*, L-12378, May 28, 1958). Similarly, if the plaintiff goes to court after *refusing* an amicable settlement by the guilty party, said plaintiff cannot recover attorney's fees if it is proved that he was asking "too much." Here, the defendant was justified in resisting the unjust claim. (*Juana Soberano & Jose B. Soberano v. The Manila Railroad Co.*, L-19407, Nov. 23, 1966). If the suit, however, was prompted by the defendant's deliberate failure to pay for the trucks it had purchased, compelling the plaintiff to litigate and incur expenses in order to protect its interest, the plaintiff is entitled both to attorney's fees under Art. 2208(2) and to *costs* under Rule 131 of the Rules of Court (now Rule 142) as the prevailing party. (*Luneta Motor Co. v. Baguio Bus Co., Inc.*, L-15167, Jun. 30, 1960; *see also Suntay Tanjangan v. Jovellanos, et al.*, L-12332, Jun. 30, 1960).

Bert Osmeña and Associates v. Court of Appeals
GR 56545, Jan. 28, 1983

If the prevailing party in a case was compelled to litigate to protect his interests he is entitled to an award of attorney's fees.

Sarming v. Dy
GR 133643, Jun. 6, 2002

The award of attorney's fees for P2,000 is justified under Art. 2208(2) of the Civil Code.

This is, in view of the trial court's finding, that the unjustified refusal of petitioners to reform or to correct the document of sale compelled respondents to litigate to protect their interest.

(6) Paragraph 3 (Malicious Prosecution)

- (a) There is malicious prosecution only if the person concerned acted deliberately and knew that his accusation was false or groundless. (*Buenaventura v. Sto. Domingo*, 54 O.G. 8439).

- (b) Hence, if there is in the record *no* indication that the action was malicious and intended only to prejudice the other party, attorney's fees on this ground cannot be recovered. (*Mercader v. Manila Polo Club*, L-8373, Sep. 28, 1956).

(7) Paragraph 4 (Unfounded Civil Action)

- (a) If A's complaints against B are found to be insincere, baseless and intended to harass, annoy, and defame B, B can now sue for and be granted attorney's fees, for the "clearly unfounded civil actions or proceedings against the plaintiff (A)." (*See Heirs of Justina v. Court of Appeals*, L-16396, Jan. 31, 1963 and *Suntay Tanjangco v. Jovelanos, et al.*, L-12332, Jun. 30, 1960; *See also Enervida v. De la Torre*, 55 SCRA 339).
- (b) Paragraph 4 also applies in favor of a *defendant* under a counterclaim for attorney's fees, because a counterclaim is a complaint filed by the defendant against the original plaintiff. (*Malonzo v. Galang, et al.*, L-13851, Jul. 27, 1960).

Hermosa, Jr. v. Zobel y Roxas
L-11836, Oct. 1958

FACTS: A sued B for annulment of a contract. A did *not* take part in the contract itself, and he did *not* know the circumstances under which it was entered into. It turned out that the contract was valid, and therefore was not annulled. Shortly thereafter, B asked A for attorney's fees incurred in the prior litigation.

HELD: Under the circumstances (good faith and lack of knowledge of the actual facts), A is not liable for attorney's fees.

Roque Enervida v. Lauro De la Torre
and Rosa De la Torre
L-38037, Jan. 28, 1974

FACTS: The owner (Ciriaco Enervida) of land covered by a homestead patent issued Nov. 17, 1952 sold the same on Nov. 20, 1957 to the spouses Dela Torre. In 1965, Roque Enervida, son of the seller, sued the spouses

for the cancellation of the deed of sale stating that the sale had been made within the 5-year prohibitory period. Incidentally, at the pre-trial, Roque admitted his father is still alive. The trial court dismissed the complaint and awarded attorney's fees and moral damages in favor of the spouses. Is the decision correct?

HELD:

- (1) The dismissal of the case is proper because the property was sold *after* the 5-year prohibitory period, and besides, Roque's father is still alive.
- (2) The award of attorney's fees is proper because the suit is clearly unfounded (*Art. 2208, No. 4*) but — there should be no award of moral damages because same is not provided for in *Art. 2219*. *Art. 2208* cannot be applied by analogy.

**Metropolitan Bank v. Tan
Chuan Leong, et al.
GR 46539, Jun. 25, 1986**

FACTS: On Apr. 22, 1965, "A" sold his house and lot to his son "B". "A" twice mortgaged the same property: first to "C" on Apr. 21, 1965, and then to "D" on Feb. 11, 1966. The first mortgage had been cancelled on Sep. 21, 1967.

On Dec. 17, 1967, the trial court ordered "A" to pay Metrobank the unliquidated balance of an overdraft line secured by "A" from the bank on Mar. 4, 1965. Unable to obtain satisfaction of this judgment, the bank sued "A," "B," and "C" for rescission to annul the sale and mortgages. It alleged that these transactions were in fraud of creditors, the sale being fictitious and the mortgages having been entered into in bad faith.

The trial court dismissed the complaint and ordered "A" to pay "C" and "D" (first and second mortgagees) P5,000 as attorney's fees. The appellate court modified this decision by nullifying the sale as fictitious, but affirming it in all respects. Petition for review was lodged with the Supreme

Court. Pending said petition, the Court approved a compromise agreement whereby "A" and "B" paid their monetary liability to "X" to the satisfaction of the latter. The award of attorney's fees, however, remained unresolved.

HELD: Attorney's fees cannot be recovered, except in cases of clearly unfounded civil action or proceeding against plaintiff.

The mortgage did not in anyway affect the bank's rights. It were as if said mortgage had never existed. With the mortgage no longer existing, the same could not be cited as reason for the bank's failure to collect its credit. Although "C" may have had knowledge of the simulated sale between "A" and his son "B" and had entered into the contract of mortgage pursuant to a design to defraud "A's" creditors, no damage or prejudice was suffered by the bank thereby. The cancellation of "C's" lien over the property had rendered the issues of rescissibility and bad faith moot and academic. The fact that the bank nevertheless impleaded "C," in its complaint, compelling the latter to litigate to protect its rights, justifies the award of attorney's fees. At the time the second mortgage was entered into, the certificate of title was in the name of "B" without any annotation of encumbrance in favor of the bank or any one else. Mortgage "D" then had every right to rely on what appeared in that certificate of title and there being none to excite suspicion, did not have to inquire further. There being good faith, "D" is an innocent purchaser for value. Since "D" had no intention to defraud "X," and in fact he is also a creditor of "A," the bank had no cause of action against "D". The award of attorney's fees in favor of "D" should also be beyond question.

Phoenix Publishing House v. Ramos
GR 32339, Mar. 29, 1988

FACTS: Phoenix charged Ramos with gross violation of the copyright law and prayed for actual,

moral and exemplary damages as well as attorney's fees. The trial court dismissed the complaint and ordered Phoenix to pay Ramos P5,000 attorney's fees as and by way of damages. The Court of Appeals affirmed the judgment of the trial court. Phoenix appealed contending that the court erred in assigning attorney's fees against it for no other apparent reason than for losing its case.

HELD: The award of attorney's fees, if at all, is proper in case of a "clearly unfounded civil action or proceeding." It cannot be said that the case filed by Phoenix is clearly an unfounded civil action. Phoenix secured the corresponding copyrights for its books. These copyrights were found to be all right by the Copyright Office, and Phoenix was conceded to be the real owner thereof. It was on the strength of these facts that Phoenix filed the complaint against Ramos. Thru a proper search warrant obtained after Phoenix was convinced that Ramos was selling spurious copies of its copyrighted books, the books were seized from the latter and were identified to be spurious. There is therefore not enough justification for such an award under paragraph 11 of Art. 2208 of the Civil Code.

(8) Paragraph 5 (Bad Faith of Defendant)

- (a) Here, the defendant (in the suit for attorney's fees) must have acted in GROSS and EVIDENT BAD FAITH in refusing to satisfy plaintiff's claim. (*Art. 2208, No. 5*). (*See Carlos M. Sison v. Gonzalo D. David, L-11268, Jan. 28, 1961*).
- (b) Therefore, where the defendant's refusal to pay the amount claimed was due *not* to malice but to the fact that the plaintiff demanded more than what it should, and consequently, the defendant had the right to refuse it, plaintiff is not entitled to attorney's fees. (*Globe Assurance Co., Inc. v. Arcache, L-12378, May 28, 1958*).
- (c) Similarly, where the defendant did *not* deny the debt but merely pleaded for *adjustment* in accordance with the

Ballantine Scale, the refusal is not done in bad faith. (*Jimenez v. Bucoy*, L- 10221, Feb. 28, 1958 and *Intestate Estate of Luther Young v. Bucoy*, 54 O.G. 7560). As a matter of fact, *even clearly untenable* defenses would be no ground for awarding attorney's fees unless the plea thereof amounts to gross and evident bad faith. (*Jimenez v. Bucoy*, L-10221, Feb. 28, 1958).

- (d) Indeed, mere failure of the defendant to pay his obligation without bad faith does *not* warrant recovery of attorney's fees. (*Lasedeco v. Gaston*, L-8938, Oct. 31, 1956; *Koster, Inc. v. Zulueta*, 99 Phil. 945 and *Francisco v. GSIS*, L18155, Mar. 30, 1963).

(9) Paragraph 8 (Workmen's Compensation and Employer's Liability)

Because Sec. 31 of the Workmen's Compensation Act does *not* govern attorney's fees recoverable from the adverse party, Art. 2208(8) of the Civil Code will apply — to supply the deficiency in the said Act, in accordance with Art. 18 of the new Civil Code. (*MRR v. Manalang*, L-20845, Nov. 29, 1965 and *Nat. Development Corp. v. WCC*, L-19863, Apr. 29, 1964).

(10) Paragraph 9 (Civil Liability Arising from a Crime)

Attorney's fees by express provision of law may be awarded in a separate civil action to recover the civil liability arising from a crime. (*Art. 2208, par. 9*). Moreover, an award of attorney's fees granted by a trial court can envisage the services of counsel only up to the date of its judgment. Therefore, if the decision is appealed, attorney's fees should perhaps be at least doubled. (*Bantoto, et al. v. Bobis, et al. & Vallejo*, L-18966, Nov. 22, 1966).

**Ebajan v. CA
GR 77930-31, Feb. 9, 1989**

Reiterating its ruling in *People v. Biador*, CA-GR 19589-R, Jan. 21, 1959 (55 O.G. No. 32, p. 6384), the Court ruled that attorney's fees, under Art. 2208 (No. 9) of the Civil Code, can

only be recovered in a separate civil action to recover civil liability arising from crime.

(11) Paragraph 11 (Any Other Case)

- (a) Paragraph 11 does *not* apply if the case was instituted *before* the effectivity of the new Civil Code. This was the ruling in the case of *Bureau of Lands v. Samia* (L-8068, Aug. 26, 1956), where the court said that *unless authorized by statute, attorney's fees cannot be recovered from the government if it abandons expropriation proceedings. It would be otherwise if the abandoner is a private entity or a quasi-public corporation.*

Thus also, if the award of attorney's fees would be *just and equitable*, still if the suit was brought *before* the new Civil Code became effective, attorney's fees (other than those allowed as *costs* under the Rules of Court) could not be recovered as damages against the losing party (otherwise, there would be a sort of penalty on the right to litigate). (*See Receiver for North Negros Sugar Co., Inc. v. Ybanez*, L-22183, Aug. 30, 1968 and *Koster v. Zulueta*, 99 Phil. 945).

- (b) Attorney's fees and expenses of litigation may be recovered when deemed by the court as just and equitable as when the defendant never questioned the correctness and legality of the plaintiff's case but based its defense and appeal entirely on a pure technicality which took up the time of two appellate courts, and *delayed* giving of appropriate relief to plaintiff for more than three years. (*Phil. Milling Co. v. Court of Appeals*, L-9404, Dec. 27, 1956). Indeed, the award of attorney's fees is essentially discretionary in the trial court (*Francisco v. GSIS*, L-18165, Mar. 30, 1963), and in the absence of abuse of discretion, the same should not be disturbed. (*Lopez, et al. v. Gonzaga*, L-18788, Jan. 31, 1964). The allowance, for example, of counsel's fees *in probate* proceedings rests largely on the sound discretion of the Court which shall not be interfered with except for manifest abuse. (*In Re Estate of Raquel*, L-16349, Jan. 31, 1964).

(12) Instance When the Insurance Code Grants Damages

**Prudential Guarantee and Assurance, Inc. v.
Trans-Asia Shipping, Lines, Inc.
491 SCRA 411 (2006)**

Sec. 244 of the Insurance Code grants damages consisting of attorney's fees and other expenses incurred by the insured after a finding by the Insurance Commissioner or the Court, as the case may be, of an unreasonable denial or withholding of payment of the claims due. Sec. 244 of the Code does not require a showing of bad faith in order that attorney's fees be granted.

In the instant controversy, Sec. 244 thereof is categorical in imposing an interest twice the ceiling prescribed by the Bangko Sentral's Monetary Board due the insured, from the date following the time prescribed in Sec. 242 or in Sec. 243 of the Code, as the case may be, until the claim is fully satisfied.

Art. 2209. If the obligation consists in the payment of a sum of money, and the debtor incurs in delay, the indemnity for damages, there being no stipulation to the contrary, shall be the payment of the interest agreed upon, and in the absence of stipulation, the legal interest, which is six per cent *per annum*.

COMMENT:**(1) Monetary Obligations**

This applies to a *monetary obligation* where the debtor is in default.

(2) Rules

- (a) give the indemnity (other than interest) agreed upon

[NOTE: Attorney's fees may be stipulated. (Andreas v. Green, 48 Phil. 463).]

- (b) if none was specified, give the *interest* agreed upon.

- (c) if none, give the legal interest (now this is 12% *per annum*).

State Investment House, Inc. v. CA
GR 90676, Jun. 19, 1991

FACTS: The promissory note executed by respondent had three components: (a) principal of the loan in the amount of P110,000; (b) regular interest in the amount of 17% *per annum*; and (c) additional or penalty interest in case of non-payment at maturity, at the rate of 2% per month or 24 per cent *per annum*. In the dispositive of his resolution, the trial judge did not specify which of these components of the loan he was ordering respondent to pay and which component or components he was in effect defecting. It cannot be assumed that the judge meant to grant the relief prayed for by respondent in all its parts. The decision was ambiguous in the sense that it was cryptic. It must be assumed that the judge meant to decide in accordance with law, that it cannot be fairly assumed that the judge was grossly ignorant of the law or that he intended to grant the respondent relief to which he was not entitled under the law. The ultimate question which arises is: If respondent was not in delay, what should he have been held liable for in accordance with law?

HELD: Since the respondent was held not to have been in delay, he is properly liable only for: (a) the principal of the loan or P110,000; and (b) regular or monetary interest in the amount of 17% *per annum*. He is not liable for penalty or compensatory interest, fixed in the promissory note at 2% per month or 24% *per annum*. The fact that the respondent was not in default did not mean that he, as a matter of law, was relieved from the payment not only of penalty or compensatory interest at the rate of 24% *per annum* but also of regular monetary interest of 17 per cent *per annum*. The regular or monetary interest continued to accrue under the terms of the relevant promissory note until actual payment is effected. The payment of regular interest continues to accrue since the debtor continues to use such principal amount. In the instant case, since respondent, while he

is properly regarded as having made a written tender or payment to the creditor, failed to consign in court the amount due at the time of the maturity of the obligation. Hence, his obligation to pay principal-cum-regular or monetary interest under the terms and conditions of the note was not extinguished by such tender of payment alone. For the respondent to continue in possession of the principal of the loan amounting to P110,000 and to continue to use the same after maturity of the loan without payment of regular or monetary interest, would constitute unjust enrichment on the part of the respondent at the expense of the creditor even though the respondent had not been guilty of *mora*. It is precisely this unjust enrichment which Art. 1256 Of the Civil Code prevents by requiring, in addition to tender of payment, the consignment of the amount due in court which amount would thereafter be deposited by the Clerk of Court in a bank and earn interest to which the creditor would be entitled.

Tio Khe Chio v. CA
GR 76101-02, Sep. 30, 1991

FACTS: Tio Khe Chio imported 1,000 bags of fish meal valued at \$36,000 which were insured with Eastern Assurance and shipped on Board the M/V Peskev, owned by Far Eastern Shipping. When the goods reach Manila, they were found to have been damaged by sea water which rendered the fishmeal useless. Chio filed a claim with Eastern Assurance and Far Eastern Shipping. Both refused to pay. So Chio sued them before the Court of First Instance (Regional Trial Court) for damages. Eastern Assurance filed a counterclaim against Chio for recovery of unpaid insurance premiums. The trial court ordered Eastern Assurance and Far Eastern Shipping to pay Chio solidarily P105,986, less P18,387 for unpaid premiums with interest at the legal rate from the filing of the complaint. Judgment became final as to Eastern Assurance, but Far Eastern Shipping appealed and was absolved from liability by the Court of Appeals. The trial court issued a writ of execution against Eastern Assur-

ance. The sheriff enforcing the writ fixed the legal rate of interest at 12%. Eastern Assurance moved to quash the writ alleging that the legal interest to be computed should be 6% in accordance with Art. 2209 of the Civil Code and not 12%. The trial court denied Eastern Assurance's motion. The Court of Appeals (CA) reduced the interest to 6%. Chio maintains that not only is it unjust and unfair but it is also contrary to the correct interpretation of the fixing of interest rates under Secs. 243 and 244 of the Insurance Code. Since Chio's claim is based on an insurance contract, then it is the Insurance Code that must govern and not the Civil Code.

HELD: The Supreme Court sustained the Court of Appeals and held that the legal rate of interest in the case at bar is 6% *per annum*. Secs. 243 and 244 of the Insurance Code are not pertinent to the instant case. They apply only when the court finds an unreasonable delay or refusal in the payment of the claims. Neither does Circular 416 of the Central Bank which took effect on Jul. 29, 1974 pursuant to Presidential Decree No. 116 (Usury Law) which raised the legal rate of interest from 6% to 12% *per annum* apply to the case at bar as contended by the petitioner. The adjusted rate mentioned in the circular refers only to loans or forbearances of money, goods or credits and court judgments thereon but not to court judgments for damages arising from injury to persons and loss of property which does not involve a loan.

The legal rate of interest is 6% *per annum* and not 12% where a judgment award is based on an action for damages for personal injury, not use or forbearance of money, goods or credit. In the same vein, the court held that the rates under the Usury law (amended by PD 116) are applicable only to interest by way of damages is governed by Art. 2209 of the Civil Code. Since the contending parties did not allege the rate of interest stipulated in the insurance contract, the legal interest was properly pegged by the appellate court, at 6% *per annum*.

(3) Absence of Stipulation

In the absence of stipulation, only the legal interest can be recovered. This is true even if a chance to make more in business can be proved, inasmuch as here, the profit would be SPECULATIVE. The Court in the case of *Lopez v. Del Rosario and Quiogue* (44 Phil. 98) said that “the deprivation of an opportunity for making money, which might have proved beneficial or might have been ruinous, is of too uncertain a character to be weighed in the even balance of the law.”

(4) From What Moment Interest Runs

In the absence of stipulation, interest (as damages) runs from *default* (after a judicial or extrajudicial demand, except when demand is NOT essential to put the debtor in default). (Art. 2209 which states “*in delay*”; *Zobel v. City of Manila*, 47 Phil. 169). If there is no evidence of an extrajudicial demand, the period starts from the judicial demand (*Vda. de Murciano v. Auditor General, et al.*, L-11744, May 28, 1958), which naturally is in the form of *filing a complaint* in court. (*Cabarroguis v. Vicente*, 107 Phil. 340).

Consuelo Piczon, et al. v. Esteban Piczon, et al. L-29139, Nov. 15, 1974

FACTS: In a contract of loan, Esteban Piczon, as guarantor, promised to pay in default of the principal debtor, the sum of P12,500 with interest, “commencing from the date of execution” (Sept. 28, 1956) of the contract. On Aug. 6, 1964 demand was made for payment, but neither the principal debtor nor the guarantor was able to pay. *Issue:* From what time will interest run on the debt: from Sept. 28, 1956 or from Aug. 6, 1964?

HELD: Interest will run from Sept. 28, 1956, in view of the express stipulation in the contract. Under Art. 2209, Civil Code, the indemnity of damages in a monetary obligation shall be the payment of interest agreed upon, as a general rule. Here it was expressly agreed that interest should commence from the execution of the contract. (*See Firestone Tire & Rubber Co. v. Delgado*, 104 Phil. 920). [NOTE — the statement in the decision that Art. 1169, Civil Code (damages in case

of default) applies only to obligations other than monetary is only an *obiter dictum*.]

[**NOTE:** While it is true that interest (by way of *compensation* for the use of money) cannot be demanded unless it was previously stipulated upon *in writing* (Art. 1956), still interest (by way of *damages or penalty*) can be recovered in case of default even if there be *no* stipulation to the effect. (See *Zobel v. City of Manila*, 47 Phil. 169).]

[**NOTE:** If the amount of the debt is *unliquidated*, it is the *final judgment* that will ascertain the amount. In such a case, interest by way of damages shall be counted only from the date the decision becomes final. (*Montilla v. Agustinian Corp.*, 25 Phil. 477; *Seton Donna v. Inouye*, 40 Phil. 728 and See Art. 2213). However, the court should not require the collection of interest when the judgment on which it is issued does not give it, and interest is not allowed by statute. This has been held to be the rule even where interest on judgments is allowed by statute, if the judgment does not include it. (*Robles, et al. v. Timario*, L-13911, Apr. 28, 1960).]

[**NOTE:** If the contract stipulates from what time interest by way of damages will be counted, said stipulated time controls, and therefore the interest is payable from such time, and not from the date of the filing of the complaint. (*Firestone Tire & Rubber Co. v. Ines Chavez & Co., Ltd., et al.*, L-11162, Dec. 4, 1958).]

[**NOTE:** If the term for payment was left to the will of the debtor, the interest should not run from the time the action was commenced in court, but only from *default* of payment AFTER the period was *fixed by the Court*. (*Tiglao v. Manila Railroad Co.*, L-7900, Jan. 2, 1956).]

**Arwood Industries, Inc.
v. D.M. Consunji, Inc.
GR 142277, Dec. 11, 2002**

FACTS: Petitioner and respondent, as owner and contractor, respectively, entered into a Civil, Structural, and Architectural Works Agreement, dated Feb. 6, 1989 for the construction of petitioner's Westwood Condominium at 23

Eisenhower St., Greenhills, San Juan, Metro Manila. The contract price for the condominium project aggregated to P20,800,000. Despite completion of the condominium project, the amount of P962,434.78 remained unpaid by petitioner. Repeated demands by respondent for petitioner to pay went unheeded. Respondent specifically prayed for payment of the amount of P962,434.78 with interest of 2% per month or a fraction thereof, from Nov. 1990 up to the time of payment. *Issue:* Is the imposition of a 2% per month interest on the award of P962,434.78 correct?

HELD: Yes. Upon the fulfillment by respondent of its obligation to complete the construction project, petitioner had the correlative duty to pay for respondent's services. However, petitioner refused to pay the balance of the contract price. From the moment respondent completed the construction of the condominium project and petitioner refused to pay in full, there was delay on the part of petitioner.

Delay in the performance of an obligation is looked upon with disfavor because, when a party to a contract incurs delay, the other party who performs his part of the contract suffers damages thereby. *Dilationes in lege sunt idiosae* ("Delays in law are idious"). Obviously, respondent suffered damages brought about by the failure of petitioner to comply with its obligation on time. And, sans elaboration of the matter at hand, damages take the form of interest. Accordingly, the appropriate measure of damages in this case is the payment of interest at the rate agreed upon, which is 2% interest for every month of delay.

Art. 2209 specifies the appropriate measure of damages where the obligation breached consisted of the payment of sum of money. (*See State Investment House, Inc. v. CA, 198 SCRA 390 [1991]*). (*See also Pacific Mills, Inc. v. CA, 206 SCRA 317 [1992]*). Payment of interest as penalty is a necessary consequence of petitioner's failure to exercise diligence in the discharge of its obligation under the contracts. And even in the absence of a stipulation on interest, under Art. 2209, respondent would still be entitled to recover the balance of the contract price with interest. Respondent court, therefore, correctly interpreted the terms of the agreement which pro-

vides that “the owner shall be required to pay the interest at a rate of 2% per month or the fraction thereof in days of the amount due for payment by the owner.”

(5) Query

In a loan, is it permissible to stipulate that in addition to 10% interest for use of the money, the debtor would pay an *additional* 10% by way of penalty (penal clause) in case of *default*?

ANS.: Generally, the answer should be in the *affirmative*, for after all, if there is NO default, the additional 10% cannot be recovered, and there would be no violation of the Usury Law which in *essence* regulates only interest (by way of compensation for the use of the money). The two interests referred to are indeed distinct and therefore separately demandable, and should NOT *be added*. (See *Lopez v. Hernaez*, 32 Phil. 631 and *Bachrach Motor Co. v. Espiritu*, 52 Phil. 346).

However, under the present Usury Law (as amended), the word “penalties” is referred to, in case of a SECURED debt, aside from the word “interests.” It would seem therefore that a strict construction of the present Usury Law results in a *negative* answer (in case of SECURED debts) to the query posed hereinabove. The *Lopez* and *Bachrach* cases referred to above were decided PRIOR to the amendment of the Usury Law.

(6) Recovery of Interest in Case of Usury

**Angel Jose Warehousing Co., Inc. v.
Chelda Enterprises and David Syjuico
L-25704, Apr. 24, 1968**

FACTS: A partnership (Chelda Enterprises and David Syjuico) borrowed some P20,000 from Angel Jose Warehousing Co. at clearly usurious rates from 2% to 2-1/2% PER MONTH).

Issues:

- (a) Can creditor recover the PRINCIPAL debt?

- (b) If the entire usurious rate has been paid by the debtor, how much of it can be recovered by said debtor from the creditor?

HELD:

- (a) Yes, the creditor can recover the PRINCIPAL debt. The contract of loan with usurious interest is valid as to the interest is valid as to the loan, and void only with respect to the interest — for the loan is the principal contract while the interest is merely an accessory element. The two are separable from each other. (*See Lopez v. El Hogar Filipino*, 47 Phil. 249). The ruling on this point by the Court of Appeals in the case of *Sebastian v. Bautista*, 58 O.G. No. 15, p. 3146, holding that even the loan itself is void is WRONG.
- (b) With respect to the usurious interest, the entire interest agreed upon is void, and if already paid, may be recovered by the debtor. It is wrong to say that the debtor can recover only the excess of 12% or 14% as the case may be — for the simple reason that the entire interest stipulated is indivisible, and being illegal, should be considered entirely void. It is true that Art. 1413 of the Civil Code states: “interest paid in excess of the interest allowed by the usury laws may be recovered by the debtor with interest thereon from the date of payment.” But as we construe it, Art. 1413, in speaking of “interest paid in excess of the interest allowed by the usury laws” means the whole usurious interest; *i.e.*, in a loan of P1,000, with interest of 20% *per annum* or P200 for one year, if the borrower pays said P200, the whole P200 is the usurious interest not just that part thereof in excess of the interest allowed by law. It is in this case that the law does not allow division. The whole stipulation as to interest is void since payment of said interest is the cause or object and said interest is illegal. Note that there is no conflict on this point between the new Civil Code and the Usury Law. Under the Usury Law, in Sec. 6, any person who for a loan shall have paid a higher rate or greater sum or value than is allowed in said law, may recover the whole interest paid. The only change

effected therefore by Art. 1413, of the New Civil Code is not to provide for the recovery of interest paid in excess of that allowed by law, which the Usury Law already provided for, but to add that the same can be recovered “with interest thereon from the date of payment.” The foregoing interpretation is reached with the philosophy of usury legislation in mind; to discourage stipulation on usurious interest. Said stipulation is treated as wholly void, so that the loan becomes one without stipulation as to payment of interest. It should not, however be interpreted to mean forfeiture even of the principal, for this would unjustly enrich the borrower at the expense of the lender. Furthermore, penal sanctions are available against a usurious lender, as further deterrence to usury.

The principal debt remaining without stipulation for payment of interest can thus be recovered by judicial action. And in case of such demand, and the debtor incurs in delay, the debt earns interest from the date of the demand, whether judicial or extrajudicial (in the instant case, from the filing of the complaint). Such interest is not due to stipulation, for there was none, the same being void. Rather, it is due to the general provision of law that in obligation to pay money, where the debtor incurs in delay, he has to pay interest, by way of damages. (*Art. 2209*).

(NOTE: As already adverted to, the Usury Law has been repealed.)

**GSIS v. CA, et al.
GR 52478, Oct. 30, 1986**

The Civil Code permits the agreement upon a penalty apart from the interest. Should there be such an agreement, the penalty does not include the interest, and as such the two are different and distinct things which may be demanded separately. The stipulation about payment of such additional rate is a penalty clause, which is sanctioned by law.

The usury law applies only to interest by way of compensation for the use or forbearance of money. Inter-

est by way of damages is governed by Art. 2209 of the Civil Code.

**Florendo v. Hon. Ruiz, et al.
GR 64571, Feb. 21, 1989**

Central Bank (Bangko Sentral) Circular 416 (dated July 29, 1974), which fixes the legal rate of interest at 12% *per annum*, applies only to loans or forbearances of money, goods or credits and court judgments thereon.

Said Circular does not apply to actions based on a breach of employment contract.

[**NOTA BENE:** In *Reformina, et al. v. Hon. Tomol, Jr., et al.*, L-59096, Oct. 11, 1985, the Supreme Court held that the judgments spoken of and referred to in CB (BS) Circular 416 are judgments in litigations involving loans or forbearance of any money, goods or credits. Any other kind of monetary judgment which has nothing to do with, nor involving loans or forbearance of any money, goods or credits does not fall within the coverage of the said law for it is not within the ambit of the authority granted by the Central Bank (Bangko Sentral).]

Art. 2210. Interest may, in the discretion of the court, be allowed upon damages awarded for breach of contract.

COMMENT:

Interest on Damages for Breach of Contract

Actual damages given by a court in a breach of contract case shall earn legal interest, *not* from the date of the filing of the complaint but from the date the judgment of the *trial court* is rendered. (*Juana Soberano & Jose B. Soberano v. The Manila Railroad Co.*, L-19407, Nov. 23, 1966).

**Pleno v. Court of Appeals and Manila Gas Corp.
GR 56919, Oct. 23, 1981**

A CFI (RTC) judgment ordering payment of a sum of money with *interest* was appealed to the Court of Appeals on

the question of prescription. The Court of Appeals affirmed the CFI (RTC) judgment but neglected to give *interest*. In executing the judgment, should interest be also given?

HELD: Yes, despite the silence of the Court of Appeals judgment. The reason is the Court of Appeals decided *merely the issue of prescription*. Interest was not discussed in the Court of Appeals judgment. Its affirmance of the CFI (RTC) decision can only mean affirmance also of the grant of interest.

Art. 2211. In crimes and quasi-delicts, interest as a part of the damages may, in a proper case, be adjudicated in the discretion of the court.

COMMENT:

Interest on Damages Because of Crimes and Quasi-Delicts

The Article explains itself.

Art. 2212. Interest due shall earn legal interest from the time it is judicially demanded, although the obligation may be silent upon this point.

COMMENT:

Interest on Interest Due

- (a) Interest due is also referred to as “accrued interest.”
- (b) Note that accrued interest earns legal interest, not from default (which may be from judicial OR extrajudicial demand) but from JUDICIAL DEMAND. (*Art. 2212; Cu Unjieng v. Mabalacat Sugar Co., 54 Phil. 976; Sunico v. Ramirez, 14 Phil. 500 and Bachrach v. Golingo, 39 Phil. 912*).
- (c) An agreement to charge interest on interest is *valid* even if in adding the combined interest, the limits under the Usury Law are exceeded. (*Valdezco v. Francisco, 52 Phil. 350 and Government v. Conde, 61 Phil. 14*).
- (d) If a stipulation governing the rate of interest is inserted in a contract for the payment of money, this rate, if lawful,

remains in force until the obligation is SATISFIED. The interest that accrues prior to the date of the filing of the complaints should be capitalized and consolidated as of that date with the capital, after which the whole bears interest at the *contract rate* until the amount is paid. The contracted obligation is *not* merged in the judgment, but remains in full force until the debt is paid. (*Zobel v. City of Manila*, 47 Phil. 169).

Art. 2213. Interest cannot be recovered upon unliquidated claims or damages, except when the demand can be established with reasonable certainty.

COMMENT:

(1) Interest on Unliquidated Claims or Damages

**Bareng v. Court of Appeals, et al.
L-12973, Apr. 25, 1960**

FACTS: The buyer of a certain equipment, because of certain alleged violations of warranties, refused to pay the balance to the seller. Instead of tendering payment of said balance and instead of depositing said balance in Court, the buyer sought to have the sale rescinded on account of the alleged breach of warranty. The alleged breach was *not* however, proved. *Issue:* Should the buyer pay *interest* on the balance?

HELD: Yes, on account of the default, counted from the *date of the filing* of the complaint by the seller (there apparently having been no extrajudicial demand). Incidentally, the arguments that the debt was unliquidated until its amount was determined by the appellate court at P3,600 and that consequently, he cannot be made answerable for interest on the amount due before the *judgment* in said court is *completely untenable*. The price of the equipment under their contract of sale was determined and known; hence, liquidated; and the obligation to pay any unpaid balance thereof did not cease to be liquidated and determined simply because the vendor and the vendee, in the suit for collection disagrees as to its amount. If the buyer had wanted to free himself from any responsibility for interests on the amount he had already ac-

knowledge he still owed his vendor, he should have deposited the same in Court at the very start of the action.

(2) No Liquidated Obligation

Abelardo Lim & Esmadito Gumabon v. CA & Donato H. Gonzales, GR 125817, Jan. 16, 2002

FACTS: Assessment of the damage on the vehicle was heavily debated upon by the parties with private respondent's demand for P236,000 being refuted by petitioners who argue that they could have the vehicle repaired easily for P20,000.

ISSUE: Was the matter a liquidated obligation?

HELD: The amount due private respondent was not a liquidated amount that was already demandable and payable. Upon the provisions of Art. 2213, interest "cannot be recovered upon unliquidated claims or damages, except when the demand can be established with reasonable certainty." It is axiomatic that if the suit were for damages, unliquidated and not known until definitely ascertained, assessed, and determined by courts after proof — interest at the rate of 6% per annum should be due from the date the judgment of the court is made (at which time the quantification of damages may be deemed to be reasonably ascertained.)

Sadly, petitioners failed to offer in evidence the estimated amount of the damage caused by private respondent's unconcern towards the damaged vehicle. It is the burden of petitioners to show satisfactorily not only that the injured party could have mitigated his damages but also the amount thereof; failing in this regard, the amount of damages award cannot be proportionally reduced.

The questioned decision awarding private respondent P236,000 with legal interest from Jul. 22, 1990 as compensatory damages and P30,000 as attorney's fees is modified. Interest at the rate of 6% *per annum* shall be computed from the time judgment of the lower court is made until the finality of this decision. If the adjudged principal and interest remain

unpaid thereafter, interest shall be 12% *per annum* computed from the time judgment becomes final and executory until it is fully satisfied.

Art. 2214. In quasi-delicts, the contributory negligence of the plaintiff shall reduce the damages that he may recover.

COMMENT:

Contributory Negligence of Plaintiff in Quasi-Delicts

Note that here the damages shall be reduced.

Art. 2215. In contracts, quasi-contracts, and quasi-delicts, the court may equitably mitigate the damages under circumstances other than the case referred to in the preceding article, as in the following instances:

(1) That the plaintiff himself has contravened the terms of the contract;

(2) That the plaintiff has derived some benefit as a result of the contract;

(3) In cases where exemplary damages are to be awarded, that the defendant acted upon the advice of counsel;

(4) That the loss would have resulted in any event;

(5) That since the filing of the action, the defendant has done his best to lessen the plaintiffs loss or injury.

COMMENT:

Mitigation of Damages in Contracts, Quasi-Contracts, and Quasi-Delicts

Note that the enumeration is *not exclusive* for the law uses the phrase “as in the following instances.”

Chapter 3

OTHER KINDS OF DAMAGES

Art. 2216. No proof of pecuniary loss is necessary in order that moral, nominal, temperate, liquidated or exemplary damages may be adjudicated. The assessment of such damages, except liquidated ones, is left to the discretion of the court, according to the circumstances of each case.

COMMENT:

(1) When No Proof of Pecuniary Loss Is Necessary

The Article was applied in *Del Castillo v. Guerrero*, L-11994, Jul. 26, 1960.

(2) Necessity of Proving the Factual Basis

While no proof of pecuniary loss is necessary in order that moral damages may be awarded, the amount of indemnity being left to the discretion of the Court, it is, nevertheless, essential that the claimant satisfactorily *prove the existence of the factual basis of the damages* (Art. 2217) and its *causal relation* to the defendant's acts. This is because moral damages though incapable of pecuniary estimation, are in the category of an award designed to compensate the claimant for actual injury suffered, and not to impose a penalty on the wrongdoer. The mere fact that a party was sued for instance without any legal foundation, does not entitle him to an award of moral damages, for it would make a moral damage a penalty, which they are not, rather than a compensation for actual injury suffered, which they are intended to be. Moral damages, in other words, are not corrective or exemplary damages. (*Malonzo v. Galang, et al.*, L-13851, Jul. 27, 1960).

- (3) In Civil Case to Recover or for Restitution, Reparation of Damages or Indemnification for Consequential and Other Damages or Any Other Civil Actions under the New Civil Code or Other Existing Laws Filed with the Sandiganbayan against Ferdinand E. Marcos, et al., the Sandiganbayan is Not to Look for Proof Beyond Reasonable Doubt. But to Determine, Based on the Evidence Presented, in Light of Common Human Experience, which of the Theories Proffered by the Parties is More Worthy of Credence**

**Yuchengco v. Sandiganbayan
479 SCRA 1 (2006)**

“Juries must often reason,” says one author, “according to probabilities, drawing an inference that the main fact in issue existed from collateral facts not directly proving, but strongly tending to prove, its existence. The vital question in such cases is the cogency of the proof afforded by the secondary facts. How likely, according to experience, is the existence of the primary fact if certain secondary facts exist?”

For the Supreme Court —

if the required quantum of proof obtains to establish illegal acquisition, accumulation, misappropriation, fraud, or illicit conduct — ours is the duty to affirm the recovery efforts of the Republic but should such proof be wanting, we have the equally-exacting obligations to declare that it is so — the guarantee against deprivation of property without due process, which, like other basic constitutional guarantees, applies to all individuals, including tyrants, charlatans, and scoundrels of enemy stripe.

Section 1

MORAL DAMAGES

Art 2217. Moral damages include physical suffering, mental anguish, fright, serious anxiety, besmirched reputation, wounded feelings, moral shock, social humiliation, and similar injury. Though incapable of pecuniary computation,

moral damages may be recovered if they are the proximate result of the defendant's wrongful act or omission.

COMMENT:

(1) Requisites for the Recovery of Moral Damages

- (a) There must be physical suffering, mental anguish, fright, etc.

NOTE:

- 1) *Physical suffering includes* pain incident to a surgical operation or medical treatment (*Serio v. American Brewing Co.*, 141 La. 290), as well as possible FUTURE pain. (*Southern Brewery & Ice Co. v. Schmidt*, 226 U.S. 162).
- 2) *Mental anguish* is a high degree of mental suffering and not a mere disappointment or regret (*Southwestern Bell Tel. Co. v. Cooks*, 30 S.W. 497) or from annoyance or vexation. (*Johnson v. Western Union Teleg Co.*, 128 Am. Rep. 905). However, inconvenience amounting to physical discomforts is a subject of compensation.
- 3) *Fright* is one form of mental suffering. (*Eastern v. United Trade School Contracting Co.*, 77 Am. State Rep. 859).
- (b) The suffering, etc. must be the proximate result of the wrongful act or omission. (*St. Francis High School v. CA*, GR 82466, Feb. 25, 1991).

Thus, the grant of moral damages is NOT subject to the whims and caprices of judges or courts. The court's discretion in granting or refusing it is governed by reason and justice. In order that an individual may be made liable, the law requires that his act be WRONGFUL. The adverse result of an action does *not per se* make the act wrongful and subject the actor to the payment of moral damages. (*Barreto v. Arevalo, et al.*, 99 Phil. 771).

**St. Mary's Academy v. William Carpitanos
& Lucia S. Carpitanos, Guada Daniel,
James Daniel II, James Daniel, Sr., &
Vivencio Villanueva
GR 143363, Feb. 6, 2002**

FACTS: Petitioner St. Mary's Academy was made liable for the death of Sherwin Carpitanos under Arts. 218 and 219 of the Family Code. It was pointed out that petitioner was negligent in allowing a minor to drive and in not having a teacher accompany the minor students in the jeep.

Respondents, however, failed to show that the negligence of petitioner was the proximate cause of the death of the victim. Respondents Daniel spouses and Villanueva admitted that the immediate cause of the accident was not the negligence of petitioner or the reckless driving of James Daniel II, but the detachment of the steering wheel guide of the jeep.

ISSUES: (1) Was petitioner liable for damages for the death of Sherwin Carpitanos?; and (2) Was the award of moral damages against petitioner proper?

HELD: On the *first issue*, considering that the negligence of the minor driver or the detachment of the steering wheel guide of the jeep owned by respondent Villanueva was an event over which petitioner St. Mary's Academy had no control, and which was the proximate cause of the accident, petitioner may not be held liable for the death resulting from such accident.

On the *second issue*, petitioner cannot be held liable for moral damages in the amount of P500,000 awarded by the trial court and affirmed by the Court of Appeals. Though incapable of pecuniary computation, moral damages may be recovered *if they are the proximate result of defendant's wrongful act or omission.* (Art. 2217). In the instant case, the proximate cause was not attributable to petitioner.

There was no question that the registered owner of the vehicle was respondent Villanueva, and who never

denied and, in fact, admitted this fact. Hence, with the overwhelming evidence presented by petitioner and respondent Daniel spouses that the accident occurred because of the detachment of the steering wheel guide of the jeep, it is not the school, but the registered owner of the vehicle who shall be held responsible for the death of Sherwin Carpitanos.

[NOTE: The registered owner of any vehicle, even if not used for public service, would primarily be responsible to the public or to third persons for injuries caused the latter while the vehicle was being driven on the highways or streets. (*Aguilar, Sr. v. Commercial Savings Bank, GR 128705, Jun. 29, and Erez v. Depte, 102 Phil. 103 [1957].*)]

- (c) There must be clear testimony on the anguish, etc. (Thus, if the plaintiff fails to take the witness stand and testify as to her social humiliation, wounded feelings, anxiety, etc., moral damages *cannot* be recovered. (*Francisco v. GSIS, L-18166, Mar. 30, 1963*).

People v. Manero
218 SCRA 85
1993

It is only when a juridical person has a good reputation that is DEBASED, resulting in social humiliation, that moral damages may be awarded.

Carlota P. Valenzuela, et al. v. CA, et al.
GR 56168, Dec. 22, 1988

The grant of moral damages is expressly allowed by law in instances where proofs are shown that mental anguish, serious anxiety, and moral shock have been suffered by the private respondent as a consequence of the fraudulent act committed by the petitioner who took advantage of the very limited education of the respondent.

Danao v. CA
GR 48276, Sep. 30, 1987

The filing alone of the foreclosure application should not be a ground for an award of moral damages.

Boysaw, et al. v. Interphil
Promotions, Inc.
GR 22590, Mar. 20, 1987

Moral damages cannot be imposed on a party litigant, although such litigant exercises it erroneously because if the action has been erroneously filed, such litigant may be penalized for costs.

(2) Social and Financial Standing

In *Layda v. Court of Appeals* (90 Phil. 724), the Supreme Court held that the social and financial standing (including the earning capacity) of the victim, is NOT important in the assessment of moral damages, because the controlling element is the dignity of man and his human value. However, in *Domingding and Aranas v. Ng, et al.* (103 Phil. 111), the Court seemingly reversed its former stand when it held that the *social and financial* standing of the offender and offended party should be taken into account in the computation of moral damages. In that case, where the *trial court* ordered the offender, an overseer of a mango store to pay the victim (a customer of the store, whom he had subjected to indignities by embracing and kissing her inside a taxi) P50,000 as moral damages, the Supreme Court *reduced* the award to a measly P1,000, considering the lack of wealth or financial consequence on the part of both parties. In *Yutuk v. Manila Electric Co., L-13016, May 31, 1961*, the Court held that the aggrieved party's moral feeling and personal pride should be weighed in the determination of the indemnity.

(3) Need for Certain Steps

The husband of a woman, who voluntarily procured her abortion, cannot recover moral damages from the physician who caused the same where the said husband appeared to have

taken no steps to investigate or pinpoint the causes thereof, and obtain the punishment of the responsible practitioner. (*Geluz v. Court of Appeals, et al.*, L-16439, Jul. 20, 1961).

(4) Necessity of Personal Injury

- (a) As a *general rule*, if a person is not himself physically hurt, he cannot obtain moral damages. Thus, mere sympathy for a close relative's physical injuries *cannot* grant moral damages to the sympathizer, even if he also suffers mental anguish, as a result of such sympathy. (*See Strebel v. Figueras, et al.*, 96 Phil. 321; 15 Am. Jur. 597-598 and *Araneta, et al. v. Arreglado, et al.*, 104 Phil. 529). Thus also, if it is the wife who suffered the *physical* injuries, moral damages may be recovered only by her, and not by her next of kin or the husband. (*Juana Soberano & Jose B. Soberano v. Manila Railroad Co.*, L-19407, Nov. 23, 1966).

- (b) *Exceptions to the rule*

Exceptions to the rule may be found in the last two paragraphs of Art. 2219.

(5) Rule Under the Old Law

Under the old Civil Code, moral damages could *not* be recovered for pain and suffering, even by the person personally injured. (*Marcelo v. Velasco*, 11 Phil. 287 and *Algarra v. Sandejas*, 7 Phil. 84).

The Code Commission decided to revise the rule, with the following explanation:

“Denial of the award of moral damages has been predicated on the idea that physical suffering, mental anguish, and similar injury are *incapable of pecuniary estimation*. But it is unquestionable that the loss or injury is *just as real* as in other cases. The ends of justice are better served by giving the judge discretion to adjudicate some definite sum as moral damages. That is more equitable than that the sufferer should be uncompensated. The wrongdoer cannot complain because it was he who caused the injury. In granting moral damages, the court proceeds upon the ancient maxim that when there

is a wrong, there is a remedy.” (*Report of the Code Commission*, p. 74).

(6) Mental Anguish

Ramos v. Ramos L-19872, Dec. 3, 1974

FACTS: Because an action for reconveyance of real properties brought against them had already prescribed, and was resultantly dismissed, the defendants sued the plaintiffs for moral damages, alleging that they had suffered from worries, anxieties, and mental anguish because of the suit that had been brought against them. However, while the action for reconveyance had indeed prescribed, there was no showing that the action had been maliciously brought. The plaintiffs in the reconveyance case had honestly believed that they had a good and valid cause of action. *Issue:* May moral damages be assessed against the unsuccessful plaintiffs?

HELD: No, moral damages cannot be awarded in favor of the defendants, and against the unsuccessful plaintiffs. The reason is because there was no malice in the institution of the suit for reconveyance. If a case is filed in good faith, and the defendant suffers from worries and anxieties, said mental anguish is not the anguish where the law allows a recovery of moral damages. The law does not impose a penalty on the right to litigate.

American Express International, Inc. v. IAC and Jose M. Alejandrino, Nov. 9, 1988

Private respondent Alejandrino was awarded moral damages amounting to P100,000 with 6% interest thereon computed from the finality of this decision until paid because of the alleged humiliation suffered by him when he was forced to surrender his credit card at Bon Department Store in Seattle. But as there are no pre-set spending limits to the use of the Amexco credit card, petitioner could not be faulted for ordering the immediate seizure of private respondent's credit card. Considering the large number of people availing themselves of the pre-set spending privilege in the use of the credit card,

petitioner's only protection consists in its ability to stop with dispatch anyone wrongfully using the credit card.

Whatever humiliation or embarrassment Alejandrino might have suffered on account of the seizure incident in Seattle, the Director of Operations of Amexco's Hongkong office apologized to private respondent. The Director offered to write a letter of explanation to Bon Department Store. He even offered to reopen Alejandrino's account. Alejandrino, however, rejected the offers. Clearly then, while petitioner was not in bad faith, its negligence caused the private respondent to suffer mental anguish, serious anxiety, embarrassment and humiliation, for which he is entitled to recover reasonable moral damages.

Pan American World Airways, Inc. v. IAC
GR 44442, Aug. 31, 1987

The award of moral damages by the trial court and the Court of Appeals in favor of a Pan American passenger, who was bumped off, in the amount of P500,000 as moral damages, P200,000 as exemplary damages and P100,000 as attorney's fees was considered by the Supreme Court to be exorbitant and consequently reduced the moral and exemplary damages to the combined total sum of P200,000 and the attorney's fees to P20,000. It retained the award of actual damages in the amount of US\$1,546.15 computed at the exchange rate prevailing at the time of payment.

Danao v. CA
GR 48276, Sep. 30, 1987

The creditor not only filed an unwarranted foreclosure proceedings, but also carried out the proceedings in a manner as to embarrass the debtor by publishing the notice of extra-judicial foreclosure and sale in the society page of a Sunday edition of a widely circulated newspaper, instead of in the "legal notices" or "classified ads" sections as usual in these types of notices, in extraordinarily large and boxed advertisements, which allegedly bespoke of the bank's malicious intent to embarrass and harass the defendant in alleged violation of the canons of conduct provided for in Articles 19, 20 and 21 of the Civil Code.

Both the Court of Appeals (CA) and the lower court took cognizance of the debtor's mental anguish, serious anxiety and besmirched reputation traceable to the unfortunate publication. The lower court awarded P100,000 moral damages, but the CA reduced said amount to P30,000. The Supreme Court increased the amount to P60,000.

(7) Courts Given Discretion to Award Moral Damages

Prudenciado v. Alliance Transport System, Inc. GR 33836, Mar. 16, 1987

Trial courts are given discretion to determine the amount of moral damages. The Court of Appeals can only modify or change the amount awarded when they are palpably and scandalously excessive "so as to indicate that it was the result of passion, prejudice or corruption on the part of the trial court." But where the awards of moral and exemplary damages are far too excessive compared to the actual losses sustained by the aggrieved party, they should be reduced to more reasonable amounts.

While the amount of moral damages is a matter left largely to the sound discretion of a court, the same when found excessive should be reduced to more reasonable amounts, considering the attendant facts and circumstances. Moral damages, though incapable of pecuniary estimation, are in the category of an award designed to compensate the claimant for actual injury suffered and not to impose a penalty on the wrongdoer. Moral damages are not intended to enrich a complainant at the expense of a defendant. They are awarded only to enable the injured party to obtain means, diversion or amusements that will serve to alleviate the moral suffering he has undergone, by reason of the defendants' culpable action. The award of moral damages must be proportionate to the suffering inflicted.

Isabelita Vital-Gozon v. CA & Alejandro dela Fuente GR 129132, Jul. 8, 1998

A public officer, like petitioner herein, may be liable for moral damages for as long as the moral damages suffered by

private respondent were the proximate result of petitioner's wrongful act or omission, *i.e.*, refusal to perform an official duty or neglect in the performance thereof.

Since moral damages are, in the language of Art. 2217, "incapable of pecuniary estimation," courts have the discretion to fix the corresponding amount, not being bound by any self-serving assessment by the claimants.

**Development Bank of the Phils. v.
CA & Emerald Resort Hotel Corp.
GR 125838, Jun. 10, 2003**

FACTS: DBP maintains that ERHC, a juridical person, is not entitled to moral damages. ERHC counters that its reputation was debased when the sheriffs and several armed men intruded into Hotel Ibalon's premises and inventoried the furniture and fixtures in the hotel. The Court of Appeals (CA) affirmed the trial court's award of moral damages.

HELD: The CA erred in awarding moral damages to ERHC, the latter having failed to present evidence to warrant the award. In a long line of decisions, the Supreme Court has ruled that the claimant for moral damages must present concrete proof to justify its award. (*Enervida v. Dela Torre*, 154 Phil. 301 [1974], citing *Algara v. Sandejas*, 27 Phil. 284 [1914]).

Moreover, as a general rule, moral damages are not awarded to a corporation because, being an artificial person and having existence only in legal contemplation, it has no feelings, no emotions, no senses. It cannot, therefore, experience physical suffering and mental anguish which can be experienced only by one having a nervous system. The statement in *People v. Manero and Mamburao Lumber Co. v. PNB* that a corporation may recover moral damages if it "has a good reputation that is debased, resulting in social humiliation" is an *obiter dictum*. On this core alone, the award for damages must be set aside. (*ABS-CBN Broadcasting Corp. v. CA*, 361 Phil. 499 [1999] and *Napocor v. Philipp Brothers Oceanic, Inc.*, GR 126204, Nov. 20, 2001).

Art. 2218. In the adjudication of moral damages, the sentimental value of property, real or personal, may be considered.

COMMENT:

Sentimental Value

Sentimental value may be considered both in civil liabilities arising from crimes (*Art. 106, Rev. Penal Code*) and in civil cases, where there are fraudulent or deceitful motives. (*See Arnaldo v. Famous Dry Cleaners, [C.A.] 52 O.G. 282*).

Art. 2219. Moral damages may be recovered in the following and analogous cases:

- (1) A criminal offense resulting in physical injuries;
- (2) Quasi-delicts causing physical injuries;
- (3) Seduction, abduction, rape or other lascivious acts;
- (4) Adultery or concubinage;
- (5) Illegal or arbitrary detention or arrest;
- (6) Illegal search;
- (7) Libel, slander or any other form of defamation;
- (8) Malicious prosecution;
- (9) Acts mentioned in article 309;
- (10) Acts and actions referred to in Articles 21, 26, 27, 28, 29, 30, 32, 34, and 35.

The parents of the female seduced, abducted, raped, or abused, referred to in No. 3 of this article, may also recover moral damages.

The spouse, descendants, ascendants, and brothers and sisters may bring the action mentioned in No. 9 of this article, in the order named.

COMMENT:**(1) Instances (Not Exclusive) When Moral Damages May Be Recovered**

- (a) The law here speaks of 9 instances and “analogous cases.”

**Mayo y Agpaoa v. People
GR 91201, Dec. 5, 1991**

Article 2219 of the New Civil Code provides: “Moral damages may be recovered in the following and analogous cases:

- (1) A criminal offense resulting in physical injuries;
- (2) Quasi-delicts causing physical injuries;

**Equitable Leasing Corp. v. Lucita Suyom,
Marissa Enano, Myrna Tamayo & Felix Oledan
GR 143360, Sep. 5, 2002**

FACTS: Petitioner claims it is not liable for moral damages, because respondents failed to establish or show the causal connection or relation between the factual basis of their claim and their wrongful act or omission, if any.

HELD: Having established the liability of petitioner as the registered owner of the vehicle, respondents have satisfactorily shown the existence of the factual basis for the award and its causal connection to the acts of the driver, who is deemed as petitioner’s employee. Indeed, the damages and injuries suffered by respondents were the proximate result of petitioner’s tortuous act or omission.

- (3) Seduction, abduction, rape or other lascivious acts;
- (4) Adultery or concubinage;
- (5) Illegal search;

- (6) Libel, slander or any other form of defamation;
- (7) Malicious prosecution;
- (8) Acts mentioned in article 309;
- (9) Acts and actions referred to in Articles 21, 26, 27, 28, 29, 30, 32, 34 and 35.”

**Garciano v. CA, et al.
GR 96126, Aug. 10, 1992**

Moral damages are recoverable only if the case falls under Art. 2219 in relation to Art. 21. In the case at bar, petitioner is not without fault. Firstly, she went on an indefinite leave of absence and failed to report back in time for the regular opening of classes. Secondly, for reasons known to herself alone, she refused to sign a written contract of employment. Lastly, she ignored the Board of Directors’ order for her to report for duty on July 5, 1982. The trial court’s award of exemplary damages to her was not justified for she is not entitled to moral, temperate, or compensatory damages.

In sum, the Court of Appeals correctly set aside the damages awarded by the trial court to the petitioner for they did not have any legal or factual basis.

- (b) “Analogous cases” refers to instances similar to the cases enumerated in the article, and *not* to ALL causes of mental anguish. (*People v. Plaza*, [C.A.] 52 O.G. 6609). One example is the institution of unfounded suits, one after another, all resulting in the dismissal of said suits; the anguish and embarrassment suffered by the defendant cannot be denied. (*Haw Pia v. Court of Appeals*, L-20047, Jun. 30, 1967). Ordinarily, a breach of contract cannot be considered as included in the descriptive term “analogous cases” used in Art. 2219, not only because Art. 2220 specifically provides for the damages that are caused by a contractual breach but because the definition of *quasi-delict* in Art. 2176 of the Code expressly excludes the cases where there is a pre-existing contractual relation between the parties. The advantageous position of a party suing a carrier for breach of the contract of

transportation explains to some extent, the limitations imposed by the new Code on the amount of the recovery. The action for breach of contract imposes on the defendant carrier a presumption of liability upon mere proof of injury to the passenger; the latter is relieved from the duty to establish the fault of the carrier, or of his employees; and the burden is placed on the carrier to prove that it was due to an unforeseen event or to *force majeure*. Moreover, the carrier, unlike in suits involving *quasi-delict*, may *not* escape liability by proving that it has exercised due diligence in the selection and supervision of the employees. Incidentally, regarding the claim that moral damages may be awarded because of Art. 1170 (incidental fraud), suffice it to state that said article merely sets forth a general principle on damages. (See *Geraldez v. CA*, GR 108253, Feb. 23, 1994, 48 SCAD 508). As regards moral damages, Art. 2219 is controlling, it being a specific provision thereon and as such, it prevails over Art. 1170. (*Verzosa v. Baytan, et al.*, 107 Phil. 1010).

**Bert Osmeña and Associates v.
Court of Appeals
GR 56545, Jan. 28, 1983**

- (1) When fraud or bad faith has been proved, moral damages may be awarded.
- (2) When moral damages are awarded, exemplary damages may also be decreed.

**Darang v. Ty Belizar
L-19487, Jan. 31, 1967**

To recover moral damages, there must be *pleading* and *proof* of moral suffering, anguish, fright, etc.

**Imperial v. Ziga
L-19726, Apr. 13, 1967**

Moral damages, imposed in a judgment, can earn *interest*, if so provided in the judgment, and reckoning can begin from the time the judgment is promulgated.

Gatchalian v. Delim
GR 56487, Oct. 21, 1991

Since respondent and his driver had been grossly negligent in connection with the bus mishap which had injured petitioner and other passengers and recalling the aggressive maneuvers of respondent, thru his wife, to get the victims to waive their right to recover damages even as they were still hospitalized for their injuries, petitioner must be held entitled to such moral damages. Considering the extent of pain and anxiety which petitioner must have suffered as a result of her physical injuries including the permanent scar on her forehead, the amount of P30,000 would be a reasonable award. Petitioner's claim for P1,000 as attorney's fees is in fact even more modest.

Mayo y Agpaoa v. People
GR 91201, Dec. 5, 1991

FACTS: June Navarette was driving a Lancer car owned by Linda Navarette, her sister. On board the car were Linda, Legionaria, Mae, Noel, Reymond, Antonette and Mercy. Before the accident took place, the Tamaraw jeep driven by Danilo was first ahead, followed by the Lancer car and behind the Lancer car was the Rabbit bus driven by Mayo travelling towards the direction of Manila. The Lancer car as well as the Rabbit bus following one after the other overtook the Tamaraw jeep. The Lancer car was then cruising steadily at the right lane of the road at a speed rate of about 40 kilometers per hour. As the vehicle approached the vicinity of Mabalacat Institute, the Rabbit bus picked up speed and swerved to the left lane to overtake the Lancer car which was running on the right lane of the highway. When the Rabbit bus was abreast with the Lancer, an oncoming vehicle from the opposite direction appeared and flashed its headlights to warn the bus to give way. The bus swerved to its right in an effort to return to the right lane to avoid collision with the oncoming vehicle, and in the process it hit the left rear side portion of

the Lancer car with its right front bumper. Because of the impact, the driver of the Lancer lost control of the wheel and the car crashed against the concrete fence. Mayo was charged and convicted with the crime of reckless imprudence resulting in damage to property with multiple serious, less serious and slight physical injuries. He filed an appeal with the Court of Appeals (CA) which affirmed the trial court's decision with the modification that the appellant suffered a straight penalty of three months, on the ground that the Indeterminate Sentence Law is not applicable, the maximum penalty impossible not exceeding one year. The complainants in the criminal case were awarded damages. The CA sustained the trial court.

ISSUE: Whether the findings of the trial court justify the award of moral damages in the amount of P700,000 in favor of Linda Navarette.

HELD: The Supreme Court modified the amount of P700,000 as moral damages granted to complainant by reducing it to P200,000 and holding that Linda is entitled to moral damages. She suffered injuries as a result of the criminal offense of Mayo. Moreover, her injuries resulting in a permanent scar at her forehead and the loss of her right eye gave her mental anguish, wounded feelings and shock. The psychological effect on her as regards the scar on her forehead and her false eye must have devastated her considering that women in general are fastidious on how they look. More important was the loss of vision of her right eye which was severely injured as a result of the accident. Since the accident, Linda had to contend with the loss of her eyesight on her right eye which necessarily hampers her not only physically but also professionally for the rest of her life. Before the accident, Linda who is a home economist by profession was doing well in her career. A graduate of the University of the Philippines with the degree of Home Economics, she is the Assistant Vice President as well as the Resident Manager of Club Solviento receiving a gross income of P10,000 a month. Simultaneously with her work at Club Solviento, she served as Food Consultant of Food City

where she received a monthly salary of P7,000. However, she had to give up her consultancy job after the accident not only because of her prolonged absences but because of the physical handicap she suffered. Nevertheless, there is no justification toward moral damages in favor of Linda for the loss of her boyfriend. No doubt, the loss of her boyfriend after the accident added to her mental and emotional sufferings and psychologically affected and disturbed her. However, there is no evidence to show that her boyfriend left her after the accident due to her physical injuries. He may have left her even if she did not suffer the slightest injury. The reasons for the break-up of a courtship are too many and too complicated such that they should not form the basis of damages arising from a vehicular accident. Moreover, granting that her boyfriend left her due to her physical injuries, there is no legal basis for the award of moral damages in favor of Linda because of the loss of a boyfriend. Art. 2219 of the new Civil Code enumerates cases wherein moral damages may be granted. Loss of a boyfriend as a result of physical injuries suffered after an accident is not one of them. Neither can it be categorized as an analogous case. The award of P700,000 as moral damages in favor of Linda is unconscionable and excessive. The Court rejects Linda's claim for the amount of P1,000,000 as moral damages for the loss of her boyfriend. She asked for the amount of P500,000 as moral damages due to her personal injuries. Therefore, the award for moral damages should not exceed P500,000. Under the circumstances, the amount of P200,000 as moral damages in favor of Linda is reasonable, just and fair. Thus, moral damages may be awarded where gross negligence on the part of the common carrier is shown.

**Spouses Quisumbing v. Manila Electric Co.
GR 142943, Apr. 3, 2002**

Art. 2219 lists the instances when moral damages may be recovered. One such instance is when the rights of individuals, including the right against deprivation of property without due process of law, are violated.

Although incapable of pecuniary computation, such damages may be recovered if they are the proximate results of the defendant's wrongful act or omission.

(2) Rule With Respect to Contracts

Note that contracts are *not* referred to in this article. However:

- (a) Under Art. 2220, moral damages may be recovered where the defendant acted *fraudulently* or in *bad faith*.

Filinvest Credit Corp. v. Mendez GR 66419, Jul. 31, 1987

FACTS: A credit corporation sued an installment buyer of a car to recover said car and/or the sum of money when the latter's check intended for the February, March and April installments bounced due to insufficiency of funds. By virtue of an order of seizure by the court, the car was repossessed. The buyer later redeposited the check and credited for the months mentioned. When the buyer negotiated with the credit company for the release of the car, the latter demanded payment of the total outstanding balance on the promissory note. Due to the persistent pleas of the buyer, the credit company released the car to him upon payment of the installment remaining unpaid for the months of April, May and June, in addition to the costs incurred in repossessing. The court dismissed the case on motion of the credit company.

HELD: The buyer is not entitled to damages. The willingness of the credit company to allow the buyer to pay only the unpaid installments for April, May and June, instead of the total outstanding balance and to release the car as well as its voluntary motion to dismiss the case indicates lack of fraud or bad faith on the part of the credit company. The buyer was not without fault. He was three months behind in his payments and he issued a bouncing check.

Moral damages cannot be awarded in the absence of a wrongful act or omission or fraud or bad faith. When the action is filed in good faith there should be no penalty on the right to litigate. One may have erred, but error alone is not a ground for moral damages.

- (b) If *death* is caused to a passenger by the negligence of a common carrier, moral damages may be recovered. (*Arts. 1764, 2206*).

(3) Re Par. 1 (Physical Injuries Because of a Crime)

“A *criminal* offense resulting in physical injuries.”

- (a) If a passenger *dies* or is *injured*, and a *criminal* case is brought by himself or by his heirs, in the proper case, moral damages may be recovered.
- (b) If there be *no death or physical injuries*, moral damages cannot be recovered. (*People v. Plaza, [C.A.] 52 O.G. 6609; Strebel v. Figueras, 96 Phil. 321*).
- (c) If a taxi driver was negligent and injures a passenger, he can be liable for *moral* damages, *but* not the taxi company, for the company did not commit the crime. (*See Cachero v. Manila Yellow Taxicab Co., Inc., 101 Phil. 523*).

[**NOTE:** Rule in *Civil Actions*: Moral damages are NOT recoverable in *damage actions* predicated on a breach of the contract of transportation in view of the provisions of Arts. 2219 and 2220 of the new Civil Code. (*Verzosa v. Baytan, et al., 107 Phil. 1010*). The exceptions to this rule are (a) where the mishap results in the death of a passenger, and (b) where it is proved that the carrier was guilty of fraud or bad faith, even if death does *not* result. (*Fores v. Miranda, 105 Phil. 266*). The mere carelessness of the carrier’s driver does *not per se* constitute or justify an inference of malice or bad faith on said carrier’s part (*Rex Taxicab Co. v. Bautista, L-15392, Sept. 30, 1960*), because fraud, malice, or bad faith must be *proved*. (*Soberano and Soberano v. Manila Railroad Co., L-19407, Nov. 23, 1966*).]

(4) Re Par. 3 (Seduction, etc.)

“Seduction, abduction, rape or other lascivious acts.”

**People of the Philippines v. Mariano Fontanilla
L-25354, Jun. 28, 1968**

FACTS: Mariano Fontanilla, 52 years of age, was accused by his servant, Fe Castro, a 15-year-old virgin of repeated carnal knowledge with her for three months. She could not recall the total number of times. She testified that she repeatedly yielded because of his promises of marriage (despite the fact that he was a married man), and because she was frightened by his acts of intimidation. The accused made love to her during the day when his wife was away, and at night, when the latter was already asleep. One night, they were caught *in flagrante* on the kitchen floor. Fontanilla denied the accusation stating, *inter alia*, that because of his age, it was impossible for him to make love to his wife more than once a week, much less, to have had Fe carnally day and night. Fontanilla was found guilty in view of the evidence presented. Regarding the repeated acts of carnal knowledge, there is a presumption that an adult male has normal powers of virility. The Court also awarded Fe or her parents moral damages amounting to P500. *Issue:* Is this award of moral damages proper?

HELD:

- (a) The award of *only* P500 is inadequate. The victim was a virgin, and she was deflowered by Fontanilla. This loss of virginity, together with the attendant shame and scandal, entitles her to the sum of P2,500 in moral damages. Her future as a woman is definitely impaired, and the resultant prejudice against her engendered in the male population of the *barrio* where she resides, cannot be blinked away.
- (b) The award must *not* be in the alternative, for under Art. 2219 of the Civil Code, the parents are **ALSO** entitled to recover moral damages. The conviction of the accused suffices as a basis to adjudge him, in the *same action*, liable for an award of moral damages, *without independ-*

ent proof thereof, to the victim AND her parents, because the law presumes that the parents also naturally suffered besmirched reputation, social humiliation, mental anguish, and wounded feelings.

People v. Manalo
GR 49810, Oct. 13, 1986

In rape cases, moral damages have been raised to P20,000.

People v. Bondoy
41 SCAD 432
1993

The indemnity to a rape victim has been increased to P50,000.

People v. Eric Baid y Ominta
GR 129667, Jul. 31, 2000

FACTS: Appellants was accusing of raping a 27-year old woman diagnosed with schizophrenia. Found guilty, appellant assailed victim's credibility on account of her ailment.

HELD: It is medically established that schizophrenic persons do not suffer from a clouding of consciousness and gross deficits of memory. The victim could understand the questions propounded to her relating to the rape and could give responsive answers to them despite exhibiting inappropriate emotions in the course of her testimony. Notably, complainant's submission to the sexual advances of appellant notwithstanding, the intercourse was without consent considering that schizophrenia caused an impairment of the judgment on complainant. Hence, appellant may be convicted of rape under Art. 335(2) of the Revised Penal Code for the victim was completely insane or deprived of reason when he had carnal knowledge of her. The phrase "deprived of reason" includes those suffering from mental abnormality, or deficiency, or some form of mental retardation, those who are feeble-minded although coherent.

The trial court is correct in awarding moral damages in the amount of P50,000 in accordance with jurisprudence that moral damages may be awarded in rape cases without any need of proof of moral suffering. Additionally, civil indemnity in the amount of P50,000 should have been awarded the complainant consistent with the ruling that rape victims are entitled to such an award without need of proof except the fact of the commission of the offense. (*People v. Capillo*, GR 123059, November 25, 1999). The prosecution's plea that the indemnity should be raised to P75,000 cannot be granted because such amount is awarded only in cases of qualified rape. In the case at bar, there have been no qualifying circumstances raising the penalty to death. (*People v. Lasola*, GR 123152, Nov. 17, 1999).

(5) Re Par. 7 (Libel, Slander, Defamation)

“Libel, slander, or any other form of defamation.”

If there is *no* libel, etc. because of the defense of “privileged communication” and malice is not proved, there will be *no* award of moral damages. This is particularly true in the case of court pleadings which may contain libelous remarks. (*See De la Rosa, et al. v. Maristela*, [C.A.] 50 O.G. 254).

On the other hand, the allegation of *forgery* in a document is all but a defamation, which in the light of Art. 2217 could by analogy be a ground for payment of moral damages, considering the wounded feelings and besmirched reputation of the parties involved. (*Heirs of Justiva v. Court of Appeals*, L-16396, Jan. 31, 1963).

(6) Re Par. 8 (Malicious Prosecution)

“Malicious Prosecution”

The defendant, to be liable, must have acted deliberately knowing that his charges were false and groundless. Indeed, the mere act of submitting a case to the authorities for prosecution does *not* make him liable for malicious prosecution, for generally, it is the Government or representative of the State that takes charge of the prosecution of the offense.

There must be proof that the prosecution was prompted by a sinister design to vex and humiliate a person, for if the rule were otherwise, every acquitted person can turn against the complainant in a civil action for damages. (*Buenaventura, et al. v. Sto. Domingo, et al.*, L-10661, Mar. 2, 1958). In order that moral damages may be recovered as a result of a writ of attachment wrongfully issued, malice must be proved to be present. (*Lazatin v. Tuano, et al.*, L-12736, Jul. 31, 1961).

**Alejo Madera, et al.
v. Heirs of Salvador Lopez
L-37105, Feb. 10, 1981**

Statutory basis for an action for moral damages due to malicious prosecution can be found in Arts. 19, 2176, and 2219 of the Civil Code.

**PCIB v. IAC
GR 73610, Apr. 19, 1991**

An action to recover damages from the plaintiff who secures a writ of attachment based on a false affidavit is identical with or analogous to the ordinary action for malicious prosecution. Moral damages may be recovered by the defendant on account of an improperly and irregularly issued writ of attachment.

**Albenson Enterprises Corp., et al. v.
CA & Eugenio S. Baltao
GR 88694, Jan. 11, 1993**

A civil action for damages for malicious prosecution is allowed under the Civil Code, more specifically Arts. 19, 20, 26, 29, 32, 33, 35, and 2219(8) thereof.

In order that such a case can prosper, however, the following three (3) elements must be present, to wit: (1) the fact of the prosecution and the further fact that the defendant was further fact that the defendant was himself the prosecutor, and that the action was finally terminated with an acquittal; (2) that in bringing the action, the prosecutor acted without probable cause; and (3) the prosecutor was actuated or impelled

by legal malice. Thus, a party injured by the filing of a court case against him, even if he is later on absolved, may file a case for damages grounded either on the principle of abuse of rights, or on malicious prosecution. It is well-settled that one cannot be held liable for maliciously instituting a prosecution where one has acted *with probable cause* (defined as the existence of such facts and circumstances as would excite the belief, in a reasonable mind, acting on the facts within the knowledge of the prosecutor, that the person charged was guilty of the crime for which he was prosecuted). To constitute malicious prosecution, there must be proof that the prosecution was prompted by a sinister design to vex and humiliate a person, that it was initiated deliberately by the defendant knowing that his charges were false and groundless. Concededly, the mere act of submitting a case to the authorities for prosecution does not make one liable for malicious prosecution. Proof and motive that the institution of the action was prompted by a sinister design to vex and humiliate a person must be clearly and preponderantly established to entitle the victims to damages.

In the case at bar, there is no proof of a sinister design on the part of petitioners to vex or humiliate private respondent by instituting the criminal case against him. While petitioners may have been negligent to some extent in determining the liability of private respondent for the dishonored check, the same is not so gross or reckless as to amount to bad faith warranting an award of damages. The questioned judgment in the instant case attests to the propensity of trial judges to award damages without basis. Lower courts are hereby cautioned anew against awarding unconscionable sums as damages without bases therefor.

(7) Re Par. 10 (Articles on Human Relations)

Bar Question

- (a) Is a breach of promise to marry an actionable wrong? Explain briefly.
- (b) A promised to marry his sweetheart B. Later, both applied for and obtained a marriage license. Thereafter, they sent out wedding invitations to friends and rela-

tives. *B* purchased her wedding trousseau, and dresses for other participants in the wedding. Two days before the wedding, *A* left for the province, and sent a note to *B* stating that he could not go on with the wedding because his mother was opposed to it. He was nowhere to be found on the date of the wedding. *Question*: Is *A* liable for damages?

Reasons:

ANS.: (a) A breach of promise to marry is *by itself* not an actionable wrong. (*Hermosisima v. Court of Appeals*, L-14628, Sept. 30, 1960 and *Estopa v. Piansay, Jr.*, L-14733, Sept. 30, 1960). And neither does it give rise to an action for specific performance. Therefore, only *actual damages* (wedding dress, etc.) may be asked; not moral damages unless there is criminal or moral seduction or abuse of a right.

- (b) *A* is liable for actual, *moral* and exemplary damages. His acts constituted a palpable, unjustifiable, and willful violation of morals and good customs, for which he can be held answerable for damages in accordance with Art. 21. And inasmuch as he acted in a wanton, reckless, and oppressive manner, he should be made to pay moral and exemplary damages pursuant to the provisions of Art. 2219, par. 10 and Art. 2232 of the Civil Code. (*Wassmer v. Velez*, L-20089, Dec. 26, 1964).

Arturo de Guzman v. NLRC, et al.
GR 90856, Jul. 23, 1992

Under Art. 2219(10) of the Civil Code, moral damages may be recovered for the acts referred to in art. 21 which reads: "Any person who willfully causes loss or injury to another in a manner that is contrary to morals, good customs or public policy shall compensate the latter for the damage."

In *Bert Osmeña & Associates v. CA* (120 SCRA 396), the Court held that "fraud and bad faith having been established, the award of moral damages is in order. And in *Pan Pacific Co. (Phil.) v. Phil. Advertising Corp.*

(23 SCRA 977), moral damages were awarded against the defendant for its wanton and deliberate refusal to pay the just debt due the plaintiff. It is settled that the court can grant the relief warranted by the allegation and the proof even if it is not specifically sought by the injured party. (*Heirs of Celso Amarante v. CA, 185 SCRA 585*).

In the case at bar, while the private respondents did not categorically pray for damages, they did allege that the petitioner, taking advantage of his position as general manager, had appropriated the properties of the Affiliated Machineries Agency Ltd. (AMAL) in payment of his own claims against the company. That was averment enough of the injury they suffered as a result of the petitioner's bad faith. It is stressed that the petitioners' liability to the private respondents is a direct liability in the form of moral and exemplary damages and not a solidary liability with AMAL for the claims of its employees against the company. He is being held liable not because he is the general manager of AMAL but because he took advantage of his position by applying the properties of AMAL to the payment exclusively of his own claims to the detriment of the other employees. In the instant case, the fact that no actual or compensatory damages was proven before the trial court does not adversely affect the private respondents' right to recover moral damages. Thus, moral damages may be awarded in the cases referred to in the Chapter on Human Relations of the Civil Code (*Arts. 19-31*) without need of proof that the wrongful act complained of had caused any physical injury upon the complainant.

(8) Moral and Exemplary Damages Were NOT Given in the Following Cases:

- (a) When no evidence was introduced thereon, and the case was submitted simply on a stipulation of facts. (*Tabora v. Montelibano, et al., L-8667, Apr. 3, 1956*).
- (b) When a complaint contained nothing derogatory to the good name or reputation of the other party, and bad

faith was not shown. (*Litam v. Espiritu, et al.*, L-7644, Nov. 27, 1956).

- (c) When there was no allegation or proof that a mayor, in dismissing a policeman, had acted with motives other than the promotion of the public interest. (*Covacha v. Amante*, L-8358, May 25, 1956).
- (d) When a broker believed in good faith that he was entitled to a commission for having intervened in a sale, and thus sued unsuccessfully his principal. (*Worcester v. Lorenzana*, 104 Phil. 234).
- (e) When a common-law wife, Esther Peralta, was prohibited by the court to represent herself as Mrs. Saturnino Silva, or as the lawful wife of her paramour. In this case, the court held that the unwarranted misrepresentation had been made in GOOD FAITH, inasmuch as she did NOT know that her common-law mate was already married to another. (*Elenita Ledesma Silva, et al. v. Esther Peralta*, L-13114, Aug. 29, 1961).
- (f) In a case of a clearly unfounded or unreasonable suit. Note that in a case like this, *attorney's fees* may be recovered (Art. 2208, No. 4) but NOT moral damages, for this is *not* one of the cases contemplated under Art. 2219. (*Malonzo v. Galang, et al.*, L-13581, Jul. 27, 1960). It is true that Art. 2219 also provides that moral damages may be awarded in “analogous cases” but we do not think the Code intended a “clearly unfounded civil action proceeding” to be one of those analogous cases wherein moral damages may be recovered or it would have *expressly* mentioned it in Art. 2219 as it did in Art. 2208; or else incorporated Art. 2208 by reference in Art. 2219. Besides, Art. 2219 specifically mentions “quasi-delicts causing physical injuries” as an instance when moral damages may be allowed, thereby implying that all other quasi-delicts not resulting in physical injuries are excluded (*Strebel v. Figueras*, 96 Phil. 321), excepting of course, the special torts referred to in Art. 309 (par. 9, Art. 2219) — relating to disrespect for the dead and wrongful interference with funerals — and in Arts. 21, 26, 27, 28, 29, 30, 32, 34, and 35 on the chapter on Hu-

man Relations. (*par. 10, Art. 2219; Malonzo v. Galang, et al., L-13851, Jul. 27, 1960*).

- (g) A brother cannot recover moral damages for his brother's death in 1937 caused by a negligent train engineer (while this was under the old Civil Code which apparently allowed such recovery, based on FRENCH decisions, still the *less severe sanction* under the new Civil Code should be applied (*Art. 2257*) and the new Civil Code is clearly less severe because under the last paragraph of Art. 2219, brothers and sisters are NOT among these who can recover moral damages.)
- (h) The passenger's contributory negligence will justify the deletion of moral damages.

Philippine National Railways v. CA
GR 55347, Oct. 4, 1985

FACTS: A train passenger insists in sitting on the open platform between the coaches of the train and does not hold on tightly to the upright metal bar found at the said platform. Because of his precarious position, he falls off the speeding train.

HELD: The passenger is chargeable with contributory negligence. But his contributory negligence will not exempt the carrier from liability. It will merely justify the *deletion of moral damages*.

(9) Liability of the State Governmental & Proprietary Functions

Fontanilla v. Maliaman
GR 55913, Feb. 27, 1991

FACTS: On December 1, 1989, through its Second Division, the Supreme Court rendered a decision declaring the National Irrigation Administration (NIA) a government agency performing proprietary functions. Like an ordinary employer, NIA was held liable for the injuries, resulting in the death of Francisco Fontanilla, caused by the fault or negligence of

NIA's driver-employee Hugo Garcia. The Court ordered NIA to pay the Fontanilla spouses, the victim's parents, for the death of the victim, for hospitalization and burial expenses, for moral and exemplary damages, and attorney's fees. NIA moved for reconsideration, alleging that it does not perform solely or primarily proprietary functions but as an agency of the government tasked with governmental functions. Thus, it may not be held liable for damages for injuries caused by its employees to a third person.

HELD: The Supreme Court *en banc* denied the motion for reconsideration and held that the National Irrigation Administration is a government agency invested with a corporate personality separate and distinct from the government and thus is governed by the Corporation Law (now Corporate Code). It had its own assets and liabilities. It also has corporate powers to be exercised by a Board of Directors. To quote Sec. 2, subsection (f): "x x x and to transact such business, as are directly or indirectly necessary, incidental or conducive to the attainment of the above powers and objectives, including the power to establish and maintain subsidiaries, and in general, to exercise all the powers of a corporation under the Corporation Law, insofar as they are not inconsistent with the provisions of this Act." (*Sec. 2, subsection [f]*). The National Irrigation Administration is a government agency with a juridical personality separate and distinct from the government. It is not a mere agency of the government but a corporate body performing proprietary functions. Therefore, it may be held liable for damages caused by the negligent act of its driver who was not its special agent.

(10) Closure of Bank Account Due to "Kiting"

Reyes v. Court of Appeals GR 95535, Jan. 21, 1991

The bank is not liable for damages for closing a depositor's current account, where the latter is guilty of "kiting" activities as defined in the Central Bank Manual, *i.e.*, "where a depositor, having only one account of his own, can still engage in kiting by using the account or accounts of other persons who may be willing to act and cooperate with him."

(11) No Hard and Fast Rule

**Ayala Integrated Steel
Manufacturing Co., Inc. v. CA
GR 94359, Aug. 2, 1991**

Moral damages includes physical suffering, mental anguish, fright, serious anxiety, besmirched reputation, wounded feelings, moral shock, social humiliation, and similar injury. Though incapable of pecuniary computation, they may be recovered if they are the proximate result of the defendant's wrongful act or omission. Damages are not intended to enrich the complainant at the expense of a defendant. They are awarded only to alleviate the moral suffering that the injured party had undergone by reason of the defendant's culpable action.

There is no hard and fast rule in the determination of what would be a fair amount of moral damages, since each case must be governed by its own peculiar circumstances. Although the Court of Appeals increased the moral and actual damages awarded by the trial court, the awards are not excessive but only commensurate with the mental anguish, hardships, inconvenience, and expenses that respondent suffered and incurred as a result of the malicious prosecutions initiated by the petitioners against him.

Art. 2220. Willful injury to property may be a legal ground for awarding moral damages if the court should find that, under the circumstances, such damages are justly due. The same rule applies to breaches of contract where the defendant acted fraudulently or in bad faith.

COMMENT:**(1) Willful Injury to Property and Breaches of Contracts**

If the breach of a contract is neither malicious nor fraudulent, no award of moral damages may be given. (*Francisco v. GSIS, L-18155, Mar. 30, 1963*).

(2) Case

Vicente & Michael Lim v. CA
GR 118347, Oct. 24, 1996
75 SCAD 574

The evidence shows that private respondent made little more than taken effort to seek the ejectment of squatters from the land, revealing her real intention to be finding a way of getting out of her contract. Her failure to make use of her resources and her insistence on rescinding the sale show quite clearly that she was indeed just looking for a way to get out of her contractual obligation by pointing to her own abject failure to rid the land of squatters.

The award of moral damages is in accordance with Art. 2220 which provides that moral damages may be awarded in case of a breach of contract where the defendant acted fraudulently or in bad faith.

[NOTE: In view of Art. 2220, it has been held that in *culpa contractual* or breach of contract, moral damages may be recovered when the defendant acted in bad faith or was guilty of gross negligence (amounting to bad faith) or in wanton disregard of his contractual obligation. Since the law presumes good faith, the person claiming moral damages must prove bad faith or ill motive by clear and convincing evidence. (*MOF Co. v. Enriquez, GR 149280, May 9, 2002*).]

Section 2

NOMINAL DAMAGES

Art. 2221. Nominal damages are adjudicated in order that a right of the plaintiff, which has been violated or invaded by the defendant, may be vindicated or recognized, and not for the purpose of indemnifying the plaintiff for any loss suffered by him.

COMMENT:

(1) The Grant of Nominal Damages – Reason Therefor

“There are instances when the vindication or recognition of the plaintiff's right is of the utmost importance to him as

in the case of trespass upon real property. The awarding of nominal damages does not therefore run counter to the maxim *de minimio non curat lex* (the law does not cure or bother with trifles).” (*Report of the Code Commission*, p. 74).

**LRT v. Navidad,
GR 145804, Feb. 6, 2003**

Nominal damages are adjudicated in order that a right of the plaintiff, which has been violated or invaded by the defendant, may be vindicated or recognized, and not for the purpose of indemnifying the plaintiff for any loss suffered by him. (*Art. 2221*).

It is an established rule that nominal damages cannot co-exists with compensatory damages. (*Medina v. Cresencia*, 99 *Phil. 506*). Nor is the award of nominal damages. Nor is the award of nominal damages in addition to actual damages tenable.

(2) Effect of Granting Compensatory and Exemplary Damages

If compensatory and exemplary damages have been exemplary damages have been awarded, this award is by itself a judicial recognition that the plaintiff's right has been violated. Therefore, a further award, this time of *nominal* damages, is unnecessary and improper. (*Meding, et al. v. Cresencia, et al.*, L-8194, *Jul. 11, 1956*). It should be remembered that nominal damages are merely for the VINDICATION of a right that has been violated, not for indemnification of the loss suffered. (*Ventanilla v. Centeno*, L-14333, *Jan. 28, 1961*).

**Sumalpong v. CA
GR 123404, Feb. 26, 1997
79 SCAD 969**

FACTS: Some species of injury have been caused to complainant because of the medical expenses he has incurred in having his wounds treated, and the loss of income due to his failure to work during his hospitalization.

ISSUE: In the absence of competent proof of the amount of actual damages, is the complainant entitled only to nominal damages?

HELD: Yes. Whenever there has been a violation of an ascertained legal right, although no actual damages resulted or none are shown, the award of nominal damages is proper. Nominal damages are adjudicated in order that a right of the plaintiff, which has violated or invaded by the defendant, may be vindicated or recognized, and not for the purpose of indemnifying the plaintiff for any loss suffered by him.

**Philippine Telegraph & Telephone Corp.
& Louie Cabalit v. CA & Lolita Sipe Escoro
GR 139268, Sep. 3, 2002**

FACTS: Petitioner PT&T, for a fee, undertook to send private respondent two telegraphic money orders in the sum of P3,000. Petitioner, however, failed to deliver the money to respondent immediately after the money order was transmitted to its Cubao branch. It was almost two months from transmitted that respondent was finally able to have her money. *Issue:* For the violation of the right of private respondent to receive timely delivery of the money transmitted thru petitioner corporation, is an award of nominal damages appropriate?

HELD: Yes. An amount of P20,000 by way of nominal damages, considering all that private respondent has had to go thru, is reasonable and fair. “Nominal damages are adjudicated in order that a right of the plaintiff, which has been violated or invaded by the defendant, may be vindicated or recognized and not for the purpose of indemnifying the plaintiff for any loss suffered by him.” (*Art. 2221, Civil Code*). (*Sumalpong v. CA, 268 SCRA 764*). Nominal damages may be awarded in every obligation arising from any source enumerated in Art. 1157 or, generally, in every case where property right is invaded.

(3) Liability of a Negligent Lawyer

A lawyer who thru negligence fails to deposit on time the appeal bond, and to file the record of appeal within the extension period (asked for by him) and granted by the Court,

while *not* liable for *actual* damages, may nevertheless be liable for *nominal* damages. This is discretionary on the part of the Court. (*Ventanilla v. Centeno*, L-14333, Jan. 28, 1961).

Art. 2222. The court may award nominal damages in every obligation arising from any source enumerated in Article 1157, or in every case where any property right has been invaded.

COMMENT:

When Nominal Damages May Be Awarded

The assessment of *nominal* damages is left to the *discretion* of the court, according to the circumstances of the case. (*Ventanilla v. Gregorio Centeno*, L-14333, Jan. 28, 1961). An award of nominal damages precludes the recovery of actual, moral, temperate, or moderate damages. (*Ibid.*).

**Dee Hua Liong Electrical Equipment
Corp. v. Reyes
GR 72182, Nov. 25, 1986**

Nominal damages may be awarded, although plaintiff is not entitled to actual, moral, or exemplary damages.

Art. 2223. The adjudication of nominal damages shall preclude further contest upon the right involved and all accessory questions, as between the parties to the suit, or their respective heirs and assigns.

COMMENT:

Effect of Granting Nominal Damages

The Article explains itself.

Section 3

TEMPERATE OR MODERATE DAMAGES

Art. 2224. Temperate or moderate damages, which are more than nominal but less than compensatory damages, may be recovered when the court finds that some pecuni-

ary loss has been suffered but its amount can not, from the nature of the case, be proved with certainty.

COMMENT:

(1) Reason for allowing Temperate or Moderate Damages

“In some States of the American union, temperate damages are allowed. There are cases where from the nature of the case, definite proof of pecuniary loss cannot be offered, although the court is convinced that there has been such loss. For instance, injury to one’s commercial credit or to the goodwill of a business firm is often hard to show with certainty in terms of money. Should damages be denied for that reason? The judge should be empowered to calculate moderate damages in such cases, rather than that the plaintiff should suffer, without redress, from the defendant’s wrongful act.” (*Report of the Code Commission, p. 75*).

(2) Suffering of Some Pecuniary Loss

It is imperative under Art. 2224 that “some pecuniary loss has been suffered” (though uncertain); otherwise, temperate damages cannot be recovered. (*See Victorino, et al. v. Nora [C.A.] 52 O.G. 911*). As long, however, as there has been an injury (such as a physical injury) the fact that the same is incapable of pecuniary estimation does *not* preclude the right to an indemnity. Here the judge may calculate moderate damages. (*Necesito v. Paras, 104 Phil. 75*).

(3) Cases

**Consolidated Plywood Industries, Inc., et al. v.
CA, et al.
GR 101706, Sep. 23, 1992**

In the case at bar, there was no showing nor proof that petitioner was entitled to an award of this kind of damages in addition to the actual damages it suffered as a direct consequence of private respondents’ act.

The nature of the contract between the parties is such that damages which the innocent party may have incurred can be substantiated by evidence.

Ramos v. CA
GR 124354, Apr. 11, 2002

The amount of damages which should be awarded, if they are to adequately and correctly respond to the injury caused, should be one which compensates for pecuniary loss incurred and proved, up to the time of trial, and one which would meet pecuniary loss certain to be suffered but which could not, from the nature of the case, be made with certainty.

Temperate damages can and should be awarded on top of actual or compensatory damages in instances where the injury is chronic and continuing. And because of the unique nature of such cases, no incompatibility arises when both actual and temperate damages are provided for. The reason is that these damages cover two distinct phases.

As it would not be equitable — and certainly not in the best interests of the administration of justice — for the victim in such cases to constantly come before the courts and invoke their aid in seeking adjustments to the compensatory damages previously awarded — temperate damages are appropriate. The amount given as temperate damages, though to a certain extent speculative, should take into account the cost of proper care.

Art. 2225. Temperate damages must be reasonable under the circumstances.

COMMENT:

Reasonable Temperate Damages

What is reasonable is a question of fact, depending on the relevant circumstances.

Section 4

LIQUIDATED DAMAGES

Art. 2226. Liquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof.

COMMENT:**Nature of Liquidated Damages**

In effect, “liquidated damages” and “penalty” are the same. Neither requires proof of actual damages. (*Lambert v. Fox*, 26 Phil. 588). After all, they had been previously agreed upon.

Art. 2227. Liquidated damages, whether intended as an indemnity or a penalty, shall be equitably reduced if they are iniquitous or unconscionable.

COMMENT:**(1) Equitable Reduction of Liquidated Damages**

The reason is that in both, the stipulation is *contra bonos mores*. It is a mere technicality to refuse to lessen the damages to their just amount simply because the stipulation is *not* meant to be a penalty. An immoral stipulation is nonetheless immoral because it is called an indemnity. (*Report of the Code Commission*, p. 75).

(2) Effect of Partial or Irregular Performance

Under Art. 2227, liquidated damages shall be reduced if *iniquitous* or *unconscionable*. Now then, suppose there has been *partial* or *irregular* performance, can there also be reduction?

HELD: Yes, because the fundamental rules governing “liquidated damages” and “a penalty clause” are the *same*. Moreover, the liquidated damages are presumed to be only for a *total* breach. Therefore, if out of 500 television sets to be delivered, 63 only are given, there can be a *reduction* in the amount of liquidated damages. (*Joe’s Electrical Supply v. Alto Electronics*, L-12376, Aug. 22, 1958).

Art. 2228. When the breach of the contract committed by the defendant is not the one contemplated by the parties in agreeing upon the liquidated damages, the law shall determine the measure of damages, and not the stipulation.

COMMENT:**Rule if Breach Was Not Contemplated in the Agreement on Liquidated Damages**

The Article explains itself.

Section 5**EXEMPLARY OR CORRECTIVE DAMAGES**

Art. 2229. Exemplary or corrective damages are imposed, by way of example or correction for the public good, in addition to the moral, temperate, liquidated or compensatory damages.

COMMENT:**(1) Reason for Imposing Exemplary or Corrective Damages**

Although in the United States exemplary damages are also called “punitive” damages, still the term “corrective” is in harmony with the modern theory of penology.

Exemplary damages are required by public policy for wanton acts must be suppressed. They are an antidote so that the poison of wickedness may not run through the body politic. (*Report of the Code Com., pp. 75-76*).

In the absence of moral, temperate, liquidated, or compensatory damages, *no* exemplary damages can be granted, for exemplary damages are allowed only in ADDITION to any of the four kinds of damages mentioned. (*Ventanilla v. Centeno, L-14333, Jan. 28, 1961; Fores v. Miranda, 105 Phil. 266 and Francisco v. GSIS, L-18155, Mar. 30, 1963*). It is advisable to specifically ask in the complaint for exemplary damages (in the proper cases), but the general prayer in the complaint for “other remedies which may be just and equitable in the premises” can allow, if warranted, the grant of exemplary damages. (*See Darang v. Belizor, L-19487, Jan. 31, 1967*).

**Guilatco v. City of Dagupan and CA
GR 61516, Mar. 21, 1989**

To serve as an example for the public good, it is high time that the court should serve warning to the city or cities

concerned to be more conscious of their duty and responsibility to their constituents, especially when they are engaged in construction work or when there are manholes on their sidewalks or streets which are uncovered, to immediately cover the same, in order to minimize or prevent accidents to the poor pedestrians.

Too often in the zeal to put up “public impact” projects such as beautification drives, the end is more important than the manner in which the work is carried out. Because of this obsession for showing off, such trivial details as misplaced flower pots betray the careless execution of the projects, causing public inconvenience and inviting accidents.

**Prudenciado v. Alliance Transport System, Inc.
GR 33836, Mar. 16, 1987**

The rationale behind exemplary or corrective damages is to provide an example or correction for the public good.

A driver running at full speed on a rainy day, on a slippery road in complete disregard of the hazards to life and limb of other people cannot be said to be acting on anything less than gross negligence. The frequent incidence of accidents of this nature caused by taxi drivers, indeed, demands corrective measures.

(2) Examples of Exemplary Damages

- (a) Exemplary damages were imposed against a corporation which persisted in oppressively invading another’s rights despite “cease and desist orders” from the Public Service Commission. This imposition of exemplary damages would be a reminder that economic power will never justify a reckless disregard of the rights of others. (*Castro, et al. v. Ice and Cold Storage Industries, et al.*, L-10147, Dec. 27, 1958).
- (b) A victim shot in the jaw by the *minor* son of the defendant with the father’s gun was given an award of P18,000. The Court said that this will remind licensed possessors of firearms of their peremptory duty to adequately safeguard such dangerous weapons at all times, and to

take all requisite measures to prevent minors and other unauthorized parties from having access thereto. Moreover, competent observers have recently called attention to the fact that the growing teenage hooliganism in our society is principally due to parent's complacency in and neglect of their progeny. (*Araneta, et al. v. Arreglado, et al.*, 104 Phil. 529).

- (c) Exemplary damages in the amount of P2,000 was awarded in a case where the overseer of a mango store abused the confidence of a female customer by subjecting her to indignities. According to the Court, this bespeaks of a perverse nature, dangerous to the community. (*Doming-ding and Aranas v. Ng, et al.*, 103 Phil. 111).

[**NOTE:** If a mayor in *good faith* dismisses an employee although the former was *not* authorized, exemplary damages of P2,000 should be considered excessive, and must be reduced to P1,000. Exemplary damages, in a case like this, according to the Court, should be imposed only to curtail the abuses that some public officials are prone to commit upon coming to power, in utter disregard of the civil service rules which constitute the only safeguard of the tenure of office guaranteed by the Constitution. (*Diaz, et al. v. Amante, L-9228, Dec. 26, 1958*)].

People v. Erlindo Talo
GR 125542, Oct. 25, 2000

FACTS: Accused-appellant Erlindo Talo was charged and found guilty of forcible abduction with rape and sentenced to death and to pay complainant Doris Saguindang the amount of P30,000 as moral damages and costs of the suit.

HELD: The trial court's decision was upheld but the penalty was reduced to *reclusion perpetua* and with the damages awarded modified. In accordance with jurisprudence (*People v. Baid, GR 129667, Jul. 31, 2000; People v. Dreu, GR 126282, Jun. 20, 2000; and People v. Licanda, GR 134084, May 4, 2000*), complainant Saguindang must be paid P50,000 as civil indemnity, P50,000 as moral damages, and the additional amount of

P25,000 as exemplary damages, in view of the attendance of aggravating circumstances, pursuant to Art. 2229 of the Civil Code. (*See People v. Santos, GR 131103, and 143472, Jun. 29, 2000*).

- (d) If an employee commits a wrongful act, may his employer be required to pay exemplary damages? NO, except insofar as said employer had participated in or ratified the act. The rule is that exemplary damages are imposed primarily on the *wrongdoer* as a deterrent in the commission of similar acts in the future. Since exemplary damages are penal in character, the motive authorizing their infliction will not be imputed by presumption to the principal when the act is committed by an agent or servant. Inasmuch as they are granted not by way of compensation, but as a punishment to the offender and as a warning to others, they can only be awarded against one who has participated in the offense and the principal therefore cannot be held liable for them merely by reason of wanton, oppressive, or malicious intent on the part of the agent. Moreover in this jurisdiction, in case of crimes, exemplary damages may be imposed only when the crime is committed with one or more aggravating circumstances. (*Art. 2230, Civil Code and Rotea v. Halili, L-1203, Sep. 30, 1960*).

Phoenix Construction, Inc. v. IAC
GR 65295, Mar. 10, 1987

In a suit for damages arising from a quasi-delict where the plaintiff's negligence was contributory, the demands of substantial justice may be satisfied by allocating most of the damages (compensatory, moral, *lucro cesante* on a 20-80 ratio). Thus, 20% of the damage, awarded by the appellate court, except the award of P10,000 as exemplary damages and P4,500 as attorney's fees and costs, shall be borne by defendant driver. Only the balance of 80% needs to be paid by the driver and his employer who shall be solidarily liable therefor to the plaintiff. The award of exemplary damages shall be borne exclusively by the defendants. The employer, of course, is entitled to reimbursement from the driver.

(3) Proper Court

If the amount of exemplary damages is NOT specific the court can grant same only in an amount that should NOT exceed its jurisdiction. (*Singson, et al. v. Aragon, et al.*, 92 Phil. 514).

(4) Effect of Granting Exemplary Damages on a Claim for Nominal Damages

If exemplary damages are granted, nominal damages can not be given. (*Medina, et al. v. Cresencia, et al.*, L-8194, Jul. 11, 1956).

(5) Cases

**Pan American World Airways, Inc.
v. IAC, et al.
L-74442, Aug. 31, 1987**

A contract to transport passengers is quite different in kind and degree from any other contractual relation. And this is because of the relation which an air carrier sustains with the public. Its business is mainly with the travelling public. It invites people to avail of the comforts and advantages it offers. The contract of carriage, therefore, generates a relation attended with a public duty. Neglect or malfeasance of the carrier's employees, naturally, could give ground for an action for damages.

By not allowing Ms. Teofista P. Tinitigan to board Flight 431 on April 29, 1973, plaintiff was not able to sign a contract with Mrs. Lilibeth Warner who had earlier placed an order for a sizeable number of "capiz" shells in which transaction Ms. Tinitigan expected to derive a profit of US\$1,000. Ms. Tinitigan had to return to the Hotel El Embajador from the aircraft costing her US\$20. She had to pay for additional accommodations in said hotel for US\$26.15 and the damage to her personal property amounted to US\$600. The carrier, Pan American World Airways, Inc. should be held liable to Ms. Tinitigan in the amount of US\$1,646.15 or its equivalent in Philippine currency at the present rate of exchange as actual or compensatory damages. Pan Am having breached

its contract with Ms. Tinitigan in bad faith, it is not error for the trial court to have awarded exemplary damages. The rationale behind exemplary or corrective damages is, as the name implies, to provide an example or correction for public good. In view of its nature, it should be imposed in such amount as to sufficiently and effectively deter similar breach of contract in the future by Pan Am and other airlines.

Arturo de Guzman v. NLRC
GR 90856, Jul. 23, 1992

When moral damages are awarded, exemplary damages may also be decreed. Exemplary damages are imposed by way of example or correction for the public good, in addition to moral, temperate, liquidated or compensatory damages.

According to the Code Commission, “exemplary damages are required by public policy, for wanton acts must be suppressed. They are an antidote so that the poison of wickedness may not run through the body politic.” These damages are legally assessible against him.

Sociedad Europea de Financiacion,
S.A., et al. v. Court of Appeals
GR 75787, Jan. 21, 1991

FACTS: Muñoz, representing a New York business firm, Carum Trading, Inc. gave Rocha US\$40,000 to open an insurance company in the Philippines. With the money, Rocha organized the Capital Insurance. Under Rocha’s direction, the company prospered. A sister corporation, Capital Life, was later set up by Rocha. In 1958, Rocha transferred all the Capital Insurance shares to Carum Trading. Garrido replaced Rocha in the insurance corporation. Effective control over Capital Insurance then passed to the hands of Sociedad Europea de Financiacion (SEF). Garrido exercised that control, and was named General Manager of the insurance firms. He also served as director of the companies, together with Muñoz, Amat, Araneta and Gamboa. In 1966, Garrido and Araneta proposed to the Board of Directors that Capital Insurance obtain a loan of P600,000 from progressive Bank, so that a better financial position could be projected when

renewal was sought of the license of its sister corporation Capital Life. Security of the loan would consist of the SEF shares in Capital Insurance. Garrido and Araneta also gave assurance that the loan will not be used and would instead be placed on time deposit in Progressive Bank. The assurance was of considerable weight since Progressive was owned by Araneta and his family, and Garrido was himself a director thereof. The Board approved the arrangement and the loan was obtained with maturity of 90 days and interest at 11% per annum. The money was deposited in favor of Capital Life. In 1966, Garrido, as Capital Life President, executed a deed assigning to Progressive all the rights of Capital Life in said time deposit and granted Progressive full control of the deposit of P600,000. On the pretext that the loan was unpaid, Progressive caused the foreclosure of the pledged SEF shares and its sale at public auction through a notary public, resulting in said shares being auctioned off to Progressive. SEF, Muñoz and Amat filed a derivative suit against Garrido, Araneta and Progressive. They sued in their own behalf and in behalf of Capital Insurance and prayed for annulment of the loan and the accompanying pledge of SEF stock on the ground of breach of trust on the part of Garrido, Araneta and the latter's bank. They also accused Garrido and Araneta of mismanagement of the corporation and prayed for damages. The trial court declared the loan and foreclosure null and void. It ordered the return of the shares to Capital Insurance, while Garrido, Araneta and Progressive were sentenced to pay P100,000 as exemplary or corrective damages. The Court of Appeals affirmed the judgment of the trial court.

HELD: The Supreme Court modified the judgment so as to increase to P600,000 the exemplary or corrective damage that Garrido, et al. were sentenced, jointly and severally, and held that it finds inexplicable, not to say ludicrous, unjust and inequitable, to hold petitioners liable to the Progressive Bank for anything on account of the latter's so-called "accommodation loan" of P600,000, considering that: (1) the proceeds of the loan were immediately placed on time deposit with the same lending institution; (2) a day after its placement, the time deposit was assigned to the same Bank, together with all rights to the interest thereon, full control of the

deposit being given to said Bank until the accommodation loan was fully paid; (3) the Bank was at no time under any risk whatsoever, for an “accommodation” that it could recall at its pleasure because it retained total control of the loan proceeds under time deposit with it; (4) while retaining full disposition of the amount fictitiously loaned, said Bank reserved and did exercise rights proper and appropriate only to the lender under a genuine forbearance, such as charging interests and later, even foreclosing on the security for alleged nonpayment; there is no evidence that it ever set off interests on the loan with interests that the time deposit should justly have earned, only fair arrangement in the circumstances; (5) as found by the trial court and affirmed by the Court of Appeals, the loan and accompanying pledge were simulated and the bank was a party to the simulation. The Court feels that the award of P100,000 in exemplary or corrective damages lets the respondents off too lightly for the part they played in this affair. Both the trial court and the Court of Appeals found that the defendants had concocted a scheme “to divest SEF of its interests in capital insurance and for themselves to own the controlling interest therein,” and carried out that illicit objective. Said award of damages should be increased to P600,000.

Northwest Airlines v. Dr. Jaime F. Laya
GR 145956, May 29, 2002

FACTS: Respondent Dr. Jaime F. Laya, a medical practitioner, was bound for San Francisco *via* a first class booking with Northwest Airlines (NWA). After his luggage passed and was cleared thru the x-ray machine of the Ninoy Aquino International Airport (NAIA). Laya proceeded to NWA’s check-in counter and was issued a boarding pass. However, while on his way requested to proceed to a long table where passengers were lined up. There, the passenger’s Samsonite hand-carried attaché cases were being subjected to further inspection. Since he noticed that he was carrying an attaché case similar to those being inspected, Laya acceded to the request.

In the course of the inspection, however, Laya noticed that his attaché case was treated differently. While the other passengers were eventually allowed to carry their cases on

board the plane, he was asked to place his attaché case in a black garbage bag for which he was handed two paper envelopes where he could put its contents. Laya felt that he was singled out for this extraordinary treatment. His situation was aggravated when the envelopes turned out to be too fragile for the contents of his attaché case. The envelopes were eventually torn. Laya asked for a replacement and provided with a used Duty-Free bag.

On May 25, 1991, Laya wrote to NWA and reported the rude treatment accorded him by its personnel. An exchange of communication ensued but NWA did not heed his complaint. On Oct. 31, 1991, he filed a complaint for damages against NWA before Br. 84 of RTC QC. After trial, judgment was rendered in favor of Laya, and against NWA. Both parties appealed the decision. NWA appealed the unfavorable ruling against it while Laya appealed the award in his favor of only P1 million as moral damages and P500,000 exemplary damages. In its decision, promulgated on Aug. 16, 2000, the Court of Appeals (CA) affirmed the trial court with modifications by reducing the award of moral damages to P500,000 and the exemplary damages to P250,000.

Its motion for reconsideration having been denied, NWA went to the Supreme Court for relief, alleging the CA: (1) gravely erred in ruling that respondent is entitled to the award of damages, and (2) not ruling that the lower court erred in finding that the United States Federal Aviation Administration (FAA) Security Directive 91-11 is unreasonable and did not coincide with the carrier's promise of polite and gracious service.

HELD: The Supreme Court is convinced that Laya suffered mental anguish and serious anxiety because of his experience with NWA personnel for which he should be awarded moral damages. He is also entitled to exemplary damages by way of correction to the NWA for the public good (*Art. 2229, Civil Code*) and in view of the malevolent manner by which the NWA personnel treated him. Damages are not intended to enrich a plaintiff at the expense of the defendant (*See Philtranco Services, Inc. v. CA, 273 SCRA 562 [1987]*), hence, the Court is further reducing the award of moral damages from P500,000 to P100,000 and the amount of exemplary

damages is reduced from P250,000 to P50,000. The Court likewise awards attorney's fees in the amount of P25,000. (*Art. 2208, Civil Code*).

On the other point raised in the instant case, the Supreme Court opined that the tragic event that unfolded on Sept. 11, 2001 underscores, more than ever, that airport and airline personnel cannot afford any lapse in the implementation of security measures mean to ensure the safety of airplane crew and passengers. Airline carriers hold the lives of passengers in their hands and they must at all times be vigilant on matters affecting their safety.

After a careful review of the records of this case, the Court finds that the security procedures adopted issued by the NWA was only the result of a directive issued by the FAA of which the NWA, being a U.S. carrier, is subject to FAA Security Directive 91-11, which was in effect at the time of the incident. Thus, on the action required by U.S. Air Carriers the following procedures, in part, shall be applied to all hardshell black, brown, or burgundy samsonite briefcase by all U.S. air carrier on flights departing Asia, Africa, and Europe. All black, brown, or burgundy Samsonite briefcases shall only be transported as check baggage. The air carrier shall deny the passenger any access to the briefcase after it has been tendered until the briefcase is claimed by the passenger upon arrival at destination. Following the application of the procedures above, the briefcase, shall be transported as checked baggage. However, the contents of the briefcase may be returned to the passenger for personal use aboard the flight.

It may be true that Laya was greatly inconvenienced by the act of the NWA when his attaché case was subjected to further inspection and not allowed to bring it on board the plane. Nevertheless, while the protection of passengers must take precedence over convenience, the implementation of security measures must be attended by basic courtesies. The Court is inclined to believe the testimony of Laya that the personnel who examined his attaché case were rude, brusque, arrogant, and domineering. On this score, the Supreme Court agrees with the trial court and the CA in stating that "[a]ny security measure must coincide with the passenger's right to

be treated by the carrier with kindness, respect, and utmost consideration in all matters relative to his trip.”

Art. 2230. In criminal offenses, exemplary damages as a part of the civil liability may be imposed when the crime was committed with one or more aggravating circumstances. Such damages are separate and distinct from fines and shall be paid to the offended party.

COMMENT:

Exemplary Damages in Criminal Offenses

If a driver, in a criminal case, is convicted and made civilly liable, but *exemplary* damages are NOT IMPOSED, the employer *cannot* in a subsequent case brought to recover *subsidiary* civil liability against him — be made liable for *exemplary* damages. As Justice JBL Reyes has aptly pointed out — “No such damages were imposed on the driver, and the master, as person subsidiarily liable, *cannot* incur greater civil liability than his convicted employee, any more than a guarantor can be held responsible for more than the principal debtor. (Cf. *Civil Code, Art. 2064*).” (*Vicente Bantoto, et al. v. Salvador Bobis, et al. & Crispin Vallejo, L-18966, Nov. 22, 1966*).

Art. 2231. In quasi-delicts, exemplary damages may be granted if the defendant acted with gross negligence.

COMMENT:

Exemplary Damages in Quasi-Delicts

Here the defendant must have acted with GROSS NEGLIGENCE. And even then, the grant is only *discretionary* on the part of the Court.

Art. 2232. In contracts and quasi-contracts, the court may award exemplary damages if the defendant acted in a wanton, fraudulent, reckless, oppressive, or malevolent manner.

COMMENT:**(1) Exemplary Damages in Contracts and Quasi-Contracts**

Under Art. 2232, exemplary damages may be awarded in contracts and quasi-contracts if defendant acts in a wanton, fraudulent, reckless, oppressive, or malevolent manner. (*MOF Co. v. Enriquez*, GR 149280, May 9, 2002).

(2) When Employer Is Also Liable for Exemplary Damages**Lourdes Munsayac v. Benedicta de Lara
L-21151, Jun. 26, 1968**

FACTS: A driver of a jeepney was found recklessly negligent in causing injuries to his passenger. Is the owner-operator of the jeepney liable for *exemplary* damages (in addition to other kinds of damages)?

HELD: Not necessarily. A principal or master can be held liable for exemplary or punitive damages based upon the wrongful act of his agent or servant only when he *participated* in the doing of such wrongful act or has *previously authorized* or *subsequently ratified* it, with full knowledge of the facts. Exemplary damages punish the intent — and this cannot be presumed on the part of the employer merely because of the wanton, oppressive, or malicious intent on the part of the agent.

**Silverio Marchan and Philippine Rabbit Bus
Co., Inc. v. Arsenio Mendoza, et al.
L-24471, Jan. 31, 1969**

FACTS: The driver of a common carrier, *thru gross or reckless negligence* caused injury to some of the passengers. *Issue:* May exemplary or corrective damages be awarded?

HELD: Yes, exemplary damages *may* be awarded in *contracts* and *quasi-contracts* if the defendant company, *thru* its driver, acted in a “wanton, fraudulent, *reckless*, oppressive or malevolent manner.” (*Art. 2232; see also Laguna-Tayabas Bus Co. v. Diasanta*, L-19882, Jun. 30, 1964).

Noda v. Cruz-Arnaldo
GR 67322, Jun. 22, 1987

The insured's claim or demand for exemplary damages cannot be sustained if he fails to show that the insurer, in contesting payment, had acted in a wanton, oppressive or malevolent manner to warrant the imposition of corrective damages.

Art. 2233. Exemplary damages cannot be recovered as a matter of right; the court will decide whether or not they should be adjudicated.

COMMENT:

Exemplary Damages Not a Matter of Right

The grant is *discretionary*. Be it noted, however, that in the Court's discretion, the same may be granted even if not *expressly pleaded or prayed for*. (See *Singson v. Aragon*, 92 *Phil.* 514).

Isabelita Vital-Gozon v.
CA & Alejandro dela Fuente
GR 129132, Jul. 8, 1998

Under Art. 2233, exemplary damages cannot be recovered as a matter of right; the court will decide whether or not they should be adjudicated.

Considering that a public official is the culprit here, the propriety of such an award cannot be questioned. It serves as an example or deterrent so that other public officials be always reminded that they are public servants bound to adhere faithfully to the constitutional injunction that a public office is a public trust. That the aggrieved party happened to be another public official will not serve to mitigate the effects of petitioner's having failed to observe the required degree of accountability and responsibility.

Art. 2234. While the amount of the exemplary damages need not be proved, the plaintiff must show that he is entitled to moral, temperate or compensatory damages before

the court may consider the question of whether or not exemplary damages should be awarded. In case liquidated damages have been agreed upon, although no proof of loss is necessary in order that such liquidated damages may be recovered, nevertheless, before the court may consider the question of granting exemplary in addition to the liquidated damages, the plaintiff must show that he would be entitled to moral, temperate or compensatory damages were it not for the stipulation for liquidated damages.

COMMENT:

(1) Amount of Exemplary Damages Need Not Be Proved

Exemplary damages need NOT be *alleged* and *proved* (*Singson, et al. v. Aragon, et al.*, 92 Phil. 514) but note the *conditio sine qua non* in the article.

(2) Culpa Contractual

In a case of *culpa contractual*, while diligence of a good father of a family in selecting and supervising employees is NOT a proper or complete defense for the employer, still it is *important* that such damages be shown or proved: firstly, because the damages may be mitigated or decreased; and secondly, because if this diligence be *not* shown, exemplary damages may be charged against the employer. (*See Villa Rey Transit v. Bello, L-18957, Apr. 23, 1963*).

(3) Case

**Philippine National Bank v. CA, Spouses Antonio
So Hu & Soledad del Rosario and Spouses
Mateo Cruz & Carlita Ronquillo
GR 126908, Jan. 16, 2003**

FACTS: Spouses So Hu have not sufficiently proved that PNB acted maliciously and in bad faith when it foreclosed the property. On the contrary, PNB believed, although mistakenly, that it still had an unpaid claim for which the property stood as a security.

HELD: Records do not support any basis for awarding moral damages to private respondents, spouses So Hu. Such damages, to be recoverable, must be the proximate result of a wrongful act or omission the factual basis for which is satisfactorily established by the aggrieved party. (*Expertravel & Tours, Inc. v. CA*, 309 SCRA 141 [1991]).

Art. 2235. A stipulation whereby exemplary damages are renounced in advance shall be null and void.

COMMENT:

The Renouncing in Advance of Exemplary Damages

This renouncing is NULL and VOID.

TITLE XIX

CONCURRENCE AND PREFERENCE OF CREDITS

Chapter 1

GENERAL PROVISIONS

Introductory Comment (Features of the Title)

“The title on ‘Concurrence and Preference of Credits’ characterized by four (4) features:

- (1) the liens and mortgages with respect to specific movable and immovable property have been increased;
- (2) the proposed Civil Code and the Insolvency Law have been brought into harmony;
- (3) preferred claims as to the free property of the insolvent have also been augmented; and
- (4) the order of the preference laid down in articles 1926 and 1927 of the Civil Code, among claims with respect to specific personal and real property, has been *abolished*, except that taxes must first be satisfied.” (*Report of the Code Commission, pp. 163-164*).

Art. 2236. The debtor is liable with all his property, present and future, for the fulfillment of his obligations, subject to the exemptions provided by law.

COMMENT:

(1) What Creditor Can Do if Debtor Has NO Money

If a debtor has no money, what can the creditor do to collect the credit?

ANS.:

- (a) attach properties not exempt from attachment, forced sale, or execution
- (b) exercise *accion subrogatoria* (the right to exercise all rights and actions except those inherent in the person)
- (c) exercise *accion pauliana* (impugn or rescind acts or contracts done by the debtor to defraud the creditors). (*Art. 1177; see Arts. 1380 to 1389*).
- (d) in certain cases ask for *datio in solutum*, *cession* (assignment in favor of creditors), *file insolvency proceedings* (provided all the requisite conditions are present)
- (e) wait till the debtor has money or property in the *future* (after all, liability is with present and future property).

[**NOTE:** The obligations must already be DUE. (*Jacinto v. De Leon*, 5 *Phil.* 992).]

(2) Examples of Properties Exempt from Attachment

- (a) the family home except in certain cases. (*Art. 155, Family Code*).
- (b) the right to support, annuities, pensions (in certain instances).
- (c) property in *custodia legis*. (*Springer v. Odlin*, 3 *Phil.* 348).
- (d) properties of a municipal corporation used *for governmental purposes*. (*Viuda de Tan Toco v. Mun. Council of Iloilo*, 49 *Phil.* 52).
- (e) in certain cases, homesteads acquired under the Public Land Act. (*See Beach v. PCC & Sheriff*, 49 *Phil.* 365).
- (f) those mentioned in Rule 39, Sec. 13, Rules of Court.

(3) Case

DBP v. Minister of Labor GR 75801, Mar. 20, 1991

FACTS: The Samahan, in representation of its 1,000 members, filed a complaint against Riverside Mills Corporation

for non-payment of Presidential Decree 1713's P1.00 daily wage increase and P60 monthly emergency cost of living allowance with the Ministry of Labor. The MOLE ordered Riverside to pay the complainant-Samahan additional mandatory ECOLA of P60 a month and P1.00 increase in the minimum wage, retroactive as of August 1981. Thereafter, the balance of the judgment award was computed at P3.3 million. It appears that the Development Bank of the Philippines had instituted extrajudicial foreclosure proceedings as early as 1983 on the properties and other assets of Riverside, as a result of the latter's failure to meet its obligations on the loan it had previously secured from DBP. Thereafter, Samahan sought to enforce the decision-award against DBP. A notice of garnishment was served upon DBP for the amount of P3.3 million.

ISSUE: Whether a writ of garnishment may be issued against the proceeds of Riverside's properties foreclosed by DBP and sold to Rosario Textile Mills, by the application of the worker's right of preference under Art. 110 of the Labor Code.

HELD: The Supreme Court set aside the order of the Ministry of Labor and held that the disputed garnishment of the money paid by Rosario to DBP corresponding to the partial installment of the sales price of RMC's foreclosed properties is not justified. The authority of the sheriff is limited to money or properties belonging to the judgment debtor in the labor case concerned. Hence, when the sheriff garnishes the moneys paid by the employer (Rosario Textile Mills) to Development Bank of the Philippines, the sheriff, in effect garnished funds not belonging to the employer but to the DBP. This is violative of the basic rule that the power of the court or tribunal in the execution of its judgment extends only over properties unquestionably belonging to the judgment debtor. Undoubtedly, when the sheriff garnished the funds belonging to the Development Bank of the Philippines, he exceeded the authority vested in him in the writ of execution, and when the Deputy Minister of Labor sustained the same in his order, he acted with grave abuse of discretion correctible by *certiorari*.

Art. 2237. Insolvency shall be governed by special laws insofar as they are not inconsistent with this Code.

COMMENT:**Civil Code Superior to Special Laws on Insolvency**

- (a) In *Velayo v. Shell Co. (Phil.)* (100 Phil. 187), the Supreme Court held that while the acts of a creditor who disposes of *his own credit*, and *not* the insolvent's property, but in a scheme to *remove* such property from the possession and ownership of the insolvent, may not come within the purview of Sec. 37 of the Insolvency Law which makes a person coming under it liable for double the value of the property sought to be disposed of, still said creditor can be so held liable for such damages under Arts. 2229, 2232, 2142 and 2143.
- (b) It is clear under the Article that in case of conflict, it is the Civil Code that prevails.

Art. 2238. So long as the conjugal partnership or absolute community subsists, its property shall not be among the assets to be taken possession of by the assignee for the payment of the insolvent debtor's obligations, except insofar as the latter have redounded to the benefit of the family. If it is the husband who is insolvent, the administration of the conjugal partnership or absolute community may, by order of the court, be transferred to the wife or to a third person other than the assignee.

COMMENT:**Exemption of Properties of the Conjugal Partnership or of the Absolute Community**

The exemption applies provided that:

- (a) the conjugal partnership or the absolute community subsists AND
- (b) the obligation did NOT redound to the benefit of the family.

Art. 2239. If there is property, other than that mentioned in the preceding article, owned by two or more persons, one of whom is the insolvent debtor, his undivided share

or interest therein shall be among the assets to be taken possession of by the assignee for the payment of the insolvent debtor's obligations.

COMMENT:

Rule in Case of Co-Ownership

The undivided share or interest shall be possessed by the assignee.

Art. 2240. Property held by the insolvent debtor as a trustee of an express or implied trust, shall be excluded from the insolvency proceedings.

COMMENT:

Property Held Because of an Express or Implied Trust

The reason for the exemption is obvious: the trustee is NOT the owner of the property held. Hence, it should *not* respond for the insolvent trustee's obligations.

Chapter 2

CLASSIFICATION OF CREDITS

Art. 2241. With reference to specific movable property of the debtor, the following claims or liens shall be preferred:

(1) Duties, taxes and fees due thereon to the State or any subdivision thereof;

(2) Claims arising from misappropriation, breach of trust, or malfeasance by public officials committed in the performance of their duties, on the movables, money or securities obtained by them;

(3) Claims for the unpaid price of movables sold, on said movables, so long as they are in the possession of the debtor, up to the value of the same; and if the movable has been resold by the debtor and the price is still unpaid, the lien may be enforced on the price, this right is not lost by the immobilization of the thing by destination, provided it has not lost its form, substance and identity, neither is the right lost by the sale of the thing together with other property for a lump sum, when the price thereof can be determined proportionally;

(4) Credits guaranteed with a pledge so long as the things pledged are in the hands of the creditor, or those guaranteed by a chattel mortgage, upon the things pledged or mortgaged, up to the value thereof;

(5) Credits for the making, repairs, safekeeping or preservation of personal property, on the movable thus made, repaired, kept or possessed;

(6) Claims for laborers' wages, on the goods manufactured or the work done;

(7) For expenses of salvage, upon the goods salvaged;

(8) Credits between the landlord and the tenant, arising from the contract of tenancy on shares, on the share of each in the fruits or harvest;

(9) Credits for transportation, upon the goods carried, for the price of the contract and incidental expenses, until their delivery and for thirty days thereafter;

(10) Credits for lodging and supplies usually furnished to travellers by hotel keepers, on the imovables belonging to the guest as long as such movables are in the hotel, but not for money loaned to the guests;

(11) Credits for seeds and expenses for cultivation and harvest advanced to the debtor, upon the fruits harvested;

(12) Credits for rent for one year, upon the personal property of the lessee existing on the immovable leased and on the fruits of the same, but not on money or instruments of credit;

(13) Claims in favor of the depositor if the depositary has wrongfully sold the thing deposited, upon the price of the sale.

In the foregoing cases, if the movables to which the lien or preference attaches have been wrongfully taken, the creditor may demand them from any possessor, within thirty days from the unlawful seizure.

COMMENT:

(1) Credits Over Specific Personal Properties

- (a) The order in this Article is NOT important.
- (b) What is important is that:
 - 1) those credits which enjoy preference with respect to *specific movables* exclude all others to the extent of the value of the personal property to which the preference refers (*Art. 2246*);
 - 2) if there are *two or more* credits with respect to the same specific movable property, they shall be satis-

fied *pro rata*, after the payment of duties, taxes and fees due the State or any subdivision thereof. (*Art. 2247*).

- 3) Duties, taxes, and fees due the Government enjoy priority only when they are with reference to a specific movable property, under Art. 2241(1) of the new Civil Code, or immovable property, under Art. 2242(1) of the same Code — with reference to the other real and personal property of the debtor, sometimes referred to as “free property,” the taxes and assessments due the National Government, other than those in Arts. 2241(1) and 2242(2) of the new Civil Code, will come only in *ninth place* in the order of preference. (*In Re: Petition for Assistance in the Liquidation of the Rural Bank of Bokod [Benguet], Inc., PDIC v. BIR, 511 SCRA 123 [2006]*).

(2) Example

Sonia has one car, the taxes on which have *not* yet been paid. Once, the car fell into the sea, was salvaged, was repaired, and has now been pledged with a creditor. If Sonia is insolvent and has not paid for any of the acts done on her car, how will the following be paid: the State, the person who salvaged it, the repairer, and the pledgee?

ANS.:

- (a) All said 4 credits have preference over the car to the exclusion of all other creditors. (*Art. 2246*).
- (b) The State will first be paid for taxes on the car. (*Art. 2247*).
- (c) The salvagor, the repairman, and the pledgee will all be paid *pro rata* from the remaining value of the car. (*Art. 2247*). There is no preference as among them; there is only a CONCURRENCE.

(3) Nature of the Claims or Credits

The claims or credits enumerated in Art. 2241 are considered:

- (a) pledges of personal property;
- (b) or liens within the purview of legal provisions governing insolvency. (*Art. 2243*).

[**NOTE:** As liens, they are considered *charges*; generally, unless otherwise stated, they are NOT possessory liens with the right of retention. (*See Graño v. Paredes, 50 Phil. 6*).]

(4) Par. 1 — Taxes, etc.

The duties, taxes, and fees referred to are those ON the specific movable concerned.

(5) Par. 3 — Unpaid Price of Movables SOLD

There are two liens referred to here:

- (a) *possessory* lien (as long as the property is still in the possession of the debtor)
- (b) *ordinary* lien on the PRICE (not a possessory lien) if the property has been resold and still *unpaid*. (*See Banco Español-Filipino v. Peterson, 7 Phil. 409 and Hunter, Kerr & Co. v. Murray, 48 Phil. 499*).

(6) Par. 4 — Pledge or Chattel Mortgage

Under the *old* law, the Court held that a repairer has preferential rights over a *chattel mortgage* of the same property; thus, the chattel mortgagee cannot get the property from the repairer without first paying for the services. (*Bachrach Motor Co. v. Mendoza, 43 Phil. 410; PCC v. Webb and Falcon, 51 Phil. 745 and Phil. Trust Co. v. Smith Navigation Co., 64 Phil. 830*).

It would seem, however, that the preference has now been *abolished* under Art. 2247 of the Civil Code.

(7) Par. 6 — Laborers' Wages

- (a) This applies only to *personal*, not to real property. (*The latter is governed by Par. 3 of Art. 2242*).

- (b) The laborer must have been employed by the owner of the goods, *not* by the contractor who in turn was employed to do the work. (*See Bautista v. Auditor General*, 97 Phil. 244).

(8) Last Paragraph — Wrongful Taking

This applies only when the debtor still OWNS the property wrongfully taken, not when he has lost ownership over the same. (*See Peña v. Mitchell*, 9 Phil. 588).

(9) Case

Ouano v. CA, et al. GR 95900, Jul. 23, 1992

Art. 667 of the Code of Commerce, the period during which the lien shall subsist is 20 days, has been modified by the Civil Code. Article 2241, whereof, provides that credits for transportation of the goods carried, for the price of the contract and incidental expenses shall constitute a preferred claim or lien on the goods carried until their delivery and for 30 days thereafter. During this period, the sale of the goods may be requested, even though there are other creditors and even if the shipper or consignee is insolvent. But this right may not be made use of where the goods have been delivered and were turned over to a third person without malice on the part of the third person and for a valuable consideration. In the present case, the cargo of cement was unloaded from the vessel and delivered to the consignee on Oct. 3, 1980, without any oral or written notice or demand having been made on respondent Supreme Merchant Construction Supply, Inc. for unpaid freight on the cargo. Consequently, after the lapse of 30 days from the date of delivery, the cargo of cement had been released from any maritime lien for unpaid freight.

Art. 2242. With reference to specific immovable property and real rights of the debtor, the following claims, mortgages and liens shall be preferred, and shall constitute an encumbrance on the immovable or real right:

- (1) Taxes due upon the land or building;**
- (2) For the unpaid price of real property sold, upon the immovable sold;**
- (3) Claims of laborers, masons, mechanics and other workmen, as well as of architects, engineers and contractors, engaged in the construction, reconstruction or repair of buildings, canals or other works, upon said buildings, canals or other works;**
- (4) Claims of furnishers of materials used in the construction, reconstruction, or repair of buildings, canals and other works, upon said buildings, canals or other works;**
- (5) Mortgage credits recorded in the Registry of Property, upon the real estate mortgaged;**
- (6) Expenses for the preservation or improvement of real property when the law authorizes reimbursement, upon the immovable preserved or improved;**
- (7) Credits annotated in the Registry of Property, in virtue of a judicial order, by attachments the executions, upon the property affected, and only as to later credits;**
- (8) Claims of co-heirs for warranty in the partition of an immovable among them, upon the real property thus divided;**
- (9) Claims of donors of real property for pecuniary charges or other conditions imposed upon the donee, upon the immovable donated;**
- (10) Credits of insurers, upon the property insured, for the insurance premium for two years.**

COMMENT:

(1) Credits Over Specific Real Properties

Comments Nos. 1 and 2 in the preceding article are applicable to this article, except that the reference to “movables” should now apply to “real property or immovables.” (*See Arts. 2248 and 2249, Civil Code*).

(2) Concurrence, Not Preference

Again, it must be stressed that *with* the sole exception of the State, the creditors with respect to the SAME specific immovable merely CONCUR; there is NO PREFERENCE. (*See Arts. 2248 and 2249, Civil Code*).

(3) Case

**Carried Lumber Co. v. ACCFA
L-21836, Apr. 22, 1975**

FACTS: The owner of a certain warehouse was indebted to two persons: the *mortgagee* thereof, and the *person who furnished materials* used in its construction. There are no other creditors. Is there a need for insolvency proceedings?

HELD: There is no need for insolvency proceedings, because the two credits can be satisfied PRO RATA from the amount that can be obtained in the foreclosure sale of the warehouse, applying Arts. 2242 and 2249 of the Civil Code.

(4) Refectionary Credit

This is a credit for the *repair* or *reconstruction* of something that had previously been made. (*See Art. 2242, No. 3*). Ordinarily, an entirely new work is *not* included, although Spanish jurisprudence appears to have sanctioned this broader conception in certain cases. (*Director of Public Works v. Sing Joco, 53 Phil. 205*).

(5) Case

**Atlantic Erectors, Inc. v. Herbal
Cove Realty Corp.
GR 146568, Mar. 20, 2003**

FACTS: Petitioner avers that its money claim on the cost of labor and materials for the townhouses it constructed on the respondent's land is a proper lien that justifies the annotation of a notice of *lis pendens* on the land titles. For

petitioner, the money claim constitutes a lien that can be enforced to secure payment for the said obligations. It argues that, to preserve the alleged improvement it had made on the subject land, such annotation on the property titles of respondent is necessary.

Respondent Herbal Cove, upon the other hand, argues that the annotation, is bereft of any factual or legal basis, because petitioner's complaint does not directly affect the title to the property, or the use of the possession thereof. It also claims that petitioner's complaint did not assert ownership of the property or any right to possess it. Respondent attacks as baseless the annotation of the Notice of *Lis Pendens* thru the enforcement of a contractor's lien under Art. 2242. It points out that the said provision applies only to cases in which there are several creditors carrying on a legal action against an insolvent debtor.

Petitioner proceeds on the premise that its money claim involves the enforcement of a lien and since the money claim is for the non-payment of materials and labor used in the construction of townhouses, the lien referred to would have to be that provided under Art. 2242, which describes a contractor's lien over an immovable property.

ISSUE: Whether or not money claims representing costs of materials for and labor on the houses constructed on property are a proper lien for annotation of *lis pendens* on the property title.

HELD: The pendency of a simple collection suit arising from the alleged non-payment of construction services, materials, unrealized income, and damages does not justify the annotation of a notice of *lis pendens* on the title to a property where construction has been done.

A careful examination of petitioner's complaint, as well as the relief it seeks, reveals that no such lien or interest over the property was ever alleged. The complaint merely asked for the payment of construction services and materials plus damages, without mentioning — much less asserting — a lien or an encumbrance over the property. Verily, it was a purely personal action and a simple collection case. It did

not contain any material avowment of any enforceable right, interest or lien in connection with the subject property. As it is, petitioner's money claim cannot be characterized as an action that involves the enforcement of a lien or an encumbrance, one that would warrant the annotation, of the Notice of *Lis Pendens*. Indeed, the nature of an action is determined by the allegations of the complaint. (*Producers Bank of the Phils. v. Bank of the Philippine Islands*, 340 SCRA 87 [2000] and *City of Olongapo v. Stallholders of the East Bajac-Bajac Public Market of Olongapo City*, 343 SCRA 705 [2000]).

Even assuming that petitioner has sufficiently alleged such lien or encumbrance in its complaint, the annotation of the Notice of *Lis Pendens* would still be unjustified, because a complaint for collection and damages is not the proper mode of the enforcement of a contractor's lien.

Clearly then, neither Art. 2242 nor the enforcement of the lien thereunder is applicable here, because petitioner's complaint failed to satisfy the requirement. Nowhere does it show that respondent's property was subject to the claims of other creditors or was insufficient to pay for all concurring debts. Moreover, the complaint did not pertain to insolvency proceedings or to any other action in which the adjudication of claims of preferred creditors could be ascertained.

Art. 2243. The claims or credits enumerated in the two preceding articles shall be considered as mortgages or pledges of real or personal property, or liens within the purview of legal provisions governing insolvency. Taxes mentioned in No. 1, Article 2241, and No. 1, Article 2242, shall first be satisfied.

COMMENT:

(1) Nature of the Claims or Credits

They are considered as pledges or mortgages.

(2) Comment of the Code Commission

"The question as to whether the Civil Code and the Insolvency Law can be harmonized is settled in this article. The

preference named in Arts. 2241 and 2242 are to be enforced in accordance with the Insolvency Law. Taxes on the specific property will be paid first.” (*Report of the Code Commission*, p. 164).

Art. 2244. With reference to other property, real and personal, of the debtor, the following claims or credits shall be preferred in the order named:

(1) Proper funeral expenses for the debtor, or children under his or her parental authority who have no property of their own, when approved by the court;

(2) Credits for services rendered the insolvent by employees, laborers, or household helpers for one year preceding the commencement of the proceedings in insolvency;

(3) Expenses during the last illness of the debtor or of his or her spouse and children under his or her parental authority, if they have no property of their own;

(4) Compensation due the laborers or their dependents under laws providing for indemnity for damages in cases of labor accident, or illness resulting from the nature of the employment;

(5) Credits and advancements made to the debtor for support of himself or herself, and family, during the last year preceding the insolvency;

(6) Support during the insolvency proceedings, and for three months thereafter;

(7) Fines and civil indemnification arising from a criminal offense;

(8) Legal expenses, and expenses incurred in the administration of the insolvent’s estate for the common interest of the creditors, when properly authorized and approved by the court;

(9) Taxes and assessments due the national government, other than those mentioned in Articles 2241, No. 1, and 2242, No. 1;

(10) Taxes and assessments due any province, other than those mentioned in Articles 2241, No. 1, and 2242, No. 1;

(11) Taxes and assessments due any city or municipality, other than those mentioned in Articles 2241, No. 1, and 2242, No. 1;

(12) Damages for death or personal injuries caused by a quasi-delict;

(13) Gifts due to public and private institutions of charity or beneficence;

(14) Credits which, without special privilege, appear in (a) a public instrument; or (b) in the final judgment, if they have been the subject of litigation. These credits shall have preference among themselves in the order of priority of the dates of the instruments and of the judgments, respectively.

COMMENT:

(1) Order of Preference in Connection With OTHER Properties

- (a) The order of preference here in Art. 2244 is VERY IMPORTANT. (*See Art. 2251*).
- (b) The order of preference here does *not* refer to specific real or personal property. It refers to *other property*.

(2) Example

A, an insolvent, owes P500,000 in favor of a funeral parlor, P1 million for the hospital expenses during the cancer illness of his late wife, and P100,000 in favor of a pedestrian whom he had hurt while driving his car carelessly and for which he was held criminally and civilly liable. Unfortunately, he has only P600,000 and an automobile, the purchase price of which he has *not* yet paid. Give the order of preference of the various creditors involved.

ANS.:

- (a) With respect to the automobile specific personal property the unpaid seller shall be preferred. (*Art. 2241*).

- (b) With respect to the P600,000 Art. 2244 (should be applied). The funeral parlor comes first, then the hospital, then the pedestrian. Here there is NO *pro rata* sharing; there is a *preference*. Therefore, the funeral parlor will be given P500,000; the hospital only P100,000. The hospital cannot recover the deficiency of P900,000; and the pedestrian cannot recover his P100,000.

(3) Taxes

Note that under Art. 2244, taxes (duties, assessments) are placed only as Nos. 9, 10, 11. This rule applies to property other than specific. If the property is *specific*, taxes are given first preference. (*See Arts. 2243, 2247, 2249*).

(4) Re Par. 14 (Ordinary Credits and Final Judgments)

It would seem here that an ordinary *credit* evidenced by a public instrument and a *final judgment* are placed on an EQUAL PLANE; hence, if both are of the *same date*, there will be a *pro rata* sharing.

(5) Some Decided Cases

Jesus Gigante v. Republic Savings Bank and Rolando Mallari L-29696, Nov. 29, 1968

FACTS: A parcel of land located in Caloocan City was registered in the name of Rolando Mallari, but a house thereon was in the name of his father, Dominador Mallari (in the tax assessment rolls of Caloocan City). However, the son, Rolando, declared the house to be in his name; he presented the tax declaration in his name, and had the tax declaration by his father cancelled.

On Apr. 23, 1959, Rolando borrowed P18,000 from the Republic Bank, with the *land and the house* as security in the form of a mortgage; the mortgage was duly registered on Apr. 24, 1959, Rolando *failed to pay the loan*; the Bank foreclosed on the mortgaged; the Bank then bought on Jun. 28, 1960 the land and the house, and a Torrens Transfer Certificate of Title was issued to it on Jul. 5, 1961.

In the meantime the father, Dominador, had borrowed from one Jesus Gigante P1,570. And on *May 6, 1958*, for failure to pay, Dominador was ordered to give Jesus the sum borrowed with interest and attorney's fees. Pursuant to a writ of execution, the Sheriff levied — on *May 29, 1961* — the house in question. Jesus bought the house at public auction on *Jun. 23, 1961*, and asked for a writ of possession. Neither judgment nor levy nor sale was recorded on the Torrens Title. The Bank blocked this writ of possession on the ground that it was already the owner of the land and the house. Jesus, alleging ownership to the house, now sues the Bank and Rolando on the ground that the transfer from Dominador to Rolando was fictitious and void, but Dominador was not made a party to the suit. *Issue*: Who should be considered the owner of the house?

HELD:

- (a) The Republic Bank should be considered the owner of the house (and of the land). *Reason*: The judgment, levy and sale in Jesus' favor is not *recorded* on the Torrens Title. Upon the other hand, the Bank's right is based on a real estate mortgage duly recorded on *Apr. 24, 1959*. The Bank's registered mortgage is thus *superior* to both said judgment and levy and sale. By virtue of the foreclosure sale, the land and the house cannot now be taken by Jesus. Note that the Bank never acted in bad faith.
- (b) The transfer of the house — alleged to be fictitious and fraudulent — from Dominador, the father, to Rolando, the son, cannot prosper — for Dominador, an *indispensable* party, is not a party to the present case. Dominador is entitled to be heard to defend the validity of the transfer to his son, Rolando.

Reyes v. De Leon
L-22331 Jun. 6, 1967

FACTS: To secure an obligation, a house owner sold it *a retro* to X (the evident purpose was to create an equitable mortgage). This sale *a retro* was *unrecorded*.

Later, the owner mortgaged the same property to Y. This time, the mortgage was registered. Which mortgagee is preferred?

HELD: The second mortgagee is preferred because the mortgage in his favor was registered. It would have been different had the equitable mortgage (in the guise of the *pacto de retro* sale) been registered.

Manabat v. Laguna Federation of Facomas
L-23888, Mar. 18, 1967

FACTS: Over a certain real property, several attachments and executions were annotated in the Registry of Property — the 1st for P17,000; the 2nd for P3,000; the 3rd for P12,000; and the 4th for P26,000. If a public sale is made and the property is sold for only P37,000, who should share in this amount of P37,000?

HELD: It is true that under the New Civil Code, there is no preference among specific creditors over the same property (except the government's preference as taxes over the specific property involved); instead, there merely is *pro rata* concurrence. BUT there is one exception to this: when there have been attachments and executions, there is *still preference* among them in order of time they were levied upon in the Registry; otherwise, the advantage of attachments and executions would be lost by the simple expedient of simply obtaining other attachments and executions, no matter how much later in point of time. Therefore, the P37,000 should satisfy first the first three attachments (total of P32,000). The excess P5,000 can now be applied to the 4th attachment.

DBP v. Hon. Labor Arbiter
Ariel C. Santos, et al.
GR 78261-62, Mar. 8, 1989

Owing to the fact that a *declaration* of bankruptcy or a *judicial liquidation* must be present before the worker's preference may be enforced, such is not confined to the situation contemplated in Arts. 2236-2245

of the Civil Code, where all the preferred creditors must necessarily be convened and the import of their claims ascertained.

Art. 2245. Credits of any other kind or class or by any other right or title not comprised in the four preceding articles, shall enjoy no preference.

COMMENT:

All Other Kinds of Credits

No preference — this is the rule indicated for these credits.

Chapter 3

ORDER OF PREFERENCE OF CREDITS

Art. 2246. Those credits which enjoy preference with respect to specific movables, exclude all others to the extent of the value of the personal property to which the preference refers.

COMMENT:

Preference of the Credits Over Specific Movables

See comments under Art. 2241.

Art. 2247. If there are two or more credits with respect to the same specific movable property, they shall be satisfied *pro rata*, after the payment of duties, taxes and fees due the State or any subdivision thereof.

COMMENT:

Pro Rata Sharing

See comments under Art. 2241.

Art. 2248. Those credits which enjoy preference in relation to specific real property or real rights, exclude all others to the extent of the value of the immovable or real right to which the preference refers.

COMMENT:

Preference of the Credits Over Specific Immovables

See comments under Art. 2242.

Art. 2249. If there are two or more credits with respect to the same specific real property or real rights, they shall be satisfied *pro rata*, after the payment of the taxes and assessments upon the immovable property or real right.

COMMENT:

Pro Rata Sharing

See comments under Art. 2242.

Art. 2250. The excess, if any, after the payment of the credits which enjoy preference with respect to specific property, real or personal, shall be added to the free property which the debtor may have, for the payment of the other credits.

COMMENT:

What Should Be Done With the Excess

The Article explains itself.

Art. 2251. Those credits which do not enjoy any preference with respect to specific property, and those which enjoy preference, as to the amount not paid, shall be satisfied according to the following rules:

- (1) In the order established in Article 2244;
- (2) Common credits referred to in Article 2946 shall be paid *pro rata* regardless of dates.

COMMENT:

Order of Preference

See comments under Art. 2244.

TRANSITIONAL PROVISIONS

Art. 2252. Changes made and new provisions and rules laid down by this Code which may prejudice or impair vested or acquired rights in accordance with the old legislation shall have no retroactive effect.

For the determination of the applicable law in cases which are not specified elsewhere in this Code, the following articles shall be observed.

COMMENT:

(1) Comment of the Code Commission (Re Non-Impairment of Vested Rights)

“Laws shall have no retroactive effect, unless the contrary is provided. The question of how far the new Civil Code should be made applicable to past acts and events is attended with the utmost difficulty. It is easy enough to understand the abstract principle that laws have *no* retroactive effect because vested or acquired rights should be respected. But what are vested or acquired rights? The Commission did not venture to formulate a definition of a vested or acquired right seeing that the problem is extremely complicated.

“What constitutes a vested or acquired right will be determined by the courts as each particular issue is submitted to them, by applying the transitional provisions sets forth, and in case of doubt, by observing Art. 9 governing the silence or obscurity of the law. In this manner, the Commission is confident that the judiciary with its enlightenment and high sense of justice will be able to decide in what cases the new one should be binding. This course has been preferred by the Commission, which did *not* presume to be able to foresee and adequately provide for each and every question that may rise.” (*Report of the Code Commission*, pp. 165-166).

(2) When Retroactivity Is Allowed

By implication, new provisions of the Code that do not prejudice vested rights can be given retroactive effect. Examples are those found in the chapter on Human Relations. (*Velayo v. Shell Co.*, 100 Phil. 187).

(3) ‘Vested Right’ Defined

In the case of *Benguet Consolidated Mining Co. v. Pineda* (L-7231, Mar. 28, 1951), the Supreme Court defined a vested right as property which has become fixed and established, and is no longer open to doubt or controversy. “It is an immediately fixed right of present or future enjoyment.” Rights are “vested” in contradistinction to being “expectant or contingent.” (See *Balboa v. Farrales*, 51 Phil. 498).

Under the Code of Commerce, a “*sociedad anonima*” could extend its corporate life; under the Corporation Law, corporate life cannot be extended beyond the original period; and said period must not exceed 50 years. Now then, if a “*sociedad anonima*” organized in 1903 could extend its corporate existence apparently without limit, could the Corporation Law passed in 1906 limit its life to 50 years? In the *Benguet Case*, the Court held that the answer was in the affirmative, for in 1903, the “*sociedad*” did *not* have any *vested right* to have a life longer than 50 years. The Court said that the prolongation of corporate existence in 1906 was merely a possibility *in futuro*, a contingency that did not fulfill the requirement of a vested right entitled to constitutional protection.

In said case, it was also held that there can be *no* vested interest in any rule of law entitling a person to insist that it shall remain *unchanged* for his benefit.

(4) Example of the Non-Impairment of a Vested Right

In *Manalansan v. Manalang, et al.* (L-13646, Jul. 26, 1960), it was held that Art. 1607 (requiring a judicial order before the registration of the consolidation of ownership in the vendee *a retro* for failure to redeem) *cannot* be applied to a sale *con pacto de retro* executed in 1949, for to do so would impair and diminish the rights that had already vested in the vendee *a retro* under the old Code.

Art. 2253. The Civil Code of 1889 and other previous laws shall govern rights originating, under said laws, from acts done or events which took place under their regime, even though this Code may regulate them in a different manner, or may not recognize them. But if a right should be declared for the first time in this Code, it shall be effective at once, even though the act or event which gives rise thereto may have been done or may have occurred under the prior legislation, provided said new right does not prejudice or impair any vested or acquired right, of the same origin.

COMMENT:

(1) Comment of the Code Commission (When the Old and the New Codes Apply)

“The first sentence is an application of the fundamental principle of respect for vested or acquired rights. But the second sentence gives a retroactive effect to newly created rights, provided they do not prejudice or impair any vested or acquired right. The retroactive character of the new right is the result of the exercise of the sovereign power of legislation, when the law-making body is persuaded that the new right is called for by considerations of justice and public policy. But such new right must *not* encroach upon a vested right.”
(*Report of the Code Commission*, p. 167).

(2) Recovery of Damages

Damages recoverable under Art. 21 can be given effect even if the acts complained of were done before the effective date of the new Code. (*Gatus v. Si Huy*, [C.A.] 53 O.G. 866).

(3) Successional Rights

New successional rights cannot be granted if the deceased died under the old Code, for ownership over the estate is transferred from the moment of death. Hence, a vested right was acquired upon such death under the old law. (*Uson v. Del Rosario, et al.*, 92 Phil. 530).

Art. 2254. No vested or acquired right can arise from acts or omissions which are against the law or which infringe upon the rights of others.

COMMENT:

(1) Comment of the Code Commission (Acts Contrary to Law)

“It is evident that no one can validly claim any vested or acquired right if the same is founded upon his having violated the law or invaded the rights of others. The principle is universally accepted.” (*Report of the Code Commission, p. 167*).

(2) Against Whom Prohibition Is Directed

The prohibition referred to in this Article is directed against the OFFENDER, not the offended party. Hence, if a husband *committed concubinage* prior to the effectivity of the new Civil Code, and an *absolute divorce* action was filed also *before* the new Civil Code, the case can continue now. The offended party in a sense acquired a vested right to still prosecute; the offender cannot, however, claim any vested right. (*Raymundo v. Penas, 96 Phil. 311*).

Art. 2255. The former laws shall regulate acts and contracts with a condition or period, which were executed or entered into before the effectivity of this Code, even though the condition or period may still be pending at the time this body of laws goes into effect.

COMMENT:

Acts and Contracts With a Condition or Period

- (a) The reason for the Article is that the legal relation was already created, although the condition or period is still pending. (*Report of the Code Commission, p. 167*).
- (b) Art. 1687 providing for an extension in lease cannot apply to lease contracts entered into prior to the new Civil

Code. (*Acasio v. Corporacion de los P.P. Dominicos de Filipinas*, 100 Phil. 523).

- (c) A sale *a retro* executed in 1949 is governed by the old Code, not by the new Civil Code. And this is so even if the resolutory condition of the repurchase was still pending at the time the new Civil Code became effective. (*Manalansan v. Manalang, et al.*, L-13646, Jul. 26, 1960).

Flores and Gallano v. So
L-28527, Jun. 16, 1988

Since the *pacto de retro* sale executed in Feb., 1950, before the effectivity of the New Civil Code in Aug. of 1950, was a contract with a resolutory condition, and the condition was still pending at the time the new law went into effect, the provisions of the old Civil Code would still apply.

Art. 2256. Acts and contracts under the regime of the old laws, if they are valid in accordance therewith, shall continue to be fully operative as provided in the same, with the limitations established in these rules. But the revocation or modification of these acts and contracts after the beginning of the effectivity of Code, shall be subject to the provisions of this new body of Laws.

COMMENT:

Revocation and Modification of Acts and Contracts

Reason for the second sentence — “These subsequent acts being executed after the new legislation has taken effect, the new requirements must of course be fulfilled.” (*Report of the Code Commission*, p. 168).

Art. 2257. Provisions of this Code which attach a civil sanction or penalty or a deprivation of rights to acts or omissions which were not penalized by the former laws, are not applicable to those who, when said laws were in force, may have executed the acts or incurred in the omission forbidden or condemned by this Code.

If the fault is also punished by the previous legislation, the less severe sanction shall be applied.

If a continuous or repeated act or omission was commenced before the beginning of the effectivity of this Code, and the same subsists or is maintained or repeated after this body of laws has become operative, the sanction or penalty prescribed in this Code shall be applied, even though the previous laws may not have provided any sanction or penalty therefor.

COMMENT:

(1) Comment of the Code Commission (Re: Civil Sanctions and Penalties)

“The article is just, for penalties and forfeitures with a retroactive effect cannot be countenanced. The last paragraph is just, for the reason that when continuous or repeated acts, though begun before the new Civil Code, extend beyond the termination of the old Code, the effect of the new body of laws must necessarily apply to them.” (*Report of the Code Commission, p. 168*).

(2) Application of the Less Severe Sanction

**Receiver for North Negros Sugar Co.,
Inc. v. Ybañez
L-22183, Aug. 30, 1968**

FACTS: In 1937, Cesar V. Ybañez, riding in a car, was killed in a collision with a train owned by the North Negros Sugar Company. The mishap having been caused by the train’s negligence, the Sugar Company was held liable for actual damages such as lost earnings, death indemnity, and funeral expenses, and said damages were paid to a brother, Pedro Ybañez. The brother, however, also asked for MORAL DAMAGES, because of the mental anguish suffered by him. *Issue:* Should said moral damages be granted the brother?

HELD: The accident having taken place in 1937, the old Civil Code (*Art. 1902*) should be applied. Under said Article, *apparently* any one who suffered, whether he was a relative or

not, and even if the damage was only moral, could recover (in view of the *generality of the Article*). In view of the absence of a precedent in Spanish and Filipino jurisprudence, reference was made to French decisions of persuasive authority (since Art. 1383 of the French Civil Code was more or less identical with Art. 1902 of the old Civil Code). Under French decisions, under Article 1383 of the French Civil Code, moral damages were awarded to *brothers and sisters*, among others. If we were to stop here, the brother would be entitled to recover moral damages for the death of the victim. BUT under Art. 2257 of the new Civil Code, if an act is punished both under the *old* and the *new legislation*, the “*less severe sanction shall be applied.*”

Now then under Art. 2206 of the new Civil Code, those who can recover *moral damages* for DEATH caused by a *crime or quasi-delict* includes *only the spouse, ascendants* (whether legitimate or illegitimate) and *descendants* (whether legitimate or illegitimate); note that brothers and sisters are NOT INCLUDED. Inasmuch as the new Civil Code is *less severe* on this point, it should be applied; hence, the brother *cannot* obtain the moral damages sought.

(3) Moral and Exemplary Damages

In the case of *Jalandoni v. Martin Guanzon, et al.*, (54 O.G. 2907), the Court said that the *moral and exemplary* (corrective) *damages* allowed under the new Civil Code cannot be given for acts that occurred prior to the new Civil Code. The *reason* is because of their deterrent, punitive character.

Art. 2258. Actions and rights which came into being but were not exercised before the effectivity of this Code, shall remain in full force in conformity with the old legislation; but their exercise, duration and the procedure to enforce them shall be regulated by this Code and by the Rules of Court. If the exercise of the right or of the action was commenced under the old laws, but is pending on the date this Code takes effect, and the procedure was different from that established in this new body of laws, the parties concerned may choose which method or course to pursue.

COMMENT:**Actions and Right Under the Old Law, Whether Exercised or Not**

“The article makes the new provisions on the exercise, duration, and procedure to enforce rights applicable to those that came into being before the effectivity of the new Code. In other words, the adjective law whereby such rights are put into operation is made retroactive. Adjective provisions may be properly made retroactive according to the principle accepted in modern legislation. These adjective rules are mere methods for rendering substantive law effective.” (*Report of the Code Commission, p. 169*).

Art. 2259. The capacity of a married woman to execute acts and contracts, is governed by this Code, even if her marriage was celebrated under the former laws.

COMMENT:**Capacity of a Married Woman**

Note that the new Family Code governs said capacity. This is true *even if* the marriage was celebrated under the old laws.

Art. 2260. The voluntary recognition of a natural child shall take place according to this Code, even if the child was born before the effectivity of this body of laws.

COMMENT:**Voluntary Recognition of a Natural Child**

The Article explains itself. See the Family Code.

Art. 2261. The exemption prescribed in Article 302 shall also be applicable to any support, pension or gratuity already existing or granted before this Code becomes effective.

COMMENT:**Exemption for Support, Pension, or Gratuity**

“As an aftermath of the last World War, there are thousands of persons receiving pension. The foregoing Article is calculated to protect them.” (*Report of the Code Commission, p. 170*).

Art. 2262. Guardians of the property of minors, appointed by the courts before this Code goes into effect, shall continue to act as such, notwithstanding the provisions of Article 320.

COMMENT:**Guardians of the Property of Minors**

“These guardians should continue as such, to avoid disturbances in the administration of property of minor children.” (*Report of the Code Commission, p. 170*).

Art. 2263. Rights to the inheritance of a person who died, with or without a will, before the effectivity of this Code, shall be governed by the Civil Code of 1889, by other previous laws, and by the Rules of Court. The inheritance of those who, with or without a will, die after the beginning of the effectivity of this Code, shall be adjudicated and distributed in accordance with this new body of laws and by the Rules of Court; but the testamentary provisions shall be carried out insofar as they may be permitted by this Code. Therefore, legitimes, betterments, legacies and bequests shall be respected; however, their amount shall be reduced if in no other manner can every compulsory heir be given his full share according to this Code.

COMMENT:**(1) Successional Rights**

“The decisive fact which gives origin to the right of the heirs, devisees, and legatees is the DEATH of the decedent.

This is the basis of the foregoing rule. No heir, devisee, or legatee has any vested right until the moment of such death.” (*Report of the Code Commission, p. 170*).

(2) Proofs of Filiation

Proofs of filiation allowed under the new Code are useless in the case of natural child claiming recognition in order to inherit from an alleged natural father who died BEFORE the new Civil Code became effective. (*Vidaurrazaga v. Court of Appeals, et al., 91 Phil. 492*). (See, however, the *Family Code*).

Art. 2264. The status and rights of natural children by legal fiction referred to in Article 89 and illegitimate children mentioned in Article 287, shall also be acquired by children born before the effectivity of this Code.

COMMENT:

See the Family Code.

Art. 2265. The right; of retention of real or personal property arising after this Code becomes effective, includes those takings which came into the creditor’s possession before said date.

COMMENT:

Right of Retention of Real or Personal Property

The Article explains itself.

Art. 2266. The following shall have not only prospective but also retroactive effect:

(1) Article 315, whereby a descendant cannot be compelled, in a criminal case, to testify against his parents and ascendants;

(2) Articles 101 and 88, providing against collusion in cases of legal separation and annulment of marriage;

(3) Articles 283, 284, and 289, concerning the proof of illegitimate filiation;

(4) Article 838, authorizing the probate of a will on petition of the testator himself;

(5) Articles 1359 to 1369, relative to the reformation of instruments;

(6) Articles 476 to 481, regulating actions to quiet title;

(7) Articles 2029 to 2031, which are designed to promote compromises.

COMMENT:

Provisions Which Have Both Prospective and Retroactive Effect

Reason — These are “*remedial*” in character and do not affect substantive rights already acquired. (*Report of the Code Commission*, p. 172).

Art. 2267. The following provisions shall apply not only to future cases but also to those pending on the date this Code becomes effective:

(1) Article 29, relative to criminal prosecutions wherein the accused is acquitted on the ground that his guilt has not been proved beyond reasonable doubt;

(2) Article 33, concerning cases of defamation, fraud and physical injuries.

COMMENT:

Provisions Appertaining to Procedure

The Article explains itself.

Art. 2268. Suits between members of the same family which are pending at the time this Code goes into effect shall be suspended, under such terms as the court may determine, in order that a compromise may be earnestly

sought, or, in case of legal separation proceedings, for the purpose or effecting, if possible, a reconciliation.

COMMENT:

See the Family Code.

Art. 2269. The principles upon which the preceding transitional provisions are based shall, by analogy, be applied to cases not specifically regulated by them.

COMMENT:

(1) Application by Analogy of the Transitional Principles

“The Article is calculated to cover cases other than those specifically regulated by the transitional provisions. The Court will be able by analogy, to decide every question that may come up as regards the applicability of the old laws or of the new Code.” (*Report of the Code Commission, p. 174*).

(2) Rule in Case of Conflict

In case of *conflict* between this chapter, and specific transitional provisions elsewhere in the Civil Code, the specific provisions will naturally apply. (*Art. 2252, par. 2*).

REPEALING CLAUSE

Art. 2270. The following laws and regulations are hereby repealed:

(1) Those parts and provisions of the Civil Code of 1889 which are in force on the date when this new Civil Code becomes effective;

(2) The provisions of the Code of Commerce governing sales, partnership, agency, loan, deposits and guaranty;

(3) The provisions of the Code of Civil Procedure on prescription as far as inconsistent with this Code; and

(4) All laws, Acts, parts of Acts, rules of court, executive orders, and administrative regulations which are inconsistent with this Code.

Approved, June 18, 1949.

COMMENT:

(1) When Spanish Civil Code Was Repealed

The Spanish Civil Code of 1889 was repealed on August 30, 1950, the date of effectivity of the new Civil Code. (*See Lara v. Del Rosario, 50 O.G. 1957 and Daney & Aznar v. Garcia & Comporendondo, L-11483, Feb. 14, 1958*).

(2) What the New Civil Code Does Not Repeal

The new Civil Code has not “superseded the Administrative Code of Mindanao and Sulu, or the Public Land Law, since these statutes are, in this regard, SPECIAL ACTS, and implied repeals are not favored.” Therefore, a deed of sale of real property executed by a non-Christian inhabitant of Mindanao or Sulu, without the approval of the provincial governor, or his representative duly authorized in writing for

the purpose as required by Sec. 145(b) of the Administrative Code of Mindanao and Sulu, is *null and void ab initio* — unless of course there should be a *special law* repealing such provision. (*See Mangayco, et al. v. Lasud, et al.*, L-19252, May 29, 1964).

(3) Complete Repeal of the Civil Code of 1889

Note that the Spanish Civil Code of 1889 is *completely repealed* with respect to the provision of said Code still in force on the effective date of this new Code. Those provisions of said Spanish Civil Code no longer in force were either repealed previously or had never been enforced here.

(4) The Family Code

Executive Order 209, as amended by EO 227, is otherwise known as “The Family Code of the Philippines.” Said Code has practically amended about 80% of the Civil Code’s provisions on family relations (marriage, legal separation, rights and obligations between husband and wife, the family, paternity and filiation, adoption, support, parental authority, emancipation and age of majority). Added were Titles XI and XII, respectively, dealing with Summary Judicial Proceedings in the Family Law and Final Provisions.

CIVIL CODE of the PHILIPPINES ANNOTATED

By

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*Associate Justice, Supreme Court
(1986-1992)*

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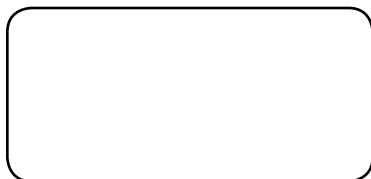
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To my dearly beloved wife Gloria,[†] my loving children Emmanuel, Edgardo, Jr., and Eugene; my caring daughter-in-law Ylva Marie, and my intelligent grandchildren Yla Gloria Marie and Edgardo III — in all of whom I have found inspiration and affection — I dedicate this humble work.

PUBLISHER'S PREFACE TO THE 2008 EDITION

The family of the late–revered Supreme Court Justice Edgardo L. Paras (who died in the grace of our Lord on September 3, 1994) would like to express their gratitude to the users of this book, now on its 16th edition, for continued patronage.

Law practice is a continuing course whereby one must keep himself abreast of all leading developments in law and jurisprudence, particularly on matters relating to Agency, Credit Transactions, Damages, Lease, Partnership, and Sales.

For the release of this 2008 edition, the Paras family values the invaluable research assistance of Dr. Edgardo C. Paras, Jr., who finished his LL.M. and D.C.L., *summa cum laude*, from the U.S.T. Graduate School of Law, and, a product of the United States (Harvard), Europe (Hague Academy of International Law), and Asia (National University of Singapore, UA & P, Ateneo de Manila, San Beda, and UST Graduate School) and also Prof. Emmanuel C. Paras (a senior partner of the Sycip, Salazar, Hernandez & Gatmaitan law offices) and Prof. Eugene C. Paras, who is now RTC Judge of Makati City, Metro Manila.

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