

# TABLE OF CONTENTS

## I. Letters of Credit

A. Definition and Nature of Letter of Credit.....	1
B. Parties to a Letter of Credit .....	2
1. Rights and Obligations of Parties.....	3
C. Basic Principles of Letter of Credit.....	3
1. Doctrine of Independence.....	3
2. Fraud Exception Principle .....	5
3. Doctrine of Strict Compliance.....	5

## II. Trust Receipts Law

A. Definition/Concept of a Trust Receipt Transaction.....	6
1. Loan/Security Feature .....	7
2. Ownership of the Goods, Documents and Instruments under a Trust Receipt .....	7
B. Rights of the Entruster .....	8
1. Validity of the Security Interest as Against the Creditors of the Entrustee/Innocent Purchasers for Value ....	8
C. Obligation and Liability of the Entrustee.....	8
1. Payment/Delivery of Proceeds of Sale or Disposition of Goods, Documents or Instruments.....	9
2. Return of Goods, Documents or Instruments in Case of Sale .....	10
3. Liability for Loss of Goods, Documents or Instruments .....	10
4. Penal Sanction.....	11
D. Remedies Available.....	13
E. Warehouseman's Lien .....	13

## III. Negotiable Instruments Law

A. Forms, Interpretation and other General Principles .....	13
1. Requisites of Negotiability.....	15
2. Order Instrument .....	23
3. Bearer Instrument.....	23
4. Kinds of Negotiable Instruments .....	24
B. Completion and Delivery.....	26
1. Insertion of Date .....	26
2. Completion of Blanks.....	26
3. Incomplete and Undelivered Instruments .....	27
4. Complete but Undelivered Instruments.....	28
C. Signature .....	29
1. Signing in Trade Name .....	29
2. Signature of Agent.....	29
3. Indorsement by Minor or Corporation.....	30
4. Forgery.....	30

D. Consideration.....	36
E. Accommodation Party.....	37
F. Negotiation.....	40
1. Distinguished from Assignment.....	40
2. Modes of Negotiation.....	41
3. Kinds of Indorsements.....	41
G. Rights of the Holder.....	43
1. Shelter Principle.....	43
2. Holder in Due Course.....	44
3. Defenses Against the Holder.....	48
H. Parties And Their Liabilities.....	49
1. Maker.....	49
2. Drawer.....	51
3. Acceptor.....	53
4. Indorser.....	53
5. Drawee.....	57
6. Warranties.....	60
I. Presentment for Payment.....	60
1. Necessity of Presentment for Payment.....	60
2. Parties to Whom Presentment for Payment Should Be Made.....	61
3. Dispensation with Presentment for Payment.....	61
4. Dishonor by Non-Payment.....	61
J. Notice of Dishonor.....	61
1. Parties to Be Notified.....	61
2. Parties Who May Give Notice and Dishonor.....	62
3. Effect of Notice.....	62
4. Form of Notice.....	63
5. Waiver.....	63
6. Dispensation with Notice.....	63
7. Effect of Failure to Give Notice.....	64
K. Discharge of Negotiable Instrument.....	64
1. Discharge of Negotiable Instrument.....	64
2. Discharge of Parties Secondarily Liable.....	65
3. Right of Party Who Discharged Instrument.....	65
4. Renunciation by Holder.....	65
L. Material Alteration.....	65
1. Concept.....	65
2. Effect of Material Alteration.....	66
M. Acceptance.....	67
1. Definition.....	67
2. Manner.....	67
3. Time for Acceptance.....	68
4. Rules Governing Acceptance.....	68

N. Presentment for Acceptance.....	68
1. Time/Place/Manner of Presentment.....	68
2. Effect of Failure to Make Presentment.....	68
3. Dishonor by Non-Acceptance.....	68
O. Promissory Notes.....	68
P. Checks.....	68
1. Definition.....	70
2. Kinds.....	70
3. Stopping Payment.....	73
4. Presentment for Payment.....	73

#### **IV. Insurance Code**

A. Concept of Insurance.....	73
B. Elements of an Insurance Contract.....	74
C. Characteristics/Nature and General Principles of Insurance Contract.....	74
D. Parties to Insurance Contract.....	75
1. Insurer.....	75
2. Insured.....	75
3. Beneficiary.....	75
E. Classes.....	78
1. Marine.....	78
2. Fire.....	84
3. Casualty.....	86
4. Suretyship.....	88
5. Life.....	88
6. Compulsory Motor Vehicle Liability Insurance.....	91
F. Insurable Interest.....	97
1. In Life/Health.....	98
2. In Property.....	102
3. Double Insurance, Over Insurance, Co-Insurance and Re-Insurance.....	107
4. Multiple or Several Interests on Same Property.....	109
G. Perfection of the Contract of Insurance.....	112
1. Offer and Acceptance/Consensual.....	113
2. Premium Payment.....	115
H. Rescission of Insurance Contracts.....	118
1. Concealment.....	118
2. Misrepresentation/Omissions.....	123
3. Breach of Warranties.....	124
I. Claims Settlement and Subrogation.....	125
1. Notice and Proof of Loss.....	125
2. Guidelines on Claims Settlement.....	125

#### **V. Transportation Laws**

A. Common Carrier vs. Private Carrier .....	127
1. Extraordinary Diligence and Presumption of Negligence .....	130
2. Liabilities of Common Carriers .....	132
B. Defenses of Common Carriers .....	135
C. Vigilance over Goods .....	136
1. Exempting Causes .....	136
2. Contributory Negligence .....	139
3. Duration of Liability .....	139
4. Stipulation for Limitation of Liability .....	140
5. Liability for Baggage of Passengers .....	143
D. Safety of Passengers .....	144
1. Void Stipulations .....	146
2. Duration of Liability .....	146
3. Liability for Acts of Others .....	148
4. Extent of Liability for Damages .....	151
5. Registered Owner Rule (Kabit-system) .....	151
E. Bill of Lading .....	153
1. Three-Fold Character .....	153
2. Delivery of Goods .....	154
3. Period for Filing Claims .....	155
4. Period for Filing Actions .....	156
F. Maritime Commerce .....	156
1. Charter Parties .....	156
2. Liability of Ship Owners and Shipping Agents .....	158
3. Accidents and Damages in Maritime Commerce .....	164
4. Carriage of Goods by Sea Act (COGSA) .....	171
5. Bottomry .....	175
G. The Warsaw Convention .....	176
1. Applicability .....	176
2. Limitation of Liability .....	176
3. Willful Misconduct .....	177
H. Public Service Act .....	177
1. Certificate of Public Convenience .....	179
2. Prior Operator Rule .....	182

## **VI. The Corporation Code**

A. Corporation .....	183
1. Definition .....	185
2. Attributes of the Corporation .....	185
3. Distinguished from Partnership .....	185
B. Other Classes of Corporations .....	185
1. De facto vs. De jure .....	185
2. Corporation by Estoppel .....	186

C. Corporations going public vs. Corporations going private .....	188
D. Nationality of Corporations.....	188
1. Place of Incorporation Test .....	188
2. Control Test .....	188
3. Grandfather Rule .....	189
E. Rules on Partly-Nationalized Business.....	190
F. Corporate Juridical Personality .....	191
1. Doctrine of Separate Juridical Personality .....	191
2. Doctrine of Piercing the Corporate Veil .....	195
G. Incorporation and Organization.....	198
1. Promoter .....	198
2. Number and Qualifications of Incorporators.....	198
3. Corporate Name — Limitations on Use of Corporate Name.....	198
4. Corporate Term.....	199
5. Minimum Capital Stock and Subscription Requirements .....	199
6. Articles of Incorporation .....	199
7. Registration and Issuance of Certificate of Incorporation .....	201
8. Adoption of By-Laws.....	202
H. Corporate Powers .....	204
1. General Powers, Theory of General Capacity.....	204
2. Specific Powers, Theory of Specific Capacity .....	205
3. Ultra Vires Acts .....	218
4. How Exercised .....	218
5. Trust Fund Doctrine.....	220
I. Board of Directors and Trustees .....	220
1. Doctrine of Centralized Management .....	221
2. Business Judgment Rule .....	221
3. Tenure, Qualifications and Disqualifications of Directors or Trustees .....	222
4. Elections .....	225
5. Removal.....	228
6. Filling of Vacancies .....	229
7. Compensation .....	230
8. Fiduciaries Duties and Liability Rules .....	230
9. Responsibility for Crimes.....	233
10. Inside Information .....	234
11. Contracts .....	234
12. Officers and Executive Committee.....	236
13. Meetings .....	237
J. Stockholders and Members.....	238
1. Rights of a Stockholder and Members .....	238
2. Participation in Management .....	238
3. Proprietary Rights.....	240
4. Remedial Rights .....	248
5. Obligation of a Stockholder .....	252
6. Meetings .....	252

K. Capital Structure.....	253
1. Subscription Agreements.....	253
2. Consideration for Stocks.....	253
3. Shares of Stock.....	254
4. Payment of Balance of Subscription.....	257
5. Certificate of Stock.....	258
6. Stock and Transfer Book.....	261
7. Disposition and Encumbrance of Shares.....	261
L. Dissolution and Liquidation.....	264
1. Modes of Dissolution.....	264
2. Methods of Liquidation.....	266
M. Other Corporations.....	267
1. Close Corporations.....	267
2. Non-Stock Corporations.....	269
3. Religious Corporations – Exclude.....	270
4. Foreign Corporations.....	271
N. Mergers and Consolidations.....	277
1. Limitations.....	278
2. Effects.....	278
O. **JURISDICTION.....	279
1. Intra-corporate Controversies.....	279
<b>VII. Securities Regulation Code (R.A. No. 8799)</b>	
A. State Policy, Purpose.....	285
1. Securities.....	285
2. Exempt Securities.....	286
3. Exempt Transactions.....	286
B. Registration.....	286
C. Prohibitions on Fraud, Manipulation and Insider Trading.....	287
1. Manipulation of Security Prices.....	287
2. Short Sales.....	287
3. Fraudulent Transactions.....	287
4. Insider Trading.....	287
D. Protection of Investors.....	291
1. Tender Offer Rule.....	291
2. Rules on Proxy Solicitation.....	293
3. Disclosure Rule.....	293
E. Civil Liability.....	293
F. Jurisdiction.....	293
<b>VIII. Banking Laws</b>	
A. The New Central Bank Act (R.A. No. 7653).....	293
1. State Policies.....	293

2. Creation of the Bangko Sentral ng Pilipinas (BSP) .....	293
3. Responsibility and Primary Objective .....	294
4. Monetary Board—Powers and Functions.....	294
5. How the BSP Handles Banks in Distress .....	294
6. How the BSP Handles Exchange Crisis .....	298

## **IX. Uniform Currency Act (Republic Act 529)**

### **X. Law on Secrecy of Bank Deposits (R.A. No. 1405, as amended)**

A. Purpose.....	300
B. Prohibited Acts.....	300
C. Deposits Covered.....	304
D. Exceptions .....	304
E. Garnishment of Deposits, including Foreign Deposits.....	310

## **XI. Foreign Currency Deposit Act**

### **XII. General Banking Law of 2000 (R.A. No. 8791)**

A. Definition and Classification of Banks .....	311
B. Distinction of Banks from Quasi-Banks and Trust Entities.....	314
C. Bank Powers and Liabilities.....	314
1. Corporate Powers.....	314
2. Banking and Incidental Powers.....	314
D. Diligence Required of Banks — Relevant Jurisprudence.....	315
E. Nature of Bank Funds and Bank Deposits.....	315
F. Stipulation on Interests .....	316
G. Grant of Loans and Security Requirements.....	317
1. Ratio of Net Worth to Total Risk Assets.....	319
2. Single Borrower’s Limit.....	319
3. Restrictions on Bank Exposure to DOSRI (Directors, Officers, Stockholders and their Related Interests) ..	319
H. Ownership of Banks .....	321

### **XIII. Intellectual Property Code (Exclude Implementing Rules & Regulations)**

A. Intellectual Property Rights in General.....	322
1. Intellectual Property Rights.....	322
2. Differences between Copyrights, Trademarks and Patent.....	322
3. Technology Transfer Arrangements.....	322
B. Patents .....	322
1. Patentable Inventions.....	323
2. Non-Patentable Inventions.....	324
3. Ownership of a Patent .....	324
4. Grounds for Cancellation of a Patent.....	325
5. Remedy of the True and Actual Inventor .....	325
6. Rights Conferred by a Patent.....	327
7. Limitations of Patent Rights.....	327
8. Patent Infringement .....	328

9. Licensing .....	329
10. Assignment and Transmission of Rights.....	329
<b>C. Trademarks.....</b>	<b>330</b>
1. Definition of Marks, Collective Marks, Trade Names.....	330
2. Acquisition of Ownership of Mark.....	330
3. Acquisition of Ownership of Trade Name .....	331
4. Non-Registrable Marks .....	331
5. Prior Use of Mark as a Requirement.....	333
6. Tests to Determine Confusing Similarity between Marks .....	334
7. Confusion of Goods and Confusion of Services .....	335
8. Well-Known Marks .....	335
9. Rights Conferred by Registration .....	335
10. Use by Third Parties of Names, etc. Similar to Registered Mark.....	335
11. Infringement and Remedies.....	336
12. Unfair Competition .....	337
13. Trade Names or Business Names.....	341
14. Collective Marks.....	341
<b>D. Copyrights .....</b>	<b>341</b>
1. Basic Principles, Sections 172.2, 175 and 181 .....	341
2. Copyrightable Works .....	342
3. Non-Copyrightable Works .....	342
4. Rights of Copyright Owner .....	343
5. Rules on Ownership of Copyright.....	345
6. Limitations on Copyright.....	348
<b>E. Rules of Procedure for Intellectual Property Rights Cases (A.M. No. 10-3-10-SC) .....</b>	<b>352</b>

**XIV. Special Laws**

**XV. Anti-Money Laundering Act (R.A. No. 9160, as amended by R.A. No. 9194)**

A. Policy of the Law.....	353
B. Covered Institutions.....	353
C. Obligations of Covered Institutions .....	353
D. Covered Transactions .....	354
E. Suspicious Transactions .....	354
F. When Is Money Laundering Committed.....	354
G. Unlawful Activities or Predicate Crimes .....	354
H. Anti-Money Laundering Council .....	355
I. Functions .....	355
J. Freezing of Monetary Instrument or Property .....	355
K. Authority to Inquire Into Bank Deposits .....	355

**XVI. Foreign Investments Act (R.A. No. 7042)**

A. Policy of the Law.....	355
<b>B. Definition of Terms.....</b>	<b>355</b>
1. Foreign Investment.....	355
2. “Doing Business” in the Philippines.....	355
3. Export Enterprise.....	355

4. Domestic Market Enterprise.....	355
C. Registration of Investments on Non-Philippine Nationals .....	356
D. Foreign Investments in Export Enterprise .....	356
E. Foreign Investments in Domestic Market Enterprise .....	356
F. Foreign Investment Negative List.....	357
<b>XVII. Truth In Lending Act</b>	
A. Disclosure Requirement.....	358
<b>XVIII. Other Special Laws</b>	
<b>XIX. PDIC Law</b>	
<b>XX. Warehouse Receipts Law</b>	
A. Definitions .....	361
B. Three Functions of Documents of Title .....	361
C. Negotiability of Warehouse Receipts .....	361
D. Formalities .....	361
E. Negotiation of Warehouse Receipts .....	361
1. By Delivery .....	361
2. By Indorsement.....	362
F. Effects of Negotiation of Warehouse Receipt.....	362
G. Warranties.....	363
H. Non-negotiable Receipts .....	363
I. Warehouseman’s defenses for Non-delivery or Misdelivery.....	363
J. Loss of the Receipt.....	365
K. Warehouseman’s Liability .....	365
L. Warehouseman’s Lien .....	367
M. Adverse Claimant .....	368
N. Attachment or Levy .....	370
<b>XXI. Financial Rehabilitation and Insolvency Act (FRIA)</b>	
A. Liquidation of Insolvent Juridical Debtors.....	375
B. Insolvency of Individual Debtors .....	379
C. Common provisions .....	385
<b>XXII. Retail Trade Law.....</b>	<b>388</b>
<b>XXIII. Bulk Sales Law.....</b>	<b>392</b>
<b>XXIV. Anti-Dummy Law.....</b>	<b>396</b>
<b>XXV. Other Questions.....</b>	<b>398</b>
A. 1976 BAR EXAMINATION .....	398
B. 1977 BAR EXAMINATION .....	398
C. 1981 BAR EXAMINATION .....	399

D. 1995 BAR EXAMINATION .....	400
E. 1999 BAR EXAMINATION .....	401
F. 2004 BAR EXAMINATION .....	401
G. 2006 BAR EXAMINATION .....	402
H. 2009 BAR EXAMINATION .....	403

I. Letters of Credit

1. Letter of Credit which is used in non-side transaction, where it serves to reduce the risk of non-performance is called—
- a) Irrevocable letter of credit;
  - b) Standby letter of credit;
  - c) Confirmed letter of credit;
  - d) None of the above.

Answer:

- a) Standby letter of credit. (BAR 2012)

A. Definition and Nature of Letter of Credit

1. Is a letter of credit a commercial transaction? Explain your answer. Is it governed by the NIL? Reason.

Answer:

Yes, it is a commercial transaction because it is covered by the Code of Commerce, and accompanies a commercial transaction. It is not a negotiable instrument because it is not for a sum certain in money and is not payable to order or to bearer but is issued in the name of a specified person. (BAR 1976)

2. ABC Company filed a Petition for Rehabilitation with the Court. An Order was issued by the Court, (1) staying enforcement of all claims, whether money or otherwise against ABC Company, its guarantors and sureties not solidarily liable with the company; and (2) prohibiting ABC Company from making payments of its liabilities, outstanding as of the date of the filing of the petition. XYZ Company is a holder of an irrevocable Standby Letter of Credit which was previously procured by ABC Company in favor of XYZ Company to secure performance of certain obligations. In the light of the Order issued by the Court,
- a) Can XYZ Company still be able to draw on their irrevocable Standby Letter of Credit when due? Explain your answer.
  - b) Explain the nature of Letters of Credit as a financial devise.

Answer:

- a) Yes, as an exception to a Stay or Suspension Order included in a Commencement Order issued pursuant to Section 16(q) of the FRIA, Section 18(c) of the said law provides that a Stay or Suspension Order shall not apply “to the enforcement of claims against sureties and other persons solidarily liable with the debtor, and third party or accommodation mortgagors as well as issuers of letters of credit x x x” Similarly, assuming that it has not been superseded by the FRIA, Section 7(b) of the Supreme Court Rules of Procedure on Corporate Rehabilitation (2008) provides that a stay order shall not cover claims against letters of credit and similar security arrangements issued by a third party to secure the payment of the debtor’s obligations. This was the basis of the decision in the case of *Metropolitan Waterworks and Sewerage System v. Hon. Reynaldo B. Daway, et al.*, G.R. No. 160732, June 21, 2004.
- b) A letter of credit is a financial device developed by merchants as a convenient and relatively safe mode of dealing with sale of goods to satisfy the seemingly irreconcilable interest of the seller, who refuses to part with his goods before he is paid, and a buyer, who wants to have control of the goods before paying. To break the impasse, the buyer may be required to contract a bank to issue a letter of credit in favor of the

seller so that, by virtue of the letter of credit, the issuing bank can authorize the seller to draw drafts and engage to pay them upon their presentment simultaneously with the tender of documents required by the letter of credit. The buyer and the seller agree on what documents are to be presented for the payment, but ordinarily they are documents of title evidencing or attesting to the shipment of the goods to the buyer. Once the credit is established, the seller ships the goods to the buyer and in the process secures the required shipping documents or documents of title. To get paid, the seller executes a draft and presents it together with the required documents to the issuing bank. The issuing bank redeems the draft and pays cash to the seller if it finds that the documents submitted by the seller conform with what the letter of credit requires. The bank then obtains possession of the documents upon paying the seller. The transaction is completed when the buyer reimburses the issuing bank and acquires the documents entitling him to the goods, while the buyer acquired the said documents and control over the goods only after reimbursing the bank.

However, letters of credit are also used in non-sale settings where they serve to reduce the risk of non-performance. Generally, letters of credit in non-sale settings have come to be known as standby letters of credit. (BAR 2012)

- 3. Letters of Credit are financial devices in commercial transactions which will ensure that the seller of the goods is sure to be paid when he parts with the goods and the buyers of the goods get control of the goods upon payment. Which statement is most accurate?**
- a) **The use of the Letter of Credit serves to reduce the risk of non-payment of the purchase price in a sale transaction;**
  - b) **The Letters of Credit can only be used exclusively in sales transaction;**
  - c) **The Letters of Credit are issued for the benefit of the seller only;**
  - d) **A, b, and c are all correct.**

**Answer:**

- b) The use of the Letter of Credit serves to reduce the risk of non-payment of the purchase price in a sale transaction. (BAR 2012)

## **B. Parties to a Letter of Credit**

- 1. In letters of credit in banking transactions, distinguish the liability of a confirming bank from a notifying bank.**

**Answer:**

In case anything wrong happens to the letter of credit, a confirming bank incurs liability for the amount of the letter of credit, while a notifying bank does not incur any liability. (BAR 1994)

- 2. Explain the 3 distinct but intertwined contract relationships that are indispensable in a letter of credit transaction.**

**Answer:**

The 3 distinct but intertwined contract relationships that are indispensable in a letter of credit transaction are:

- a. Between the applicant/buyer/importer and the beneficiary/seller/exporter—The applicant/buyer/importer is the one who procures the letter of credit and obliges himself to reimburse the issuing bank upon receipt of the documents of title, while the beneficiary/seller/exporter is the one who in compliance with the contract of sale ships the goods to the buyer and delivers the documents of title and

draft to the issuing bank to recover payment for the goods. Their relationship is governed by the contract of sale.

- b. Between the issuing bank and the beneficiary/seller/exporter—The issuing bank is the one that issues the letter of credit and undertakes to pay the seller upon receipt of the draft and proper documents of title and to surrender the documents to the buyer upon reimbursement. Their relationship is governed by the terms of the letter of credit issued by the bank.
- c. Between the issuing bank and the applicant/buyer/importer—Their relationship is governed by the terms of the application and agreement for the issuance of the letter of credit by the bank. (BAR 2002)

### 1. Rights and Obligations of Parties

### C. Basic Principles of Letter of Credit

#### 1. Doctrine of Independence

1. **“A” applies with Prime Bank for a letter of credit in the amount of P50,000 in favor of Melmart Trading of California, to cover “A’s” importation of 500 bales of cotton.**

**After shipment, Melmart Trading presented all the pertinent documents to Prime Bank’s correspondent Bank in San Francisco, California, and obtained payment under the letter of credit. Prime Bank now seeks payment from “A” who refuses to pay on the ground that Melmart Trading violated certain conditions in their Contract of Sale and, therefore, should not have been paid under the letter of credit. Can the bank recover from “A”? Reasons.**

**Answer:**

Yes, Prime bank can recover from “A”. Banks in providing financing in international business transactions (such as that entered into by “A” with Prime Bank) do not deal with the property to be exported or shipped to the importer (by Melmart Trading), but deal only with documents. The custom in international banking negates any duty on the part of the banks to verify whether what has been described in the letters of credit or drafts or shipping documents actually tallies with what is loaded aboard ship. (*Bank of Phil. Islands v. De Reny Fabric Industries, Inc., Oct. 16, 1970; 35 SCRA 256*) (BAR 1981)

2. **X Corporation entered into a contract with PT Construction Corp. for the latter to construct and build a sugar mill within 6 months. They agreed that in case of delay, PT Construction Corp. will pay X Corporation P100,000 for every day of delay. To ensure payment of the agreed amount of damages, PT secured from Atlantic Bank a confirmed and irrevocable letter of credit which was accepted by X Corporation in due time. 1 week before the expiration of the 6 month period, PT requested for an extension of time to deliver claiming that the delay was due to the fault of X Corporation. A controversy as to the cause of the delay which involved the workmanship of the building ensued. The controversy remained unresolved. Despite the controversy, X Corporation presented a claim against Atlantic Bank by executing a draft against the letter of credit.**

- a) **Can Atlantic Bank refuse payment due to the unresolved controversy? Explain.**
- b) **Can X Corporation claim directly from PT Construction Company?**

**Answer:**

- a) Atlantic Bank cannot refuse to pay because in a letter of credit, where the credit is stipulated as irrevocable, there is a definite undertaking by the issuing bank to pay the beneficiary, provided that the stipulated documents are presented and the conditions of the credit are complied with. Under the “independence principle”, the issuing bank is not obligated to ascertain compliance by the parties in the main contract. In

other words, where the legal relation arises from a letter of credit, such letter of credit contains the entire contract of the parties and the resulting obligations should be measured by its provisions. It is unaffected by any breach of contract on the part of one of the parties or by any controversy which may arise between them.

b) Yes, X Corp. can claim directly from PT. the call upon the letter of credit is not exclusive; it is merely an alternative remedy in case of delay due to the fault of PT. (BAR 2008)

3. **AAA Carmakers opened an irrevocable Letter of Credit with BBB Banking Corporation with CCC Cars Corporation as beneficiary. The irrevocable Letter of Credit was opened to pay for the importation of 10 units of Mercedes Benz S class. Upon arrival of the cars, AAA Carmakers found out that the cars were all not in running condition and some parts were missing. As a consequence, AAA Carmakers instructed BBB Banking Corporation not to allow drawdown on the Letter of Credit. Is this legally possible?**

a) **No, because under the “Independence Principle” conditions for the drawdown on the Letters of Credit are based only on documents, like shipping documents, and not with the condition of the goods subject of the importation.**

b) **Yes, because the acceptance by the importer of the goods subject of importation is material for the drawdown of the Letter of Credit.**

c) **Yes, because under the “Independence Principle”, the seller of or the beneficiary is always assured of prompt payment if there is no breach in the contract between the seller and the buyer.**

d) **No, because what was opened was an irrevocable letter of credit and not a confirmed letter of credit.**

**Answer:**

a) **No, because under the “Independence Principle” conditions for the drawdown on the Letters of Credit are based only on documents, like shipping documents, and not with the condition of the goods subject of the importation. (BAR 2012)**

4. **Muebles Classico, Inc. (MC), a Manila-based furniture shop, purchased hardwood lumber from Surigao Timber, Inc. (STI), a Mindanao-based logging company. MC was to pay STI the amount of P5 M for 50 tons of lumber. To pay STI, MC opened a letter of credit with Banco de Plata (BDP). BDP duly informed STI of the opening of a letter of credit in its favor.**

**In the meantime, MC—which had been undergoing financial reverses—filed a petition for corporate rehabilitation. The rehabilitation court issued a Stay Order to stay the enforcement of all claims against MC.**

**After shipping the lumber, STI went to DBP, presented the shipping documents, and demanded payment of the letter of credit opened in its favor. MC, on the other hand, informed the bank of the Stay Order and instructed it to deny payment to STI because of the Stay Order.**

**BDP comes to you for advice. Your best advice is to \_\_\_\_.**

a) **Grant STI’s claim. Under the “Independence Principle,” the bank deals only with the document and not the underlying circumstances; hence, the presentation of the letter of credit is sufficient;**

b) **Deny STI’s claim. The Stay Order covers all claims against the debtor and binds all its creditors. The letter of credit is a claim against the debtor that is covered by the Stay Order;**

c) **Grant STI’s claim. The letter of credit is not a claim against the debtor under rehabilitation, but against the bank which has assumed a solidary obligation;**

d) **Deny STI’s claim. If the bank disregards the Stay order, it may be subject to contempt by the rehabilitation court. STI should file its claim with the rehabilitation court;**

e) **File an action for interpleader to resolve the parties’ competing claims.**

**Answer:**

c) Grant STI's claim. The letter of credit is not a claim against the debtor under rehabilitation, but against the bank which has assumed a solidary obligation. (BAR 2013)

**2. Fraud Exception Principle**

- 1. The Supreme Court has held that fraud is an exception to the "independence principle" governing letters of credit. Explain this principle and give an example of how fraud can be an exception.**

**Answer:**

The "independence principle" posits that the obligations of the parties to a letter of credit are independent of the obligations of the parties to the underlying transaction. Thus, the beneficiary of the letter of credit, which is able to comply with the documentary requirements under the letter of credit, must be paid by the issuing or confirming bank, notwithstanding the existence of a dispute between the parties to the underlying transaction, say a contract of sale of goods where the buyer is not satisfied with the quality of the goods delivered by the seller. The Supreme Court in *Transfield Philippines, Inc. v. Luzon Hydro Corporation*, 443 SCRA 307 (2004) for the first time declared that fraud is an exception to the independence principle. For instance, if the beneficiary fraudulently presents to the issuing or confirming bank documents that contain material facts that, to his knowledge, are untrue, then payment under the letter of credit may be prevented through court injunction. (BAR 2010)

**3. Doctrine of Strict Compliance**

- 1. BV agreed to sell to AC, a Ship and Merchandise Broker, 2,500 cubic meters of logs at \$27 per cubic meter FOB. After inspecting the logs, CD issued a purchase order.**

On the arrangements made upon instruction of the consignee, H&T Corporation of Los Angeles, California, the SP Bank of Los Angeles issued an irrevocable letter of credit available at sight in favor of BV for the total purchase price of the logs. The letter of credit provided that the draft to be drawn is on SP Bank and that it be accompanied by, among other things, a certification from AC, stating that the logs have been approved prior to shipment in accordance with the terms and conditions of the purchase order.

Before loading on the vessel chartered by AC, the logs were inspected by custom inspectors and representatives of the Bureau of Forestry, who certified to the good condition and exportability of the logs. After the loading was completed, the Chief Mate of the vessel issued a mate receipt of the cargo which stated that the logs are in good condition. However, AC refused to issue the required certification in the letter of credit. Because of the absence of the certification, FE Bank refused to advance payment on the letter of credit.

- 1. May FE Bank be held liable under the letter of credit? Explain.**
- 2. Under the facts stated above, the seller, BV, argued that FE Bank, by accepting the obligation to notify him that the irrevocable letter of credit. Consequently, FE Bank is liable under the letter of credit. Is the argument tenable? Explain.**

**Answer:**

- 1. No. The letter of credit provide as a condition a certification from AC. Without such certification, there is no obligation on the part of FE Bank to advance payment of the letter of credit.**

2. No. FE Bank may have confirmed the letter of credit when it notified BV, that an irrevocable letter of credit has been transmitted to it on its behalf. But the conditions in the letter of credit must first be complied with, namely, that the draft be accompanied by a certification from AC. Further, confirmation of a letter of credit must be expressed. (BAR 1993)

2. **At the instance of CCC Corporation, AAA Bank issued an irrevocable Letter of Credit in favor of BBB Corporation. The terms of the irrevocable Letter of Credit state that the beneficiary must present certain documents including a copy of the Bill of Lading of the importation for the bank to release the funds. BBB Corporation could not find the original copy of the Bill of Lading so it instead presented to the bank a Xerox copy of the Bill of lading. Would you advise the bank to allow the drawdown on the Letter of Credit?**

- a) **No, because the rule of strict compliance in commercial transactions involving letters of credit, requiring documents set as conditions for the release of the fund has to be strictly complied with or else funds will not be released;**
- b) **Yes, because an irrevocable letter of credit means that the issuing bank undertakes to release the fund anytime when claimed by the beneficiary, regardless of the kind of document presented;**
- c) **Yes, because the issuing bank can always justify to CCC Corporation that Xerox copies are considered as faithful reproduction of the original copies;**
- d) **Yes, because the issuing bank has no discretion to determine whether the documents presented by the beneficiary are sufficient or not.**

**Answer:**

- a) **No, because the rule of strict compliance in commercial transactions involving letters of credit, requiring documents set as conditions for the release of the fund has to be strictly complied with or else funds will not be released. (BAR 2012)**

## II. Trust Receipts Law

### A. Definition/Concept of a Trust Receipt Transaction

1. **C contracted D to renovate his commercial building. D ordered construction materials from E and received delivery thereof. The following day, C went to F Bank to apply for loan to pay for the construction materials. As security for the loan, C was made to execute a trust receipt. One year later, after C failed to pay the balance of the loan, F Bank charged him with violation of the Trust Receipts Law.**

- a) **What is a Trust Receipt?**
- b) **Will the case against C prosper? Reason briefly.**

**Answer:**

- a) **A Trust Receipt is a written or printed document signed by the entrustee in favor of the entrustor containing terms and conditions substantially complying with the provisions of the Trust Receipts law, whereby the bank as entruster releases the goods to the possession of the entrustee but retains ownership thereof while the entrustee may sell the goods and apply the proceeds for the full payment of his liability to the bank.**
- b) **No, the case against C will not prosper. Since C received the construction materials from E before the trust receipt transaction was entered into, the transaction was a simple loan, with the trust receipt merely as a collateral or security for the loan. This is inconsistent with a trust receipt transaction where the title to the goods remains with the bank and the goods are released to the entrustee before the loan is granted. (BAR 2007)**

2. **Delano Cruz is in default in the payment of his existing loan from BDP Bank. To extend and restructure this loan, Delano agreed to execute a trust receipt in the bank's favor covering the iron pellets Delano imported from China one year earlier. Delano subsequently succeeded in selling the iron pellets to a smelting plant, but the proceeds went to the payment of the separation benefits of his employees who were laid off as he reduced his operations.**

**When the extended loan period expired without any significant payment from Delano (not even to the extent of the proceeds of the sale of the iron pellets), BDP Bank consulted you to on how to proceed against Delano. The bank is contemplating the filing of estafa pursuant to the provisions of PD 115 (Trust Receipts Law) to force Delano to turn in at least the proceeds of the sale of the iron pellets.**

**Would you, as bank counsel and as officer of the court, advise the bank to proceed with its contemplated action?**

**Answer:**

I will not advise BDP Bank to file a criminal case for estafa against Delano. Delano received the iron pellets he imported one year before the trust receipt was executed. As held by the Supreme Court, where the execution of a trust receipt agreement was made after the goods covered by it had been purchased by and delivered to the trustee and the latter as a consequence acquired ownership to the goods, the transaction does not involve a trust receipt but a simple loan even though the parties denominated the transaction as one of trust receipt. (BAR 2013)

### **1. Loan/Security Feature**

1. **X & Co., obtained a loan from a local bank in the amount of P500,000, mortgaging as security therefore its real property. Subsequently, the company applied with the same bank for a Letter of Credit (L/C) for \$200,000 in favor of a foreign bank to cover the importation of machinery. To guarantee payment of the obligation under the L/C, the company and its President and Treasurer executed a Surety Agreement in the local bank's favor.**

**The machinery arrived and was received to the company under a trust receipt agreement. As the company defaulted in the payment of its obligations, the bank took possession of the imported machinery. At the same time, it sought to foreclose the mortgaged property and to hold the company, as well as its President and Treasurer, liable under the Surety Agreement.**

**Did the taking of possession of the machinery by the bank result in the (1) full payment of the obligations of the company, and (2) foreclosure of the mortgage? Why?**

**Answer:**

The taking of possession of the machinery by the bank did not result in full payment of the obligations owing from the company and its officers. The taking of such possession must be considered merely as a measure in order to protect or further safeguard the bank's security interest. *Dacion en pago* can only be considered as having taken place when a creditor accepts and appropriates the ownership of goods in payment of a due obligation.

The mere taking of possession of mortgaged assets does not amount to foreclosure. Foreclosure requires a sale at public auction. The foreclosure, therefore, has not yet been effected. (BAR 1992)

### **2. Ownership of the Goods, Documents and Instruments under a Trust Receipt**

1. "X", a dealer in imported textiles, opened with "Y" Bank an irrevocable letter of credit in favor of his American supplier, ABC Textiles, Inc. in the amount of \$50,000 covering the full invoice value of 200 bales of suiting materials. He paid "Y" Bank a marginal deposit of \$40,000, and the amount of \$50,000. The clothing materials were subsequently shipped by ABC Textiles to Manila, with "Y" Bank as consignee. "Y" Bank took delivery of the shipment and had it stored in its bodega. Thereafter, "X" executed the corresponding trust receipt, but before "X" could take possession of the goods, a fire of unknown origin gutted the bodega of "Y" Bank, resulting in the total loss of the goods. When sued for the balance of \$10,000 "X" denied liability, contending that "Y" Bank, as consignee and owner of the goods, should bear the loss. Is the contention of "X" tenable? Reasons.

**Answer:**

*Yes, the contention of X is tenable. Y bank, in said trust receipt, is the entruster who, according to law, owns or holds absolute title on said goods, and the goods were still in the bodega of Y Bank and not yet actually delivered to the trustee X, when the goods were totally burned by a fire of unknown origin. Hence, the goods are deemed to be lost for the account of Y Bank. (BAR 1982)*

## **B. Rights of the Entruster**

### **1. Validity of the Security Interest as Against the Creditors of the Entrustee/Innocent Purchasers for Value**

1. Upon execution of a trust receipt over goods, the party who is obliged to release such goods and who retains security interest on those goods, is called the
  - a. Holder.
  - b. Shipper.
  - c. Entrustee.
  - d. Entrustor.

**Answer:**

d. Entrustor. (BAR 2011)

2. Which phrase best completes the statement—In accordance with the Trust Receipt Law, purchasers of the goods from the Entrustee will:
  - a) Get the goods only as a collateral;
  - b) Not get good title to the goods;
  - c) Only get security interest over the goods;
  - d) Get good title to the goods.

**Answer:**

d) Get good title to the goods. (BAR 2012)

## **C. Obligation and Liability of the Entrustee**

1. Who is the Entrustee in a Trust Receipt arrangement?
  - a) The owner of the goods;
  - b) The one who holds the goods and receives the proceeds from the sale of the goods;
  - c) The person to whom goods are delivered for sale and who bears the risk of the loss;
  - d) The party who acquires security interest in the goods.

**Answer:**

a) The person to whom goods are delivered for sale and who bears the risk of the loss. (BAR 2012)

### 1. Payment/Delivery of Proceeds of Sale or Disposition of Goods, Documents or Instruments

1. **H” opens a letter of credit with ABC Banking Corporation for the importation of 500 cases of Black Label Whisky with an invoice value of US\$50,000.00. the goods and the covering documents arrive and “H” would like to take the possession of the 500 cases of whisky under a trust receipt. The bank agrees to release the goods to him under the trust receipt, subject to the condition that “H” holds the 500 cases in trust for the bank, and for him to turn over the proceeds of the sale of said whisky, or to return the goods in the event of their non-sale within 90 days from date thereof.**

**“H” sells the 500 cases to various customers but fails to turn over the proceeds within the period stipulated, despite repeated demands from ABC Banking Corporation.**

**The bank files an estafa case against “H” with the City Fiscal of Manila. In his defense, “H” contends that he should not be held liable because the transaction emanates from a letter of credit, which he claims, is civil in nature. He invokes the constitutional provision that no one should be imprisoned for non-payment of indebtedness.**

**If you were the City Fiscal, would you file the case?**

**Answer:**

Yes, I would file the estafa case against H, if I were the City Fiscal. The failure of H, entrustee, to turn over the proceeds of 500 cases of Black Label Whisky, covered by a trust receipt, to the extent of the amount of owing to the entruster, within the period stipulated, to ABC Banking Corporation, entruster, shall constitute the crime of estafa, by express statutory provision. The defense of H, therefore, is untenable. (BAR 1980)

2. **Mr. Noble, as the President of ABC Trading, Inc., executed a trust receipt in favor of BPI Bank to secure the importation by his company of certain goods. After release and sale of the imported goods, the proceeds from the sale were not turned over to BPI. Would BPI be justified in filing a case for estafa against Noble?**

**Answer:**

BPI would be justified in filing a case for estafa under PD 115 against Noble. The fact that the trust receipt issued in favor of a bank, instead of a seller, to secure the importation of the goods did not preclude the application of the Trust Receipts Law (PD 115). Under the law, any officer or employee of a corporation responsible for the violation of a trust receipt is subject to the personal liability thereunder. (BAR 1991)

3. **Mr. Noble, as the President of ABC Trading, Inc., executed a trust receipt in favor of BPI Bank to secure the importation by his company of certain goods. After release and sale of the imported goods, the proceeds from the sale were not turned over to BPI. Would BPI be justified in filing a case for estafa against Noble?**

**Answer:**

BPI would be justified in filing a case for estafa under PD 115 against Noble. The fact that the trust receipt issued in favor of a bank, instead of a seller, to secure the importation of the goods did not preclude the application of the Trust Receipts Law (PD 115). Under the law, any officer or employee of a corporation responsible for the violation of a trust receipt is subject to the personal liability thereunder. (BAR 1991)

4. **A buys goods from a foreign supplier using his credit line with a bank to pay for the goods. Upon arrival of the goods at the pier, the bank requires A to sign a trust receipt before A is allowed to take delivery of the goods. The trust receipt contains the usual language. A disposes of the goods and receives**

**payment but does not pay the bank. The bank files a criminal action against A for violation of the Trust Receipts Law. A asserts that the trust receipt is only to secure his debt and that a criminal action cannot lie against him because that would be violative of his constitutional right against “imprisonment for non-payment of a debt.” Is he correct?**

**Answer:**

No. Violation of a trust receipt is criminal as it is punished as estafa under Art. 315 of the RPC. There is a public policy involved which is to assure the entruster with the reimbursement of the amount advanced or the balance thereof for the goods subject of the trust receipt. The execution of the trust receipt or the use thereof promotes the smooth flow of commerce as it helps the importer or buyer of the goods covered thereby. (BAR 1997)

5. **CCC Car, Inc. obtained a loan from BBB Bank, which fund was used to import 10 units of Mercedes Benz S Class vehicles. Upon arrival of the vehicles and before the release of said vehicles to CCC Car, Inc, X and Y, the president and treasurer, respectively, of CCC signed the Trust Receipt to cover the value of the 10 units of Mercedes Benz S class vehicles, after which, the vehicles were all delivered to the car display room of CCC. Sales of the vehicles were slow, and it took a month to dispose the 10 units. CCC wanted to be in business and to save on various documentations requires by the bank, decided that instead of turning over the proceeds of the sales, CCC used the proceeds to buy another 10 units of BMW 3 series.**

**Is the action of CCC legally justified?**

**Answer:**

No. It is the obligation of CCC, as entrustee, to receive the proceed of the sale of the Mercedes Benz S class vehicles in trust for BBB Bank, as entruster, and turn over the same to BBB Bank to the extent of the amount owing to the latter or as appears in the trust receipt. (BAR 2012)

- 2. **Return of Goods, Documents or Instruments in Case of Sale**
- 3. **Liability for Loss of Goods, Documents or Instruments**

1. **Tom Cruz obtained a loan of P1M from XYZ Bank to finance his purchase of 5,000 bags of fertilizer. He executed a trust receipt in favor of XYZ Bank over the 5,000 bags of fertilizer. Tom withdrew the 5,000 bags from the warehouse to be transported to Lucena City where his store was located. On the way, armed robbers took from Tom the 5,000 bags of fertilizer. Tom now claims that his obligation to pay the loan to XYZ Bank is extinguished because the loss was not due to his fault. Is Tom correct? Explain.**

**Answer:**

Being the entrustee, the obligation of Tom Cruz to pay XYZ Bank is not extinguished by the loss of goods. Section 10 of the Trust Receipts Law provides:

“Section 10. *Liability of entrustee for loss.* The risk of loss shall be borne by the entrustee. Loss of goods, documents or instruments which are the subject of a trust receipt, pending their disposition, irrespective of whether or not it was due to the fault or negligence of the entrustee, shall not extinguish his obligation to the entruster for the value thereof.” (BAR 2008)

2. **Anton imported perfumes from Taiwan and these were released to him by the bank under a trust receipt. While the perfumes were in Anton’s warehouse, thieves broke in and stole all of them.**

**Who will shoulder the loss of the stolen perfumes?**

- a) **The loss of the perfumes will be borne by the bank in whose behalf the perfumes were held in trust;**

- b) Anton will bear the loss;
- c) The exporter can hold both the bank and Anton liable for the loss;
- d) The exporter from whom Anton bought the perfumes will bear the loss;
- e) No one bears the loss for an unforeseen event.

**Answer:**

b) Anton will bear the loss. (BAR 2013)

#### 4. Penal Sanction

1. Mr. Noble, as the President of ABC Trading, Inc., executed a trust receipt in favor of BPI Bank to secure the importation by his company of certain goods. After release and sale of the imported goods, the proceeds from the sale were not turned over to BPI. Would BPI be justified in filing a case for estafa against Noble?

**Answer:**

BPI would be justified in filing a case for estafa under PD 115 against Noble. The fact that the trust receipt issued in favor of a bank, instead of a seller, to secure the importation of the goods did not preclude the application of the Trust Receipts Law (PD 115). Under the law, any officer or employee of a corporation responsible for the violation of a trust receipt is subject to the personal liability thereunder. (BAR 1991)

2. What acts or omissions are penalized under the Trust Receipts Law?

**Answer:**

Failure of the entrustee to turn over the proceeds of the sale of the goods, documents or instrument covered by a trust receipt to the extent of the amount owing to the entruster or to return the goods, documents or instruments if they were not sold or disposed of in accordance with the terms of the trust receipt is penalized as estafa under Article 315(1) of the Revised Penal Code. (BAR 2006)

3. Is lack of intent to defraud a bar to the prosecution of these acts or omissions?

**Answer:**

No. there is no requirement to prove intent to defraud. The mere failure to account for or return the goods, documents or instruments in question gives rise to the crime, which is *malum prohibitum*. (BAR 2006)

4. E received goods from T for display and sale in E's store. E was to turn over to T the proceeds of any sale and return the ones unsold. To document their agreement, E executed a trust receipt in T's favor covering the goods. When E failed to turn over the proceeds from the sale of the goods or return the ones unsold despite demand, he was charged in court for estafa. E moved to dismiss on the ground that his liability is only civil. Is he correct?

- a. No, since he committed fraud when he promised to pay for the goods and did not.
- b. No, since his breach of the trust receipt agreement subjects him to both civil and criminal liability for estafa.
- c. Yes, since E cannot be charged with estafa over goods covered a trust receipt.
- d. Yes, since it was merely a consignment sale and the buyer could not pay.

**Answer:**

- a. No, since his breach of the trust receipt agreement subjects him to both civil and criminal liability for estafa. (BAR 2011)

5. CCC Car, Inc. obtained a loan from BBB Bank, which fund was used to import 10 units of Mercedes Benz S Class vehicles. Upon arrival of the vehicles and before the release of said vehicles to CCC Car, Inc, X and Y, the president and treasurer, respectively, of CCC signed the Trust Receipt to cover the value of the 10 units of Mercedes Benz S class vehicles, after which, the vehicles were all delivered to the car display room of CCC. Sales of the vehicles were slow, and it took a month to dispose the 10 units. CCC wanted to be in business and to save on various documentations requires by the bank, decided that instead of turning over the proceeds of the sales, CCC used the proceeds to buy another 10 units of BMW 3 series.

**Will the corporate officers of CCC be held liable under the circumstances? Explain your answer.**

**Answer:**

Yes, particularly the president and the treasurer of CCC who both signed the trust receipts in the problem. Section 13 of the Trust receipts Law provides that if the violation or offense is committed by a corporation, partnership, association, or other juridical entity, the penalty provided for in the law shall be imposed upon the directors, officers, employees or other officials or persons therein responsible for the offense, without prejudice to the civil liabilities arising from the criminal offense. (BAR 2012)

6. BBB Banking Corporation issued a Letter of Credit in the amount of P5 M, for the purchase of 5 tons of corn by X. upon arrival of the goods, the goods were delivered to the warehouse of X. thereafter, he was asked to sign a Trust Receipt covering the goods. When the goods were sold, X did not deliver the proceeds to BBB Banking Corporation, arguing that he will need the fund for the subsequent importation. Is there sufficient basis to sue for criminal action?
- Yes, because X's failure to turn over the proceeds to the bank is a violation of the Trust Receipt Law;
  - No, because the trust receipt was signed only after the delivery of the goods. When the trust receipt was signed, the ownership of the goods was already with X;
  - Yes, because violation of Trust Receipt Law is mala prohibita, intention is irrelevant;
  - No, because X has a valid reason not to deliver the proceeds to BBB Banking Corporation.

**Answer:**

- Yes, because X's failure to turn over the proceeds to the bank is a violation of the Trust Receipt Law
- Yes, because violation of Trust Receipt Law is mala prohibita, intention is irrelevant. (BAR 2012)

7. X secured a loan from BBB Bank to pay for the importation of some dried fruits. Upon arrival of the goods consisting of dried fruits imported by X but before delivery to him, a trust receipt was executed by X to cover the transfer of the dried fruits to his possession. The dried fruits were so saleable but instead of turning over the proceeds of the sale, X used the funds to pay for the medical expenses of his mother who was sick of cancer of the bone. Which statement is most accurate?
- X cannot be held criminally liable because although he did not pay the bank he used the proceeds for a good reason;
  - Fraud or deceit is a necessary element to hold X criminally liable for non-payment under the Trust Receipts Law;
  - X can be held criminally liable under the Trust Receipts Law regardless of the purpose or intention for the use of the proceeds;
  - X cannot be held criminally liable because the underlying obligation is one of simple loan.

**Answer:**

- X can be held criminally liable under the Trust Receipts Law regardless of the purpose or intention for the use of the proceeds. (BAR 2012)

8. **X is the President of AAA Products Corporation. X signs all the Trust Receipts documents for certain importations of the company. In the event of failure to deliver the proceeds of the sale of the goods to the bank, which statement is most accurate?**
- a) **The criminal liability will not attach to X as president because of separate juridical personality;**
  - b) **For violation of Trust Receipts Law, the law specifically provides for the imposition of penalty upon directors/officers of the corporation;**
  - c) **The officer will not be held criminally accountable because he is just signing the trust receipt for and in behalf of the corporation;**
  - d) **The officer of the corporation will be held liable provided it is clear that the officer concerned participated in the decision not to pay.**

**Answer:**

- c) For violation of Trust Receipts Law, the law specifically provides for the imposition of penalty upon directors/officers of the corporation. (BAR 2012)

#### **D. Remedies Available**

1. **Ricardo mortgaged his fishpond to AC Bank to secure a P1 M loan. In a separate transaction, he opened a letter of credit with the same bank for \$500,000 in his favor of HS Bank, a foreign bank, to purchase outboard motors. Likewise, Ricardo executed a Surety Agreement in favor of AC Bank.**

**The outboard motors arrived and were delivered to Ricardo, but he was not able to pay the purchase price thereof.**

- a) **Can AC Bank take possession of the outboard motors? Why?**
- b) **Can AC Bank also foreclose the mortgage over the fishpond? Explain.**

**Answer:**

- a) If what Ricardo executed is a trust receipt, AC Bank can take possession of the outboard motors so that it can exercise its lien and sell them. If what Ricardo executed is a Surety Agreement, AC Bank cannot take possession of the outboard motors, because it has no lien on them.
- b) AC Bank can also foreclose the mortgage over the fishpond if Ricardo fails to pay the loan of P1 M. (BAR 2005)

#### **E. Warehouseman's Lien**

### **III. Negotiable Instruments Law**

#### **A. Forms, Interpretation and other General Principles**

1. **How do you treat a negotiable instrument that is so ambiguous that there is doubt whether it is a bill or a note?**

**Answer:**

Where a negotiable instrument is so ambiguous that there is doubt whether it is a bill or note, the holder may treat it either as a bill of exchange or a promissory note at his election. (BAR 1998)

2. **Distinguish a negotiable document from a negotiable instrument.**

**Answer:**

A negotiable document is governed by the Civil Code, while a negotiable instrument is governed by the NIL. The subject matter of a negotiable document is things or goods, while that of a negotiable instrument is capable of accumulating secondary contracts resulting from indorsements at the back thereof, while a negotiable document is not, especially considering that indorsement of the latter does not result in liability of the indorser when the depositary, like the warehouseman, fails to comply with his duty to deliver the things or goods deposited and covered by the warehouse receipt by the depositary. (BAR 2005)

**3. What is a negotiable instrument? Give the characteristics of a negotiable instrument?**

**Answer:**

A negotiable instrument is an instrument in writing, signed by the maker or drawer, containing an unconditional promise or order to pay a sum certain in money, on demand, or at a fixed or determinable future time. It must be payable to order or bearer. When in the form of a bill of exchange, the drawee to whom the order to pay is addressed must be named or otherwise indicated therein with reasonable certainty. Otherwise stated, to be negotiable, the instrument must comply with Section 1 of the NIL.

It must be capable of being transferred from one person to another, thereby transferring the title thereof to the latter so as to make him a holder who is entitled to payment thereof. Another characteristic is that the instrument is capable of accumulating contracts resulting from indorsements at the back thereof. (BAR 2005)

**4. X issued a check in favor of his creditor, Y. It reads: "Pay to Y the amount of Seven Thousand Hundred Pesos (Php700,000.00). Signed, X." What amount should be construed as true in such case?**

- a. Php 700,000.00.
- b. Php 700.00.
- c. Php 7,000.00.
- d. Php 700,100.00.

**Answer:**

- a. Php 700,000.00. (BAR 2011)

**5. P sold to M a pair of gecko (tuko) for P50,000. M issued a promissory note to P promising to pay the money within 90 days. Unknown to P and M, a law was passed a month before the sale that prohibits and declares void any agreement to sell gecko in the country. If X acquired the note in good faith and for value, may he enforce payment on it?**

- a. No, since the law declared void the contract on which the promissory note was founded.
- b. No, since it was not X who bought the gecko.
- c. Yes, since he is a holder in due course of a note which is distinct from the sale of gecko.
- d. Yes, since he is a holder in due course and P and M were not aware of the law that prohibited the sale of gecko.

**Answer:**

- a. No, since the law declared void the contract on which the promissory note was founded. (BAR 2011)

**6. Negotiable instruments are used as substitutes for money, which means—**

- a) That they can be considered legal tender.
- b) That when negotiated, they can be used to pay indebtedness;
- c) That at all times the delivery of the instrument is equivalent to delivery of the case;
- d) That at all times negotiation of the instruments requires proper indorsement.

**Answer:**

b) That when negotiated, they can be used to pay indebtedness; (BAR 2012)

**7. In a negotiable instrument, when the sum is expressed both in numbers and in words and there is discrepancy between the words and numbers—**

- a) The sum expressed in words will prevail over the one expressed in numbers;**
- b) The sum expressed in numbers will prevail over the one expressed in words;**
- c) The instrument becomes void because of the discrepancy;**
- d) This will render the instrument invalid.**

**Answer:**

a) The sum expressed in words will prevail over the one expressed in numbers. (BAR 2012)

### **1. Requisites of Negotiability**

**1. A postal money order was received by a bookstore as part of its sales receipts, and was later deposited with a bank. The bank cleared the money order with the Bureau of Posts, and received its value of P200.00. about five months later, the Manila Post Office notified the bank that said money order had been irregularly issued (in the sense that the money order had not been duly paid for), and accordingly, the P200.00 value of the money order was deducted from the bank's clearing account. The bank on its part debited the bookstore with the same amount, and gave the store advise thereof by means of a debit memo. The bookstore sued the proper officials of the Bureau of Posts stating under the Negotiable Instruments Law, the bookstore must be properly redressed or indemnified. Rule on the bookstore's contention, with reasons.**

**Answer:**

A postal money order as usually issued is not a negotiable instrument because it imposes conditions on the obligation to pay. Therefore, the Negotiable Instruments Law is not applicable. Any defense of the Post office against the purchase is available against any subsequent party, although the latter may be in good faith. Thus, the bookstore's contention is untenable.

Assuming however that the postal money order in this case is Negotiable Instrument Law, absence or failure of consideration is a defense available only against holders not in due course. Therefore, the Post Office is liable to it. (BAR 1975)

**2. A bookstore received 5 postal money orders totaling P1,000 as part of its sales receipts, and deposited the same with a bank. A day after, the bank tried to clear them with the Bureau of Posts. It turned out, however, that the postal money orders were irregularly issued thereby prompting the Bureau of Posts to serve notice upon all banks not to pay the money orders if presented for payment. The Bureau of Posts further informed the bank that the amount of P1,000 had been deducted from the bank's clearing account. For its part, the bank debited the book store's account with the same amount.**

**A complaint was filed by the bookstore against the Bureau of Posts and the bank for the recovery of the sum of P1,000, which, however, was dismissed by the trial court. The bookstore appealed contending that the postal money orders are negotiable instruments and that their nature could not have been affected by the notice sent by the Bureau of Post to the banks.**

**How would you resolve the controversy?**

**Answer:**

The contention of the bookstore that postal money orders are negotiable instruments cannot be sustained. Postal money orders, being under the restrictions and limitations of the postal laws, do not contain unconditional promise or order, as required by the Negotiable Instruments Law. (*Sec. 1 & 3; also Bolognesi v. U.S., 189 Feb. 335; 7 Am. Jur. 921; also Philippine Education Co., Inc. v. Soriano, 39 SCRA 587.*) (BAR 1980)

**3. A promissory note read as follows: "I promise to pay Gabriela Silangan P100 three years after the unconditional withdrawal of the U.S. of its military bases in the Philippines."**

- a) Discuss the negotiability or non-negotiability of the above note.
- b) Discuss the effect of each of the following upon the note's negotiability:
  - 1) No date is given
  - 2) The places where drawn and where payable are not stated.

**Answer:**

- a) The promissory note is not a negotiable instrument. Section of the NIL requires, among other things, for an instrument to be negotiable, that it must be payable to order or to bearer. Without being so payable, the note is not a negotiable instrument.
- b)
  - 1) The negotiability of an instrument is not adversely affected by its being undated. Even if it is needed to determine the maturity of the instrument, the holder is implicitly authorized to place the date thereof or to consider it dated as of its issue.
  - 2) For the negotiability of a promissory note it is not necessary that it must express the place where it is made or where it is payable. All that is required under the NIL is compliance with Section 1 thereof. (BAR 1988)

**4. (1) What is the test to determine whether an instrument is negotiable or not?**

**(2) X bought a jeep from Reliable Motors Company for a consideration of P50,000. He paid P25,000 in cash and executed the following promissory note on the balance:**

**September 1, 1989**

**I promise to pay the sum of P25,000 to Reliable Motors Company on or before December 31, 1989.**

**Sgd. X**

**At the bottom of the note, X wrote in his own handwriting the following: "I will not sell the jeep until I shall have paid it in full." Is the note negotiable? Reasons.**

**Answer:**

- 1) In determining whether an instrument is negotiable or not, the sole test is whether or not the requisites of negotiability expressed in Sec. 1 of the NIL are met on the face of the instrument itself. The intrinsic validity of the instrument is of no moment. Even the acceptance or non-acceptance by the drawee of the instrument would be irrelevant.
  - 2) The promissory note is not negotiable since the same is payable to Reliable Motors merely and not "to order or to bearer" or words of similar import. (BAR 1989)
- 5. Perla brought a motor car payable in installments from Automotive Company for P250,000. She made a down payment of P50,000 and executed a promissory note for the balance. The company subsequently indorsed the note to Reliable Finance Corporation which financed the purchase. The promissory note read:**

**“For value received, I promise to pay Automotive Company or order at its office in Legaspi City, the sum of P200,000.00 with interest at twelve (12%) per cent per annum, payable in equal installments of P20,000.00 monthly for ten (10) months starting October 21, 1991.**

**Manila September 21, 1991.**

**(Sgd.) Perla**

**Pay to the order of Reliable Finance Corp.**

**Automotive Company**

**By:**

**(Sgd.) Manager**

**Because Perla defaulted in the payment of her installments, Reliable Finance Corporation initiated a case against her for a sum of money. Perla argued that the promissory note is merely open to all defenses available to the assignor and, therefore, Reliable Finance Corporation is not a holder in due course.**

**a) Is the promissory note a mere assignment of credit or a negotiable instrument? Why?**

**Answer:**

The promissory note in the problem is a negotiable instrument, being in compliance with the provisions of Section 1 of the NIL. Neither the fact that the payable sum is to be paid with interest nor that the maturities are in stated installments render uncertain the amount payable. (BAR 1992)

**6. Discuss the negotiability or non-negotiability of the following notes:**

**1. Manila, September 1, 1993**

**P2,500.00**

**I promise to pay Pedro San Juan or order the sum of P2,500.00**

**(Sgd.) NOEL CASTRO**

**2. Manila, June 3, 1993**

**P10,000.00**

**For value received, I promise to pay Sergio Dee or order the sum of P10,000.00 in five (5) installments, with the first installment payable on October 5, 1993 and the other installments on or before the fifth day of the succeeding month thereafter.**

**(Sgd.) LITO VILLA**

**Answer:**

- 1. The promissory note is negotiable as it complies with Sec. 1, NIL. Firstly, it is in writing and signed by the maker, Noel Castro. Secondly, the promise is unconditional to pay a sum certain in money, that is, P2,500.00 Thirdly, it is payable on demand as no date of maturity is specified. Fourth, it is payable to order.**

2. The promissory note is not negotiable. All the requirements of Sec. 1, NIL, are complied with. The sum to be paid is still certain despite that the sum is to be paid by installments. (BAR 1993)

**7. What are the requisites of a negotiable instrument?**

**Answer:**

The requisites of a negotiable instrument are as follows:

1. It must be in writing and signed by the maker or drawer;
2. It must contain an unconditional promise or order to pay a sum certain in money;
3. It must be payable to order or to bearer; and
4. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty. (BAR 1996)

**8. Can a bill of exchange or a promissory note qualify as a negotiable instrument if—**

- a) **It is not dated; or**
- b) **The day and month, but not the year of its maturity, is given; or**
- c) **It is payable to “cash”; or**
- d) **It names two alternative drawees.**

**Answer:**

- a) Yes. Date is not a material particular required by Sec. 1, NIL, for the negotiability of an instrument.
- b) No. The time for payment is not determinable in this case. The year is not stated
- c) Yes. Sec. 9(d), NIL, makes the instrument payable to bearer because the name of the payee does not purport to be the name of any person.
- d) A bill may not be addressed to two or more drawees in the alternative or in succession, to be negotiable. To do so makes the order conditional. (BAR 1997)

9. a) MP bought a used cellphone from JR. JR preferred cash but MP is a friend so JR accepted MP's promissory note for P10,000. JR thought of converting the note into cash by endorsing it to his brother KR. The promissory note is a piece of paper with the following hand-printed notation: "MP WILL PAY JR TEN THOUSAND PESOS IN PAYMENT FOR HIS CELLPHONE 1 WEEK FROM TODAY". Below this notation MP's signature with "8/1/00" next to it, indicating the date of the promissory note. When JR presented MP's note to KR, the latter said it was not a negotiable instrument under the law and so could not be a valid substitute for cash. JR took the opposite view, insisting on the note's negotiability. You are asked to referee. Which of the opposing views is correct? Explain.

b) TH is an indorsee of a promissory note that simply states: "PAY TO JUAN TAN OR ORDER 400 PESOS." The note has no date, no place of payment and no consideration mentioned. It was signed by MK and written under his letterhead specifying the address, which happens to be his residence. TH accepted the promissory note as payment for services he rendered to SH, who in turn received the note from Juan Tan as payment for a prepaid cellphone card worth 450 pesos. The payee acknowledged having received the note on August 1, 2000. A Bar reviewee had told TH, who happens to be your friend, that TH is not a holder in due course under Article 52 of the NIL and therefore does not enjoy the rights and protection under the statute. TH asks for your advice specifically in connection with the note being undated and not mentioning a place of payment and any consideration. What would your advice be?

**Answer:**

- a) KR is right. The promissory note is not negotiable. It is not issued to order or bearer. There is no word of negotiability contained therein. It is not issued in accordance with Section 1 of the NIL.

- b) The fact that the instrument is undated and does not mention the place of payment does not militate against its being negotiable. The date and place of payment are not material particulars required to make an instrument negotiable.

The fact that no mention is made of any consideration is not material. Consideration is presumed. (BAR 2000)

**10. Which of the following stipulations or feature of a promissory note (PN) affect or do not affect its negotiability, assuming that the PN is otherwise negotiable? Indicate your answer by writing the paragraph number of the stipulation or feature of the PN as shown below and explain your corresponding answer, either "Affected" or "Not affected". Explain.**

- 1) The date of the PN is "February 30, 2002"**
- 2) The PN bears interest payable on the last day of each calendar quarter at a rate equal to 5% above the then prevailing 91-day Treasury Bill rate as published at the beginning of such calendar quarter.**
- 3) The PN gives the maker the option to make payment either in money or in quantity of palay of equivalent value.**
- 4) The PN gives the holder the option either to require payment in money or to require the maker to serve as the bodyguard or escort of the holder for 30 days.**

**Answer:**

- 1) Paragraph 1—negotiability is "NOT AFFECTED". The date is not one of the requirements for negotiability.
- 2) Paragraph 2—negotiability is "NOT AFFECTED". The interest is to be computed at a particular time and is determinable. It does not make the sum uncertain or the promise conditional.
- 3) Paragraph 3—negotiability is "AFFECTED". Giving the maker the option renders the promise conditional.
- 4) Paragraph 4—negotiability is "NOT AFFECTED". Giving the option to the holder does not make the promise conditional. (BAR 2002)

**11. R issued a check for P1 M which he used to pay S for killing his political enemy. Can the check be considered a negotiable instrument?**

**Answer:**

Yes, the check can be considered a negotiable instrument even if it was issued to pay S to kill his political enemy. The validity of the consideration is not one of the requisites of a negotiable instrument (Section 1, NIL). It merely constitutes a defect of title. (Section 55, NIL) (BAR 2007)

**12. TRUE or FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**A document, dated July 15, 2009, that reads: "Pay to X or order the sum of P5,000.00 five days after his pet dog, Sparky, dies. Signed Y." is a negotiable instrument.**

**Answer:**

True. The document is subject to a term and not a condition. The dying of the dog is a day which is certain to com. Therefore, the order to pay is unconditional, in compliance with Section 1 of the NIL. (BAR 2009)

**13. Lorenzo drew a bill of exchange in the amount of P100,000 payable to Barbara or order, with his wife, Diana, as drawee. At the time the bill was drawn, Diana was unaware that Barbara is Lorenzo's paramour.**

Barbara then negotiated the bill to her sister, Elena, who paid for it for value, and who did not know who Lorenzo was. On due date, Elena presented the bill to Diana for payment, but the latter promptly dishonored the instrument because, by then, Diana had already learned of her husband's dalliance.

a) Does the illicit cause or consideration adversely affect the negotiability of the bill? Explain.

**Answer:**

No. The illicit cause or consideration does not adversely affect the negotiability of the bill, especially in the hands of a holder in due course. Under Sec. 1 of the NIL, the bill of exchange is a negotiable instrument. Every negotiable instrument is deemed prima facie to have been issued for valuable consideration, and every person whose signature appears thereon is deemed to have become a party thereto for value. (BAR 2009)

14. A promissory note states, on its face: "I, X, promise to pay Y the amount of P5,000.00 five days after completion of the on-going construction of my house. Signed, X." Is the note negotiable?

- a. Yes, since it is payable at a fixed period after the occurrence of a specified event.
- b. No, since it is payable at a fixed period after the occurrence of an event which may not happen.
- c. Yes, since it is payable at a fixed period or determinable future time.
- d. No, since it should be payable at a fixed period before the occurrence of a specified event.

**Answer:**

b. No, since it is payable at a fixed period after the occurrence of an event which may not happen. (BAR 2011)

15. A writes a promissory note in favor of his creditor, B. it says: Subject to my option, I promise to pay B P1 M or his order to give P1 M worth of cement or to authorize him to sell my house worth P1 M. signed, A." Is the note negotiable?

- a. No, because the exercise of the option to pay lies with A, the maker and debtor.
- b. No, because it authorizes the sale of collateral securities in case the note is not paid at maturity.
- c. Yes, because the note is really payable to B or his order, the other provisions being merely optional.
- d. Yes, because an election to require something to be done in lieu of payment of money does not affect negotiability.

**Answer:**

a. No, because the exercise of the option to pay lies with A, the maker and debtor. (BAR 2011)

16. B borrowed P1 M from L and offered to him his BMW car worth P1 M as collateral. B then executed a promissory note that reads: "I, B, promise to pay L or bearer the amount of P1 M and to keep my BMW car (loan collateral) free from any other encumbrance. Signed, B." Is this note negotiable?

- a. Yes, since it is payable to bearer.
- b. Yes, since it contains an unconditional promise to pay a sum certain in money.
- c. No, since the promise to just pay a sum of money is unclear.
- d. No, since it contains a promise to do an act in addition to the payment of money.

**Answer:**

d. No, since it contains a promise to do an act in addition to the payment of money. (BAR 2011)

17. Indicate and explain whether the promissory note is negotiable or non-negotiable.

- a) I promise to pay A or bearer P100,000 from my inheritance which I will get after the death of my father.
- b) I promise to pay A or bearer P100,000 plus the interest rate of 90—day treasury bills.
- c) I promise to pay A or bearer P100,000 if A passes the 2012 bar exams.
- d) I promise to pay A or bearer P100,000 on or before December 30, 2012.
- e) I promise to pay A or bearer P100,000.

**Answer:**

- a) Not negotiable. There is no unconditional promise to pay a sum certain in money as the promise is to pay the amount out of a particular funds, i.e., the inheritance from the father of the promisor.
- b) Not negotiable. There is no unconditional promise to pay a sum certain in money. The promise to pay “the interest rate of 90—day treasury bills” is vague because, first, there are no 90—day treasury bills; second, the promise does not specify whether the so-called “interest rate” is that established at the primary market (where new T-bills are sold for the first time by the Bureau of Treasury) or at the secondary market (where T bill can be bought and sold after they have been issued in the primary market); and third, T-bills are conventionally quoted in terms of their discount rate, rather than their interest rate. They do not pay any interest directly; instead, they are sold at a discount of their face value and thus “earn” by selling at face value upon maturity.
- c) Not negotiable. The promise to pay is subject to a condition, i.e., that A will pass the 2012 bar exams.
- d) Negotiable. It conforms fully with the requirements of negotiability under Section 1 of NIL.
- e) Negotiable. It conforms fully with the requirements of negotiability under Section 1 of NIL. It is payable on demand because the note does not express a time for its payment. (BAR 2012)

**18. X issued a promissory note which states, “I promise to pay Y or order P100,000 or 1 unit Volvo Sedan.” Which statement is most accurate?**

- a) The promissory note is negotiable because the forms of payment are clearly stated;
- b) The promissory note is non-negotiable because the option as to which form of payment is with the maker;
- c) The promissory note is an invalid instrument because there is more than one form of payment;
- d) The promissory note can be negotiated by way of delivery.

**Answer:**

- b) The promissory note is non-negotiable because the option as to which form of payment is with the maker (BAR 2012)

**19. X issued a promissory note which states “I promise to pay Y or bearer the amount of HK\$50,000 on or before December 30, 2013.” Is the promissory note negotiable?**

- a) No, the promissory note becomes invalid because the amount is in foreign currency;
- b) Yes, the promissory note is negotiable even though the amount is stated in foreign currency;
- c) No, the promissory note is not negotiable because the amount is in foreign currency;
- d) Yes, the promissory note is negotiable because the Hong Kong dollar is a known foreign currency in the Philippines.

**Answer:**

- a) Yes, the promissory note is negotiable even though the amount is stated in foreign currency (BAR 2012)

20. As payment for a debt, X issued a promissory note in favor of Y but the promissory note on its face was marked non-negotiable. Then Y instead of indorsing the promissory note, assigned the same in favor of Z to whom he owed some debt also. Which statement is most accurate?

- a) Z cannot claim payment from X on the basis of the promissory note because it is marked non-negotiable;
- b) Z can claim payment from X even though it is marked non-negotiable;
- c) Z can claim payment from Y because under the NIL, negotiation and assignment is one and the same;
- d) Z can claim payment from Y only because he was the endorser of the promissory note.

**Answer:**

- a) Z can claim payment from X even though it is marked non-negotiable; (BAR 2012)

21. Antonio issued the following instrument:

August 10, 2013  
Makati City

P100,000.00

Sixty days after date, I promise to pay Bobby or his designated representative the sum of ONE HUNDRED THOUSAND PESOS (P100,000.00) from my BPI Acct. No. 1234 if, by this due date, the sun still sets in the west to usher in the evening and rises in the east the following morning to welcome the day.

(Sgd.) Antonio Reyes

**Explain each requirement of negotiability present or absent in the instrument.**

**Answer:**

The instrument contains a promise to pay and was signed by the maker, Antonio Reyes.

The promise to pay is unconditional insofar as the reference to the setting of the sun in the west in the evening and its rising in east in the morning are concerned. These are certain to happen. The promise to pay is conditional, because the money will be taken from a particular fund, BPI Acct. No. 1234.

The instrument contains a promise to pay a sum certain in money, P100,000.00.

The money is payable at a determinable future time, 60 days after August 10, 2013.

The instrument is not payable to order or to bearer. (BAR 2013)

22. Which of the following instruments is negotiable if all the other requirements of negotiability are met?

- a. A promissory note with promise to pay out of the U.S. Dollar account of the maker in XYZ Bank.
- b. A promissory note which designates the U.S. Dollar currency in which payment is to be made.
- c. A promissory note which contains in addition a promise to paint the portrait of the bearer.
- d. A promissory note made payable to the order of Jose Cruz or Josefa Cruz.

**Answer:**

- c. A promissory note which contains in addition a promise to paint the portrait of the bearer. (BAR 2014)

- 2. Order Instrument
- 3. Bearer Instrument

1. A delivers a bearer instrument to B. B then specially indorses it to C and C later indorses it in blank to D. E steals the instrument from D and, forging the signature of D, succeeds in “negotiating” it to F who acquires the instrument in good faith and for value.
- a) If, for any reason, the drawee bank refuses to honor the check, can F enforce the instrument against the drawer?
  - b) In case of the dishonor of the check by both the drawee and the drawer, can F hold any of B, C and D liable secondarily on the instrument?

**Answer:**

- a) Yes. The instrument was payable to bearer as it was a bearer instrument. It could be negotiated by mere delivery despite the presence of special indorsements. The forged signature is unnecessary to presume the juridical relation between or among the parties prior to the forgery and the parties after the forgery. The only party who can raise the defense of forgery against a holder in due course is the person whose signature is forged.
- b) Only B and C can be held liable by F. the instrument at the time of the forgery was payable to bearer, being a bearer instrument. Moreover, the instrument was indorsed in blank by C to D. D, whose signature was forged by E cannot be held liable by F. (BAR 1997)

2. Richard Clinton makes a promissory note payable to bearer and delivers the same to Aurora Page. Aurora Page, however, endorses it to X in this manner:

“Payable to X. Signed: Aurora Page.”

Later, X, without endorsing the promissory note, transfers and delivers the same to Napoleon. The note is subsequently dishonored by Richard Clinton. May Napoleon proceed against Richard Clinton for the note?

**Answer:**

Yes. Richard Clinton is liable to Napoleon under the promissory note. The note made by Richard Clinton is a bearer instrument. Despite special indorsement made by Aurora Page thereon, the note remained a bearer instrument and can be negotiated by mere delivery. When X delivered and transferred the note to Napoleon, the latter became a holder thereof. As such holder, Napoleon can proceed against Richard Clinton. (BAR 1998)

3. M makes a promissory note that states: “I, M, promise to pay P5,000.00 to B or bearer. Signed, M.” M negotiated the note by delivery to B, B to N, N to O. B had known that M was bankrupt when M issued the note. Who would be liable to O?
- a. M and N sine they may be assumed to know of M’s bankruptcy.
  - b. N, being O’s immediate negotiator of a bearer note.
  - c. B, M, and N, being indorsers by delivery of a bearer note.
  - d. B, having known of M’s bankruptcy.

**Answer:**

- a. N, being O’s immediate negotiator of a bearer note. (BAR 2011)

4. X delivered a check issued by him and payable to the order of CASH to Y in payment for certain obligations incurred by X in favor of Y. Y then delivered the checks to Z in payment for certain obligations. Which statement is most accurate?
- a) Z can encash the check even though Y did not indorse the check;
  - b) Z cannot encash the check for lacking in proper endorsement;
  - c) Y is the only one liable because he was the one who delivered the check to Z;
  - d) The negotiation is not valid because the check is an instrument payable to order.

**Answer:**

- a) Z can encash the check even though Y did not indorse the check. (BAR 2012)

5. Which phrase best completes the statement— A check which is payable to bearer is a bearer instrument and:

- a) Negotiation can be made by delivery only;
- b) Negotiation must be by written indorsement;
- c) Negotiation must be by specific indorsement;
- d) Negotiation must be by indorsement and delivery.

**Answer:**

- b) Negotiation can be made by delivery only; (BAR 2012)

#### 4. Kinds of Negotiable Instruments

1. State and explain whether the following are negotiable instruments under the NIL:

- a. Postal Money Order;
- b. A certification of time deposit which states “This is to certify that bearer has deposited in this bank the sum of FOUR THOUSAND PESOS (P4,000.00) only, repayable to the depositor 200 days after date”.
- c. Letters of credit;
- d. Warehouse receipts;
- e. Treasury warrants payable from a specific fund.

**Answer:**

- a. A Postal Money Order is not a negotiable instrument because of the condition appearing at the back thereof, thereby making the order conditional, contrary to Section 1 of the NIL.
- b. A certificate of time deposit is a negotiable instrument, because it is an acknowledgment in writing by the bank of the amount of deposit with a promise to repay the same to the depositor or bearer thereof at a specific time.
- c. A letter of credit is not a negotiable instrument, because it is not payable to order or bearer and is generally conditional; therefore, it does not comply with Section 1 of the NIL.
- d. Warehouse receipts are not negotiable instruments, because their subject matter is things or goods, and not a sum certain in money as required by Section 1 of the NIL.
- e. Treasury warrants payable from a specific fund are not negotiable instruments as they are payable out of a particular fund which may or may not exist, thereby making the order conditional, in contravention of Section 1 of the NIL. (BAR 2005)

a. **Bill of Exchange**

1. **Define the following: (1) a bill of exchange**

**Answer:**

A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or bearer. (BAR 2002)

b. **Promissory Note**

1. **A. Define the following: (1) a negotiable promissory note**

**B. You are Pedro Cruz. Draft the appropriate contract language for (1) your negotiable promissory note containing the essential elements of a negotiable instrument.**

**Answer:**

A. A negotiable promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed determinable future time, a sum certain in money to order or bearer.

B. Negotiable promissory note—

“September 15, 2002

“For value received, I hereby promise to pay Juan Santos or order the sum of TEN THOUSAND PESOS (P10,000.00) thirty (30) days from date hereof.

(Signed) Pedro Cruz” (BAR 2002)

2. **P authorized A to sign a bill of exchange in hi (P’s) name. the bill reads: “Pay to B or order the sum of P1 M. Signed, A (for and in behalf of P).” The bill was drawn on P. B indorsed the bill to C, C to D, and D to E. May E treat the bill as a promissory note?**

- a. **No, because the instrument is payable to order and the same person.**
- b. **Yes, because the drawer and the drawee are one and the same person.**
- c. **No, because the instrument is a bill of exchange.**
- d. **Yes, because A was only an agent of P.**

**Answer:**

b. Yes, because the drawer and the drawee are one and the same person. (BAR 2011)

3. **If the drawer and the drawee are the same person, the holder may present the instrument for payment without need of a previous presentment for acceptance. In such case, the holder treats it as a**

- a. **Non-negotiable instrument.**
- b. **Promissory note.**
- c. **Letter of credit.**
- d. **Check.**

**Answer:**

a. Promissory note. (BAR 2011)

**4. A promissory note which is undated is presumed to be—**

- a) Dated as of the date of issue;**
- b) Dated as of the date of the first indorsement;**
- c) Promissory note is invalid because there is no date;**
- d) Dated on due date.**

**Answer:**

- a) Dated as of the date of issue. (BAR 2012)

**B. Completion and Delivery**

- 1. Insertion of Date**
- 2. Completion of Blanks**

- 1. A, single proprietor of a business concern, is about to leave for a business trip and, as he so often does on these occasions, signs several checks in blank. He instructs B, his secretary, to safekeep the checks and fill them out when and as required to pay accounts during his absence. B fills out one of the checks by placing her name as payee, fills in the amount, endorses and delivers the check to C who accepts it in good faith as payment for goods sold to B. B regrets her action and tells A what she did. A directs the Bank in time to dishonor the check. When C encashes the check, it is dishonored.**

**Can A be held liable to C?**

**Answer:**

Yes. A can be held liable to C, assuming that the latter gave notice of dishonor to A, this case of an incomplete instrument but delivered as it was entrusted to B, the secretary of A. Moreover, under the doctrine of comparative negligence, as between A and C, both innocent parties, it was the negligence of A in entrusting the check to B which is the proximate cause of the loss. (BAR 1997)

- 2. AX, a businessman, was preparing for a business trip abroad. As he usually did in the past, he signed several checks in blank and entrusted them to his secretary with instruction to safeguard them and fill them out only when required to pay accounts during his absence. OB, his secretary, filled out one of the checks by placing her name as the payee. She filled out the amount, endorsed and delivered the check to KC, who accepted it in good faith for payment of gems that KC sold to OB. Later, OB told AX of what she did with regrets. AX timely directed the bank to dishonor the check. Could AX be held liable to KC? Answer and reason briefly.**

**Answer:**

Yes. AX could be held liable to KC. This is a case of an incomplete check, which has been delivered. Under Section 14 of the NIL, KC, as a holder in due course, can enforce payment of the check as if it had been filled up strictly in accordance with the authority given by AX to OB and within a reasonable time. (BAR 2004)

- 3. AB Corporation drew a check for payment to XY Bank. The check was given to an officer of AB Corporation who was instructed to deliver it to XY Bank. Instead, the officer, intending to defraud the Corporation, filled up the check by making himself as the payee and delivered it to XY Bank for deposit to his personal account. XY Bank debited AB Corporation's account. AB Corporation came to know of the officer's fraudulent act after he absconded. AB Corporation asked XY Bank to recredit its amount. XY Bank refused.**

- a) If you were the judge, what issues would you consider relevant to resolve the case? Explain.**

**b) How would you decide the case? Explain.**

**Answer:**

- a) If I were the judge, I will consider the following issues: (1) whether the check was a complete instrument; (2) whether the check has been delivered; and (3) whether AB Corporation can be held liable for the amount of the check.
- b) The check was an incomplete instrument in as much as the name of the payee as not written by the drawer, AB Corporation. However, the said instrument has been delivered by AB Corporation to its officer. Thus, the check became binding on AB Corporation as drawer thereof. An incomplete instrument, if delivered, as in this case, creates liability on the part of the drawer. Therefore, AB Corporation cannot ask XY Bank to recredit the amount of the check to his account. (BAR 2008)

**3. Incomplete and Undelivered Instruments**

**1. A signed a blank check which he inadvertently left on his desk at his Escolta Office. The same was later stolen by B, who filled in the amount of P22,300.00 and a fictitious name as payee. B then endorsed the check in the payee's name and passed the check to C; thereafter C passed it to D; then D to E, and E to F.**

- 1) Can F enforce the instrument against A? Explain.**
- 2) Suppose that F is a holder in due course, what will be your answer? Explain.**
- 3) Can F enforce the instrument against B? Against C? Give reasons.**

**Answer:**

- 1) No. An incomplete instrument (of A) which has not been delivered, it will not, if completed and negotiated without authority (by B), be a valid contract in the hands of any holder (F), as against any person (A) whose signature was placed thereon before delivery.
- 2) No also, for the same reason as indicated above. The law says "in the hands of any holder", meaning, whether a holder in due course or not.
- 3) Yes, if F can enforce the said instrument against B, the thief who, having no good title on the instrument, endorsed it in an assumed (fictitious) name, thereby making a breach of his warranty.

F may not enforce the instrument against C, unless there had been due presentment, and dishonor, of the instrument, and notice of dishonor given to C. (BAR 1978)

**2. Jose makes a note payable to bearer with the amount blank and delivers it to Karen for safekeeping. Marina fills up the note for P20,000 and negotiates it to Adriano. Can Jose dishonor the note and refuse payment to Adriano on the ground that the note (A) was incomplete and (B) was originally delivered to Karen for safekeeping only and not for negotiating? Reason.**

**Answer:**

Yes, Jose can dishonor the note. This is a case of incomplete and not delivered instrument. When an incomplete instrument has not been delivered it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder (whether Adriano is a holder in due course or not), as against any person (Jose) whose signature was placed thereon before. (*Sec. 15, N.I.L.*) (BAR 1982)

**3. Jose Reyes signed a blank check, and in his haste to attend a party, left the check on top of his executive desk in his office. Later, Nazareno forced open the door to Reyes' office, and stole the blank check. Nazareno immediately filled in the amount of P50,000 and a fictitious name as payee on the said check. Nazareno then endorsed the check in the payee's name and passed it to Roldan. Thereafter, Roldan endorsed the check to Dantes.**

- a) **Can Dantes enforce the check against Jose Reyes? Explain.**

- b) If Dantes is a holder in due course, will your answer to question a) be the same? Explain.**  
**c) Can Dantes enforce the check against Roldan? Explain.**

**Answer:**

- a) Dantes cannot enforce the check against Jose Reyes, who can raise the defense that the check as incomplete and not delivered, when only stolen and filled up by Nazareno.
- b) If Dantes is a holder in due course, my answer will be the same, because such a check, being incomplete and not delivered originally, although later on completed and negotiated without authority from Jose Reyes, cannot be valid contract in the hands of any holder in due course.
- c) Yes, Dantes, however, may enforce the check against Roldan, provided there would be presentment of the check to the drawee bank, dishonor by the bank, and notice of dishonor given to Roldan. (BAR 1985)
- 4. PN makes a promissory note for P5,000, but leaves the name of the payee in blank because he wanted to verify its correct spelling first. He mindlessly left the note on top of his desk at the end of the workday. When he returned the following morning, the note was missing. It turned up later when X presented it to PN for payment. Before X, T, who turned out to have filched the note from PN's office, had endorsed the note after inserting his own name in the blank space as the payee. PN dishonored the note, contending that he did not authorize its completion and delivery. But X said he had no participation in, or knowledge about, the pilferage and alteration of the note and therefore he enjoys the rights of a holder in due course under the NIL. Who is correct and why?**

**Answer:**

PN is right. The instrument is incomplete and undelivered. It did not create any contract that would bind PN to an obligation to pay the amount thereof. (BAR 2000)

- 5. Jun was to leave for a business trip. As his usual practice, he signed several blank checks. He instructed Ruth, his secretary, to fill them as payment for his obligations. Ruth filled one check with her name as payee, placed P30,000 thereon, endorsed and delivered it to Marie. She accepted the check in good faith as payment for goods she delivered to Ruth. Eventually, Ruth regretted what she did and apologized to Jun. immediately, he directed the drawee bank to dishonor the check. When Marie encashed the check, it was dishonored.**

**Supposing the check was stolen while in Ruth's possession and a thief filled the blank check, endorsed and delivered it to Marie in payment for the goods he purchased from her, is Jun liable to Marie if the check is dishonored?**

**Answer:**

No. section 15 of the NIL provides that "where an incomplete instrument has not been delivered, it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery." The want of delivery of an incomplete instrument is a real defense available against any holder, including a holder in due course. (BAR 2006)

#### **4. Complete but Undelivered Instruments**

- 1. Jun was to leave for a business trip. As his usual practice, he signed several blank checks. He instructed Ruth, his secretary, to fill them as payment for his obligations. Ruth filled one check with her name as payee, placed P30,000 thereon, endorsed and delivered it to Marie. She accepted the check in good faith as payment for goods she delivered to Ruth. Eventually, Ruth regretted what she did and apologized to Jun. immediately, he directed the drawee bank to dishonor the check. When Marie encashed the check, it was dishonored.**

## Is Jun liable to Marie?

### Answer:

Yes. Jun is liable to Marie, as she is a holder in due course. Pursuant to Sec. 14 of the NIL, in order that an incomplete instrument, when completed, may be enforced against any person who became a party thereto prior to its completion, it must be filled up strictly in accordance with the authority given and within a reasonable time. However, if any such instrument, after completion, is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it in accordance with the authority given and within a reasonable time. Considering that Marie accepted the check in good faith and for value, she is a holder in due course, who has the right to enforce payment of the check for the full amount thereof against Jun. That the blank check was filled-up not in accordance with the authority given is only a personal defense that cannot be used against a holder in due course. (BAR 2006)

### C. Signature

#### 1. Signing in Trade Name

1. **A check was issued to Tiger Woods. But what was written as payee is the word "Tiger Woods". To validly endorse the check—**
  - a) **Tiger Woods must sign his real name;**
  - b) **Tiger Woods must sign both his real name and assumed name;**
  - c) **Tiger Woods can sign his assumed name;**
  - d) **The check has become non-negotiable.**

### Answer:

c) Tiger Woods can sign his assumed name. (BAR 2012)

#### 2. Signature of Agent

1. **In a signature by procuration, the principal is bound only in case the agent acted within the actual limits of his authority. The signature of the agent in such a case operates as notice that he has**
  - a. **A qualified authority to sign.**
  - b. **A limited authority to sign.**
  - c. **A special authority to sign.**
  - d. **A full authority to sign.**

### Answer:

a. A limited authority to sign. (BAR 2011)

2. **Under the NIL, a signature by the procuration operates as a notice that the agent has but a limited authority to sign. Thus, a person who takes a bill that is drawn, accepted, or indorsed by procuration is duty-bound to inquire into the extent of the agent's authority by:**
  - a. **Examining the agent's special power of attorney.**
  - b. **Examining the bill to determine the extent of such authority.**
  - c. **Asking the agent about the extent of such authority.**
  - d. **Asking the principal about the extent of such authority.**

### Answer:

b. Examining the bill to determine the extent of such authority. (BAR 2011)

### 3. Indorsement by Minor or Corporation

1. **X makes a promissory note for P500 payable to A, a minor, to help him buy school books. A indorses the note to B who, in turn, indorses the note to C. C knows A's minority. If C sues X on the note, can X set up the defense of minority and lack of consideration?**

**Answer:**

The promissory note not being payable to order or to bearer, is not a negotiable instrument. Accordingly, the transferee merely steps into the shoes of the transferor and, being merely a successor-in-interest, has no right greater than that of the transferor. X may thus set up against C the possible defenses of minority and lack of consideration. (BAR 1989)

2. **X makes a promissory note for P10,000 payable to A, a minor, to help him buy school books. A endorses the note to B for value, who in turn endorses the note to C. C knows A is a minor. If C sues X on the note, can X set up the defenses of minority and lack of consideration?**

**Answer:**

Yes. C is not a holder in due course. The promissory note is not a negotiable instrument as it does not contain any word of negotiability, that is, order or bearer, or words of similar meaning or import. Not being a holder in due course, C is to subject such personal defenses of minority and lack of consideration. C is a mere assignee who is subject to all defenses. (BAR 1998)

3. **A bill of exchange has T for its drawee, U as drawer, and F as holder. When F went to T for presentment, F learned that T is only 15 years old. F wants to recover from U but the latter insists that a notice of dishonor must first be made the instrument being a bill of exchange. Is he correct?**
- a. **Yes, since a notice of dishonor is essential to charging the drawer.**
  - b. **No, since T can waive the requirement of notice of dishonor.**
  - c. **No, since F can treat U as maker due to minority of T, the drawee.**
  - d. **Yes, since in a bill of exchange, notice of dishonor is at all times required.**

**Answer:**

a. No, since F can treat U as maker due to minority of T, the drawee. (BAR 2011)

4. **Y, as President of and in behalf of AAA Corporation, as a way to accommodate X, one of its stockholders, endorsed the check issued by X. Which statement is most accurate?**
- a) **It is an ultra vires act;**
  - b) **It is a valid indorsement;**
  - c) **The corporation will be held liable to any holder in due course;**
  - d) **It is an invalid indorsement.**

**Answer:**

a) It is an ultra vires act.  
b) It is a valid indorsement. (BAR 2012)

### 4. Forgery

- 1. Monsato, Inc drew a check for P5,000.00 payable to Daez, Inc. drawn against the Manila Bank. The check was indorsed and delivered to Martel and Co., which in turn deposited the check in its current account with the PNB. The check was cleared in due course, and Manila Bank paid PNB the amount of the check. Twenty days later, it was discovered that the signature of Daez, Inc. was forged. PNB paid Manila Bank and notified Martel and Co. that it had debited its account with the corresponding amount. Who, as between Martel and Co. and PNB, should bear the loss?**

**Answer:**

Martel and Co. should bear the loss for two reasons. First, in depositing the check in its account with the PNB, it must have indorsed the check to the PNB. Assuming that the endorsement was a general one, Martel as endorser warranted that the instrument is genuine, and valid and subsisting at the time of his endorsement. It is therefore liable for breach of its warranties. Second, by depositing the check with the PNB, as between it and the PNB, the latter merely became a collecting agent of Martel. Any liability arising out of the check is therefore chargeable by the agent, PNB, to the principal, Martel and Co. (*Great Eastern Life Insurance Co. v. Hongkong & Shanghai Bank*, 43 Phil. 679 and *Republic v. Ebrada*, 65 SCRA 680) (BAR 1976)

- 2. Pedro writes out a check for P1,000.00 in favor of Jose or order against his current account with Bank of America. Juan steals the check, erases the name of Jose and superimposes his own name. Juan deposits the check at Citibank and after clearing, Juan withdraws the amount and absconds. Upon discovery by Pedro of the material alteration, he lodged a complaint at the Bank of America, who debited the amount to Pedro. Bank of America demands reimbursement for Citibank which refuses on the ground that it only acted as an agent for collection. Who bears the loss? Why?**

**Answer:**

The Bank of America shall bear the loss. Undisputedly, it is liable to Pedro (drawer) for the amount of the check, for the simple reason that his order on the check was to pay "Jose or order," and Jose or his order" was not paid. Barring a case of notorious negligence on his part, Pedro has a right to be credited or reimbursed for the amount taken from his account.

On the other, Citibank is not liable. First, the check was cleared by the Bank of America, in view of which the former credited the corresponding amount to the depositor of the check (Juan) and then honored his check for said amount. Thus, the Bank of America had not only been negligent in clearing its own check, but had, also, thereby, induced Citibank to pay the amount thereof to said depositor. Second, although when Citibank sent the check to the Bank of America for clearing it stamped thereon "all prior endorsement guaranteed" (as may be reasonably presumed being a used banking practice) it does not, however, include the guarantee that the check had not been materially altered. It must be noted at this point that the signature of Pedro, although he is not the real payee, is genuine. There was no breach, therefore, of Citibank's guarantee. Reason dictates that its guarantee cannot be enlarged to include that prior endorsements had not been materially altered. (BAR 1977)

- 3. Fernando forged the name of Daniel, manager of a Trading Company, as the drawer of a check. The Bank of the Philippine Islands, the drawee bank, did not detect the forgery and paid the amount.**

**May the bank charge the amount paid against the account of the alleged drawer? Reasons.**

**Answer:**

No. a bank that cashes a check must know to whom it pays. It is an elementary principle both of banking and of the NIL that a bank is bound to know the signature of its customers; and if it pays a forged check, it must be considered as making the payment out of its funds, and cannot ordinarily charge the amount so paid to the account of the depositor whose name was forged. (BAR 1977)

- 4. Hernan issued a check payable to the order of Fernando in the sum of P12,000, and drawn on "X" Bank. The check was delivered to Matilde by Adriano for encashment. At the time, the check had the indorsements of (1) Fernando and (2) Rosa. When Matilde encashed it with "X" Bank, she affixed her**

signature on the check. Upon Matilde's receipt of the cash proceeds of the check, she turned over the amount to Adriano. "X" Bank was informed by Hernan that the alleged indorsement of the payee Fernando was a forgery, since the latter had died 2 years ago. "X" Bank, having refunded the amount to Hernan, sued Matilde, who refused to return the money.

**Was "X" Bank correct in paying Hernan?**

**Answer:**

Yes. X Bank was correct in paying Hernan. It is the duty of X bank to know that the check was only endorsed by the original payee, and when it pays the check to a third person, the loss falls upon the bank which cashed the check, and not on the drawer, Hernan. (*Great Eastern Life Ins. Co. v. Hongkong & Shanghai Bank & P.N.B.*, 43 Phil. 678) (BAR 1982)

5. **To cover his medical bill, A issued a check payable to Dr. Prospero Fuego. He put the check in a sealed envelope and gave it to X, his trusted messenger for 8 years, for delivery to Dr. Fuego. X, suspecting that the envelope contained a check, opened it, forged Dr. Fuego's signature on the back of the check, and deposited the check in his own savings account with the PNB. The PNB credited the amount of the check to X's account after it had been cleared by the drawee, the PCIB. When A asked X for Dr. Fuego's receipt, X replied that Dr. Fuego was out of town but his secretary received the check.**

One week later, A called Dr. Fuego and was surprised to discover that the latter never got the check. X feigning illness, had been absent for the last 2 days and, therefore, could not be questioned, A immediately went to the PCIB and found that his check had been cleared 4 days before. Upon PCIB's immediate inquiry from the PNB, the latter informed the former that X had already been paid the amount of the check and had in fact closed his account 2 days before.

**A demands that the PCIB recredit his account with the amount of the check. PCIB, in turn, demands that PNB reimburse it.**

**Decide with reasons.**

**Answer:**

As against the PCIB, A is entitled to a recredit of the amount of the check. Under the NIL, a forged signature is wholly inoperative to give any right to any party to enforce payment thereof or to give a discharge thereof, unless the party against whom such right is being enforced is precluded from setting up forgery. Under this provision, the PCIB, the drawee bank, because of the forged signature of Dr. Fuego, did not obtain any right to discharge the instrument by clearing/paying it and must therefore account to A for doing so. A bank is duty bound to pay only according to the order of the drawer. Here the order of A was to pay Dr. Fuego or anyone who legally obtains his indorsement. The PCIB did not follow A's order and must therefore account to him.

On the other hand, the PNB must also account to the PCIB because it paid to X the forger who had no right to enforce payment of the check, by clearing the check, the PCIB cannot be said to be in estoppel as it was not aware of the forgery. Unlike the case of the forgery of the drawer's signature where the drawee by paying/clearing admits the genuineness of such signature, the PCIB by paying or clearing the check had not impliedly warranted that any indorsement on the check is genuine. It was incumbent on the PNB to satisfy itself that Dr. Fuego's signature was genuine before paying or receiving the check, and as between two innocent banks, the PNB which made the loss possible, must suffer the burden of such loss. Its remedy lies against X the forger, who is legally liable not only civilly but criminally.

6. **Juan makes a promissory note payable to the order of Pedro, who indorses it to Jose. Somehow, Roberto obtains possession of the note and, forging the signature of Jose, indorses it to Amado. Amado then idorses the note to Nilo, the holder.**

**Sate the rights and liabilities of the parties.**

**Answer:**

- a) Nilo cannot enforce the note against the maker, Juan, and the payee, Pedro, because Nilo's rights against them are cut off by the forged signature of Jose, which is wholly inoperative.

When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to enforce payment thereof against any party thereto can be acquired through or under such signature. (*Sec. 23, NIL*)

- b) Nilo cannot enforce the note against Jose because Jose's signature, which has been forged, is wholly inoperative.
- c) Nilo may proceed against Amado, whose signature is genuine and, therefore, operative. Amado is a general indorser who has warranted to the holder that the instrument is genuine and in all respects what it purports to be and that the instrument is at the same time of his indorsement valid and subsisting. (*Sec. 66, NIL*)
- d) Jose or Amado have a right of recourse against Roberto, the forger. (BAR 1984)

- 7. "B" forged "A's" signature as drawer of a check drawn on Citibank. The check was purportedly payable to the order of "B". "B" then endorsed the check to "C", a holder in due course, who deposited the same to his account with Bank of P.I. The check passed through the normal course of clearing and accordingly the drawee, Citibank, credited the collecting bank, Bank of P.I., with the amount of the check which Citibank in turn debited from "A's" deposit account. Upon receiving his monthly statement from Citibank, together with the cancelled checks debited from his deposit account, "A" discovered the forgery.**

- a) **Can "A" compel Citibank to re-credit to his account the amount of the forged check?**  
b) **Does Citibank in turn have recourse against the collecting bank, Bank of P.I.? Explain.**  
c) **Can Citibank or Bank of P.I., as the case may be, proceed against "C" as indorser? Explain.**

**Answer:**

- a) "A" can compel Citibank to re-credit to his account the amount of the forged check, he being not a party to the instrument. Forgery renders the forged signature totally inoperative. Additionally, the drawee bank is charged with knowledge of the drawer's signature.
- b) Citibank has no right of recourse against Bank of P.I. having gone through "the normal course of clearing", the latter can assume that the check was properly drawn by the drawer. The drawee bank is charged with knowledge of the drawer's signature. The negligence, if at all, is attributed more to Citibank than with the bank of P.I.
- c) Recourse may be had by either against "C" as indorser because of his warranty. In the case particularly of Bank of P.I., its right of recourse may be based likewise on the agency rule that puts the risk of loss on the principal (Bank of P.I.) (BAR 1987)

- 8. Adam makes a note payable to Bert or order. Bert indorses the note to Cora. Douglas steals the note and indorses it to Elvin by forging Cora's signature. Elvin then indorses the note to Felix who is not aware of the forgery. What is the right of Felix against Adam, Bert, Cora, Douglas and Elvin?**

**Answer:**

On the assumption that Bert made a blank endorsement, thereby rendering the instrument payable to bearer in the hands of Cora, the latter's signature would be unnecessary so as to preserve the juridical relation between

parties prior to the forgery and parties after the forgery. On the further assumption that Felix had acquired the instrument for value, thus making him holder in due course, he may accordingly hold Adam, Bert and Douglas liable. The liability of Adam, as maker, and Douglas, as forger, is primary and that of Bert, as blank indorser, secondary. If, however, Felix did not acquire it for value and is not thus a holder in due course, he then acquires no right greater than that of the immediate transferor and Adam, Bert and Cora would be without any liability in favor of Felix.

On the assumption that Bert made a special indorsement, the signature of Cora would be essential to pass title to the instrument. Her signature, forged by Douglas would be inoperative, and Elvin, whether a holder in due course which is forged is required to pass title, all parties prior to the forgery may raise the real defense of forgery against all parties subsequent thereto. (BAR 1989)

**9. Jose loaned Mario some money and, to evidence his indebtedness, Mario executed and delivered to Jose a promissory note payable to his order.**

**Jose endorsed the note to Pablo. Bert fraudulently obtained the note from Pablo and endorsed it to Julian by forging Pablo's signature. Julian then endorsed the note to Camilo.**

- a) **May Camilo enforce the said promissory note against Mario and Jose?**
- b) **May Camilo go against Pablo?**
- c) **May Camilo enforce said note against Julian?**
- d) **Against whom can Julian have the right of recourse?**
- e) **May Pablo recover from either Mario or Jose?**

**Explain your answers.**

**Answer:**

- a) Camilo may not enforce said promissory note against Mario and Jose. The promissory note at the time of forgery being payable to order, the signature of Pablo was essential for the instrument to pass title to subsequent parties. A forged signature is inoperative. Accordingly, the parties after the forgery are not juridically related to parties after the forgery to allow such enforcement.
- b) Camilo may not go against Pablo, the latter not having indorsed the instrument.
- c) Camilo may enforce the instrument against Julian because of his special indorsement to Camilo, thereby making him secondarily liable, both being parties after the forgery.
- d) Julian, in turn, may enforce the instrument against Bert who, by his forgery, has rendered himself primarily liable.
- e) Pablo preserves his right to recover from either Marion or Jose who remain parties juridically related to him. Mario is still considered primarily liable to Pablo. Pablo may, in case of dishonor, go after Jose who, by his special indorsement, is secondarily liable. (BAR 1990)

**10. Alex issued a negotiable promissory note (PN) payable to Benito or order in payment of certain goods. Benito indorsed the PN to Celso in payment of an existing obligation. Later Alex found the goods to be defective. While in Celso's possession the PN was stolen by Dennis who forged Celso's signature and discounted it with Edgar, a money lender who did not make inquiries about the PN. Edgar indorsed the PN to Felix, a holder in due course. When Felix demanded payment of the PN from Alex the latter refused to pay. Dennis could no longer be located.**

- 1. What are the rights of Felix, if any, against Alex. Bento, Celso and Edgar? Explain.**

**2. Does Celso have any right against Alex, Benito and Felix? Explain.**

**Answer:**

1. Felix has no right to claim against Alex, Benito and Celso who are parties prior to the forgery of Celso's signature by Dennis. Parties to an instrument who are such prior to the forgery cannot be held liable by any party who became such at or subsequent to the forgery. However, Edgar, who became a party to the instrument subsequent to the forgery and who indorsed the same to Felix, can be held liable by the latter.
2. Celso has the right to collect from Alex and Benito. Celso is a party subsequent to the two. However, Celso has no right to claim against Felix who is a party subsequent to Celso. (BAR 1995)

**11. "A" issued a promissory note payable to "B" or bearer. "A" delivered the note to "B". "B" indorsed the note to "C". "C" placed the note in his drawer, which was stolen by the janitor "X". "X" indorsed the note to "D" by forging "C's" signature. "D" indorsed the note to "E" who in turn delivered the note to "F", a holder in due course, without indorsement. Discuss the individual liabilities to "F" of "C".**

**Answer:**

"C" is not liable to "F" since the latter cannot trace his title to the former. The signature of "C" in the supposed indorsement by him to "D" was forged by "X". "C" can raise the defense of forgery since it was his signature that was forged. (BAR 2001)

**12. CX maintained a checking account with UBANK, Makati Branch. One of his checks in a stub of 50 was missing. Later, he discovered that Ms. DY forged his signature and succeeded to encash P15,000 from another branch of the bank. DY was able to encash the check when ET, a friend, guaranteed due execution, saying that she was a holder in due course.**

**Can CX recover the money from the bank? Reason briefly.**

**Answer:**

Yes, CX can recover from the bank. Under Section 23 of the NIL, forgery is a real defense. The forged check is wholly inoperative in relation to CX. CX cannot be held liable thereon by anyone, not even by a holder in due course. Under a forged signature of the drawer, there is no valid instrument that would give rise to a contract which can be the basis or source of liability on the part of the drawer. The drawee bank has no right or authority to touch the the drawer's funds deposited with the drawee bank. (BAR 2004)

**13. TRUE or FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**"A bank is bound to know its depositor's signature" is an inflexible rule in determining the liability of a bank in forgery cases.**

**Answer:**

False. In cases of forgery, the forger may not necessarily be a depositor of the bank, especially in the case of a drawee bank. Yet in many cases of forgery, it is the drawee that is held liable for the loss. (BAR 2009)

**14. Forgery of bills of exchange may be subdivided into, a) forgery of an indorsement on the bill and b) forgery of the drawer's signature, which may either be with acceptance by the drawee, or**

- a. With acceptance but the bill is paid by the drawee.
- b. Without acceptance but the bill is paid by the drawer.
- c. Without acceptance but the bill is paid by the drawee.
- d. With acceptance but the bill is paid by the drawer.

**Answer:**

- a. Without acceptance but the bill is paid by the drawee. (BAR 2011)

**15. Due to his debt to C, D wrote a promissory note which is payable to the order of C. C's brother, M, misrepresenting himself as agent of C, obtained the note from D. M then negotiated the note to N after forging the signature of C. May N enforce the note against D?**

- a. Yes, since D is the principal debtor.
- b. No, since the signature of C was forged.
- c. No, since it is C who can enforce it, the note being payable to the order of C.
- d. Yes, since D, as maker, is primarily liable on the note.

**Answer:**

- a. No, since the signature of C was forged. (BAR 2011)

**16. X found a check on the street, drawn by Y against ABC Bank, with Z as payee. X forged Z's signature as an indorser, then indorsed it to ABC Bank which charged it to the Y's account. Y later sued ABC Bank but it set up the forgery as its defense. Will it prosper?**

- a. No, since the payee's signature has been forged.
- b. No, since Y's remedy is to run after the forger, X.
- c. Yes, since forgery is only a personal defense.
- d. Yes, since ABC Bank is bound to know the signature of Y, its client.

**Answer:**

- d. Yes, since ABC Bank is bound to know the signature of Y, its client. (BAR 2011)

#### **D. Consideration**

**1. R issued a check for P1 M which he used to pay S for killing his political enemy.**

- a) Can the check be considered a negotiable instrument?
- b) Does S have a cause of action against R in case of dishonor by the drawee bank?
- c) If S negotiated the check to T, who accepted it in good faith and for value, may R be held secondarily liable by T?

**Reason briefly in a, b, and c.**

**Answer:**

- a) Yes, the check can be considered a negotiable instrument even if it was issued to pay S to kill his political enemy. The validity of the consideration is not one of the requisites of a negotiable instrument (Section 1, NIL). It merely constitutes a defect of title. (Section 55, NIL)
- b) No, S does not have a cause of action against R in case of dishonor of the check by the drawee bank. S is not a holder in due course, thus, R can raise the defense that the check was issued for an illegal consideration. (Section 58, NIL)
- c) Yes, R may be held secondarily liable by T who took the check in good faith and for value. T is a holder in due course. R cannot raise the defense of illegality of the consideration, because T took the check free from the defect of title of S (Section 57, NIL) (BAR 2007)

## E. Accommodation Party

- 1. To accommodate M, drawer of a promissory note, A signed as indorser thereon, and the instrument was negotiated to H, a holder for value. At the time H took the instrument, he knew A to be only an accommodation party. When the promissory note was not paid, and H discovered M to be without funds, he sued A. A pleads in defense the fact that he had indorsed the instrument without receiving value therefor, and the further fact that H knew at the time he took the instrument that A had not received any value or consideration of any kind for his indorsement. Is A liable? Reasons.**

**Answer:**

Assuming that there has been due presentment and notice of dishonor, A is liable to H. Under the Negotiable Instruments Law, an accommodation party shall be liable to a holder for value although the latter may have known that he was merely an accommodation party. Lack or absence of consideration is not defense available to an accommodation party. (BAR 1975)

- 2. A purchased some merchandise from B for P1,000.00. Not having any cash, A offered to pay in check. B refused to accept the check unless it is indorsed by X. X endorsed A's check, and B, knowing that X had not received value for indorsing the check, accepted it. Upon maturity, B presented the check for payment. Payment was refused for lack of funds. B gave notice of dishonor, in accordance with law to X. X refused to pay. Is X liable to B? Reasons.**

**Answer:**

Yes, X is liable to B. X, as accommodation indorser, is liable to a holder for value although the latter may know that he is a mere accommodation party. B is a holder for value. X as indorser agreed to pay should the check be dishonored upon due presentment, provided he is given a notice of dishonor. X is therefore liable to B. (Secs. 29 and 66, NIL and *Ang Tiong v. Ting*, 22 SCRA 713) (BAR 1976)

- 3. Santos purchased Vera's car for P50,000. Not having enough cash on hand, Santos offered to pay in check. Vera refused to accept the check unless it is endorsed by Reyes, their mutual friend. Reyes endorsed Santos' check and Vera, knowing that Reyes had not received any value for endorsing the check, accepted it. The next day, Vera presented the check to the drawee bank for payment. Payment was refused for lack of funds. Vera gave notice of dishonor to Reyes, but Reyes refused to pay, saying that he endorsed merely as a friend.**

**a) Is Reyes liable to Vera? Explain.**

**b) In the event Reyes voluntarily pays Vera, does Reyes have the right to recover from Santos? Explain.**

**Answer:**

a) Yes, Reyes is liable to Vera. Reyes is an irregular indorser, but an accommodation indorser for Santos, and liable as a regular indorser, provided there is presentment, dishonor, and notice of dishonor to Reyes.

b) Yes, Reyes, after voluntarily paying Vera can recover from Santos, since the relation between Santos and Reyes is in effect that of principal and surety, the accommodation party, Reyes, being the surety. (BAR 1985)

- 4. To accommodate Carmen, drawer (sic- should be maker) of a promissory note, Jorge signed as indorser thereon, and the instrument was negotiated to Raffy a holder for value. At the time Raffy took the instrument, he knew Jorge to be an accommodation party only. When the promissory note was not paid, and Raffy discovered that Carmen had no funds, he sued Jorge. He pleads in defense the fact the he had endorsed the instrument without receiving value therefor, and the further fact that Raffy knew that**

**at the time he took the instrument Jorge had not received any value or consideration of any kind for his instrument.**

**Is Jorge liable? Discuss with reasons.**

**Answer:**

Yes, Jorge is liable. Section 29 of the NIL provides that an accommodation party is liable on the instrument to a holder for value, notwithstanding the holder at the time of taking said instrument knew him to be only an accommodation party. This is the nature or the essence of accommodation. (BAR 1990)

5. **On June 1, 1990, A obtained a loan of P100,000 from B, payable not later than December 20, 1990. B required A to issue him a check for that amount to be dated December 20, 1990. Since he does not have any checking account, A, with the knowledge of B, requested his friend, C, President of the Saad Banking Corp. (SAAD), to accommodate him. C agreed, he signed a check for the aforesaid amount, dated December 20, 1990, drawn against SAAD's account with the ABC Commercial Banking Corp. the By-laws of SAAD requires that checks issued by it must be signed by the President and the Treasurer or the Vice-President. Since the Treasurer was absent, C requested the Vice-President to co-sign the check, which the latter reluctantly did. The check was delivered to B. the check was dishonored upon presentment on due date for insufficiency of funds.**

**a) Is the SAAD liable on the checks as an accommodation party?**

**Answer:**

No. SAAD is not liable on the checks as an accommodation party. The act of the corporation in accommodating a friend of the President, is ultra vires. While it may be legally possible for a corporation, whose business is to provide financial accommodation in the ordinary course of business, such as one given by a financing company, to be an accommodation party, this situation, however, is not the case in the bar problem.

**b) If it is not, who then, under the above facts, is/are the accommodation party?**

**Answer:**

Considering that both the President and the Vice-President were signatories to the accommodation, they themselves can be subject to the liabilities of accommodation parties to the instrument in their personal capacity. (BAR 1991)

6. **Juan Sy purchased from "A" Appliance center 1 generator set on installment with the chattel mortgage in favor of the vendor. After getting hold of the generator set, Juan Sy immediately sold it without consent of the vendor. Juan Sy was criminally charged with estafa.**

**To settle the case extra-judicially, Juan Sy paid the sum of P20,000 and for the balance of P5,000, he executed a promissory note for said amount with Ben Lopez as an accommodation party. Juan Sy failed to pay the balance.**

- 1. What is the liability of Ben Lopez as an accommodation party? Explain.**
- 2. What is the liability of Juan Sy?**

**Answer:**

- 1. Ben, as an accommodation party, is liable as maker to the holder up to the sum of P5,000 even if he did not receive any consideration for the promissory note. This is the nature of accommodation. But Ben can ask for reimbursement from Juan, the accommodated party.**
- 2. Juan is liable to the extent of P5,000 in the hands of a holder in due course. If Ben paid the promissory note, Juan has the obligation to reimburse Ben for the amount paid. If Juan pays directly to the holder of the**

promissory note, or he pays Ben for the reimbursement of the payment by the latter to the holder, the instrument is discharged. (BAR 1993)

7. **Nora applied for loan of P100,000 with BUR Bank. By way of accommodation, Nora's sister, Vilma, executed a promissory note in favor of BUR Bank. When Nora defaulted, BUR Bank sued Vilma, despite its knowledge that Vilma received no part of the loan.**

**May Vilma be held liable? Explain.**

**Answer:**

Yes, Vilma may be held liable. Vilma is an accommodation party. As such, she is liable on the instrument to a holder for value such as BUR Bank. This is true even if BUR Bank was aware at the time it took the instrument that Vilma is merely an accommodation party and received no part of the loan. (BAR 1996)

8. **For the purpose of lending his name without receiving value therefor, Pedro makes a note for P20,000 payable to the order of X who in turn negotiates it to Y, the latter knowing that Pedro is not a party for value.**

- a) **May Y recover from Pedro if the latter interposes the absence of consideration?**  
b) **Supposing under the same facts, Pedro pays the said P20,000, may he recover the same amount from X?**

**Answer:**

a) Yes. Y can recover from Pedro. Pedro is an accommodation party. Absence of consideration is in the nature of an accommodation. Defense of absence of consideration cannot be validly interposed by accommodation party against a holder in due course.

b) If Pedro pays the said P20,000 to Y, Pedro can recover the amount from X. X is the accommodated party or the party ultimately liable for the instrument. Pedro is only an accommodation party. Otherwise, it would be unjust enrichment on the part of X if he is not to pay Pedro. (BAR 1998)

9. **Dagul has a business arrangement with Facundo. The latter would lend money to another, through Dagul, whose name would appear in the promissory note as the lender. Dagul would then immediately indorse the note to Facundo.**

**Is Dagul an accommodation party? Explain.**

**Answer:**

Dagul is not an accommodation party. An accommodation party is one who signs the instrument as maker, drawer, or indorser, without receiving any valuable consideration and for the purpose of lending his name or credit to another. (BAR 2005)

10. **As a rule under the NIL, a subsequent party may hold a prior party liable but not vice-versa. Give 2 instances where a prior party may hold a subsequent party liable.**

**Answer:**

A party may hold a subsequent party liable in the following instances: (1) in case of an accommodated party; and (2) in case of an acceptor for honor.

An accommodation party may hold the party accommodated liable to him, even if the party accommodated is a subsequent party. The relation between them is that of principal and surety. For the same reason, an acceptor for honor may hold the party for whose honor he accepted a bill of exchange liable to him. A payer for honor is

subrogated to the rights of the holder as regards the party for whose honor he paid and all parties liable to the latter. (BAR 2008)

**11. X acted as an accommodation party in signing as a maker of a promissory note. Which phrase best completes the sentence—This means that X is liable on the instrument to any holder for value:**

- a) For as long as the holder does not know that X is only an accommodation party;
- b) Even though the holder knew all along that X is only an accommodation party;
- c) For as long as X did not receive any consideration for acting as accommodation party;
- d) Provided X received consideration for acting as accommodation party.

**Answer:**

- a) Even though the holder knew all along that X is only an accommodation party. (BAR 2012)

## F. Negotiation

### 1. Distinguished from Assignment

**1. Gaudencio, a store owner, obtained a P1 M loan from Bathala Financing Corporation (BFC). As security, Gaudencio executed a “Deed of Assignment of Receivables,” assigning 15 checks received from various customers who bought merchandise from his store. The checks were duly indorsed by Gaudencio’s customers.**

**The Deed of Assignment contains the following stipulation:**

*“If, for any reason, the receivables or any part thereof cannot be paid by the obligors, the ASSIGNOR unconditionally and irrevocably agrees to pay the same, assuming the liability to pay, by way of a penalty, 3% of the total amount unpaid, for the period of delay until the same is fully paid.”*

**When the checks became due, BFC deposited them for collection, but the drawee banks dishonored all the checks for one of the following reasons: “account closed,” “payment stopped,” “account under garnishment,” or “insufficiency of funds”. BFC wrote Gaudencio notifying him of the dishonored checks, and demanding payment of the loan. Because Gaudencio did not pay, BFC filed a collection suit.**

**In his defense, Gaudencio contended that: (a) BFC did not give timely notice of dishonor of the checks; and (b) considering that the checks were duly indorsed, BFC should proceed against the drawers and the indorsers of the checks.**

**Are Gaudencio’s defenses tenable? Explain.**

**Answer:**

No. Gaudencio’s defenses are untenable. The cause of action of BFC was really on the contract of loan, with the checks merely serving as collateral to secure the payment of the loan. By virtue of the Deed of Assignment which he signed, Gaudencio undertook to pay for the receivables if for any reason they cannot be paid by the obligors. (BAR 2009)

**2. A issued a check in the amount of P20,000 payable to B. B endorsed the check but only to the extent of P10,000. Which statement is most accurate?**

- a) The partial indorsement is not a valid indorsement, although will result in the assignment of that part;
- b) The partial indorsement will invalidate the whole instrument;

- c) **The endorsee will be considered as a holder in due course;**
- d) **The partial indorsement is valid indorsement up to the extent of the P10,000.**

**Answer:**

- a) The partial indorsement is not a valid indorsement, although will result in the assignment of that part. (BAR 2012)

**3. A promissory note which does not have the words “or order” or “or bearer” will render the promissory note non-negotiable and, therefore—**

- a) **It will render the maker not liable;**
- b) **The note can still be assigned and the maker made liable;**
- c) **The holder can become holder in due course;**
- d) **The promissory note can just be delivered and the maker will still be liable.**

**Answer:**

- b) The note can still be assigned and the maker made liable. (BAR 2012)

## 2. Modes of Negotiation

**1. X makes a promissory note payable to bearer, and delivers the same to Y. Y indorses it to Z in this manner: “Pay to Z, sgd. Y”. Later, Z without indorsing the promissory note transfers and delivers the same to R. the note is subsequently dishonored by X. May R hold X liable?**

**Answer:**

Yes, R may hold X liable. Since the instrument is payable to bearer on its face, the special indorsement of Y did not affect the right of the holder to negotiate it by mere delivery. The transfer and delivery to R by Z, therefore constituted a valid negotiation, vesting in R all the rights of a holder. R can therefore hold Y liable. (BAR 1975)

**2. As payment for good received, Masikap gave to Humimok on November 3, his check drawn on the Eternal Bank of Manila. On November 11, Kahusayan went to Eternal bank to encash the check. He could not cash the check because on November 10, Central Bank forbidden Eternal Bank to do business in the Philippines on grounds of insolvency. Masikap, Humimok, and Kahusayan all reside in Manila.**

- a) Can Kahusayan hold Humimok liable on the uncashed check? Explain briefly.

**Answer:**

- a) The liability of Humimok would depend on how he negotiated the check to Kahusayan. If it was negotiated by delivery (as when it is payable to “cash”), Humimok would not be secondarily liable; if, however, Humimok endorsed the check as a general endorser then Kahusayan could hold Humimok secondarily liable. A qualified indorsement by Humimok would, upon the other hand, preclude Kahusayan from holding the former secondarily liable. (BAR 1986)

## 3. Kinds of Indorsements

**1. A makes a promissory note payable to bearer and delivers it to B. In turn, B negotiates it by mere delivery to C, who indorses it specially to D. D negotiates it by special indorsement to E, who negotiates it to F my delivery. A did not pay. To whom are B, C, D, and E liable? Explain your answer.**

**Answer:**

B, C, D, and E are not liable. B and E being negotiators by mere delivery are not liable unless they made a breach of their warranties, and it appeared that they had not. On the other hand, C and D are also not liable to F, since the latter did not make title through the special indorsements of C and D. (BAR 1979)

2. **Anna makes a promissory note payable to bearer and delivers it to Bing. In turn, Bing negotiates it by mere delivery to Carmen, who endorses it especially to Dong. Dong negotiates it by special indorsement to Emma, who negotiates it to Fe by mere delivery. Anna did not pay. To whom are Bing, Carmen, Dong and Emma liable? Explain your answer fully.**

**Answer:**

Bing, not being an indorser, may only be held liable for breach of warranty but the facts in the problem do not disclose any such breach.

Carmen, under her special indorsement, may be held secondarily liable by Dong and Emma since the latter (Dong and Emma) derived title under Carmen's special indorsement. Carmen is not secondarily liable to Fe since the latter obtained it by mere delivery from Emma and therefore did not obtain title through Carmen's special indorsement.

Dong holds himself secondarily liable to Emma since the latter derived title under Dong's special indorsement but not to Fe who acquired the instrument only by delivery.

Emma, not being an indorser, is not secondarily liable to Fe. Emma's only possible source of liability to Fe would be for a breach of warranty but the facts in the problem do not disclose any such breach.

Secondary liability requires due notice of dishonor, unless excused, which we assume had properly been observed. (BAR 1988)

3. **"A" issued a promissory note payable to "B" or bearer. "A" delivered the note to "B". "B" indorsed the note to "C". "C" placed the note in his drawer, which was stolen by the janitor "X". "X" indorsed the note to "D" by forging "C's" signature. "D" indorsed the note to "E" who in turn delivered the note to "F", a holder in due course, without indorsement. Discuss the individual liabilities to "F" of "A", "B" and "C".**

**Answer:**

"A" is liable to "F" as the maker of the promissory note, "A" is directly or primarily liable to "F", who is a holder in due course. Despite the presence of the special indorsements on the note, these do not detract from the fact that a bearer instrument, like the promissory note in question, is always negotiable by mere delivery, until it is indorsed restrictively "For Deposit Only".

"B", as a general endorser, is liable to "F" secondarily, and warrants that the instrument is genuine and in all respects what it purports to be; that he has good title to it; that all prior parties had capacity to contract; that he has no knowledge of any fact which would impair the validity of the instrument or render it valueless; that at the time of his indorsement, the instrument is valid and subsisting; and that on due presentment, it shall be accepted or paid, or both, according to its tenor, and that if it be dishonored and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay.

"C" is not liable to "F" since the latter cannot trace his title to the former. The signature of "C" in the supposed indorsement by him to "D" was forged by "X". "C" can raise the defense of forgery since it was his signature that was forged. (BAR 2001)

4. A negotiable instrument can be indorsed by way of a restrictive indorsement, which prohibits further negotiation and constitutes the indorsee as agent of the indorser. As agent, the indorsee has the right, among others, to:
- Demand payment of the instrument only.
  - Notify the drawer of the payment of the instrument.
  - Receive payment of the instrument.
  - Instruct that payment be made to the drawee.

Answer:

c. Receive payment of the instrument. (BAR 2011)

5. X is the holder of an instrument payable to him (X) or his order, with Y as maker. X then indorsed it as follows: "Subject to no recourse, pay to Z. Signed, X." When Z went to collect from Y, it turned out that Y's signature was forged. Z now sues X for collection. Will it prosper?
- Yes, because X, as a conditional indorser, warrants that the note is genuine.
  - Yes, because X, as a qualified indorser, warrants that the note is genuine.
  - No, because X made a qualified indorsement.
  - No, because a qualified indorsement does not include the warranty of genuineness.

Answer:

b. Yes, because X, as a qualified indorser, warrants that the note is genuine. (BAR 2011)

6. P sold to M 10 grams of shabu worth P5,000. As he had no money at the time of the sale, M wrote a promissory note promising to pay P or his order P5,000. P then indorsed the note to X (who did not know about the shabu), and X to Y. Unable to collect from P, Y then sued X on the note. X set up the defense of illegality of consideration. Is he correct?
- No, since X, being a subsequent indorser, warrants that the note is valid and subsisting.
  - No, since X, a general indorser, warrants that the note is valid and subsisting.
  - Yes, since a void contract does not give rise to any right.
  - Yes, since the note was born of an illegal consideration which is real defense.

Answer:

b. No, since X, a general indorser, warrants that the note is valid and subsisting. (BAR 2011)

### G. Rights of the Holder

1. Under the NIL, if the holder has a lien on the instrument which arises either from a contract or by implication of law, he would be a holder for value to the extent of
- His successor's interest.
  - His predecessor's interest.
  - The lien in his favor.
  - The amount indicated on the instrument's face.

Answer:

c. The lien in his favor. (BAR 2011)

### 1. Shelter Principle

1. **How does the “shelter principle” embodied in the NIL operate to give the rights of a holder in due course to a holder who does not have the status of a holder in due course?**

**Answer:**

The “shelter principle” provides that in the hands of a holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. This principle is extended to a holder who is not himself a holder in due course but derives title from a holder in due course, provided he himself is not a party to any fraud or illegality affecting the instrument. Section 58 of the NIL provides:

“Sec. 58. *When subject to original defense.* In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter”. (BAR 2008)

## 2. **Holder in Due Course**

1. **Rolando intending to buy a car, saw an old friend, Roger, who is an agent to sell the car belonging to Delgado Clinic. After negotiation, Rolando decided to buy the said car. He drew upon request of Roger a crossed check for P600.00 payable to Delgado Clinic as evidence of his good faith, but which will merely be shown to Delgado Clinic by Roger who received the check. The check would then be returned when Roger brings the car and its registration certificate for Rolando’s inspection.**

**For failure of Roger to bring the car and its certificate of registration, and return the check, Rolando issued a “stop payment order” to the drawee bank. In the meantime, Roger paid the check to Delgado Clinic for the hospital bill of his wife and was given P158.25 as change. Delgado Clinic filed suit against Rolando to recover the value of the check. May Delgado Clinic be considered a holder in due course, hence, entitled to recover? Decide with reasons.**

**Answer:**

Delgado Clinic may not be considered a holder in due course, hence, not entitled to recover. It is not disputed that Delgado Clinic was not aware of the circumstance under which the check was delivered to Roger. But the circumstances—such as the fact that Rolando had no relation with it; that the amount of the check did not correspond exactly with the obligation of Roger to the clinic; and that the check is a crossed check, which means that the check could only be deposited but could not be converted into cash—should have put the clinic to inquiry as to why’s and wherefore’s of the possession of the check by Roger, and why he used it to pay his accounts. It was payee’s duty to ascertain from Roger what the nature of the latter’s title to the check was or the nature of his possession. Having failed in this respect, Delgado Clinic was guilty of gross neglect amounting to the legal absence of good faith, and it may not be considered as a holder of the check in good faith. The rule that a possessor of the instrument is a prima facie a holder in due course does not apply because there was a defect in the title of the holder (Roger) because the instrument is not payable to him or to bearer. (BAR 1977)

2. **A induces B by fraud to make a promissory note payable on demand to the order of A in the sum of P5,000.00.**
  - 1) **Can A file an action successfully against the maker B for the amount of the note?**
  - 2) **Going further, A transfers the note to C who pays P5,000.00 therefore and acquires the note under circumstances that make C a holder in due course. Can C file an action successfully against B, the maker of the note, for the amount of the note? Explain.**
  - 3) **What defense/s can B interpose? Reasons.**

**Answer:**

- 1) No. B may raise the defense of absence of consideration against A who is not a holder in due course.

- 2) Yes. C can file an action successfully against B, since C is a holder in due course, against whom absence of consideration is not a defense.
- 3) As against A, being not a holder in due course, all defenses, real or absolute and personal or equities, may be interposed by B. But as against C, being a holder in due course, only real or absolute defenses can be interposed. (BAR 1978)

3. **Sumabod issued a promissory note payable to the order of Panloob as consideration for the textiles purchased from the latter. The promissory note recites that the amount of P100,000 is payable in 5 monthly installments of P20,000 each, beginning on December 1, 1986 and every first day of the month thereafter until fully paid, provided that the holder may declare the entire amount due and demandable in the event the maker fails to pay on time any installment in full, or whenever the holder for valid reasons finds his claim insecure. Panloob indorsed and delivered the note for value to Humabol who acted in good faith.**

**Panloob's factory burns down and he is unable to deliver the textiles. Sumabod did not pay as promised.**

**Can Humabol as an innocent purchaser for value hold Sumabod liable on the promissory note? Explain.**

**Answer:**

Humabol can hold Suamabod liable on the promissory note. The statement in the instrument providing for installment payment and an acceleration clause did not adversely affect the negotiability of the instrument. Humabol, being a holder in due course, may hold the maker liable under the note. Personal defenses that Sumabod may raise against an immediate party may not be raised against a holder in due course. (BAR 1986)

4. **Perla brought a motor car payable in installments from Automotive Company for P250,000. She made a down payment of P50,000 and executed a promissory note for the balance. The company subsequently indorsed the note to Reliable Finance Corporation which financed the purchase. The promissory note read:**

**"For value received, I promise to pay Automotive Company or order at its office in Legaspi City, the sum of P200,000.00 with interest at twelve (12%) per cent per annum, payable in equal installments of P20,000.00 monthly for ten (10) months starting October 21, 1991.**

**Manila September 21, 1991.**

**(Sgd.) Perla**

**Pay to the order of Reliable Finance Corp.**

**Automotive Company**

**By:**

**(Sgd.) Manager**

**Because Perla defaulted in the payment of her installments, Reliable Finance Corporation initiated a case against her for a sum of money. Perla argued that the promissory note is merely open to all defenses available to the assignor and, therefore, Reliable Finance Corporation is not a holder in due course.**

- b) Is Reliable Finance Corporation a holder in due course? Explain briefly.**

**Answer:**

Yes, Reliable Finance Corporation is a holder in due course given the factual settings. Said corporation apparently took the promissory note for value, and there are no indications that it acquired it in bad faith. (BAR 1992)

**5. Larry issued a negotiable promissory note to Evelyn and authorized the latter to fill up the amount in blank with his loan account in the sum of P1,000. However, Evelyn inserted P5,000 in violation of the instruction. She negotiated the note to Julie who had knowledge of the infirmity. Julie in turn negotiated said note to Devi for value and who had no knowledge of the infirmity.**

- 1. Can Devi enforce the note against Larry and if she can, for how much? Explain.**
- 2. Supposing Devi endorses the note to Baby for value but who has knowledge of the infirmity, can the latter enforce the note against Larry?**

**Answer:**

1. Yes. Devi can enforce the negotiable promissory note against Larry in the amount of P5,000. Devi is a holder in due course and the breach of trust committed by Evelyn cannot be set up by Larry against Devi because it is a personal defense. As a holder in due course, Devi is not subject to such personal defense.
2. Yes. Baby is not a holder in due course because she had knowledge of the breach of trust committed by Evelyn against Larry which is just a personal defense. But having taken the instrument from Devi, a holder in due course, Baby has all the rights of a holder in due course. Baby did not participate in the breach of trust committed by Evelyn who filled the blank but filled up the instrument with P5,000 instead of P1,000 as instructed by Larry. (BAR 1993)

**6. Eva issued to Imelda a check in the amount of P50,000 post-dated September 30, 1995, as security for a diamond ring to be sold on commission. On September 15, 1995, Imelda negotiated the check to MT Investment which paid the amount of P40,000 to her.**

**Eva failed to sell the ring, so she returned it to Imelda on September 19, 1995. Unable to retrieve her check, Eva withdrew her funds from the drawee bank. Thus, when MT Investment presented the check for payment, the drawee bank dishonored it. Later on, when MT Investment sued her, Eva raised the defense of absence of consideration, the check having been issued merely as security for the ring that she could not sell.**

**Does Eva have a valid defense? Explain.**

**Answer:**

No, Eva does not have a valid defense. First, MT Investment is a holder in due course and, as such, holds the post dated check free from any defect of title of prior parties and from defenses available to prior parties among themselves. Eva can invoke the defense of absence of consideration against MT only if the latter was a privy to the purpose for which the checks were issued and, therefore, not a holder in due course. Second, it is not a ground for the discharge of the post-dated check as against a holder in due course that it was issued merely as security. The only grounds for the discharge of negotiable instruments Law and none of those grounds are available to Eva. The latter may not unilaterally discharge herself from her liability by mere expediency of withdrawing her funds from the drawee bank. (BAR 1996)

**7. What constitutes a holder in course?**

**Answer:**

A holder in due course is one who has taken the instrument under the following conditions:

1. That it is complete and regular upon its face;

2. That he became a holder of it before it was overdue and without notice that it had been previously dishonored, if such was the fact;
  3. That he took it in good faith and for value;
  4. That at the time it was negotiated to him, he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it. (BAR 1996)
8. **PN makes a promissory note for P5,000, but leaves the name of the payee in blank because he wanted to verify its correct spelling first. He mindlessly left the note on top of his desk at the end of the workday. When he returned the following morning, the note was missing. It turned up later when X presented it to PN for payment. Before X, T, who turned out to have filched the note from PN's office, had endorsed the note after inserting his own name in the blank space as the payee. PN dishonored the note, contending that he did not authorize its completion and delivery. xxx**

**Can the payee in a promissory note be a "holder in due course" within the NIL? Explain your answer.**

**Answer:**

A payee in a promissory note cannot be a "holder in due course" within the meaning of the NIL, because a payee is an immediate party in relation to the maker. The payee is subject to whatever defenses, real or personal, available to the maker of the promissory note. (BAR 2000)

9. **Lorenzo drew a bill of exchange in the amount of P100,000 payable to Barbara or order, with his wife, Diana, as drawee. At the time the bill was drawn, Diana was unaware that Barbara is Lorenzo's paramour.**

**Barbara then negotiated the bill to her sister, Elena, who paid for it for value, and who did not know who Lorenzo was. On due date, Elena presented the bill to Diana for payment, but the latter promptly dishonored the instrument because, by then, Diana had already learned of her husband's dalliance.**

**b) Was the bill lawfully dishonored by Diana? Explain.**

**Answer:**

No, the bill was not lawfully dishonored by Diana. Elena, to whom the instrument was negotiated, was a holder in due course inasmuch as she paid value therefor in good faith. (BAR 2009)

10. **A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves. An example of such defense is-**
- a. **Fraud in inducement.**
  - b. **Duress amounting to forgery.**
  - c. **Fraud in esse contractus.**
  - d. **Alteration.**

**Answer:**

- a. **Fraud in inducement. (BAR 2011)**

11. **X borrowed money from Y in the amount of P1 M and as payment, issued a check. Y then endorsed the check to his sister Z for no consideration. When Z deposited the check to her account, the check was dishonored for insufficiency of funds.**

**Is Z a holder in due course? Explain your answer.**

**Answer:**

Z is not a holder in due course. She did not give any valuable consideration for the check. To be a holder in due course, the holder must have taken the check in good faith and for value. (BAR 2012)

12. **Arnold, representing himself as an agent of Brian for the sale of Brian's car, approached Dennis who appeared interested in buying the car. At Arnold's prodding, Dennis issued a crossed check payable to Brian for P25,000 on the understanding that the check would only be shown to Brian as evidence of Dennis' good faith and interest in buying the car. Instead, Arnold used the check to pay for the medical expenses of his wife in Brian's clinic after Brian, a doctor, treated her.**

**Is Brian a holder in due course?**

- a) **Yes, Brian is a HIDC because he was the payee of the check and he received it for services rendered;**
- b) **Yes, Brian is a HIDC because he did not need to go behind the check that was payable to him;**
- c) **No, Brian is not a HIDC because Dennis issued the check only as evidence of good faith and interest in buying the car;**
- d) **No, Brian is not a HIDC because Brian should have been placed on notice: the check was crossed in his favor and Arnold was not the drawer;**
- e) **No, Brian is not a HIDC because the requisite consideration to Dennis was not present.**

**Answer:**

d) No, Brian is not a HIDC because Brian should have been placed on notice: the check was crossed in his favor and Arnold was not the drawer. (BAR 2013)

### **3. Defenses Against the Holder**

1. **On March 1, 1996, Pentium Company ordered a computer from CD Bytes, and issued a crossed check in the amount of P30,000 post-dated March 31, 1996. Upon receipt of the check, CD Bytes discounted the check with Fund House.**

**On April 1, 1996, Pentium stopped payment of the check for failure of CD Bytes to deliver the computer. Thus, when Fund House deposited the check, the drawee bank dishonored it.**

**If Fund House files a complaint against Pentium and CD Bytes for the payment of the dishonored check will the complaint prosper? Explain.**

**Answer:**

The complaint filed by Fund House against Pentium will not prosper but the one against CD Bytes will. Fund House is not a holder in due course and, therefore, Pentium can raise the defense of failure of consideration against it. The check in question was issued by Pentium to pay for a computer that it ordered from CD Bytes. The computer not having been delivered, there was a failure of consideration. The check discounted with Fund House by CD Bytes is a crossed check and this should have put Fund House on inquiry. It should have ascertained the title of CD Bytes to the check or the nature of the latter's possession. Failing in this respect, Fund House is deemed guilty of gross negligence amounting to legal absence of good faith and, thus, not a holder in due course. Fund House can collect from CD Bytes as the latter was the immediate indorser of the check. (BAR 1996)

2. **X, Y and Z signed a promissory note in favor of A stating: "We promise to pay A on December 31, 2001 the sum of P5,000. "When the note fell due, A sued X and Y who put up the defense that A should have impleaded Z. is the defense valid? Why?"**

**Answer:**

The defense is not valid. The liability of X, Y and Z under the promissory note is joint. Such being the case, Z is not an indispensable party. The fact that A did not implead Z will not prevent A from collecting the proportionate share of X and Y in the payment of the loan. (BAR 2001)

3. **Brad was in desperate need of money to pay his debt to Pete, a loan shark. Pete threatened to take Brad's life if he failed to pay. Brad and Pete went to Senorita Isobel, Brad's rich cousin, and asked her if she could sign a promissory note in his favor in the amount of P10,000 to pay Pete. Fearing that Pete would kill Brad, Senorita Isobel acceded to his request. She affixed her signature on a piece of paper with the assurance of Brad that he will just fill it up later. Brad then filled up the blank paper, making a promissory note for the amount of P100,000. He then indorsed and delivered the same to Pete, who accepted the note as payment of the debt.**

**What defense/s can Senorita Isobel set up against Pete? Explain.**

**Answer:**

Senorita Isobel can raise the personal defense of breach of trust against Pete that Brad's authority to fill up the amount of the promissory note was limited o P10,000. Pete is not a holder in due course as he was present when Brad asked Senorita Isobel to sign the promissory note for P10,000. Hence, Pete was aware of the infirmity of the instrument. (BAR 2005)

4. **R issued a check for P1 M which he used to pay S for killing his political enemy.**

- d) Can the check be considered a negotiable instrument?**
- e) Does S have a cause of action against R in case of dishonor by the drawee bank?**
- f) If S negotiated the check to T, who accepted it in good faith and for value, may R be held secondarily liable by T?**

**Reason briefly in a, b, and c.**

**Answer:**

- d) Yes, the check can be considered a negotiable instrument even if it was issued to pay S to kill his political enemy. The validity of the consideration is not one of the requisites of a negotiable instrument (Section 1, NIL). It merely constitutes a defect of title. (Section 55, NIL)**
- e) No, S does not have a cause of action against R in case of dishonor of the check by the drawee bank. S is not a holder in due course, thus, R can raise the defense that the check was issued for an illegal consideration. (Section 58, NIL)**
- f) Yes, R may be held secondarily liable by T who took the check in good faith and for value. T is a holder in due course. R cannot raise the defense of illegality of the consideration, because T took the check free from the defect of title of S (Section 57, NIL) (BAR 2007)**

## **H. Parties And Their Liabilities**

### **1. Maker**

1. **Juan de la Cruz signs a promissory note payable to Pedro Lim or bearer, and delivers it personally to Pedro Lim. The latter somehow misplaces the said note and Carlos Ros finds the note lying around the corridor of the building.**

**Carlos Ros endorses the promissory note to Juana Bond, for value, by forging the signature of Pedro Lim.**

## **May Juana Bond hold Juan de la Cruz liable on the note?**

### **Answer:**

It depends. A promissory note payable to Pedro Lim or bearer is a bearer negotiable instrument, being payable to a person named therein or bearer. It is negotiated by mere delivery, and no need to indorse it to Juana Bond, in order to make the latter a holder. However, Carlos Ros, who found it, endorsed it by forging the signature of Pedro Lim. Therefore, Juana Bond may hold Juan de la Cruz liable on the note, if the former is a holder in due course; but no, if Juana Bond is not a holder in due course. (BAR 1980)

2. **“A” makes a promissory note payable to “B” or bearer. “A” delivers the note to “B”. “B” indorses the note to “C”. “C” places the note in his wallet, which was stolen by “X”, who, finding the note, indorses it to “D”, by forging “C’s” signature. “D” indorses the note to “E”, who in turn delivers the note to “F”, a holder in due course, without indorsement.**

### **What are the liabilities of “A”, “B”, and “C” to “F”? Explain briefly.**

#### **Answer:**

As to “A’s” liability: Since “A” is the maker of the promissory note, he is primarily liable, and therefore liable on the same to “F”, a holder in due course of said instrument. (*Sec. 60, N.I.L.*)

As to “B’s” liability: B being an indorser is secondarily liable on said promissory note. *First Alternative Answer*—If “A” would pay the instrument, thereby discharging it, all, including “B”, are no longer liable. *Second Alternative Answer*—If “A” would dishonor it, and “F” would have given notice of dishonor to “B”, the latter is liable to “F”.

As to “C’s” liability: “C” is also a party secondarily liable on said promissory note. *First Alternative Answer*—If “A” would pay the instrument, thereby discharging it, all, including “C”, are no longer liable. *Second Alternative Answer*—If “A” would dishonor it, and “F” would have given notice of dishonor to “C”, the latter would be liable to “F”. But “C” may raise the defense that his said instrument was stolen from him and his signature in the indorsements was a forgery, which defense, being real or absolute one, can be raised even against a holder in due course. (BAR 1981)

3. **Juan makes a promissory note payable to the order of Pedro, who indorses it to Jose. Somehow, Roberto obtains possession of the note and, forging the signature of Jose, indorses it to Amado. Amado then idorses the note to Nilo, the holder.**

### **Sate the rights and liabilities of the parties.**

#### **Answer:**

- e) Nilo cannot enforce the note against the maker, Juan, and the payee, Pedro, because Nilo’s rights against them are cut off by the forged signature of Jose, which is wholly inoperative.

When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to enforce payment thereof against any party thereto can be acquired through or under such signature. (*Sec. 23, NIL*)

- f) Nilo cannot enforce the note against Jose because Jose’s signature, which has been forged, is wholly inoperative.
- g) Nilo may proceed against Amado, whose signature is genuine and, therefore, operative. Amado is a general indorser who has warranted to the holder that the instrument is genuine and in all respects what it

purports to be and that the instrument is at the same time of his indorsement valid and subsisting. (Sec. 66, NIL)

h) Jose or Amado have a right of recourse against Roberto, the forger. (BAR 1984)

4. **As payment for good received, Masikap gave to Humimok on November 3, his check drawn on the Eternal Bank of Manila. On November 11, Kahusayan went to Eternal bank to encash the check. He could not cash the check because on November 10, Central Bank forbidden Eternal Bank to do business in the Philippines on grounds of insolvency. Masikap, Humimok, and Kahusayan all reside in Manila.**

**Assume that Eternal Bank was not closed by Central Bank but simply refused to honor and encash the check. Can Kahusayan hold Masikap liable? Explain briefly.**

**Answer:**

The secondary liability of Masikap to Kahusayan, as expressed in letter a) above, is not dependent on the ability or capability of the drawee to honor the instrument. Accordingly, Kahusayan can still hold Masikap liable. (BAR 1986)

5. **PN is the holder of a negotiable promissory note within the meaning of the NIL. The note was originally issued by RP to XL as payee. XL indorsed the note to PN for goods bought by XL. The note mentions the place of payment on the specified maturity date as the office of the corporate secretary of PX bank during banking hours. On maturity date, RP was at the aforesaid office ready to pay the note but PN did not show up. What PN later did was to sue XL for the face value of the note, plus interest and costs. Will the suit prosper? Explain.**

**Answer:**

Yes. The suit will prosper as far as the face value of the note is concerned, but not with respect to the interest due subsequent to the maturity of the note and the costs of collection. RP was ready and willing to pay the note at the specified place of payment on the specified maturity date, but PN did not show up. PN lost his right to recover the interest due subsequent to the maturity of the note and the cost of collection. (BAR 2000)

6. **X executed a promissory note with a face value of P50,000, payable to the order of Y. Y indorsed the note to Z, to whom Y owed P30,000. If X has no defense at all against Y, for how much may Z collect from X?**
- a. **P20,000, as he is a holder for value to the extent of the difference between Y's debt and the value of the note.**
  - b. **P30,000, as he is a holder for value to the extent of his lien.**
  - c. **P50,000, but with the obligation to hold P20,000 for Y's benefit.**
  - d. **None, as Z's remedy is to run after his debtor, Y.**

**Answer:**

c. P50,000, but with the obligation to hold P20,000 for Y's benefit. (BAR 2011)

## 2. Drawer

1. **As payment for good received, Masikap gave to Humimok on November 3, his check drawn on the Eternal Bank of Manila. On November 11, Kahusayan went to Eternal bank to encash the check. He could not cash the check because on November 10, Central Bank forbidden Eternal Bank to do business in the Philippines on grounds of insolvency. Masikap, Humimok, and Kahusayan all reside in Manila.**

**Can Kahusayan hold Masikap liable on the uncashed check? Explain briefly.**

**Answer:**

Kahusayan can hold Masikap secondarily liable on the uncashed check. A drawer of a negotiable instrument assumes secondary liability under the NIL, which is to say that an immediate right of recourse ensues in favor of the holder once the instrument is dishonored. (BAR 1986)

2. **Mr. Pablo sought to borrow P200,000 from Mr. Carlos. The latter agreed to loan the amount in the form of a post-dated check which was crossed (i.e., two parallel lines diagonally drawn on the top left portion of the check). Before the due date of the check, Mr. Pablo discounted it with Mr. Noble. On due date, Mr. Noble deposited the check with his bank. The check was dishonored. Mr. Noble sued Mr. Pablo. The court dismissed Mr. Noble's complaint. Was the court's decision correct?**

**Answer:**

The court's decision was incorrect. Mr. Pablo and Mr. Carlos, being immediate parties to the instrument, are governed by the rules of privity. Given the factual circumstances of the problem, Mr. Pablo has no valid excuse from denying liability. Mr. Pablo undoubtedly had benefited in the transaction. To hold otherwise would also contravene the basic rules of unjust enrichment. Even in negotiable instruments, the Civil Code and other laws of general application can still apply suppletorily. (BAR 1991)

3. **Pancho drew a check to Bong and Gerard jointly. Bong indorsed the check and also forged Gerard's indorsement. The payor bank paid the check and charged Pancho's account for the amount of the check. Gerard received nothing from the payment.**

**Based on the facts, was Pancho as drawer discharged on the instrument? Why?**

**Answer:**

Pancho was not discharged on the instrument, because the payment was not in due course. (BAR 2008)

4. **D draws a bill of exchange that states: "One month from date, pay to B or his order P100,000. Signed, D." The drawee named in the bill is E. B negotiated the bill to M, M to N, N to O, and O to P. Due to non-acceptance and after proceedings for dishonor were made, P asked O to pay, which O did. From whom may O recover?**
- a. B, being the payee.
  - b. N, as indorser to O.
  - c. E, being the drawee.
  - d. D, being the drawer.

**Answer:**

d. D, being the drawer. (BAR 2011)

5. **X borrowed money from Y in the amount of P1 M and as payment, issued a check. Y then endorsed the check to his sister Z for no consideration. When Z deposited the check to her account, the check was dishonored for insufficiency of funds.**

**Who is liable on the check? The drawer or the indorser? Explain your answer.**

**Answer:**

X, the drawer, will be liable. As drawer, X engaged that on due presentment the check would be paid according to its tenor and that if it is dishonored and he is given notice of dishonor, he will pay the amount to the holder. No notice of dishonor need be given to X if he is aware that he has insufficient funds in his account. Under

Section 114(d) of the NIL, notice of dishonor is not required to be given to the drawer where he has no right to expect that the drawee will honor the instrument.

Z cannot hold Y, the endorser, liable as the latter can raise the defense that there was no valuable consideration for the endorsement of the check. (BAR 2012)

### 3. Acceptor

- 1. A drew a check for P1,000 on B, the Bank, payable to the order of C and delivered the check to the latter for value. C indorsed the check in blank and negotiated it to D, who lost it. At D's request, A ordered payment stopped by notifying B. The stop order was overlooked and the check was paid to E, who had taken the check, without actual knowledge of the loss, in payment of merchandise sold to a stranger whom he thought owned the check. D now sues the bank, B, for the amount of the check. Decide the case with brief reasons.**

**Answer:**

D may not sue the bank. A check of itself does not operate as an assignment of any part of the funds to the credit of drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check, and D was not even the holder of the check in question, he having lost the same. (BAR 1979)

- 2. X draws a check against his current account with the Ortigas branch of Bonifacio Bank in favor of B. Although X does not have sufficient fund, the bank honors the check when it is presented to payment. Apparently, X has conspired with the bank's bookkeeper so that his ledger card would show that he still has sufficient funds.**

**The bank files an action for recovery of the amount paid to B because the check presented has no sufficient funds. Decide the case.**

**Answer:**

The bank cannot recover the amount paid to B for the check. When the bank honored the check, it became an acceptor. As acceptor, the bank became primarily and directly liable to the payee/holder B.

The recourse of the bank should be against X and its bookkeeper who conspired to make X's ledger show that he has sufficient funds. (BAR 1998)

- 3. A bill of exchange has D as drawer, E as drawee and F as payee. The bill was then indorsed to G, G to H, and H to I, the current holder presented the bill to E for acceptance. E accepted but, as it later turned out, D is a fictitious person. Is E freed from liability?**
  - a. No, since by accepting, E admits the existence of the drawer.**
  - b. No, since by accepting, E warrants that he is solvent.**
  - c. Yes, if E was not aware of that fact at the time of acceptance.**
  - d. Yes, since a bill of exchange with a fictitious drawer is void and inexistent.**

**Answer:**

- b. No, since by accepting, E admits the existence of the drawer. (BAR 2011)**

### 4. Indorser

1. **A negotiable warehouse receipt was indorsed by X in favor of Y presents the receipt to W, the warehouse man, but W refuses to turn over the goods to Y, would X be liable? Would your answer be the same if the goods are actually given but they turn out to be unfit for the particular purpose intended? Explain.**

**Answer:**

X is not liable to Y if W should refuse to turn over the goods to Y. An indorser of a negotiable warehouse receipt does not warrant that the warehouseman will perform his obligation.

However, such an indorser makes some warranties, among which is that the goods are merchantable and fit for the particular purpose intended. Therefore, X would be liable to Y if W delivers the good but such goods are found unfit for the particular purpose intended.

**Alternative Answer:**

An indorser of a negotiable, X is not liable to Y if W should refuse to turn over the goods to Y. An indorser of a negotiable warehouse receipt is only liable for breach of his warranties which does not include this particular case. If the goods are actually given by the warehouse man to Y, but said goods turn out to be unfit for the particular purpose intended, X will not be liable to Y, in as much as there is a warranty on the part of X regarding this matter in which the goods turn out to be unfit for the particular purpose intended. Although there is such a warranty in the law regarding goods, yet that warranty applies exclusively to a case where the warranty would be present if the goods were directly sold without any warehouse receipt. (BAR 1975)

2. **Juan makes a promissory note payable to the order of Pedro, who indorses it to Jose. Somehow, Roberto obtains possession of the note and, forging the signature of Jose, indorses it to Amado. Amado then idorses the note to Nilo, the holder.**

**Sate the rights and liabilities of the parties.**

**Answer:**

- i) Nilo cannot enforce the note against the maker, Juan, and the payee, Pedro, because Nilo's rights against them are cut off by the forged signature of Jose, which is wholly inoperative.

When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to enforce payment thereof against any party thereto can be acquired through or under such signature. (*Sec. 23, NIL*)

- j) Nilo cannot enforce the note against Jose because Jose's signature, which has been forged, is wholly inoperative.
- k) Nilo may proceed against Amado, whose signature is genuine and, therefore, operative. Amado is a general indorser who has warranted to the holder that the instrument is genuine and in all respects what it purports to be and that the instrument is at the same time of his indorsement valid and subsisting. (*Sec. 66, NIL*)
- l) Jose or Amado have a right of recourse against Roberto, the forger. (BAR 1984)

3. **Anna makes a promissory note payable to bearer and delivers it to Bing. In turn, Bing negotiates it by mere delivery to Carmen, who endorses it especially to Dong. Dong negotiates it by special indorsement to Emma, who negotiates it to Fe by mere delivery. Anna did not pay. To whom are Bing, Carmen, Dong and Emma liable? Explain your answer fully.**

**Answer:**

Bing, not being an indorser, may only be held liable for breach of warranty but the facts in the problem do not disclose any such breach.

Carmen, under her special indorsement, may be held secondarily liable by Dong and Emma since the latter (Dong and Emma) derived title under Carmen's special indorsement. Carmen is not secondarily liable to Fe since the latter obtained it by mere delivery from Emma and therefore did not obtain title through Carmen's special indorsement.

Dong holds himself secondarily liable to Emma since the latter derived title under Dong's special indorsement but not to Fe who acquired the instrument only by delivery.

Emma, not being an indorser, is not secondarily liable to Fe. Emma's only possible source of liability to Fe would be for a breach of warranty but the facts in the problem do not disclose any such breach.

Secondary liability requires due notice of dishonor, unless excused, which we assume had properly been observed. (BAR 1988)

**4. Distinguish an irregular indorser from a general indorser.**

**Answer**

An irregular indorser, not otherwise a party to the instrument, places his signature thereon in blank before delivery to add credit thereto. A general indorser is a regular party to the instrument like a maker, drawer or acceptor and he signs upon delivery of the instrument. While an irregular indorser signs for valuable consideration. (BAR 2005)

**5. Pancho drew a check to Bong and Gerard jointly. Bong indorsed the check and also forged Gerard's indorsement. The payor bank paid the check and charged Pancho's account for the amount of the check. Gerard received nothing from the payment.**

**Pancho asked the payor bank to recredit his account. Should the bank comply? Explain fully.**

**Answer:**

Yes, the bank should recredit the full amount of the check to the account of Pancho. Considering that the check was payable to the account of Pancho. Considering that the check was payable to Bong and Gerard jointly, the indorsement of Gerard was necessary to negotiate the check pursuant to Sec. 41 of the NIL, to wit:

*"Sec. 41. Indorsement where payable to two or more persons.—Where an instrument is payable to the order of 2 or more payees or indorsees who are not partners, all must indorse unless the one indorsing has authority to indorse for the others"*

Since Bong forged the signature of Gerard without authority, the indorsement was wholly inoperative. (BAR 2008)

**6. May the indorsee of a promissory note indorsed to him "for deposit" file a suit against the indorser?**

- a. **Yes, as long as the indorser received value for the restrictive indorsement.**
- b. **Yes, as long as the indorser received value for the conditional indorsement.**
- c. **Yes, whether or not the indorser received value for the conditional indorsement.**
- d. **Yes, whether or not the indorser received value for the restrictive indorsement.**

**Answer:**

- a. Yes, as long as the indorser received value for the restrictive indorsement. (BAR 2011)

7. Z wrote out an instrument that states: "Pay to X the amount of P1 M for collection only. Signed, Z." X indorsed it to his creditor, Y, to whom he owed P1 M. Y now wants to collect and satisfy X's debt through the P1 M on the check. May he validly do so?
- Yes, since the indorsement to Y is for P1 M.
  - No, since Z is not a party to the loan between X and Y.
  - No, since X is merely an agent of Z, his only right being to collect.
  - Yes, since X owed Y P1 M.

**Answer:**

- c. No, since X is merely an agent of Z, his only right being to collect. (BAR 2011)

8. Which of the following indorsers expressly warrants in negotiating an instrument that 1) it is genuine and true; 2) he has a good title to it; 3) all prior parties have capacity to negotiate; and 4) it is valid and subsisting at the time of his indorsement?
- The irregular indorser.
  - The regular indorser.
  - The general indorser.
  - The qualified indorser.

**Answer:**

- c. The general indorser. (BAR 2011)

9. M, the maker, issued a promissory note to P, the payee which states: "I, M, promise to pay P or order the amount of Php1 Million. Signed, M." P negotiated the note by indorsement to N, then N to O also by indorsement, and O to Q, again by indorsement. But before O indorsed the note to Q, O's wife wrote the figure "2" on the note after "Php1" without O's knowledge, making it appear that the note is for Php12 Million. For how much is O liable to Q?
- Php 1 Million since it is the original tenor of the note.
  - Php 1 Million since he warrants that the note is genuine and in all respects what it purports to be.
  - Php 12 Million since he warrants his solvency and that he has a good title to the note.
  - Php 12 Million since he warrants that the note is genuine and in all respects what it purports to be.

**Answer:**

- d. Php 12 Million since he warrants that the note is genuine and in all respects what it purports to be. (BAR 2011)

10. D, debtor of C, wrote a promissory note payable to the order of C. C's brother, M, misrepresenting himself as C's agent, obtained the note from D, then negotiated it to N after forging C's signature. N indorsed it to E, who indorsed it to F, a holder in due course. May F recover from E?
- No, since the forgery of C's signature results in the discharge of E.
  - Yes, since only the forged signature is inoperative and E is bound as indorser.
  - No, since the signature of C, the payee, was forged.
  - Yes, since the signature of C is immaterial, he being the payee.

**Answer:**

- a. Yes, since only the forged signature is inoperative and E is bound as indorser. (BAR 2011)

**11. X is the holder of an instrument payable to him (X) or his order, with Y as maker. X then indorsed it as follows: "Subject to no recourse, pay to Z. Signed, X." When Z went to collect from Y, it turned out that Y's signature was forged. Z now sues X for collection. Will it prosper?**

- e. Yes, because X, as a conditional indorser, warrants that the note is genuine.**
- f. Yes, because X, as a qualified indorser, warrants that the note is genuine.**
- g. No, because X made a qualified indorsement.**
- h. No, because a qualified indorsement does not include the warranty of genuineness.**

**Answer:**

b. Yes, because X, as a qualified indorser, warrants that the note is genuine. (BAR 2011)

**12. P sold to M 10 grams of shabu worth P5,000. As he had no money at the time of the sale, M wrote a promissory note promising to pay P or his order P5,000. P then indorsed the note to X (who did not know about the shabu), and X to Y. Unable to collect from P, Y then sued X on the note. X set up the defense of illegality of consideration. Is he correct?**

- e. No, since X, being a subsequent indorser, warrants that the note is valid and subsisting.**
- f. No, since X, a general indorser, warrants that the note is valid and subsisting.**
- g. Yes, since a void contract does not give rise to any right.**
- h. Yes, since the note was born of an illegal consideration which is real defense.**

**Answer:**

b. No, since X, a general indorser, warrants that the note is valid and subsisting. (BAR 2011)

## **5. Drawee**

**1. Romeo has P100,000 in his current account at the Matatag Banking Corporation. Romeo learned that his enemy had hired a contract killer to liquidate him. Fearful for his life, he mailed to his fiancée, Juliet, a check for P100,000 in the bank. The check was payable to Juliet or order and was accompanied by a letter stating that he was giving her his money out of his great love for her and because something would happen to him anytime now.**

- a) Juliet presented the check for payment but the bank refused to honor it. Does Juliet have any right of action against the bank? Explain.**
- b) The hit contract was called off by Romeo's enemy. Meanwhile, Juliet broke off her engagement to Romeo because of the humiliation she suffered at the bank. Does Romeo have a right of action against the bank? Explain.**

**Answer:**

a) Juliet has no cause of action against the bank. Under the NIL, a drawee has no liability to the holder under an instrument until and after it has been accepted by such drawee.

b) Romeo has a right of action against the bank. The juridical relation between the drawer and drawee is not governed solely by the NIL. The relationship between the bank and the drawer is governed primarily by their own agreement and by the applicable provisions of the Civil Code under which a possible breach of obligation is likely under the factual setting in the problem. (BAR 1986)

**2. Mr. Lim issued a check drawn against BPI Bank in favor of Mr. Yu as payment for certain shares of stock which he purchased. On the same day that he issued the check to Mr. Yu, Mr. Lim ordered BPI to stop payment. Per standard banking practice, Mr. Lim was made to sign a waiver of BPI's liability in the event that it should pay Mr. Yu through oversight or inadvertence. Despite the stop order by Mr. Lim,**

**BPI nevertheless paid Mr. Yu upon presentation of the check. Mr. Lim sued BPI for paying his order. Decide the case.**

**Answer:**

In the event that Mr. Lim, in fact, had sufficient legal reasons to issue the stop payment order, he may sue BPI for paying against his order. The waiver executed by Mr. Lim did not mean that it need not exercise due diligence to protect the interest of its account holder. It is not amiss to state that the drawee, unless the instrument had earlier been accepted by it, is not bound to honor payment to the holder of the check that thereby excludes it from any liability if it were to comply with the stop payment order. (BAR 1991)

- 3. Placido, a bank depositor, left his checkbook on his desk at his house. Unknown to him, a visitor at the time, noticing the same, took a check therefrom, filled it up in the amount of P3,000 and succeeded in encashing the check on the same day. Placido's account was thereby debited in the same amount.**

**Discovering the erroneous debit, Placido demanded that the bank credit him with a like amount. The bank refused on the ground that Placido was negligent in leaving his checkbook on his desk so that he could not put up the defense of forgery or want of authority under the NIL.**

**The facts disclose that even to the naked eye, there were marked differences between Placido's signature and the one in the check forged by the visitor.**

**As between Placido and the bank, who should bear the loss? Explain.**

**Answer:**

The bank should bear the loss. A drawee bank must exercise the highest diligence in safeguarding the accounts of its client-depositors. The bank is also charged with genuineness of the signatures of its current account holders. But what can be more striking is that there were marked differences between Placido's signature and the one in the check forged by the visitor. Certainly, Placido was not negligent in leaving his checkbook on his desk. (BAR 1992)

- 4. A check for P50,000 was drawn against drawee bank and made payable to XYZ Marketing or order. The check was deposited with payee's account at ABC Bank which then sent the check for clearing to drawee bank.**

**Drawee bank refused to honor the check on ground that the serial number thereof had been altered.**

**XYZ Marketing sued drawee bank.**

**In instant suit, drawee bank contended that XYZ Marketing as payee could not sue the drawee bank as there was no privity between them. Drawee theorized that there was no basis to make it liable for the check. Is this contention correct? Explain.**

**Answer:**

Yes. As a general rule, the drawee is not liable under the check because there is no privity of contract between XYZ Marketing, as payee, and ABC Bank as the drawee bank. However, if the action taken by the bank is an abuse of right which caused damage not only to the issuer of the check but also to the payee, the payee has a cause of action under quasi-delict. (BAR 1999)

- 5. Discuss the legal consequences when a bank honors a forged check.**

**Answer:**

A bank, which honors a check wherein the drawer's signature was forged, must bear the loss, because it has the legal duty to ascertain that the drawer's signature is genuine before encashing a check. The liability chain ends with the drawee bank.

On the other hand, if the drawee bank pays under forged indorsement, the drawee bank is still liable to the payee as it has guaranteed the genuineness of all prior indorsements. However, the drawee bank may generally pass liability back through the collection chain to the party who obtained the check from the forger and from the forger himself. (BAR 2006)

6. **Marlon deposited with LYRIC bank a money market placement of P1 M for a term of 31 days. On maturity date, one claiming to be Marlon called up the LYRIC Bank account officer and instructed him to give the manager's check representing the proceeds of the money market placement to Marlon's girlfriend, Ingrid.**

**The check, which bore the forged signature of Marlon, was deposited in Ingrid's account with YAMAHA Bank. YAMAHA Bank stamped a guaranty on the check reading: "All prior endorsements and/or lack of endorsement guaranteed."**

**Upon presentment of the check, LYRIC Bank funds the check. Days later, Marlon goes to LYRIC Bank to collect his money market placement and discovers the foregoing transactions.**

**Marlon thereupon sues LYRIC Bank which in turn files a third-party complaint against YAMAHA Bank. Discuss the respective rights and liabilities of the two banks.**

**Answer:**

Since the money market placement of Marlon is in the nature of a loan to Lyric Bank, and since he did not authorize the release of the money market placement to Ingrid, the obligation of Lyric Bank to him has not been paid. Lyric Bank still has the obligation to pay him.

Since Yamaha Bank indorsed the check bearing the forged endorsement of Marlon and guaranteed all endorsements, including the forged endorsement, when it presented the check to Lyric Bank, it should be held liable to it.

However, since the issuance of the check was attended with the negligence of Lyric Bank, it should share the loss with Yamaha Bank on a 50% basis. (BAR 2010)

7. **A bill of exchange states on its face: "One (1) month after sight, pay to the order of Mr. R the amount of P50,000.00, chargeable to the account of Mr. S. Signed, Mr. T." Mr. S, the drawee, accepted the bill upon presentment by writing on it the words "I shall pay P30,000.00 three (3) months after sight." May he accept under such terms, which varies the command in the bill of exchange?**
- Yes, since a drawee accepts according to the tenor of his acceptance.**
  - No, since, once he accepts, a drawee is liable according to the tenor of the bill.**
  - Yes, provided the drawer and the payee agree to the acceptance.**
  - No, since he is bound as drawee to accept the bill according to its tenor.**

**Answer:**

- Yes, since a drawee accepts according to the tenor of his acceptance. (BAR 2011)**

8. **The signature of X was forged as drawer of a check. The check was deposited in the account of Y and when deposited was accepted by AAA Bank, the drawee bank. Subsequently, AAA Bank found out that the signature of X was actually forged. Which statement is most accurate?**

- a) The drawee bank can recover from Y, because the check was deposited in his account;
- b) The drawee bank can recover from X, because he is the drawer even though his signature was forged;
- c) The drawee bank is estopped from denying the genuineness of the signature of the X, the drawer of the check;
- d) The drawee bank can recover from Y because as endorser he warrants the genuineness of the signature.

**Answer:**

- c) The drawee bank is estopped from denying the genuineness of the signature of the X, the drawer of the check. (BAR 2012)

## 6. Warranties

1. Hernan issued a check payable to the order of Fernando in the sum of P12,000, and drawn on "X" Bank. The check was delivered to Matilde by Adriano for encashment. At the time, the check had the indorsements of (1) Fernando and (2) Rosa. When Matilde encashed it with "X" Bank, she affixed her signature on the check. Upon Matilde's receipt of the cash proceeds of the check, she turned over the amount to Adriano. "X" Bank was informed by Hernan that the alleged indorsement of the payee Fernando was a forgery, since the latter had died 2 years ago. "X" Bank, having refunded the amount to Hernan, sued Matilde, who refused to return the money.

**Does "X" Bank have a cause of action against Matilde?**

**Answer:**

Yes. X Bank has a cause of action against Matilde. Although Matilde, to whom the plaintiff Bank paid the check, was not proven to be the author of the supposed forgery, yet as last indorser of the check, she has warranted that she has good title to it even if in fact she does not have, because the payee was already dead 2 years ago, before the check was issued. The fact that immediately after receiving the cash proceeds of the check in question, she immediately turned over the said amount to Adriano, would not exempt her from liability, because by doing so, she acted as an accommodation party in the check, for which she is also liable as an accommodation party. (*Sec. 29 & 66, N.I.L.; Republic v. Ebrada, July 31, 1975, 665 SCRA 680*) (BAR 1982)

### I. Presentment for Payment

#### 1. Necessity of Presentment for Payment

1. Gemma drew a check on September 13, 1990. The holder presented the check to the drawee bank only on March 5, 1994. The bank dishonored the check on the same date. After dishonor by the drawee bank, the holder gave a formal notice of dishonor to Gemma through a letter dated April 27, 1994.
  1. What is meant by "unreasonable time" as applied to presentment?
  2. Is Gemma liable to the holder?

**Answer:**

1. As applied to presentment for payment, "reasonable time" is meant not more than 6 months from the date of issue. Beyond said period, it is "unreasonable time" and the check becomes stale.
2. No. Aside from the check being already stale, Gemma is also discharged from liability under the check, being a drawer and a person whose liability is secondary, this is due to the giving of the notice of dishonor beyond the period allowed by law. The giving of notice of dishonor on April 27, 1994 is more than 1 month

from March 5, 1994 when the check was dishonored. Since it is not shown that Gemma and the holder resided in the same place, the period within which to give notice of dishonor must be the same time that the notice would reach Gemma if sent by mail. (BAR 1994)

2. **A. AB issued a promissory note for P1,000 payable to CD or his order on September 15, 2002. CD indorsed the note in blank and delivered the same to EF. GH stole the note from EF and on September 14, 2002 presented it to AB for payment. When asked by AB, GH said CD gave him the note in payment for 2 cavans of rice. AB therefore paid GH P1,000 on the same date. On September 15, 2002, EF discovered that the note of AB was not in possession and he went to AB. It was then that EF found out that AB had already made payment on the note. Can EF still claim payment from AB? Why?**

**B. As a sequel to the same facts narrated above, EF, out of pity for AB who had already paid P1,000 to GH, decided to forgive AB and instead go after CD who indorsed the note in blank to him. Is CD still liable to EF by virtue of the indorsement in blank? Why?**

**Answer:**

A. No. EF cannot claim payment from AB. EF is not a holder of the promissory note. To make presentment for payment, it is necessary to exhibit the instrument, which EF cannot do because he is not in possession thereof.

B. No, because CD negotiated the instrument by delivery. (BAR 2002)

## 2. Parties to Whom Presentment for Payment Should Be Made

1. **X executed a promissory note in favor of Y by way of accommodation. It says: "Pay to Y or order the amount of P50,000.00. Signed, X." Y then indorsed the note to Z, and Z to T. When T sought collection from Y, the latter countered as indorser that there should have been a presentment first to the maker who dishonors it. Is Y correct?**

- a. **No, since Y is the real debtor and thus, there is no need for presentment for payment and dishonor by the maker.**
- b. **Yes, since as an indorser who is secondarily liable, there must first be presentment for payment and dishonor by the maker.**
- c. **No, since the absolute rule is that there is no need for presentment for payment and dishonor to hold an indorser liable.**
- d. **Yes, since the secondary liability of Y and Z would only arise after presentment for payment and dishonor by the maker.**

**Answer:**

a. No, since Y is the real debtor and thus, there is no need for presentment for payment and dishonor by the maker. (BAR 2011)

## 3. Dispensation with Presentment for Payment

### 4. Dishonor by Non-Payment

## J. Notice of Dishonor

### 1. Parties to Be Notified

1. **A issued a promissory note to B in the following tenor: "I promise to pay to the order of B P1,000 sixty days after date. (Sgd.) A". The note was subsequently negotiated with proper indorsement by B to C, C to D, and D to E, the holder. When E presented the note for payment to A, the latter refused to pay. E then gave a notice of dishonor to C only.**

**May E immediately proceed against B, C or D? What should C do to protect his rights, if any, against A, B, and D?**

**Answer:**

E may immediately proceed to demand payment only from C, to whom notice of dishonor was previously given. As notice of dishonor was not given to B and D, who are parties secondarily liable as indorsers, they are considered discharged and E may not proceed against them.

When a negotiable instrument has been dishonored by non-payment, notice of dishonor must be given to each indorser, and any indorser to whom such notice is not given is discharged.

To protect his rights, C, who received notice of dishonor from E, must give notice of dishonor within the time fixed by the NIL to B to preserve his right of recourse against prior parties.

C cannot give notice of dishonor to A, who has directly refused to pay.

C cannot give notice of dishonor to D, because C has no right to reimbursement from D, who is a subsequent party who is discharged. (BAR 1984)

## 2. Parties Who May Give Notice and Dishonor

1. **A issued a promissory note to B in the following tenor: "I promise to pay to the order of B P1,000 sixty days after date. (Sgd.) A". The note was subsequently negotiated with proper indorsement by B to C, C to D, and D to E, the holder. When E presented the note for payment to A, the latter refused to pay. E then gave a notice of dishonor to C only.**

**May E immediately proceed against B, C or D? What should C do to protect his rights, if any, against A, B, and D?**

**Answer:**

E may immediately proceed to demand payment only from C, to whom notice of dishonor was previously given. As notice of dishonor was not given to B and D, who are parties secondarily liable as indorsers, they are considered discharged and E may not proceed against them.

When a negotiable instrument has been dishonored by non-payment, notice of dishonor must be given to each indorser, and any indorser to whom such notice is not given is discharged.

To protect his rights, C, who received notice of dishonor from E, must give notice of dishonor within the time fixed by the NIL to B to preserve his right of recourse against prior parties.

C cannot give notice of dishonor to A, who has directly refused to pay.

C cannot give notice of dishonor to D, because C has no right to reimbursement from D, who is a subsequent party who is discharged. (BAR 1984)

## 3. Effect of Notice

1. A issued a promissory note to B in the following tenor: "I promise to pay to the order of B P1,000 sixty days after date. (Sgd.) A". The note was subsequently negotiated with proper indorsement by B to C, C to D, and D to E, the holder. When E presented the note for payment to A, the latter refused to pay. E then gave a notice of dishonor to C only.

**May E immediately proceed against B, C or D? What should C do to protect his rights, if any, against A, B, and D?**

**Answer:**

E may immediately proceed to demand payment only from C, to whom notice of dishonor was previously given. As notice of dishonor was not given to B and D, who are parties secondarily liable as indorsers, they are considered discharged and E may not proceed against them.

When a negotiable instrument has been dishonored by non-payment, notice of dishonor must be given to each indorser, and any indorser to whom such notice is not given is discharged.

To protect his rights, C, who received notice of dishonor from E, must give notice of dishonor within the time fixed by the NIL to B to preserve his right of recourse against prior parties.

C cannot give notice of dishonor to A, who has directly refused to pay.

C cannot give notice of dishonor to D, because C has no right to reimbursement from D, who is a subsequent party who is discharged. (BAR 1984)

4. Form of Notice
5. Waiver
6. Dispensation with Notice

1. **When is notice of dishonor not required to be given to the drawer?**

**Answer:**

Notice of dishonor not required to be given to the drawer in any of the following cases:

1. Where the drawer and the drawee are the same person;
2. When the drawee is a fictitious person or a person not having capacity to contract;
3. When the drawer is the person to whom the instrument is presented for payment;
4. Where the drawer has no right to expect or require that the drawee or acceptor will honor the instrument;
5. Where the drawer has countermanded payment (BAR 1996)

2. **Notice of dishonor is not required to be made in all cases. One instance where such notice is not necessary is when the indorser is the one to whom the instrument is suppose to be presented for payment. The rationale here is that the indorser**

- a. **Already knows of the dishonor and it makes no sense to notify him of it.**
- b. **Is bound to make the acceptance in all cases.**
- c. **Has no reason to expect the dishonor of the instrument.**
- d. **Must be made to account for all his actions.**

**Answer:**

- a. **Already knows of the dishonor and it makes no sense to notify him of it. (BAR 2011)**

## 7. Effect of Failure to Give Notice

1. **A issued a promissory note to B in the following tenor: "I promise to pay to the order of B P1,000 sixty days after date. (Sgd.) A". The note was subsequently negotiated with proper indorsement by B to C, C to D, and D to E, the holder. When E presented the note for payment to A, the latter refused to pay. E then gave a notice of dishonor to C only.**

**May E immediately proceed against B, C or D? What should C do to protect his rights, if any, against A, B, and D?**

**Answer:**

E may immediately proceed to demand payment only from C, to whom notice of dishonor was previously given. As notice of dishonor was not given to B and D, who are parties secondarily liable as indorsers, they are considered discharged and E may not proceed against them.

When a negotiable instrument has been dishonored by non-payment, notice of dishonor must be given to each indorser, and any indorser to whom such notice is not given is discharged.

To protect his rights, C, who received notice of dishonor from E, must give notice of dishonor within the time fixed by the NIL to B to preserve his right of recourse against prior parties.

C cannot give notice of dishonor to A, who has directly refused to pay.

C cannot give notice of dishonor to D, because C has no right to reimbursement from D, who is a subsequent party who is discharged. (BAR 1984)

## K. Discharge of Negotiable Instrument

### 1. Discharge of Negotiable Instrument

1. **Bong bought 300 bags of rice from Ben for P300,000. As payment, Bong indorsed to Ben a BPI check issued by Baby in the amount of P300,000. Upon presentment for payment, the BPI check was dishonored because Baby's account from which it was drawn has been closed. To replace the dishonored check, Bong indorsed a crossed DBP check issued also by Baby for P300,000. Again, the check was dishonored because of insufficient funds. Ben sued Bong and Baby on the dishonored BPI check. Bong interposed the defense that the BPI check was discharged by novation when Ben accepted the crossed DBP check as replacement for the BPI check. Bong cited Section 119 of the NIL which provides that a negotiable instrument is discharged "by any other act which will discharge a simple contract for the payment of money." Is Bong correct?**

**Answer:**

No. Bong is not correct. While Section 119 of the NIL in relation to Article 1231 of the Civil Code provides that one of the modes of discharging a negotiable instrument is by any other act which will discharge a simple contract for the payment of money, such as novation, the acceptance by the holder of another check which replaced the dishonored bank check did not result to novation.

There are only 2 ways which indicate the presence of novation and thereby produce the effect of extinguishing an obligation by another which substitutes the same. First, novation must be explicitly stated and declared in unequivocal terms as novation is never presumed. Secondly, the old and the new obligation must be incompatible on every point.

In the instant case, there was no express agreement that the holder's acceptance of the replacement check will discharge the drawer and endorser from liability. Neither is there incompatibility because both checks were given precisely to terminate a single obligation arising from the same transaction. (BAR 2014)

## 2. Discharge of Parties Secondarily Liable

1. **The rule is that the intentional cancellation of a person secondarily liable results in the discharge of the latter. With respect to an indorser, the holder's right to cancel his signature is:**
  - a. **Without limitation.**
  - b. **Not limited to the case where the indorsement is necessary to his title.**
  - c. **Limited to the case where the indorsement is not necessary to his title.**
  - d. **Limited to the case where the indorsement is necessary to his title.**

**Answer:**

- b. Limited to the case where the indorsement is not necessary to his title. (BAR 2011)

2. **Any agreement binding upon the holder to extend the time of payment or to postpone the holder's right to enforce the instrument results in the discharge of the party secondarily liable unless made with the latter's consent. This agreement refers to one which the holder made with the**
  - a. **Principal debtor**
  - b. **Principal creditor**
  - c. **Secondary creditor**
  - d. **Secondary debtor**

**Answer:**

- a. Principal debtor (BAR 2011)

## 3. Right of Party Who Discharged Instrument

### 4. Renunciation by Holder

## L. Material Alteration

### 1. Concept

1. **A check for P50,000 was drawn against drawee bank and made payable to XYZ Marketing or order. The check was deposited with payee's account at ABC Bank which then sent the check for clearing to drawee bank.**

**Drawee bank refused to honor the check on ground that the serial number thereof had been altered.**

**XYZ Marketing sued drawee bank.**

**Is it proper for the drawee bank to dishonor the check for the reason that it had been altered? Explain.**

**Answer:**

No. The serial number is not a material particular of the check. Its alteration does not constitute material alteration of the instrument. The serial number is not material to the negotiability of the instrument. (BAR 1999)

## 2. Effect of Material Alteration

1. **In consideration of some goods he bought, A issued to B a personal check in the amount of P280. Without the knowledge of A, B raised the amount to P2,800. The alteration is not apparent to the naked eye. B then deposited the altered check in his account with the PNB, which released it for clearing. The Bank of P.I., which is the drawee bank, did not notice the alteration and the check was therefore cleared.**

**B was able to withdraw the P2,800. After which he closed his account. When A received his bank statement and cancelled checks for that month, he noticed the discrepancy in the amount when he compared the altered check with his check stub. He immediately notified the Bank of P.I. in turn demanded recredit from the PNB, which cannot now locate B.**

**Discuss the rights and liabilities of the parties under the circumstances.**

### **Answer:**

A is entitled to have the Bank of P.I. recredit his account with P2,520. Under the NIL, a material alteration avoids the instrument, except as to those who made, authorized or assented to the alteration and subsequent indorsers. However, where such altered instrument is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor. The PNB is a holder in due course as it was not aware of the alteration and had paid value for the instrument by virtue of B's withdrawal of his deposit. However, under the above provision, material alteration is a real defense to which even a holder in due course is subject, except only as to the original tenor. The original tenor of the check was only P280, so as to this amount the PNB cannot be made to pay back the Bank of P.I., it has no right however to the difference of P2,520 because of the material alteration. It must therefore pay back to or recredit the Bank of P.I. this latter amount, and the Bank of P.I. on the other hand, must in turn recredit A's account with the same amount. (BAR 1983)

2. **Mario Guzman issued to Honesto Santos a check for P50,000 as payment for a second-hand car. Without the knowledge of Mario, Honesto changed the amount to P150,000 which alteration could not be detected by the naked eye. Honesto deposited the altered check with Shure Bank which forwarded the same to Progressive Bank for payment. Progressive Bank without noticing the alteration paid the check, debiting P150,000 from the account of Mario. Honesto withdrew the amount of P150,000 from Shure Bank and disappeared. After receiving his bank statement, Mario discovered the alteration and demanded restitution from Progressive Bank.**

**Discuss fully the rights and liabilities of the parties concerned.**

### **Answer:**

The demand of Mario for restitution of the amount of P150,000 to his account is tenable. Progressive Bank has no right to deduct said amount from Mario's account since the order of Mario is different. Moreover, Progressive Bank is liable for the negligence of its employees in not noticing the alteration which, though it cannot be detected by the naked eye, could be detected by a magnifying instrument used by tellers.

As between Progressive Bank and Shure Bank, it is the former that should bear the loss. Progressive Bank failed to notify Shure Bank that there was something wrong with the check within the clearing hour rule of 24 hours. (BAR 1995)

3. William issued to Albert a check for P100,000 drawn on XM Bank. Albert alerted the amount of the check to P210,000, and deposited the check to his account with ND Bank. When ND Bank presented the check for payment through the Clearing House, XM Bank honored it. Thereafter, Albert withdrew the P210,000, and closed his account.

When the check was returned to him after a month, William discovered the alteration. XM Bank recredited P210,000 to William's current account, and sought reimbursement from ND Bank. ND Bank refused, claiming that XM Bank failed to return the altered check to it within the 24-hour clearing period.

Who, as between, XM Bank and ND Bank, should bear the loss? Explain.

**Answer:**

ND Bank should bear the loss if XM Bank returned the altered check to ND Bank within 24 hours after its discovery of the alteration. Under the given facts, William discovered the alteration when the altered check was returned to him after a month. It may safely be assumed that William immediately advised XM Bank of such fact and that William immediately advised XM Bank of such fact and that the latter promptly notified ND Bank thereafter. CB Circular No. 9, as amended, on which the decisions of the Supreme Court, in the Hongkong & Shanghai Banking Corporation v. People's Bank & Trust Co. and Republic Bank v. CA, et al. were based was expressly cancelled and superseded by the CB Circular No. 317, dated December 23, 1970. The latter was in turn amended by CB Circular No. 580, dated September 19, 1977. As to the altered checks, the new rules provide that the drawee bank can still return them even after 4:00pm of the next day provided it does so within 24 hours from discovery of the alteration but in no event beyond the period fixed or provided by law for filing of a legal action by the returning bank against the bank sending the same. Assuming that the relationship between the drawee bank and the collecting bank is evidenced by some written document, the prescriptive period would be 10 years. (BAR 1996)

4. Can the drawee who accepts a materially altered check recover from the holder and the drawer?
- No, he cannot recover from either of them.
  - Yes from both of them.
  - Yes but only from the drawer.
  - Yes but only from the holder.

**Answer:**

- a. No, he cannot recover from either of them. (BAR 2011)

5. A material alteration of an instrument without the assent of all parties liable thereon results in its avoidance, EXCEPT against a
- Prior indorsee.
  - Subsequent acceptor.
  - Subsequent indorser.
  - Prior acceptor.

**Answer:**

- c. Subsequent indorser. (BAR 2011)

**M. Acceptance**

- Definition
- Manner

1. **X, drawee of a bill of exchange, wrote the words: "Accepted, with promise to make payment within two day. Signed, X." The drawer questioned the acceptance as invalid. Is the acceptance valid?**
  - a. **Yes, because the acceptance is in reality a clear assent to the order of the drawer to pay.**
  - b. **Yes, because the form of the acceptance is really immaterial.**
  - c. **No, because the acceptance must be a clear assent to the order of the drawer to pay.**
  - d. **No, because the document must not express that the drawee will perform his promise within two days.**

**Answer:**

- a. **Yes, because the acceptance is in reality a clear assent to the order of the drawer to pay. (BAR 2011)**

3. **Time for Acceptance**

4. **Rules Governing Acceptance**

**N. Presentment for Acceptance**

1. **P authorized A to sign a negotiable instrument in his (P's) name. It reads: "Pay to B or order the sum of P1 M. Signed, A (for and in behalf of P)." The instrument shows that it was drawn on P. B then indorsed to C, C to D, and D to E. E then treated it as a bill of exchange. Is presentment for acceptance necessary in this case?**
  - a. **No, since the drawer and the drawee are the same person.**
  - b. **No, since the bill is non-negotiable, the drawer and drawee being the same person.**
  - c. **Yes, since the bill is payable to order, presentment is required for acceptance.**
  - d. **Yes, in order to hold all persons liable on the bill.**

**Answer:**

- a. **No, since the drawer and the drawee are the same person. (BAR 2011)**

1. **Time/Place/Manner of Presentment**

2. **Effect of Failure to Make Presentment**

3. **Dishonor by Non-Acceptance**

**O. Promissory Notes**

**P. Checks**

1. **As payment for good received, Masikap gave to Humimok on November 3, his check drawn on the Eternal Bank of Manila. On November 11, Kahusayan went to Eternal bank to encash the check. He could not cash the check because on November 10, Central Bank forbidden Eternal Bank to do business in the Philippines on grounds of insolvency. Masikap, Humimok, and Kahusayan all reside in Manila.**
  - b) **Can Kahusayan still collect from Humimok for the dental work done on the latter? Explain briefly.**

**Answer:**

- b) **Kahusayan can still collect from Humimok what may be due for the dental work done, since payment by means of check will only produce the effect of payment once the instrument is encashed or, by the fault of the holder, it is impaired. (BAR 1986)**

2. **A stale check is a check—**

- a) That cannot anymore be paid although the underlying obligation still exists;
- b) That cannot anymore be paid and the underlying obligation under the check is also extinguished;
- c) That can still be negotiated or indorsed so that whoever is the holder can claim payment therefrom;
- d) Which has not been presented for payment within a period of 30 days.

**Answer:**

- a) That cannot anymore be paid although the underlying obligation still exists (BAR 2012)

3. **Paul George Pua (Pua) filed a complaint for a sum of money against the spouses Benito and Caroline James (Spouses James). In the complaint, Pua prayed that the defendants pay Pua the amount of P8.5 M covered by a check. Pua asserts that defendants owed him a sum of money way back in 1988 for which the Spouses James gave him several checks. The checks, however, had all been dishonored and Pua has not been paid the amount of the loan plus the agreed interest. In 1996, the Spouses James approached Pua to get the computation of their liability including the 2% compounded interest. After bargaining to lower the amount of their liability, the Spouses James gave Pua a postdated check bearing the discounted amount of P8.5 M. Like the 1988 checks, the drawee bank likewise dishonored this check. To prove his allegations, Pua submitted the original copies of the 17 checks issued by Caroline in 1988 and the check issued in 1996, Manilatrust Check No. 750. The Spouses James, on the other hand, completely denied the existence of the debt asserting that they had never approached Pua to borrow money in 1988 or in 1996. They assert, instead, that Pua is simply acting at the instance of his sister, Lilian, to file a false charge against them using a check left to fund a gambling business previously operated by Lilian and Caroline. Decide.**

**Answer:**

The 17 original checks, completed and delivered to Pua, are sufficient by themselves to prove the existence of the loan obligation of Spouses James to Pua. In *Pacheco v. Court of Appeals*, the Court has expressly recognized that a check “constitutes an evidence of indebtedness” and is a veritable “proof of an obligation.” Hence, it can be used “in lieu of and for the same purpose as a promissory note.” In fact, in the seminal case of *Lozano v. Martinez*, the Court pointed out that a check functions more than a promissory note since it not only contains an undertaking to pay an amount of money but is an “order addressed to a bank and partakes of a representation that the drawer has funds on deposit against which the check is drawn, sufficient to ensure payment upon its presentation to the bank.” The Court reiterated this rule in *Lim v. Mindanao Wines and Liquor Galleria* stating that “a check, the entries of which are in writing, could prove a loan transaction.” This is the very same principle underpin Section 24 of the NIL which provides that “every negotiable instrument is deemed prima facie to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party for value.” Consequently, the case should be decided in favor of Pua and against Spouses James. (BAR 2014)

4. **A criminal complaint for violation of BP22 was filed by Foton Motors (Foton), an entity engaged in the business of car dealership, against Pura Felipe (Pura) with the office of the City Prosecutor of Quezon City. The office found probable cause to indict Pura and filed an information before the MeTC of Quezon City, for her issuance of a postdated check in the amount of P1,020,000.00 which was subsequently dishonored upon presentment due to “Stop Payment”.**

**Pura issued the check because her son, Freddie, attracted by a huge discount of P220,000, purchased a Foton Blizzard 4x2 from Foton. The term of the transaction was Cash-on-Delivery and no down payment was required. The car was delivered on May 14, 1997, but Freddie failed to pay upon delivery. Despite non-payment, Freddie took possession of the vehicle.**

**Pura was eventually acquitted of the charge of violating BP 22 but was found civilly liable for the amount of the check plus legal interest. Pura appealed the decision as regards the civil liability, claiming that there was no privity of contract between Foton and Pura. No civil liability could be adjudged against her because of her acquittal from the criminal charge. It was Freddie who was civilly**

liable to Foton, Pura claimed. Pura added that she could not be an accommodation party either because she only came in after Freddie failed to pay the purchase price, or 6 months after the execution of the contract between Foton and Freddie. Her liability was limited to her act of issuing a worthless check, but by her acquittal in the criminal charge, there was no more basis for her to be held civilly liable to Foton. Pura's act of issuing the subject check did not, by itself, assume the obligation of Freddie to Foton or automatically make her a party to the contract. Is Pura liable?

**Answer:**

Yes. Pura is liable. The rule is that every act or omission punishable by law has its accompanying civil liability. The civil aspect of every criminal case is based on the principle that every person criminally liable is also civilly liable. If the accused however, is not found to be criminally liable, it does not necessarily mean that she will not likewise be held civilly liable because extinction of the penal action does not carry with it extinction of civil action. Although Pura was not an accommodation party, she cannot escape civil liability. In cases of violation of BP 22, a special law, the intent in issuing a check is immaterial. Pura issued the bouncing check. Thus, regardless of her intent, she remains civilly liable because the act or omission, the making and issuing of the subject check, from which her civil liability arises. (BAR 2014)

**1. Definition**

**1. A. Define the following: (1) a check.**

**B. You are Pedro Cruz. Draft the appropriate contract language for (1) your check, containing the essential elements of a negotiable instrument.**

**Answer:**

(A) A check is a bill of exchange drawn on a bank payable on demand.

(B) Check—

“September 15, 2002

“Pay to the order of Juan Santos the sum of TEN THOUSAND PESOS (P10,000.00), Philippine currency.

(Signed) Pedro Cruz

To: Philippine National Bank  
Escolta, Manila Branch” (BAR 2002)

**2. A check is—**

- a) A bill of exchange;**
- b) The same as a promissory note;**
- c) Is drawn by a maker;**
- d) A non-negotiable instrument**

**Answer:**

a) A bill of exchange. (BAR 2012)

**2. Kinds**

**a. Manager's Check**

1. In payment for his debt in favor of X, Y gave X a Manager's Check in the amount of P100,000 dated May 30, 2012. Which phrase best completes the statement—A Manager's Check:

- a) Is a check issued by a manager of a bank for his own account;
- b) Is a check issued by a manger of a bank in the name of the bank against the bank itself for the account of the bank;
- c) Is like any ordinary check that needs to be presented for payment also;
- d) Is better than a cashier's check in terms of use and effect.

Answer:

- b) Is a check issued by a manger of a bank in the name of the bank against the bank itself for the account of the bank. (BAR 2012)

**b. Cross Check**

1. Po Press issued in favor of Jose a postdated crossed check, in payment of newsprint which Jose promised to deliver. Jose sold and negotiated the check to Excel Inc. at a discount. Excel did not ask Jose the purpose of crossing the check. Since Jose failed to deliver the newsprint, Po ordered the drawee bank to stop payment on the check.

Efforts of Excel to collect from Po failed. Excel wants to know from you as counsel:

- 1. What are the effects of crossing a check?
- 2. Whether as second indorser and holder of the crossed check, is it a holder in due course?
- 3. Whether Po's defense of lack of consideration as against Jose is also available as against Excel?

Answer:

- 1. The effects of crossing a check are:

- a) The check is for deposit only in the account of the payee.
- b) The check may be indorsed only once in favor of a person who has an account with the bank.
- c) The check is issued for a specific purpose and the person who takes it not in accordance with said purpose does not become a holder in due course and is not entitled to payment thereunder.

- 2. No. It is a crossed check and Excel did not take it in accordance with the purpose for which the check was issued. Failure on its part to inquire as to said purpose, prevented Excel from becoming a holder in due course, as such failure or refusal constituted bad faith.

- 3. Yes. Not being a holder in due course, Excel is subject to the personal defense which Po Press can set up against Jose. (BAR 1994)

2. On October 12, 1993, Chelsea Straights (CHELSEA), a corporation engaged in the manufacture of cigarettes, ordered from Moises Lim 2,000 bales of tobacco. CHELSEA issued to Moises Lim 2 crossed checks postdated March 15, 1994 and April 15, 1994 in full payment therefor. On January 19, 1994 Moises Lim sold to Dragon Investment House (DRAGON) at a discount the 2 checks drawn by CHELSEA in his favor.

Moises Lim failed to deliver the bales of tobacco as agrees despite CHELSEA's demand. Consequently, on March 1, 1994 CHELSEA issued a "stop payment" order on the 2 checks issued to Moises Lim. DRAGON,

**claiming to be a holder in due course, filed a complaint for collection against CHELSEA for the value of the checks.**

**Rule on the complaint of DRAGON. Give your legal basis.**

**Answer:**

DRAGON cannot collect from CHELSEA. The instruments are crossed checks which were intended to pay for the 2,000 bales of tobacco to be delivered by Moises Lim. It was therefore the obligation of DRAGON to inquire as to the purpose of the issuance of the 2 crossed checks before causing them to be discounted. Failure on its part to make such inquiry, which resulted in its bad faith, DRAGON cannot claim to be a holder in due course. Moreover, the checks were sold, not endorsed, by him to DRAGON which did not become a holder in due course. Not being a holder in due course, DRAGON is subject to the personal defense on the part of CHELSEA concerning the breach of trust on the part of Moises Lim in not complying with his obligation to deliver the 2,000 bales of tobacco. (BAR 1995)

**3. What are the effects of crossing a check?**

**Answer:**

The effects of crossing a check are as follows:

1. The check may not be encashed but only deposited in a banks;
2. The check may be negotiated only once to one who has an account with a bank;
3. The act of crossing a check serves as a warning to the holder thereof that the check has been issued for a definite purpose so that the holder must inquire if he has received the check pursuant to that purpose, otherwise he is not a holder in due course. (BAR 1996)

**4. Distinguish clearly (1) crossed checks from cancelled checks; and (2) cash bond from surety bond.**

**Answer:**

A crossed check is one with two parallel lines drawn diagonally across its face or across a corner thereof. On the other hand, a cancelled check is one marked or stamped "paid" and/or "cancelled" by or on behalf of a drawee bank to indicate payment thereof.

A surety bond is issued by a surety or insurance company in favor of a designated beneficiary, pursuant to which such company acts as a surety to the debtor or obligor of such beneficiary.

A cash bond is a security in the form of cash established by a guarantor or surety to secure the obligation of another. (BAR 2004)

**5. What is a crossed check? What are the effects of crossing a check? Explain.**

**Answer:**

A crossed check is a check with 2 parallel lines, written diagonally on the upper right corner thereof. It is a warning to the drawee bank that payment must be made to the right party, otherwise the bank has no authority to use the drawer's funds deposited with the bank. To be assured that it will avoid any mistake in paying to the wrong party, banks adopted the policy that crossed checks must be deposited in the payee's account. When withdrawal is made, the banks can be sure that they are paying to the right party. Later, jurisprudence added to the development of crossed checks in that the crossing becomes a warning also to whoever deals with the said instrument to inquire as to the purpose of its issuance. Otherwise, if something wrong happens to the payment thereof, that person cannot claim to be a holder in due course. Hence, he is subject to the personal defense on the part of the drawer that there is breach of trust committed by the payee in not complying with the drawer's instruction. (BAR 2005)

### 3. Stopping Payment

1. **Mr. Lim issued a check drawn against BPI Bank in favor of Mr. Yu as payment for certain shares of stock which he purchased. On the same day that he issued the check to Mr. Yu, Mr. Lim ordered BPI to stop payment. Per standard banking practice, Mr. Lim was made to sign a waiver of BPI's liability in the event that it should pay Mr. Yu through oversight or inadvertence. Despite the stop order by Mr. Lim, BPI nevertheless paid Mr. Yu upon presentation of the check. Mr. Lim sued BPI for paying his order. Decide the case.**

#### **Answer:**

In the event that Mr. Lim, in fact, had sufficient legal reasons to issue the stop payment order, he may sue BPI for paying against his order. The waiver executed by Mr. Lim did not mean that it need not exercise due diligence to protect the interest of its account holder. It is not amiss to state that the drawee, unless the instrument had earlier been accepted by it, is not bound to honor payment to the holder of the check that thereby excludes it from any liability if it were to comply with the stop payment order. (BAR 1991)

### 4. Presentment for Payment

- a. Time
- b. Effect of Delay

### IV. Insurance Code

1. **A group of Malaysians wanted to invest in the Philippines' insurance business. After negotiations, they agreed to "FIMA Insurance Corp." with a group of Filipino businessmen. FIMA would have a P50 M paid up capital. P40 M of which would come up from the Filipino group. All corporate officers would be Filipinos and 8 out of 10-member Board of Directors would be Filipinos. Can FIMA operate an insurance business in the Philippines?**
  - a. No, since an insurance company must have at least P74 M paid up capital.
  - b. Yes, since there is substantial compliance with our nationalization laws respecting paid-up capital and Filipino dominated Board of Directors.
  - c. Yes, since FIMA's paid up capital more than meets the country's nationalization laws.
  - d. No, since an insurance company should be 100% owned by Filipinos.

#### **Answer:**

- a. No, since an insurance company must have at least P74 M paid up capital. (BAR 2011)

### A. Concept of Insurance

1. **May a member of the MILF or its breakaway group, the Abu Sayyaf, be insured with a company licensed to do business under the Insurance Code of the Philippines? Explain.**
  - b) **BD has a bank deposit of half a million pesos. Since the limit of the insurance coverage of the PDIC is only 1/10 of BD's deposit, he would like some protection for the excess by taking out an insurance against all risk or contingencies of loss arising from any unsound or unsafe banking practices including unforeseen adverse effects of the continuing crisis involving the banking and financial sector in the Asian region. Does BD have an insurable interest within the meaning the Insurance Code of the Philippines?**

**Answer:**

- a) A member of the MILF or the Abu Sayyaf may be insured with a company licensed to do business under the Insurance Code of the Philippines. What is prohibited to be insured is a public enemy. A public enemy is a citizen or national of a country with which the Philippines is at war. Such member of the MILF or the Abu Sayyaf is not a citizen or national of another country, but of the Philippines.
- b) Yes. BD has insurable interest in his bank deposit. In case of loss of said deposit, more particularly to the extent of the amount in excess of the limit covered by the PDIC Act, BD will be damnified. He will suffer pecuniary loss of P400,000, that is, his bank deposit of half a million pesos minus P100,000 which is the maximum amount recoverable from the PDIC. (BAR 2000)

**2. What is a mutual insurance company or association?**

**Answer:**

A mutual insurance company is a cooperative enterprise where the members are both the insurer and the insured. In it, the members all contribute, by a system of premiums or assessments, to the creation of a fund from which all losses and liabilities are paid, and where the profits are divided among themselves, in proportion of their interest. (BAR 2006)

3. In return for the 20 years of faithful service of X as a house helper to Y, the latter promised to pay P100,000 to X's heirs if he (X) dies in an accident by fire. X agreed. Is this an insurance contract?
  - a. Yes, since all the elements of an insurance contract are present.
  - b. Yes, since X's services may be regarded as the consideration.
  - c. No, since Y actually made a conditional donation in X's favor.
  - d. No, since it is in fact an innominate contract between X and Y.

**Answer:**

- b. No, since Y actually made a conditional donation in X's favor. (BAR 2011)

**B. Elements of an Insurance Contract**

**C. Characteristics/Nature and General Principles of Insurance Contract**

1. The Civil Code adopts the *theory of cognition*, while the Code of Commerce generally recognizes the *theory of manifestation*, in the perfection of contracts. How do these two theories differ?

**Answer:**

Under the theory of cognition, the acceptance is considered to effectively bind the offeror only from the time it came to his knowledge. Under the theory of manifestation, the contract is perfected at the moment when the acceptance is declared or made by the offeree. (BAR 1997)

2. An Insurance Contract is a contract of adhesion, which means that in resolving ambiguities in the provision of the insurance contract –
  - a) The general rule is that, the insurance contract is to be interpreted strictly in accordance with what is written in the contract;
  - b) Are to be construed liberally in favor of the insured and strictly against the insurer who drafted the insurance policy;
  - c) Are to be construed strictly against the insured and liberally in favor of the insurer;
  - d) If there is an ambiguity in the insurance contract, this will invalidate the contract.

**Answer:**

b) Are to be construed liberally in favor of the insured and strictly against the insurer who drafted the insurance policy. (BAR 2012)

3. **An insurance contract is an aleatory contract, which means that—**

- a) **An insurer will pay the insured equivalent to the amount of the premium;**
- b) **The obligation of the insurer is to pay depending upon the happening of an uncertain event;**
- c) **The insured pays a fixed premium for the duration of the policy period and the amount of the premiums paid to the insurer is not necessarily the same amount as what the insured will get upon the happening of an uncertain future event;**
- d) **The obligation of the insurer is to pay depending upon the happening of an event that is certain to happen.**

**Answer:**

b) The obligation of the insurer is to pay depending upon the happening of an uncertain event. (BAR 2012)

#### **D. Parties to Insurance Contract**

##### **1. Insurer**

1. **X Company procured a group accident insurance policy for its construction employees variously assigned to its provincial infrastructure projects. Y Insurance Company underwrote the coverage, the premiums of which were paid for entirely by X Company without any employee contributions. While the policy was in effect, five of the covered employees perished at sea on their way to their provincial assignments. Their wives sued Y Insurance Company for payment of death benefits under the policy. While the suit was pending, the wives signed a power of attorney designating an X Company executive, PJ as their authorized representative to enter into a settlement with the insurance company. When a settlement was reached, PJ instructed the insurance company to issue a settlement check to the order of the X Company, which will undertake the payment to the individual claimants of their respective shares. PJ misappropriated the settlement amount and the wives pursued their case against Y Insurance Company. Will the suit prosper? Explain.**

**Answer:**

Yes. The suit will prosper. Y insurance Company is liable. X Company, through its executive, PJ, acted as agent of Y Insurance Company. The latter is thus bound by the misconduct of its agent. It is the usual practice in the group insurance business that the employer-policy holder is the agent of the issuer. (BAR 2000)

##### **2. Insured**

##### **3. Beneficiary**

1. **On July 1, 1979, Crispulo, married to Laura with whom he has two legitimate children, was issued Policy No. 8008 of the Midland Life Insurance Co. on a whole-life plan for P10,000. He designated Angie, his common-law wife as the recoverable beneficiary. He referred to her, in his application and policy, as his wife.**

**Two years later, Crispulo died. Angie filed her claim for the proceeds of the policy as the designated beneficiary therein. The widow, Laura, also filed her claim as legal wife.**

**If you were the Legal Counsel for the Insurance Company, to whom would you adjudicate the proceeds of the insurance policy? Reason out your answer briefly.**

**Answer:**

I would adjudicate the proceeds of the insurance policy to Laura, the legal wife. In the appointment of beneficiary, the New Civil Code imposed certain limitations; one of them being that the insured may not appoint, as his beneficiary, one with whom he is guilty of concubinage, at the time of designation. Since Crispulo was married to Laura at the time when he designate as his beneficiary his concubine Angie, with whom he was guilty of concubinage at the time of designation, Laura may have said designation of Angie nullified, by mere preponderance of evidence in the same action for nullification. There is even no need of the criminal conviction for concubinage. (*Arts. 739 and 2012, N.C.C.; Insular Life assn. Co., Ltd. v. Ebrado, Oct. 28, 1977; 80 SCRA 181*) (BAR 1981)

2. **On December 20, 1974, A took out a life insurance policy and named his wife B, as beneficiary. The policy was silent with regard to any change of beneficiary. Suspecting that B was committing adultery, A immediately notified the insurance company in writing that he is substituting his brother C as beneficiary in place of B. A died later on June 30, 1975. B claims the proceeds of the insurance policy, contending that as designated beneficiary, she cannot be changed without her consent, she having acquired a vested right to the proceeds of the policy. Decide. Give reasons for your answer.**

**Answer:**

B cannot claim the proceeds of A's life insurance policy. A's action in substituting his brother C as his beneficiary in place of B, his wife, in his insurance policy, is valid. The insured, A, can change the beneficiary in a policy of life insurance, without the consent of the beneficiary. (BAR 1978)

3. **Eduardo Fernandez applied for and was issued Policy No. 0777 by Atlas Life Insurance Corporation on a whole-life plan for P200,000. Although he was married to Clara, with whom he had 5 legitimate children, he designated his common-law wife, Diana Cruz, as his revocable beneficiary in the policy, and referred to Diana in his application and policy, as his wife. 5 years thereafter, he died. Diana immediately filed her claim for the proceeds of the policy as the designated beneficiary. Clara also filed her claim as legal wife. The insurance company filed a petition for Interpleader before the RTC of Rizal to determine who should be entitled to the proceeds of the policy.**

**If you were the judge, how would you decide the said interpleader action? Explain.**

**Answer:**

If I were the judge, I would decide that the legal wife, Clara, be entitled to the proceeds of insurance taken by Eduardo Fernandez who named his common-law wife, Diana, as his revocable beneficiary, at the time they were guilty of concubinage. In that case, the designation of Diana is void, being prohibited by the New Civil Code (Art. 739 and 2012). The guilt of Eduardo and Diana for concubinage may be proved by mere preponderance of evidence in the same action and there is no need for a criminal conviction for concubinage. (BAR 1985)

4. **On October 18, 1980, P, took out a life insurance policy and named his only son Q as beneficiary. The policy was silent with regard to any change of beneficiary. P later learned that Q was hooked on drugs and immediately notified the insurance company in writing that he is substituting his sister, R, as his beneficiary in place of Q. P later died of advanced tuberculosis. In the application form filled up by the agent of the insurance company prior to the issuance of the life insurance policy by the insurance company, the agent, without the knowledge of P, filled in a false answer and made it appear that P was in good health. Upon P's death, Q claimed the proceeds of the insurance policy contending that as designated beneficiary, he cannot be changed without his consent, he having acquired a vested right to the proceeds of the policy.**

- a) **Is Q's contention correct? Reasons.**

**Answer:**

a) No, the designation of the beneficiary is revocable unless the right to revoke is waived. (BAR 1988)

5. **Juan de la Cruz was issued Policy No. 8888 of the midland Life Insurance Co. On a whole life plan for P20,000 on August 19, 1989. Juan de la Cruz is married to Cynthia with whom he has three legitimate children. He, however, designated Purita, his common-law-wife, as the revocable beneficiary. Juan de la Cruz referred to Purita in his application and policy as the legal wife.**

**3 years later, Juan de la Cruz died. Purita filed her claim for the proceeds of the policy as the designated beneficiary therein. The widow, Cynthia, also filed a claim as the legal wife. To whom should the proceeds of the insurance policy be awarded?**

**Answer:**

The proceeds of the insurance policy shall be awarded to the estate of Juan. Purita, the common-law wife, is disqualified as the beneficiary of the deceased because of illicit relation between the deceased and Purita, the designated beneficiary. Due to such illicit relation, Purita cannot be a donee of the deceased. Hence, she cannot also be his beneficiary. (BAR 1998)

6. **Jacob obtained a life insurance policy for P1 M designating irrevocably Diwata, a friend, as his beneficiary, Jacob, however, changed his mind and wants Yob and Jojo, his other friends, to be included as beneficiaries considering that the proceeds of the policy are sufficient for the three friends.**

**Can Jacob still add Yob and Jojo as his beneficiaries? Explain.**

**Answer:**

The insured cannot add other beneficiaries as this would diminish the interest of Diwata who is the irrevocably designated beneficiary. The insured can only do so with the consent of Diwata. (BAR 2005)

7. **What are the effects of an irrevocable designation of a beneficiary under the Insurance Code? Explain.**

**Answer:**

The irrevocable beneficiary has a vested interest in the policy, including its incident such as the policy loan and cash surrender value. (BAR 2005)

8. **On January 1, 2000, Antonio Rivera secured a life insurance from SOS Insurance Corp. for P1 M with Gemma Rivera, his adopted daughter, as the beneficiary. Antonio Rivera died on March 4, 2005 and in the police investigation, it was ascertained that Gemma Rivera participated as an accessory in the killing of Antonio Rivera. Can SOS Insurance Corp. avoid liability by setting up as a defense the participation of Gemma Rivera in the killing of Antonio Rivera? Discuss with reasons.**

**Answer:**

SOS cannot avoid liability under the policy. While Gemma's interest as beneficiary in the policy is considered forfeited since she is an accessory to the killing of Antonio, the proceeds of the policy should be paid to the nearest relative of Antonio (if not otherwise disqualified). The Insurance Code provides that the interest of a beneficiary in a life insurance policy shall be forfeited when the beneficiary is the principal, accomplice, or accessory in willfully bringing about the death of the insured; in which event, the nearest relative of the insured shall receive the proceeds of said insurance if not otherwise disqualified. (BAR 2008)

9. **X is the common law wife of Y. Y loves X so much that he took out a life insurance on his own life and made her the sole beneficiary. Y did this to ensure that X will be financially comfortable when he is gone. Upon the death of Y—**

- a) X as sole beneficiary under the life insurance policy on the life of Y will be entitled to the proceeds of the life insurance;
- b) Despite the designation of X as the sole beneficiary, the proceeds of the life insurance will go to the estate of Y;
- c) The proceeds of the life insurance will go to the compulsory heirs of Y;
- d) The proceeds of the life insurance will be divided equally amongst X and the compulsory heirs of Y.

**Answer:**

b) Despite the designation of X as the sole beneficiary, the proceeds of the life insurance will go to the estate of Y; (BAR 2012)

## E. Classes

### 1. Marine

- a. Coverage
- b. Implied Warranties

#### 1. What warranties are implied in marine insurance?

**Answer:**

The following warranties are implied in marine insurance:

- 1. That the ship is seaworthy to make the voyage and/or to take in certain cargoes;
- 2. That the ship shall not deviate from the voyage insured;
- 3. That the ship shall carry the necessary documents to show nationality or neutrality and that it will not carry document which will cast reasonable suspicion thereon;
- 4. That the ship shall not carry contraband, especially if it is making voyage through belligerent waters. (BAR 2000)

#### 2. Paolo, the owner of an ocean-going vessel, offered to transport the logs of Constantino from Manila to Nagoya. Constantino accepted the offer, not knowing that the vessel was manned by an irresponsible crew with deep-seated resentments against Paolo, their employer.

Constantino insured the cargo of logs against both perils of the sea and barratry. The logs were improperly loaded on one side, thereby causing the vessel to tilt on one side. On the way to Nagoya, the crew unbolted the sea valve of the vessel causing water to flood the ship hold. The vessel sank.

Constantino tried to collect from the insurance company which denied liability, given the unworthiness of both the vessel and its crew.

Constantino countered that he was not the owner of the vessel and he could therefore not be responsible for conditions about which he was innocent.

**Is the insurance company liable?**

**Answer:**

No. the insurance company is not liable because there is an implied warranty in every marine insurance that the ship is seaworthy whoever is insuring the cargo, whether it be the shipowner or not. There was a breach of warranty, because the logs were improperly loaded and the crew was irresponsible. It is the obligation of the owner of the cargo to look for a reliable common carrier which keeps its vessel in seaworthy condition. (BAR 2010)

3. On October 30, 2007, M/V Pacific, a Philippine registered vessel owned by Cebu Shipping Company (CSC), sank on her voyage from Hong Kong to Manila. Empire Assurance Company (Empire) is the insurer of the lost cargoes loaded on board the vessel which were consigned to Debenhams Company. After it indemnified Debenhams, Empire as subrogee filed an action for damages against CSC.

a) Assume the vessel was not seaworthy as in fact its hull had leaked, causing flooding in the vessel. Will your answer be the same? Explain.

b) Assume the facts in question b). Can the heirs of the 3 crew members who perished recover from CSC? Explain fully.

**Answer:**

a) No, my answer will be different. Allowing the vessel to depart on a voyage when it is not seaworthy is a violation of the implied warranty of seaworthiness, and thus constitutes negligence on the part of owner of the ship and the ship captain. The hypothecary principle in maritime commerce—limiting the ship owner’s liability to the amount of insurance proceeds—is not applicable when the unseaworthiness of the vessel is due to the owner’s fault or negligence.

b) Yes, the heirs of the 3 crew members perished can recover from CSC for negligence which constitutes a quasi-delict in this case. (BAR 2008)

c. Insurable Interest

d. Perils of the Sea and Perils of the Ship

1. A marine insurance policy on a cargo states that “the insurer shall be liable for losses incident to perils of the sea”. During the voyage, seawater entered the compartment where the cargo was stored due to the defective drainpipe of the ship. The insured filed an action on the policy for recovery of the damages caused to the cargo. May the insured recover damages?

**Answer:**

No. the proximate cause of the damage to the cargo insured was the defective drainpipe of the ship. This is peril of the ship, and not peril of the sea. The defect in the drainpipe was the result of the ordinary use of the ship. To recover under a marine insurance policy, the proximate cause of the loss or damage must be peril of the sea. (BAR 1998)

2. Perils of the ship, under marine insurance law, refer to loss which in the ordinary course of events results from

a. Natural and inevitable actions of the sea.

b. Natural and ordinary actions of the sea.

c. Unnatural and inevitable actions of the sea.

d. Unnatural and ordinary actions of the sea.

**Answer:**

a. Natural and inevitable actions of the sea. (BAR 2011)

3. T Shipping, Co. insured all of its vessels with R insurance, Co. The insurance policies stated that the insurer shall answer for all damages due to perils of the sea. One of the insured’s ship, the MV Don Priscilla, ran aground in the Panama Canal when its engine pipes leaked and the oil seeped into the cargo compartment. The leakage was caused by the extensive mileage that the ship had accumulated. May the insurer be made to answer for the damage to the cargo and the ship?

- a. Yes, because the insurance policy covered any or all damage arising from perils of the sea.
- b. Yes, since there appears to have been no fault on the part of the shipowner and ship captain.
- c. No, since the proximate cause of the damage was the breach of warranty of seaworthiness of the ship.
- d. No, since the proximate cause of the damage was due to ordinary usage of the ship, and thus not due to perils of the sea.

**Answer:**

d. No, since the proximate cause of the damage was due to ordinary usage of the ship, and thus not due to perils of the sea. (BAR 2011)

- e. Concealment
- f. Seaworthiness

1. A shipped 100 pieces of plywood from Davao City to Manila. He took a marine insurance policy to insure the shipment against loss or damage due to “perils of the sea, barratry, fire, jettison, pirates and other such perils”.

When the ship left the port of Davao, the shipman in charge forgot to secure one of the portholes, thru which sea water seeped during the voyage, damaging the plywood. A filed a claim against the insurance company which refused to pay on the ground that the loss or damage was not due to a peril of the sea or any of the risks covered by the policy. It was admitted that the sea was reasonably calm during the voyage and that no strong winds or waves were encountered by the vessel.

How would you decide the case? Explain.

**Answer:**

I would decide in favor of the insured A because the insurer was guilty of breach of the implied warranty of seaworthiness. The Insurance Code provides that in every contract of marine insurance, there is a warranty that the ship is seaworthy at the commencement of the risk. Seaworthiness refers not only to the structure of the ship but also as to its being properly laden. In other words, a ship which is seaworthy for the insurance on the ship, may, by reason of being unfit to receive the cargo, be unseaworthy for the purpose of insurance upon the cargo. In this case, the fact that the porthole was not secured at the port of departure made the ship unseaworthy as far as the cargo of plywood was concerned. Thus, the insurer should be liable for the damage thereto although the loss was not one due to perils insured against. (BAR 1983)

2. Jacob, the owner of a barge, offered to transport the logs of Esau from Palawan to Manila. Esau accepted the offer not knowing that the barge was manned by an irresponsible crew with deep-seated resentments against Jacob, their employer.

Esau insured his cargo of logs against both perils of the sea and barratry.

The logs were improperly loaded on one side, thereby causing the barge to tilt and to navigate on an uneven keel. When the strong winds and high waves, normal for that season, started to pound the barge, the crew took advantage of the situation and unbolted the sea valves of the barge, causing sea water to come in. the barge sank.

When Esau tried to collect from the insurance firm, the latter stated that it could not be held responsible considering the unworthiness of both the barge and its crew. Esau countered that he was not the owner of the barge and he could not be held responsible for conditions about which he was innocent.

**Is the insurance company liable? Decide with reasons.**

**Answer:**

In marine insurance, the implied warranty of seaworthiness of the vessel applies also to the insurance of the cargo. In an insurance against perils of the sea, it is the responsibility of the insured rather than the insurer to see to it that the vessel is seaworthy. That responsibility, however, shifts to the insurer where the covered risks include perils of the ship. Accordingly, the insurance company in the problem can be held liable. (BAR 1986)

**g. Deviation**

- 1. On a clear weather, MV Sundo, carrying insured cargo, left the port of Manila bound for Cebu. While at sea, the vessel encountered a strong typhoon forcing the captain to steer the vessel to the nearest island where it stayed for 7 days. The vessel ran out of provisions for its passengers. Consequently, the vessel proceeded to Leyte to replenish its supplies.**
  - a) Assuming that the cargo was damaged because of such deviation, who between the insurance company and the owner of the cargo bears the loss? Explain.**
  - b) Under what circumstances can a vessel properly proceed to a port other than its port of destination? Explain.**

**Answer:**

- a) The insurance company should bear the loss. Since the deviation was caused by a strong typhoon, it was caused by circumstances beyond the control of the captain, and also to avoid a peril whether or not insured against. Deviation is therefore proper.
  - b) A vessel can properly proceed to a port other than its port of destination in the following cases:
    1. When caused by circumstances over which neither the master or the owner of the ship has any control;
    2. When necessary to comply with a warranty, or to avoid a peril, whether or not the peril is insured against;
    3. When made in good faith, and upon reasonable grounds of belief in the necessity to avoid peril;
    4. When made in good faith for the purpose of saving human life or relieving another vessel in distress. (BAR 2005)
- 2. On October 30, 2007, M/V Pacific, a Philippine registered vessel owned by Cebu Shipping Company (CSC), sank on her voyage from Hong Kong to Manila. Empire Assurance Company (Empire) is the insurer of the lost cargoes loaded on board the vessel which were consigned to Debenhams Company. After it indemnified Denbenhams, Empire as subrogee filed an action for damages against CSC.**

**Assume that the vessel was seaworthy. Before departing, the vesse was advised by the Japanese Meteorological Center that it was safe to travel to its destination. But while at sea, the vessel received a report of a typhoon moving within its general path. To avoid the typhoon, the vessel changed its course. However, it was still at the fringe of the typhoon when it was repeated hit by huge waves, foundered and eventually sank. The captain and the crew were saved except 3 who perished. Is CSC liable to Empire? Explain.**

**Answer:**

No, CSC is not liable to Empire. The doctrine of proper deviation is applicable in this case. The change of course made by the vessel is proper as it was to avoid the typhoon and the huge waves which are considered perils of the sea. (BAR 2008)

3. T, the captain of MV Don Alan, while asleep in his cabin, dreamt of an Intensity 8 earthquake along the path of his ship. On waking up, he immediately ordered the ship to return to port. True enough, the earthquake and tsunami struck 3 days later and the ship was saved. Was the deviation proper?
- Yes, because the deviation was made in good faith and on reasonable ground for believing that it was necessary to avoid a peril.
  - No, because no reasonable ground for avoiding a peril existed at the time of the deviation.
  - No, because T relied merely on his supposed gift of prophecy.
  - Yes, because the deviation took place based on a reasonable belief of the captain.

**Answer:**

- b. No, because no reasonable ground for avoiding a peril existed at the time of the deviation. (BAR 2011)

#### h. Loss and Abandonment

1. An inter-island vessel, insured for P2 M against “total and constructive total loss,” sank in 150 ft of water one mile off Paranaque during a typhoon. After the typhoon, the ship owner gave written notice of abandonment of his interest in the entire sunken ship to the insurance company. Refusing to accept the offer of abandonment, the insurer hired salvors to refloat the vessel at a total cost of P40,000. Because the refloated vessel needed repairs, the insurer issued invitations to bid for repairs. Several firms submitted separate sealed bids ranging from P1.2 M to P1.3 M for the complete refurbishing and/or restoration of the vessel to its original condition. On the basis of the following facts, the insurance company rejected the claim of the ship owner for payment of total loss on the ground that the ground that there was no constructive total loss.
- Was the notice of abandonment given by the owner properly made? Reason.
  - Is the position of the insurance company as to the absence of constructive total loss well taken? Reason.
  - Assuming that the ship owner failed to give the proper notice of abandonment, may he still recover from the insurer? Why?

**Answer:**

- a) *First Suggested Answer:* The notice of abandonment made in writing by the insured to the insurer was sufficient, had the loss been a constructive total loss of the vessel, meaning more than  $\frac{3}{4}$  of the value of the vessel. (Sec. 139, Corporation Code)

*Second Suggested Answer:* The notice of abandonment made in writing was not proper, since the existence of the constructive total loss of the vessel had not yet been determined. (Sec. 141, Insurance Code)

- b) Yes, the position of the insurance company as to the absence of constructive total loss is well taken. The sum total of the damage to the vessel was only P1,340,000.00 (P40,000 for the salvors, and P1,300 for the restoration of the vessel to its original condition) which amount is not more than  $\frac{3}{4}$  of the value of the vessel (P2 M). (Sec. 139, Corporation Code)
- c) Yes, the shipowner may still recover from the insurer, his actual loss, the amount of P1,340,000.00 which is now only partial loss, being not total loss. But since the said amount was already spent by the insurer on the vessel, the insurer is no longer liable to the shipowner, except to deliver the vessel. (BAR 1982)
2. An insurance company issued a marine insurance policy covering a shipment by sea from Mindoro to Batangas of 1,000 pieces of Mindoro garden stones against “total loss only”. The stones were loaded in two lighters, the first with 600 pieces and the second with 400 pieces. Because of rough seas, damage was caused the second lighter resulting in the loss of 325 out of the 400 pieces. The owner of the

**shipment filed claims against the insurance company on the ground of constructive total loss inasmuch as more than  $\frac{3}{4}$  of the value of the stones had been lost in one of the lighter.**

**Is the insurance company liable under its policy? Why?**

**Answer:**

The insurance company is not liable under its policy covering against "total loss only" the shipment of 1,000 pieces of Mindoro garden stones. There is no constructive total loss that can be claimed since the  $\frac{3}{4}$  rule is to be computed on the total 1,000 pieces of Mindoro garden stones covered by the single policy coverage. (BAR 1992)

- 3. RC Corporation purchased from Thailand, which it intended to sell locally. Due to stormy weather, the ship carrying the rice became submerged in sea water and with it the rice cargo. When the cargo arrived in Manila, RC filed a claim for total loss with the insurer, because the rice was no longer fit for human consumption. Admittedly, the rice could still be used as animal feed.**

**Is RC's claim for total loss justified? Explain.**

**Answer:**

Yes, RC's claim for total loss is justified. The rice, which was imported from Thailand for sale locally, is obviously intended for consumption by the public. The complete physical destruction of the rice is not essential to constitute an actual loss. Such a loss exists in this case since the rice, having been soaked in sea water and thereby rendered unfit for human consumption, has become totally useless for the purpose for which it was imported. (BAR 1996)

- 4. MV Pearly Shells, a passenger and cargo vessel, was insured for P40 M against "constructive total loss". Due to typhoon, it sank near Palawan. Luckily, there were no casualties, only injured passengers. The shipowner sent a notice of abandonment of his interest over the vessel to the insurance company which then hired professionals to afloat the vessel for P900,000. When re-floated, the vessel needed repairs estimated at P2 M. the insurance company refused to pay the claim of the shipowner, stating that there was "no constructive total loss."**

- a) Was there "constructive total loss" to entitle the shipowner to recover from the insurance company? Explain.**
- b) Was it proper for the shipowner to send a notice of abandonment to the insurance company? Explain.**

**Answer:**

- a) There was constructive total loss. When the vessel sank, it was likely that it would be totally lost because of the improbability of recovery.
- b) It was proper for the shipowner to send a notice of abandonment to the insurance company, because there was reliable information of the loss of the vessel. (BAR 2005)

- 5. X Shipping Co., insured its vessel MV Don Teodoro for P100 M with ABC Insurance Co. through T, an agent of X Shipping. During a voyage, the vessel accidentally caught fire and suffered damages estimated at P80 M. T personally informed ABC Insurance that X Shipping was abandoning the ship. Later, ABC Insurance denied X Shipping's claim for loss on the ground that a notice of abandonment through its agent was improper. Is ABC Insurance right?**

- a. Yes, since X Shipping should have ratified its agent's action.**
- b. No, since T, as agent of X Shipping who procured the insurance, can also give notice of abandonment for his principal.**

- c. Yes, since only the agent of X Shipping relayed the fact of abandonment.
- d. No, since in the first place, the damage was more than  $\frac{3}{4}$  of the ship's value.

**Answer:**

b. No, since T, as agent of X Shipping who procured the insurance, can also give notice of abandonment for his principal. (BAR 2011)

6. A cargo ship of X Shipping Co. ran aground off the coast of Cebu during a storm and lost all its cargo amounting to P50 M. the ship itself suffered damages estimated at P80 M. the cargo owners filed a suit against X Shipping but it invoked the doctrine of limited liability since it vessel suffered an P80 M damage, more than the collective value of all lost cargo. Is X Shipping correct?
- a. Yes, since under the doctrine, the value of the lost cargo and the damage to the ship can be set-off.
  - b. No, since each cargo owner has a separate and individual claim for damages.
  - c. Yes, since the extent of the ship's damage was greater than that of the value of the lost cargo.
  - d. No, since X Shipping neither incurred a total loss nor abandoned its ship.

**Answer:**

d. No, since X Shipping neither incurred a total loss nor abandoned its ship. (BAR 2011)

7. For a constructive total loss to exist in marine insurance, it is required that the person insured relinquish his interest in the thing insured. This relinquishment must be
- a. Actual.
  - b. Constructive first and if it fails, then actual.
  - c. Either actual or constructive.
  - d. Constructive.

**Answer:**

a. Actual. (BAR 2011)

**i. Barratry**

1. What is "barratry" in marine insurance?

**Answer:**

Barratry is any willful misconduct on the part of the master or the crew in pursuance of some unlawful or fraudulent purpose without the consent of the owner and to the prejudice of the interest of the owner. (BAR 2010)

**2. Fire**

**a. Extent of Liability under Open Policy**

1. A) Suppose that Fortune owns a house valued at P600,000 and insured the same against fire with 3 insurance companies as follows:

X ----- P400,000.00  
 Y ----- P200,000.00  
 Z ----- P600,000.00

**In the absence of any stipulation in the policies from which insurance company or companies may Fortune recover in case of fire should destroy his house completely?**

- b) If each of the fire insurance policies obtained by Fortune in problem (a) is a valued policy and the value of his house was fixed in each of the policies at P1 M, how much would Fortune recover from X if he has already obtained full payment on the insurance policies issued by Y and Z?**
- c) If each of the policies obtained by Fortune in problem (a) above is an open policy and it was immediately determined after the fire that the value of Fortune's house was P2.4 M, how much may he collect from X, Y and Z?**
- d) In problem (a), what is the extent of the liability of the insurance companies among themselves?**
- e) Supposing in problem (a) above, Fortune was able to collect from both Y and Z, may he keep the entire amount he was able to collect from the said 2 insurance companies?**

**Explain your answer.**

**Answer:**

- a) Fortune may recover from the insurers in such order as he may select up to their concurrent liability.
- b) One Answer (assuming that the real value is P1 M):  
Fortune may still recover only the balance of P200,000 from X Insurance Company since the insured may only recover up to the extent of his loss.

Another Answer (assuming that the real value is P600,000):

Having obtained full payment on the insurance policies issued by Y and Z, Fortune may no longer recover from X Insurance Company.

- c) In an open policy, the insured may recover his total loss up to the amount of the insurance coverage. Thus, the extent of recovery would be P400,000 from X; P200,000 from Y; and P600,000 from Z.
- d) In the problem (a), the insurance companies among themselves would be liable, viz:

$$\begin{aligned} X &— 4/12 \text{ of } P600,000 = P200,000 \\ Y &— 2/12 \text{ of } P600,000 = P100,000 \\ Z &— 6/12 \text{ of } P600,000 = P300,000 \end{aligned}$$

- e) No, he can only be indemnified for his loss, not profit thereby; hence, he must return P200,000 of the P800,000 he was able to collect. (BAR 1990)

### **b. Alteration**

- 1. On May 13, 1996, PAM, Inc. obtained a P15 M fire insurance policy from Ilocano Insurance covering its machineries and equipment effective for 1 year or until May 14, 1997. The policy expressly stated that the insured properties were located at "Sanyo Precision Phils. Building, Phase III, Lots 4 and 6, Block 15, PEZA, Rosario Cavite." Before its expiration, the policy was renewed on "as is" basis for another year until May, 13, 1998. The subject properties were later transferred to Pace Factory also in PEZA. On October 12, 1997, during the effectivity of the renewed policy, a fire broke out at the Pace Factory which totally burned the insured properties.**

**The policy forbade the removal of the insured properties unless sanctioned by Ilocano. Condition 9(c) of the policy provides that “the insurance ceases to attach as regards the property affected unless the insured, before the occurrence of any loss or damage, obtains the sanction of the company signified by endorsement upon the policy x x x (c) if the property insured is removed to any building or place other than in that which is herein stated to be insured.” PAM claims that it has substantially complied with notifying Ilocano for the insurance coverage. Is Ilocano liable under the policy?**

**Answer:**

Ilocano is not liable under the policy. With the transfer of the location of the subject properties, without notice and without insurer’s consent, after the renewal of the policy, the insured clearly committed concealment, misrepresentation and a breach of material warranty. The Insurance Code provides that a neglect to communicate that which a party knows and ought to communicate, is called concealment. A concealment entitles the injured party to rescind a contract of insurance in case of an alteration in the use or condition of the thing insured. An alteration in the use or condition of a thing insured from that to which it is limited by the policy made without the consent of the insurer, by means within the control of the insured, and increasing the risks, entitles the insurer to rescind the contract of fire insurance. (BAR 2014)

### **c. Friendly fire vs. Hostile fire**

- 1. Queens Insurance Company insured X, a resident of Baguio City, “against all direct loss and damage by fire.” X lived in a house heated by a furnace. His servant built a fire in the furnace using material that was highly flammable. The furnace fire caused intense heat and great volumes of smoke and soot that damaged the furnishings in the rooms of X. when X tried to collect on the policy, Queens Insurance refused to pay contending that the damage is not covered by the policy, where the fire is confined within the furnace. Decide.**

**Answer:**

The refusal of Queens to pay is justified. The damage is not covered by the policy which only insures “against all direct loss and damage by fire.” The damage being claimed by X was caused by intense heat and great volumes of smoke and soot and not directly by fire. The stipulation in the policy is paramount, not being contrary to law. (BAR 1989)

### **3. Casualty**

#### **a. Accident vs Intentional**

- 1. In a course of a voluntary boxing contest, B who had an accident insurance policy, slid and slipped, enabling his opponent boxer to hit him with a blow that threw him to the ropes, hitting his head against the canvass, causing B’s eventual death. There is nothing in the insurance contract appertaining to boxing. Is the Insurance Company liable? Reasons.**

**Answer:**

The insurer is liable because the death in this case was an accident within the meaning of the policy. It was an accident because the insured did not expect to die by entering such contest. His slipping was accidental and this caused him to hit his head against the canvass, leading to his death. (BAR 1975)

- 2. Luis was the holder of an accident insurance policy effective November 1, 1988 to October 31, 1989. At a boxing contest held on January 1, 1989 and sponsored by his employer, he slipped and was hit on the face by his opponent so he fell and his head hit one of the posts of the boxing ring. He was rendered unconscious and was dead on arrival at the hospital due to “intracranial hemorrhage.”**

**Can his father who is a beneficiary under said insurance policy successfully claim indemnity from the insurance company? Explain your answer.**

**Answer:**

Yes, the father who is a beneficiary under the accident insurance can successfully claim indemnity for the death of the insured. Clearly, the proximate cause of the death was the boxing contest. Death is sustained in a boxing contest is an accident. (BAR 1990)

**3. S Insurance Company issued a Personal Accident Policy to Bob Tan with a face value of P500,000.**

**In the evening of September 5, 1992, after his birthday party, Tan was in a happy mood but not drunk. He was playing with his handgun, from which he previously removed the magazine. As his secretary was watching television, he stood in front of her and pointed the gun at her. She pushed it aside and said that it may be loaded. He assured her that it was not and then pointed it at his temple. The next moment, there was an explosion and Tan slumped to the floor lifeless.**

**The wife of the deceased sought payment on the policy but her claim was rejected. The insurance company agreed that there was no suicide. However, it was the submission of the insurance company that there was no accident. In support thereof, it contended (a) that there was no accident when a deliberated act was performed unless some additional, unexpected, independent and unforeseen happening occur which produces or brings about the injury or death; and (b) that the insured willfully exposed himself to needless peril and thus removed himself from the coverage of the insurance policy. Are the two contentions of the insurance company tenable? Explain.**

**Answer:**

No. these 2 contentions of the insurance company are not tenable. The insurer is liable for injury or death even due to the insured's gross negligence. The fact that the insured removed the magazine from the handgun means that the insured did not willfully expose himself to needless peril. At most, the insured is only guilty of negligence. (BAR 1993)

**4. Sun-Moon Insurance issued a Personal Accident Policy to Henry Dy with a face value of P500,000. A provision in the policy states that "the company shall not be liable in respect of bodily injury consequent upon the insured person attempting to commit suicide or willfully exposing himself to needless peril except in an attempt to save human life". 6 months later, Henry died of a bullet wound in his head. Investigation showed that one evening Henry was in a happy mood although he was not drunk. He was playing with his handgun from which he had previously removed its magazine. He pointed the gun at his sister who got scared. He assured her it was not loaded. He then pointed the gun at his temple and pulled the trigger. The gun fires and Henry slumped dead on the floor.**

**Henry's wife, Beverly, as the designated beneficiary, sought to collect under the policy. Sun-Moon rejected her claim on the ground that the death of Henry was not accidental. Beverly sued the insurer.**

**Decide. Discuss fully.**

**Answer:**

Beverly can recover the proceeds of the policy from the insurer. The death of the insured was not due to suicide or willful exposure to needless peril which are the excepted risks. The insured's act was purely on act of negligence which is covered by the policy and for which the insured got the insurance for his protection. In fact, he removed the magazine from the gun and when he pointed the gun to his temple he did so because he thought that it was safe for him to do so. He did so to assure his sister that the gun was harmless. There is none in the policy that would relieve the insurer of liability for the death of the insured since the death was an accident. (BAR 1995)

5. CNI insured SAM under a homeowner's policy against claims for accidental injuries by neighbors. SAM's minor son, BOY, injured 3 children of POS, a neighbor, who sued SAM for damages.

SAM's lawyer was at ATT, who was paid for his services by the insurer for reporting periodically on the case to CNI. In one report, ATT disclosed to CNI that after his investigations, he found the injuries to the 3 children not accidental but intentional.

SAM lost the case in court, and POS was awarded P1 M in damages which he sought to collect from the insurer. But CNI used ATT's report to deny the claim on the ground that the injuries to POS' 3 children were intentional, hence excluded from the policy's coverage. POS countered that CNI was stopped from using ATT's report because it was unethical for ATT to provide prejudicial information against his client to the insurer, CNI.

**Who should prevail: the claimant, POS; or the insurer, CNI? Decide with reasons briefly.**

**Answer:**

CNI is not stopped from using ATT's report because CNI, in the first place, commissioned it and paid ATT for it. On the other hand, ATT has no conflict of interest because SAM and CNI are on the same side—their interests being congruent with each other, namely, to oppose POS' claim. It cannot be said that ATT has used the information to the disadvantage or prejudice of SAM.

However, in *Finman General Assurance Corp. v. Court of Appeals*, 213 SCRA 493 (1992), it was explained that there is no "accident" in the context of an accident policy, if it is the natural result of the insured's voluntary act, unaccompanied by anything unforeseen except the injury. There is no accident when a deliberate act is performed, unless some additional and unforeseen happening occurs that brings about the injury. This element of deliberateness is not clearly shown from the facts of the case, especially considering the fact that BOY is a minor, and the injured parties are also children. Accordingly, it is possible that CNI may not prosper. ATT's report is not conclusive on POS or the court. (BAR 2004)

4. Suretyship

5. Life

a. **Incontestability Clause**

1. On May 5, 1982, Juan applied for a life insurance policy with Acme Life Insurance Co. The policy was issued to Juan on June 30, 1982 but the date of issue, as appearing on the policy was May 15, 1982, the date of his application. Juan subsequently realized that some of his answers in the insurance application were erroneous. Accordingly, he supplied the insurance company with the correct replies. However, his letter to the insurance company was lost in the mails. Juan died June 1, 1984.

**The insurance company now refuses to pay Juan's beneficiary contending that Juan misrepresented the state of his health at the time of his application. Is the insurance company liable? State your reason.**

**Answer:**

Yes. The incontestability clause that must be contained in every individual life insurance policy refers to the date of its issue as shown in the policy. Since the policy of life insurance had been in force during the lifetime of the insured, Juan, for a period of 2 years from May 15, 1982, the date of issue as shown in the policy, the policy has become incontestable. The insurance company can no longer prove that the policy is void *ab initio* or rescindable by reason fraudulent concealment or misrepresentation of the insured. (BAR 1984)

2. Manpower Company obtained a group life insurance policy for its employees from Phoenix Insurance Company. The master policy issued by Phoenix on June 1, 1986 contained a provision that eligible employees for insurance coverage were all full time employees of Manpower regularly working at least

**30 hours per week. The policy had also an incontestable clause. Beforehand, Phoenix sent enrollment cards to Manpower for distribution to its eligible employees. X filled out the card which contained a printed clause: "I request the insurance for which I may become eligible under said Group Policy." The cards were then sent to Phoenix and X was among the employees of Manpower who was issued a certificate of coverage by Phoenix**

**On July 3, 1988, X was killed on the occasion of a robbery in their house. While processing the claim of X's beneficiary, Phoenix found out that X was not an eligible employee as defined in the group policy since he has not been employed 30 hours a week by Manpower. Phoenix refused to pay. May X's beneficiary invoke the incontestability clause against Phoenix? Reasons.**

**Answer:**

The beneficiary of X may validly invoke the incontestability clause. If the incontestability clause can apply even to cases of intentional concealment and misrepresentation, there would be no cogent reason for denying such application where the insured had not been guilty thereof. When X filled out the card containing the printed clause "I request the insurance for which I may become eligible under said Group Policy", it behooved the insurer to look into the qualifications of X whether he can thus be covered or not by the group life insurance policy. In issuing the certificate of coverage to X, Phoenix may, in fact, be said to have waived the 30-hour per week requirement. (BAR 1989)

- 3. Atty. Roberto took out a life insurance policy from Dana Insurance Corp. (DIC) on September 1, 1989. On August 31, 1990, Roberto died. DIC refused to pay his beneficiaries because it discovered that Roberto had misrepresented certain material facts in his application. The beneficiaries sued on the basis that DIC can contest the validity of the insurance policy only within 2 years from the date of issue and during the lifetime of the insured. Decide the case.**

**Answer:**

I would rule in favor of the insurance company. The incontestability clause, applies only if the policy had been in effect for at least 2 years. The 2-year period is counted from the time the insurance becomes effective until the death of the insured and not thereafter. (BAR 1991)

- 4. On September 23, 1990, Tan took a life insurance policy from Philam. The policy was issued on November 6, 1990. He died on April 26, 1992 of hepatoma. The insurance company denied the beneficiaries' claim and rescinded the policy by reason of alleged misrepresentation and concealment of material facts made by Tan in his application. It returned the premiums paid.**

**The beneficiaries contend that the company had no right to rescind the contract as rescission must be done "during the lifetime" of the insured within 2 years and prior to the commencement of the action.**

**Is the contention of the beneficiaries tenable?**

**Answer:**

No. The incontestability clause does not apply. The insured died within less than 2 years from the issuance of the policy on September 23, 1990. The insured died on April 26, 1992, or less than 2 years from September 23, 1990.

The right of the insurer to rescind is only lost if the beneficiary has commenced an action on the policy. There is no such action in this case. (BAR 1994)

- 5. Renato was issued a life insurance policy on January 2, 1990. He concealed the fact that 3 years prior to the issuance of his life insurance policy, he had been seeing a doctor about his heart ailment.**

**On March 1, 1992, Renato died of heart failure. May the heirs file a claim on the proceeds of the life insurance policy of Renato?**

**Answer:**

Yes. The life insurance policy in question was issued on January 2, 1990. More than 2 years had elapsed when Renato, the insured, died on March 1, 1992. The incontestability clause applies. (BAR 1998)

**6. The “incontestability clause” in a Life Insurance Policy means—**

- a) That life insurance proceeds cannot be claimed 2 years after the death of the insured;**
- b) That 2 years after date of issuance or reinstatement of the life insurance policy, the insurer cannot anymore prove that the policy is void ab initio or rescindable by reason of fraudulent concealment or misrepresentation of the insured;**
- c) That the insured can still claim from the insurance policy after 2 years even though premium is not paid;**
- d) That the insured can only claim proceeds in a life insurance policy 2 years after death.**

**Answer:**

- a) That 2 years after date of issuance or reinstatement of the life insurance policy, the insurer cannot anymore prove that the policy is void ab initio or rescindable by reason of fraudulent concealment or misrepresentation of the insured. (BAR 2012)**

**7. X, in January 30, 2009, or 2 years before reaching the age of 65, insured his life for P20 M. for reason unknown to his family, he took his own life 2 days after his 65<sup>th</sup> birthday. The policy contains no excepted risk. Which statement is most accurate?**

- a) The insurer will be liable;**
- b) The insurer will not be liable;**
- c) The state of sanity of the insured is relevant in cases of suicide in order to hold the insurer liable;**
- d) The state of sanity of the insured is irrelevant in cases of suicide in order to hold the insurer liable.**

**Answer:**

- b) The insurer will be liable. (BAR 2012)**

**8. On July 3, 1993, Delia Sotero (Delia) took out a life insurance policy from Ilocos Bankers Life Insurance Corporation (Ilocos Life) designating Creencia Aban (Aban), her niece, as her beneficiary. Ilocos Life issued Policy No. 747, with a face value of P100,000, in Sotero’s favor on August 30, 1993, after the requisite medical examination and payment of the premium.**

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

- 1. Sotero did not personally apply for insurance coverage, as she was illiterate.**
- 2. Sotero was sickly since 1990.**
- 3. Sotero did not have the financial capability to pay the premium on the policy.**
- 4. Sotero did not sign the application for insurance.**
- 5. Aban was the one who filed the insurance application and designated herself as the beneficiary.**

**For the above reasons and claiming fraud, Ilocos Life denied Aban’s claim on April 16, 1997, but refunded the premium paid on the policy.**

- a. May the incontestability period set in even in cases of fraud as alleged in this case?**
- b. Is Aban entitled to claim the proceeds under the policy?**

**Answer:**

- a. Yes. The “incontestability clause” is a provision in law that after a policy of life insurance made payable on the death of the insured shall have been in force during the lifetime of the insured for a period of 2 years from the date of its issue or of its last reinstatement, the insurer cannot prove that the policy is void ab initio or is rescindable by reason of fraudulent concealment or misrepresentation of the insured or his agent.

In this case, the policy was issued on August 30, 1993, and the insured died on April 10, 1996. The insurance policy was thus in force for a period of 3 years, 7 months and 24 days. Considering that the insured died after the 2-year period, Ilocos is, therefore, barred from proving that the policy is void ab initio by reason of the insured’s fraudulent concealment or misrepresentation or want of insurable interest on the part of the beneficiary.

- b. Yes, Aban is entitled to claim the proceeds. After the 2-year period lapse, or when the insured dies within the period, the insurer must make good on the policy, even though the policy was obtained by fraud, concealment, or misrepresentation, as in this case, when the insured did not personally apply for the policy as she was illiterate and that it was the beneficiary who filled up the insurance application designating herself as beneficiary. (BAR 2014)

**6. Compulsory Motor Vehicle Liability Insurance**

1. **X was riding a suburban utility vehicle (SUV) covered by a comprehensive motor vehicle liability insurance (CMVLI) underwritten by FastPay Insurance Company when it collided with a speeding bus owned by RM Travel, Inc. the collision resulted in serious injuries to X; Y, a passenger of the bus; and Z, a pedestrian waiting for a ride at the scene of the collision. The police report established that the bus was the offending vehicle. The bus had a CMVLI policy issued by Dragon Insurance Corporation, X, Y and Z jointly sued RM Travel and Dragon Insurance for indemnity under the Insurance Code of the Philippines. The lower court applied the “no-fault” indemnity policy of the statute, dismissed the suit against RM Travel, and ordered Dragon insurance to pay indemnity to all three plaintiffs. Do you agree with the court’s judgment? Explain.**

**Answer:**

No. The cause of action of Y is based on the contract of carriage, while that of X and Z is based on torts. The court should not have dismissed the suit against RM Travel. The court should have ordered Dragon Insurance to pay each of X, Y, and Z to the extent of the insurance coverage, but whatever amount is agreed upon in the policy should be answered first by RM Travel and the succeeding amount should be paid by Dragon Insurance up to the amount of the insurance coverage. The excess of the claims of X, Y and Z, over and above such insurance coverage, if any, should be answered or paid by RM Travel. (BAR 2000)

2. **As a rule, an insurance contract is consensual and voluntary. The exception in the case of:**

- a. **Inland Marine Insurance**
- b. **Industrial Life Insurance**
- c. **Motor Vehicle Liability Life Insurance**
- d. **Life Insurance**

**Answer:**

- c. Motor Vehicle Liability Life Insurance (BAR 2014)

- a. **No fault indemnity clause**

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

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

**Answer:**

Jose’s claim for the death of Maria against the insurer of said three motor vehicles will not prosper. According to Section 378 of the Insurance Code, “Any claim for death or injury to any passenger or third-party pursuant to the provisions of this chapter shall be paid without necessity of proving fault or negligence of any kind; Provided, that for purposes of this section.

x x x x

(iii) Claim may be made against one motor vehicle only. In the case of an occupant of a vehicle, claim shall lie against the insurer of the vehicle in which the occupant is riding, mounting or dismounting from. Clearly, in the instant case, the NO-FAULT claim against the vehicle in which the deceased was riding is the one authorized, but the claim against the other vehicle will not prosper.

*Jose may claim only up to an amount not exceeding P5,000.00 pursuant to par. (i), Section 378 of the Insurance Code which provides that “the total indemnity in respect to any one person shall not exceed P5,000.00.” (NOTE: amount has been adjusted to P15,000)*

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

**Answer:**

Jose’s claim for damages for his car will not prosper. As may be clearly gleaned from Section 378 of the Insurance Code on NO-FAULT Insurance applies only to “any claim for death or injury to any passenger or third party”. (BAR 1977)

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

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

**Can passenger “B” recover from the insurance company? Explain.**

**Answer:**

Yes, passenger “B” may recover from the insurance company. The insurance covers the operation of “X’s” jeepneys against accidents with third parties; therefore, the insurance covers the liability for death or body injuries of third persons, like what happened to “B”, and the claim shall be against the insurer of the directly offending vehicle (X’s vehicle). Furthermore, any claim of this nature shall be paid without necessity of proving fault or negligence of any kind, provided that the total indemnity in respect of any person shall be in accordance as provided under the law. (BAR 1981)

3. **Driving his car one night, A crossed an intersection as the signal light turned green. Suddenly he saw an old woman crossing the street just a few feet from his car. He applied his brakes immediately, but just the same, he hit the woman who turned out to be senile already. He brought her to the nearest hospital where she was confined for 3 days due to her injuries. Upon her discharge, A had to pay the hospital bill which amounted to P2,000 including X-rays, doctor's fees and medicines.**

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

**Is the insurance company liable to reimburse A for the hospital expenses? Explain.**

**Answer:**

Yes, the insurance company is liable provided A can present the police report of the accident and the medical report as well as the hospital receipts. The Insurance Code has the "no-fault" provision imposing liability for any claim for death or injury to any third party under the compulsory motor vehicle liability insurance. Under the provision, the insurance company may be held liable for the maximum amount of P5,000 without necessity of proving fault or negligence of any kind, provided the aforementioned proofs are submitted under oath.

Note: Sec. 391 of RA No. 10607 now provides that the total indemnity in respect of any person shall not be less than P15,000.00. (BAR 1983)

4. **(1) What do you understand by the "no fault indemnity" provision in the Insurance Code? What are the rules on claims under said provision?**

**Answer:**

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

- a. The total indemnity in respect of any person shall not be less than P15,000;
- b. The following proofs of loss, when submitted under oath, shall be sufficient evidence to substantiate the claim:
  - b.1. Police report of accident; and
  - b.2. Death certificate and evidence sufficient to establish the proper payee; or
  - b.3. Medical report and evidence of medical or hospital disbursement in respect of which refund is claimed.
- c. Claim may be made against one motor vehicle only. In the case of an occupant of a vehicle, claim, shall lie against the insurer of the vehicle in which the occupant is riding, mounting or dismounting from. In any other case, claim shall lie against the insurer of the directly offending vehicle. In all cases, the right of the party paying the claim to recover against the owner of the vehicle responsible for the accident shall be maintained. (BAR 1989)

5. **What is your understanding of a "no fault indemnity" clause found in an insurance policy?**

**Answer:**

Under the "no fault indemnity" clause any claim for the death or injury of any passenger or third party shall be paid without the necessity of proving fault or negligence of any kind. The indemnity in respect of any one person shall not exceed P15,000, provided they are under oath, the following proofs shall be sufficient:

- a) Police report of the accident; and
- b) Death certificate and evidence sufficient to establish the proper payee; or
- c) Medical report and evidence of medical or hospital disbursement in respect of which refund is claimed.

Claim may be made against one motor vehicle only. (BAR 1994)

6. **While driving his car along EDSA, Cesar sideswiped Roberto, causing injuries to the latter. Roberto sued Cesar and the third party liability insurer for damages and/or insurance proceeds. The insurance company moved to dismiss the complaint, contending that the liability of Cesar has not yet been determined with finality.**

1. **Is the contention of the insurer correct? Explain.**
2. **May the insurer be held liable with Cesar?**

**Answer:**

1. No, the contention of the insurer is not correct. There is no need to wait for the decision of the court determining Cesar's liability with finality before the third party liability insurer could be sued. The occurrence of the injury to Roberto immediately gave rise to the liability of the insurer under its policy. In other words, where an insurance policy insures directly against liability, the insurer's liability accrues immediately upon the occurrence of the injury or event upon which the liability depends.
  2. The insurer cannot be held solidarily liable with Cesar. The liability of the insurer is based on contract while that of Cesar is based on tort. If the insurer were solidarily liable with Cesar, it could be made to pay more than the amount stated in the policy. This would, however, be contrary to the principles underlying insurance contracts. On the other hand, if the insurer were solidarily liable with Cesar and it is made to pay only up to the amount stated in the insurance policy, the principles underlying solidary obligations would be violated. (BAR 1996)
7. **X is a passenger of a jeepney for hire being driven by Y. the jeepney collided with another passenger jeepney being driven by Z who was driving recklessly. As a result of the collision, X suffered injuries. Both passenger jeepneys are covered by Comprehensive Motor Vehicular Insurance Coverage. If X wants to claim under the "no fault indemnity clause", his claim will lie—**
- a) **Against the insurer of the jeepney being driven by Z who was the one at fault;**
  - b) **The claim shall lie against the insurer of the passenger jeepney driven by Y because X was his passenger;**
  - c) **X has a choice against whom he wants to make his claim;**
  - d) **None of the above.**

**Answer:**

- a) The claim shall lie against the insurer of the passenger jeepney driven by Y because X was his passenger. (BAR 2012)

## **b. Other Rules Concerning Motor Vehicles**

### **1. Authorized Driver Clause**

1. **Mayari obtained a comprehensive insurance policy on his car. The policy carried the standard "authorized driver" clause which states that the insurance company is not liable for any loss, accident or damage sustained while the car is being driven by someone other than a duly authorized driver. One day, Mayari allowed his friend, Kainigan, to drive the car. Kaibigan figured in a mishap and the car was a total loss.**

**Kaibigan had been driving for the past 5 years but it appears that his driver's license was irregularly issued because he cannot read or write; neither did he take any of the prescribed driver's tests. After the initial case was issued, he merely asked his wife to go to the LTC office to get a renewal of his license. Mayari did not know about the irregularity in the driver's license of Kaibigan.**

**Can Mayari recover on the insurance policy? Explain.**

**Answer:**

Mayari cannot recover under the policy. The standard “authorized driver” clause requires that the driver at the time of the accident must be duly authorized and licensed to drive. An irregular license is not a license at all. (BAR 1986)

2. Sheryl insured her newly acquired car, a NISSAN Maxima against any loss or damage for P50,000 and against third party liability for P20,000 with the XYZ Insurance Corp. (XYZ). Under the policy, the car must be driven only by an authorized driver who is either: (1) the insured, or (2) any person driving on the insured’s order or with his permission: provided that the person driving is permitted in accordance with the licensing or other laws or regulations to drive the motor vehicle and is not disqualified from driving such motor vehicle by order of a court.

During the effectivity of the policy, the car, then driven by Sheryl herself, who had no driver’s license, met an accident and was extensively damaged. The estimated cost of the repair was P40,000. Sheryl immediately notified XYZ, but the latter refused to pay on the policy alleging that Sheryl violated the terms thereof when she drove it without a driver’s license.

**Is the insurer correct?**

**Answer:**

No. the insurer is not correct in denying the claim since the proviso “that the person driving is permitted in accordance with the licensing, etc.” qualifies only a person driving the vehicle, other than the insured, at the time of the accident. (BAR 1991)

## 2. Theft Clause

1. “A” was the owner of a car insured with Fortune Insurance Company for “Own Damage”, “Theft”, and “Third-Party-Liability” effective May 16, 1977 to May 16, 1978. On May 9, 1978, the car was brought to a machine shop for repairs. On May 11, 1978, while in the custody of the machine shop, the car was taken by one of the employees to be driven out to a certain place. While travelling along the highway, the car smashed into parked truck and suffered extensive damage.

“A” filed a claim for recovery under the policy but was refused payment. The insurance company averred that the car was not stolen and, therefore, was not covered by the “Theft Clause.”

**Decide the merits of the insurer’s contention, with reasons.**

**Answer:**

The insurer is liable to “A” under the “Theft Clause”. The taking of a car even though temporary and only for a joy ride, without the car owner’s consent is theft; and, therefore, insurer is liable for total loss due to car accident of insured’s car wrongfully taken, without the insured’s consent, from the repair shop entrusted for repairs. (*Villacorta v. Insurance Commissioner, Oct. 28, 1980, 100 SCRA 467*) (BAR 1981)

2. Rey Bautista insured his 1984 Galant with Alpha Insurance Co., Inc. for own damage, theft and third-party liability effective August 21, 1984 to August 20, 1985. On August 3, 1985 the car was brought to “Car Specialist”, a well-known auto repair shop for general check-up. On August 11, 1985, while in the custody of the said shop, the car was taken by one of the employees of the shop and driven to a hide-out in Montalban, Rizal. While travelling along a narrow street, the car smashed into a parked gravel and

**sand truck and it suffered an extensive damage. Rey filed a claim for total loss with Alpha, but the claim was denied. Rey then sued Alpha to collect on the policy.**

**Rule on the said case stating the legal basis in support of your decision.**

**Answer:**

The insurer is liable. The contract of insurance shall be interpreted, in case of doubt, in favor of the insured Rey Bautista, who is entrusting his car and key to the shop owner; its employees are presumed to have insured's (Bautista) permission. The theft clause applies, since the aforesaid act of the employees of the shop owner is within the article on theft of the Revised Penal Code. (BAR 1985)

- 3. Mr. Gonzales was the owner of a car insured with Masagana Insurance Company for "Own Damage", "Theft", and "Third Party Liability" effective May 14, 1986 to May 14, 1987. On May 2, 1987, the car was brought to a machine shop for repairs. On May 11, 1987, while in the custody of the machine shop, the car was taken by one of the employees (of the machine shop) to show off to his girlfriend. While on the way to his girlfriend's house, the car smashed into a parked truck and was extensively damaged. Mr. Gonzales filed a claim for recovery under the policy but was refused payment. The insurance company averred that the car was not stolen, and therefore was not covered by the "Theft Clause".**

**Decide the merits of the insurer's contention, with reasons.**

**Answer:**

I would decide in favor of the insured. The coverage of the policy was rather comprehensive in scope. The Theft Clause particularly, at least by intent, should cover situations of the loss of the property occasioned by the taking or use by another without the authority of the insured. Furthermore, doubts on the insurance, being a "contract by adherence" must be construed against the insurer. (BAR 1988)

- 4. HL insured his brand new car with P Insurance Company for comprehensive coverage wherein the insurance company undertook to indemnify him against loss or damage to the car (a) by accidental collision xxx (b) by fire, external explosion, burglary, or theft, and (c) malicious act.**

**After a month, the car was carnapped while parked in the parking space in front of the Intercontinental Hotel in Makati. HL's wife who was driving the said car when it was carnapped was in possession of an expired driver's license, a violation of the "authorized driver" clause of the insurance company.**

- 1. May the insurance company be held liable to indemnify HL for the loss of the insured vehicle? Explain.**
- 2. Supposing that the car was brought by HL on installment basis and there were installments due and payable before the loss of the car, the vendor demanded from HL the unpaid balance of the promissory note. HL resisted the demand and claimed that he was only liable for the installments due and payable before the loss of the car but no longer liable for the other installments not yet due at the time of the loss of the car.**

**Decide.**

**Answer:**

- 1. Yes. The car was lost due to theft. What applies in this case is the "theft" clause, and not the "authorized driver" clause. It is immaterial that HL's wife was driving the car with an expired driver's license at the time it was carnapped.**
- 2. The promissory note is not affected by whatever befalls the subject matter of the accessory contract. The unpaid balance on the promissory note should be paid and not only the installments due and payable before the loss of the car. (BAR 1993)**

5. On May 26, 201, Jess insured with Jack Insurance (Jack) his 2014 Toyota Corolla sedan under a comprehensive motor vehicle insurance policy for one year. On July 1, 2014, Jess' car was unlawfully taken. Hence, he immediately reported the theft to the Traffic management Command (TMC) of the Philippine National Police (PNP), which made Jess accomplish a complaint sheet as part of its procedure. In the complaint sheet, Jess alleged that a certain Ric Silat (Silat) took possession of the subject vehicle to add accessories and improvements thereon. However, Silat failed to return the subject vehicle within the agreed 3-day period. As a result, Jess notified Jack of his claim for reimbursement of the value of the vehicle under the insurance policy. Jack refused to pay claiming that there is no theft as Jess gave Silat lawful possession of the car. Is Jack correct?

**Answer:**

No. Jack is not correct. The "theft clause" of a comprehensive motor vehicle insurance policy has been interpreted by the Court in several cases to cover situations like (1) when one takes the motor vehicle of another without the latter's consent even if the motor vehicle is later returned, there is theft—there being intent to gain as the use of the thing unlawfully taken constitutes gain, or (2) when there is taking of a vehicle by another person without the permission or authority from the owner thereof. (BAR 2014)

6. On February 21, 2013, Barrack entered into a contract of insurance with Matino Insurance Company (Matino) involving a motor vehicle. The policy obligates Matino to pay Barrack the amount of P600,000 in case of loss or damage to said vehicle during the period covered, which is from February 26, 2013 to February 26, 2014.

On April 16, 2013, at about 9:00am, Barrack instructed his driver, JJ, to bring the motor vehicle to a nearby auto shop for tune-up. However, JJ no longer returned and despite diligent efforts to locate the said vehicle, the efforts proved futile. Resultantly, Barrack promptly notified Matino of the said loss and demanded payment of the insurance proceeds of P600,000.

In a letter dated July 5, 2013. Matino denied the claim, reasoning as stated in the contract that "the company shall not be liable for any malicious damage caused by the insured, any member of his family or by a person in the insured's service. Is Matino correct in denying the claim?

**Answer:**

No. Matino is not correct in denying the claim. An insurance company cannot deny a claim by the owner of a motor vehicle who insured it against loss or damage because the driver he employed stole it. Matino cannot invoke the provision excluding malicious damages caused by a person in the service of the insured. In common ordinary usage, loss means failure to keep possession, while malicious damage is damage resulting from the willful act of the driver. Words which have different meanings shall be understood in the sense which is most in keeping with the nature and object of the insurance contract. If a stipulation admits several meanings, it should be understood as bearing the meaning which is most adequate to render it effectual. It may be shown that the words have a local, technical or peculiar meaning and were so used and understood by the parties. (BAR 2014)

#### **F. Insurable Interest**

1. "A" owns a house valued at P50,000 which he had insured against fire for P100,000. He obtained a loan from "B" in the amount of P100,000, and to secure payment thereof, he executed a deed of mortgage on the house, but without assigning the insurance policy to the latter. For "A's" failure to pay the loan upon maturity, "B" initiated foreclosure proceedings and in the ensuing public sale, the house was sold by the sheriff to "B" as highest bidder. Immediately upon issuance of the sheriff's certificate of sale in his favor, "B" insured the house against fire for P120,000 with another insurance company. In order to redeem the house, "A" borrowed P100,000 from "C" and, as security device, he assigned the insurance

policy of P100,000 to "C". However, before "A" could pay "B" his obligation of P100,000, the house was accidentally and totally burned.

**Does "A", "B" or "C" have any insurance interest in the house? May "A", "B" and "C" recover under the policies? If so, how much? (BAR 1982)**

**Answer:**

As to A: He has insurable interest in his house, an existing interest, but only for P50,000, the value of the said house. But, when he assigned it to C, said A had no more interest in his insurance policy, and A cannot anymore recover on said insurance policy.

As to B: He has insurable interest on A's house, having an interest founded upon an existing interest, but only for P50,000, the value of A's house, and therefore, he can recover only the amount of P50,000.

As to C: He has no insurable interest on A's house, being mere contingent or expectant interest not founded on an actual right or valid contract to A's house; besides, the assignment to him of A's insurance policy was not approved by the insurer; hence, C cannot recover.

### 1. In Life/Health

1. **On January 4, 1983, Mr. P joined Alpha Corporation (ALPHA) as President of the company. ALPHA took out a life insurance policy on the life of Mr. P with Mutual Insurance Company, designating ALPHA as the beneficiary. ALPHA also carried fire insurance with Beta Insurance Co. on a house owned by it, but temporarily occupied by Mr. P again with ALPHA as beneficiary.**

**On September 1, 1983, Mr. P resigned from ALPHA and purchased the company house he had been occupying. A few days later, a fire occurred resulting in the death of Mr. P and the destruction of the house.**

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

**Answer:**

- a) ALPHA can recover against Mutual Life Insurance Co. in the life insurance policy as its insurable interest in the life of the person insured, Mr. P, existed when the insurance took effect. In life insurance, insurable interest need not exist thereafter or when the loss occurred. (BAR 1984)
2. **Blanco took out a P1 M life insurance policy naming his friend and creditor, Montenegro, as his beneficiary. When Blanco died, his outstanding loan obligation to Montenegro was only P50,000. Blanco's executor contended that only P50,000 out of the insurance proceeds should be paid to Montenegro and the balance of P950,000 should be paid to Blanco's estate.**

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

**Answer:**

The contention of the executor is incorrect. The beneficiary of a life insurance need not have any insurable interest in the life of the insured.

**Alternative Answer:**

The contention of the executor is incorrect because it was Blanco himself who took out the life insurance policy on his own life, naming only Montenegro as the beneficiary. It would have been different if it was Montenegro, as creditor, who took out a life insurance policy on the life of Blanco, as a debtor. In that case, Montenegro's

insurable interest in the life of Blanco would be only to the extent of P50,000, which is the amount of his credit. (BA 1987)

3. **On July 14, 1985, X, a homosexual, took an insurance policy on the life of his boyfriend, Y. In the insurance application, X misrepresented that Y was in perfect health although he knew all the time that Y was afflicted with AIDS. On October 18, 1987, Y died in a motor accident. Shortly thereafter, X filed his insurance claim.**

**Should the insurer pay? Reasons.**

**Answer:**

The insurer is not obliged to pay. Friendship alone is not the insurable interest contemplated in life insurance. Insurable interest in the life of others (other than one's own life, spouses or children) is merely to the extent of the pecuniary interest in that life.

Assuming that such pecuniary interest exists, an insurer would be liable despite concealment or misrepresentation if the insurance had been in effect for more than 2 years (incontestability clause). (BAR 1987)

4. **A obtains insurance over his life and names his neighbor B the beneficiary because of A's secret love for B. If A dies, can B successfully claim against the policy?**

**Answer:**

Yes. In life insurance, it is required that the beneficiary must have insurable interest in the life of the insured. It was the insured himself who took the policy on his own life. (BAR 1997)

5. **IS, is an elderly bachelor with no known relatives, obtained life insurance coverage for P250,000 from Starbrite Insurance Corporation, an entity licensed to engage in the insurable business under the Insurance Code of the Philippines. He also insured his residential house for twice that amount with the same corporation. He immediately assigned all his rights to the insurance proceeds to BX, a friend-companion living with him. 3 years later, IS died in a fire that gutted his insured house 2 days after he had sold it. There is no evidence of suicide or arson or involvement of BX in these events. BX demanded payment of the insurance proceeds from the 2 policies, the premiums for which IS had been faithfully paying during all the time he was alive. Starbrite, refused payment, contending that BX had no insurable interest and therefore was not entitled to receive the proceeds from IS' insurance coverage on his life and also on his property. Is Starbrite's contention valid? Explain.**

**Answer:**

Starbrite is correct with respect to the insurance coverage on the property of IS. The beneficiary in the property insurance policy or the assignee thereof must have insurable interest in the property insured. BX, a mere friend-companion of IS, has no insurable interest in the residential house of IS. BX is not entitled to receive the proceeds from IS' insurance on his property.

As to the insurance coverage on the life of IS, BX is entitled to receive the proceeds. There is no requirement that BX should have insurable interest in the life of IS. It was IS himself who took the insurance on his own life. (BAR 2000)

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

**Answer:**

- 1) In property insurance, the expectation of benefit must have a legal basis. In life insurance, the expectation of benefit to be derived from the continued existence of a life need not have any legal basis.

- 2) In property insurance, the actual value of the interest therein is the limit of the insurance that can validly be placed thereon. In life insurance, there is no limit to the amount of insurance that may be taken upon life.
- 3) In property insurance, an interest insured must exist when the insurance takes effect and when the loss occurs but need not exist in the meantime. In life insurance, it is enough that insurable interest exists at the time when the contract is made but it need not exist at the time of loss. (BAR 2002)

7. **X, Co. a partnership, is composed of A (capitalist partner), B (capitalist partner) and C (industrial partner). If you were partner A, who between B and C would you have an insurable interest on, such that you may then insure him?**
- a. **No one, as there is merely a partnership contract among A, B and C.**
  - b. **Both B and C, as they are your partners.**
  - c. **Only C, as he is an industrial partner.**
  - d. **Only B, as he is a capitalist partner.**

**Answer:**

- b. Both B and C, as they are your partners. (BAR 2011)

8. **X has been a long-time household helper of Z. X's husband, Y, has also been Z's long-time driver. May Z insure the lives of both X and Y with Z as beneficiary?**
- a. **Yes, since X and Y render services to Z.**
  - b. **No, since X and Y have no pecuniary interest on the life of Z arising from their employment with him.**
  - c. **No, since Z has no pecuniary interest in the lives of X and Y arising from their employment with him.**
  - d. **Yes, since X and Y are Z's employees.**

**Answer:**

- c. No, since Z has no pecuniary interest in the lives of X and Y arising from their employment with him. (BAR 2011)

9. **For both the Life Insurance and Property Insurance, the insurable interest is required to be—**
- a) **Existing at the time of perfection of the contract and at the time of loss;**
  - b) **Existing at the time of perfection and at the time of loss for property;**
  - c) **Existing at the time of perfection for property insurance but for life insurance both at the time of perfection and at the time of loss;**
  - d) **Existing at the time of perfection only.**

**Answer:**

- b) Existing at the time of perfection and at the time of loss for property. (BAR 2012)

10. **X, a minor, contracted an insurance on his own life. Which statement is most accurate?**
- a) **The life insurance policy is void ab initio;**
  - b) **The life insurance is valid provided it is with the consent of the beneficiary;**
  - c) **The life insurance policy is valid provided the beneficiary is his estate or his parents, or spouse or child;**
  - d) **The life insurance is valid provided the disposition of the proceeds will be subject to the approval of the legal guardian of the minor.**

**Answer:**

c) The life insurance policy is valid provided the beneficiary is his estate or his parents, or spouse or child. (BAR 2012)

**11. In 2010, the PNP declared Kaddafy Benjelani “Public Enemy No. 1” because of his terrorist activities in the country that have resulted in the death of thousands of Filipinos. A ransom of P15 M was placed on Kaddafy Benjelani’s head.**

**Worried about the future of their family, Kaddafy Benjelani’s estranged wife, Aurelia, secured in December 2010 a life insurance policy on his life and designated herself as beneficiary.**

**Is the policy valid and binding?**

- a) **Yes, the policy is valid and binding because Aurelia has an insurable interest on the life of Kaddafy Benjelani.**
- b) **No, the policy is not valid and binding because Kaddafy Benjelani has been officially declared a public enemy;**
- c) **Yes, the policy is valid and binding because it has been in force for more than 2 years;**
- d) **No, the policy is not valid and binding since the spouses’ estrangement removed Aurelia’s insurable interest in Benjelani’s life;**
- e) **None of the above.**

**Answer:**

- a) **Yes, the policy is valid and binding because Aurelia has an insurable interest on the life of Kaddafy Benjelani. (BAR 2013)**

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

**Answer:**

Yes. Carlo can claim the insurance benefit. If a person insures the life or health of another person with himself as beneficiary, all his rights, title and interests in the policy shall automatically vest in the person insured. Carlo, as the husband of Bianca, has an insurable interest in the life of the latter. Also, every person has an insurable interest in the life and health of any person on whom he depends wholly or in part for support. The insurable interest in the life of the person insured must exist when the insurance takes effect but need not exist when the loss occurs. Thus, the subsequent knowledge of Carlo, upon the death of Bianca, that the latter is a transgender does not destroy his insurable interest on the life of the insured. (BAR 2014)

**13. A person is said to have an insurable interest in the subject matter insured where he has a relation or connection with, or concern in it that he will derive pecuniary benefit or advantage from its preservation. Which among the following subject matters is not considered insurable?**

- a. **A partner in a firm on its future profits.**
- b. **A general creditor on the debtor’s property**
- c. **A judgment creditor on debtor’s property**
- d. **A mortgage creditor on debtor’s mortgaged property.**

**Answer:**

a. A partner in a firm on its future profits. (BAR 2014)

**14. On July 3, 1993, Delia Sotero (Delia) took out a life insurance policy from Ilocos Bankers Life Insurance Corporation (Ilocos Life) designating Creencia Aban (Aban), her niece, as her beneficiary. Ilocos Life issued Policy No. 747, with a face value of P100,000, in Sotero's favor on August 30, 1993, after the requisite medical examination and payment of the premium.**

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

- 6. Sotero did not personally apply for insurance coverage, as she was illiterate.**
- 7. Sotero was sickly since 1990.**
- 8. Sotero did not have the financial capability to pay the premium on the policy.**
- 9. Sotero did not sign the application for insurance.**
- 10. Aban was the one who filed the insurance application and designated herself as the beneficiary.**

**For the above reasons and claiming fraud, Ilocos Life denied Aban's claim on April 16, 1997, but refunded the premium paid on the policy.**

**c. May Sotero validly designate her niece as beneficiary?**

**Answer:**

c. Yes. Sotero may validly designate her niece, Aban, as beneficiary. Sotero had insurable interest in her own life, and could validly designate anyone as her beneficiary. (BAR 2014)

## **2. In Property**

**1. A owns a house worth P500, 000.00. He insured It against fire for P250, 000.00 for the period from January 1, 1977 to January 1, 1978. At the instance of B, who is a judgment creditor of A, the said house was levied upon by the Sheriff and sold at public auction on March 15, 1977. It was adjudicated to B for P150, 000.00 at the auction sale. B insured the house against fire for P150, 000.00 for the period from March 16, 1977 to March 16, 1978. The house was accidentally burned on April 1, 1977. May A recover under his policy? Give reasons.**

**Answer:**

A can recover under his policy. A judgment debtor whose property has been seized on execution has an insurable interest therein until the right to redeem or have the same set aside has been lost. Inasmuch as the right of A to redeem has not expired, the 12 months' time after the sale having not elapsed before the loss occurred; A has an insurable interest in the house at the time of loss.

**May B recover under his policy? Give reasons.**

**Answer:**

B can recover upon his policy because as purchaser at a judicial sale he has an insurable interest in the property to the extent of the amount for which he insured it not exceeding his interest in the property. (BAR 1977)

**2. "N" owns a condominium unit presently insured with Holy Insurance Co. for P1 Million. "N" later sells the condominium unit to "O". Somehow "O" fails to obtain the transfer of the insurance policy to his name from "N". Subsequently, fire of unknown origin destroys completely the condominium unit.**

### **Who may collect the insurance proceeds?**

**Answer:**

Neither N nor O may collect. As to N; *First Alternative Reason*—An interest in property insured must exist when the insurance takes effect and when the loss occurs. Although N had insurable interest when the insurance takes effect, yet he had no more interest when the loss happened. *Second Alternative Reason*—A change of interest in any part of a thing insured unaccompanied by a corresponding change of interest in the insurance, suspends the insurance to an equivalent extent, until the interest in the thing insured and the interest in the insurance are vested in the same person.

*As to O:* He cannot recover, because he had no insurance contract on the said condominium unit which he bought from N. (BAR 1980)

3. **The agent in Davao of the insured “A” was employed to ship “A”’s copra to Manila and to communicate the shipment to the buyer “A” in Manila. The said agent wrote the owner of the copra announcing the sailing of the ship, but failed to state that the ship had run a ground, which fact he already knew before announcing the sailing. “A,” the buyer of the copra, in all good faith, took out a marine insurance on the copra. The copra was badly damaged and was a total loss. Can the insured recover on the policy? Reason.**

**Answer:**

The insured may not recover on the policy, since the subject matter of the marine insurance at the time of contracting the insurance was already lost. An interest in property insured must exist when the insurance takes effect and when the loss occurs. (BAR 1979)

4. **On January 4, 1983, Mr. P joined Alpha Corporation (ALPHA) as President of the company. ALPHA took out a life insurance policy on the life of Mr. P with Mutual Insurance Company, designating ALPHA as the beneficiary. ALPHA also carried fire insurance with Beta Insurance Co. on a house owned by it, but temporarily occupied by Mr. P again with ALPHA as beneficiary.**

**On September 1, 1983, Mr. P resigned from ALPHA and purchased the company house he had been occupying. A few days later, a fire occurred resulting in the death of Mr. P and the destruction of the house.**

### **What are the rights of ALPHA against Beta Insurance Company on the fire insurance?**

**Answer:**

ALPHA cannot recover from Beta Insurance Co. since an interest in the property insured must exist not only when the insurance took effect but also when the loss occurs. Since the fire that destroyed the insured’s house took effect after ALPHA had sold the house to Mr. P, the insurable interest of ALPHA in the property insured no longer exists when the loss occurred. (BAR 1984)

5. **On February 3, 1987, while Jose Palacio was in the hospital preparatory to a heart surgery, he called his only son, Boy Palacio, and showed the latter a will naming the son as sole heir to all the father’s estate including the family mansion in Forbes Park. The following day, Boy Palacio took out a fire insurance policy on the Forbes Park mansion. One week later, the father died. After his father’s death, Boy Palacio moved his wife and children to the family mansion which he inherited. On March 30, 1987, a fire occurred razing the mansion to the ground. Boy Palacio then proceeded to collect on the fire insurance he took earlier on the house.**

### **Should the insurance company pay? Reasons.**

**Answer:**

In property insurance, insurable interest must exist both at the time of the taking of the insurance and at the time the risk insured against occurs. The insurable interest must be an existing interest. The fact alone that Boy Palacio was the expected sole heir of his father's estate does not give the prospective heir any existing interest prior to the death of the decedent. (BAR 1987)

6. **A piece of machinery was shipped to Mr. Pablo on the basis of C&F, Manila. Mr. Pablo insured said machinery with the Talaga Merchants Insurance Corp. (TAMIC) for loss or damage during the voyage. The vessel sank en route to Manila. Mr. Pablo then filed a claim with TAMIC which was denied for the reason that prior to delivery, Mr. Pablo had no insurable interest. Decide the case.**

**Answer:**

Mr. Pablo had an existing insurable interest on the piece of machinery he bought. The purchase of goods under a perfected contract of sale already vested equitable interest on the property in favor of the buyer even while it is pending delivery. (BAR 1991)

7. **In a civil suit, the Court ordered Benjie to pay Nat P500,000. To execute the judgment, the sheriff levied upon Benjie's registered property (a parcel of land and the building thereon), and sold the same at public auction to Nat, the highest bidder. The latter, on March 18, 1992, registered with the Register of Deeds the certificate of sale issued to him by the sheriff. Meanwhile, on January 27, 1993, Benjie insured with Garapal Insurance for P1 M the same building that was sold at public auction to Nat. Benjie failed to redeem the property by March 18, 1993.**

**On March 19, 1993, a fire razed the building to the ground. Garapal Insurance refused to make good its obligation to Benjie under the insurance contract.**

- 1. Is Garapal Insurance legally justified in refusing payment to Benjie?**
- 2. Is Nat entitled to collect on the insurance policy?**

**Answer:**

1. Yes. At the time of the loss, Benjie was no longer the owner of the property insured as he failed to redeem the property. The law requires in property insurance that a person can recover the proceeds of the policy if he has insurable interest at the time of the issuance of the policy and also at the time when the loss occurs. At the time of fire, Benjie no longer had insurable interest in the property insured.
2. No. While at the time of the loss he has insurable interest in the building, as he was the owner thereof, Nat did not have any interest in the policy. There was no automatic transfer clause in the policy that would give him such interest in the policy. (BAR 1994)

8. **A obtains a fire insurance on his house and as a generous gesture names his neighbor as the beneficiary. If A's house is destroyed by fire, can B successfully claim against the policy?**

**Answer:**

No. in property insurance, the beneficiary must have insurable interest in the property insured. B does not have insurable interest in the house insured. (BAR 1997)

9. **A businessman in the grocery business obtained from First Insurance an insurance policy for P5 M to fully cover his stocks-in-trade from the risk of fire.**

**3 months later, a fire of accidental origin broke out and completely destroyed the grocery including his stocks-in-trade. This prompted the businessman to file with First Insurance a claim for P5 M representing the full value of his goods.**

**First Insurance denied the claim because it discovered that at the time of the loss, the stock-in-trade were mortgaged to a creditor who likewise obtained from Second Insurance Company fire insurance coverage for the stocks at their full value of P5 M.**

- a) **May the businessman and the creditor obtain separate insurance coverage over the same stocks-in-trade? Explain.**
- b) **Suppose you are the Judge, how much would you allow the businessman and the creditor to recover from their respective insurers. Explain.**

**Answer:**

- a) Yes. The businessman, as owner, and the creditor, as mortgagee, have separate insurable interests in the same stocks-in-trade. Each may insure such interest to protect his own separate interest.
- b) As judge, I would allow the businessman to recover his total loss of P5 M pesos representing the full value of his goods which were lost through fire. As to the creditor, I would allow him to recover the amount to the extent of or equivalent to the value of the credit he extended to the businessman for the stocks-in-trade which were mortgaged by the businessman. (BAR 1999)

**10. IS, is an elderly bachelor with no known relatives, obtained life insurance coverage for P250,000 from Starbrite Insurance Corporation, an entity licensed to engage in the insurable business under the Insurance Code of the Philippines. He also insured his residential house for twice that amount with the same corporation. He immediately assigned all his rights to the insurance proceeds to BX, a friend-companion living with him. 3 years later, IS died in a fire that gutted his insured house 2 days after he had sold it. There is no evidence of suicide or arson or involvement of BX in these events. BX demanded payment of the insurance proceeds from the 2 policies, the premiums for which IS had been faithfully paying during all the time he was alive. Starbrite, refused payment, contending that BX had no insurable interest and therefore was not entitled to receive the proceeds from IS' insurance coverage on his life and also on his property. Is Starbrite's contention valid? Explain.**

**Answer:**

Starbrite is correct with respect to the insurance coverage on the property of IS. The beneficiary in the property insurance policy or the assignee thereof must have insurable interest in the property insured. BX, a mere friend-companion of IS, has no insurable interest in the residential house of IS. BX is not entitled to receive the proceeds from IS' insurance on his property.

As to the insurance coverage on the life of IS, BX is entitled to receive the proceeds. There is no requirement that BX should have insurable interest in the life of IS. It was IS himself who took the insurance on his own life. (BAR 2000)

**11. JQ, owner of a condominium unit, insured the same against fire with XYZ Insurance Co., and made the loss payable to his brother, MLQ. In case of loss by fire of the said condominium unit, who may recover on the fire insurance policy? State the reason/s for your answer.**

**Answer:**

JQ can recover on the fire insurance policy for the loss of the said condominium unit. He has the insurable interest as owner-insured. As beneficiary in the fire insurance policy, MLQ cannot recover on the fire insurance policy. For the beneficiary to recover on the fire or property insurance policy, it is required that he must have insurable interest in the property insured. In this case, MLQ does not have insurable interest in the condominium unit. (BAR 2001)

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

**Answer:**

- 1) In property insurance, the expectation of benefit must have a legal basis. In life insurance, the expectation of benefit to be derived from the continued existence of a life need not have any legal basis.
- 2) In property insurance, the actual value of the interest therein is the limit of the insurance that can validly be placed thereon. In life insurance, there is no limit to the amount of insurance that may be taken upon life.
- 3) In property insurance, an interest insured must exist when the insurance takes effect and when the loss occurs but need not exist in the meantime. In life insurance, it is enough that insurable interest exists at the time when the contract is made but it need not exist at the time of loss. (BAR 2002)

**13. Ciriaco leased a commercial apartment from Supreme Building Corporation (SBC). One of the provisions of the 1-year lease contract states:**

**“18. x x x The LESSEE shall not insure against fire the chattels, merchandise, textiles, goods and effects placed at any stall or store or space in the leased premises without first obtaining the written consent of the LESSOR. If the LESSEE obtains fire insurance coverage without the consent of the LESSOR, the insurance policy is deemed assigned and transferred to the LESSOR for the latter’s benefit.”**

**Notwithstanding the stipulation in the contract, without the consent of SBC, Ciriaco insured the merchandise inside the premises against loss by fire in the amount of P500,000 with First United Insurance Corporation (FUIC).**

**A day before the lease contract expired, fire broke out inside the leased premises, damaging Ciriaco’s merchandise. Having learned of the insurance earlier procured by Ciriaco, SBC demanded from FUIC that the proceeds of the insurance policy be paid directly to it, as provided in the lease contract.**

**Who is legally entitled to receive the insurance proceeds? Explain.**

**Answer:**

Ciriaco is entitled to receive the proceeds of the insurance policy. The stipulation that the policy is deemed assigned and transferred to SBC is void, because SBC has no insurable interest in the merchandise of Ciriaco. (BAR 2009)

**14. X owned a house and lot. X insured the house. The house got burned. Then he sold the partially burnt house and the lot to Y. Which statement is most accurate?**

- a) X is not anymore entitled to the proceeds of the insurance policy because he already sold the partially burnt house and lot;
- b) X is still entitled to the proceeds of the insurance policy because what is material is that at the time of the loss, X is the owner of the house and lot;
- c) No one is entitled to the proceeds because ownership over the house and lot was already transferred;
- d) Y will be the one entitled to the proceeds because he now owns the partially burnt house and lot.

**Answer:**

b) X is still entitled to the proceeds of the insurance policy because what is material is that at the time of the loss, X is the owner of the house and lot. (BAR 2012)

**15. For both the Life Insurance and Property Insurance, the insurable interest is required to be—**

- a) Existing at the time of perfection of the contract and at the time of loss;
- b) Existing at the time of perfection and at the time of loss for property;

- c) Existing at the time of perfection for property insurance but for life insurance both at the time of perfection and at the time of loss;
- d) Existing at the time of perfection only.

**Answer:**

b) Existing at the time of perfection and at the time of loss for property. (BAR 2012)

### 3. Double Insurance, Over Insurance, Co-Insurance and Re-Insurance

1. **Julie and Alma formed a business partnership. Under the business name Pino Shop, the partnership engaged in a sale of construction materials. Julie insured the stocks in trade of Pino Shop with WGC Insurance Company for P350,000. Subsequently, she again got an insurance contract with RSI for P1 M and then from EIC for P200,000. A fire of unknown origin gutted the store of the partnership. Julie filed her claims with the 3 insurance companies. However, her claims were denied separately for breach of policy condition which required the insured to give notice of any insurance effected covering the stocks in trade. Julie went to court and contended that she should not be blamed for the omission, alleging that the insurance agents for WGC, RSI and EIC knew of the existence of the additional insurance coverage and that she was not informed about the requirement that such other or additional insurance should be stated in the policy.**

**Is the contention of Julie tenable? Explain.**

**Answer:**

No. An insured is required to disclose the other insurances covering the subject matter of the insurance being applied for. (BAR 1993)

2. **Distinguish co-insurance from re-insurance.**

**Answer:**

Co-insurance is the percentage in the value of the insured property which the insured himself assumes or undertakes to act as insurer to the extent of the deficiency in the insurance of the insured property. In case of loss or damage, the insurer will be liable only for such proportion of the loss or damage as the amount of insurance bears to the designated percentage of the full value of the property insured.

Reinsurance is where the insurer procures a third party, called the reinsurer, to insure him against liability by reason of such original insurance. Basically, reinsurance is an insurance against liability which the original insurer may incur in favor of the original insured. (BAR 1994)

3. **A businessman in the grocery business obtained from First Insurance an insurance policy for P5 M to fully cover his stocks-in-trade from the risk of fire.**

**3 months later, a fire of accidental origin broke out and completely destroyed the grocery including his stocks-in-trade. This prompted the businessman to file with First Insurance a claim for P5 M representing the full value of his goods.**

**First Insurance denied the claim because it discovered that at the time of the loss, the stock-in-trade were mortgaged to a creditor who likewise obtained from Second Insurance Company for insurance coverage for the stocks at their full value of P5 M.**

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

**Answer:**

The contention of First Insurance that double insurance is contrary to law is untenable. There is no law providing that double insurance is illegal per se. moreover, in the problem at hand, there is no double insurance because the insured with the First Insurance is different from the insured with the Second Insurance Company. The same is true with respect to the interests insured in the two policies. (BAR 1999)

4. a) **When does double insurance exist?**  
b) **What is the nature of the liability of the several insurers in double insurance? Explain.**

**Answer:**

- a) Double insurance exists where the same person is insured by two or more insurers separately with respect to the same subject matter and interest.
- b) In double insurance, the insurers are considered as co-insurers. Each one is bound to contribute ratably to the loss in proportion to the amount for which he is liable under his contract. (BAR 2005)

5. **Terrazas de Pation Verde, a condominium building, has a value of P50 M. The owner insured the building against fire with 3 insurance companies for the following amounts:**

**Northern Insurance Corp.—P20 M**  
**Southern Insurance Corp.—P30 M**  
**Eastern Insurance Corp.—P50 M**

- a) **Is the owner's taking of insurance for the building with 3 insurers valid? Discuss.**  
b) **The building was totally razed by fire. If the owner decides to claim from Eastern Insurance Corp. only P50 M, will the claim prosper? Explain.**

**Answer:**

- a) The taking of insurance from the 3 insurers is valid. It is a case of "double insurance". The Insurance Code provides that a double insurance exist where the same person is insured by several insurers separately in respect to the same subject and interest.

Double insurance is valid. What is prohibited is for the insured to recover more than his interest or value of the property pursuant to the "principle of indemnity".

- b) Yes, the owner may legally claim the entire P50 M from Eastern Insurance, Corp. The Insurance Code provides that where the insured is overinsured by double insurance, the insured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may select, up to the amount for which the insurers are severally liable under their respective contracts. Each insurer is bound, as between himself and the other insurers, to contribute ratably to the loss in proportion to the amount for which he is liable under his contract. (BAR 2008)

6. **If an insurance policy prohibits additional insurance on the property insured without the insurer's consent, such provision being valid and reasonable, a violation by the insured**

- a. **Reduces the value of the policy.**  
b. **Avoids the policy.**  
c. **Offsets the value of the policy with the additional insurance's value.**  
d. **Forfeits premiums already paid.**

**Answer:**

- a. Avoids the policy. (BAR 2011)

7. **X borrowed from CCC Bank. She mortgaged her house and lot in favor of the bank. X insured her house. The bank also got the house insured.**
- a) **Is this double insurance? Explain your answer.**
  - b) **Is this legally valid? Explain your answer.**
  - c) **In case of damage, can X and CCC bank separately claim for the insurance proceeds?**

**Answer:**

- a) No, there is no double insurance. Double insurance exists where the same person is insured by several insurers separately with respect to the same subject and interest.
- b) Yes, X and CCC Bank can both insure the house as they have different insurable interests therein. X, the borrower-mortgagor, has an insurable interest in the house being the owner thereof while CCC Bank, the lender, also has an insurable interest in the house as mortgagee thereof.
- c) Yes. If X obtained an open policy then she could claim an amount corresponding to the extent of the damage based on the value of the house determined as of the date the damaged occurred, but not to exceed the face value of the insurance policy; however, if she obtained a valued policy then she could claim an amount corresponding to the extent of the damage based on the agreed upon valuation of the house.

As for CCC Bank, it could claim an amount corresponding to the extent of the damage but not to exceed the amount of the loan it extended to X or so much thereof as may remain unpaid. (BAR 2012)

8. **X insured the building she owns with 2 insurance companies for the same amount. In case of damage—**
- a) **X cannot claim from any of the 2 insurers because with the double insurance, the insurance coverage becomes automatically void;**
  - b) **The 2 insurers will be solidarily liable to the extent of the loss;**
  - c) **The 2 insurers will be proportionately liable;**
  - d) **X can choose who he wants to claim against.**

**Answer:**

- d) X can choose who he wants to claim against. (BAR 2012)

#### **4. Multiple or Several Interests on Same Property**

1. **To secure a loan of P10 M, O mortgaged his building to C. in accordance with the loan arrangements, O had the property insured with Acme Insurance Company for P10 M with C as the beneficiary. C also took an insurance on the building upon his own interest with Beta Insurance Co. for P5 M.**

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

**How much can C recover from either or both insurance companies? What happens to the P10 M debt of O to C?**

**Answer:**

- a) C cannot recover from Acme Insurance Co. unless the policy otherwise provides, where a mortgagor of property effects insurance in his own name providing that the loss shall be payable to the mortgagee, the insurance is deemed to be upon the interest of the mortgagor. Any act of the mortgagor prior to the loss

which would otherwise avoid the insurance will have the same effect. Apart from the storing of the inflammable materials, the act of the owner-mortgagor, O, caused the peril insured against.

With respect to the Beta Insurance Co., C can recover the full amount of P5 M since the act of O in intentionally starting the fire that caused the loss cannot be attributable to the mortgagee, C. The act of O in storing inflammable in the building contrary to the loan agreement does not affect the insurance policy, unless the insurance policy itself prohibited any storing of inflammable materials.

- b) The P10 M debt of O to C will be affected by the amount which C is able to collect from the insurance companies. If C is unable to recover any amount, the full amount of the debt remains. If C is able to recover P5 M from Beta insurance Co., the great weight of authority is that the mortgagee is not allowed to retain his claim against O, the mortgagor, but it passes by subrogation to the insurer to the extent of the money paid. (Palileo v. Cosio, 97 Phil. 919). In this case, Beta Ins. Co. will become entitled to collect P5 M from O, and O will continue to remain liable to C for the balance of P5 M. (BAR 1984)

2. **A businessman in the grocery business obtained from First Insurance an insurance policy for P5 M to fully cover his stocks-in-trade from the risk of fire.**

**3 months later, a fire of accidental origin broke out and completely destroyed the grocery including his stocks-in-trade. This prompted the businessman to file with First Insurance a claim for P5 M representing the full value of his goods.**

**First Insurance denied the claim because it discovered that at the time of the loss, the stock-in-trade were mortgaged to a creditor who likewise obtained from Second Insurance Company fore insurance coverage for the stocks at their full value of P5 M.**

- c) **May the businessman and the creditor obtain separate insurance coverage over the same stocks-in-trade? Explain.**  
d) **Suppose you are the Judge, how much would you allow the businessman and the creditor to recover from their respective insurers. Explain.**

**Answer:**

- c) Yes. The businessman, as owner, and the creditor, as mortgagee, have separate insurable interests in the same stocks-in-trade. Each may insure such interest to protect his own separate interest.
- d) As judge, I would allow the businessman to recover his total loss of P5 M pesos representing the full value of his goods which were lost through fire. As to the creditor, I would allow him to recover the amount to the extent of or equivalent to the value of the credit he extended to the businessman for the stocks-in-trade which were mortgaged by the businessman. (BAR 1999)

3. **To secure a loan of P10 M, Mario mortgaged his building to Armando. In accordance with the loan arrangements, Mario had the building insured with First Insurance Company for P10 M, designating Armando as the beneficiary.**

**Armando also took an insurance on the building upon his own interest with Second Insurance Company for P5 M.**

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

1. **How much, if any, can Armando recover from either or both insurance companies?**

**Answer:**

Armando can receive P5 M from Second Insurance Company. As mortgagee, he had an insurable interest in the building. Armando cannot collect anything from First Insurance Company. First Insurance Company is not liable for the loss of the building. First, it was due to a willful act of Mario, who committed arson. Second, fire insurance policies contain a warranty that the insured will not store hazardous materials within the insured's premises. Mario breached this warranty when he stored inflammable materials in the building. These two factors exonerate First Insurance Company from liability to Armando as mortgagee even though it was Mario who committed them.

**2. What happens to the P10 M debt of Mario to Armando? Explain.**

**Answer:**

Since Armando would have collected P5 M from Second Insurance Company, this amount should be considered as partial payment of the loan. Armando can only collect the balance of P5 M. Second Insurance Company can recover from Mario the amount of P5 M it paid, because it became subrogated to the rights of Armando. (BAR 2010)

**4. X borrowed from CCC Bank. She mortgaged her house and lot in favor of the bank. X insured her house. The bank also got the house insured.**

**d) Is this double insurance? Explain your answer.**

**e) Is this legally valid? Explain your answer.**

**f) In case of damage, can X and CCC bank separately claim for the insurance proceeds?**

**Answer:**

d) No, there is no double insurance. Double insurance exists where the same person is insured by several insurers separately with respect to the same subject and interest.

e) Yes, X and CCC Bank can both insure the house as they have different insurable interests therein. X, the borrower-mortgagor, has an insurable interest in the house being the owner thereof while CCC Bank, the lender, also has an insurable interest in the house as mortgagee thereof.

f) Yes. If X obtained an open policy then she could claim an amount corresponding to the extent of the damage based on the value of the house determined as of the date the damaged occurred, but not to exceed the face value of the insurance policy; however, if she obtained a valued policy then she could claim an amount corresponding to the extent of the damage based on the agreed upon valuation of the house.

As for CCC Bank, it could claim an amount corresponding to the extent of the damage but not to exceed the amount of the loan it extended to X or so much thereof as may remain unpaid. (BAR 2012)

**5. A house and lot is covered by a real estate mortgage (REM) in favor of ZZZ Bank. The Bank required that the house be insured. The owner of the policy failed to endorse nor assign the policy to the bank. However, the Deed of REM has an express provision which says that the insurance policy is also endorsed with the signing of the REM. Will this be sufficient?**

**a) No, insurance policy must be expressly endorsed to the bank so that the bank will have a right in the proceeds of such insurance in the event of loss;**

**b) The express provision contained in the Deed of REM to the effect that the policy is also endorsed is sufficient;**

**c) Endorsement of the Insurance Policy in any form is not legally allowed;**

**d) Endorsement of the Insurance Policy must be in a formal document to be valid.**

**Answer:**

- b) No, insurance policy must be expressly endorsed to the bank so that the bank will have a right in the proceeds of such insurance in the event of loss (BAR 2012)

### G. Perfection of the Contract of Insurance

1. **Antarctica Life Assurance Corporation (ALAC) publicly offered a specially designed insurance policy covering persons between the ages of 50 to 75 who may be afflicted with serious and debilitating illnesses. Quirco applied for insurance coverage, stating that he was already 80 years old. Nonetheless, ALAC approved his application.**

**Quirco then requested ALAC for the issuance of a cover note while he was trying to raise funds to pay the insurance premium. ALAC granted the request. 10 days after he received the cover note, Quirco had a heart seizure and had to be hospitalized. He then filed a claim on the policy.**

- a) **Can ALAC validly deny the claim on the ground that the insurance coverage, as publicly offered was available only to persons 50 to 75 years of age? Why or why not?**

**Answer:**

No. by approving the application of Quirino who disclosed that he was already 80 years old, ALAC waived the age requirement. ALAC is now stopped from raising such defense of age of the insured.

- b) **Did ALAC's issuance of a cover note result in the perfection of an insurance contract between Quirco and ALAC? Explain.**

**Answer:**

Yes. The issuance of a cover note resulted in the perfection of the contract of insurance. In that case, it is only because there is delay in the issuance of the policy that the cover note was issued.

The cover note is a receipt whereby the company agrees to insure the insured for 60 days pending the issuance of a regular policy. No separate premium is to be paid on a cover note. It is not a separate policy but is integrated in the regular policy to be subsequently issued. (BAR 2009) Armando, a resident of Manila, borrowed P3 M from Bernardo, offering as security his 500 shares of stock worth P1.5 M in Xerxes Corporation, and his 2007 BMW sedan, valued at P2 M. the mortgage on the shares of stock was registered in the Office of the Register of Deeds of Makati City where Xerxes Corporation has its principal office. The mortgage on the car was registered in the Office of the Register of Deeds of Manila. Armando executed a single Affidavit of Good Faith, covering both mortgages.

Armando defaulted on the payment of his obligation; thus, Bernardo foreclosed on the two chattel mortgages. Armando filed suit to nullify the foreclosure and the mortgages, raising the following issues:

- a) **The execution of only one Affidavit of Good Faith for both mortgages invalidated the two mortgages; and**

**Answer:**

The execution of only one Affidavit of Good Faith for both mortgages is not a ground to nullify the said mortgages and the foreclosure thereof. Said mortgages are valid as between immediate parties, although they cannot bind third parties.

- b) **The mortgage on the shares of stocks should have been registered in the Office of the Register Deeds of Manila where he resides, as well as in the stock and transfer book of Xerxes Corporation.**

### **Rule on the foregoing issues with reasons.**

#### **Answer:**

The mortgage on the shares of stock should be registered in the chattel mortgage registry in the register of Deeds of Makati City where the corporation has its principal office and also in the Register of Deeds of Manila where the mortgagor resides. Registration of chattel mortgage in the stock and transfer book is not required to make the chattel mortgage valid. Registration of dealings in the stock and transfer book under Section 63 of the Corporation Code applies only to sale or disposition of shares, and has no application to mortgages and other forms of encumbrances.

- c) Assume that Bernardo extrajudicially foreclosed on the mortgages, and both the car and the shared of stock were sold at public auction. If the proceeds from such public sale should be 1-million short of Armando's total obligation, can Bernardo recover the deficiency? Why or why not?**

#### **Answer:**

Yes. Bernardo can recover the deficiency. Chattels are given as mere security, and not as payment or pledge.

### **1. Offer and Acceptance/Consensual**

- 1. "P" filed an application with an insurance company for a 20-year endowment policy in the amount of P50,000.00 on the life of his one-year-old daughter, supplying all the essential data in the application form, but without disclosing that his daughter was a mongoloid child. Upon "P's" payment of the annual premium, a binding deposit receipt was issued to "P" by the insurance agent, subject to processing by the company. The insurance company disapproved the insurance application stating that the plan applied for was not available for minors below seven years old, and offered another plan. The insurance agent did not inform "P" of the disapproval nor of the alternative plan offered, and instead, strongly recommended that the company reconsider and approve the insurance application.**

**As fate would have it, "P's" daughter died. "P" sought payment of the proceeds of the insurance but the company refused on the grounds that there was concealment of a material fact in the insurance application form and that it had rejected the application. "P" contended, on the other hand, that the binding deposit receipt constituted a temporary contract of life insurance.**

**How would you resolve the issue?**

#### **Answer:**

The insurance company is not liable. The binding deposit receipt is merely conditional and does not insure outright. Where an agreement is made between the applicant and the agent, no liability shall attach until the principal (insurance company) approves the risk. The binding deposit receipt is subordinated to the act of the insurance company in approving or rejecting the application; thus, in life insurance, a "binding slip" or "binding receipt" does not insure by itself; and, when as in this case the application was disapproved, before the death of the insured, there was no perfected contract of insurance in order to make the company liable. (*Great Pacific Life Ass. Co. v. C.A.*, April 30, 1979; 89 SCRA 549.) (BAR 1980)

- 2. On June 1, 2011, X mailed to Y Insurance, Co. his application for life insurance, with payment for 5 years of premium enclosed in it. On July 21, 2011, the insurance company accepted the application and mailed, on the same day, its acceptance plus the cover note. It reached X's residence on August 11, 2011. But, as it happened, on August 4, 2011, X figured in a car accident. He died a day later. May X's heir recover on the insurance policy?**

- a. Yes, since under the Cognition Theory, the insurance contract was perfected upon acceptance by the insurer of X's application.
- b. No, since there is no privity of contract between the insurer and X's heirs.
- c. No, since X had no knowledge of the insurer's acceptance of his application before he died.
- d. Yes, since under the Manifestation Theory, the insurance contract was perfected upon acceptance of the insurer of X's application.

**Answer:**

c. No, since X had no knowledge of the insurer's acceptance of his application before he died. (BAR 2011)

- a. Delay in Acceptance
- b. Delivery of Policy

1. On September 25, 2013, Danny Marcial (Danny) procured an insurance on his life with a face value of P5 M from RN Insurance Company (RN), with his wife Tina Marcial (Tina) as sole beneficiary. On the same day, Danny issued an undated check to RN for the full amount of the premium. On October 1, 2013, RN issued the policy covering Danny's life insurance. On October 5, 2013, Danny met a tragic accident and died. Tina claimed the insurance benefit, but RN was quick to deny the claim because at the time of Danny's death, the check was not yet encashed and therefore the premium remained unpaid.

**Is RN correct? Will your answer be the same if the check is dated October 15, 2013?**

**Answer:**

No. RN is not correct. After the issuance of the check by Danny for the full amount of the premium, the unconditional delivery of an insurance policy of RN to Danny corresponding to the terms of the application ordinarily consummates the contract, and the policy as delivered becomes the final contract between the parties. Where the parties, so intend, the insurance becomes effective at the time of the delivery of the policy notwithstanding the fact that the check was not yet encashed. My answer will still be the same even if the check is dated October 15, 2013 since an acknowledgment in a policy of the receipt of premium is conclusive evidence of its payment for the purpose of making the policy binding. (BAR 2014)

- c. Transfer of Policy

1. The policy of insurance upon his life, with a face value of P100,000, was assigned by Jose, a married man with 2 legitimate children, to his nephew, Y as security for a loan of P50,000. He did not give the insurer any written notice of such assignment despite the explicit provision to that effect in the policy. Jose died. Upon the claim on the policy by the assignee, the insurer refused to pay on the ground that it was not notified of the assignment. Upon the other hand, the heirs of Jose contended that Y is not entitled to any amount under the policy because the assignment without due notice to the insurer was void. Resolve the issues.

**Answer:**

A life insurance is assignable. A provision, however, in the policy stating that written notice of such an assignment should be given to the insurer is valid. The failure of the notice of assignment would thus preclude the assignee from claiming rights under the policy. The failure of notice did not, however, avoid the policy; hence, upon the death of Jose, the proceeds would, in the absence of a designated beneficiary, go to the estate of the insured. The estate, in turn, would be liable for the loan of P50,000 owing in favor of Y. (BAR 1991)

#### d. Kinds of Policy

1. In 1964, Jose constructed a house worth P50,000.00, which he insured against fire for the same amount. The insurance for the same amount was renewed every year. In 1974, when the house was already worth P100,00.00 on account of inflationary prices (in case of a rebuilding), one-fifth (1/5) of the house was destroyed by fire. As nothing illegal about the contract, how much, if any, can Jose successfully recover from the Insurance Company? Reason.

**Answer:**

If the fire policy is a *valued* one, then Jose can recover 1/5 of P50,000.00. i.e., P10,000.00. Under the Insurance Code, the valuation in a valued policy is conclusive between the parties in the absence of fraud. So Jose cannot claim that since his house was worth P100,00.00 at the time of the loss, he should be able to recover P20,000.00 (actual value of loss—1/5 of P100,00.00)

If the policy is an *open* policy then under the law, appraisal of loss is made after the fire. Since the house was worth P100,00.00 at such time, then the loss of Jose is P20,000.00 and he can recover this amount under such an open policy. (BAR 1975)

#### 2. Premium Payment

1. A insured his house against loss by fire for P100,000.00. The policy provides that the insurer shall be liable “if the property insured shall be damaged or destroyed by fire after payment of premium, at anytime from, from June 15, 1976 to June 15, 1977.” The policy was delivered to A on June 14, 1976. Instead of paying the premium in cash, A issued a promissory note dated June 15, 1976, for the amount of premium, payable within 30 days. The note was accepted. On June 29, 1976, the property insured was burned. The insurer refused to pay on the ground that the premium had not been paid, and the note did not have the effect of payment as its value had not been realized at the time the house was burned. Decide with reasons.

**Answer:**

Since the case given took place after the effectivity of the Insurance Code, it must be governed by its provisions. Section 77 thereof provides: “Notwithstanding any agreement to the contrary, no policy or contract of insurance issued by an insurance company is valid and binding unless and until the premium thereof has been paid...” Considering that this cited provision replaces Section 72 of old Insurance Act expressly permitting the granting of credit extension, the only conclusion is that the law-making power intended by the amendment to disallow any agreement postponing payment of premium, including a grant of credit extension. The issuance of a promissory note postpones payment by granting credit extension. Therefore, the insurer is not liable under this express provision of the new Insurance Code. The case of *Capital Insurance & Surety Co. v. Plastic Era Co* which held that acceptance of a promissory note constitutes waiver of the stipulation that the insurer will be liable only after the payment of premium and that in the absence of stipulation as to mode of payment, a promissory note constitutes payment, took place before the Insurance Code came into effect and was based on Section 72 of the old Insurance Act. It can therefore not be made applicable to the given case. (BAR 1976)

2. On December 17, 1975, a fire policy, insuring a building and its contents, was delivered to the insured company. By agreement, it was allowed to pay the premium within 30 days. On January 8, 1976, it paid the premium by means of a check postdated January 16, 1976. The check was deposited by the insurance company only on February 20, but the check bounced, although January 19, the insured has a sufficient bank balance. On January 18, two days after the premium became due, the insured property was burned and became a total loss.

Can the insurance company cancel the policy for non-payment of premium? Give reasons for your answers.

**Answer:**

Yes, the insurance company can cancel the policy for nonpayment of the premium. The new Insurance Code provides that notwithstanding any agreement to contrary, no policy or contract of insurance is valid and binding unless and until the premium thereof has been paid. (BAR 1978)

3. **The Peninsula Insurance Company offered to insure Francis' brand new car against all risks in the sum of P1 M per year. The policy was issued with the premium fixed at P60,000 payable in 6 months. Francis only paid the first two months installments. Despite demands, he failed to pay the subsequent installments. 5 months after the issuance of the policy, the vehicle was carnapped. Francis filed with the insurance company a claim for its value. However, the company denied his claim on the ground that he failed to pay the premium resulting in the cancellation of the policy.**

**Can Francis recover from the Peninsula Insurance Company?**

**Answer:**

Yes, Francis can recover from Peninsula considering that his car was carnapped before the 6 month period to pay the premium installments expired. An insurance premium can be paid in installments, and the insurance contract became valid and binding upon payment of the first premium. When the insurer granted a credit term for the payment of the premium, it is liable when the loss occurred before the expiration of such term. It could not deny liability on the ground that payment was not made in full, for the reason that it agreed to accept installment payments. For the same reason, it could not validly cancel the policy, more so, without giving notice to the insured of its cancellation. (BAR 2006)

4. **Alfredo took out a policy to insure his commercial building against fire. The broker for the insurance company agreed to give a 15-day credit within which to pay the insurance premium. Upon delivery of the policy on May 15, 2006, Alfredo issued a postdated check payable on May 30, 2006. On May 28, 2006, a fire broke out and destroyed the building owned by Alfredo.**
- a) **May Alfredo recover on the insurance policy?**
  - b) **Would your answer in a) be the same if it as found that the proximate cause of the fire was an explosion and that fire was but the immediate cause of the loss and there is no excepted peril under the policy?**
  - c) **If the fire was found to have been caused by Alfredo's own negligence, can he still recover on the policy?**

**Reason briefly in a, b and c.**

**Answer:**

- a) Yes, Alfredo may recover on the policy. It is valid to stipulate that the insured will be granted credit term for the payment of premium. Payment by means of a check which was accepted by the insurer, bearing a date prior to the loss, would be sufficient. The subsequent effects of encashment retroact to the date of the check.
- b) Yes, recovery under the insurance contract is allowed if the cause of the loss was either the proximate or the immediate cause as long as an excepted peril, if any, was not the proximate cause of the loss.
- c) Yes, mere negligence on the part of the insured will not prevent recovery under the insurance policy. The law merely prevents recovery when the cause of loss is the willful act of the insured, alone or in connivance with others. (BAR 2007)

5. Enrique obtained from Seguro Insurance Company a comprehensive motor vehicle insurance to cover his top of the line Aston Martin. The policy was issued on March 31, 2010 and, on even date, Enrique paid the premium with a personal check postdated April 6, 2010.

On April 5, 2010, the car was involved in an accident that resulted in its total loss.

On April 10, 2010, the drawee bank returned Enrique's check with the notation "Insufficient Funds." Upon notification, Enrique immediately deposited additional funds with the bank and asked the insurer to redeposit the check.

Enrique thereupon claimed indemnity from the insurer. Is the insurer liable under the insurance coverage? Why or why not?

**Answer:**

The insurer is not liable under the insurance policy. Under Art 1249 of the Civil Code, the delivery of a check produces the effect of payment only when it is encashed. The loss occurred on April 5, 2010. When the check was deposited, it was returned on April 10, 2010, for insufficiency of funds. The check was honored only after Enrique deposited additional funds with the bank. Hence, it did not produce the effect of payment. (BAR 2010)

6. Stable Insurance Co. (SIC) and St. Peter Manufacturing Co. (SPMC) have had a long-standing insurance relationship with each other; SPMC secured the comprehensive fire insurance on its plant and facilities from SIC. The standing business practice between them has been to allow SPMC a credit period of 90 days from the renewal of the policy within which to pay the premium.

Soon after the new policy was issued and before premium payments could be made, a fire gutted the covered plant and facilities to the ground. The day after the fire, SPMC issued a manager's check to SIC for the fire insurance premium, for which it was issued a receipt; a week later SPMC issued its notice of loss.

SIC responded by issuing its own manager's check for the amount of the premiums SPMC had paid, and denied SPMC's claim on the ground that under the "cash and carry" principle governing fire insurance, no coverage existed at the time the fire occurred because the insurance premium had not been paid.

Is SPMC entitled to recover for the loss from SIC?

**Answer:**

SPMC is entitled to recover for the loss from SIC. SIC granted a credit term to pay the premiums. This is not against the law, because the standing business practice of allowing SPMC to pay the premiums after 60 or 90 days, was relied upon in good faith by SPMC. SIC is in estoppel. (BAR 2013)

- a. Non-Default Options in Life Insurance
- b. Reinstatement of a Lapsed Policy of Life Insurance
- c. Refund of Premiums

1. Name at least 3 instances when an insured is entitled to a return of the premium paid.

**Answer:**

Three instances when an insured is entitled to a return of premium paid are:

- 1. To the whole premium, if no part of his interest in the thing insured be exposed to any of the perils insured against.

2. Where the insurance is made for a definite period of time and the insured surrenders his policy, to such portion of the premium as corresponds with the unexpired time at a pro rata rate, unless a short period rate has been agreed upon and appears on the face of the policy, after deducting from the whole premium any claim for loss or damage under the policy which has previously accrued.
3. When the contract is voidable on account of the fraud or misrepresentation of the insurer or of his agent or on account of facts the existence of which the insured was ignorant without his fault; or when, by any default of the insured other than actual fraud, the insurer never incurred any liability under the policy. (BAR 2000)

## H. Rescission of Insurance Contracts

1. **Shipowner X, in applying for a marine insurance policy from ABC, Co., stated that his vessel usually sails middle of August and with normally 100 tons of cargo. It turned out later that the vessel departed on the first week of September and with only 10 tons of cargo. Will this avoid the policy that was issued?**
  - a. Yes, because there was breach of implied warranty.
  - b. No, because there was no intent to breach an implied warranty.
  - c. Yes, because it relates to a material representation.
  - d. No, because there was only representation of intention.

**Answer:**

d. No, because there was only representation of intention. (BAR 2011)

2. **When X insured his building, X indicated in the application that it is a residential building, but actually the building was being used as a warehouse for some hazardous materials. What is the effect on the insurance policy, if any?**
  - a) The insurance policy can be cancelled because of the change in the use;
  - b) The insurance policy will automatically be changed;
  - c) The insurance policy need not be changed;
  - d) The insurance policy is fixed regardless of the changes in the use.

**Answer:**

Any of the above should be given full credit. (BAR 2012)

### 1. Concealment

1. **In a non-medical insurance contract (one where the company waives medical examination) the insured failed to disclose that she had once been operated on, although the information on this matter was supposed to have been supplied the company. Within the proper period, may the Insurance Company have the contract rescinded? Reasons.**

**Answer:**

Yes, the Insurance Company can rescind the contract on the ground of misrepresentation or concealment of material fact. The fact of the insured's operation is material to the insurer, who may have refused to issue the life policy had it known of such fact. This is even more true in a non-medical insurance where no medical exam is made and the information given by the insured concerning his past health and diseases is a very important factor which the insurer takes into consideration in deciding to issue the policy. (BAR 1975)

2. **Pedro Reyes applied for fire insurance on his house. In his application, it was asked the following question: "Is the house insured with another Insurance Company? If so, for how much?" His answer was "No". The fact, however, is that the house had been insured with the FGU for P100,000.00. The application was approved and made a part of the policy. Subsequently, a fire occurred in a neighboring house, and spread to the house of Pedro Reyes which was completely burned. Demand for payment having been refused by the insurer, Pedro Reyes filed a complaint. May he recover? Reason.**

**Answer:**

No, Pedro Reyes may not recover. He was guilty of concealment or misrepresentation of a material fact. The fact of the existence of the other insurance is material because had he answered truthfully, the insurer would probably have charged him higher premium, or would have made further inquiries, or would have imposed some other conditions in the policy to protect its interest. The existence of a large amount of insurance increases the moral hazard or the temptation to commit arson. Concealment of a material fact is a ground for rescission and is a valid defense of an insurer in an action based on the policy. (BAR 1976)

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

**Answer:**

Yes, the insured may recover since there is no concealment. The face of the policy bore already the annotation, "Co-insurance declared" which is a notice to the insurer as to the existence of other insurance contracts on the property insured. (Gen. Insurance & Surety Corporation v. Ng Hua, L-14373, Jan. 30, 1960) (BAR 1979)

4. **Marine insurance was secured upon goods on board a ship which departed from Madagascar to Manila, without any disclosure to the insurer of the fact that the ship had been reported at Lloyd of London as seen at sea, deep in water and leaky. This report turned out later to be wrong because the ship was at no time during the voyage leaky or in trouble, but was lost through another insured risk. The insurer refuses to pay the insured, claiming concealment. The insured counters that the fact not disclosed was erroneous and did not increase the risk and therefore immaterial. Decide the dispute with reasons.**

**Answer:**

The insured may not recover from the insurer. The information that the ship in question was seen at sea, deep in water and leaky, although erroneous, was material, and its concealment entitled the insurer to rescind the contract of insurance. (BAR 1979)

5. **In June 1981, Juan applied for a life insurance policy with a double indemnity provision in case of death by accident. Despite an express inquiry in the application form for insurance, he did not mention the fact that he had suffered from viral hepatitis the previous year. As Juan had fully recovered from the disease, the medical examination performed by the insurance company's physician did not reveal such previous illness, and showed that Juan was healthy and was an insurable risk. The policy was issued forthwith.**

**In March 1983, Juan died in an automobile accident. Subsequent investigation revealed that Juan was negligent in not having his brakes checked.**

**The insurance company refused to pay Juan's wife, the designated beneficiary, on two grounds: that Juan was guilty of fraudulent concealment of his liver ailment, and that Juan's death was caused by his own negligence.**

**The policy is silent as to the effect of the insured's negligence on the right to recover thereunder. Juan's wife insists that she has a right to recover because Juan's death was caused by an accident which had nothing to do whatsoever with his liver ailment. She therefore insists on double indemnity.**

**a) Is she entitled to any indemnity? Explain.**

**b) If Juan's accident occurred in July 1983, would your answer be the same?**

**Answer:**

a) No, she is not entitled to any indemnity. Although Juan did not die of a liver ailment, the fact of his concealment vitiated the insurer's consent to the contract of insurance. Under the Insurance Code, concealment of a material fact is a ground for rescission. And materiality is determined not by the event which caused the death but by the probable and reasonable influence of the fact concealed upon the other party in forming his estimate of the disadvantages of the proposed contract, or in making inquiries. If the insurer had known of Juan's previous liver ailment, it would in all probabilities have at least made more detailed inquiries about it or make a special examination of his liver function, or perhaps even charge a higher premium because of the greater risk involved. The concealment was therefore of a material fact, relieving the insurer from any liability on the policy, regardless of the cause of death. Since the insurer is relieved from liability, the question as to whether the event was an accident or not becomes moot. In any case, under the Insurance Code, negligence of the insured or of others does not exonerate the insurer.

b) My conclusion would be different. The insurer would be liable despite the fraudulent concealment because the policy has become uncontestable since more than 2 years had elapsed from the date thereof. (BAR 1983)

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

**Answer:**

The beneficiary of X cannot collect on the policy. Concealment, as a defense against liability by the insurer, may either be intentional or unintentional. Lack of knowledge on the part of the insured about her ailment will not preclude the insurer from raising the defense. The insurer may be held in estoppel only if, having known of the concealed or misrepresented fact, still accepts the payment of premium which is not the situation in this case. (BAR 1989)

**7. Juan procured a "non-medical" life insurance from Good Life Insurance. He designed his wife, Petra, as the beneficiary. Earlier, in his application in response to the question as to whether or not he had ever been hospitalized, he answered in the negative. He forgot to mention his confinement at the Kidney Hospital.**

**After Juan died in a plane crash, Petra filed a claim with Good Life. Discovering Juan's previous hospitalization, Good Life rejected Petra's claim on the ground of concealment and misrepresentation. Petra sued Good Life, invoking good faith on the part of Juan.**

**Will Petra's suit prosper? Explain.**

**Answer:**

No. Petra's suit will not prosper (assuming that the policy of life insurance has been in force for a period of less than 2 years from the date of its issue). The matters which Juan failed to disclose was material and relevant to the approval and issuance of the insurance policy. They would have affected Good Life's action on his

application, either by approving it with the corresponding adjustment for a higher premium or rejecting the same. Moreover, a disclosure may have warranted a medical examination of Juan by Good Life in order for it to reasonably assess the risk involved in accepting the application. In any case, good faith is no defense in concealment. The waiver of a medical examination in the “non-medical” life insurance from Good Life makes it even more necessary that Juan supply complete information about his previous hospitalization for such information constitutes an important factor which Good Life takes into consideration in deciding whether to issue the policy or not.

If the policy of life insurance has been in force for a period of 2 years or more from the date of its issue (on which point the given facts are vague) then Good Life can no longer prove that the policy is *void ab initio* or is rescindable by reason of the fraudulent concealment or misrepresentation of Juan. (BAR 1996)

- 8. The assured answers “No” to the question in the application for a life policy. “Are you suffering from any form of heart illness?” In fact, the assured has been a heart patient for many years. On September 7, 1991, the assured is killed in a plane crash. The insurance company denies the claim for insurance proceeds and returns the premium paid.**

**Is the decision of the insurance company justified?**

**Answer:**

Assuming that the incontestability clause does not apply because the policy has not been in force for 2 years from date of issue, during the lifetime of the insured, the decision of the insurance company not to pay is justified. There was fraudulent concealment. It is not material that the insured died of a different cause than the fact concealed. The fact concealed, that is the heart ailment, is material to the determination by the insurance company whether or not to accept the application for insurance and to require the medical examination of the insured.

However, if the incontestability clause applies to the insurance policy covering the life of the insured had been in force for 2 years from the issuance thereof, the insurance company would not be justified in denying the claim for the proceeds of the insurance and in returning the premium paid. In that case, the insurer cannot prove the policy void ab initio or rescindable by reason of fraudulent concealment or misrepresentation of the insured. (BAR 1997)

- 9. Renato was issued a life insurance policy on January 2, 1990. He concealed the fact that 3 years prior to the issuance of his life insurance policy, he had been seeing a doctor about his heart ailment.**

**On March 1, 1992, Renato died of heart failure. May the heirs file a claim on the proceeds of the life insurance policy of Renato?**

**Answer:**

Yes. The life insurance policy in question was issued on January 2, 1990. More than 2 years had elapsed when Renato, the insured, died on March 1, 1992. The incontestability clause applies. (BAR 1998)

- 10. “A” applied for a non-medical life insurance. The insured did not inform the insurer that one week prior to his application for insurance, he was examined and confined at St. Luke’s Hospital where he was diagnosed for lung cancer. The insured soon thereafter died in a plane crash. Is the insurer liable considering that the fact concealed had no bearing with the cause of death of the insured? Why?**

**Answer:**

No. The concealed fact is material to the approval and issuance of the insurance policy. It is well settled that the insured need not die of the disease he failed to disclose to the insurer. It is sufficient that his non-disclosure misled the insurer in forming his estimate of the risks of the proposed insurance policy or in making inquiries. (BAR 2001)

**11. X, in the hospital for kidney dysfunction, was about to be discharged when he met his friend Y. X told Y the reason for his hospitalization. A month later, X applied for an insurance covering serious illness from ABC Insurance, Co., where Y was working as Corporate Secretary. Since X had already told Y about his hospitalization, he no longer answered a question regarding it in the application form. Would this constitute concealment?**

- a. Yes, since the previous hospitalization would influence the insurer in deciding whether to grant X's application.
- b. No, since Y may be regarded as ABC's agent and he already knew of X's previous hospitalization.
- c. Yes, it would constitute concealment that amounts to misrepresentation on X's part.
- d. No, since the previous illness is not a material fact to the insurance coverage.

**Answer:**

- a. Yes, since the previous hospitalization would influence the insurer in deciding whether to grant X's application. (BAR 2011)

**12. An insured, who gains knowledge of a material fact already after the effectivity of the insurance policy, is not obliged to divulge it. The reason for this is that the test of concealment of material fact is determined.**

- a. At the time of the issuance of the policy.
- b. At any time before the payment of premium.
- c. At the time of the payment of the premium.
- d. At any time before the policy becomes effective.

**Answer:**

- d. any time before the policy becomes effective. (BAR 2011)

**13. Benny applied for life insurance for P1.5 M. the insurance company approved his application and issued an insurance policy effective Nov. 6, 2008. Benny named his children as his beneficiaries. On April 6, 2010, Benny died of hepatoma, a liver ailment.**

**The insurance company denied the children's claim for the proceeds of the insurance policy on the ground that Benny failed to disclose in his application 2 previous consultations with his doctors for diabetes and hypertension, and that he had been diagnosed to be suffering from hepatoma. The insurance company also rescinded the policy and refunded the premiums paid.**

**Was the insurance company correct?**

**Answer:**

The insurance company correctly rescinded the policy because of concealment. Benny did not disclose that he was suffering from diabetes, hypertension, and hepatoma. The concealment is material because these are serious ailments. Benny died less than 2 years from the date of the issuance of the policy. (BAR 2013)

**14. On May 13, 1996, PAM, Inc. obtained a P15 M fire insurance policy from Ilocano Insurance covering its machineries and equipment effective for 1 year or until May 14, 1997. The policy expressly stated that the insured properties were located at "Sanyo Precision Phils. Building, Phase III, Lots 4 and 6, Block 15, PEZA, Rosario Cavite." Before its expiration, the policy was renewed on "as is" basis for another year until May, 13, 1998. The subject properties were later transferred to Pace Factory also in PEZA. On October 12, 1997, during the effectivity of the renewed policy, a fire broke out at the Pace Factory which totally burned the insured properties.**

**The policy forbade the removal of the insured properties unless sanctioned by Ilocano. Condition 9(c) of the policy provides that “the insurance ceases to attach as regards the property affected unless the insured, before the occurrence of any loss or damage, obtains the sanction of the company signified by endorsement upon the policy x x x (c) if the property insured is removed to any building or place other than in that which is herein stated to be insured.” PAM claims that it has substantially complied with notifying Ilocano for the insurance coverage. Is Ilocano liable under the policy?**

**Answer:**

Ilocano is not liable under the policy. With the transfer of the location of the subject properties, without notice and without insurer’s consent, after the renewal of the policy, the insured clearly committed concealment, misrepresentation and a breach of material warranty. The Insurance Code provides that a neglect to communicate that which a party knows and ought to communicate, is called concealment. A concealment entitles the injured party to rescind a contract of insurance in case of an alteration in the use or condition of the thing insured. An alteration in the use or condition of a thing insured from that to which it is limited by the policy made without the consent of the insurer, by means within the control of the insured, and increasing the risks, entitles the insurer to rescind the contract of fire insurance. (BAR 2014)

## **2. Misrepresentation/Omissions**

- 1. A, an agent of life insurance company X, induced B who has been suffering from advance tuberculosis to apply for P10,000.00 life insurance which B did and he (B) requested A to fill the application form. Thru the connivance of the physician, it was made to appear in the application that B is in good health and the P10,000.00 life insurance policy was issued by X to B. If B dies of tuberculosis, may his beneficiaries recover?**

**Answer:**

It depends. The insurer is bound when its agent writes a false answer into the application without the knowledge of the insured, in which case his (insured) beneficiaries may recover, but a collusion between the agent and the insured in misrepresenting the facts will vitiate the policy; thus, in the instant case, if A obtained from B a correct and truthful answer to interrogatories contained in the application but without the knowledge of B filed in false answer and thru the connivance with the company physician, it was made to appear that B is in good health, the insurer cannot assert the falsity of such answers as a defense to liability on the policy. (BAR 1976)

- 2. On October 18, 1980, P, took out a life insurance policy and named his only son Q as beneficiary. The policy was silent with regard to any change of beneficiary. P later learned that Q was hooked on drugs and immediately notified the insurance company in writing that he is substituting his sister, R, as his beneficiary in place of Q. P later died of advanced tuberculosis. In the application form filled up by the agent of the insurance company prior to the issuance of the life insurance policy by the insurance company, the agent, without the knowledge of P, filled in a false answer and made it appear that P was in good health. Upon P’s death, Q claimed the proceeds of the insurance policy contending that as designated beneficiary, he cannot be changed without his consent, he having acquired a vested right to the proceeds of the policy.**

**Can the insurance company refuse liability on the policy? Reasons.**

**Answer:**

No, the insurer cannot escape liability. The insurance agent is an agent not of the insured but of the insurer and the latter must thus suffer for the misconduct of the agent. The result would have been different had the false answer been made by the agent in connivance with the insured. (BAR 1988)

### 3. Breach of Warranties

1. **Pabaya paid for a fire insurance policy on his multi storey building. At the time he applied for the insurance, he told the representative of the insurance company that he planned to assign a security guard on every floor of the building right away. Except for the ground floor, no security guards were assigned. 11 months after the policy was issued, the building was gutted by fire which started on the third floor. Unknown to Pabaya, the insurance company had incorporated his planned undertaking in the policy.**

**Can Pabaya recover on the fire insurance policy?**

**Answer:**

Pabaya can recover under the insurance policy. The statement of Pabaya that he planned to assign a security guard on every floor of the insured building, whether incorporated in the policy or not, did not amount to firm commitment so as to constitute an express warranty or representation. The facts indicate that it was simply planned, not obligatory or promissory, undertaking. (BAR 1986)

2. **Julie and Alma formed a business partnership. Under the business name Pino Shop, the partnership engaged in a sale of construction materials. Julie insured the stocks in trade of Pino Shop with WGC Insurance Company for P350,000. Subsequently, she again got an insurance contract with RSI for P1 M and then from EIC for P200,000. A fire of unknown origin gutted the store of the partnership. Julie filed her claims with the 3 insurance companies. However, her claims were denied separately for breach of policy condition which required the insured to give notice of any insurance effected covering the stocks in trade. Julie went to court and contended that she should not be blamed for the omission, alleging that the insurance agents for WGC, RSI and EIC knew of the existence of the additional insurance coverage and that she was not informed about the requirement that such other or additional insurance should be stated in the policy.**

**May she recover on her fire insurance policies? Explain.**

**Answer:**

No, because she is guilty of violation of a warranty/ condition. (BAR 1992)

3. **To secure a loan of P10 M, Mario mortgaged his building to Armando. In accordance with the loan arrangements, Mario had the building insured with First Insurance Company for P10 M, designating Armando as the beneficiary.**

**Armando also took an insurance on the building upon his own interest with Second Insurance Company for P5 M.**

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

**How much, if any, can Armando recover from either or both insurance companies?**

**Answer:**

Armando can receive P5 M from Second Insurance Company. As mortgagee, he had an insurable interest in the building. Armando cannot collect anything from First Insurance Company. First Insurance Company is not liable for the loss of the building. First, it was due to a willful act of Mario, who committed arson. Second, fire insurance policies contain a warranty that the insured will not store hazardous materials within the insured's premises. Mario breached this warranty when he stored inflammable materials in the building. These two

factors exonerate First Insurance Company from liability to Armando as mortgagee even though it was Mario who committed them. (BAR 2010)

## I. Claims Settlement and Subrogation

### 1. Notice and Proof of Loss

### 2. Guidelines on Claims Settlement

#### a. Unfair Claims Settlement; Sanctions

#### b. Prescription of Action

1. **Robin insured his building against fire with EFG Assurance. The insurance policy contained the usual stipulation that any action or suit must be filed within 1 year after the rejection of the claim.**

**After his building burned down, Robin filed his claim for fire loss with EFG. On February 28, 1994, EFG denied Robin's claim. On April 3, 1994, Robin sought reconsideration of the denial, but EFG reiterated its position. On March 20, 1995, Robin commenced judicial action against EFG.**

**Should Robin's action be given due course? Explain.**

**Answer:**

No, Robin's action should not be given due course. His filing of the request for reconsideration did not suspend the running of the prescriptive period of 1 year stipulated in the insurance policy. Thus, when Robin commenced judicial action against EFG on March 20, 1995, his ability to do so had already prescribed. The 1 year period is counted from February 28, 1994 when EFG denied Robin's claim, not from the date (presumably after April 3, 1994) when EFG reiterated its position denying Robin's claim. The reason for this rule is to insure that claims against insurance companies are promptly settled and that insurance suits are brought by the insured while the evidence as to the origin and cause of the destruction has not yet disappeared. (BAR 1996)

### c. Subrogation

1. **A helicopter of ABC Co. collided with XYZ's tramway steel cables in its logging area in Surigao resulting in the destruction of the helicopter and death of two pilots. ABC Co. insured at its expense the helicopter and death of two pilots. ABC Co. insured at its expense the helicopter for P80,000.00 and the two pilots (life insurance) for P50,000.00 each, and as a result of the crash, the insurer paid ABC Co. a total indemnity of P180,000.00. Nevertheless, ABC Co sustained additional damages of about P100,000.00 which were not covered by insurance.**

- 1) **ABC Co. sued XYZ to recover not only the additional damages, but also the P180,000 which was already compensated by the insurer. Decide. Give reasons.**
- 2) **What right/recourse, if any, has the insurer in order to be reimbursed for the amount it paid to ABC Co? Give reasons.**

**Answer:**

- 1) ABC Co may bring the action against XYZ for its claim for the additional damages not covered by insurance, but not for the P180,000 covered by the insurance. If a property is insured and the owner received indemnity from the insurer, the latter is deemed subrogated to the rights of the insured against the wrongdoer, and if the amount paid by the insurer does not fully cover the loss, then the aggrieved party is the one entitled to recover the deficiency.
- 2) The insurer is deemed subrogated to the rights of ABC Co against XYZ to the extent of P80,000 insurance paid for the helicopter only, but not for the life insurance of the two dead pilots, since subrogation in the

New Civil Code refers only to property, and not to the life insurance. (*Philippine Air Lines, Inc. v. Herald Lumber Co.*, G.R. L-11497, August 16, 1957; for both 1 and 2 answers.) (BAR 1978)

2. **“L” borrows P50,000 from “M” payable 360 days after date, at 12% interest per annum. To secure the loan, “L” mortgages his house and lot in favor of “M”. To protect himself from certain contingencies, “M” insures the house for the full amount of the loan with Rock Insurance Company. A fire breaks out and burns the house and “M” collects from the insurance company the full value of the insurance.**

Upon maturity of the loan, the insurance company demands payment from “L”. The latter refuses to pay on the ground that the loan had been extinguished by the insurance payment which “M” received from the insurance company. He argues that he has not entered into any loan or contract of whatever nature with the insurance company. He further contends that it is bad enough to lose a house but it is worse if one has to pay off a paid obligation to somebody who has not extended any loan to him. Besides, he states, that the insurance payment should inure to his benefit because he owns the house.

**Pass upon the merits of “L’s” contentions.**

**Answer:**

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

L’s argument that he has not entered into any loan or contract of whatever nature with the insurance company is also untenable. When the secured creditor’s interest in the mortgaged property of the mortgagor, L, was insured and said property would be burned, the insurance company had to pay the insured, M, and payment by the insurer to the insured creates legal subrogation and makes the insurer an assignee on equity to run after the mortgagor, L. Said right of the insurer is not dependent upon nor does it grow out of, any privity of contract, or upon written assignment of claim, and payment to insured makes the insurer an assignee in equity; thus, L’s consent to said subrogation is not necessary. (Art. 2207, N.C.C.; *Fireman’s Fund Insurance Co. v. Jamila & Co.*, April 7, 1976; 70 SCRA 323) (BAR 1980)

3. **Raul’s truck bumped the car owned by Luz. The car was insured by Cala Insurance. For the damage caused, Cala paid Luz P5,000 in amicable settlement. Luz executed a release claim, subrogating Cala to all her rights against Raul. When Cala demanded reimbursement from Raul, the latter refused saying that he had already paid Luz P4,500 for the damage to the car as evidenced by a release of claim executed by Luz discharging Raul.**

**So Cala demanded reimbursement from Luz, who refused to pay, saying that the total damage to the car was P9,500. Since Cala paid P5,000 only, Luz contends that she was entitled to go after Raul to claim the additional P4,500.**

- 1. Is Cala, as subrogee of Luz, entitled to reimbursement from Raul?**
- 2. May Cala recover what it has paid Luz?**

**Answer:**

- No. Luz executed a release in favor of Raul.
- Yes. Cala lost its right against Raul because of the release executed by Luz. Since the release was made without the consent of Cala, Cala may recover the amount of P5,000. (BAR 1994)

4. Where the insurer was made to pay the insured for a loss covered by the insurance contract, such insurer can run after the third person who caused the loss through subrogation. What is the basis for conferring the right of subrogation to the insurer?
  - a. Their express stipulation in the contract of insurance.
  - b. The equitable assignment that results from the insurer's payment of the insured.
  - c. The insured's formal assignment of his right to indemnification to the insurer.
  - d. The insured's endorsement of its claim to the insurer.

**Answer:**

b. The equitable assignment that results from the insurer's payment of the insured. (BAR 2011)

5. ELP Insurance, Inc. issued a Marine Policy No. 888 in favor of FCL Corp. to insure the shipment of 132 bundles of electric copper cathodes against all risks. Subsequently, the cargoes were shipped on board the vessel "M/V Menchu" from Leyte to Pier 10, North Harbor, Manila.

Upon arrival, FCL Corp. engaged the services of CGM, Inc. for the release and withdrawal of the cargoes from the pier and the subsequent delivery to its warehouses/plants in Valenzuela City. The goods were loaded on board 12 trucks owned by CGM, Inc., driven by its employed drivers and accompanied by its employed truck helpers. Of the 12 trucks en route to Valenzuela City, only 11 reached the destination. One truck, loaded with 11 bundles of copper cathodes, failed to deliver its cargo.

Because of this incident, FCL Corp. filed with ELP Insurance, Inc. a claim for insurance indemnity in the amount of P1.5 M. After the requisite investigation and adjustment, ELP Insurance, Inc. paid FCL Corp. the amount of P1,350,000.00 as insurance indemnity.

ELP Insurance, Inc., thereafter, filed a complaint for damages against CGM, Inc. before the RTC, seeking reimbursement of the amount it had paid to FCL Corp. for the loss of the subject cargo. CGM, Inc. denied the claim on the basis that it is not privy to the contract entered into by and between FCL Corp. and ELP Insurance, Inc., and hence, it is not liable therefor. If you are the judge, how will you decide the case?

**Answer:**

CGM, Inc. should be held liable for damages against ELP Insurance, Inc. The insurer, upon happening of the risk insured against and after payment to the insured is subrogated to the rights and cause of action of the latter. As such, the insurer has the right to seek reimbursement for all the expenses paid. (BAR 2014)

## V. Transportation Laws

### A. Common Carrier vs. Private Carrier

1. Mabuhay Lines, Inc. a common carrier, entered into a contract with Company X, whereby it agreed to furnish Company X, for a fixed amount, a bus for a company excursion on its anniversary day. It was agreed that Company X would have the use of the bus and its driver from 7:00 am to 7:00 pm on the stipulated date, and that the bus driver would be obliged to follow the instructions of the company's general manager as to the places to be visited. Company X agreed to bear the cost of the gasoline consumed.

The transportation contract signed by Company X contained a stipulation that Mabuhay Lines, Inc. would be exempt from liability on account of acts or omissions of its employees.

On the return trip from the excursion site, the bus had an accident and several employees of Company X were injured.

**State the liability, if any, of Mabuhay Lines, Inc.**

**Answer:**

Although a common carrier, Mabuhay Lines, Inc. was not acting as such in the instant case but as a private carrier. Accordingly, the provision applicable to a common carrier in respect of extraordinary diligence cannot be imposed upon the bus company.

The stipulation limiting the liability of Mabuhay Lines, Inc. is valid and the bus company cannot be held liable for the injuries suffered by the employees of Company X on the basis of the contract of carriage. However, the employees who were injured may proceed against the bus company on the basis of a *quasi-delict* (culpa aquiliana) but the party charging negligence or wrong doing has the burden of proving the same.

It has been held that a common carrier is exempt from the application of the strict public policy governing common carriers where the carrier is not acting as such but as a private carrier. Such strict public policy has no force where the public at large is not involved, as when the carrier charters its bus totally for the use of a single party. (*Home Ins. Co. v. American Steamship Agencies, Inc. vs. Luzon Stevedoring Corp. L-25599, April 24, 1968*)

Article 1745 of the Civil Code declaring a stipulation that the common carrier shall not be responsible for the acts or omissions of his or its employees as unreasonable unjust and contrary to public policy is not applicable here since Company X and the bus company have entered into a contract for private carriage. Likewise, the presumption created under Article 1756 of the Civil Code, that in case of death 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, finds no application here. (BAR 1984)

- 2. During the elections last May, AB, a congressional candidate in Marinduque, chartered the helicopter owned by Lode Mining Corporation (LMC) for use in the election campaign. AB paid LMC the same rate normally charged by companies regularly engaged in the plane chartering business. In the charter agreement between LMC and AB, LMC expressly disclaimed any responsibility for the acts or omissions of its pilot or for the defective condition of the plane's engine. The helicopter crashed killing AB. Investigations disclosed that pilot error was the cause of the accident. LMC now consults you on its possible liability for AB's death in the light of the above findings.**

**How would you reply to LMC's query?**

**Answer:**

I would reply to LMC's query as follows:

LMC may not be held liable for the death of AB. A stipulation with a private carrier that would disclaim responsibility for simple negligence of the carrier's employees is a valid stipulation. Such a stipulation, however, will not hold in cases of liability for gross negligence or bad faith. (BAR 1987)

- 3. Alejandro Camaling of Alegria, Cebu, is engaged in buying copra, charcoal, firewood and used bottles and in reselling them in Cebu City. He uses 2 big Isuzu trucks for the purpose; however, he has no certificate of public convenience or franchise to do business as a common carrier. On the return trips to Alegria, he loads his trucks with various merchandise of other merchants in Alegria and the neighboring municipalities of Badian and Ginatilan. He charges them freight rates much lower than the regular rates. In one of the return trips, which left Cebu City at 8:30pm, 1 cargo truck was loaded with several boxes of sardines, valued at P100,000, belonging to one of his customers, Pedro Rabor. While passing the zigzag road between Carcar and Barili, Cebu, which is midway between Cebu City and Alegria, the trucks was hijacked by 3 armed men who took all the boxes of sardines and kidnapped the driver and his helper, releasing them in Cebu City only 2 days later.**

**Pedro Rabor sought to recover from Alejandro the value of the sardines. The latter contends that he is not liable therefor because he is not a common carrier under the Civil Code and, even granting for the sake of argument that he is, he is not liable for the occurrence of the loss as it was due to a cause beyond his control.**

**If you were the Judge, would you sustain the contention of Alejandro?**

**Answer:**

If I were the Judge, I would hold Alejandro as having engaged as a common carrier. A person who offers his services to carry passengers or goods for a fee is a common carrier regardless of whether he has a certificate of public convenience or not, whether it is his main business or incidental to such business, whether it is scheduled or unscheduled service, and whether he offers his services to the general public or to a limited few.

I will however, sustain the contention of Alejandro that he is not liable for the loss of the goods. A common carrier is not an insurer of the cargo. If it can be established that the loss, despite the exercise of extraordinary diligence, could not have been avoided, liability does not ensue against the carrier. The hijacking by 3 armed men of the truck used by Alejandro is one of such cases. (BAR 1991)

- 4. AM Trucking, a small company, operates 2 trucks for hire on selective basis. It caters to only a few customers, and its trucks do not make regular or scheduled trips. It does not even have a certificate of public convenience.**

**On one occasion, Reynaldo contracted AM to transport, for a fee, 100 sacks of rice from Manila to Tarlac. However, AM failed to deliver the cargo, because its truck was hijacked when the driver stopped in Bulacan to visit his girlfriend.**

**May Reynaldo hold AM liable as a common carrier? Explain.**

**Answer:**

Reynaldo may hold AM liable as a common carrier. The facts that AM operates only 2 trucks for hire on a selective basis, caters only to a few customers, does not make regular or scheduled trips, and does not have a certificate of public convenience are of no moment as the law (i) does not distinguish 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, (ii) 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, and (iii) refrains from the general public and one who offers services or solicits business only from a narrow segment of the general population. (BAR 1996)

- 5. Define a common carrier?**

**Answer:**

A common carrier is a person, corporation, firm or association engaged in the business of carrying or transporting passengers or goods or both, by land, water or air for compensation, offering its services to the public. (BAR 1996)

- 6. What is the test for determining whether or not one is a common carrier?**

**Answer:**

The test for determining whether or not one is a common carrier is whether the person or entity, for some business purpose and with general or limited clientele, offers the service of carrying or transporting passengers or goods or both for compensation. (BAR 1996)

7. **X has a Tamaraw FX among other cars. Every other day during the workweek, he goes to his office in Quezon City using his Tamaraw FX and picks up friends as passengers at designated points along the way. His passengers pay him a flat fee for the ride, usually P20 per person, one way. Although a lawyer, he never bothered to obtain a license to engage in this type of income-generating activity. He believes that he is not a common carrier within the purview of the law. Do you agree with him? Explain.**

**Answer:**

No. I do not agree with X. A common carrier holds himself out to the public as engaged in the business of transporting persons or property from place to place, for compensation, offering his services to the public generally. The fact that X has a limited clientele does not exclude him from the definition of a common carrier. The law does not make any distinction between one whose principal business activity is the carrying of persons or goods or both, and the one who does such carrying only as an ancillary activity or in the local idiom, as a "sideline" (BAR 2000)

8. **Name 2 characteristics which differentiate a common carrier from a private carrier.**

**Answer:**

Two characteristics that differentiate a common carrier from a private carrier are:

1. A common carrier offers its service to the public; a private carrier does not.
2. A common carrier is required to observe extraordinary diligence; a private carrier is not required. (BAR 2002)

### 1. Extraordinary Diligence and Presumption of Negligence

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

**The bus carried the following sign: "Do not talk to driver while bus is on motion, otherwise the company will not assume liability for any accident."**

**Explain briefly the extent of the liability, if any, of the bus company, giving the legal provisions and principles involved.**

**Answer:**

The bus company is liable for damages to A's heirs and to all the injured passengers. Under the Civil Code, a common carrier is duty bound to exercise extraordinary diligence in carrying its passengers through the negligence or willful acts of its employees even if the latter have acted beyond the scope of their authority or in violation of their orders. This liability cannot be eliminated or limited by stipulation or by posting notices. Although it may be urged that A was guilty of contributory negligence, such an argument loses its force in the face of the driver's recklessness in taking the dare. And even if such argument would be accepted, at most it can only mitigate the amount of damages, since the proximate cause of the accident was the driver's willful and reckless act in running a race with the other bus. (BAR 1983)

2. **The vessel M/V Sweet Perceptions, commanded by Kapitan, its captain, was unloading goods at a private wharf in Naval, Leyte, when the ship bumped the wharf of the pier causing it to collapse into the sea. It turned out that Kapitan failed to drop the vessel's bow anchors and to fasten the vessel property to the pier. The vessel was pushed by the combined action of the currents in the Biliran Island Strait and the usual southwest monsoon winds of the season. As a result, Pantalan, the owner of the wharf, lost not only the wharf but also the goods that had just been unloaded on the pier pending their**

delivery to him. Pantalan sued both the owner of the M/V Sweet Perceptions and kapitan for the loss of the cargoes and the destruction of the wharf of the pier. The vessel's owner, who is in Manila, states that he exercised due diligence in the selection and supervision of Kapitan.

**Can the vessel's owner and kapitan be held liable for the loss of the wharf and the cargoes? Explain.**

**Answer:**

The vessel's owner is not liable for the loss of or damage to the wharf but he can be held liable for the loss of the cargo. The cause of action on the loss of or damage to the wharf is one of *culpa acquillana* where due diligence in the selection and supervision of employees is a valid defense against liability. That defense, however, is not available for the loss of the cargo since the cause of action is one of *culpa contractual* (the goods had not yet been delivered to the consignee). (BAR 1986)

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

**Answer:**

The bus company is liable for the loss of the maleta. The duty of extraordinary diligence in the vigilance over the goods is due on such goods as are deposited or surrendered to the common carrier for transportation. The fact that the maleta was not declared nor the charges paid thereon would not be consequential so long as it was received by the carrier for transportation. (BAR 1989)

4. **X, an 80-year old epileptic, boarded the S/S Tamaraw in Manila going to Mindoro. To disembark, the passengers have to walk thru a gang plant. While negotiating the gang plank, X slipped and fell into the waters. X was saved from drowning, brought to a hospital but after a month died from pneumonia. Except for X, all the passengers were able to walk thru the gang plank. What is the liability of the owner of S/S Tamaraw?**

**Answer:**

The owner of S/S Tamaraw is liable for the death of X in failing to exercise utmost diligence in the safety of passengers. Evidently, the carrier did not take the necessary precautions in ensuring the safety of passengers in the boarding of and disembarking from the vessel. Unless shown to the contrary, a common carrier is presumed to have been negligent in cases of death or injury to its passengers. Since X has not completely disembarked yet, the obligation of the ship-owner to exercise utmost diligence still then subsisted and he can still be held (BAR 1989)

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

**Answer:**

No. in the carriage of passengers, the failure of the common carrier to bring the passengers safely to their destination immediately raises the presumption that such failure is attributable to the carrier's fault or negligence. In the case at bar, the fact of death and injury of the bus passengers raises the presumption of fault or negligence on the part of the carrier. The carrier must rebut such presumption. Otherwise, the conclusion can be properly made that the carrier failed to exercise extraordinary diligence as required by law. (BAR 1997)

6. **Why is the defense of due diligence in the selection and supervision of an employee not available to a common carrier?**

**Answer:**

The defense of due diligence in the selection and supervision of an employee is not available to a common carrier because the degree of diligence required of a common carrier is not the diligence of a good father of a family but extraordinary diligence, i.e., diligence of the greatest skill and utmost foresight (BAR 2002)

**2. Liabilities of Common Carriers**

- 1. While docking his vessel, "Taurus", the master, thru negligence, damaged the wharf and the merchandise loaded on the deck. The owner of the wharf and the damaged merchandise sued the owner of the vessel and the master of the vessel for the damage.**

**Questions:**

- (1) What is the basis of the liability of the owner of the vessel with respect to the damage to the wharf?  
(2) With respect to the damage to the merchandise?  
(3) Does the defense of exercise of diligence of a good father of a family lie? Reason.**

**Answer:**

- (1) The basis of the liability of the shipowner with respect to the damaged wharf is tort. There was damage due to negligence without any preexisting contractual relations between the parties.  
(2) The basis of the liability with respect to the merchandise on deck is the contract of carriage. There was a breach of contract because the goods were not carried safely to their destination due to the negligence of the master.  
(3) The defense of exercise of the diligence of a good father of a family will lie in case of tort but not in case of contract. In the latter, such defense is not available because the contract was to carry the goods safely and unless loss is due to caso fortuito or force majeure, there is a breach of contract. The due diligence of the shipowner is against his employee, the master. (BAR 1976)

- 2. X, a businessman boarded a PANTRANCO bus bound for Dagupan City where he would meet Y, to arrange a business transaction. Somewhere in San Fernando, Pampanga, Z, the Deputy Sheriff of Pampanga, intercepted and seized the PANTRANCO but at the instance of W who had earlier obtained from the court a writ of attachment. As a result of the seizure by the Sheriff, X failed to reach Dagupan City where he was supposed to transact business. Feeling aggrieved by the loss of an otherwise juicy transaction, sued PANTRANCO for breach of contract. Decide with reasons.**

**Answer:**

It is undeniable that there is a pre-existing contractual relation of carriage between X and the PANTRANCO Bus and that X failed to reach his destination in breach of the PANTRANCO Bus' obligation to transport him to the same. However, it is notable that there was no fraud, bad faith, malice or wanton attitude on the part of the carrier.

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 at the time the obligation was constituted.

In the case at bar, it can reasonably be assumed that the claim for damages refers to the profits which X failed to obtain. In determining the extent of the liability of PANTRANCO Bus the first paragraph of Art. 2201 of the Civil Code is applicable. Under this provision, the company is liable for all the natural and probable consequences of the breach of the obligation which the parties have foreseen or could have reasonably foreseen at the time the obligation was constituted. In this regard the loss of profits from the would-be business transaction is not only a natural and probable consequences of the breach; it could have been reasonably foreseen by the parties at the time X boarded the bus. At that time he was bound for Dagupan City

to arrange a business transaction and we can very well assume that the said transaction would be consummated and that he could have possibly gained from the said transaction. Therefore, the claim for damages will prosper. (BAR 1977)

- 3. The vessel M/V Sweet Perceptions, commanded by Kapitan, its captain, was unloading goods at a private wharf in Naval, Leyte, when the ship bumped the wharf of the pier causing it to collapse into the sea. It turned out that Kapitan failed to drop the vessel's bow anchors and to fasten the vessel property to the pier. The vessel was pushed by the combined action of the currents in the Biliran Island Strait and the usual southwest monsoon winds of the season. As a result, Pantalan, the owner of the wharf, lost not only the wharf but also the goods that had just been unloaded on the pier pending their delivery to him. Pantalan sued both the owner of the M/V Sweet Perceptions and kapitan for the loss of the cargoes and the destruction of the wharf of the pier. The vessel's owner, who is in Manila, states that he exercised due diligence in the selection and supervision of Kapitan.**

**Can the vessel's owner and kapitan be held liable for the loss of the wharf and the cargoes? Explain.**

**Answer:**

The vessel's owner is not liable for the loss of or damage to the wharf but he can be held liable for the loss of the cargo. The cause of action on the loss of or damage to the wharf is one of *culpa acquillana* where due diligence in the selection and supervision of employees is a valid defense against liability. That defense, however, is not available for the loss of the cargo since the cause of action is one of *culpa contractual* (the goods had not yet been delivered to the consignee). (BAR 1986)

- 4. Peter So hailed a taxicab owned and operated by Jimmy Cheng and driven by Hermie Cortez. Peter asked Cortez to take him to his office in Malate. On the way to Malate, the taxicab collided with a passenger jeepney, as a result of which Peter was injured, i.e., he fractured his left leg. Peter sued Jimmy for damages, based upon a contract of carriage, and Peter won. Jimmy wanted to challenge the decision before the Supreme Court on the ground that the trial court erred in not making an express finding as to whether or not Jimmy was responsible for the collision and, hence, civilly liable to Peter. He went to see you for advice. What will you tell him? Explain your answer.**

**Answer:**

I will counsel Jimmy to desist from challenging the decision. The action of Peter being based on *culpa contractual*, the carrier's negligence is presumed upon the breach of contract. The burden of proof instead would lie on Jimmy to establish that despite an exercise of utmost diligence the collision could not have been avoided. (BAR 1990)

- 5. Marino was a passenger on a train. Another passenger, Juancho, had taken a gallon of gasoline placed in a plastic bag into the same coach where Marino was riding. The gasoline ignited and exploded causing injury to Marino who filed a civil suit for damages against the railway company claiming that Juancho should have been subjected to inspection by its conductor.**

**The railway company disclaimed liability resulting from the explosion contending that it was unaware of the contents of the plastic bag and invoking the right of Juancho to privacy.**

**a) Should the railway company be held liable for damages?**

**Answer:**

No. The railway company is not liable for damages. In overland transportation, the common carrier is not bound nor empowered to make an examination on the contents of packages or bags, particularly those hand carried by passengers.

**b) If it were an airline company involved, would your answer be the same? Explain your answer briefly.**

**Answer:**

No. If it were an airline company, the common carrier should be made liable. In the case of air carriers, it is not lawful to carry flammable materials in passenger aircrafts, and airline companies may open and investigate suspicious packages and cargoes. (BAR 1992)

**6. X was riding a suburban utility vehicle (SUV) covered by a comprehensive motor vehicle liability insurance (CMVLI) underwritten by FastPay Insurance Company when it collided with a speeding bus owned by RM Travel, Inc. the collision resulted in serious injuries to X; Y, a passenger of the bus; and Z, a pedestrian waiting for a ride at the scene of the collision. The police report established that the bus was the offending vehicle. The bus had a CMVLI policy issued by Dragon Insurance Corporation, X, Y and Z jointly sued RM Travel and Dragon Insurance for indemnity under the Insurance Code of the Philippines. The lower court applied the “no-fault” indemnity policy of the statute, dismissed the suit against RM Travel, and ordered Dragon insurance to pay indemnity to all three plaintiffs. Do you agree with the court’s judgment? Explain.**

**Answer:**

No. The cause of action of Y is based on the contract of carriage, while that of X and Z is based on torts. The court should not have dismissed the suit against RM Travel. The court should have ordered Dragon Insurance to pay each of X, Y, and Z to the extent of the insurance coverage, but whatever amount is agreed upon in the policy should be answered first by RM Travel and the succeeding amount should be paid by Dragon Insurance up to the amount of the insurance coverage. The excess of the claims of X, Y and Z, over and above such insurance coverage, if any, should be answered or paid by RM Travel. (BAR 2000)

**7. Nelson owned and controlled Sonnel Construction Company. Acting for the company, Nelson contracted the construction of a building. Without first installing a protective net atop the sidewalks adjoining the construction site, the company proceeded with the construction work. One day a heavy piece of lumber fell from the building. It smashed a taxicab which at that time had gone offroad and onto the sidewalk in order to avoid the traffic. The taxicab passenger died as a result.**

**a) Assume that the company had no more account and property in its name. As counsel for the heirs of the victim, who will you sue for damages, and what theory will you adopt?**

**b) Could the heirs hold the taxicab owner and driver liable? Explain.**

**Answer:**

a) As counsel for the heirs of the victim, I will sue Sonnel Construction Company and Nelson for gross negligence which constitutes a quasi-delict. As an officer and controlling stockholder of Sonnel Construction Company, Nelson is solidarily liable with the corporation for quasi-delict.

b) Yes, the heirs can hold the taxicab owner and the driver solidarily liable for breach of contract of carriage and for quasi-delict. The common carrier has the duty to safely transport its passenger, which it failed to do in this case. It cannot escape liability by passing the blame to Nelson and Sonnel Construction Company as the taxicab driver himself is concurrently negligent. (BAR 2008)

**8. One of the passenger buses owned by Continental Transit Corporation (CTC), plying its usual route, figured in a collision with another bus owned by Unniversla Transport Inc. (UTI). Among those injured inside the CTC bus were: Romeo, a stow away; Samuel, a pickpocket then in the act of robbing his seatmate when the collision occurred; Teresita, the bus driver’s mistress who usually accompanied the driver on his trips for free; and Uriel, a holder of a free riding pass he won in a raffle held by CTC.**

**Do Romeo, Samuel, Teresita, and Uriel have a cause of action for damages against UTI? Explain.**

**Answer:**

Romeo, Samuel, Teresita, and Uriel may sue UTI on the basis of quasi-delict since they have no pre-existing contractual relationship with UTI. They may allege that the collision was due to the negligence of driver of UTI and UTI was negligent in the selection and supervision of its driver. (BAR 2009)

9. **X, while driving his Toyota Altis, tried to cross the railway tract of PNR along Blumentritt Avenida Ext., Manila. The train as it approached Blumentritt, applied its horn as a warning to all the vehicles that might be crossing the railway tract, but there was really nobody manning the crossing. X was listening to his iPod touch, hence, he did not hear the sound of the horn of the train and so his car was hit by the train. As a result of the accident, X suffered some injuries and his car was totally destroyed as a result of the impact. Is PNR liable?**
- a) PNR is not liable because X should have known that he was crossing a place designated as crossing for train, and therefore should have been more careful;
  - b) PNR is a liable because Railroad companies owe to the public a duty of exercising a reasonable degree of care to avoid injury to person and property at railroad crossings which means a flagman or a watchman should have been posted to warn the public at all times;
  - c) PNR is not liable because it blew its horn when it was about to cross the railway along Blumentritt Avenida Ext.;
  - d) PNR is not liable because X was negligent, for listening to his iPod touch while driving.

**Answer:**

- a) PNR is not liable because X should have known that he was crossing a place designated as crossing for train, and therefore should have been more careful. (BAR 2012)

### **B. Defenses of Common Carriers**

1. **Suppose “A” was riding on an airplane of a common carrier when the accident happened and “A” suffered serious injuries. In an action by “A” against the common carrier, the latter claimed that (1) there was a stipulation in the ticket issued to “A” absolutely exempting the carrier from liability from the passenger’s death or injuries and notices were posted by the common carrier dispensing with the extraordinary diligence of the carrier, and (2) “A” was given a discount on his plane fare thereby reducing the liability of the common carrier with respect to “A” in particular.**
- a) **Are those valid defenses?**
  - b) **What are the defenses available to any common carrier to limit it from liability?**

**Answer:**

- a) No. These are not valid defenses because they are contrary to law as they are in violation of the extraordinary diligence required of common carriers.
- b) The defenses available to any common carrier to limit or exempt it from liability are: observance of extraordinary diligence, or the proximate cause of the incident is a fortuitous event or force majeure, act or omission of the shipper or owner of the goods, the character of the goods or defects in the packing or in the containers, and order or act of competent public authority, without the common carrier being guilty of even simple negligence. (BAR 2001)

2. **One of the passenger buses owned by Continental Transit Corporation (CTC), plying its usual route, figured in a collision with another bus owned by Unniversla Transport Inc. (UTI). Among those injured inside the CTC bus were: Romeo, a stow away; Samuel, a pickpocket then in the act of robbing his seatmate when the collision occurred; Teresita, the bus driver's mistress who usually accompanied the driver on his trips for free; and Uriel, a holder of a free riding pass he won in a raffle held by CTC.**

**What, if any, are the valid defenses that CTC and UTI can raise in the respective actions against them? Explain.**

**Answer:**

With respect to Romeo, Samuel and Teresita, since there was no pre-existing contractual relationship between them and CTC, CTC can raise the defense that it exercised the due diligence of a good father of a family in the selection of its driver.

It can raise the same defense against Uriel if there is a stipulation that exempts it from liability for simple negligence, but not for willful acts or gross negligence.

CTC can also raise against all the plaintiffs the defense that the collision was due exclusively to the negligence of the driver of UTI, and this constitutes a fortuitous event, because there was no concurrent negligence on the part of its own driver.

CTC can also raise against Samuel the defense that he was engaged in a seriously illegal act at the time of the collision, which can render him liable for damages on the basis of quasi-delict.

Since UTI had no pre-existing contractual relationship with any of the plaintiffs, it can raise the defense that it exercised due diligence in the selection and supervision of its driver, that the collision was due exclusively to the negligence of the driver of CTC, and that Samuel was committing a seriously illegal act at the time of the collision. (BAR 2009)

3. **B, while drunk, accepted a passenger in his taxicab. B then drove the taxi recklessly, and inevitably, it crashed into an electric post, resulting in serious physical injuries to the passengers. The latter then filed a suit for tort against B's operator, A, but A raised the defense of having exercised extraordinary diligence in the safety of the passenger. Is his defense tenable?**
- a. **Yes, as a common carrier can rebut the presumption of negligence by raising such a defense.**
  - b. **No, as in tort actions, the proper defense is due diligence in the selection and supervision of the employee by the employer.**
  - c. **No, as B, the common carrier's employee, was obviously negligent due to his intoxication.**
  - d. **Yes, as a common carrier can invoke extraordinary diligence in the safety of passengers in tort cases.**

**Answer:**

- a. **No, as in tort actions, the proper defense is due diligence in the selection and supervision of the employee by the employer. (BAR 2011)**

**C. Vigilance over Goods**

**1. Exempting Causes**

- a. **Requirement of Absence of Negligence**

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

**Answer:**

The maritime carrier is liable. Where the fact of improper packing is known to the carrier or its servants, or apparent upon ordinary observations, but the carrier accepts the goods notwithstanding such conditions, it is not relieved of liability for loss or injury resulting therefrom. (*Southern Lines, Inc. v. Court of Appeals*, 4 SCRA 259) (BAR 1978)

- 2. Archipelago Lines, Inc., a carrier, accepted for shipment from Iloilo to Manila a cargo consisting of 800 sacks of rice, knowing that some sacks had big holes and others had their openings just loosely tied with strings. Due to spillage of the rice during the trip, there was shortage in the rice delivered by the carrier to the consignee. When sued, Archipelago Lines, Inc. interposed the defense that the carrier was not liable because the spillage was due to the defective condition of the sacks.**

**As a judge, how would you rule on the liability of the carrier? Reasons.**

**Answer:**

As a judge, I would rule that the Archipelago Lines, Inc., the carrier, is liable for the shortage in the rice delivered to the consignee. If the fact of improper packing is known to the carrier or its servants, or apparent upon ordinary observant, but the carrier accepts the goods notwithstanding such condition, it is not relieved of liability for loss or injury resulting therefrom. (*Southern Lines, Inc. v. Court of Appeals, January 31, 1962; 4 SCRA 259*) (BAR 1984)

- 3. Philip Mauricio shipped a box of cigarettes to a dealer in Naga City through Bicol Bus Company (BBC). When the bus reached Lucena City, the bus developed engine trouble. The driver brought the bus to a repair shop in Lucena where he was informed by the mechanic that an extensive repair was necessary, which would take at least 2 days. While the bus was in the repair shop, Typhoon Coring lashed Quezon Province. The cargoes inside the bus, including Mauricio's cigarettes, got wet and were totally spoiled. Mauricio sued BBC for damage to his cargoes. Decide.**

**Answer:**

The BBC is liable for damages to the cargoes lost by Mauricio. A natural disaster would relieve liability if it is the proximate and only cause of the damage. The carrier itself, in this case, had been negligent. The presumption of negligence in culpa contractual is not overcome by engine trouble which does not preclude its having been due to the fault of the common carrier. The fact that an extensive repair work was necessary which, in fact, took 2 days to complete somehow justifies an impression that the engine trouble could have been detected, if not already known, well before the actual breakdown. (BAR 1987)

- 4. Alejandro Camaling of Alegria, Cebu, is engaged in buying copra, charcoal, firewood and used bottles and in reselling them in Cebu City. He uses 2 big Isuzu trucks for the purpose; however, he has no certificate of public convenience or franchise to do business as a common carrier. On the return trips to Alegria, he loads his trucks with various merchandise of other merchants in Alegria and the neighboring municipalities of Badian and Ginatilan. He charges them freight rates much lower than the regular rates. In one of the return trips, which left Cebu City at 8:30pm, 1 cargo truck was loaded with several boxes of sardines, valued at P100,000, belonging to one of his customers, Pedro Rabor. While passing the zigzag road between Carcar and Barili, Cebu, which is midway between Cebu City and Alegria, the trucks was hijacked by 3 armed men who took all the boxes of sardines and kidnapped the driver and his helper, releasing them in Cebu City only 2 days later.**

**Pedro Rabor sought to recover from Alejandro the value of the sardines. The latter contends that he is not liable therefor because he is not a common carrier under the Civil Code and, even granting for the sake of argument that he is, he is not liable for the occurrence of the loss as it was due to a cause beyond his control.**

**If you were the Judge, would you sustain the contention of Alejandro?**

**Answer:**

If I were the Judge, I would hold Alejandro as having engaged as a common carrier. A person who offers his services to carry passengers or goods for a fee is a common carrier regardless of whether he has a certificate of public convenience or not, whether it is his main business or incidental to such business, whether it is scheduled or unscheduled service, and whether he offers his services to the general public or to a limited few.

I will however, sustain the contention of Alejandro that he is not liable for the loss of the goods. A common carrier is not an insurer of the cargo. If it can be established that the loss, despite the exercise of extraordinary diligence, could not have been avoided, liability does not ensue against the carrier. The hijacking by 3 armed men of the truck used by Alejandro is one of such cases. (BAR 1991)

- 5. M. Dizon Trucking (DIZON) entered into a hauling contract with Fairgoods Corporation (FAIRGOODS) whereby the former bound itself to haul the latter's 2,000 sacks of soya bean meal from Manila Port Area to Calamba, Laguna. To carry out faithfully its obligation DIZON subcontracted with Enrico Reyes the delivery of 400 sacks of the soya bean meal. Aside from the driver, three male employees of Reyes rode on the truck with the cargo. While the truck was on its way to Laguna two strangers suddenly stopped the trucks and hijacked the cargo. Investigation by the police disclosed that one of the hijackers was armed with a bladed weapon while the other was unarmed. For failure to deliver the 400 sacks, FIARGOODS sued Dizon for damages. DIZON in turn set up a third-party complaint against Reyes which the latter resisted on the ground that the loss was due to force majeure.**

**Did the hijacking constitute force majeure to exculpate Reyes from any liability to DIZON? Discuss fully.**

**Answer:**

No. the hijacking in this case cannot be considered force majeure. Only one of the two hijackers was armed with a bladed weapon. As against 4 male employees of Reyes, 2 hijackers, with only one of them being armed with a bladed weapon, cannot be considered force majeure. The hijackers did not act with grave or irresistible threat, violence or force. (BAR 1995)

- 6. AM Trucking, a small company, operates 2 trucks for hire on selective basis. It caters to only a few customers, and its trucks do not make regular or scheduled trips. It does not even have a certificate of public convenience.**

**On one occasion, Reynaldo contracted AM to transport, for a fee, 100 sacks of rice from Manila to Tarlac. However, AM failed to deliver the cargo, because its truck was hijacked when the driver stopped in Bulacan to visit his girlfriend.**

**May AM set up the hijacking as a defense to defeat Reynaldo's claim?**

**Answer:**

AM may not set up the hijacking as a defense to defeat Reynaldo's claim as the facts given do not indicate that the same was attended by the use of grave or irresistible threat, violence or force. It would appear that the truck was left unattended by its driver and was taken while he was visiting his girlfriend. (BAR 1996)

7. **Star Shipping Lines accepted 100 cartons of sardines from Master to be delivered to 555 Company of Manila. Only 88 cartons were delivered, however, these were in bad condition.**

**555 Company claimed from Star Shipping Lines the value of the missing goods, as well as the damaged goods. Star Shipping Lines refused because the former failed to present a bill of lading.**

**Resolve with reasons the claim of 555 Company.**

**Answer:**

Star Shipping Lines should pay the claim of 555 Company. The mere fact that some cartons were lost and the 88 cartons were damaged is sufficient proof of the fault of Star Shipping Lines. The fact that 555 Company failed to present a bill of lading makes no difference, because it was the actual consignee. Moreover, under Art. 353 of the Code of Commerce, the surrender of the original bill of lading is not a condition precedent for a common carrier to be discharged of its obligation. If surrender of the original bill of lading is not possible, acknowledgment of delivery by signing the delivery receipt suffices. (BAR 2005)

**b. Absence of Delay**

1. **A, in Manila, shipped on board a vessel of B, chairs to be used in the restaurant of consignee C in Cebu. No date for delivery or indemnity for delay was stipulated. The chairs, however, were not claimed promptly by C and were shipped by mistake back to Manila, where it was discovered and re-shipped to Cebu. By the time the chairs arrived, the date of inauguration of the movie house passed by and it had to be postponed. C brings action for damages against B, claiming loss of profits during the Christmas season when he expected the movie house to be opened. Decide the case with reasons.**

**Answer:**

C, may bring action for damages against B for loss of profits. The obligation of the carrier to carry cargo includes the duty not to delay their transportation, so that if the carrier is guilty of delay in the shipment of the cargo, causing damages to consignee, it will be liable. (*Tan Liao v. American President Lines*, L-7280, January 20, 1956) (BAR 1979)

**c. Due Diligence to Prevent or Lessen the Loss**

2. **Contributory Negligence**
3. **Duration of Liability**

- a. **Delivery of Goods to Common Carrier**
- b. **Actual or Constructive Delivery**

1. **The liability of a common carrier for the goods it transports begins from the time of**
  - a. **Conditional receipt.**
  - b. **Constructive receipt.**
  - c. **Actual receipt.**
  - d. **Either actual or constructive receipt.**

**Answer:**

d. Either actual or constructive receipt. (BAR 2011)

**c. Temporary Unloading or Storage**

1. **S delivered 10 boxes of cellphones to Trek Bus Liner, for transport from Manila to Ilocos Sur on the following day, for which S paid the freightage. Meanwhile, the boxes were stored in the bus liner's bodega. That night, however, a robber broke into the bodega and stole S's boxes. S sues Trek Bus Liner for contractual breach but the latter argues that S has no cause of action based on such breach since the loss occurred while the goods awaited transport. Who is correct?**
  - a. **The bus liner since the goods were not lost while being transported.**
  - b. **S since the goods were unconditionally placed with T for transportation**
  - c. **S since the freightage for the goods had been paid.**
  - d. **The bus liner since the loss was due to a fortuitous event.**

**Answer:**

b. S since the goods were unconditionally placed with T for transportation. (BAR 2011)

#### 4. Stipulation for Limitation of Liability

##### a. Void Stipulations

1. **Discuss whether or not the following stipulations in a contract of carriage of a common carrier are valid:**

**A stipulation limiting the sum that may be recovered by the shipper or owner to 90% of the value of the goods in case of loss due to theft.**

**Answer:**

The stipulation is considered unreasonable, unjust and contrary to public policy under Article 1745 of the Civil Code. (BAR 2002)

##### b. Limitation of Liability to Fixed Amount

1. **In the plane ticket stub of Air Manila Inc. (AMI), there appears a statement that the liability "if any loss or damage of checked baggage or for delay in the delivery thereof" of the AMI "is limited to its value and unless the passenger declares in advance a higher valuation and pays an additional charge therefore, the value shall be conclusively deemed not to exceed P100 for each ticket." A passenger whose baggage was lost in transit from Manila to Cebu sued for a higher amount, i.e. P5,000. May AMI successfully claim that the above statement precludes the plaintiff from asking more than P100? Decide. Give reasons for your answer.**

**Answer:**

No. AMI may not successfully claim that the plaintiff was precluded from asking more than P100 for each ticket. The liability of a common carrier may by contract be limited to a fixed amount, but said agreement must be in writing and signed by the shipper or owner of the goods, besides the other requirements of the law, but said requirements have not been shown to have been met by the carrier, AMI. (*Shewaran v. Philippine Airlines*, L-20099, July 7, 1966) (BAR 1978)

2. **A, in Holland, shipped on board a vessel owned by B, 500 cases of canned milk to consignee C in Iloilo. Upon arrival, the vessel discharged the canned milk into the custody and possession of the arrastre operator appointed by the Bureau of Customs. In the Bill of Lading, it was stipulated that the vessel is no longer liable for the cargo upon its delivery to the hands of the customs authorities. The cargo checker of the arrastre found the cargo to be in good order. Upon delivery to the consignee, a marine surveyor found 20 cases of milk missing. C sued B for the value of the 20 missing cases on the ground that under the contract of carriage B was obliged to deliver the cargo safely to the consignee and that the stipulation limiting the liability of the carrier is contrary to morals and public policy. B disclaims liability for short delivery. Decide the dispute, with reasons.**

**Answer:**

Yes, B may disclaim liability for short delivery. The stipulation is valid because nothing therein is contrary to morals or public policy, said stipulation being adopted to mitigate the responsibility of the carrier. (BAR 1979)

3. **Juan, a paying passenger, noted the stipulation at the back of the bus ticket stating that the liability of the bus company is limited to P1,000 in case of injuries to its passengers and P500 in case of loss or damage to baggage caused by the negligence or willful acts of its employees.**

**Upon arrival at his destination, Juan got into an altercation with the ticket conductor, who pulled out a knife and inflicted several wounds on Juan. The bus driver intervened, heaping abusive language on Juan and completely destroying Juan's baggage which contained expensive goods worth P3,000. The hospital expenses for Juan would probably amount to at least P6,000.**

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

**Answer:**

The bus company's liability for the injuries inflicted upon Juan is at least P6,000, notwithstanding the stipulation limiting its liability, and only for P500, the amount stipulated in the bus ticket, as the damage and destruction to Juan's baggage.

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

The rule is different with respect to a stipulation limiting the carrier's liability for the loss, destruction or deterioration of goods shipped. Under Article 1750, Civil Code, a contract fixing the sum that may be recovered by the owner or shipper for the loss, destruction, or deterioration of the goods is valid, if it is reasonable and just under the circumstances and has been fairly and freely agreed upon. (BAR 1984)

4. **Martin Nove shipped an expensive video equipment to a friend in Cebu. Martin had bought the equipment from Hong Kong for U.S. \$5,000. The equipment was shipped through M/S Lapu-Lapu under a bill of lading which contained the following provision in big bold letters:**

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

**The cargo was totally damaged before reaching Cebu. Martin Nove claimed for the value of his cargo (\$5,000 or about P100,000) instead of just P200 as per the limitation on the bill of lading.**

**Is there any legal basis for Nove's claim?**

**Answer:**

There is legal basis for the claim of Martin Nove. The stipulation limiting the carrier's liability up to a certain amount "regardless of the actual value of such cargo, whether declared by its shipper or otherwise," is violative of the requirement of the "Civil Code that such limiting stipulations should be fairly and freely agreed upon (Arts. 1749-1750 Civil Code). A stipulation that denies to the shipper the right to declare the actual value of his cargoes and to recover, in case of loss or damage, on the basis would be invalid. (BAR 1987)

5. **X shipped thru M/V Kalayaan, spare parts worth P500,000. The bill of lading limits the liability of the carrier to P50,000 and contains a notation indicating the amount of the letter of credit (i.e. P500,000) which X obtained from a bank to import the spare parts. The spare parts were not delivered to X so X sued the carrier for P500,000. Decide.**

**Answer:**

The limit of liability stipulated in the bill of lading is subordinated to a declaration therein of the actual value of the goods. Since the bill of lading itself contains a notation indicating the true value of the goods shipped (supported by the letter of credit), X can sue the carrier on the basis of such true value. (BAR 1989)

**c. Limitation of Liability in Absence of Declaration of Greater Value**

1. **A takes a plane from Manila bound for Cagayan de Oro via Cebu, where there was a change of planes. A arrived Cagayan de Oro safely, but to his dismay, his two suitcases were left behind in Cebu. The airline company assured him that the suitcases would come in the next flight, but they never did.**

**A claims P1,000 damages for the loss of both suitcases, but the airline is willing to pay only P400 on the ground that the airline ticket stipulates that unless a higher value is declared, any claim for loss cannot exceed P200 for each piece of luggage.**

**A had not declared a greater value, despite the fact that the clerk had called his attention to the stipulation in the ticket.**

**Is A entitled to P1,000 or only P400? Explain.**

**Answer:**

A is entitled to only P400. Under the Civil Code, a stipulation limiting a common carrier's liability to the value of the goods as stated on the bill of lading unless the shipper declares a greater value, is binding. Under Art. 1754, this provision of Art 1749, along with others, is made applicable to a passenger's baggage which is not in his personal custody. A cannot claim lack of knowledge of the limitation since his attention was called to it. He can therefore not insist on claiming P1,000. (BAR 1983)

2. **Dona Buding checked in at the PAL counter of the Manila Domestic Airport on a flight to Bacolod. Noticing that Dona Buding had two big baggages being checked in, the counter clerk called her attention to the stipulation in the plane ticket and asked if she was going to make any declaration on the value of the same, but Dona Buding just looked at him and did not say anything. The plane arrived in Bacolod, but the two baggages could nowhere be found. PAL promised to deliver the two baggages the next day, but it never did.**

**Dona Buding sued PAL, claiming P10,000 damages for the loss of the two baggages. PAL answered that it was liable only for P200 for the plane ticket clearly stipulated that: "That total liability of the carrier for lost or damaged baggage is limited to P100 per baggage, unless the passenger declares a higher valuation in excess of P100 but not in excess, however, of a total valuation of P1,000, and unless additional charges are paid pursuant to Carrier's Tariffs." The trial court ruled in favor of PAL.**

### **Comment on the legality of the court's decision.**

#### **Answer:**

The ruling of the trial court against Dona Buding is legal, being in accordance with the New Civil Code on Common Carriers. As 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. (*Art. 1749 NCC; Freixas & Co. v. Pacific Mail Steamship Co., 42 Phil. 198*) (BAR 1985)

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

**X claimed P2,000 for the loss of both suitcases, but the airline was willing to pay only P500 because the airline ticket stipulated that unless a higher value was declared, any claim for the loss cannot exceed P250 for each piece of luggage. X however reasoned out that he did not sign the stipulation and in fact had not even read it.**

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

#### **Answer:**

Even if he did not sign the ticket, X is bound by the stipulation that any claim for loss cannot exceed P250 for each luggage. He did not declare a higher value. X is entitled to P500 for the two luggages lost. (BAR 1998)

4. **Discuss whether or not the following stipulations in a contract of carriage of a common carrier are valid:**

**A stipulation that in the event of loss, destruction or deterioration of goods on account of the defective condition of the vehicle used in the contract of carriage, the carrier's liability is limited to the value of the goods appearing in the bill of lading unless the shipper or owner declares a higher value.**

#### **Answer:**

The stipulation limiting the carrier's liability to the value of the goods appearing in the bill of lading unless the shipper or owner declares a higher value, is expressly recognized in Article 1749 of the Civil Code. (BAR 2002)

### **5. Liability for Baggage of Passengers**

#### **a. Checked-In Baggage**

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

**X claimed P2,000 for the loss of both suitcases, but the airline was willing to pay only P500 because the airline ticket stipulated that unless a higher value was declared, any claim for the loss cannot exceed P250 for each piece of luggage. X however reasoned out that he did not sign the stipulation and in fact had not even read it.**

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

#### **Answer:**

Even if he did not sign the ticket, X is bound by the stipulation that any claim for loss cannot exceed P250 for each luggage. He did not declare a higher value. X is entitled to P500 for the two luggages lost. (BAR 1998)

### **b. Baggage in Possession of Passengers**

- 1. Pasahero, a paying passenger, boarded a Victory Liner bus bound for Olongapo. He chose a seat at the front near the bus driver. Pasahero told the bus driver that he had valuable items in his bag which was placed near his feet. Since he had not slept 24 hours, he requested the driver to keep an eye on the bag should he doze off during the trip.**
  - a) While Pasahero was asleep, another passenger took the bag away and alighted at Guagua, Pampanga. Is Victory Liner liable to Pasahero? Explain.**
  - b) Supposing the two armed men staged a hold-up while the bus was speeding along the North Expressway. One of them pointed a gun at Pasahero and stole not only his bag but also his wallet as well. Is Victory Liner liable to Pasahero? Explain.**

#### **Answer:**

- a) The responsibility of common carriers in the case of loss or damage to hand-carried baggage is governed by the rule on necessary deposits. The common carrier is thus liable for the loss of the personal property caused by its employees or by strangers.**
  - b) The use of arms (in the staging of the holdup) is force majeure under the rule on necessary deposits. Accordingly, Pasahero may not hold Victory Liner liable. (BAR 1986)**
- 2. X boarded an air-conditioned Pantranco Bus bound for Baguio. X was given notice that the carrier is not liable for baggage brought in by passengers. X kept in his custody his attache case containing \$10,000. In Tarlac, all the passengers, including X, were told to get off and to take their lunch, the cost of which is included in the ticket. X left his attaché case on his seat as the door of the bus was locked. After lunch and when X returned to the bus, he discovered that his attaché case was missing. A vendor said that a man picked the lock of the door, entered the bus and ran away with the attaché case. What, if any, is the liability of the carrier?**

#### **Answer:**

Hand-carried pieces of luggage of passengers are governed by the rules on necessary deposit. Under Article 2000 of the Civil Code the responsibility of the depository shall, among other cases, include the loss of property of the guest caused by strangers but not that which may proceed from force majeure. Article 2001 of the same Code considers an act of a thief as not one of force majeure unless done with the use of arms or through an irresistible force. Accordingly, the carrier may, given the factual setting in the problem, still be held liable. (BAR 1989)

### **D. Safety of Passengers**

- 1. X brought 7 sacks of palay to the PNR. He paid his freight charges and was issued Way Bill No. 1. The cargo was loaded on the freight wagon of the train. Without any permission, X boarded the freight wagon and not the passenger coach. Shortly after the train started, it was derailed. The freight wagon fell on its side, killing X. There is no evidence that X bought a ticket or paid his fare at the same time that he paid the freight charges for his cargo. Is X passenger of PNR?**

#### **Answer:**

No, X was not a "passenger". A "stowaway", being a trespasser, has been held to assume the risk of damage. (BAR 1989)

2. **One of the passenger buses owned by Continental Transit Corporation (CTC), plying its usual route, figured in a collision with another bus owned by Unniversla Transport Inc. (UTI). Among those injured inside the CTC bus were: Romeo, a stow away; Samuel, a pickpocket then in the act of robbing his seatmate when the collision occurred; Teresita, the bus driver's mistress who usually accompanied the driver on his trips for free; and Uriel, a holder of a free riding pass he won in a raffle held by CTC.**

**Will a suit for breach of contract of carriage filed by Romeo, Samuel, Teresita, and Uriel against CTC prosper? Explain.**

**Answer:**

Romeo cannot sue for breach of contract of carriage. A stowaway like Romeo, who secures passage by fraud, is not a passenger.

Samuel and Teresita cannot sue for breach of contract of carriage. The elements in the definition of a passenger are: an undertaking of a person to travel in the conveyance provided by the carrier and an acceptance by the carrier of the person as a passenger. Samuel did not board the bus to be transported but to commit robbery. Teresita did not board the bus to be transported but to accompany the driver while he was performing his work

Uriel can sue for breach of contract of carriage. He was a passenger although he was being transported gratuitously, because he won a free riding pass in a raffle held by CTC. (BAR 2008)

3. **In a contract of carriage, the common carrier is liable for the injury or death of a passenger resulting from its employee's fault although the latter acted beyond the scope of his authority. This is based on the**
- Rule that the carrier has an implied duty to transport the passenger safely.**
  - Rule that the carrier has an express duty to transport the passenger safely.**
  - Doctrine of Respondeat Superior.**
  - Rule in culpa aquiliana.**

**Answer:**

- Rule that the carrier has an implied duty to transport the passenger safely. (BAR 2011)

4. **Fil-Asia Air Flight 916 was on a scheduled passenger flight from Manila when it crashed as it landed at the Cagayan de Oro airport; the pilot miscalculated the plane's approach and undershot the runway. Of the 150 people on board, 10 passengers died at the crash scene.**

**Of the 10 who dies, one was a passenger who managed to leave the plane but was run over by an ambulance coming to the rescue. Another was an airline employee who hitched a free ride to Cagayan de Oro and who was not in the passenger manifest.**

**It appears from the Civil Aeronautics Authority investigation that the co-pilot who had control of the plane's landing had less than the required flying and landing time experience, and should not have been in control of the plane at the time. He was allowed to fly as a co-pilot because of the scarcity of pilots—Philippine pilots have been recruited by foreign airlines under vastly improved flying terms and wages so that newer and less trained pilots are being locally deployed. The main pilot, on the other hand, had a very high level of blood alcohol at the time of the crash.**

**You are part of the team that the victims hired to handle the case for them as a group. In your case conference, the following questions came up:**

- a) Explain the causes of action legally possible under the given facts against the airline and the pilots; whom will you specifically implead in these causes of action?
- b) How will you handle the cases of the passenger run over by the ambulance and the airline employee allowed to hitch a free ride to Cagayan de Oro?

**Answer:**

- a) A complaint for breach of contract of carriage can be filed against Fil-Asia air for failure to exercise extraordinary diligence in transporting the passengers safely from their point of embarkation to their destination.

A complaint based on a quasi-delict can be filed against the pilots because of their fault and negligence. Fil-Asia Air can be included for negligence in the selection and supervision of the pilots.

A third cause of action may be a criminal prosecution for reckless imprudence resulting in homicide against two pilots. The airline will be subsidiarily liable for the civil liability only after the pilots are convicted and found to be insolvent.

- b) It is the driver of the ambulance and his employer who should be held liable for damages, because a passenger was run over. This is in accordance with Articles 2176 and 2180 of the Civil Code. There could also be a criminal prosecution for reckless imprudence resulting in homicide against the ambulance driver and the consequent civil liability.

Since the airline employee was being transported gratuitously, Fil-Asia Air was not required to exercise extraordinary diligence for his safety and only ordinary care. (BAR 2013)

**1. Void Stipulations**

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

- c) Are those valid defenses?

**Answer:**

- c) No. These are not valid defenses because they are contrary to law as they are in violation of the extraordinary diligence required of common carriers. (BAR 2001)

**2. Duration of Liability**

**a. Waiting for Carrier or Boarding of Carrier**

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

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

**Answer:**

Santiago may hold GL liable for breach of contract of carriage. It was the duty of the driver, when he stopped the bus, to do no act that would have the effect of increasing the peril to a passenger such as Santiago while he was attempting to board the same. When a bus is not in motion there is no necessity for a person who wants to ride the same to signal his intention to board. A public utility bus, once it stops, is in effect making a continuous offer to bus riders. It is the duty of common carriers of passengers to stop their conveyances for a reasonable length of time in order to afford passengers an opportunity to board and enter, and they are liable for injuries suffered by boarding passengers resulting from the sudden starting up or jerking of their conveyances while they are doing so. Santiago, by stepping and standing on the platform of the bus, is already considered a passenger and is entitled to all the rights and protection pertaining to a contract of carriage. (BAR 1996)

2. **City Railways, Inc. (CRI) provides train service, for a fee, to commuters from Manila to Calamba, Laguna. Commuters are required to purchase tickets and then proceed to designated loading and unloading facilities to board the train. Ricardo Santos purchased a ticket for Calamba and entered the station. While waiting, he had an altercation with the security guard of CRI leading to a fistfight. Ricardo Santos fell on the railway just as the train was entering the station. Ricardo Santos was run over by the train. He died.**

**In the action for damages files by the heirs of Ricardo Santos, CRI interposed lack of cause of action, contending that the mishap occurred before Ricardo Santos boarded the train and that it was not guilty of negligence. Decide.**

**Answer:**

CRI is liable. It has a contract of carriage with Ricardo, created from the moment the latter purchased a ticket and entered the station. The duty of a common carrier like the CRI is to provide safety to its passengers, not only during the course of the trip, but as long as they are within its premises and where they ought to be in pursuance to the contract of carriage. Furthermore, a common carrier is liable for the death of or injuries to passengers through the negligence or willful act of its employees, pursuant ot Art. 1759 of the Civil Code, to wit:

“Art. 1759. Common carriers are liable for the death of or injuries to passengers through the negligence or willful acts of the former’s employees, although such employees may have acted beyond the scope of their authority or in violation of the orders of the common carriers.

The 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.” (BAR 2008)

3. **P, a sales girl in a flower shop at the Ayala Station of the Metro Rail Transit (MRT) bought two tokens or tickets, one for her ride to work and another for her ride home. She got to her flower shop where she usually worked from 8:00am-5:00pm. At about 3:00pm, while P was attending to her duties at the flower shop, two crews of the MRT got into a fight near the flower shop, causing injuries to P in the process. Can P sue the MRT for contractual breach as she was within the MRT premises where she would shortly take her ride home?**
- No, since the incident took place, not in the MRT train coach, but at the MRT station.**
  - No, since P had no intention to board an MRT train coach when the incident occurred.**
  - Yes, since she already had a ticket for her ride home and was in the MRT’s premises at the time of the incident.**
  - Yes, since she bought a round trip ticket and MRT had a duty while she was at its station to keep her safe for her return trip.**

**Answer:**

b. No, since P had no intention to board an MRT train coach when the incident occurred. (BAR 2011)

**b. Arrival at Destination**

- 1. X, an 80-year old epileptic, boarded the S/S Tamaraw in Manila going to Mindoro. To disembark, the passengers have to walk thru a gang plank. While negotiating the gang plank, X slipped and fell into the waters. X was saved from drowning, brought to a hospital but after a month died from pneumonia. Except for X, all the passengers were able to walk thru the gang plank. What is the liability of the owner of S/S Tamaraw?**

**Answer:**

The owner of S/S Tamaraw is liable for the death of X in failing to exercise utmost diligence in the safety of passengers. Evidently, the carrier did not take the necessary precautions in ensuring the safety of passengers in the boarding of and disembarking from the vessel. Unless shown to the contrary, a common carrier is presumed to have been negligent in cases of death or injury to its passengers. Since X has not completely disembarked yet, the obligation of the ship-owner to exercise utmost diligence still then subsisted and he can still be held (BAR 1989)

**3. Liability for Acts of Others**

**a. Employees**

- 1. Juan, a paying passenger, noted the stipulation at the back of the bus ticket stating that the liability of the bus company is limited to P1,000 in case of injuries to its passengers and P500 in case of loss or damage to baggage caused by the negligence or willful acts of its employees.**

**Upon arrival at his destination, Juan got into an altercation with the ticket conductor, who pulled out a knife and inflicted several wounds on Juan. The bus driver intervened, heaping abusive language on Juan and completely destroying Juan's baggage which contained expensive goods worth P3,000. The hospital expenses for Juan would probably amount to at least P6,000.**

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

**Answer:**

The bus company's liability for the injuries inflicted upon Juan is at least P6,000, notwithstanding the stipulation limiting its liability, and only for P500, the amount stipulated in the bus ticket, as the damage and destruction to Juan's baggage.

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

The rule is different with respect to a stipulation limiting the carrier's liability for the loss, destruction or deterioration of goods shipped. Under Article 1750, Civil Code, a contract fixing the sum that may be recovered by the owner or shipper for the loss, destruction, or deterioration of the goods is valid, if it is reasonable and just under the circumstances and has been fairly and freely agreed upon. (BAR 1984)

2. **City Railways, Inc. (CRI) provides train service, for a fee, to commuters from Manila to Calamba, Laguna. Commuters are required to purchase tickets and then proceed to designated loading and unloading facilities to board the train. Ricardo Santos purchased a ticket for Calamba and entered the station. While waiting, he had an altercation with the security guard of CRI leading to a fistfight. Ricardo Santos fell on the railway just as the train was entering the station. Ricardo Santos was run over by the train. He died.**

**In the action for damages files by the heirs of Ricardo Santos, CRI interposed lack of cause of action, contending that the mishap occurred before Ricardo Santos boarded the train and that it was not guilty of negligence. Decide.**

**Answer:**

CRI is liable. It has a contract of carriage with Ricardo, created from the moment the latter purchased a ticket and entered the station. The duty of a common carrier like the CRI is to provide safety to its passengers, not only during the course of the trip, but as long as they are within its premises and where they ought to be in pursuance to the contract of carriage. Furthermore, a common carrier is liable for the death of or injuries to passengers through the negligence or willful act of its employees, pursuant to Art. 1759 of the Civil Code, to wit:

“Art. 1759. Common carriers are liable for the death of or injuries to passengers through the negligence or willful acts of the former’s employees, although such employees may have acted beyond the scope of their authority or in violation of the orders of the common carriers.

The 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.” (BAR 2008)

3. **The AAA Bus Company picks up passengers along EDSA, X, the conductor, while on board the bus, drew his gun and randomly shot the passengers inside. As a result, Y, a passenger, was shot and died instantly. Is AAA Bus Company liable?**
- a) **The bus company is not liable for as long as the bus company can show that when they hired X, they did the right selection process;**
  - b) **The bus company cannot be held liable because what X did is not part of his responsibility;**
  - c) **The bus company is liable because common carriers are liable for the negligence or willful act of its employees even though they acted beyond the scope of their responsibility;**
  - d) **The bus company is not liable because there is no way that the bus company can anticipate the act of X.**

**Answer:**

c) The bus company is liable because common carriers are liable for the negligence or willful act of its employees even though they acted beyond the scope of their responsibility. (BAR 2012)

#### **b. Other Passengers and Strangers**

1. **Pasahero, a paying passenger, boarded a Victory Liner bus bound for Olongapo. He chose a seat at the front near the bus driver. Pasahero told the bus driver that he had valuable items in his bag which was placed near his feet. Since he had not slept 24 hours, he requested the driver to keep an eye on the bag should he doze off during the trip.**
- c) **There have been incidents of unknown persons throwing stones at passing vehicles from the overpasses in the North Expressway. While the bus was traversing the superhighway, a stone**

**hurled from the Sto. Domingo overpass smashed the front windshield and hit Pasahero in the face. Pasahero lost an eye and suffered other injuries. Can Pasahero hold the bus company liable for damages? Explain.**

**Answer:**

c) Pasahero can hold the bus company liable because of its failure to exercise utmost diligence. Since incidents of stone-throwing had earlier been known, it behooved upon the common carrier to warn its passengers against seating themselves close to the windshield or to provide other precautionary measures for its passengers. (BAR 1986)

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

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

**Answer:**

Mariter cannot legally hold the bus company liable. There is no showing that any such incident previously happened so as to impose an obligation on the part of the personnel of the bus company to warn the passengers and to take the necessary precaution. Such hurling of a stone constitutes fortuitous event in this case. The bus company is not an insurer. (BAR 1994)

- 3. Antonio, a paying passenger, boarded a bus bound for Batangas City. He chose a seat at the front row, near the bus driver, and told the bus driver that he had valuable items in his hand-carried bag which he then placed beside the driver's seat. Not having slept for 24 hours, he requested the driver to keep an eye on the bag should he doze off during the trip. While Antonio was asleep, another passenger took the bag away and alighted at Calamba, Laguna. Could the common carrier be held liable by Antonio for the loss?**

**Answer:**

Yes. Ordinarily, the common carrier is not liable for acts of other passengers. But the common carrier cannot relieve itself from liability if the common carrier's employees could have prevented the act or omission by exercising due diligence. In this case, the passenger asked the driver to keep an eye on the bag which was placed beside the driver's seat.

If the driver exercised due diligence, he could have prevented the loss of the bag. (BAR 1997)

- 4. P rode a Sentinel Liner bus going to Baguio from Manila. At a stop-over in Tarlac, the bus driver, the conductor, and the passengers disembarked for lunch. P decided, however, to remain in the bus, the door of which was not locked. At this point, V, a vendor, sneaked into the bus and offered P some refreshments. When P rudely declined, V attacked him, resulting in P suffering from bruises and contusions. Does he have cause to sue Sentinel Liner?**
- a. Yes, since the carrier's crew did nothing to protect a passenger who remained in the bus during the stop-over.**
  - b. No, since the carrier's crew could not have foreseen the attack.**
  - c. Yes, since the bus is liable for anything that goes wrong in the course of the trip.**
  - d. No, since the attack on P took place when the bus was at a stop-over.**

**Answer:**

- a. Yes, since the carrier's crew did nothing to protect a passenger who remained in the bus during the stop-over. (BAR 2011)

4. **Extent of Liability for Damages**

5. **Registered Owner Rule (Kabit-system)**

1. **A is a registered owner of a truck for hire. He sold the truck to B and possession was immediately delivered to B who operated the same. The truck, however, remained registered in the name of A. while operating the truck, B's driver ran over a child who died thereafter. The heirs of the child sued A for damages. A's defense is that he cannot be held liable as he had already sold the truck to B and it was B's driver who was responsible for the accident. Decide with reasons.**

**Answer:**

A is liable to the heirs of the victim. As far as third persons without knowledge are concerned, the registered owner of a motor vehicle is its true owner regardless of any unregistered sale of the vehicle. (BAR 1976)

2. **A was driving a jeepney registered in the name of B. The jeepney, while being driven negligently by A, hit and injured X, so X sued B for damages. The defense of B was that he had sold the jeepney to C and that X should sue C. Rule on B's defense with reasons.**

**Answer:**

Assuming the said jeepney in question to be not a common carrier or public service, and A was the driver of C, the actual owner, although not yet registered in his name, then C, and not B (the registered owner), shall be liable to X. Employer C shall be liable for damages caused by his employee acting within the scope of his assigned task. (Art. 2180, Civil Code) (BAR 1979)

3. **Mr. Villa, a franchise holder and the registered owner of a truck for hire, entered into a lease contract with Mrs. Santos for the lease by the latter of said truck. The lease contract was not brought to the knowledge of the Land Transportation, Franchising, and Regulatory Board and was therefore not approved by the Land Transportation, Franchising, and Regulatory Board. One stormy night, the said truck which was speeding along EDSA, skidded and ran over X who died on the spot. The parents of X brought an action for damages against Mr. Villa for the death of their son.**

a) **Will the action against Mr. Villa prosper? Reasons.**

b) **What recourse, if any, does X have?**

**Answer:**

a) Yes, the action will prosper. Both the registered owner and the actual user or operator of a motor vehicle are liable for damages sustained in the operation thereof. Hence, the action against Villa can prosper.

b) The heirs of X may likewise bring an action for tort against Mrs. Santos and/or the driver of the vehicle. The latter may also be charged criminally. (BAR 1988)

4. **Johnny owns a Sarao jeepney. He asked his neighbor Van if he could operate the said jeepney under Van's certificate of public convenience. Van agreed and, accordingly, Johnny registered his jeepney in Van's name.**

**On June 10, 1990, one of the passenger jeepneys operated by Van bumped Tomas. Tomas was injured and in due time, he filed a complaint for damages against Van and his driver for the injuries he suffered. The court rendered judgment in favor of Tomas and ordered Van and his driver, jointly and severally, to pay Tomas actual and moral damages, attorney's fees, and cost.**

**The Sheriff levied on the jeepney belonging to Johnny but registered in the name of Van. Johnny filed a third-party claim with the Sheriff alleging ownership of the jeepney levied upon and stating that the jeepney was registered in the name of Van merely to enable Johnny to make use of Van's certificate of public convenience.**

**May the Sheriff proceed with the public auction of Johnny's jeepney? Discuss the reasons.**

**Answer:**

Yes, the Sheriff may proceed with the auction sale of Johnny's jeepney. In contemplation of law as regards the public and third persons, the vehicle is considered the property of the registered operator. (BAR 1990)

- 5. Baldo is a driver of Yellow Cab Company under the boundary system. While cruising along the South Expressway, Baldo's cab figured in a collision, killing his passenger, Pietro. The heirs of Pietro sued Yellow Cab Company for damages, but the latter refused to pay to the heirs, insisting that it is not liable because Baldo is not an employee.**

**Resolve with reasons.**

**Answer:**

Yellow Cab Company is liable because there exists an employer-employee relationship between a jeepney owner and a driver under the boundary system arrangement in accordance with Art. 103 of the RPC. Indeed to exempt from liability the owner of a public vehicle who operates it under the "boundary system" on the ground that he is a mere lessor would not only 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 depends largely on 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 the damages they might cause. (BAR 2005)

- 6. Procopio purchased an Isuzu passenger jeepney from Enteng, a holder of a certificate of public convenience for the operation of public utility vehicle plying the Calamba-Los Banos route. While Procopio continued offering the jeepney for public transport services he did not have the registration of the vehicle transferred in his name. Neither did he secure for himself a certificate of public convenience for its operation. Thus, per the records of the LTFRB, Enteng remained its registered owner and operator. One day, while the jeepney was travelling southbound, it collided with a ten-wheeler truck owned by Emmanuel. The driver of the truck admitted responsibility for the accident, explaining that the truck lost its brakes.**

**Procopio sued Emmanuel for damages, but the latter moved to dismiss the case on the ground that Procopio is not the real party in interest since he is not the registered owner of the jeepney.**

**Resolve the motion with reasons.**

**Answer:**

The motion to dismiss should be denied. The rule enjoining the registered owner of the motor vehicle under the "kabit system" from proving another person is the owner is intended to protect third parties. Since this case does not involve liability of the registered owner to third parties, and it is the owner of the motor vehicle who is seeking compensation for damages, the rule is not applicable. (BAR 2005)

- 7. Discuss the "kabit system" in land transportation and its legal consequences.**

**Answer:**

The "kabit system" is an arrangement whereby a person who has been granted a certificate of public convenience allows another who owns a motor vehicle to operate under his certificate for a fee or a percentage

of the earnings. The owner of the certificate of public convenience and the actual owner of the motor vehicle should be held jointly and severally liable for damages to third persons as a consequence of the negligent operation of the motor vehicle. (BAR 2005)

8. X owns a fleet of taxicabs. He operates it through what is known as boundary system. Y drives one of such taxicabs and pays X a fixed amount of P1,000 daily under the boundary system. This means that anything above P1,000 would be the earnings of Y. Y, driving recklessly, hit an old lady crossing the street. Which statement is most accurate?
- a) X as the owner is exempt from liability because he was not the one driving;
  - b) X as the owner is exempt from liability because precisely the arrangement is one under the "boundary system";
  - c) X will not be exempt from liability because he remains to be the registered owner and the boundary system will not allow the circumvention of the law to avoid liability;
  - d) Y is the only one liable because he drove recklessly.

**Answer:**

b) X will not be exempt from liability because he remains to be the registered owner and the boundary system will not allow the circumvention of the law to avoid liability. (BAR 2012)

9. X owns a passenger jeepney covered by Certificate of Public Convenience. He allowed Y to use its Certificate of Convenience for a consideration. Y therefore was operating the passenger jeepney under the same Certificate of Public Convenience (Kabit System) under the name of X. the passenger jeepney met an accident. Who will be liable?
- a) Y, the one actually operating the jeepney, will be liable to the injured party;
  - b) X will be the one liable to the injured party despite the fact that it is Y who is actually operating the jeepney, because while the Kabit System is tolerated, the public should not be inconvenienced by the arrangement;
  - c) X will not be held liable if he can prove that he is not the owner anymore;
  - d) Public Policy dictates that the real owner, even not the registered one, will be hld liable.

**Answer:**

b) X will be the one liable to the injured party despite the fact that it is Y who is actually operating the jeepney, because while the Kabit System is tolerated, the public should not be inconvenienced by the arrangement. (BAR 2012)

## **E. Bill of Lading**

### **1. Three-Fold Character**

1. JRT, Inc. entered into a contract with C. Co. of Japan to export anahaw fans valued at \$23,000. As payment thereof, a letter of credit was issued to JR, Inc. by the buyer. The letter of credit required was issued to JR, Inc. by the buyer. The letter of credit required the issuance of an on-board bill of lading and prohibited the transshipment. The President of JRT, inc. then contracted a shipping agent to ship the anahaw fans through O Containers Lines, specifying the requirements of the letter of credit. However, the bill of lading issued by the shipping lines bore the notation "received for shipment" and contained an entry indicating transshipment in Hongkong. The President of JRT, Inc, personally received and signed the bill of lading and despite the entries, he delivered the corresponding check in payment of the freight.

The shipment was delivered at the port of discharge but the buyer refused to accept the anahaw fans because there was no on-board bill of lading, and there was transshipment since the goods were transferred in Hongkong from MV Pacific, the feeder vessel, to MV Oriental, a mother vessel. The same cannot be considered transshipment because both vessels belong to the same shipping company.

JRT, Inc. further argued that assuming there was transshipment, it cannot be deemed to have agreed thereto even if it signed the bill of lading containing such entry because it has made known to the shipping lines from the start that transshipment was prohibited under the letter of credit and that, therefore, it had no intention to allow transshipment of the subject cargo. Is the argument tenable? Reason.

**Answer:**

No. JRT is bound by the terms of the bill of lading when it accepted the bill of lading with full knowledge of its contents which included transshipment in Hongkong. Acceptance under such circumstances makes the bill of lading binding contract. (BAR 1993)

2. a) What do you understand by a "bill of lading"?
- b) Explain the two-fold character of a "bill of lading."

**Answer:**

- a) A bill of lading may be defined as written acknowledgment of the receipt of goods and an agreement to transport and to deliver them at a specified place to a person named therein or on his order.
- b) A bill of lading has two-fold character, namely, (a) it is a receipt of goods to be transported; and (b) it constitutes a contract of carriage of the goods. (BAR 1998)

## 2. Delivery of Goods

1. If a shipper, without changing the place of delivery changes the consignment or consignee of the goods (after said goods had been delivered to the carrier), under what condition will the carrier be required to comply with the new orders of the shipper?

**Answer:**

If the shipper should change the consignee of the goods, without changing their destination, the carrier shall comply with the new order provided the shipper returns to the carrier the bill of lading, and a new one is issued showing the novation of the contract. All expenses for the change must be paid by the shipper. (BAR 1975)

2. JRT, Inc. entered into a contract with C. Co. of Japan to export anahaw fans valued at \$23,000. As payment thereof, a letter of credit was issued to JR, Inc. by the buyer. The letter of credit required was issued to JR, Inc. by the buyer. The letter of credit required the issuance of an on-board bill of lading and prohibited the transshipment. The President of JRT, Inc. then contracted a shipping agent to ship the anahaw fans through O Containers Lines, specifying the requirements of the letter of credit. However, the bill of lading issued by the shipping lines bore the notation "received for shipment" and contained an entry indicating transshipment in Hongkong. The President of JRT, Inc. personally received and signed the bill of lading and despite the entries, he delivered the corresponding check in payment of the freight.

The shipment was delivered at the port of discharge but the buyer refused to accept the anahaw fans because there was no on-board bill of lading, and there was transshipment since the goods were transferred in Hongkong from MV Pacific, the feeder vessel, to MV Oriental, a mother vessel. The same cannot be considered transshipment because both vessels belong to the same shipping company.

**Was there transshipment? Explain.**

**Answer:**

Yes. Transshipment is the act of taking cargo out of one ship and loading it in another. It is immaterial whether or not the same person, firm or entity owns the 2 vessels. (BAR 1993)

3. **X is a trader of school supplies in Calapan, Oriental Mindoro. To bring the school supplies to Calapan, it has to be transported by a vessel. Because there were so many passengers, the 2 boxes of schools supplies were loaded but the shipping company was not able to issue the Bill of lading. So, on board, the Ship Captain issued the Bill of Lading. So, on board, the Ship Captain issued instead a “shipping receipt” to X indicating the 2 boxes of school supplies being part of the cargo of the vessel. Which phrase therefore, is the most accurate?**
- a) **The owner of the vessel is not liable because no bill of lading was issued to X hence, no contract of carriage was perfected;**
  - b) **It is possible to have a contract of carriage of cargo even without a bill of lading, and the “shipping receipt” would be sufficient;**
  - c) **The only acceptable document of title is a Bill of Lading;**
  - d) **None of the above.**

**Answer:**

c) It is possible to have a contract of carriage of cargo even without a bill of lading, and the “shipping receipt” would be sufficient. (BAR 2012)

- a. **Period of Delivery**
- b. **Delivery Without Surrender of Bill of Lading**

1. **For a cargo of machinery shipped from abroad to a sugar central in Dumaguete, Negros Oriental, the Bill of Lading (B/L) stipulated “To Shipper’s Order,” with notice of arrival to be addressed to the Central. The cargo arrived at its destination and was released to the Central without surrender of the B/L on the basis of the latter’s undertaking to hold the carrier free and harmless from any liability.**

**Subsequently, a Bank to whom the Central was indebted claimed the cargo and presented the original of the B/L stating that the Central had failed to settle its obligations with the Bank.**

**Was there misdelivery by the carrier to the sugar central considering the non-surrender of the B/L? Why?**

**Answer:**

There was no misdelivery to the carrier since the cargo was consigned to the sugar central per the “Shipper’s Order”. (BAR 1992)

- c. **Refusal of Consignee to Take Delivery**

### **3. Period for Filing Claims**

1. **X shipped several boxes of goods from Manila to Cebu on board a vessel owned by Mabuhay Lines, Inc., the consignee, several boxes externally appeared to have been damaged. The proprietor of Y Dry Goods, Inc. paid the freight charges upon receipt of the goods. However, when the boxes were opened 2 days later, it was discovered that the contents of all the boxes had been damaged.**

**The proprietor of Y Dry Goods, Inc. seeks your advice on whether he may proceed against the carrier for damages. State your answers with reasons.**

**Answer:**

No action for damages to the goods may be maintained against the carrier.

With respect to a claim arising from damages caused to the goods contained in the boxes where the damage was ascertainable from the outside part of the packages, Article 366 of the Code of Commerce requires that the claim against the carrier must be made at the time of the receipt.

With respect to the goods contained in the boxes where the damage was not ascertainable from the outside part of the packages and such damage was only ascertainable upon the opening of the boxes, the claim against the carrier must be made within 24 hours following receipt of the merchandise.

It does not appear that the proprietor of Y Dry Goods, Inc. made any claim for damages to the goods within the periods set forth in Article 366. Moreover, as he paid the freight charges upon his receipt of the goods shipped, it is too late for the proprietor of Y Dry Goods Inc. to make a claim against the carrier for damages to the goods. (BAR 1984)

#### 4. Period for Filing Actions

##### F. Maritime Commerce

- 1. The goods imported from the United States were unloaded by the carrier in Manila. While in the custody of the arrastre operator, part of the shipment worth P1,000 was lost. Does the case involve admiralty and maritime commerce so that the action for short delivery has to be files in the Court of First Instance regardless of the amount? Reasons.**

**Answer:**

No, the matter does not involve admiralty or maritime commerce which relate only to incidents occurring during the sea voyage. Even assuming that the case involves an admiralty and maritime case, under B.P. 129, jurisdiction now also lies with the Metropolitan, MTC and MCTC if the amount involved does not exceed P20,000. (BAR 1981)

#### 1. Charter Parties

##### a. Bareboat/Demise Charter

- 1. Tirso Molina charters a vessel owned and operated by Star Shipping Co., a common carrier, for the purpose of transporting two tractors to his logging concession. The crane operator of the shipping company somehow negligently puts the tractors in a place where they would tilt each other. During the trip, a strong wind hits the vessel, causing severe damage to the tractors.**

**Tirso Molina sues the shipping company for damages. The latter cites a stipulation in the charter agreement exempting the company from liability from loss or damage arising from the negligence of its agents. Tirso Molina countered by stating that the aforementioned stipulation is against public policy and, therefore, null and void.**

**Is the stipulation valid? Would you hold the shipping company liable?**

**Answer:**

Yes, the stipulation in the charter party is valid, and Star Shipping Co. is not liable. The Civil Code provides on common carriers should not apply where the common carrier is not acting as such but as a private carrier, as in the case in the above problem. A common carrier undertaking to carry a special cargo or chartered to a special person only, becomes a private carrier. As a private carrier, a stipulation exempting the owner (Star Shipping Co.) from liability for the negligence of its agent is valid, being not against public policy. (*Home Insurance Co. v. American Steamship Agencies*, April 4, 1968; 23 SCRA 24) (Bar 1980)

2. **“C” Company shipped 20,000 bags of soy beans through the S/S Melon, owned and operated by “X” Shipping Lines, consigned to the Toyo Factory and insured by the Surety Insurance Co., against all risks. “C” Company hired the entire vessel, with the option to go north or south, loading, stowing and discharging at its risk and expense. The owner and shipper agreed on a stipulation exempting the owner from liability for the negligence of its agents.**

**When the cargo was delivered to the consignee, there were shortages amounting to P10,500. The insurance company paid for the damage and sought reimbursement from the “X” Shipping Lines as carrier.**

**Is the carrier liable? Select the correct answer from the following and explain.**

The carrier is:

- (A) Liable, because the stipulation exempting its owner from liability for the negligence of its agent is against public policy, hence, void.
- (B) Liable, because in case of loss, destruction or deterioration of goods, common carriers are presumed at fault under Art. 1735 of the Civil Code.
- (C) Not liable because it exercised due diligence in stowing the goods.
- (D) Not liable because it is not a common carrier and the parties to a contract, as such, may enter into a stipulation exempting the owner from liability for the negligence of its agents.

**Answer:**

The carrier is not liable. A common carrier undertaking to carry a special cargo or chartered to a special person only, becomes a private carrier. The provisions of the New Civil Code on common carriers should not be applied where the carrier is not acting as such but as a private carrier. As a private carrier, a stipulation exempting the ship-owner from liability for the negligence of its agents is not against public policy and is deemed valid. (*Home Insurance Co. v. American Steamship Agencies, Inc., April 4, 1968; 23 SCRA 25*) (BAR 1981)

3. **X owns the ship M/V Aguinaldo. He bareboat chartered the ship to Y who appointed all its crew members from the captain down to its last official. Y then transported a shipment of 10,000 bags of sugar belonging to Z. Thru the negligence of the ship captain, half of the sugar was damaged due to sea water. Since Y is bankrupt, Z sued the captain and X. Will the suit prosper?**

**Answer:**

The action could prosper against the ship captain whose negligence caused the damage but not against X who merely was a lessor of the vessel and who was neither a party to the contract for the shipment of the goods nor an employer of the ship captain. (BAR 1989)

- b. Time Charter
- c. Voyage/Trip Charter

1. **The Saad Development Corp. enters into a voyage charter with the XYZ Shipping Corp. over the latter's vessel, the M/V Lady Love. Before the Saad Development Corp. could load it, XYZ Shipping Corp. sold M/V Lady Love to Oslob Maritime Corp., which decided to load it for its own account.**
  - a) **May YZ Shipping Corp. validly ask for the rescission of the charter party? If so, can Saad Development Corp. recover damages? To what extent?**

**Answer:**

XYZ Shipping Corporation may ask for the rescission of the charter party if, as in this case, it sold the vessel before the charterer has begun to load the vessel and the purchaser loads it for his own account. Saad Development Corp. may recover damages to the extent of its losses.

- b) If Oslob Maritime Corp. did not load it for its own account, is it bound by the charter party?**

**Answer:**

Oslob Maritime Corp. did not load M/V Lady Love for its own account, it would be bound by the charter party, but XYZ Shipping would have to indemnify Oslob Maritime if it was not informed of the Charter Party at the time of sale.

2. **The term "owner pro hac vice of the vessel." In what kind of charter party does this obtain?**

**Answer:**

The term "owner pro hac vice of the vessel", is generally understood to be the charterer of a vessel in the case of bareboat or demise charter. (BAR 1991)

## 2. Liability of Ship Owners and Shipping Agents

1. **"S" shipped goods from Australia on board a foreign vessel owned and operated by "X", a shipping company, based in Australia and represented in the Philippines by "R". The goods were consigned to "T" of Manila and insured by "U" against all risks. Upon arrival in Manila Bay, the goods were discharged from the vessel to a lighter owned by the Bay Brokerage Co.**

**When delivered to and received by "T", the goods were found to have sustained losses or damages. Evidence disclosed that the damage occurred while the goods were in the custody of the carrier.**

**The insurance company paid the amount of the loss but sought reimbursement from "X" and/or "R". "R" disclaimed any liability alleging that he is a mere agent of "X", and having acted as agent of a disclosed principal is, therefore, not liable.**

- a) **Can the insurance company recover from "R"? Reasons.**
- b) **What is the liability, if any, of Bay Brokerage Co.? Explain.**

**Answer:**

- a) Yes, the insurance company can recover from "R". A ship agent ("R") under the Code of Commerce is liable solidarily with its principal (X), in an amount representing the value of the good lost or damaged. (*Switzerland General Insurable Co., Ltd. v. Ramirez, February 21, 1980; 96 SCRA 297*)
- b) The Bay Brokerage Co. is not liable. The evidence disclosed that the damage occurred while the goods were yet in the custody of the carrier, before that goods were discharged from the vessel to a lighter owned by the Bay Brokerage Co. (BAR 1981)

2. **X Mining Co. shipped a cargo of machineries on board the S/S Good Ship which was chartered by the Able Shipping Co., a foreign corporation represented in the Philippines by its agent, Best Lines, Inc. When the goods were delivered to the consignee, Y Corporation, they were found to have sustained losses. The insurer, Sunshine Insurance Co., paid for the losses, thereby subrogating itself to the rights of X Mining Company or Y Corporation vis-à-vis the shipping company and the shipping agent.**

**Upon arrival of the S/S Good Ship in Manila, Best Lines, Inc. took charge of the following: (a) unloading of the cargo and issuing of cargo receipts in its own name for the purpose of evidencing the condition and discharge of the cargo from the vessel to the arrastre operator and/or unto the barge lighters; (b) filing and processing of claims against the vessel S/S Good Ship for damages/ losses sustained by the cargo.**

**When Sunshine Insurance Co. sued both Able Shipping Co. and Best Lines, Inc. the latter contended that it was a disclosed agent and could not therefore be held liable, despite the insolvency of Able Shipping Co.**

**Rule on the contention of Best Lines, Inc., with reasons.**

**Answer:**

On the basis of the activities performed by Best Lines, Inc. upon the arrival of the S/S Good Ship in Manila, it is clear that Best Lines, Inc. is the entity that represents the vessel in the port of Manila and hence is a ship agent within the meaning and context of Article 586 of the Code of Commerce: “the person who represents the vessel in the port in which she happens to be.” Considering the peculiar relationship of the parties, Best Lines, Inc. cannot be considered as a “mere agent” of a disclosed principal under the civil law on agency as distinguished from a ship agent within the context of the Code of Commerce. Our Supreme Court has held that the doctrine having reference to the relation between principal and agents cannot be applied in the case of ship agents and ship owners. (*Yu Biao Suntua & Co. v. Ossorio, 43 Phil. 51*) (BAR 1984)

The Code of Commerce provides that the ship agent shall be liable for indemnities in favor of third persons which arise from the conduct of the captain in the care of the goods which the vessel carried.

The insolvency of Able Shipping Co. has no bearing insofar as the liability of Best Lines, Inc. is concerned. The law does not make the liability of the ship agent dependent upon the solvency or insolvency of the ship owner.

Best Lines, Inc., as ship agent, is liable solidarily with its principal, Able Shipping Co., for the amount of the losses damages sustained by the goods. (*Switzerland General Insurance Co., Ltd. V. Ramirez, 96 SCRA 297 1980*)

#### **a. Liability for Acts of Captain**

1. **Pablo Esparadon, a duly-licensed ship captain of the M/V Don Jose was drunk while he was on duty as such, and while M/V Don Jose was sailing from Manila to the Visayas. As a consequence thereof, the M/V Don Jose rammed another vessel near Corregidor, causing both vessel to sink completely and thus become total losses. The cargo owners of both sunken vessels sued the owner of the M/V Don Jose for their losses.**

**Is the shipowner of M/V Don Jose liable? Explain your answer.**

**Answer:**

No. the shipowner of M/V Don Jose is not liable. The civil liability of the shipowner of a vessel, in maritime collision which is caused by the fault of the captain, as in this problem (being drunk), is merely co-existent with his interest in the vessel (M/V Don Jose), such that the total loss thereof, results in the extinction of such

liability. (*Urrutia & Co. v. Baco River Plantation Co.*, 26 Phil. 362; *Guan v. Cia Maritime* (SC), 38 Off. Gaz. 2536; etc) (BAR 1978)

- 2. X chartered the ship of Y to transport his logs from Zamboanga to Manila. In the course of their voyage, the ship met a storm and had to dock in Cebu for 3 days. Z, the captain of the ship, borrowed P20,000 from X on the pretext that he would need the money for the repair of the ship. Z misappropriated the money and converted it to his own benefit. What is the liability of Y, if any?**

**Answer:**

A ship-owner would only be liable for contracts made by the captain (a) when duly authorized or (b) even when unauthorized, for ship repairs, or for equipping or provisioning the vessel when the proceeds are invested therein. Since the loan by the captain from X does not fall under any of the foregoing cases, the amount borrowed shall be considered a personal liability of Z, the captain, and Y, the ship-owner, cannot thus be held liable (BAR 1989)

- 3. MV Mariposa, one of five passenger ships owned by the Marina Navigation Company, sank off the coast of Mindoro while en route to Iloilo City. More than 200 passengers perished in the disaster. Evidence showed that the ship captain ignored typhoon bulletins issued by PAGASA during the 24-hour period immediately prior to the vessel's departure from Manila. The bulletins warned all types of sea crafts to avoid the typhoon's expected path near Mindoro. To make matters worse, he took more load than was allowed for the ship's rated capacity. Sued for damages by the victim's surviving relatives, Marina Navigation Company contended: (1) that its liability, if any, had been extinguished with the sinking of MV Mariposa; and (2) that assuming it had not been so extinguished, such liability should be limited to the loss of the cargo. Are these contentions meritorious in the context of applicable provisions of the Code of Commerce?**

**Answer:**

Yes. The contentions of Marina Navigation Company are meritorious. The captain of MV Mariposa is guilty of negligence in ignoring the typhoon bulletins issued by PAGASA and in overloading the vessel. But only the captain of the vessel MV Mariposa is guilty of negligence. The shipowner is not. Therefore, the shipowner can invoke the doctrine of limited liability. (BAR 2000)

- 4. Under a charter party XXO Trading Company shipped sugar to Coca-Cola Company through SS Negros Shipping Corp., insured by Capitol Insurance Company. The cargo arrived but with shortages. Coca-Cola demanded from Capital Insurance Co. P500,000 in settlement for XXO Trading. The MM RTC, where the civil suit was filed, "absolved the insurance company, declaring that under the Code of Commerce, the shipping agent is civilly liable for damages in favor of third persons due to the conduct of the carrier's captain, and the stipulation in the charter party exempting the owner from liability is not against public policy. Coca-Cola appealed. Will its appeal prosper? Reason briefly.**

**Answer:**

No. The appeal of Coca-Cola will not prosper. Under Article 587 of the Code of Commerce, the shipping agent is civilly liable for damages in favor of third persons due to the conduct of the carrier's captain, and the shipping agent can exempt himself therefrom only by abandoning the vessel with all his equipment and the freight he may have earned during the voyage. On the other hand, assuming there is bareboat charter, the stipulation in the charter party exempting the owner from liability is not against public policy because the public at large is not involved. (BAR 2004)

## **b. Limited Liability Rule**

- 1. a) Explain the limited liability rule or the so called real or hypothecary nature of maritime law.**

**b) In an action grounded on the contract of carriage, is there need for the court to make an express finding of fault or negligence on the part of the carrier in order to hold it liable for claims filed in behalf of the injured or deceased passengers? Explain. Is there any exception to any answer you may give on this question?**

**Answer:**

- a) under the real or hypothecary nature of maritime law, the liability of the ship owner or agent, arising from the operation of a ship, is limited to the vessel, equipment and freight during the voyage, so that if ship owner or agent would abandon the vessel, equipment and freight, his liability would be extinguished. However, if the vessel would sink and never be recovered, that would also extinguish the liability of the ship owner or agent, unless those would be insured, and in this case it would suffice to surrender the insurance to the creditors to extinguish his liability. (*Abueg v. San Diego, 44 Off. Gaz. 80*)
- b) In case of death or injuries to passengers, common carriers are presumed to have been at fault or to have acted negligently, unless they prove that they observed the utmost diligence of very cautious persons, with a due regard for all circumstances. (*Arts. 1755 & 1756 N.C.C.*) (BAR 1982)

**2. What is the “limited liability rule” in maritime law, otherwise known as the “real or hypothecary nature of maritime law?” Explain.**

**Answer:**

The “real or hypothecary nature of maritime law” means that the liability of the shipowner or ship agent arising from the operation of a ship (in the transportation of goods and passengers) is confined to the vessel, equipment, and freight, or insurance, if any, so that if shipowner or ship agent abandons the ship, equipment and freight, his liability would be extinguished, just as well if the vessel would totally sink or be a total loss, and there is no insurance. (*Abueg, et al., v. San Diego, 44, O.G. 80*) (BAR 1985)

**3. Captain Hook, the ship captain of M.V. Peter Pan, overloaded the M.V. Peter Pan, as a consequence of which the vessel sank in the middle of the Sulu Sea, and nothing whatsoever was recovered. The owners of the cargo and the heirs of the three passengers of the vessel filed an action for damages in the amount of P500,000 against Mr. Wendy, the owner.**

**Will the action prosper? Reasons.**

**Answer:**

The total loss or the lawful abandonment of the vessel precludes further liability on the part of the shipowner, except to the extent of earned freightage or proceeds of insurance, if any, for the loss of cargo arising from the “conduct of the captain in the care of goods”. This right of abandonment likewise applies to collisions and shipwreck but in the latter case only for unpaid wages.

Accordingly, the action filed by the owners of the lost cargo, absent any remaining value of the vessel, earned freightage or insurance proceeds, may not prosper. The action filed by the heirs of the deceased passengers may, however, prosper since, except in collisions, the shipowners are not granted the right of abandonment. (BAR 1988)

**4. X, a rich trader, boarded the M/V Cebu, a small vessel with a value of P3 M and owned by Y, plying the route Cotabato to Pagadian City. X had in his possession a diamond worth P5 M. the vessel had a capacity of 40 passengers. Near Pagadian, the vessel met squally weather and was hit by a six foot waves every three seconds. Soon, water entered the engine room and the hull of the vessel. The patron of the vessel ordered the distribution of life belts to the passengers. He told them the vessel was sinking and for them to take care of themselves. The vessel turned out to be overloaded by 20 passengers and had no sufficient life belts. X failed to get a life belt and died when the vessel totally sunk. The heirs of X sued Y for P10 M damages. Y raised as a defense of limited liability.**

**Answer:**

The doctrine of limited liability does not apply when death or injury or damage sustained is attributable to the fault or negligence of the shipowner or shipagent or to concurring fault or negligence of the shipowner or shipagent or captain (or patron) of the vessel. Undoubtedly, the shipowner himself, was guilty of such fault or negligence in not making certain that the passenger vessel is not overload, as well as and is having failed to provide sufficient life belts on board the vessel. (BAR 1989)

5. **In a collision between M/T Manila, a tanker, and M/V Don Claro, an inter-island vessel, M/V Don Claro sank and many of its passengers drowned and died. All its cargoes were lost. The collision occurred at nighttime but the sea was calm, the weather fair and visibility was good. Prior to the collision and while still 4 nautical miles apart, M/V Don Claro already sighted M/T Manila on its radar screen. M/T Manila had no radar equipment. As for speed, M/V Don Claro was twice as fast as M/T Manila.**

**At the time of the collision, M/T Manila failed to follow Rule 19 of the International Rules of the Road which required 2 vessels meeting head on to change their course by each vessel steering to starboard (right) so that each vessel may pass on the port side (left) of the other. M/T Manila signaled that it would turn to port side and steered accordingly, thus resulting in the collision. M/T Don Claro's captain was off-duty and was having a drink at the ship's bar at the time of the collision.**

- a) **If M/V Don Claro was at fault, may the heirs of the passengers who died and the owners of the cargoes recover damages from the owner of said vessel?**

**Answer:**

Yes, but subject to the doctrine of limited liability. The doctrine is to the effect that the liability of the shipowners would only be to the extent of any remaining value of the vessel, proceeds of insurance, if any, and earned freightage. Given the factual settings, the shipowner himself was not guilty of negligence and, therefore, the doctrine can well apply. (BAR 1991)

6. **Toni, a copra dealer, loaded 1,000 sacks of copra on board the vessel M/V Tonichi (a common carrier engaged in coastwise trade owned by Ichi) for shipment from Puerto Galera to Manila. The cargo did not reach Manila because the vessel capsized and sank with all its cargo. When Toni sued Ichi for damages based on breach of contract, the latter invoked the "limited liability rule"**

**What do you understand of the "rule" invoked by Ichi?**

**Answer:**

By "limited liability rule" is meant that the liability of a ship owner for damages in case of loss is limited to the value of the vessel involved. His other properties cannot be reached by the parties entitled to damages. (BAR 1994)

7. **Explain these two doctrines in Maritime accidents—  
The Doctrine of Limited Liability XXX**

**Answer:**

Under the "doctrine of limited liability" the exclusively real and hypothecary nature of maritime law operates to limit the liability of the shipowner to the value of the vessel, earned freightage and proceeds of the insurance. However, such doctrine does not apply if the shipowner and the captain are guilty of negligence. (BAR 1997)

8. **Thinking that the impending typhoon was still 24 hours away, MV Pioneer left port to sail for Leyte. That was a miscalculation of the typhoon signals by both the ship-owner and the captain as the typhoon came earlier and overtook the vessel. The vessel sank and a number of passengers disappeared with it.**

**Relatives of the missing passengers claimed damages against the shipowner. The shipowner set up the defense that under the doctrine of limited liability, his liability was co-extensive with his interest in the vessel. As the vessel was totally lost, his liability had also been extinguished.**

- a) How will you advise the claimants? Discuss the doctrine of limited liability in maritime law.**
- b) Assuming that the vessel was insured. May the claimants go after the insurance proceeds?**

Answer:

a) Under the doctrine of limited liability in maritime law, the liability of the shipowner arising from the operation of a ship is confined to the vessel, equipment, and freight, or insurance, if any, so that if the shipowner abandoned the ship, equipment, and freight, his liability is extinguished. However, the doctrine of limited liability does not apply when the shipowner or captain is guilty of negligence.

b) Yes. In case of a lost vessel, the claimants may go after the proceeds of the insurance covering the vessel. (BAR 1999)

- 9. X Shipping Company spent almost a fortune in refitting and repairing its luxury passenger vessel, the MV Marina, which plied the inter-island routes of the company from La Union in the north to Davao City in the south. The MV Marina met an untimely fate during its post-repair voyage. It sank off the coast of Zambales while en route to La Union from Manila. The investigation showed that the captain alone was negligent. There were no casualties in that disaster. Faced with a claim for the payment of the refitting and repair, X Shipping Company asserted exemption from liability on the basis of the hypothecary or limited liability rule under Article 587 of the Code of Commerce. Is X Shipping Company's assertion valid? Explain.**

Answer:

No. the assertion of X Shipping Company is not valid. The total destruction of the vessel does not affect the liability of the shipowner for repairs on the vessel completed before its loss. (BAR 2000)

### **c. Exceptions to Limited Liability**

- 1. What are the exceptions to the said rule? Explain.**

- a) Some exceptions to the above rule are any of the 2 succeeding enumerations, among others:
  - 1) In case the voyage is not maritime, but only in river, bay, or gulf;
  - 2) In the case of the expenses for equipping, repairing or provisioning the vessel;
  - 3) In case the vessel is not a common, but special carrier; and
  - 4) In case the vessel would totally sink or be a total loss, due to shipowner's or ship agent's own fault. (BAR 1985)

- 2. Toni, a copra dealer, loaded 1,000 sacks of copra on board the vessel M/V Tonichi (a common carrier engaged in coastwise trade owned by Ichi) for shipment from Puerto Galera to Manila.**

**The cargo did not reach Manila because the vessel capsized and sank with all its cargo.**

**When Toni sued Ichi for damages based on breach of contract, the latter invoked the "limited liability rule"**

**Are there exceptions to the "limited liability rule"**

**Answer:**

Yes. When the ship owner of the vessel involved is guilty of negligence, the “limited liability rule” does not apply. In such case, the ship owner is liable to the full extent of the damages sustained by the aggrieved parties. (BAR 1994)

**3. Accidents and Damages in Maritime Commerce**

**a. General Average and Particular Average**

1. The vessel “General Mascardo” was loaded with 5,000 tons of gold and copper concentrates by Syndicated Ores, Inc. (the charterer) for delivery to the U.S. The master of the vessel issued the corresponding bill of lading which contained a prohibition against the loading of dangerous cargo per se or cargo which may become dangerous and make the voyage unsafe. The master has had 10 years of experience as captain, but this was his first experience with cargo of gold and copper concentrates. The cargo was loaded, stowed and trimmed at the sole risk and expense of Syndicated Ore, Inc. While enroute to its destination, the vessel met a typhoon and because of the heavy stress, the shifting boards or compartments constructed by Syndicated broke, causing the cargo of ore concentrates to shift. Since the vessel was listing on its side to almost 14° for several hours, the master, in the hope of saving the vessel, decided to jettison some of the cargo belonging to other shippers. At this point, a powerful tugboat offered to help in maneuvering the vessel, which the master accepted on no-cure no pay basis. To save the vessel and the remaining cargo, the master, after consulting with his officers, deviated to Japan, the nearest port, instead of proceeding to the U.S. Thereafter, the cargo of gold and copper concentrates were examined by international surveyors who declare that the moisture content of said concentrates was beyond transportable limit and the same was much higher than as certified by Syndicated. The master and the shipowner, after declaring that the cargo was of dangerous nature and condition, unloaded the cargo in Japan, abandoned the voyage and informed the cargo owners to transship their cargo at their own cost and expense. The master and the shipowner also slapped a lien on said cargo for freight up to Japan as well as other expenses.

- a) Was there a general average situation? Did the vessel have the right to jettison other cargo, hire salvors and deviate the vessel to Japan?
- b) Assuming Syndicated Ores, Inc. refused general average, may the vessel declare the cargo as dangerous, unload the same, store the cargo in Japan and abandon the voyage, at the same time slapping a lien on cargo for freightage, expenses for unloading, expenses for jettison, salvage and/or general average?
- c) Does Syndicated Ores, Inc. have the right to insist that the vessel carry the cargo to the U.S. per bill of lading, or that the shipowner hire a substitute vessel to complete the contracted voyage in accordance with the “extraordinary diligence” required of common carriers in the carriage of goods?

**Answer:**

- a) As to general average— *First suggested answer:* No, there was no general average situation, the requisites of a general average being absent.

*Second suggested answer:* Assuming that the missing facts for requirements (there are four requisites) were present, then there was general average. (*A. Magsaysay, Inc. v. Agan, L-6393, Jan. 31, 1955*)

As to jettison— *First suggested answer:* Since the requisites of a general average were not existing, the captain had no right to jettison other cargo.

*Second suggested answer:* If the requisites of general average were present (there are four), then the captain had the right to jettison the other cargo.

As to hiring salvor— *First suggested answer*: Yes, because the cargo of the vessel was beyond the control of the crew.

Second suggested answer: No, because the requisites of a valid salvage claim were not present (there are three)

As to deviation— *First suggested answer*: The vessel/captain had no right to deviate the vessel to Japan because the requisites of arrival under stress were not present.

*Second suggested answer*: Yes, the vessel/captain had the right to deviate the vessel to Japan, because made in good faith, upon reasonable grounds of belief in its necessity to avoid a peril.

- b) It depends. If the requisites of law as to general average, salvage work and deviation of the vessel to Japan, would not be present or satisfied, as discussed above, under question letter (a), then the vessel/captain may not do these accts/things stated in question letter (b) to the prejudice of the shipper. If otherwise, the vessel/captain may.
- c) It depends. If during the voyage the vessel should become unseaworthy, the captain shall be obliged to charter at his expense another one in good condition to carry the cargo to its destination, U.S.A. If the captain should not furnish thru indolence or malice, a vessel to take the cargo to its destination, the shippers may charter one at the expense of the captain/shipowner. (BAR 1982)

2. **The MV Maliksi, laden with cargo, was on its way from Manila to Davao. Typhoon Bebang which had been last reported as leaving the Philippine area, suddenly changed its course without giving enough time for warning, and met MV Maliksi with all her strength. In order to lighten the vessel and prevent it from sinking, the Captain, after taking the proper steps, decided to jettison part of the cargo. Among those jettisoned were 20 barrels of petroleum which had been loaded on deck with the consent of the shipper, Juan Reyes. Some big crates below deck were also jettisoned.**

**The storm gradually subsided, and the MV Maliksi, although it suffered some damage, remained seaworthy and continued on its way to Davao. Visibility was still poor so that the vessel kept its light on.**

**About 2 hours later, the captain and the crew of the MV Maliksi suddenly saw another ship, without any lights on, was a few meters away from its port side and would apparently cross its path. They blew their whistles to warn the other vessel, at the same time trying to veer from its path. In spite of this, the MV Maliksi was hit on its port side and subsequently sank. It appeared that the watch of the other vessel, the MV Malakas, had fallen asleep.**

**The MV Malakas took the captain and the crew of MV Maliksi on board, and was able to salvage part of the MV Maliksi's cargo and carried this also on board.**

**Discuss briefly the rights and/or liabilities, if any, of Juan Reyes, the owners of the crates jettisoned, the owners of the cargo saved, and the owners of MV Maliksi and the MV Malakas, respectively.**

**Answer:**

Juan Reyes and the other owners of the cargo jettisoned are entitled to contribution for general average. All the requisites for the proper general average are present: the jettisoning was made deliberately for the purpose of saving both the vessel and its cargo from imminent danger, and the vessel was saved. This right to contribution subsists although the ship subsequently sank because the sinking was due to another and subsequent accident. Juan Reyes has the right to contribution although his goods were loaded on deck because petroleum due to its inflammable nature, is allowed to be and in fact must be loaded on deck and not in the hold (Art. 855 Code of

Commerce) Besides, Reyes knew and consented to his cargo being loaded on deck. However, only the cargo saved from both risks (i.e. typhoon and collision) can be made subject to such contribution, after deducting the expenses for saving them. The cargo saved during the typhoon but lost as a result of the collision cannot be made to contribute although they also benefited from the jettisoning. Their complete loss extinguished any obligation on their part to be subject to contribution for general average.

The owner of the MV Malakas is of course liable for the damages to the MV Maliksi as well as to the owner of the cargo lost due to the collision, because such collision was due to the negligence of its watchman. However, such civil liability is limited to the value of the vessel MV Malakas with all its appurtenances and freightage earned during the voyage. Unless of course it is covered by insurance. (BAR 1983)

3. **MV SuperFast, a passenger-cargo vessel owned by SF Shipping Company plying the inter-island routes, was on its way to Zamboanga City from the Manila port when it accidentally, and without fault or negligence of anyone on the ship, hit a huge floating object. The accident caused damage to the vessel and loss of an accompanying crated cargo of passenger PR. In order to lighten the vessel and save it from sinking and in order to avoid risk of damage to or loss of the rest of the shipped items (none of which was located on the deck), some had to be jettisoned. SF Shipping had the vessel repaired at its port of destination. SF Shipping thereafter filed a complaint demanding all the other cargo owners to share in the total repair costs incurred by the company and in the value jettisoned cargoes. In answer to the complaint, the shippers' sole contention was that, under the Code of Commerce, each damaged party should bear its or his own damage and those that did not suffer any loss or damage were not obligated to make any contribution in favor of those who did. Is the shippers contention valid? Explain.**

**Answer:**

No. the shippers' contention is not valid. The owners of the cargo jettisoned, to save the vessel from sinking and to save the rest of the cargoes, are entitled to contribution. The jettisoning of said cargoes constitute general average loss which entitles the owners thereof to contribution from the owner of the vessel and also from the owners of the cargoes saved.

SF Shipping is not entitled to contribution/reimbursement for the cost of repairs on the vessel from the shippers. (BAR 2000)

4. **Global Transport Services, Inc (GTSI) operates a fleet of cargo vessels plying interisland routes. One of its vessels, MV Donna Juana, left the port of Manila for Cebu laden with, among other goods, 10,000 television sets consigned to Romualdo, a TV retailer in Cebu.**

When the vessel was about 10 nautical miles away from Manila, the ship captain heard on the radio that a typhoon which, as announced by PAG-ASA, was on its way out of the country, had suddenly veered back into Philippine territory. The captain realized that MV Dona Juana would traverse the storm's path, but decided to proceed with the voyage. True enough, the vessel sailed into the storm. The captain ordered the jettison of the 10,000 television sets, along with some other cargo, in order to lighten the vessel and make it easier to steer the vessel out of the path of the typhoon. Eventually, the vessel, with its crew intact, arrived safely in Cebu.

- a) **Will you characterize the jettison of Romualdo's TV sets as an average? If so, what kind of an average, and why? If not, why not?**

**Answer:**

The jettison of Romualdo's TV sets resulted in a general average loss, which entitles him compensation or indemnification from the shipowner and the owners of the cargoes saved by the jettison.

- b) **Against whom does Romualdo have a cause of action for indemnity of his lost TV sets? Explain.**

**Answer:**

Romualdo has a cause of action for his lost TV sets against the shipowner and the owners of the cargoes saved by the jettison. The jettison of the TV sets resulted in a general average loss, entitling Romualdo to indemnity for the lost TV sets. (BAR 2009)

**5. What are the types of averages in marine commerce?**

**Answer:**

The types of averages are particular and general average. Particular averages include all expenses and damages caused to the vessel or to the cargo which did not inure to the common benefit and profit of all the persons interested in the vessel and the cargo. General averages include all damages and expenses which are deliberately caused to save the vessel, its cargo, or both at the same time, from real and known risk. (BAR 2010)

**6. An importer of Christmas toys loaded 100 boxes of Santa Clause talking dolls aboard a ship in Korea bound for Manila. With the intention of smuggling ½ of his cargo, he took a bill of lading for only 50 boxes to save the more precious cargo.**

**Is the importer entitled to receive any indemnity for average?**

**Answer:**

No. The importer is not entitled to receive any indemnity for average. In order that the goods jettisoned may be included in the general average and the owner be entitled to indemnity, it is necessary that their existence on board be proven by means of the bill of lading. (BAR 2010)

**b. Collisions**

**1. Vessel “U” and “V” collided with each other causing damage to both vessels. Vessel “U” had the last clear chance to avoid the collision but failed to do so.**

- 1) Is the doctrine of last clear chance in tort applicable to collisions of vessels at sea under the Code of Commerce? Which vessel should shoulder liability for the damage suffered by both vessels and by the cargo?**
- 2) Assume that the negligence of the captain of vessel “U” was the proximate cause of collision, while the negligence of the captain of vessel “V” was merely contributory. To which vessel should the collision be deemed imputable?**

**Answer:**

- 1) The doctrine of last clear chance in tort is not applicable to collision of vessels at sea under the Code of Commerce, and the case is deemed as if the collision is imputable to both vessels; thus, each one of the vessels shall suffer her own damage, and both shall be solidarily liable for the damages occasioned to their cargoes. (*C. B. Williams v. Yangco*, 27 Phil. 68; *Sarasola v. Sontua*, 47 Phil 365.)
  - 2) The collision shall be deemed imputable also to both vessels, as in the preceding answer to No. 1 question. Since the “doctrine of contributory negligence” in tort is not also applicable to collisions of vessel at sea under the Code of Commerce, the case is deemed as if the collision is imputable to both vessels. (*Gov’t of the P.I. v. Phil. Steamship Co. Inc.*, 44 Phil. 359) (BAR 1980)
- 2. In a collision between M/T Manila, a tanker, and M/V Don Claro, an inter-island vessel, M/V Don Claro sank and many of its passengers drowned and died. All its cargoes were lost. The collision occurred at nighttime but the sea was calm, the weather fair and visibility was good. Prior to the collision and while still 4 nautical miles apart, M/V Don Claro already sighted M/T Manila on its radar screen. M/T Manila had no radar equipment. As for speed, M/V Don Claro was twice as fast as M/T Manila.**

**At the time of the collision, M/T Manila failed to follow Rule 19 of the International Rules of the Road which required 2 vessels meeting head on to change their course by each vessel steering to starboard (right) so that each vessel may pass on the port side (left) of the other. M/T Manila signaled that it would turn to port side and steered accordingly, thus resulting in the collision. M/T Don Claro's captain was off-duty and was having a drink at the ship's bar at the time of the collision.**

**b) Who would you hold liable for the collision?**

**Answer:**

I could hold the 2 vessels liable. In the problem given, whether on the basis of the factual settings or under the doctrine of inscrutable fault, both vessels can be said to have been guilty of negligence. The liability of the 2 carriers for the death or injury of passengers and for the loss of or damage to the goods arising from the collision is solidary. Neither carrier may invoke the doctrine of last clear chance which can only be relevant, if at all, between the 2 vessels but not on the claims made by passengers or shippers. (BAR 1991)

- 3. Two vessels coming from opposite directions collided with each other due to fault imputable to both. What are the liabilities of the two vessels with respect to the damage caused to them and their cargoes? Explain.**

**Which party should bear the damage to the vessels and the cargoes if the cause of the collision was a fortuitous event? Explain.**

**Answer:**

Each vessel must bear its own damage. Both of them are at fault.

No party shall be held liable since the cause of the collision is fortuitous event. The carrier is not an insurer. (BAR 1995)

- 4. A severe typhoon was raging when the vessel SS Masdaam collided with the M/V Princess. It is conceded that the typhoon was the major cause of collision, although there was a very strong possibility that it could have been avoided if the captain of the SS Masdaam was not drunk and the captain of the M/V Princess was not asleep at the time of the collisions.**

**Who should bear the damages to the vessels and their cargoes?**

**Answer:**

The shipowners of the SS Masdaam and M/V Princess shall each bear their respective loss of vessels. For the losses and damages suffered by their cargoes, both shipowner are solidarily liable. (BAR 1998)

### **c. Doctrine of Inscrutable Fault**

- 1. There was a severe typhoon when the vessel M/V Fortuna collided with M/V Suerte. It is conceded that the typhoon was a major cause of the collision, although there was a strong possibility that it could have avoided if the captain of M/V Fortuna was not asleep at the time of the collision.**

**Who should bear the damages to the vessels and their cargoes?**

**Answer:**

Under the doctrine of inscrutable fault, neither of the carriers may go after the other.

The shippers may claim damages against the shipowners and the captains of both vessels, having been both negligent. Their liability is solidary.

The shipowners have the right to recover damages from the master of the vessels who were both guilty of negligence. The presence of a typhoon in the area had in fact warranted a greater degree of alertness on their part. (BAR 1987)

2. **If it cannot be determined which of the vessels was at fault resulting in the collision, which party should bear the damage caused to the vessels and the cargoes? Explain.**

**Answer:**

Each of them should bear their respective damages. Since it cannot be determined as to which vessel is at fault. This is under the doctrine of “inscrutable fault”. (BAR 1995)

3. **Explain these two doctrines in Maritime accidents—**

**The Doctrine of Inscrutable Fault; xx**

**Answer:**

Under the “doctrine of inscrutable fault”, where fault is established but it cannot be determined which of the 2 vessels were at fault, both shall be deemed to have been at fault. (BAR 1997)

**d. Salvage**

1. **If the cargo of a vessel is saved entirely by another vessel, who in the latter vessel will be entitled to salvage reward?**

**Answer:**

If the cargo of a vessel is saved entirely by another vessel, the salvage reward shall be divide between the owner, the captain, and the remainder of the crew of the latter vessel, so as to give the owner a half, the captain a fourth, and all the remainder of the crew the other fourth, in the absence of an agreement to the contrary. (BAR 1975)

2. **About 8:00 pm of March 20, 1974, X as captain of the MV Christina, received an S.O.S. or distressed signal by blinkers, from the MV Rosario, owned by Y. answering the S.O.S. call, X altered the course of his vessel which was then sailing from Dumaguete City, and headed towards the beckoning MV Rosario. X found MV Rosario to be in trouble due to engine failure and the loss of her propeller, for which reason, it was drifting slowly southward from Negros Island towards Borneo in the open China Sea, at the mercy of a moderate easterly wind. About 8:25 pm on the same day, the MV Christina succeeded in getting near the MV Rosario—in fact as near as about 7 meters from the latter ship. With the consent and knowledge of the captain and/or master of the MV Rosario, X caused the MV Rosario to be tied to, or well-secured and connected with tow lines from the MV Christina. The MV Christitna had the MV Rosario in tow and proceeded towards the direction of Dumaguete City, as evidenced by a written certificate to this effect executed by the Master, the Chief Engineer, the Chief Officers, and he Second Engineer of the MV Rosario, who were then on board the ship at the time of the occurrence stated above.**

**Did the service rendered by X to Y constitute “salvage” or “towage”? Why?**

**Answer:**

The circumstance all show that there was no marine peril, and the vessel was not a quasi-derelect, as to warrant a valid salvage claim for the towing of the vessel. X's service to Y can be considered as a quasi-contract of "towage" because in consenting to X's offer to tow the vessel, Y thereby impliedly entered into a juridical relation of "towage" with the owner of the towing vessel, captained by X.

**May X recover from Y compensation for such service? Why?**

**Answer:**

No. Where the contract created is one of towage, only the owner of the towing vessel, to the exclusion of the crew of said vessel, may be entitled to compensation. (*Barios v. Carlos A. Go Thong & Co.*, 7 SCRA 535) (BAR 1977)

3. **While at sea, the captain of vessel A received distress signals from vessel B, and vessel A responded and found vessel B with engine failure and drifting off course. Upon acceptance by vessel B and towed it safely to port. There was no grave marine peril because the sea was smooth and vessel B was far from the rocks. In a suit for compensation for towage, who are entitled to recover, the owner, the crew, or both? Give brief reasons.**

**Answer:**

Where the contract created is one for towage, and not for salvage, like that stated in the question, only the shipowner of the towing vessel, to the exclusion of the crew of the said vessel, may be entitled to compensation. The towage in question was not salvage of the vessel B, since there was no marine peril which would endanger the said vessel. (*Barrrios v. Carlos A. Go Thong & Co.*, L-17192, March 30, 1963)

**When as a result of a successful salvage, both ship A and the cargo therein are saved, against whom should the salvage allowance be charged and in what proportion, if any?**

**Answer:**

The salvage allowance shall be a charge on the owner of the ship or ship itself, and the owners of the cargo or cargo itself, so salvaged, and in proportion to their respective value. (BAR 1979)

#### e. Maritime Protest

1. **In the morning of April 2, 1977, the South-bound FS-90 belonging to William Lines, Inc. reached the waters of the Verde island Passage. About the same time, the M.S. General Del Pilar, another interisland vessel owned by the General Shipping, was likewise in the same waters, steaming northward to Manila. The vessels, coming from the opposite directions and towards each other, suddenly collided at a certain point of the passage which resulted in the sinking of FS-190, together with all its cargoes, part of which belonged to Tanya, who was a paying passenger and Rafael, who was a shipper.**

**Tanya and Rafael brought an action in court to recover for their losses and for damages arising from the collision.**

**Were they under obligation to file a maritime protest for a successful maintenance of the action? Why?**

**Answer:**

No, Tanya and Rafael are not under obligation to file maritime protest. Art. 835 of the Code of Commerce states that "the action for recovery of damages and losses arising from collisions cannot be admitted without a previous protest or declaration presented by the captain within 24 hours before the competent authority of the point where the collision took place, or of the first port of arrival." Therefore, a marine protest is required to be made by the master of the vessel not by the passenger or shipper. (BAR 1977)

**2. Explain a maritime protest.**

**Answer:**

Maritime Protest—a written statement by the master of vessel, attested by a proper judicial officer or a notary, to the effect that damage suffered by the ship or her voyage was caused by storms or other perils of the sea, without any negligence or misconduct on his part. (BAR 1977)

- 3. Captain Hook, the ship captain of M.V. Peter Pan, overloaded the M.V. Peter Pan, as a consequence of which the vessel sank in the middle of the Sulu Sea, and nothing whatsoever was recovered. The owners of the cargo and the heirs of the three passengers of the vessel filed an action for damages in the amount of P500,000 against Mr. Wendy, the owner.**

**Explain a maritime protest. When and where should it be filed?**

**Answer:**

A maritime protest is a sworn statement stating the circumstances of collision which must be presented within 24 hours before the competent authority of the port nearest to where the collision had taken place or the first port of arrival or, if it occurs in a foreign country, the Philippine consular representative. An action to recover losses and damages arising from collisions cannot be admitted if such protest, however, will not prejudice such action by owners of cargo who were not on board the vessel or who were not in a condition to make known their wishes. (BAR 1988)

- 4. Two vessels figured in a collision along the Straits of Guimaras resulting in considerable loss of cargo. The damaged vessels were safely conducted to the Port of Iloilo. Passenger A failed to file a maritime protest. B, a non-passenger but a shipper who suffered damage to his cargo, likewise did not file a maritime protest at all.**

**a) What is a maritime protest?**

**b) Can A and B successfully maintain an action to recover losses and damages arising from the collision? Reason briefly.**

**Answer:**

- a) A maritime protest is a sworn statement made within 24 hours after a collision in which the circumstances thereof are declared or made known before a competent authority at the point of accident or the first port of arrival if in the Philippines or the Philippine consul in a foreign country.
- b) B, the shipper, can successfully maintain an action to recover losses and damages arising from the collision notwithstanding his failure to file a maritime protest since the filing thereof is required only on the part of A, who, being a passenger of the vessel at the time of the collision, was expected to know the circumstances of the collision. A's failure to file a maritime protest will therefore prevent him from successfully maintaining an action to recover his losses and damages. (BAR 2007)

**4. Carriage of Goods by Sea Act (COGSA)**

**a. Application**

- 1. The goods imported from the United States were unloaded by the carrier in Manila. While in the custody of the arrastre operator, part of the shipment worth P1,000 was lost. Does the case involve admiralty and maritime commerce so that the action for short delivery has to be filed in the Court of First Instance regardless of the amount? Reasons.**

**Answer:**

a) *No, the matter does not involve admiralty or maritime commerce which relate only to incidents occurring during the sea voyage. Even assuming that the case involves an admiralty and maritime case, under B.P. 129, jurisdiction now also lies with the Metropolitan, MTC and MCTC if the amount involved does not exceed P20,000.(BAR 1988)*

2. **Akiro of Tokyo, Japan sent various goods to his friend Juan in Cebu City, Philippines, through one of the vessels of Worthwell Shippers, Inc., an American corporation. En route to Cebu City, the vessel had two stops, first in Hong Kong, and second, in Manila.**

**While travelling from Tokyo to Hong Kong, the goods were damaged.**

**What law will govern?**

- a) Japanese law;
- b) Hong Kong law;
- c) Chinese law;
- d) Philippine law;
- e) American law.

**Answer:**

d) Philippine law (BAR 2013)

**b. Notice of Loss or Damage**

1. **Under the provisions of Section 3 of the Carriage of Goods by Sea Act, notice must be given of loss or damage to the goods. Within what period must notice be given, if the loss or damage is not apparent? Does the term “loss” in this Act cover delivery to the wrong person? Explain.**

**Answer:**

Notice of loss must be given within three days from the delivery of the goods, if the loss is not apparent.

The Supreme Court has held in one case that “loss” under this Act does not cover misdelivery or delivery to the wrong person. (BAR 1975)

2. **RC imported computer motherboards from the USA and had them shipped to Manila aboard an ocean-going cargo ship owned by BC Shipping Company. When the cargo arrived at the Manila seaport and delivered to RC, the crate appeared intact; but upon inspection of the contents, RC discovered that the items inside had all been badly damaged. He did not file any notice of damage or anything with anyone, least of all with BC Shipping Company. What he did was to proceed directly to your office to consult you about whether he should have given a notice of damage and how long a time he had to initiate a suit under the provisions of the COGSA. What would your advise be?**

**Answer:**

My advice would be that RC should give notice of the damage sustained by the cargo within 3 days and that he has to file the suit to recover the damage sustained by the cargo within 1 year from the date of the delivery of the cargo to him. (BAR 2000)

**c. Period of Prescription**

1. **The plaintiff, as subrogee of the consignee, sued the defendant, a contractor and operator of arrastre service in the port of Manila, for its failure to deliver one case of merchandise consisting of electronic spare parts shipped from Europe which it received from the carrier. The action was brought within the period of 4 years, but after the lapse of 1 year, from the date the goods should have been delivered. Invoking the provisions of the Carriage of Goods by Sea Act, the lower court dismissed the complaint on the ground that it was filed after 1 year from the time that the cause of action accrued.**

**Was the lower court justified in dismissing the complaint? Why?**

**Answer:**

("BONUS" since it refers to "arrastre services", excluded from the coverage of the "MERCANTIE LAW") (BAR 1978)

2. **A local consignee sought to enforce judicially a claim against the carrier for loss of a shipment of drums of lubricating oil from Japan under the COGSA after the carrier had rejected its demand. The carrier pleaded in its Answer the affirmative defense of prescription under the provisions of the same Act inasmuch as the suit was brought by the consignee after 1 year from delivery of the goods. In turn, the consignee contended that the period of prescription was suspended by the written extrajudicial demand it had made against the carrier within the 1-year period, pursuant to Article 1155 of the Civil Code providing that the prescription of actions is interrupted when there is a written extrajudicial demand by the creditors.**

**a) Has the action, in fact, prescribed? Why?**

**Answer:**

The action taken by the local consignee has, in fact, prescribed. The period of 1 year under the COGSA is not interrupted by a written extrajudicial demand. The provision of Article 1155 of the Civil Code merely apply to the prescriptive periods provided for in said Code and not the special laws except when otherwise provided.

**b) If the consignee's action were predicated on misdelivery or conversion of the goods, would your answer be the same? Explain briefly.**

**Answer:**

If the consignee's action were predicated on misdelivery or conversion of the goods, the provisions of the COGSA would be inapplicable. In these case, the Civil Code prescriptive periods, including Art. 1155 of the Civil Code, will apply. (BAR 1992)

3. **What is the prescriptive period for actions involving lost or damaged cargo under the Carriage of Goods by Sea Act?**

**Answer:**

One (1) year after delivery of the goods or the date when the goods should have been delivered. (BAR 1995)

4. **RC imported computer motherboards from the USA and had them shipped to Manila aboard an ocean-going cargo ship owned by BC Shipping Company. When the cargo arrived at the Manila seaport and delivered to RC, the crate appeared intact; but upon inspection of the contents, RC discovered that the items inside had all been badly damaged. He did not file any notice of damage or anything with anyone, least of all with BC Shipping Company. What he did was to proceed directly to your office to consult you about whether he should have given a notice of damage and how long a time he had to initiate a suit under the provisions of the COGSA. What would your advise be?**

**Answer:**

My advice would be that RC should give notice of the damage sustained by the cargo within 3 days and that he has to file the suit to recover the damage sustained by the cargo within 1 year from the date of the delivery of the cargo to him. (BAR 2000)

5. **AA entered into a contract with BB thru CC to transport ladies' wear from Manila to France with transshipment at Taiwan. Somehow the goods were not loaded at Taiwan on time. Hence, when the goods arrived in France, they arrived "off-season" and AA was paid only for ½ the value by the buyer. AA claimed damages from the shipping company and its agent. The defense of the respondents was prescription.**

**Considering that the ladies' wear suffered "loss value", as claimed by AA, should the prescriptive period be one year under the COGSA, or 10 years under the Civil Code? Explain briefly.**

**Answer:**

The applicable prescriptive period is 10 years under the Civil Code. The 1-year prescriptive period under the COGSA applies in cases of loss or damage to the cargo. The term "loss" as interpreted by the Supreme Court in Mitsui O.S.K. Lines, contemplates a situation where no delivery at all was made by the carrier of the goods because the same had perished or gone out of commerce deteriorated or decayed while in transit. In the present case, the shipment of ladies' wear was actually delivered. The "loss of value" is not the total loss contemplated by the COGSA (BAR 2004)

6. **AA entered into a contract with BB for the latter to transport ladies wear from Manila to France with transshipment via Taiwan. Somehow the goods were not loaded in Taiwan on time, hence, these arrived in France "off-season." AA was only paid ½ the value by the buyer.**

**AA claimed damages from BB. BB invoked prescription as a defense under the COGSA. Considering the "loss of value" of the ladies wear as claimed by AA, is BB's defense tenable? Explain.**

**Answer:**

No. the defense of BB is not tenable. The 1 year prescriptive period in the COGSA applies only in case the goods were not delivered or were delivered in a damaged condition. It does not apply to damages as a result of delay in the delivery of the goods. The prescription of the action is governed by Article 1144 of the Civil Code, which provides for a prescriptive period of 10 years in case of actions based on a written contract. (BAR 2010)

7. **Akiro of Tokyo, Japan sent various goods to his friend Juan in Cebu City, Philippines, through one of the vessels of Worthwell Shippers, Inc., an American corporation. En route to Cebu City, the vessel had two stops, first in Hong Kong, and second, in Manila.**

**Assuming Philippine law is to be applicable and Juan fails to file a claim with the carrier, may he still commence an action to recover damages with the court?**

- a) **No, the failure to file a claim with the carrier is a condition precedent for recovery;**
- b) **Yes, provided he files the complaint within 10 years from delivery;**
- c) **Yes, provided he files the complaint within 10 years from discovery of the damage;**
- d) **Yes, provided he files the complaint within 1 year from delivery;**
- e) **Yes, provided he files the complaint within 1 year from discovery of the damage;**

**Answer:**

d) Yes, provided he files the complaint within 1 year from delivery. (BAR 2013)

8. On December 1, 2010, Kore A Corporation shipped from South Korea to LT Corporation in Manila some 300,000 sheets of high-grade special steel. The shipment was insured against all risk by NA Insurance (NA). The carrying vessel arrived at the Port of Manila on January 10, 2011. When the shipment was discharged, it was noted that 25,000 sheets were damaged and in bad order. The entire shipment was turned over to the custody of ATI, the arrastre operator, on January 21, 2011 for storage and safekeeping, pending its withdrawal by the consignee's authorized customs broker, RVM.

On January 26 and 29, 2011, the subject shipment was withdrawn by RVM from the custody of ATI. On January 29, 2011, prior to the withdrawal of the last batch of the shipment, a joint inspection of the cargo was conducted per the Request for bad Order Survey (RBO) dated January 28, 2011. The examination report showed that 30,000 sheets of steel were damaged and in bad order.

NA Insurance paid LT Corporation the amount of P30 M for the 30,000 sheets that were damaged, as shown in the Subrogation Receipt dated January 13, 2013. Thereafter, NA Insurance demanded reparation against ATI for the goods damaged in its custody, in the amount of P5 M. ATI alleged that the COGSA applies in this case since the goods were shipped from a foreign port to the Philippines. NA Insurance claims that the COGSA does not apply, since ATI is not a shipper or carrier. Who is correct?

**Answer:**

NA Insurance is correct. ATI should be ordered to pay NA Insurance notwithstanding the lapse of the one year prescriptive period for filing a suit under the COGSA. The term "carriage of goods" under Section 1 in COGSA, covers the period from the time when the goods are loaded to the time when they are discharged from the ship infer that the period of time when the goods have been discharged from the ship and given to the custody of the arrastre operator is not covered by the COGSA. The COGSA does not mention that an arrastre operator may invoke the prescriptive period of one year; hence, it does not cover the arrastre operator. (BAR 2014)

**d. Limitation of Liability**

**5. Bottomry**

1. Under what conditions, if any, may a ship captain borrow on bottomry for his own transactions?

**Answer:**

The captain may borrow on bottomry for his own transactions on the portion of the vessel he owns, provided no money has been previously borrowed on the whole vessel, and there is no other lien or obligation chargeable against the vessel. He must state his interest in the vessel. (BAR 1975)

2. "S", a shipowner, secure a loan on bottomry for P1 Million from "T" for the repair of a vessel, payable 120 days after date (estimated time for the return voyage), and as security for its repayment mortgages the keel and bottom of the vessel. In addition to the usual terms and conditions for this type of loan, "T", because of the risk of losing his money, imposes an interest rate of 30% to which "S" reluctantly agrees.

Could "S" later on question the validity of the interest rate of 30% as being violative of the Usury Law?

**Answer:**

No, S cannot question the validity of the interest rate of 30% as being violative of the Usury Law. In usury statute, it is essential to constitute usury, that the principal sum be repayable absolutely; and therefore, usury statute has no application to loans on bottomry; thus the perils of marine navigation have been always considered sufficient to take bottomry or respondentia loans out of the usury law. (*Lloyd v. Scott*, 4 Pet. 205, 7 L. Ed. 833; *Laughlin v. Irwin*, 262 Ill. App. 40; *Webb on usury*, p.47)

**Note:** The Usury Law is now legally non-existent pursuant to CB Circular 905. (BAR 1980)

3. Gigi obtained a loan from JOJO Corporation, payable in installments. Gigi executed a chattel mortgage in favor of JOJO whereby she transferred "in favor of JOJO, its successors and assigns, all her title, rights xxx to a vessel of which GIGI is the absolute owner." The chattel mortgage was registered with the Philippine Coast Guard pursuant to PD No. 1521. Gigi defaulted and had a total accountability of P3 M. But JOJO could not foreclose the mortgage on the vessel because it sank during a typhoon.

Meanwhile, Lutang Corporation which rendered salvage for refloating the vessel sued Gigi.

Whose lien should be given preference, that of JOJ or of Lutang?

**Answer:**

Lutang Corporation's lien should be given preference. The lien of JOJO by virtue of a loan on bottomry was extinguished when the vessel sank. Under such loan on bottomry JOJO acted not only as creditor but also as insurer. JOJO's right to recover the amount of the loan is predicated on the safe arrival of the vessel at the port of destination. The right was lost when the vessel sank.

**G. The Warsaw Convention**

1. Applicability
2. Limitation of Liability
  - a. Liability to Passengers
  - b. Liability for Checked Baggage

1. A shipped 13 pieces of luggage through LG Airlines from Teheran to Manila as evidences by LG Air Waybill which disclosed that the actual gross weight of the luggage was 180Kg. Z did not declare an inventory of the contents or the value of the 13 pieces of luggage. After the said pieces of luggage arrived in Manila, the consignee was able to claim from the cargo broker only 12 pieces, with a total weight of 174Kg. X advised the airlines of the loss of one of the 13 pieces of luggage and of the contents thereof. Efforts of the airlines to trace the missing luggage were fruitless. Since the airlines failed to comply with the demand of X to produce the missing luggage, X filed an action for breach of contract with damages against LG Airlines. In its answer, LG Airlines of the carrier, if any, with respect to cargo to a sum of \$20 per kilo or \$9.07 per pound, unless a higher value is declared in advance and additional charges are paid by the passenger and the conditions of the contract as set forth in the air waybill. Expressly subject the contract of the carriage of cargo to the Warsaw Convention. May the allegation of LG Airlines be sustained? Explain.

**Answer:**

Yes. Unless the contents of a cargo are declared or the contents of a lost luggage are proved by the satisfactory evidence other than the self-serving declaration of one party, the contract should be enforced as it is the only reasonable basis to arrive at a just award. The passenger or shipper is bound by the terms of the passenger ticket or the waybill. (BAR 1993)

2. X took PAL Flight PR 102 to Los Angeles, USA. She had 2 luggage checked-in and was 2 baggage checks. When X reached Los Angeles, 1 of the 2 checked-in luggage could not be found. Which statement is most accurate?
- a) PAL is liable for the loss of the checked-in-luggage under the provision of the Warsaw Convention on Air Transport;
  - b) PAL is liable for the loss only if the baggage check expressly states that the airline shall be liable in case of loss;

- c) PAL cannot be held liable because that is the risk that a passenger takes when she checks-in her baggage;
- d) PAL can only be held liable if it can be proven that PAL was negligent.

**Answer:**

a) PAL is liable for the loss of the checked-in-luggage under the provision of the Warsaw Convention on Air Transport. (BAR 2012)

**c. Liability for Hand carried Baggage**

**3. Willful Misconduct**

**H. Public Service Act**

3. On September 1, 1971, then Public Service Commission in BC Case No. 70-3496 made permanent and effective immediately the provisional increase of rates by PLDT previously so authorized on the ground among others, that public interest would be served thereby.

Pending appeal to the Supreme Court of BC Case No. 70-3496, PLDT filed on February 27, 1973 with the Board of Communications (successor to the Public Service Commission) another application for an across-the-board increase of 40% of its present authorized rates docketed as BC Case No. 73-011.

On April 27, 1973, the Board of Communications issued an Order which provisionally authorized PLDT to charge a 35% across-the-board increase of its present authorized rates subject to the conditions stated therein.

In the case at bar, has the Board of Communications, as successor to the defunct Public Service Commission, the power to amend, modify or revoke rates to be charged by the PLDT? Explain.

**Answer:**

The power of the Board of Communications, as successor to the defunct Public Service Commission, to amend, modify or revoke or establish rates in lieu of those set forth in the final decision is affirmed in Section 16 (c) of the Public Service Act, as amended (*PLDT v. Medina*, 20 SCRA 659), which rates shall immediately be operative (Sec. 33, Public Service Act), as amended, provided a new case is filed therefore under separate docket in the Public Service Commission. The 1973 BC Case No. 73-011 is new and separate from the 1970 BC Case No. 70-3496.

May the order or decision of said Board on rates be stayed by a petition for certiorari in the Supreme Court? Why?

**Answer:**

The order or decision of the Board for Public Service Commission and now the Board of Communications cannot be stayed by the institution of a petition for certiorari, or other special remedies in the Supreme Court, unless the Supreme Court shall so direct. (*Gonzales v. Public Service Commission*, 61 SCRA 504) (BAR 1977)

4. **The City of Manila passed an ordinance banning provincial buses from the city. The ordinance was challenged as invalid under the Public Service Act by X who has a certificate of public convenience to operate auto-trucks with fixed routes from certain towns in Bulacan and Rizal to Manila and within Manila. Firstly, he claimed that the ordinance was null and void because, among other things, it in effect amends his certificate of public convenience, a thing which only the Public Service Commission can do so under Section 16(m) of the Public Service Act. Under said section, the Commission is empowered to amend, modify or revoke a certificate of public convenience after notice and hearing. Secondly, he contended that even if the ordinance was valid, it is only the Commission which can require compliance with its provisions under Section 17(j) of said Act and since the implementation of the ordinance was without sanction or approval of the Commission, its enforcement was unauthorized and illegal.**
1. **May the reliance of X on Section 16(m) of the Public Service Act be sustained? Explain.**
  2. **Was X correct in his contention that under Section 17 (j) of the public Service Act it is only the Commission which can require compliance with the provision of the ordinance? Explain.**

**Answer:**

1. No. The power vested in the public Service Commission under Section 16(m) is subordinate to the authority of the City of Manila under Section 18(hh) of its revised charter, to superintend, regulate or control the streets of the City of Manila.
  2. No. The powers conferred by law upon the Public Service Commission were not designed or supersede the regulatory power of local governments over motor traffic in the streets subject to their control. (BAR 1993)
5. **Angelene is a customer of Meralco Electric Company (MECO). Because of the abrupt rise of the electricity rates. Angelene complained with MECO insisting that she should be charged the former rates. However, Angelene did not tender any payment.**

**When MECO's employees served the first 48-hour notice of disconnection, Angelene protested. MECO, however, did not implement the 48-hour notice of disconnection. Instead, its employees examined Angelene's electric meter, changed the same, and installed another. Still, Angelene made no tender of payment.**

**MECO served a second 48-hour notice of disconnection on June 22, 1984. It gave Angelene until 5:00pm of June 25, 1984, within which to pay. As no payment had been made, MECO cut Angelene's electric service on June 28, 1984.**

**Angelene contends that the 48-hour written notice of disconnection rule cannot be invoked by MECO when there is a bona fide and just dispute as to the amount due as her electric consumption rate.**

**Is Angelene's contention valid?**

**Answer:**

No. Angelene's only legal recourse in this case was to pay the electric bill under protest. Her failure to do so justified Meralco to cut the electric service. (BAR 1994)

6. **WWW Communications Inc., is an e-commerce company whose present business activity is limited to providing its clients with all types of information technology hardware. It plans to re-focus its corporate direction of gradually converting itself into a full convergence organization. Towards this objective, the company has been aggressively acquiring telecommunications businesses and broadcast media enterprises, and consolidating their corporate structures. The ultimate plan is to have only two organizations: one to own the facilities of the combined businesses and to develop and produce content materials, and another to operate the facilities and provide mass media and commercial telecommunications services. WWW Communications will be the flagship entity which will own the facilities of the conglomerate and provide content to the other new corporation which, in turn, will operate those facilities and provide the services. WWW seeks your professional advice on whether or not its reorganized business activity would be considered a public utility requiring a franchise or certificate or any other form of authorization from the government. What will be your advice? Explain.**

**Answer:**

The reorganized business activity of WWW Communications Inc. would not be considered a public utility requiring a franchise or certificate or any other form of authorization from the government. It owns the facilities, but does not operate the same. (BAR 2000)

7. **CG, a customer, sued MERALCO in the MM RTC to disclose the basis of the computation of the purchased power adjustment (PPA). The trial court ruled it had no jurisdiction over the case because, as contended by the defendant, the customer not only demanded a breakdown of MERALCO's bill with respect to PPA but questioned as well the imposition of the PPA, a matter to be decided by the Board of Energy, the regulatory agency which should also have jurisdiction over the instant suit.**

**Is the trial court's ruling correct or not? Reason briefly.**

**Answer:**

The trial court's ruling is correct. As held in Manila Electric Company v. Court of Appeals, 27 SCRA 41& (1997), the Board of Energy had the power to regulate and fix power rates to be charged by franchised electric utilities like MERALCO. In fact, pursuant to E.O. No. 478 (April 17, 1998), this power has been transferred to the Energy Regulatory Board (now the Energy regulatory Commission). Under Section 43(u) of the Electric Power Industry Reform Act of 2001, the Energy Regulatory Commission has original and exclusive jurisdiction over all cases contesting power rates. (BAR 2004)

8. **Under the Public Service Act, an administrative agency has the power to approve provisionally the rates of public utilities without a hearing in case of urgent public needs. The exercise of this power is**
- a. **Supervisory**
  - b. **Absolute**
  - c. **Discretionary**
  - d. **Mandatory**

**Answer:**

c. Discretionary. (BAR 2011)

**1. Certificate of Public Convenience**

- 1. A was granted by the Board of Transportation a certificate of public convenience to operate 50 provincial buses, plying between Ilocos Norte and Manila passing through Rizal Avenue Extension then right on Doroteo Jose. Because of traffic congestion between the hours of 7 and 9 o'clock in the morning, and 4 to 8 o'clock in the evening, a municipal ordinance was passed prohibiting provincial buses from entering Manila on those hours but allowing them to use one shuttle bus for every 5 buses. A challenged the validity of the ordinance, on the ground that it infringes on his certificate of public convenience, and that he had acquired a vested right to enter Manila at anytime of the day, thru aforementioned route. Decide with reasons.**

**Answer:**

The ordinance is valid. Under its charter, the City of Manila has the power to regulate the use of its streets. This charter is a special law and therefore prevails over the Public Service Act. Consequently, the power of the BOT to grant certificates is subject to this provision of the charter of Manila. A has thus not acquired any vested right as alleged by him. (*Lagman v. City of Manila*, G.R. No.- L-23305, June 30, 1966) (BAR 1976)

- 2. A bus line's service between Manila and Malolos is satisfactory. A new road is opened between said points, and a new carrier applies for a certificate of public convenience to operate a bus line along the new road. The old bus line opposes, claiming that it should first be given an opportunity to extend its service. Which party should prevail? Reason.**

**Answer:**

Where all conditions being equal, priority in the filing of the application for a certificate of public convenience becomes an important factor in the granting thereof; so the new carrier who applies first shall prevail. (*Batangas Transportation Co., v. Orlanes*, 52 Phil., 455). (BAR 1979)

- 3. The Continental Marble Corporation filed with the Board of Energy an application for Certificate of Public Convenience for the purpose of supplying electric power and light to its factory and its employees living within its compound. The application was opposed by the Norzagaray Electric & Power Co., Inc., contending that the Continental Marble Corporation has not secured a franchise to operate and maintain an electric plant.**

**Rule on the merits of the oppositor's contention with supporting reasons.**

**Answer:**

A franchise in this case is not necessary to operate and maintain an electric plant. Such a franchise necessary only in order to operate and maintain an electric line or power plant and line for business purpose, that is, to render service to the general public for compensation. Clearly, therefore, it should not be made to apply to Continental Marble Corporation which will only supply the electric power and light to its factory and its employees living within its compound. (*Teresa Electric & power Co., Inc. v. Public Service Commission*, Sept. 25, 1967; 21 SCRA 198) (BAR 1981)

- 4. Acme Transportation Co. has a certificate of public convenience to operate buses in Southern Luzon and Eastern Visayas, including the Manila-Bicol-Samar-Leyte route. In order to get to Samar, its buses take a ferry from Matnog, Sorsogon, across the babuyan Channel, an 8-Km ride more or less to the coastal town of Allen in Samar. Acme Transportation Co. finds that the fees it pays for the ferry come to a quite substantial amount each year and it calculates that it will be more economical to have its own ferry to transport its buses. It therefore applies for an authorization to operate such a ferry as an additional unit of equipment for the exclusive use of its buses on the Manila-Leyte route.**

**X Lighterage Service Co. which has been operating a ferry service on said route for the past 6 years, objects on the following grounds: (a) the certificate of public convenience of Acme is to operate land transportation and this does not include ferry service which is already inter-island shipping. It therefore needs a new certificate of public convenience to operate inter-island transportation, a mere**

authority to acquire and operate an additional unit not being sufficient, and (b) granting that the operation of said ferry is within Acme's certificate of public convenience, X Lighterage Service Co. is a prior operator, and since it is giving adequate service, there is no need for an additional ferry service on said route. In fact, Acme Transportation Co. has been availing itself of the ferry service of X Lighterage Service Co. for several years.

**Decide with reasons.**

**Answer:**

Acme may be given the permit it seeks. As to the first objection, it is generally held that where a ferry service which connects two points on opposite sides of an arm of the sea such as a bay or the like, and which does not involve too great a distance or too long a time to navigate, it is considered merely a continuation or extension of the highway. Therefore, the ferry service in question may still be considered land transportation within the scope of Acme's present certificate of public convenience. There is no need for Acme to obtain another certificate for inter-island transportation. As to the second objection, even assuming that X, a prior operator, is rendering adequate service and there is no need for a new ferry operator on said route, Acme's petition is to use the ferry for its purposes exclusively, and therefore will not compete with X. The fact that X will lose Acme as a customer is no justification to prevent the latter from ferrying its own buses to lessen its expenses, as long as it does not offer its services to others. (BAR 1983)

5. **Antonio was granted a Certificate of Public Convenience (CPC) in 1986 to operate a ferry between Mindoro and Batangas using the motor vessel "MV Lotus". He stopped operations in 1988 due to unserviceability of the vessel.**

**In 1989, Basilio was granted a CPC for the same route. After a few months, he discovered that Carlos was operating on his route under Antonio's CPC. Because Basilio filed a complaint for illegal operations with the Maritime Industry Authority, Antonio and Carlos jointly filed an application for sale and transfer of Antonio's CPC and substitution of the vessel "MV Lotus" with another owned by Carlos.**

**Should Antonio's and Carlos' joint application be approved? Give your reasons.**

**Answer:**

The joint application of Antonio and Carlos for the sale and transfer of Antonio's CPC and substitution of the vessel MV Lotus with another vessel owned by the transferee should not be approved. The CPC and "MV Lotus" are inseparable. The unserviceability of the vessel covered by the certificate had likewise rendered ineffective the certificate itself, and the holder thereof may not legally transfer the same to another. (BAR 1992)

6. **Robert is a holder of a certificate of public convenience to operate a taxicab service in Manila and suburbs. One evening, one of his taxicab units was boarded by 3 robbers as they escaped after staging a hold-up. Because of said incident, the LTFRB revoked the certificate of public convenience of Robert on the ground that said operator failed to render safe, proper and adequate service as required under Section 19(a) of the Public Service Act.**
- a. **Was the revocation of the certificate of public convenience of Robert justified? Explain.**
  - b. **When can the Commission (Board) exercise its power to suspend or revoke certificate of public convenience?**

**Answer:**

- a) No. A single hold-up incident which does not link Robert's taxicab cannot be construed that he rendered a service that is unsafe, inadequate and improper.

b) Under Section 19(a) of the Public Service Act, the Commission (Board) can suspend or revoke a certificate of public convenience when the operator fails to provide a service that is safe, proper or adequate, and refuses to render any service which can be reasonably demanded and furnished. (BAR 1993)

7. **Pepay, a holder of a certificate of public convenience, failed to register the complete number of units required by her certificate. However, she tried to justify such failure by the accidents that allegedly befell her, claiming that she was so shocked and burdened by the successive accidents and misfortunes that she did not know what she was doing, she was confused and thrown off tangent momentarily, although she always has the money and financial ability to buy new trucks or repair the destroyed one. Are the reasons given by Pepay sufficient grounds to excuse her from completing her units? Explain.**

**Answer:**

No. The reasons given by Pepay are not sufficient grounds to excuse her from completing her units. The same could be undertaken by her children or by other authorized representatives. (BAR 1993)

8. **What requirements must be met before a certificate of public convenience may be granted under the Public Service Act?**

**Answer:**

The following are the requirements for the granting of a certificate of public convenience, to wit:

- a) The applicant must be a citizen of the Philippines, or a corporation, co-partnership or association organized under the laws of the Philippines and at least 60% of the stock or paid-up capital of which must belong to citizens of the Philippines.
- b) The applicant must prove public necessity.
- c) The applicant must prove that the operation of the public service proposed and the authorization to do business will promote the public interest in a proper and suitable manner.
- d) The applicant must be financially capable of undertaking the proposed service and meeting the responsibilities incident to its operation. (BAR 1995)

9. **The Batong Bakal Corporation filed with the Board of Energy an application for a Certificate of Public Convenience for the purpose of supplying electric power and lights to the factory and its employees living within the compound. The application was opposed by the Bulacan Electric Corporation, contending that the Batong Bakal Corporation has not secured a franchise to operate and maintain an electric plant.**

**Is the opposition's contention correct?**

**Answer:**

No. A certificate of public convenience may be granted to Batong Bakal Corporation, though not possessing a legislative franchise, if it meets all the other requirements. There is nothing in the law nor the Constitution, which indicates that a legislative franchise is necessary or required for an entity to operate as supplier of electric power and light to its factory and its employees living within the compound. (BAR 1998)

## **2. Prior Operator Rule**

1. **Mr. Mangasiwa applied for a certificate of public convenience to operate 5 jeepneys from Batasang Pambansa area to Cubao, Quezon City. The application was opposed by Hallelujah Transit and Kingdom Bus Co., which were already serving the area. They invoked the "prior or old operator rule" in their opposition. Mangasiwa, in turn, invoked the "prior applicant rule".**

**Discuss the “prior or old operator rule” and the limitations or provisos on its application. In case of conflict between the “prior or old operator rule” and the “prior applicant rule”, which rule shall prevail? Explain.**

**Answer:**

The “prior or old operator rule” allows an existing franchised operator to invoke preferential right to render the public service within the authorized territory as long as he does so satisfactorily and economically. In case of conflict between the “prior or old operator rule” and the “prior applicant rule”, the former will apply as long as again the operator is able to render satisfactory and economically service. (BAR 1986)

## **VI. The Corporation Code**

### **A. Corporation**

- 1. Distinguish clearly (1) a private corporation from a public corporation; and (2) a stock corporation from a non-stock corporation.**

**Answer:**

A private corporation is one formed for some private purpose, benefit or end, while a public corporation is formed for the government of a portion of the State for the general good or welfare. The true test is the purpose of the corporation. If the corporation is created for political or public purpose connected with the administration of government, then it is a public corporation. If not, it is a private corporation although the whole or substantially the whole interest in the corporation belongs to the State. A public corporation is created by special legislation or act of Congress. A private corporation must be organized under the Corporation Code.

A stock corporation is one that has capital stock divided into shares and is authorized to distribute to the holders of such shares dividends or allotment of the surplus profits on basis of the shares held. All other corporations are non-stock corporations. (BAR 2004)

- 2. Since February 8, 1935, the legislature has not passed even a single law creating a private corporation. What provision of the Constitution precludes the passage of such law?**

**Answer:**

Section 16, Article XII of the 1987 Constitution states “The Congress shall not, except by general law, provide for the formation, organization, or regulation of private corporations.” The same provision is contained in Section 7, Article XIV of the 1935 Constitution and Section 4, Article XIV of the 1973 Constitution. (BAR 2008)

- 3. Your client Dianne approaches you for legal advice on putting up a medium-sized restaurant business that will specialize in a novel type of cuisine. As Dianne feels that the business is a little risky, she wonders whether she should use a corporation as the business vehicle, or just run it as a single proprietorship. She already has an existing corporation that is producing meat products profitably and is also considering the alternative of simply setting up the restaurant as a branch office of the existing corporation.**

**Briefly explain to your client what you see as the legal advantages and disadvantages of using a separate corporation, a single proprietorship, or a branch of an existing corporation for the proposed restaurant business.**

**Answer:**

If Dianne will set up a separate corporation, her liability for its obligations and losses will be limited to the amount of her subscription in the absence of showing that there is a ground to disregard its separate juridical personality. If she were to operate a single proprietorship, her liability for its debts and losses will be unlimited.

The formation and the operation of a corporation require a great deal of paper work and record-keeping. This is not the situation in the case of a single proprietorship.

If she were to set-up the restaurant as a branch office an existing corporation, the corporation will have more funds as capital than if she were to form a separate corporation. However, all the assets of the existing corporation will be liable for the debts and losses of the restaurant business. (BAR 2010)

### Stock Corporation and Non-stock Corporation

1. **“XY” is a recreational club which was organized to operate a golf course for its members with an original authorized capital stock of P100 M. the articles of incorporation nor the by-laws did not provide for distribution of dividends although there is a provision that after its dissolution, the assets shall be given to a charitable corporation. Is “XY” a stock corporation? Give reasons for you answer.**

**Answer:**

“XY” is a stock corporation because it is organized as a stock corporation and there is no prohibition in its Articles of Incorporation or in its by-laws for it to declare dividends. When a corporation is organized as a stock corporation and its Articles of Incorporation or By-Laws are silent, the corporation is deemed to have the power to declare dividends under Section 43. Since it has the power to declare dividends, “XY” is a stock corporation.

The provision in its Articles of Incorporation that at dissolution the assets of the corporation shall be given to a charitable corporation does not prohibit the corporation from declaring dividends before dissolution. (BAR 2001)

2. **“X” company is a stock corporation composed of the Reyes family engaged in real estate business. Because of the regional crisis, the stockholders decided to convert their stock corporation into a charitable non-stock and non-profit association by amending the articles of incorporation.**
  - a) **Could this be legally done? Why?**
  - b) **Would your answer be the same if at the inception, “X” company is a non-stock corporation? Why?**

**Answer:**

- a) Yes, it can be legally done. In converting the stock corporation to a non-stock corporation by a mere amendment of the Articles of Incorporation, the stock corporation is not distributing any of its assets to the stockholders. On the contrary, the stockholders are deemed to have waived their right to share in the profits of the corporation which is a gain not a loss to the corporation.
- b) No, my answer will not be the same. In a non-stock corporation, the members are not entitled to share in the profits of the corporation because all present and future profits belong to the corporation. In converting the non-stock corporation to a stock corporation by a mere amendment of the Articles of Incorporation, the non-stock corporation is deemed to have distributed an asset of the corporation—i.e. its profits, among its members, without a prior dissolution of the corporation. Under Section 122, the non-stock corporation must be dissolved first. (BAR 2001)

3. **Distinguish clearly a stock corporation from a non-stock corporation.**

**Answer:**

A stock corporation is one that has capital stock divided into shares and is authorized to distribute to the holders of such shares dividends or allotment of the surplus profits on basis of the shares held. All other corporations are non-stock corporations. (BAR 2004)

1. Definition
2. Attributes of the Corporation
3. Distinguished from Partnership

1. a) What is a joint account?  
b) Distinguish joint account from partnership.

**Answer:**

- a) A joint account is a transaction of merchants where other merchants agree to contribute the amount of capital agreed upon, and participating in the favorable or unfavorable results thereof in the proportion they may determine.
- b) The following are the distinctions between joint account and partnership:
  1. A partnership has a firm name while a joint account has none and is conducted in the name of the ostensible partner.
  2. While a partnership has juridical personality and may sue or be sued under its firm name, a joint account has no juridical personality and can sue or be sued only in the name of the ostensible partner.
  3. While a partnership has a common fund, a joint account has none.
  4. While in a partnership, all general partners have the right of management, in a joint account, the ostensible partner manages its business operations.
  5. While liquidation of a partnership may, by agreement, be entrusted to a partner or partners, in a joint account liquidation thereof can only be done by the ostensible partner. (BAR 2000)

**B. Other Classes of Corporations**

1. De facto vs. De jure

1. Mamuhunan was invited by his friends to invest in Adelantado Corporation, a newly organized firm engaged in money market and financing operations. Because of his heavy investments, Mamuhunan became the firm's President and, as such, purchased a big number of computers, typewriters and other equipment from Taktak Corporation on installment basis. Adelantado Corporation paid the down payment and Taktak Corporation issued the corresponding receipt. To his chagrin, Mamuhunan discovered that the articles of incorporation had not been filed by his friends at that late date so he hurriedly attended to the matter. No sooner had the certificate of incorporation been issued by the SEC three months later when Adelantado Corporation became bankrupt.

Upon being sued by Taktak Corporation in his personal capacity, Mamuhunan raised among his defenses the doctrines of de facto corporation and corporation by estoppel.

Can the two defenses be validly raised by Mamuhunan? Explain.

**Answer:**

Neither the doctrine of de facto corporation nor the doctrine of corporation by estoppel is applicable or of relevance. An attack against a de facto corporation may be raised only by the State. In the case of a corporation by estoppel, rights or defenses are established in favor of persons with whom the corporation deals but not in favor of those who represent themselves as such corporation where none exists. Mamuhunan, instead, may

raise the defense that personal liability on the part of officers and directors of a corporation is incurred only in cases of patently illegal acts committed or consented to by them, bad faith or gross negligence on their part and in conflict of interest situations, not one of which is involved in the problems. (BAR 1986)

2. **A corporation was created by a special law. Later, the law creating it was declared invalid. May such corporation claim to be a de facto corporation?**

**Answer:**

No. a private corporation may be created only under the Corporation Code. Only public corporation may be created under a special law.

Where a private corporation is created under a special law, there is no attempt at a valid incorporation. Such corporation cannot claim a de facto status. (BAR 1994)

3. **Is there a difference between a de facto corporation and a corporation by estoppel? Explain briefly.**

**Answer:**

A de facto corporation is one which actually exists for all practical purposes as a corporation but which has no legal right to corporate existence as against the State. It is essential to the existence of a de facto corporation that there be:

1. A valid law under which a corporation might be incorporated
2. A bona fide attempt to organize as a corporation under such law, and
3. Actual use or exercise in good faith of corporate powers conferred upon it by law

A corporation by estoppels exists when person assume to act as a corporation knowing it to be without authority to do so. In this case, those persons will be liable as general partners for all debts, liabilities and damages incurred or arising as a result of their actions. (BAR 2004)

4. **The Articles of Incorporation of AAA Corporation was approved by SEC. After the receipt of the Certificate of Approval from the SEC, AAA Corporation decided to immediately start the operation of its business despite the fact that it has no approved By-Laws. What is the legal status of the AAA Corporation?**

- a) **A de jure corporation;**
- b) **A de facto corporation;**
- c) **A corporation by estoppels;**
- d) **An unregistered corporation.**

**Answer:**

- a) A de jure corporation. (BAR 2012)

## 2. Corporation by Estoppel

1. **Mamuhunan was invited by his friends to invest in Adelantado Corporation, a newly organized firm engaged in money market and financing operations. Because of his heavy investments, Mamuhunan became the firm's President and, as such, purchased a big number of computers, typewriters and other equipment from Taktak Corporation on installment basis. Adelantado Corporation paid the down payment and Taktak Corporation issued the corresponding receipt. To his chagrin, Mamuhunan discovered that the articles of incorporation had not been filed by his friends at that late date so he**

**hurriedly attended to the matter. No sooner had the certificate of incorporation been issued by the SEC three months later when Adelantado Corporation became bankrupt.**

**Upon being sued by Taktak Corporation in his personal capacity, Mamuhunan raised among his defenses the doctrines of de facto corporation and corporation by estoppel.**

**Can the two defenses be validly raised by Mamuhunan? Explain.**

**Answer:**

Neither the doctrine of de facto corporation nor the doctrine of corporation by estoppel is applicable or of relevance. An attack against a de facto corporation may be raised only by the State. In the case of a corporation by estoppel, rights or defenses are established in favor of persons with whom the corporation deals but not in favor of those who represent themselves as such corporation where none exists. Mamuhunan, instead, may raise the defense that personal liability on the part of officers and directors of a corporation is incurred only in cases of patently illegal acts committed or consented to by them, bad faith or gross negligence on their part and in conflict of interest situations, not one of which is involved in the problems. (BAR 1986)

- 2. (1) A, B, C, D & E decided to form Alphabet, Inc., a corporation dealing with the manufacture and sale of school supplies, with an authorized capital stock of P1 M. The five equally subscribed to 25% of the authorized capital stock or P50,000 each. Even before they could pay the 25% of their total subscription, however, they entered into a contract with Manila College. Determine the liability of A, B, C, D, and E and Alphabet, Inc. vis-à-vis Manila College.**

**Answer:**

Alphabet not having been issued as yet a certificate of registration of its articles of incorporation (for its failure to meet the minimum paid-up requirement) is without any legal personality, and it cannot thus itself be made liable for the breach of contract. The rule, furthermore, is that contracts for and in behalf of a corporation prior to its incorporation are not binding on it unless and until they are approved, expressly or impliedly, by its board of directors after due incorporation. A, B, C, D and E themselves, as a rule, would not themselves be liable for the breach of contract subject however, to their respective representations and extent thereof. Pre-incorporation expenses, in general, are for the account of the corporation and unless, in general, are for the account of the corporation and unless the corporation is fictitious, the incorporators or stockholders are not personally liable therefore. (BAR 1989)

- 3. Is there a difference between a de facto corporation and a corporation by estoppel? Explain briefly.**

**Answer:**

A de facto corporation is one which actually exists for all practical purposes as a corporation but which has no legal right to corporate existence as against the State. It is essential to the existence of a de facto corporation that there be:

5. A valid law under which a corporation might be incorporated
6. A bona fide attempt to organize as a corporation under such law, and
7. Actual use or exercise in good faith of corporate powers conferred upon it by law

A corporation by estoppels exists when person assume to act as a corporation knowing it to be without authority to do so. In this case, those persons will be liable as general partners for all debts, liabilities and damages incurred or arising as a result of their actions. (BAR 2004)

- 4. Unknown to the other four proponents, Enrico (who had been given the task of attending to the Articles of Incorporation of the proposed corporation, Auto Mo, Ayos Ko) misappropriated the filing fees and never filed the Articles of Incorporation with the SEC. instead, he prepared and presented to the proposed incorporators a falsified SEC certificate approving the Articles. Relying on the falsified SEC certificate, the latter began assuming and discharging corporate powers.**

Auto Mo, Ayos Ko is a \_\_\_\_\_.

- a) De jure corporation;
- b) De facto corporation;
- c) Corporation by estoppel;
- d) General partnership;
- e) None of the above.

**Answer:**

- c) Corporation by estoppel— if the term “latter” refers to the incorporators.
- e) None of the above—if the term “latter” refers to Enrico. (BAR 2013)

### C. Corporations going public vs. Corporations going private

1. **Distinguish between a corporation that is “going public” and a corporation that is “going private”. What provisions would you expect to find in the articles of incorporation of a corporation that organizes itself under the narrow concept of “going private”**

**Answer:**

A corporation is deemed to be “going public” when it decide to list its shares in the stock exchanges. The term can also be used to convey the fact that a corporation would initially go into a public offering of its shares or to otherwise invite equity investments from the public. A corporation is said to be “going private” when it would restrict equity investment in the corporation within the organization itself or its existing subject structure. In another context, the term can likewise be understood as a corporation whose articles of incorporation would have the feature of a close or closely-held corporation.

It might be pointed out that the above terms do not have technical meanings either in law or in business finance. Accordingly, a layman’s understanding thereof, such as for instance, the disposition of ownership by the government of GOCC to the private sector would be acceptable in describing a corporation “going private”. (BAR 1986)

### D. Nationality of Corporations

- 1. Place of Incorporation Test
- 2. Control Test

1. **What is the nationality of a corporation organized and incorporated under the laws of a foreign country, but owned 100% by Filipinos?**

**Answer:**

Under the control test of corporate nationality, this foreign corporation is of Filipino Nationality.

Where there are grounds for piercing the veil of corporate entity, that is, disregarding the fiction, the corporation will follow the nationality of the controlling members or stockholders, since the corporation will then be considered as one and the same. (BAR 1998)

2. **Several American doctors wanted to set up a group clinic in the Philippines so they could render modern medical services. If the clinic is to be incorporated under our laws, what is the required foreign equity participation in such a corporation?**

- a. 40%

- b. 0%
- c. 60%
- d. 70%

**Answer:**

- b. 0% (BAR 2011)

### 3. Grandfather Rule

1. **Acme Manufacturing Co. (ACME) is engaged in the manufacture of electrical equipment. Its general manager is Otto, a German engineer. 50% of the capital stock of ACME is owned by Filipino individuals and the remaining 50% is owned by corporation XYZ, whose stock is in turn 60% Filipino-owned and 40% German-owned.**
  - a) **Is ACME eligible to engage in the retail business?**
  - b) **If ACME sells some of the electrical equipment produced by it to industrial and manufacturing firms which would use the same in their establishments, would there be a violation of the Retail Trade Nationalization Law? From the legal standpoint, would it be necessary to replace Otto with a Filipino general manager if Corporation XYZ sells its shares to a wholly-owned Filipino company?**

**Answer:**

- a) R.A. 1180, otherwise known as the Retail Trade Nationalization Law, prohibits a corporation the capital of which is not wholly owned by Filipino citizens from engaging, directly or indirectly in retail business. While there are certain statutes that define a Philippine national as including a corporation organized under Philippine laws of which at least 60% of the capital stock and entitled to vote is owned and held by Philippine citizens, there are certain administrative regulations that trace the citizenship of stockholders of corporations holding shares in another corporation to the so-called “grandfather rule”—in determining the citizenship of the affected corporation. Considering the intent and purpose of the law, and the rather peremptory provisions in respect of a violation thereof, it would be prudent and advisable to consider ACME as not qualified to engage in the retail business. The 40% holding of aliens in XYZ Corporations, which holds 50% of ACME’s capital stock, may be viewed as a circumvention of the Filipino ownership requirement. Note that the law prohibits a non-qualified entity from “indirectly” engaging in retail business. To hold ACME is qualified would render it relatively easy for a non-qualified corporation such as XYZ Corporation to join with other qualified Filipinos to subvert the requirement that the corporation be wholly owned by Filipinos.
- b) “Retail business” is defined as habitually selling direct to the general public merchandise or goods for consumption. P.D. 714 expanded the exceptions from the coverage of the law to include manufacturer or processor selling to industrial or commercial users or consumers who use the products bought by them to render service to the general public and/or to produce or manufacture goods which are in turn sold by them.

The question is whether the term “use” encompasses within its purview not only “direct use” but likewise “indirect use” of the products bought (electrical equipment) by the industrial manufacturing firms to render service to the general public and/or to produce or manufacture goods which are in turn sold by them. Whether a product is “indirectly used” to render service or to produce or manufacture goods for sale is generally a question of fact as well as the degree of utility of the product. In the case of electrical equipment, there can be no serious question that it is indispensably used and necessary in any establishment wherein electricity is used. Moreover, the essence of the exception created by P.D. 714 is the sale to an industrial or commercial user or consumer.

Accordingly, ACME's sales of electrical equipment to industrial and manufacturing firm which would use the same in their establishments do not constitute "retail business" as such sales fall within the purview of section 4(c) of R. A. 1180, as amended by P.D. 714. There would be no violation of the Retail Trade Nationalization Law.

The Anti Dummy Law penalizes, among others, any corporation which is engaged in a nationalized activity such as retail business which in any manner permits or allows any person not possessing the qualifications required by the law, to intervene in the management, operation, administration or control thereof, whether as an officer, employee or laborer therein, with or without remuneration.

If Corporation XYZ sells its shares to a wholly owned Filipino company, ACME would become a corporation wholly owned by Filipinos and qualified to engage in retail business.

Since it is believed that ACME will not be engaged in retail business by selling electrical equipment produced by it to industrial and manufacturing firms, the prohibitions of the Anti Dummy Law will not apply to Otto, even though German, may continue as general manager. (BAR 1984)

#### **E. Rules on Partly-Nationalized Business**

- 1. X Mining Co. is 70% Filipino-owned, the 30% remaining stock being owned by aliens. Under its Articles of Incorporation, its Board of Directors has 9 members. At the last election, 3 aliens were elected as Directors, but some stockholders moved to disqualify all three of them on account of their alien citizenship, the mining company being engaged in a nationalized business.**

**Decide with reasons.**

**Answer:**

Under the Constitution, the mining business is partially nationalized and at least 60% of its capital must belong to Filipino citizens. Under the Anti-Dummy Law as amended, the election of aliens as members of the board of directors of corporations engaged in partially nationalized activities is allowed in proportion to their allowable participation or share in the capital of such corporations. In the case at hand, 70% of the capital is owned by Filipinos and 30% by aliens. Therefore, only 30% of its directors may be aliens. Since 3 out of 9 is more than 30% only 2 aliens may sit in X's board. One of the elected alien directors is therefore disqualified and must give way to a Filipino director. (BAR 1983)

- 2. Bohol Mining Corporation is 60% Filipino-owned and 40% Canadian-owned. As provided in its Articles of Incorporation and By-Laws, its Board of Directors is composed of 9 members. During the last annual stockholders meeting held on May 31, three of the nine elected directors were Canadian citizens. Juan de la Cruz together with two other Filipino stockholders petitioned the SEC to disqualify the said three Canadians and to enjoin them from discharging their functions as directors, on the grounds that (1) aliens cannot participate in any capacity in a nationalized industry, like mining; and (2) the exploitation of natural resources is reserved under the Constitution to Filipino citizens.**

**Will the petition prosper?**

**Answer:**

The petition will not prosper. The elections of aliens as members of the board of directors or governing body of corporations or associations, engaging in partially nationalized-activities, are allowed by law, in proportion to their allowable participation or share in the capital of such entities, like mining or development of natural resources, in which the foreigners may even own 40% of the capital. (BAR 1985)

3. **A Korean national joined a corporation which is engaged in the furniture manufacturing business. He was elected to the Board of Directors. To complement its furniture manufacturing business, the corporation also engaged in the logging business.**

**With the additional logging activity, can the Korean nationals still be a member of the Board of Directors? Explain.**

**Answer:**

Yes. The Korean national can still be a member of the board of directors, if he has sufficient equity to entitle him to a seat. Since the corporation is only required to be at least 60% owned by Filipino citizens, foreigners can be members of the board of directors in proportion to their equity which cannot exceed 40%. (BAR 2005)

4. **The Articles of Incorporation of ABC Transport Co., a public utility, provides for 10 members in its Board of Directors. What is the prescribed minimum number of Filipino citizens in its Board?**
- a. 10
  - b. 6
  - c. 7
  - d. 5

**Answer:**

b. 6 (BAR 2011)

5. **Bell Philippines, Inc. (BelPhil) is a public utility company, duly incorporated and registered with the SEC. its authorized capital stock consists of voting common shares and non-voting preferred shares, with equal par values of P100/share. Currently, the issued and outstanding capital stock of BelPhil consists only of common shares shared between Bayani Cruz, a Filipino with 60% of the issued common shares, and Bernard Fleet, a Canadian, with 40%.**

**To secure additional working fund, BelPhil issued preferred shares to Bernard Fleet equivalent to the currently outstanding common shares. A suit was filed questioning the corporate action on the ground that the foreign equity holdings in the company would now exceed the 40% foreign equity limit allowed under the Constitution for public utilities.**

**Rule on the legality of Bernard Fleet's current holdings.**

**Answer:**

The holding of Bernard Fleet equivalent to the outstanding common shares is illegal. His holdings of preferred shares should not exceed 40%. Since the constitutional requirement of 60% Filipino ownership of the capital of public utilities applies not only to voting control but also to beneficial ownership of the corporation, it should also apply to the preferred shares. Preferred shares are also entitled to vote in certain corporate matters. The State shall develop a self-reliant and independent national economy effectively controlled by Filipinos. The effective control here should be mirrored across the board on all kinds of shares. (BAR 2013)

## **F. Corporate Juridical Personality**

### **1. Doctrine of Separate Juridical Personality**

1. **In a complaint for damages, Zebra Corporation allege that its president, Anton Molina, suffered mental anguish, social humiliation and serious anxiety as a result of the tortuous acts of Omega Corporation. In its answer with counterclaim, Omega Corporation alleged that it suffered besmirched reputation**

**because of the unfounded suit of Zebra Corporation and accordingly claimed for the award of moral damages.**

**May Zebra Corporation recover moral damages based on its allegations in the complaint? Discuss.**

**Answer:**

Zebra cannot recover moral damages for the mental anguish, social humiliation, and serious anxiety of its president, Anton, as a result of the tortuous acts of Omega; and this is so, because Zebra has a separate and distinct personality from that of its president; hence, Anton will be the one personally, to have said right of action, if any. (BAR 1985)

- 2. Richard owns 90% of the shares of the capital stock of GOM Corporation. On one occasion, GOM Corporation, represented by Richard as President and General Manager, executed a contract to sell a subdivision lot in favor of Tomas. For failure of GOM Corporation to develop the subdivision, Tomas filed an action for rescission and damages against GOM Corporation and Richard.**

**Will the action prosper? Explain.**

**Answer:**

The action may prosper against GOM Corporation but definitely not against Richard. Richard has a legal personality separate and distinct from that of GOM Corporation. If he signed the contract to sell, he did so as the President and General Manager of GOM Corporation and not in his personal capacity. Mere ownership by Richard of 90% of the capital stock of GOM Corporation is not of itself sufficient ground to disregard his separate legal personality absent a showing, for example, that he acted maliciously or in bad faith. (BAR 1996)

- 3. As a result of perennial business losses, a corporation's net worth has been wiped out. In fact, it is now in negative territory. Nonetheless, the stockholders did not like to give up.**

**Creditor-banks, however, do not share the confidence of the stockholders and refuse to grant more loans.**

**Assuming that the corporation continues to operate even with depleted capital, would the stockholders or the managers be solidarily liable for the obligations incurred by the corporation? Explain.**

**Answer:**

No. As a general rule, the stockholders or the managers cannot be held solidarily liable for the obligations incurred by the corporation. The corporation has a separate and distinct personality from that of the stockholders and managers. The latter are presumed to be acting in good faith in continuing the operation of the corporation. The obligations incurred by the corporation are those of the corporation which alone is liable therefor. However, when the corporation is already insolvent, the directors and officers become trustees of the business and assets of the corporation for the benefit of the creditors and are liable for negligence or mismanagement. (BAR 1999)

- 4. Marulas Creative Technology Inc., an e-business enterprise engaged in the manufacture of computer multimedia accessories, rents an office and store space at a commercial building owned by X. being a start-up company, Marulas enjoyed some leniency in its rent payment; but after 3 years, X put a stop to it and asked Marulas president and general manager, Y, who is a stockholder, to pay back rentals amounting to a hundred thousand pesos or to vacate the premises at the end of the month. Marulas neither paid its debt nor vacated the premises. X sued Marulas and Y for collection of the unpaid rentals, plus interest and costs of litigation. Will the suit prosper against X? Against Y?**

**Answer:**

Yes, the suit will prosper against Marulas. It is the one renting the office and store space, as lessee, from the owner of the building, X, as lessor.

But the suit against Y will not prosper. Y, as president and general manager, and also stockholder of Marulas Creative Technology, Inc., has a legal personality separate and distinct from that of the corporation and not that of its officers and stockholders who are not liable for corporate liabilities. (BAR 2000)

5. **Nine individuals formed a private corporation pursuant to the provisions of the Corporation Code of the Philippines. Incorporator S was elected director and president—general manager. Part of his emolument is a Ford Expedition, which the corporation owns. After a few years. S lost his corporate positions but he refused to return the motor vehicle claiming that as a stockholder with a substantial equity share, he owns that portion of the corporate assets now in his possession. Is the contention of S valid? Explain.**

**Answer:**

No. the contention of S is not valid. The Ford Expedition is owned by the corporation. The corporation has a legal personality separate and distinct from that of its stockholder. What the corporation owns is its own property and not property of any stockholder even how substantial the equity share that stockholder owns. (BAR 2000)

6. **Nelson owned and controlled Sonnel Construction Company. Acting for the company, Nelson contracted the construction of a building. Without first installing a protective net atop the sidewalks adjoining the construction site, the company proceeded with the construction work. One day a heavy piece of lumber fell from the building. It smashed a taxicab which at that time had gone offroad and onto the sidewalk in order to avoid the traffic. The taxicab passenger died as a result.**

**If you were the counsel for Sonnel Construction, how would you defend your client? What would be your theory?**

**Answer:**

If I were the counsel for Sonnel Construction Company, I will argue that the proximate cause of the death of the victim is the gross negligence of the taxicab driver. The latter drove the taxicab offroad and onto the sidewalk in order to avoid the traffic. Furthermore, I will argue that assuming that Nelson was negligent, he alone should be sued as the Sonnel Coonstruction Company has a separate and distinct personality. Nelson's controlling interest in Sonnel Construction Company does not justify the piercing of the corporate veil. (BAR 2008)

7. **X Corp. operates a call center that received orders for pizzas on behalf of Y Corp. which operates a chain of pizza restaurants. The two companies have the same set of corporate officers. After 2 years, X Corp. dismissed its call center agents for no apparent reason. The agents filed a collective suit for illegal dismissal against both X Corp. and Y Corp. based on the doctrine of piercing the veil of corporate fiction. The latter set up a defense that the agents are in the employ of X Corp. which is a separate juridical entity. Is the defense appropriate?**
- No, since the doctrine would apply, the two companies having the same set of corporate officers.**
  - No, the real employer is Y Corp., the pizza company, with X Corp. serving as an arm for receiving its outside orders for pizzas.**
  - Yes, it is not shown that one company completely dominates the finances, policies, and business practices of the latter.**
  - Yes, since the two companies perform two distinct businesses.**

**Answer:**

- Yes, it is not shown that one company completely dominates the finances, policies, and business practices of the latter. (BAR 2011)

8. X sold all his shares in AAA Hotel Corporation to Y. X owns 99% of AAA Hotel Corporation. As the new owner, Y wanted a reorganization of the hotel which is to include primarily the separation of all existing employees and the hiring of new employees. Which statement is most accurate?
- a) With the change in ownership, in effect there is a new juridical entity and therefore all employees are considered separated;
  - b) Despite the change in shareholder, there is actually no change in the juridical entity and therefore existing employees cannot automatically be considered separated;
  - c) Y, as the new shareholder, has the right to retain only those employees who in his judgment are qualified;
  - d) For as long as the existing employees are given their separation pay, they can be terminated.

**Answer:**

b) Despite the change in shareholder, there is actually no change in the juridical entity and therefore existing employees cannot automatically be considered separated. (BAR 2012)

9. X owns 99% of the capital stock of SSS Corporation. X also own 99% of TTT Corporation. SSS Corporation obtained a loan from VVV Banks. On due date, SSS Corporate defaulted. TTT Corporation is financially healthy. Which statement is most accurate?
- a) X being a controlling owner of SSS Corporation can automatically be held personally liable for the loan of SSS Corporation;
  - b) TTT Corporation, owned by 99% by X, can automatically be held liable;
  - c) SSS Corporation and TTT Corporation, although both are owned by X, are 2 distinct corporations with separate juridical personalities hence, the TTT Corporation cannot automatically be held liable for the loan of SSS Corporation;
  - d) The principle of piercing the veil of corporation fiction can be applied in this case

**Answer:**

b) SSS Corporation and TTT Corporation, although both are owned by X, are 2 distinct corporations with separate juridical personalities hence, the TTT Corporation cannot automatically be held liable for the loan of SSS Corporation. (BAR 2012)

10. In an action for collection of a sum of money, the RTC of Makati City issued a decision finding D-Securities, Inc. liable to Rehouse Corporation for P10 M. Subsequently, the writ of execution was issued but returned unsatisfied because D-Securities had no more assets to satisfy the judgment. Rehouse moved for an Alias Writ of Execution against Fairfield Bank (FB), the parent company of D-Securities. FB opposed the motion on the grounds that it is a separate entity and that it was never made party to the case. The RTC granted the motion and issued the Alias Writ of Execution. In its Resolution, the RTC relied on the following facts: 499,995 out of the 500,000 outstanding shares of stocks of D-Securities are owned by FB; FB had actual knowledge of the subject matter of litigation as the lawyers who represented D-Securities are also the lawyers of FB. As an alter ego, there is no need for a finding of fraud or illegality before the doctrine of piercing the veil of corporate fiction can be applied. The RTC ratiocinated that being one and the same entity in the eyes of the law, the service of summons upon D-Securities has bestowed jurisdiction over both the parent and wholly-owned subsidiary. Is the RTC correct?

**Answer:**

No, the RTC is not correct. The court must have first acquire jurisdiction over the corporation(s) involved before its or their separate personalities are disregarded; and the doctrine of piercing the veil of corporate entity can only be raised during a full-blown trial over a cause of action duly commenced involving parties duly

brought under the authority of the court by way of service of summons or what passes as such service. (BAR 2014)

- a. Liability for Torts and Crimes
- b. Recovery of Moral Damages

1. In the complaint filed by XYZ Corporation, its President alleged that he suffered mental anguish, fright, social humiliation, and serious anxiety as a result of the tortuous acts of ABC Corporation. In its counterclaim, ABC Corporation claimed to have suffered moral damages due to besmirched reputation or goodwill.

- 1) May XYZ Corporation recover moral damages based on the allegations in the complaint?
- 2) May ABC Corporation recover moral damages? Give reasons for your answer.

**Answer:**

- 1) No. A corporation is a legal entity separate and distinct from its president.
- 2) Yes. ABC Corporation may recover moral damages. A corporation may have a good reputation which, if besmirched, is a ground for the award of moral damages. (BAR 1978)

2. In a complaint for damages, Zebra Corporation allege that its president, Anton Molina, suffered mental anguish, social humiliation and serious anxiety as a result of the tortuous acts of Omega Corporation. In its answer with counterclaim, Omega Corporation alleged that it suffered besmirched reputation because of the unfounded suit of Zebra Corporation and accordingly claimed for the award of moral damages.

- a) May Omega Corporation recover moral damages on its counterclaim? Reasons.

**Answer:**

- a) It depends. Omega may demand moral damages, if it has a good reputation which is besmirched, because of the unfounded suit of Zebra; and, if otherwise, it cannot. (BAR 1985)

3. In a complaint filed against XYZ Corporation, Luzon Trading Corporation allege that its President & General Manager, who is also a stockholder, suffered mental anguish, fright, social humiliation and serious anxiety as a result of the tortuous acts of XYZ Corporation.

In its counterclaim, XYZ Corporation claimed to have suffered moral damages due to besmirched reputation or goodwill as a result of Luzon Trading Corporation's complaint.

- a) May Luzon recover moral damages based on the allegations in the complaint?
- b) May XYZ Corporation recover moral damages?

**Answer:**

- a) No. A corporation, being an artificial person which has no feelings, emotions or senses, and which cannot experience physical suffering or mental anguish, is not entitled to moral damages.
- b) Yes. When a juridical person has a good reputation that is debased, resulting in social humiliation, moral damages may be awarded. Moreover, goodwill can be considered an asset of the corporation. (BAR 1998)

## 2. Doctrine of Piercing the Corporate Veil

1. What is the doctrine of "piercing the veil of corporate entity?" Explain.

**Answer:**

Under the doctrine of “piercing the veil of corporate entity”, the legal fiction that a corporation is an entity with a juridical personality separate and distinct from its members or stockholders may be disregarded and the corporation will be considered as a mere association of persons, such that liability will attach directly to the officers and the stockholders. It is an equitable doctrine developed to address situations where the separate corporate personality of a corporation is abused or used for wrongful purposes. (BAR 2006)

**a. Grounds for Application of Doctrine**

- 1. C, a Steel and Nail Co., Inc., owned by X had financial obligations to its employees. C ceased operation, and was immediately succeeded on the next day by, and all its assets were turned over to, the E Steel Corporation, 90% of the subscribed shares of which were also owned by X. May the E Steel Corporation be held liable for the financial obligation of the C Steel and Nail Co. Inc. to its employees?**

**Answer:**

Yes. E Steel Corporation may be held liable for the financial obligation of the C Steel and Nail Co., Inc. to its employees, under the rule of “piercing the veil of corporate fiction”. It is very obvious that E Steel Corporation seeks the protective shield of a corporate fiction whose veil in the present case could, and should, be pierced as it was deliberately designed to evade the financial obligation of C steel and Nail Co. Inc., to its employees. (*Claparols v. Court of Industrial Relations*, 65 SCCRA 613) (BAR 1978)

- 2. Tantalus Corporation, of which 97% of the issued and outstanding shares of stock were owned by Roger Mano, had financial obligations to its employees by way of unpaid wages and allowances. Tantalus Corporation was dissolved by shortening its corporate life and all its assets turned over to Suceso Corporation, of which 95% of the subscribed shares were held by Roger Mano and his wife. Then Tantalus Corporation ceased to operate.**
- a) May the employees of Tantalus Corporation proceed against the Suceso Corporation to recover their unpaid claims? Discuss.**
- b) What is the doctrine of “piercing the veil of corporate entity” and in what cases did the Supreme Court apply the said doctrine?**

**Answer:**

- a) Yes. It is very obvious that Suceso Corporation seeks the protective shield of a corporate fiction whose veil could and should be pierced (piercing the veil of corporate fiction), as it is deliberately and maliciously designed to evade a financial obligation to employees; thus, when the notion of legal entity is used to justify wrong or protect fraud, the law will merge the two corporations into one.
- b) “Piercing the veil of corporate entity” means that a corporation may not generally be made to answer for acts or liabilities of its stockholders or members, or those of the legal entities to which it may be connected, and vice versa; but if this corporation is used as an alter ego, dummy, business conduit or shield to commit any act of illegality, fraud or wrong, or to confuse legitimate issues, then it would be otherwise, and the corporate fiction will be disregarded.

The Supreme Court applied the doctrine of “piercing the veil of corporate entity” in the following cases:

- 1) Where the corporation is used as dummy to commit illegality, fraud, or wrong, or confuse legitimate issues by the stockholders of said corporation;
- 2) Where the corporation is an agency for a parent corporation to commit illegality, fraud, or wrong, or confuse legitimate issues; and
- 3) Where a person owned all, or controls, the stocks of a corporation, and the latter is used by him to commit illegality, fraud, or wrong, or confuse legitimate issues. (BAR 1985)

3. **Mr. Pablo, a rich merchant in his early forties, was a defendant in a lawsuit which could subject him to substantial damages. A year before the court rendered judgment, Mr. Pablo sought his lawyer's advice on how to plan his estate to avoid taxes. His lawyer suggested that he should form a corporation with himself, his wife and his children (all students and still unemployed) as stockholders and then transfer all his assets and liabilities to this corporation. Mr. Pablo and the plaintiff sought to enforce this judgment. The sheriff, however, could not locate any property in the name of Mr. Pablo and therefore returned the writ of execution unsatisfied. What remedy, if any, is available to the plaintiff?**

**Answer:**

The plaintiff can avail himself of the doctrine of piercing the veil of corporate fiction which can be invoked when a corporation is formed or used in avoiding a just obligation. While it is true that a family corporation may be organized to pursue an estate tax planning, which is not per se illegal or unlawful, the factual settings, however, indicate the existence of a lawsuit that could subject Mr. Pablo to a substantial amount of damages. It would thus be difficult for Mr. Pablo to convincingly assert that the incorporation of the family corporation was intended merely as a case of "estate tax planning". (BAR 1991)

4. **Plaintiffs filed a collection action against "X" Corporation. Upon execution of the court's decision, "X" Corporation was found to be without assets. Thereafter plaintiffs filed an action against its present and past stockholder "Y" Corporation which owned substantially all of the stocks of "X" Corporation. The two corporations have the same board of directors and "Y" Corporation financed the operations of "X" Corporation. May "Y" Corporation be held liable for the debts of "X" Corporation? Why?**

**Answer:**

Yes, "Y" Corporation may be held liable for the debts of "X" Corporation. The doctrine of piercing the veil of corporate fiction applies to this case. The two corporations have the same board of directors and "Y" corporation owned substantially all of the stocks of "X" Corporation, which facts justify the conclusion that the latter is merely an extension of the personality of the former, and that the former controls the policies of the latter. Added to this is the fact that "Y" Corporation controls the finances of "X" Corporation which is merely an adjunct, business conduit or alter-ego of "Y" Corporation. (BAR 2001)

5. **How does one pierce the veil of corporate fiction?**

**Answer:**

The veil of corporate fiction may be pierced by proving the court that the notion of legal entity is being used to defeat public convenience, justify wrong, protect fraud, or defend a crime or the entity is just an instrument or alter ego or adjunct of another entity or person. (BAR 2004)

6. **To what circumstances will the "piercing the veil of corporate entity" apply?**

**Answer:**

The doctrine of "piercing the veil of corporate entity" will apply when the corporation's separate juridical personality is used:

- a) To defeat public convenience;
- b) To justify wrong, protect fraud, or defend crime;
- c) As a shield to confuse the legitimate issues;
- d) Where a corporation is the mere alter ego or business conduit of a person; or
- e) Where the corporation is so organized and controlled and its affairs are so conducted as to make it merely an instrumentality, agency, conduit or adjunct of another corporation. (BAR 2006)

**b. Test in Determining Applicability**

## G. Incorporation and Organization

### 1. Promoter

- a. Liability of Promoter
- b. Liability of Corporation for Promoter's Contracts

### 2. Number and Qualifications of Incorporators

7. **What is the minimum and maximum number of incorporators required to incorporate a stock corporation? Is this also the same minimum and maximum number of directors in a stock corporation?**

**Answer:**

To incorporate a stock corporation, a minimum of 5 and a maximum of 15 incorporators are required. Yes, the same minimum and maximum number of directors is required in a stock corporation. (BAR 2006)

8. **Must all incorporators and directors be residents of the Philippines?**

**Answer:**

No. Only a majority of the incorporators and a majority of the directors must be residents of the Philippines. (BAR 2006)

9. **X is a Filipino immigrant residing in Sacramento, California. Y is a Filipino residing Quezon City. Z is a resident alien residing in Makati City. GGG Corporation is a domestic corporation—40% owned by foreigners and 60% owned by Filipinos, with T as authorized representative. CCC Corporation is a foreign corporation registered with the Philippines SEC, KKK Corporation is a domestic corporation (100%) Filipino owned. S is a Filipino, 16 years of age, and daughter of Y.**

- a) **Who can be incorporators? Who can be subscribers?**
- b) **What are the differences between an incorporator and a subscriber, if there are any?**

**Answer:**

- a) X, Y, Z and T could all be incorporators and subscribers. Note, however, that Section 10 of the Corporation Code requires that there must be at least 5 but not more than 15 incorporators (who must all be natural persons) and that a majority of the incorporators must be residents of the Philippines. S, being a minor, could neither be an incorporator nor a subscriber. GGG Corporation, CCC Corporation, and KKK Corporation could not be incorporators as they are not natural persons. However, they could be subscribers.
- b) Some of the differences are as follows: first, all the incorporators are required to sign and acknowledge the Articles of Incorporation while the subscribers, as such, are not subject to the same requirement; second, the incorporators are all required to be natural persons while the subscribers could either be natural or juridical persons; and third, the number of incorporators cannot exceed 15 while the number of subscribers could be more than 15 (subject to compliance, in the appropriate cases, with the requirements of the SRC). (BAR 2012)

### 3. Corporate Name — Limitations on Use of Corporate Name

1. **A, the proprietor of a fleet of 10 taxicabs, decides to adopt, as his business name, "A Transport Co., Inc." May this be allowed?**
- a. **No, it would be deceptive since he is a proprietor, not a corporation.**

- b. No, since “A” is a generic name, not suitable for registration.
- c. Yes, since his line of business is public transportation.
- d. Yes, since such name would give his business a corporate identity.

**Answer:**

- a. No, it would be deceptive since he is a proprietor, not a corporation. (BAR 2011)

- 4. Corporate Term
- 5. Minimum Capital Stock and Subscription Requirements
- 6. Articles of Incorporation

- 1. The Articles of Incorporation must be accompanied by a Treasurer’s Affidavit certifying under oath, among others, that the total subscription paid is:
  - a. Not less than P25,000.00
  - b. Not more than P5,000.00
  - c. Not less than P5,000,00
  - d. Not more than P25,000.00

**Answer:**

- b. Not less than P5,000,00 (BAR 2011)

**a. Nature and Function of Articles**

- 1. Triple A Corporation (Triple A) was incorporated in 1960, with 500 founder’s shares and 78 common shares as its initial capital stock subscription. However, Triple A registered its stock and transfer books only in 1978, and recorded merely 33 common shares as the corporation’s issued and outstanding shares.

In 1982, Juancho, the sole heir of one of the original incorporators filed a petition with the SEC for the registration of his property rights over 120 founder’s shares and 12 common shares. The petition was supported by a copy of the Articles of Incorporation indicating the incorporators’ initial capital stock subscription. Will the petition be granted? Why or why not?

**Answer:**

Yes. The articles of incorporation defines the charter of the corporation and the contractual relationship between the State and the corporation, the State and the stockholders, and between the corporation and the stockholders. Its contents are thus binding upon both the corporation and the stockholders, conferring on Juancho a clear right to have his stockholding recorded. (BAR 2009)

**b. Contents**

- 1. M Corporation is a Philippine Corporation engaged in deep sea fishing. Its operation resulted in losses. Because of the unprofitable operations in deep sea fishing, the Corporation wants to engage in general construction business, one of its secondary purposes.

Discuss briefly how the corporation may validly engage in the construction business.

**Answer:**

In order that M Corporation may validly engage in the construction business and thereby invest its funds therein the following requisites must be complied with, to wit:

There must be a meeting called for the purpose, notice of which shall be given to all of the stockholders on record whether or not they shall be entitled to vote thereat. In said meeting the board of directors of the corporation must be authorized to engage in such business in a resolution by the affirmative vote of stockholders holding shares in the corporation entitling them to exercise at least 2/3 of the voting power on such a proposal at the said stockholder's meeting. (BAR 1977)

**2. The articles of incorporation to be registered in the SEC contained the following provisions—**

- a) **“First Article. The name of the corporation shall be Toho Marketing Company.”**
- b) **“Third Article. The principal office of the corporation shall be located in Region III, in such municipality therein as its Board of Directors may designate.”**
- c) **“Seventh Article. The capital stock of the corporation is One Million Pesos (P1,000.00), Philippine Currency.”**

**What are your comments and suggested changes to the proposed articles?**

**Answer:**

- a) On the First Article, I would suggest that the corporate name indicate the fact of incorporation by using either “Toho Marketing Corporation” or “Toho Marketing Company, Incorporated”.
- b) The Third Article should indicate the City or the Municipality and the Province in the Philippines, and not merely the region or as its Board of Directors may later designate, to be its place of principal office.
- c) The Seventh Article must additionally point out the number of shares into which the capital stock is divided, as well as the par value thereof or a statement that said stock or a portion thereof are without par value. (BAR 1990)

**c. Amendment**

- 1. **Guetze and his wife have 3 children: Neymar, 25, who is now based in Rio de Janeiro, Brazil; Muelter, 23, who has migrated to Munich, Germany; and James, 21, who resides in Bogota, Colombia. Neymar and Muelter have since renounced their Philippine citizenship in favor of their country of residence. Nearing 70 years old, Guetze decided to incorporate his business in Binondo, Manila. He asked his wife and 3 children to act as incorporators with 1 share of stock each, while he owned 999,996 shares of the 1,000,000 shares of the capital stock.**

**Assuming the corporation has been properly registered, may the Articles of Incorporation now be amended to reduce the number of directors to two—Guetze and his wife—to reflect the real owners of the shares of stock?**

**Answer:**

No, the Articles of Incorporation may not be amended to reduce the number of directors to two. Section 14 of the Corporation Code requires that the Articles of Incorporation shall contain the number of directors, which shall not be less than 5 nor more than 15. Hence, the reduction of the number of directors to two, to reflect the real owners of the shares of stock, is not valid (BAR 2014)

**d. Non-Amenable Items**

## 7. Registration and Issuance of Certificate of Incorporation

1. **While the incorporation papers of XYZ, Inc. were pending before the SEC for approval, A, the designated Treasurer in the Articles of Incorporation held real estate property worth P20,000 which E turned over for shares he (E) purchased in XYZ Inc. Before the certificate of incorporation for XYZ, Inc could be issued, H, who claims to be the owner of said real estate property, filed an action against XYZ, Inc. for recovery of possession of the same.**

**Will H suit prosper? Why?**

**Answer:**

No. H's suit will not prosper. Since the incorporation papers of XYZ, Inc. were still pending before the SEC for approval, said XYZ Inc. has not yet been registered, and, therefore, it has yet no juridical personality in order to have the power to sue or be sued in any court. (*Hall v. Picio*, 86 Phil. 603) (BAR 1978)

2. **You have been asked to incorporate a new company to be called FSB Savings & Mortgage Bank, Inc. List the documents that you must submit to the SEC to obtain a certificate of incorporation for FSB Savings & Mortgage Bank, Inc.**

**Answer:**

The documents to be submitted to the SEC to incorporate a new company to be called FSB Savings & Mortgage Bank, Inc., to obtain the certificate of incorporation for said company, are:

- 1) Articles of Incorporation;
  - 2) Treasurer's affidavit;
  - 3) Certificate of Authority from the Monetary Board of the BSP;
  - 4) Verification slip from the records of the SEC whether or not the proposed name has already been adopted by another corporation, partnership or association;
  - 5) Letter undertaking to change the proposed name if already adopted by another corporation, partnership or association;
  - 6) Bank certificate of deposit concerning the paid-up capital;
  - 7) Letter authorizing the SEC or Monetary Board or its duly authorized representative to examine the bank records regarding the deposit of the paid-up capital;
  - 8) Registration sheet.
3. **A corporation organized under the Corporation Code commences to have corporate existence and juridical personality and is deemed incorporated:**
    - a. **From the date the application for incorporation is filed with the SEC.**
    - b. **From the date the SEC issues a certificate of incorporation under its official seal.**
    - c. **30 days after the date the application for incorporation is filed with the SEC.**
    - d. **30 days after the date the SEC issues a certificate of incorporation under its official seal.**

**Answer:**

b. From the date the SEC issues a certificate of incorporation under its official seal. (BAR 2014)

4. **Guetze and his wife have 3 children: Neymar, 25, who is now based in Rio de Janeiro, Brazil; Muelter, 23, who has migrated to Munich, Germany; and James, 21, who resides in Bogota, Colombia. Neymar and Muelter have since renounced their Philippine citizenship in favor of their country of residence. Nearing 70 years old, Guetze decided to incorporate his business in Binondo, Manila. He asked his wife and 3 children to act as incorporators with 1 share of stock each, while he owned 999,996 shares of the 1,000,000 shares of the capital stock.**

**Assuming all other requirements are met, should the SEC accept or reject the Articles of Incorporation? Why?**

**Answer:**

Yes, the SEC should accept the Articles of Incorporation. If the Articles of Incorporation substantially comply with the statute and all other requirements are met, the SEC has no discretion, but may be compelled by mandamus to file them. The discretion exercised by SEC does not extend to the merits of an application for incorporation, although it may be exercised as to matters of form. (BAR 2014)

## **8. Adoption of By-Laws**

- a. Nature and Functions of By-Laws**
- b. Requisites of Valid By-Laws**

**1. The proposed Amended By-laws of CXT Inc., a corporation listed in the Makati Stock Exchange, contain the following provisions:**

- a) That the holders of a majority of the outstanding capital stock may elect all the members of the Board of Directors;**
- b) That no officer of the corporation shall be required to be a stockholder;**
- c) That the directors' bonuses shall be equivalent to 10% of gross revenues in any given year;**
- d) That a candidate for director must own at least 1,000 shares;**
- e) That meetings of the Board of Directors need not be held in the principal office and may even be held outside the country.**

**As Corporate Secretary of CXT, you are asked to comment on the validity of the above proposed amendments.**

**Answer:**

As Corporate Secretary of CXT, I would give the following comments on the question of validity of the various proposed amendments to the By-laws, as follows:

- a) The minority stockholders may not be deprived of their right to vote in electing the members of the board of directors; hence, the proposed amendment would be invalid.
  - b) The President should be a director who should thus own at least one share of stock. Therefore, the suggested amendment would be invalid unless the President is excluded from the proposed amendment.
  - c) The director's bonuses (total compensation) cannot exceed 10% of net income; accordingly, the proposed amendment fixing the directors' bonuses to 10% of gross venues in any given year would be invalid.
  - d) While the By-laws may provide additional qualifications for directors such qualifications must not be unreasonable. A qualification requiring a director to own at least 1,000 shares, in my view, would be unreasonable and a denial of the right of representation by the minority shareholders in the Board of Directors.
  - e) The meetings of the Board of Directors, unlike those of the stockholders, may be held outside the Philippines; accordingly, the proposed amendment to the by-laws on the matter can be valid. (BAR 1987)
- 2. Suppose that the by-laws of "X" Corporation, a mining firm, provides that "The directors shall be relieved from all liability for any contract entered into by the corporation with any firm in which the**

**directors may be interested.” Thus, director “A” acquired claims which overlapped with “X’s” claims and where necessary for the development and operation of “X’s” mining properties.**

**Is the by-law provision valid?**

**Answer:**

No. it is in violation of Section 32 of the Corporation Code. (BAR 2001)

- c. Binding Effects
- d. Amendment or Revision

- 1. The Board of Directors of X Corporation, acting on a standing authority of the stockholders to amend the by-laws, amended its by-laws so as to disqualify any of its stockholders who is also a stockholder and director of a competitor from being elected to its Board of Directors.**

**Y, a stockholder holding sufficient shares to assure him of a seat in the Board, filed a petition with the SEC for a declaration of nullity of the amended by-laws. He alleged among other things that as a stockholder, he had acquired rights inherent in stock ownership such as the right to vote and be voted upon in the election of directors. Is the stockholder’s petition tenable?**

**Answer:**

No. There is no vested right of a stockholder to be elected as director. When a person buys stock in a corporation he does so with the knowledge that its affairs are dominated by a majority of the stockholders. To this extent, the stockholder parted with his personal right to regulate the disposition of his property which he invested in the capital stock of the corporation and surrendered it to the will of the majority of his fellow incorporators or stockholders.

Corporations have the power to make by-laws declaring a person employed in the service of a rival company to be ineligible for the Corporation’s Board of Directors. An amendment which renders a director ineligible, or if elected, subjects him to removal, if he is also a director in a corporation whose business is in competition with or is antagonistic to the other corporation, is valid. (BAR 1998)

- 2. At the annual stockholders’ meeting of MS Corporation, the stockholders unanimously passed a resolution authorizing the Board of Directors to amend the corporate by-laws so as to disqualify any stockholder who is also a director or stockholder of a competing business from being elected to the Board of Directors of MS Corporation. The by-laws were accordingly amended. GK, a stockholder of MS Corporation and a majority stockholder of a competitor, sought election to the Board of Directors of MS Corporation. His nomination was denied on the ground that he was ineligible to run for the position. Seeking a nullification of the offending disqualification provision, GK consults you about its validity under the Corporation Code of the Philippines. What would your legal advice be?**

**Answer:**

The provision in the amended by-laws, disqualifying any stockholder who is also a director or stockholder of a competing business from being elected to the Board of Directors of MS Corporation, is valid. The corporation is empowered to adopt a code of by-laws for its government not inconsistent with the Corporation Code. Such disqualifying provision is not inconsistent with the Corporation Code. (BAR 2000)

- 3. Is a by-law provision of “X” Corporation “rendering ineligible or if elected, subject to removal, a director if he is also a director in a corporation whose business is in competition with or is antagonistic to said corporation” valid and legal? State your reason.**

**Answer:**

Yes, the by-law provision is valid. It is the right of a corporation to protect itself against possible harm and prejudice that may be caused by its competitors. The position of director is highly sensitive and confidential. To say the least, to allow a person, who is a director in a corporation whose business is in competition with or is antagonistic to "X" Corporation, to become also a director in "X" Corporation would be harboring a conflict of interest which is harmful to the latter. (BAR 2001)

4. **In a special meeting called for the purpose, 2/3 of the stockholders representing the outstanding capital stock in X Co. authorized the company's Board of Directors to amend its By-laws. By majority vote, the Board then approved the amendment. Is the amendment valid?**
- a. **No, since the stockholders cannot delegate their right to amend the By-laws to the Board.**
  - b. **Yes, since the majority votes in the Board was sufficient to amend the By-laws.**
  - c. **No, because, the voting in the Board should have been by a majority of a quorum.**
  - d. **Yes, since the votes of 2/3 of the stockholders and majority of the Board were secured.**

**Answer:**

- a. No, since the stockholders cannot delegate their right to amend the By-laws to the Board. (BAR 2011)

## H. Corporate Powers

### 1. General Powers, Theory of General Capacity

1. **Can a corporation validly change its corporate name under its general power to amend its articles of incorporation?**

**Does a change in the name of a corporation result in its dissolution? Explain your answer.**

**Answer:**

Yes, a corporation may validly change its name under its general power to amend its articles of incorporation in accordance with Section 18 of the Corporation Law. Since there is no restriction in said section relating to change of name, there is no reason why a corporation cannot change its name as long as it follows the procedure laid down by law.

The change in name does not result in its dissolution, since there is no change in its being. Just as a natural person does not cease to exist due to change of name, so is the corporate existence not affected by a change in corporate name. (BAR 1976)

2. **Which of the following corporate acts are valid, void, or voidable? Indicate your answer by writing the paragraph number of the query, followed by your corresponding answer as "valid", "void" or "voidable", as the case may be. If your answer is "void", explain your answer. In the case of a "voidable" answer, specify what conditions must be present or complied with to make the corporate act valid.**

**XL Food Corporation guaranteed the loan of its sister company XL Meat Products.**

**Answer:**

Void—This is an *ultra vires* act on the part of XL Foods Corporation, and is not one of the powers provided for in Sec. 36 of the Corporation Code. (BAR 2002)

### a. Enter into Contracts

1. AAA Corporation is a wholly owned subsidiary of BBB Corporation. To support the business of AAA Corporation, BBB Corporation agreed to give its corporate guarantee to the loan of AAA Corporation. What is required so that the corporate guarantee will be valid?
  - a) It only requires the approval of the Board of Directors of BBB Corporation;
  - b) The Articles of Incorporation must provide such power and be approved by the Board of Directors;
  - c) Providing corporate guarantee to another corporation is a necessary exercise of power of a corporation;
  - d) It would require both the approval of the Board of Directors and the stockholders on record.

**Answer:**

- a) It only requires the approval of the Board of Directors of BBB Corporation. (BAR 2012)

### i. Doctrine of Apparent Authority

1. YKS Trading filed a complaint for specific performance with damages against the PWC Corporation for failure to deliver cement ordered by plaintiff. In its answer, PWC denied liability on the ground, inter alia, that YKS has no personality to sue, not being incorporated, and that the President of PWC was not authorized to enter into a contract with plaintiff by the PWC Board of Directors, hence the contract is ultra vires. YKS Trading replied that it is a sole proprietorship owned by YKS, and that the President of PWC had made it appear in several letters presented in evidence that he had authority to sign contracts on behalf of the Board of Directors of PWC.

**Will the suit prosper or not? Reason briefly.**

**Answer:**

Yes, the suit will prosper. As the sole proprietorship, the proprietor of YKS Trading has the capacity to act and the personality to sue PWC. It is not necessary for YKS Trading to be incorporated before it can sue. On the other hand, PWC is stopped from asserting that its President had no authority to enter into the contract, considering that, in several of PWC's letters, it had clothed its President with apparent authority to deal with YKS Trading. (BAR 2004)

## 2. Specific Powers, Theory of Specific Capacity

### a. Power to Extend or Shorten Corporate Term

1. A group of stockholders of Sesame Corporation filed a court suit against the members of the Board of Directors to make good to the shareholders, in proportion to their shareholdings, the losses incurred by the corporation because of the defendant Board of Directors' management.

**While the case was pending, the corporation was dissolved. During the 3-year period from its dissolution, the Board of Directors decided to extend the corporate life by an amendment of its Articles of Incorporation. Can the Board of Directors do so? Reasons.**

**Answer:**

The Board of Directors may not do so. The corporate life may be extended so long as the proper steps therefore (charter amendment) are done by the corporation before its expiry date. (BAR 1988)

2. **The corporate term of a stock corporation is that which is stated in its Articles of Incorporation. It may be extended or shortened by an amendment of the Articles when approved by majority of its Board of Directors and:**
- Approved and ratified by at least 2/3 of all stockholders
  - Approved by at least 2/3 of the stockholders representing the outstanding capital stock.
  - Ratified by at least 2/3 of all stockholders.
  - Ratified by at least 2/3 of the stockholders representing the outstanding capital stock.

**Answer:**

d. Ratified by at least 2/3 of the stockholders representing the outstanding capital stock. (BAR 2011)

3. **T Corp. has a corporate term of 20 years under its Articles of Incorporation or from June 1, 1980 to June 1, 2000. On June 1, 1991 it amended its Articles of Incorporation to extend its life by 15 years from June 1, 1980 to June 1, 2015. The SEC approved this amendment. On June 1, 2011, however, T Corp. decided to shorten its term by 1 year or until June 1, 2014. Both the 1991 and 2011 amendments were approved by majority vote of its Board of Directors and ratified in a special meeting by its stockholders representing at least 2/3 of its outstanding capital stock. The SEC, however, disapproved the 2011 amendment on the ground that it cannot be made earlier than 5 years prior to the expiration date of the corporate term, which is June 1, 2014. Is this SEC disapproval correct?**
- No, since the 5-year rule on amendment of corporate term applies only to extension, not shortening, of term.
  - Yes, any amendment affecting corporate term cannot be made earlier than 5 years prior to the corporation's expiration date.
  - No, since a corporation can in fact have a corporate life of 50 years.
  - Yes, the amendment to shorten corporate term cannot be made earlier than 5 years prior to the corporation's expiration date.

**Answer:**

b. No, since the 5-year rule on amendment of corporate term applies only to extension, not shortening, of term. (BAR 2011)

**b. Power to Increase or Decrease Capital Stock or Incur, Create, Increase Bonded Indebtedness**

1. **"X" Realty, Inc., a corporation engaged in the subdivision business, has an authorized capital of P800,000, all of which has been fully subscribed. At a special meeting of the board of directors, the majority vote decided on the basis of the recommendation of its Executive Committee, that the corporation purchase a 5-hectare property offered to it because it was ideal for its subdivision business, the price offered was lower than the prevailing market price and John Roque, the owner of the property, was willing to accept P200,000 worth of shares of the corporation in exchange of, or as payment for, his property. No cash was involved in the transaction. Thus, the board approved a resolution increasing the authorized capital stock from P800,000 to 1 Million, stipulating that the additional P200,000 worth of shares be issued in exchange for the 5-hectare property and that the existing stockholders would have pre-emptive right to subscribe to the additional shares as the same were being issued to pay for the property.**

**Was the action of the Board correct and sufficient?**

**Answer:**

The action of the Board of Directors was correct, but not sufficient. The Corporation Code requires that the resolution of the Board of Directors shall still be approved by 2/3 of the outstanding capital stock, and further

to be approved by the SEC, and there are no such approvals. Furthermore, the pre-emptive rights of the stockholders to subscribe the additional shares cannot be denied, except by Articles of Incorporation. (*Secs. 38 & 39, Corporation Code*) (BAR 1982)

**2. The stockholders of People Power, Inc. (PPI) approved the following two resolutions in a special stockholder's meeting: (i) Resolution increasing the authorized capital stock of PPI, and (ii) Resolution authorizing the Board of Directors to issue for cash payment the new shares from the proposed capital stock increase in favor of outside investors who are non-stockholders. The foregoing resolutions were approved by stockholders representing 99% of the total outstanding capital stock. The sole dissenter was Jose Estrada who owned the rest 1% of the stock.**

- a) Are the resolutions binding on the corporations and its stockholders, including Estrada, the dissenting stockholder?**
- b) What remedies, if any, are available to Estrada?**

**Answer:**

- a) The board resolutions (i) increasing the authorized capital stock of PPI, and (ii) authorizing the Board to issue new shares from that increase of capital stock in favor of outside investors is binding on the stockholders since the said resolutions were approved by the stockholders representing at least 2/3 of the total outstanding capital stock.
- b) Estrada, the dissenting stockholder, may avail himself of the appraisal rights by claiming that since the resolutions appear to favor outside investors, as against incumbent stockholders, on the increase in capital stock, he may demand the payment of the appraised value of his shares. (BAR 1987)

**3. The stockholders of People Power, Inc. (PPI) approved two resolutions in a special stockholders' meeting:**

- a) Resolution increasing the authorized capital stock of PPI; and**
- b) Resolution authorizing the Board of Directors to issue, for cash payment, the new shares from the proposed capital stock increase in favor of outside investors who are non-stockholders.**

**The foregoing resolutions were approved by stockholders representing 99% of the total outstanding capital stock. The sole dissenter was Jimmy Morato who owned 1% of the stock.**

**Are the resolutions binding on the corporation and its stockholders including Jimmy Morato, the dissenting stockholder?**

**Answer:**

No. the resolutions are not binding on the corporation and its stockholders including Jimmy. While these resolutions were approved by the stockholders, the directors' approval, which is required by law in such case, does not exist. (BAR 1998)

**4. Suppose "X" Corporation has an authorized capital stock of P1 M divided into 100,000 shares of stock with par value of P10 each.**

- a) Give two ways whereby said authorized capital stock may be increased to about P1.5 M.**
- b) Give three practical reasons for a corporation to increase its capital stock.**

**Answer:**

- a) Two ways of increasing the Authorized Capital Stock of "X" Corporation to P1.5 M are:
  - 1. Increase the number of shares from 100,000 to 150,000 shares with the same par value of P10 each.

2. Increase par value of the 1000,000 shares to P15 each.

b) Three practical reasons for a corporation to increase its capital stock are:

1. To generate more working capital;
2. To have more shares with which to pay for the acquisition of more assets like acquisition of company car, stocks, house, machinery or business; and
3. To have extra share with which to cover or meet the requirement for declaration of stock dividend. (BAR 2001)

**5. Distinguish clearly (1) crossed checks from cancelled checks; and (2) cash bond from surety bond.**

**Answer:**

A crossed check is one with two parallel lines drawn diagonally across its face or across a corner thereof. On the other hand, a cancelled check is one marked or stamped "paid" and/or "cancelled" by or on behalf of a drawee bank to indicate payment thereof.

A surety bond is issued by a surety or insurance company in favor of a designated beneficiary, pursuant to which such company acts as a surety to the debtor or obligor of such beneficiary.

A cash bond is a security in the form of cash established by a guarantor or surety to secure the obligation of another. (BAR 2004)

**6. If ABC Corporation will increase its authorized capital stock, the Corporation Code requires—**

- a) **The approval of the majority of the Board of Directors only;**
- b) **The approval of the majority of the stockholders and the Board of Directors;**
- c) **The approval of 2/3 of the shareholders of the outstanding capital stock as well as the approval of the SEC;**
- d) **The approval of the majority of the Board of Directors and approval of the shareholders holding 2/3 share of the outstanding capital stock.**

**Answer:**

Examinees should be given full credit for whatever answer they gave as the question is vague. (BAR 2012)

**c. Power to Deny Pre-Emptive Rights**

**1. ABC Corp. increased its capital stocks from P10 M to P15 M and, in the process, issued 1,000 new shares divided into Common Shares "B" and common shares "C". T, a stockholder owning 500 shares, insists on buying the newly issued shares through a right of pre-emption. The company claims, however, that its By-laws deny T any right of pre-emption. Is the corporation correct?**

- a. **No, since the by-laws cannot deny a shareholder his right of pre-emption.**
- b. **Yes, but the denial of his pre-emptive right extends only to 500 shares.**
- c. **Yes, since the denial of the right under the By-laws is binding on T.**
- d. **No, since pre-emptive rights are governed by the articles of incorporation.**

**Answer:**

c. No, since the by-laws cannot deny a shareholder his right of pre-emption. (BAR 2011)

**d. Power to Sell or Dispose of Corporate Assets**

1. **The Board of Directors of “X” Corporation, with the unanimous authority and approval of its stockholders in a meeting called for the purpose, sells to “Y” Corporation for P10M, substantially all of the corporation’s assets consisting of pieces of machinery, fixtures and equipment used in the business of said corporation. “Z” a creditor, now questions the sale as fraudulent, and therefore, null and void.**

**Answer:**

Assuming that X Corporation was engaged in retail business, and therefore the Bulk Sales Law is applicable, Z, a creditor may question the sale as fraudulent because X Corporation (1) did not make detailed inventory of what would be sold and give notice thereof to creditors, and (2) did not deliver a sworn statement of the names and addresses of all creditors to X Corporation, pursuant to law (BAR 1980)

2. **The Board of Directors of Union Corporation, with the unanimous authority of its stockholders in a meeting duly called for the purpose, sold to Victory Corporation for P880 Million substantially all of the company’s assets consisting of pieces of machinery, fixtures, and equipment used in the alcoholic beverage business of the company. Acme Bottlers, Inc., creditor-supplier of the bottle requirements of Union Corporation, now questions the sale as fraudulent and therefore null and void, contending that it learned of the sale only from the column of Leticia Locsin at the Daily Globe.**

- a) **Is Acme Bottlers, Inc. correct in alleging that the said sale is null and void?**
- b) **What are the rights and liabilities of Victory Corporation?**

**Answer:**

a) No, the allegation of Acme that the sale is null and void cannot be sustained. The Corporation Code expressly authorizes corporations to sell all or substantially all of its assets under the conditions therein expressed which had been complied with according to the facts stated in the problem. The Bulk Sales Law, upon the other hand, cannot successfully be invoked as the legal basis for the nullity of the sale as the Act applies only to the conveyance in bulk of stocks in trade. Had the law been applicable, notice to the creditors before the sale would have been required under the Bulk Sales Law for its validity.

b) Victory has acquired rights as lawful buyer in the sale of Union’s corporate assets. If, as alleged by Acme, the sale is fraudulent and it is rescinded on that ground, the rescission would only be to the extent that there is prejudice to the creditors. Assuming further, that the rescission, in fact, takes place, Victory Corporation may go after the seller for breach of sale or warranty as the ultimate facts would warrant. (BAR 1988)

3. **E Corporation sold its assets to M, Inc. after complying with the requirements of the Bulk Sales Law. Subsequently, one of the creditors of E Corporation tried to collect the amount due it, but found out that E Corporation had no more assets left. The creditor then sued M, Inc. on the theory that M, Inc. is a mere alter ego of E Corporation.**

**Will the suit prosper? Explain.**

**Answer:**

The suit will not prosper. The sale by E Corporation of its assets to M, Inc. does not result in the transfer of the liabilities of the latter to, nor in the assumption thereof by the former. The facts given do not indicate that such transfer or assumption took place or was stipulated upon by the parties in their agreement. Furthermore, the sale by E Corporation of its assets is a sale of its property. It does not involve the sale of the shares of stock of the corporation belonging to its stockholder. There is, therefore, no merger or consolidation that took place. E Corporation continues to exist and remains liable to the creditor. (BAR 1996)

4. **Divine Corporation is engaged in the manufacture of garments for export. In the course of its business, it was able to obtain loans from individuals and financing institutions. However, due to the drop in the demand for garments in the international market, Divine Corporation could not meet its obligations. It decided to sell all its equipment such as sewing machines, perma-press machines, high speed sewers, cutting tables, ironing tables, etc., as well as its supplies and materials to Top Grade Fashion Corporation, its competitor.**

- a) **How would you classify the transaction?**
- b) **Can Divine Corporation sell the aforesaid items to Top Grade Fashion Corporation? What are the requirements to the validly sell the items? Explain.**
- c) **How would you protect the interest of the creditors of Divine Corporation?**
- d) **In case Divine Corporation violated the law, what remedies are available to Top Grade Fashion Corporation?**

**Answer:**

- a) The sale is a sale in bulk, because it is a sale of all or substantially all of the fixtures used in and about the business of the vendor, a garments manufacturer.
- b) Divine Corporation can sell the aforesaid items to Top Grade Fashion Corporation. But it must secure the approval of at least 2/3 of its stockholders and a majority vote of the members of its board of directors as this is a sale of all or substantially all of its assets.
- c) To protect the interest of the creditors, I will require the seller to prepare an affidavit stating the names of all its creditors, their addresses, the amount of their credits and their respective maturities, and to submit the affidavit to the buyer who, in turn, should notify the creditors about the transaction he is about to conclude with the seller.

If the transaction was made to defraud the creditors, the latter may have the contract rescinded. The creditors may also file a petition for involuntary insolvency and have the sale voided if it was made in fraud of creditors.

- d) Top Grade Fashion Corporation may recover the amount paid if the sale was made in fraud of creditors and sue for damages. (BAR 2005)

#### **e. Power to Acquire Own Shares**

1. **B, an alien commercial bank doing business in the Philippines was paid by a Filipino debtor, C, who had no other assets, with a piece of land located in Bulacan. In the meantime that there were no buyers yet of the land, B sought to have the land registered in its name by the Register of Deeds of Bulacan. But the Register of Deeds refused to register it on the ground that the said bank, B, is alien owned and therefore the transfer violates the constitutional prohibition of alien holding of private agricultural land. The bank, B, contends that Republic Act 337, the General Banking Act, in section 25(c) authorizes commercial banks to purchase and hold real estate as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings. Decide the dispute with reasons.**

**Answer:**

Yes, the Register of Deeds may legally refuse to register the land in question in the name of B, an alien commercial bank, due to constitutional provision that the disposition, exploitation or utilization of any of the natural resources of the Philippines, or to corporations or associations at least 60% of the capital of which is owned by such citizens. (Sec. 9, Art. XIV, Constitution of the Philippines.) (BAR 1979)

2. A corporation executed a promissory note binding itself to pay its President/ Director, who had tendered his resignation, a certain sum in payment of the latter's shares and interests in the company. The corporation defaulted in paying the full amount so that the said former President filed suit for collection of the balance before the SEC.

**Under what condition is a stock corporation empowered to acquire its own shares?**

**Answer:**

A stock corporation may only acquire its own shares of stock if the trust fund doctrine is not impaired. This is to say, for instance, that it may purchase its own shares of stock by utilizing merely its surplus profits over and above the subscribed capital of the corporation. (BAR 1992)

3. **Under what conditions may a stock corporation acquire its own shares?**

**Answer:**

The conditions under which a stock corporation can acquire its own share are as follows:

- a. That it be for a legitimate and proper corporate purpose; and
  - b. That there shall be unrestricted retained earnings to purchase the same and its capital is not thereby impaired. (BAR 2003)
4. **ABC Holdings Company, a Hong Kong company, owns 10% of XYZ Bank. Because of the peace and order situation in the Philippines, ABC Holding Company wanted to sell its shareholdings in XYZ Bank. Unfortunately, nobody is interested to buy a 10% shareholdings in a bank. The board of directors of XYZ Bank thought that it would be a good idea to buy back the shares owned by ABC Holding Company. Which statement is most accurate?**
- a) **Buying back the shares by XYZ Bank is absolutely not allowed;**
  - b) **Buying back the shares may be allowed provided it is with the approval of the Monetary Board and disposed of within 6 months;**
  - c) **Buying back the shares may be allowed provided such shares will be disposed of within 10 years;**
  - d) **Buying back the shares may be done anytime provided the Board of Directors will approve the same.**

**Answer:**

b) Buying back the shares may be allowed provided it is with the approval of the Monetary Board and disposed of within 6 months. (BAR 2012)

#### **f. Power to Invest Corporate Funds in Another Corporation or Business**

1. **ABC Corporation is engaged in the business of manufacturing soft drinks. For the past 10 years, it has bought all its bottles from XYZ Corporation. Considering the volume of its production, it now finds that it will be more economical to manufacture its own bottles.**

**The Board of Directors, after studying and discussing the matter thoroughly, decides to set aside the amount of 1 Million for this project. Most of this amount will go to the cost of equipment and materials.**

**M is a stockholder of ABC Corporation and is against this investment in the bottling project and would like to withdraw from the corporation by exercising his appraisal right if the project goes through. He therefore demands that the project be submitted to the stockholders for approval, but the board**

**refuses to do so on the ground that there is no need for such approval and that the calling of a special stockholder's meeting would entail too much expenses.**

**M thus cannot have the opportunity to exercise his appraisal right. He wants to sue the board to compel it to submit the matter to the stockholders and to enjoin it from pursuing the project until the stockholders shall have approved it.**

**a) Do you think the matter needs the stockholders' approval or is the action of the Board of Directors sufficient? Explain.**

**Answer:**

a) No, it does not need the approval of the stockholders. Under the Corporation Code, a corporation may, as a general rule, invest its funds in another business or in any purpose other than the primary purpose for which it was organized, when approved by the Board of Directors and by 2/3 of the outstanding capital stock in a meeting called for the purpose. Any dissenting stockholder shall have the appraisal right. However, the same provision makes an exception: where the investment is reasonably necessary to accomplish its primary purpose, the approval of the stockholders is not necessary. In the case at hand, the manufacture of bottles is reasonably necessary for the corporation's primary business of manufacturing soft drinks and does not therefore need the approval of the stockholders. The action of the board is sufficient. (*De l Rama v. Maa Sugar Central*, GR 17504, Feb. 28, 1969) (BAR 1983)

**2. Stikki Cement Corporation (STIKKI) was organized primarily for cement manufacturing. Anticipating substantial profits, its President proposed that STIKKI invest in (a) a power plant project, (b) a concrete road project, and (c) quarry operations for limestone used in the manufacture of cement.**

**1. What corporate approvals or votes are needed for the proposed investments? Explain.**

**2. Describe the procedure in securing these approvals.**

**Answer:**

1. Unless the power plant and the concrete road project are reasonably necessary to the manufacture of cement by STIKKI (and they do not appear to be so), then the approval of the said projects by a majority of the Board of Directors and the ratification of such approval by the stockholders representing at least 2/3 of the outstanding capital stock would be necessary.

As for the quarry operations for limestone, the same is an indispensable ingredient in the manufacture of cement and may, therefore, be considered reasonably necessary to accomplish the primary purpose of STIKKI. In such case, only the approval of the Board of Directors would be necessary.

2. a) The procedure in securing the approval of the Board of Directors is as follows:

- i) A notice of meeting of the Board should be sent to all the directors. The notice should state the purpose of the meeting.
- ii) At the meeting, each of the project should be approved by a majority of the Board (not merely a majority of those present at the meeting).

b) The procedure in securing the approval of the stockholders is as follows:

- i) Written notice of the proposed investment and the time and place of the stockholders' meeting should be sent to each stockholder at his place of residence as shown on the books of the corporation and deposited to the addressee in the post office with postage prepaid, or served personally.

- ii) At the meeting, each of the projects should be approved by the stockholders representing at least 2/3 of the outstanding capital stock. (BAR 1995)

**3. May a corporation enter into a joint venture?**

**Answer:**

A corporation may enter into a joint venture. However, inasmuch as the term joint venture has no precise legal definition, it may take various forms. It could take the form of a simple pooling of resources (not involving incorporation) between 2 or more corporations for a specific project, purpose or undertaking, or for a limited time. It may involve the creation of a more formal structure and, hence, the formation of a corporation. If the joint venture would involve the creation of a partnership, as the term is understood under the Civil Code, then a corporation cannot be a party to it. (BAR 1996)

**4. When may a corporation invest its funds in another corporation or business or for any other purposes?**

**Answer:**

A corporation may invest its funds in another corporation or business or for any purpose other than the primary purpose for which it was organized when the said investment is approved by a majority of the Board of Directors and such approval is ratified by the stockholders representing at least 2/3 of the outstanding capital. Written notice of the proposed investment and the date, time and place of the stockholders' meeting at which such proposal will be taken up must be sent to each stockholder. (BAR 1996)

**g. Power to Declare Dividends**

**1. Palmavera Corporation has an authorized capital stock of P500,000, all subscribed and outstanding as of December 31, 1981. The corporation also has an unrestricted retained earnings in its book amounting to P375,000. Since the corporation needed the cash surplus to carry out its expansion projects, the board of directors, in its meeting held on January 5, 1982, approved a resolution declaring and ordering the issuance of 50% stock dividends in lieu of cash dividends.**

- a) Was the resolution declaring the issuance of stock dividends valid? Explain your answer.
- b) What step or steps need be taken in order that the decision of the board could be implemented? State the required vote.

**Answer:**

- a) Yes, the resolution of the Board of Directors declaring the issuance of stock dividends was valid, but still insufficient for purposes of stock dividend. (*Sec. 43, Corporation Code*)
- b) The aforesaid approval of the Board of Directors for the declaration of stock dividends shall still be approved by the stockholders representing not less than 2/3 of the outstanding capital stock, at a regular or special meeting called for the purpose. In addition, there must be the increase of the authorized capital stock at least to accommodate the stock dividends, to be approved by the SEC, inasmuch as the authorized capital stock of Palmavera Corporation was fully subscribed already. (*Secs. 38 & 43, Corporation Code*) (BAR 1982)

**2. On December 9, 1985, Matatag Corporation revalued its assets. On the basis of the reappraisal, the Board of Directors also declared cash dividends for all stockholders. On December 16, 1985, Matatag Corporation amassed substantial profits in a highly lucrative transaction. Some minority stockholders, however, did not want to complicate their income tax problems for 1985 and refused to accept the cash**

**dividends. They also filed suit to compel the other stockholders to return to Matatag Corporation the money received as dividends. Not one of the stockholders who formed the majority joined in the suit since they were happy with the money they received.**

**a) Will the action prosper? Explain.**

**Answer:**

a) Two alternative answers are suggested:

- i. The action will prosper. A cash dividend based on re-appraisal value is improper. Dividends may only be declared from surplus profit from operations.
- ii. The action will not prosper. The fact that, shortly after the declaration of cash dividends, the corporation had earned substantial profits (assuming that the amount thereof would be sufficient to cover the dividend declaration) during the same month would be sufficient to cure the defect. A violation of the trust fund doctrine, which is the rationale of the legal requirement on dividend declaration, is not void per se and it is, therefore, susceptible to curative events in ultimate results. (BAR 1986)

**3. Taurus Corporation (TC) commenced operation in 1985. During that year TC's loss from operations amounted to P500,000. In 1986, TC recouped all its losses in 1985, registering a net after tax profit of P500,000. In the same year, the management of the company discovered that a parcel of land originally acquired in 1985 for P300,000 had at least doubled in value and accordingly the Board of Directors of TC, with the conformity of the external auditors and backed up by a valuation report of a reputable appraiser, recognized a revaluation or appraisal surplus of P300,000.**

**May the Board of Directors of TC declare a cash dividend out of this surplus? Explain.**

**Answer:**

The Board of Directors cannot declare cash dividends out of the revaluation or appraisal surplus that may fluctuate from time to time. Dividends can only be declared from surplus profits arising from its operations. (BAR 1987)

**4. (1) Distinguish between cash dividend and stock dividend. When may the declarations of these dividends be revoked?**

**(2) After 1 year of operation, Safe Realty, Inc., wanted to declare dividends to its stockholders. Ramos, its President, asked Santos, its Treasurer, whether this feasible, considering the financial standing of the corporation. Santos reported that the corporation posted a P1 M profit and its real estate has appreciated in value to the tune of P4 M. The Board then declared dividends to its stockholders computed on the basis of P5 M representing profits and appreciation in value of its real estate. Is the dividend declaration proper? Reasons.**

**Answer:**

1) Dividends may either be cash (property) or stock. Any dividend other than from the unissued shares of the corporation is, in contemplation of law, a cash dividend. A stock dividend is one that is declared and paid out from the unissued shares of corporation. Declaration of stock dividends, unlike cash dividends, need the concurrence of the stockholders.

A declaration of dividends may be revoked if the same was irregularly declared, such as when the same is violative of the trust fund doctrine; otherwise, it can no longer be revoked once the right thereto has already vested in the stockholders.

2) The dividend declaration is improper. Dividends may be declared only out of unrestricted retained earnings and, as understood in generally accepted accounting principles, such declaration would preclude its being sourced from mere increments in the value of corporate assets which may fluctuate from time to time. (BAR 1989)

5. **At least 2/3 of the stockholders of Solar Corporation, meeting upon the recommendation of the Board of Directors, declared a 50% stock dividend during their annual meeting. The notice of the annual stockholders' meeting did not mention anything about a stock dividend declaration. The matter was taken up only under the item "Other Business" in the agenda of the meeting. C.K. Senwa, a stockholder, who received his copy of the notice but did not attend the meeting, subsequently learned about the 50% stock dividend declaration. He desires to have the stock dividend declaration cancelled and set aside, and wishes to retain your services as a lawyer for the purpose.**

**Will you accept the case? Discuss with reasons.**

**Answer:**

I will not accept the case. Section 43 of the Corporation Code states that no stock dividend shall be issued without the approval of the stockholders representing not less than 2/3 of the outstanding capital stock at a regular or special meeting duly called for that purpose. Conformably with Section 50 of the Corporation Code, a written notice of the holding of the regular meeting sent to the shareholders will suffice. The notice itself specifies the said subject matter. (BAR 1990)

6. **ABC Management, Inc. presented to DEF Mining Corp. the draft of its proposed Management Contract. As an incentive, ABC included in the terms of compensation that ABC would be entitled to 10% of any stock dividend which DEF may declare during the lifetime of the Management Contract. Would you approve of such provision? If not, what would you suggest as an alternative?**

**Answer:**

I would not approve of a proposed stipulation in the management contract that the managing corporation, as an additional compensation to it, should be entitled to 10% of any stock dividend that may be declared. Stockholders are the only ones entitled to receive stock dividends. I would add that the unsubscribed capital stock of a corporation may only be issued for cash or property or for services already rendered constituting a demandable debt. As an alternative, I would suggest that the managing corporation should instead be given a net profit participation and, if later so desires, to then convert the amount that may be due thereby to equity or shares of stock at no less than the par value thereof. (BAR 1991)

7. **During the annual stockholders meeting, Riza, a stockholder proposed to the body that a part of the corporation's undeserved earned surplus be capitalized and stock dividends be distributed to the stockholders, arguing that as owners of the company, the stockholders, by majority vote, can do anything. As chairman of the meeting, how would you rule on the motion to declare stock dividends?**

**Answer:**

As the chairman of the meeting, I would rule against the motion considering that a declaration of stock dividends should initially be taken by the board of directors and thereafter to be concurred in by a 2/3 vote of the stockholders. There is no prohibition, however, against the stockholders' resolving to recommend to the board of directors that it consider a declaration of stock dividends for concurrence thereafter by the stockholders. (BAR 1991)

8. **For the past 3 years of its commercial operation, "X", an oil company, has been earning tremendously in excess of 100% of the corporation's paid-in capital. All of the stockholders have been claiming that they share in the profits of the corporation by way of dividends but the Board of Directors failed to lift its finger.**

- a) Is Corporation "X" guilty of violating a law? If in the affirmative, state the basis.
- b) Are there instances when a corporation shall not be liable for not declaring dividends?

**Answer:**

- a) Corporation "X" is guilty of violating Section 43 of the Corporation Code. This provision prohibits stock corporations from retaining surplus profits in excess of 100% of their paid-in capital.
- b) The instances when a corporation shall not be held liable for not declaring dividends are:
  - 1. When justified by definite corporate expansion projects or programs approved by the board of directors;
  - 2. When the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its or his consent, and such consent has not yet been secured; or
  - 3. When it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is need for special reserve for probable contingencies. (BAR 2001)

**9. Which of the following corporate acts are valid, void, or voidable? Indicate your answer by writing the paragraph number of the query, followed by your corresponding answer as "valid", "void" or "voidable", as the case may be. If your answer is "void", explain your answer. In the case of a "voidable" answer, specify what conditions must be present or complied with to make the corporate act valid.**

- 1) The board of directors of XL Food Corporation declared and paid cash dividends without approval of the stockholders.

**Answer:**

- 1) Valid. (BAR 2002)

- 10. a) Under what circumstances may a corporation declare dividends?**
- b) Distinguish dividend from profit; cash dividend from stock dividend.**
- c) From what funds are cash and stock dividends sourced? Explain why.**

**Answer:**

- a) A corporation may declare dividends if it has unrestricted retained earnings.
- b) Profits belong to the corporation, while dividends belong to the stockholders when dividend is declared.

A cash dividend involves disbursement of earnings to stockholders, while stock dividend does not involve any disbursement. A cash dividend affects the fractional interest in property which each share represents, while a stock dividend decreases the fractional interest in corporate property which each share represents. A cash dividend does not increase the legal capital, while a stock dividend does, as there is no cash outlay involved. Cash dividends are subject to income tax, while stock dividends are not. Declaration of stock dividend requires the approval of both the majority of the members of the board of directors and at least 2/3 of the stockholders. In the declaration of cash dividend, the approval by a majority of the members of the board of directors will suffice.

- c) Both cash dividend and stock dividend may be declared out of unrestricted retained earnings. Paid-in surplus can be declared stock dividend but not cash dividend, because a stock dividend merely transfers the paid-in surplus to capital. (BAR 2005)

**11. On September 15, 2007, XYZ Corporation issued to Paterno 800 preferred shares with the following terms:**

*“The Preferred Shares shall have the following rights, preferences, qualifications, and limitations, to wit:*

- 1. The right to receive a quarterly dividend of 1% cumulative participating;*
- 2. These shares may be redeemed, by drawing of lots, at any time after 2 years from date of issue, at the option of the Corporation; x x x.”*

**Today, Paterno sues XYZ Corporation for specific performance, for the payment of dividends on, and to compel the redemption of, the preferred shares, under the terms and conditions provided in the stock certificates. Will the suit prosper? Explain.**

**Answer:**

No. the suit will not prosper. Paterno cannot compel XYZ Corporation to pay dividends, which have to be declared by the Board of Directors and the latter cannot do so, unless there are sufficient unrestricted retained earnings. Otherwise, the corporation will be forced to use its capital to make said payments in violation of the trust fund doctrine. Likewise, redemption of shares cannot be compelled. While the certificate allows such redemption, the option and discretion to do so are clearly vested in the Corporation. (BAR 2009)

- 12. TRUE OR FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**Dividends on shares of stock can only be declared out of unrestricted retained earnings of the corporation.**

**Answer:**

True. Dividends on shares of stock of a corporation, whether cash dividend or stock dividend, can be validly declared only out of unrestricted retained earnings. It cannot be declared out of the capital. Otherwise, such declaration of dividend will violate the trust fund doctrine. (BAR 2009)

- 13. The rule is that no stock dividend shall be issued without the approval of stockholders representing at least 2/3 of the outstanding capital stock at a regular or special meeting called for the purpose. As to other forms of dividends:**

- a. A mere majority of the entire Board of Directors applies.**
- b. A mere majority of the quorum of the Board of Directors applies.**
- c. A mere majority of the votes of stockholders representing the outstanding capital stock applies.**
- d. The same rule of 2/3 votes applies.**

**Answer:**

b. A mere majority of the quorum of the Board of Directors applies. (BAR 2011)

- 14. ABC Corporation declared stock dividends to its stockholders. The stock dividends were approved by the Board of Directors of ABC Corporation. In the subsequent year, however, the Board again approved the redemption of all stock dividends and to pay the shareholdings in cash. Which statement is most accurate?**

- a) The redemption of the stock dividends can be validly approved but hr Board without any conditions;**
- b) The redemption of stock dividends may only be allowed if there are sufficient earnings and should not be violative of the trust fund doctrine;**
- c) The redemption of the shares may be taken from the existing property and other assets of the corporation;**
- d) None of the above.**

**Answer:**

Examinee should be given full credit for whatever answer they gave as the question is vague. (BAR 2012)

h. Power to Enter Into Management Contract

3. Ultra Vires Acts

- a. Applicability of Ultra Vires Doctrine
- b. Consequences of Ultra Vires Acts

4. How Exercised

- a. By the Corporation

**1. When is there an *ultra vires* act on the part of (a) the corporation.**

**Answer:**

Under Sec. 45 of the Corporation Code, no corporation shall possess or exercise any corporate power except those conferred by the Code or by its articles of incorporation and except such as are necessary or incidental to the exercise of the powers so conferred. When the corporation does an act or engages in an activity which is outside of its express, implied or incidental powers set out in its articles of incorporation, the act is deemed to be *ultra vires*. (BAR 2009)

- b. By the Shareholders
- c. By the Board of Directors

**1. When is there an *ultra vires* act on the part of (b) the board of directors.**

**Answer:**

When the Board engages in an activity or enters into a contract without the ratificatory vote of the stockholders in those instances where the Corporation Code so requires such ratificatory vote, such as when the corporation is made to invest in another corporation or engage in a business which is not in pursuit of its primary purpose, the board resolution not ratified by stockholders owning or representing at least 2/3 of the outstanding capital stock would make the transaction void, as being *ultra vires*. (BAR 2009)

**2. X Corp., whose business purpose is to manufacture and sell vehicles, invested its funds in Y Corp., an investment firm, through a resolution of its Board of Directors. The investment grew tremendously on account of Y Corp's excellent business judgment. But a minority stockholder in X Corp. assails the investment as *ultra vires*. Is he right and, if so, what is the status of the investment?**

- a. Yes, it is an *ultra vires* act of the corporation itself but voidable only, subject to stockholder's ratification.
- b. Yes, it is an *ultra vires* act of its Board of Directors and thus void.
- c. Yes, it is an *ultra vires* act of its Board of Directors but voidable only, subject to stockholders' ratification.
- d. Yes, it is an *ultra vires* act of the corporation itself and, consequently, void.

**Answer:**

c. Yes, it is an *ultra vires* act of its Board of Directors but voidable only, subject to stockholders' ratification. (BAR 2011)

**d. By the Officers**

1. **Ronald Sham doing business under the name of SHAMRON Macineries (SHAMRON) sold to Turtle Mercantile (TURTLE) a diesel farm tractor. In payment, TURTLE's President and Manager Dick Seldon issued a check for P50,000 in favor of SHAMRON. A week after, TURTLE sold the tractor to Briccio Industries (BRICCIO) for P60,000. BRICCIO discovered that the engine of the tractor was reconditioned so he refused to pay TURTLE. As a result, Dick Seldon ordered "stop payment" of the check issued to SHAMRON.**

**SHAMRON sued TURTLE and Dick Seldon. SHAMRON obtained a favorable judgment holding co-defendants TURTLE and Seldon jointly and severally liable.**

**Comment on the decision of the trial court. Discuss fully.**

**Answer:**

The trial court erred in holding Dick, President and General Manager of Turtle, jointly and severally liable with TURTLE.

In issuing the check issued to SHAMRON and, thereafter, stopping payment thereof, Seldon was acting in his capacity as an officer of TURTLE. He was not acting in his personal capacity. Furthermore, no facts have been provided which would indicate that the action of Seldon was dictated by intent to defraud SHAMRON by himself or in collusion with TURTLE. Having acted in what he considered as his duty as an officer of the corporation, Seldon should not be held personally liable. (BAR 1995)

2. **Rodman, the President of TF Corporation wrote a letter to Gregorio, offering to sell to the latter 5,000 bags of fertilizer at P100 per bag. Gregorio signed his conformity to the letter-offer, and paid a down payment of P50,000. A few days later, the Corporate Secretary of TF informed Gregorio of the decision of the Board of Directors not to ratify the letter-offer. However, since Gregorio had already paid the down payment, TF delivered the 500 bags of fertilizer which Gregorio accepted. TF made it clear that the delivery should be considered an entirely new transaction. Thereafter, Gregorio sought enforcement of the letter-offer.**

**Is there a binding contract for the 5,000 bags of fertilizer? Explain.**

**Answer:**

No, there is no binding contract for the 5,000 bags of fertilizers. First, the facts do not indicate that Rodman, the President of TF Corporation, was authorized by the Board of Directors to enter into the said contract or that he was empowered to do so under some provision of the by-laws of TF. The facts do not also indicate that Rodman has been clothed with the apparent power to execute the contract or agreements similar to it. Second, TF has specifically informed Gregorio that it has not ratified the contract for the sale of 5,000 bags of fertilizer and that the delivery to Gregorio of 500 bags, which Gregorio accepted, is an entirely new transaction. (BAR 1996)

3. **When is there an *ultra vires* act on the part of (c) the corporate officers.**

**Answer:**

When a corporate officer enters into a contract on behalf of the corporation without having been so expressly or impliedly authorized by the board of Directors, even when the act or contract falls within the corporation's

express, implied or incidental power, then the unauthorized act of the corporate officer is deemed to be *ultra vires*. (BAR 2009)

4. **Y, as President of and in behalf of AAA Corporation, as a way to accommodate X, one of its stockholders, endorsed the check issued by X. Which statement is most accurate?**

- e) It is an *ultra vires* act;
- f) It is a valid indorsement;
- g) The corporation will be held liable to any holder in due course;
- h) It is an invalid indorsement.

**Answer:**

- c) It is an *ultra vires* act.
- d) It is a valid indorsement. (BAR 2012)

## 5. Trust Fund Doctrine

1. **A corporation executed a promissory note binding itself to pay its President/ Director, who had tendered his resignation, a certain sum in payment of the latter's shares and interests in the company. The corporation defaulted in paying the full amount so that the said former President filed suit for collection of the balance before the SEC.**

**Is the arrangement between the corporation and its President covered by the trust fund doctrine? Explain your answers briefly.**

**Answer:**

The arrangement between the corporation and its President to the extent that it calls for the payment of the latter's shares is covered by the trust fund doctrine. The only exceptions from the trust fund doctrine are the redemption of redeemable shares and, in the case of close corporation, when there should be a deadlock and the SEC orders the payment of the appraised value of a stockholder's share. (BAR 1992)

2. **Discuss the trust fund doctrine.**

**Answer:**

The trust fund doctrine means that the capital stock, properties and other assets of a corporation are regarded as equity in trust for the payment of corporate creditors. Stated simply, the trust fund doctrine states that all funds received by the corporation in payment of the shares of stock shall be held in trust for the corporate creditors and other stockholders of the corporation. Under such doctrine, no fund shall be used to buy back the issued shares of stock except only in instances specifically allowed by the Corporation Code. (BAR 2007)

### I. Board of Directors and Trustees

1. **May the composition of the board of directors of the National Power Corporation (NPC) be validly reduced to 3? Explain your answer fully.**

**Answer:**

The composition of the board of directors of the NPC may not be validly reduced to 3. The Corporation Code applies in a supplementary manner to corporations created by special law. A corporation must have at least 5 directors. (BAR 2008)

2. Section 39 of the SRC defines an independent director as a person who must not have a relation with the corporation which would interfere with his exercise of independent judgment in carrying out the responsibilities of a director. To ensure independence therefore, he must be—
- Nominated and elected by the entire shareholders;
  - Nominated and elected by the minority shareholders;
  - Nominated and elected by the majority shareholders;
  - Appointed by the board.

**Answer:**

c) Nominated and elected by the majority shareholders. (BAR 2012)

### 1. Doctrine of Centralized Management

1. If a corporate lawyer who is at the same time the administrative manager of the corporation, enters into a compromise agreement in court so that a case involving the corporation could be settled, would the corporation itself be bound by such compromise agreement? Reasons.

**Answer:**

The corporation is not bound by the compromise agreement. Only the board of directors can act on behalf of the corporation in compromising a court action, unless they have validly delegated such power to an officer or other agent. The Rules of Court require written authority to compromise for a corporation. Since the lawyer and administrative manager in this case as not authorized by the board, who did not even know of the compromise, the corporation could not be bound. (BAR 1975)

2. What vote is needed to consider every decision to be valid corporate act?

- A majority of the directors present at the meeting
- 2/3 of the directors present at the meeting
- A majority of the directors present at the meeting at which there is a quorum
- 2/3 of the directors present at the meeting at which there is a quorum

**Answer:**

c. A majority of the directors present at the meeting at which there is a quorum (BAR 2014)

### 2. Business Judgment Rule

1. On December 9, 1985, Matatag Corporation revalued its assets. On the basis of the reappraisal, the Board of Directors also declared cash dividends for all stockholders. On December 16, 1985, Matatag Corporation amassed substantial profits in a highly lucrative transaction. Some minority stockholders, however, did not want to complicate their income tax problems for 1985 and refused to accept the cash dividends. They also filed suit to compel the other stockholders to return to Matatag Corporation the money received as dividends. Not one of the stockholders who formed the majority joined in the suit since they were happy with the money they received.
- b) As one of its defenses in court, the board of Directors raised the “business judgment rule”. What is the business judgment rule and does it have any relevance to this case? Explain.

**Answer:**

b) The business judgment rule would allow the board of directors to exercise absolute but sound discretion on matters they are authorized to consider and act upon. In the declaration of dividends, the rule has

relevance for it lies upon the Board's discretion when to declare dividends, as well as the class and extent thereof. (BAR 1986)

2. **X, the President of ZZZ Corporation, was authorized by the Board of Directors of ZZZ Corporation to obtain a loan from YYY Bank and to sign documents in behalf of the corporation. X personally negotiated for the loan and got the loan at very low interest rates. Upon maturity of the loan, ZZZ Corporation was unable to pay. Which statement is most accurate?**
- a) **Because X was personally acting in behalf of the Corporation, he can be held personally liable;**
  - b) **X, as President, cannot be personally held liable for the obligation of the corporation even though he signed all the loan documents, because the loan was authorized by the Board;**
  - c) **YYY Bank can choose as to who it wants to hold liable for the loan;**
  - d) **If ZZZ Corporation cannot pay, X can be held subsidiarily liable.**

**Answer:**

- c) X, as President, cannot be personally held liable for the obligation of the corporation even though he signed all the loan documents, because the loan was authorized by the Board. (BAR 2012)

### **3. Tenure, Qualifications and Disqualifications of Directors or Trustees**

1. **The Board of Directors of "C" Corporation, engaged in the manufacture and sale of food products, acting on a standing authority of the stockholders to amend the By-laws, amended its By-Laws so as to disqualify any stockholder, who is also a stockholder and director of a competitor, from being elected to its Board of Directors.**

**"S", a stockholder holding sufficient shares to assure him a seat in the Board, filed a petition with the SEC for a declaration of nullity of the amended By-Laws and the cancellation of the Certificate of Filing of Amended-By-Laws. He alleged, among others, that as stockholder. He had acquired rights inherent in stock ownership, such as the right to vote and be voted upon in the election of directors.**

**Reason out the merits of the stockholder's petition.**

**Answer:**

Such an amendment in the By-Laws of "C" Corporation is reasonable and valid. This is based upon the principle that where the director is so employed in the service of a rival company, he cannot serve both, but must betray one or the other. (*Gokongwei, Jr. v. Securities and Exchange Commission, April 11, 1979; 89 SCRA 336; April 21, 1980; 97 SCRA 78*) (BAR 1981)

2. **At the annual meeting of ABC Corporation for the election of five directors as provided for in its articles of incorporation, A, B, C, D, E, F and G were nominated. A, B, C, D and E received the highest number of votes and were proclaimed elected. F received ten votes less than E.**

**Subsequently, E sold all his shares to F. In the next Board of Directors' meeting following the transfer of the shares in the books of the corporation, both E and F appeared. E claimed that notwithstanding the sale of his shares to F, he remained a director since the Corporation Code provides that directors "shall hold office for 1 year and until their successors are elected and qualified." On the other hand, F claimed that since he would have been elected as a director had it not been for E's nomination and election, then he (F) should now be considered a director as he had acquired all the shares of E.**

**Decide with reasons.**

**Answer:**

Neither E nor F are directors of ABC Corporation. E automatically ceased to be a director upon the transfer of all his shares to F in the books of the corporation. Every director must own at least one share of the capital stock of the corporation of which he is a director, which share shall stand in his name on the books of the corporation. Any director who ceases to be the owner of at least 1 share of the capital stock of the corporation of which he is a director shall thereby cease to be a director.

F's claims are without merit since he was not duly elected as a director at the stockholders' meeting. Only the candidates receiving the highest number of votes shall be declared elected. (BAR 1984)

- 3. Bohol Mining Corporation is 60% Filipino-owned and 40% Canadian-owned. As provided in its Articles of Incorporation and By-Laws, its Board of Directors is composed of 9 members. During the last annual stockholders meeting held on May 31, three of the nine elected directors were Canadian citizens. Juan de la Cruz together with two other Filipino stockholders petitioned the SEC to disqualify the said three Canadians and to enjoin them from discharging their functions as directors, on the grounds that (1) aliens cannot participate in any capacity in a nationalized industry, like mining; and (2) the exploitation of natural resources is reserved under the Constitution to Filipino citizens.**

**Will the petition prosper?**

**Answer:**

The petition will not prosper. The elections of aliens as members of the board of directors or governing body of corporations or associations, engaging in partially nationalized-activities, are allowed by law, in proportion to their allowable participation or share in the capital of such entities, like mining or development of natural resources, in which the foreigners may even own 40% of the capital. (BAR 1985)

- 4. Primero, Segundo, Tercero, Pedro and Juan are the five original members of the Board of Directors of a stock corporation. The only interest of Primero is that 50% of the corporation's stocks were pledged to him. Pedro and Juan died in a vehicular accident.**

**Primero, Segundo, and Tercero held an emergency board meeting to fill up the two vacancies in the board. Primero and Tercero were able to push through the selection of Cuatro and Cinco as new directors over the strong objections of Segundo who, as corporation president, wanted two other persons as board members.**

**Subsequently, the composition of the Board was validly increased to six. At another board meeting, the four members of Primero's group voted Seis as the new sixth director. Segundo voted for another person. When the six-member board convened, it decided by a five-to-one vote to replace President Segundo with Tercero as the new President.**

**Were the elections of Cuatro, Cinco and Seis as directors valid? Was the election of Tercero as new President valid? Explain.**

**Answer:**

The elections of Cuatro, Cinco and Seis as directors were not valid. Primero was not validly elected as a director since he was not a stockholder. Upon the death of Pedro and Juan, only two remained as duly elected directors, namely: Segundo and Tercero. The agreement between these two remaining directors obviously could not have permitted the due election of other to fill the vacancies.

When the number of directors is increased, the new position can only be filled by the stockholders in an election duly conducted.

Prescinding from all the foregoing. Tercero was not duly elected as the new President of the corporation. (BAR 1986)

5. **The Board of Directors of X Corporation, acting on a standing authority of the stockholders to amend the by-laws, amended its by-laws so as to disqualify any of its stockholders who is also a stockholder and director of a competitor from being elected to its Board of Directors.**

**Y, a stockholder holding sufficient shares to assure him of a seat in the Board, filed a petition with the SEC for a declaration of nullity of the amended by-laws. He alleged among other things that as a stockholder, he had acquired rights inherent in stock ownership such as the right to vote and be voted upon in the election of directors. Is the stockholder's petition tenable?**

**Answer:**

No. There is no vested right of a stockholder to be elected as director. When a person buys stock in a corporation he does so with the knowledge that its affairs are dominated by a majority of the stockholders. To this extent, the stockholder parted with his personal right to regulate the disposition of his property which he invested in the capital stock of the corporation and surrendered it to the will of the majority of his fellow incorporators or stockholders.

Corporations have the power to make by-laws declaring a person employed in the service of a rival company to be ineligible for the Corporation's Board of Directors. An amendment which renders a director ineligible, or if elected, subjects him to removal, if he is also a director in a corporation whose business is in competition with or is antagonistic to the other corporation, is valid. (BAR 1998)

6. **At the annual stockholders' meeting of MS Corporation, the stockholders unanimously passed a resolution authorizing the Board of Directors to amend the corporate by-laws so as to disqualify any stockholder who is also a director or stockholder of a competing business from being elected to the Board of Directors of MS Corporation. The by-laws were accordingly amended. GK, a stockholder of MS Corporation and a majority stockholder of a competitor, sought election to the Board of Directors of MS Corporation. His nomination was denied on the ground that he was ineligible to run for the position. Seeking a nullification of the offending disqualification provision, GK consults you about its validity under the Corporation Code of the Philippines. What would your legal advice be?**

**Answer:**

The provision in the amended by-laws, disqualifying any stockholder who is also a director or stockholder of a competing business from being elected to the Board of Directors of MS Corporation, is valid. The corporation is empowered to adopt a code of by-laws for its government not inconsistent with the Corporation Code. Such disqualifying provision is not inconsistent with the Corporation Code. (BAR 2000)

7. **Is a by-law provision of "X" Corporation "rendering ineligible or if elected, subject to removal, a director if he is also a director in a corporation whose business is in competition with or is antagonistic to said corporation" valid and legal? State your reason.**

**Answer:**

Yes, the by-law provision is valid. It is the right of a corporation to protect itself against possible harm and prejudice that may be caused by its competitors. The position of director is highly sensitive and confidential. To say the least, to allow a person, who is a director in a corporation whose business is in competition with or is antagonistic to "X" Corporation, to become also a director in "X" Corporation would be harboring a conflict of interest which is harmful to the latter. (BAR 2001)

8. **Your client Dianne approaches you for legal advice on putting up a medium-sized restaurant business that will specialize in a novel type of cuisine. As Dianne feels that the business is a little risky, she wonders whether she should use a corporation as the business vehicle, or just run it as a single proprietorship. She already has an existing corporation that is producing meat products profitably and**

is also considering the alternative of simply setting up the restaurant as a branch office of the existing corporation.

1. If you advise your client to use a corporation, what officer position must the corporation at least have?

**Answer:**

The corporation must have at least 4 directors. It must also have a president, treasurer, and a secretary.

2. What particular qualifications, if any, are these officers legally required to possess under the Corporation Code?

**Answer:**

Every director must own at least 1 share of the capital stock of the corporation, which must be recorded in his name on the books of the corporation, and a majority of the directors must be residents of the Philippines.

The president must also be a director. The secretary must be a resident and citizen of the Philippines. (BAR 2010)

9. X is a director in T Corp. who was elected to a 1-year term on Feb. 1, 2010. On April 11, 2010, X resigned and was replaced by R, who assumed as director on May 17, 2010. On Nov. 21, 2010, R died. S was then elected in his place. Until which time should S serve as director?
  - a. April 11, 2011
  - b. Feb. 1, 2011
  - c. May 17, 2011
  - d. Nov. 21, 2011

**Answer:**

b. Feb. 1, 2011 (BAR 2011)

10. X is a Filipino immigrant residing in Sacramento, California. Y is a Filipino residing Quezon City. Z is a resident alien residing in Makati City. GGG Corporation is a domestic corporation—40% owned by foreigners and 60% owned by Filipinos, with T as authorized representative. CCC Corporation is a foreign corporation registered with the Philippines SEC, KKK Corporation is a domestic corporation (100%) Filipino owned. S is a Filipino, 16 years of age, and daughter of Y.

- c) Who are qualified to become members of the board of directors of the corporation?

**Answer:**

c) X, Y, Z and T could be directors (subject to the residency requirement mentioned in (a) above and any nationality requirement under the law governing the business of the corporation) but not GGG Corporation, CCC Corporation, and KKK Corporation as they are not natural persons. However, the aforementioned corporations could have their respective representatives nominated and possibly elected as directors by the stockholders. Each director must own at least one share of the capital stock of the corporation. (BAR 2012)

#### 4. Elections

1. **X Mining Co. is 70% Filipino-owned, the 30% remaining stock being owned by aliens. Under its Articles of Incorporation, its Board of Directors has 9 members. At the last election, 3 aliens were elected as Directors, but some stockholders moved to disqualify all three of them on account of their alien citizenship, the mining company being engaged in a nationalized business.**

**Decide with reasons.**

**Answer:**

Under the Constitution, the mining business is partially nationalized and at least 60% of its capital must belong to Filipino citizens. Under the Anti-Dummy Law as amended, the election of aliens as members of the board of directors of corporations engaged in partially nationalized activities is allowed in proportion to their allowable participation or share in the capital of such corporations. In the case at hand, 70% of the capital is owned by Filipinos and 30% by aliens. Therefore, only 30% of its directors may be aliens. Since 3 out of 9 is more than 30% only 2 aliens may sit in X's board. One of the elected alien directors is therefore disqualified and must give way to a Filipino director. (BAR 1983)

2. **At the annual meeting of ABC Corporation for the election of five directors as provided for in its articles of incorporation, A, B, C, D, E, F and G were nominated. A, B, C, D and E received the highest number of votes and were proclaimed elected. F received ten votes less than E.**

**Subsequently, E sold all his shares to F. In the next Board of Directors' meeting following the transfer of the shares in the books of the corporation, both E and F appeared. E claimed that notwithstanding the sale of his shares to F, he remained a director since the Corporation Code provides that directors "shall hold office for 1 year and until their successors are elected and qualified." On the other hand, F claimed that since he would have been elected as a director had it not been for E's nomination and election, then he (F) should now be considered a director as he had acquired all the shares of E.**

**Decide with reasons.**

**Answer:**

Neither E nor F are directors of ABC Corporation. E automatically ceased to be a director upon the transfer of all his shares to F in the books of the corporation. Every director must own at least one share of the capital stock of the corporation of which he is a director, which share shall stand in his name on the books of the corporation. Any director who ceases to be the owner of at least 1 share of the capital stock of the corporation of which he is a director shall thereby cease to be a director.

F's claims are without merit since he was not duly elected as a director at the stockholders' meeting. Only the candidates receiving the highest number of votes shall be declared elected. (BAR 1984)

3. **The AB Memorial Foundation, Inc. was incorporated as a non-profit, non-stock corporation in order to establish and maintain a library and museum in honor of the deceased parents of the incorporators. Its Articles of Incorporation provide for a board of trustees composed of the 5 incorporators, which is authorized to admit new members. The Articles of Incorporation also allow the Foundation to receive donations from members. As of January 30, 1993, 60 members had been admitted by the board of trustees.**

**One of the original trustees died and the other 2 resigned because they immigrated to the United States. How will the vacancies in the board of trustees be filled?**

**Answer:**

Since there are only 2 of the members of the board of trustee remaining and there is no quorum, the vacancies will have to be filled up in a special meeting of the members. (BAR 1993)

4. The term 1 year of the Board of Directors of AAA Corporation expired last February 15, 2012. No new election of the Board of Directors was called, hence, the existing members of the Board continue as Directors in hold over capacity. Which statement is most accurate?
- a) This is allowed provided there is a valid and justifiable reason for not calling for an election of the new members of the Board;
  - b) This is not allowed because the term of the directors must only be for a period of 1 year;
  - c) The positions of the members of the Board of Directors will be automatically declared vacant;
  - d) Acting as member of the Board of Directors in a hold over capacity must be ratified by the stockholders.

**Answer:**

- a) This is allowed provided there is a valid and justifiable reason for not calling for an election of the new members of the Board. (BAR 2012)
5. In the November 2010 stockholder's meeting of Greenville Corporation, 8 directors were elected to the board. The directors assumed their posts in January 2011. Since no stockholders' meeting was held in November 2011, the 8 directors served in a holdover capacity and thus continued discharging their powers.

In June 2012, 2 of Greenville Corporation's directors—Director A and Director B—resigned from the board. Relying on Section 29 of the Corporation Code, the remaining 6 directors elected 2 new directors to fill in the vacancy caused by the resignation of Directors A and B.

Stockholder X questioned the election of the new directors, initially, through a letter-complaint addressed to the board, and later (when his letter-complaint went unheeded), through a derivative suit filed with the court. He claimed that the vacancy in the board should be filled up by the vote of the stockholders of Greenville Corporation. Greenville Corporation's directors defended the legality of their action, claiming as well that Stockholder X's derivative suit was improper.

**Rule on the issued raised.**

**Answer:**

The remaining directors cannot elect new directors to fill in the two vacancies. The board of directors may fill up vacancy only if the ground is not due to expiration of term, removal or increase in the number of board seats. In this case, the term of the two directors expired after 1 year. They remained in office in a hold-over capacity only until their resignation. The hold-over period is not part of their term. The vacancies should be filled up by election by the stockholders.

The derivative suit was improper. In a derivative suit, the corporation, not the individual stockholder, must be the aggrieved party and that the stockholder is suing on behalf of the corporation. What stockholder X is asserting is his individual right as a stockholder to elect the two directors. The case partakes more of an election contest under the rules on intra-corporate controversy. (BAR 2013)

**a. Cumulative Voting/Straight Voting**

1. EFG Foundation, Inc., a non-profit organization, scheduled an election for its six-member Board of Trustees. X, Y and Z, who are minority members of the foundation, wish to exercise cumulative voting in order to protect their interest, although the Foundation's Articles and By-laws are silent on the matter. As to each of the three, what is the maximum number of votes that he/she can cast?

- a. 6
- b. 9
- c. 12
- d. 3

**Answer:**

- a. 6 (BAR 2011)

2. In elections for the Board of Trustees of non-stock corporations, members may cast as many votes as there are trustees to be elected but may not cast more than one vote for one candidate. This is true-
- a. Unless set aside by the members in a plenary session.
  - b. In every case even if the Board of Trustees resolves otherwise.
  - c. Unless otherwise provided in the Articles of Incorporation or in the By-laws.
  - d. In every case even if the majority of the members decide otherwise during the elections.

**Answer:**

- c. Unless otherwise provided in the Articles of Incorporation or in the By-laws. (BAR 2011)

### b. Quorum

1. To constitute a quorum for the transaction of corporate business, only a majority of the number of Board of Directors is required:
- a. As fixed by the corporate by-laws
  - b. As fixed in the articles of incorporation
  - c. Actually serving in the board
  - d. Actually serving in the board but constituting a quorum

**Answer:**

- b. As fixed in the articles of incorporation (BAR 2014)

### 5. Removal

1. If the minority stockholders in a stock corporation cumulate their votes so that they could be assured of being represented in the Board of Directors, what assurance do they have that the director/s representing them would not be removed, considering that under the Corporation Code, a director "may be removed from office with or without cause by the vote of the stockholders holding or representing at least 2/3 of the outstanding capital stock?"

**Answer:**

Although the Corporation Code allows removal of a director with or without cause, it contains a proviso to the effect that such removal, if without cause, cannot be used to deprive the minority stockholders of their right to representation through the use of cumulative voting. Therefore, the minority stockholders who cumulate their votes to elect a representative to the Board of Directors can be assured of his continuance in office during his term, unless he gives just cause for his removal. (BAR 1983)

2. ABC Management, Inc. presented to DEF Mining Corp. the draft of its proposed Management Contract. As an incentive, ABC included in the terms of compensation that ABC would be entitled to 10% of any

**stock dividend which DEF may declare during the lifetime of the Management Contract. Would you approve of such provision? If not, what would you suggest as an alternative?**

**Assuming that the minority block of the XYZ Corporation is able to elect only 1 director and therefore, the majority stockholders can always muster a 2/3 vote, would you allow the majority stockholders to remove the one director representing the minority?**

**Answer:**

No. I would not allow the majority stockholders to remove the director. While the stockholders may, by a 2/3 vote, remove a director, the law also provides, however, that this right may not, without just cause, be exercised so as to deprive the minority of representation in the board of directors. (BAR 1991)

- 3. A law was passed disqualifying former members of Congress from sitting in the Board of Directors of GOCC. Because of this, the Board of Directors of ABC Corp., a GOCC, disqualified C, a former Congressman, from continuing to sit as one of its members. C objected, however, insisting that under the Corporation Code members of the board of directors of corporations may only be removed by vote of stockholders holding 2/3 of its outstanding capital stock in a regular or special meeting called for that purpose. Is C correct?**
- Yes, since the new law cannot be applied to members of the board of directors already elected prior to its passage.**
  - No, since the disqualification takes effect by operation of law, it is sufficient that he was declared no longer member of the board.**
  - Yes, since the provisions of the Corporation Code applies as well to GOCC.**
  - No, since the board has the power to oust him even without the new law.**

**Answer:**

b. No, since the disqualification takes effect by operation of law, it is sufficient that he was declared no longer member of the board. (BAR 2011)

## **6. Filling of Vacancies**

- 1. Primero, Segundo, Tercero, Pedro and Juan are the five original members of the Board of Directors of a stock corporation. The only interest of Primero is that 50% of the corporation's stocks were pledged to him. Pedro and Juan died in a vehicular accident.**

**Primero, Segundo, and Tercero held an emergency board meeting to fill up the two vacancies in the board. Primero and Tercero were able to push through the selection of Cuatro and Cinco as new directors over the strong objections of Segundo who, as corporation president, wanted two other persons as board members.**

**Subsequently, the composition of the Board was validly increased to six. At another board meeting, the four members of Primero's group voted Seis as the new sixth director. Segundo voted for another person. When the six-member board convened, it decided by a five-to-one vote to replace President Segundo with Tercero as the new President.**

**Were the elections of Cuatro, Cinco and Seis as directors valid? Was the election of Tercero as new President valid? Explain.**

**Answer:**

The elections of Cuatro, Cinco and Seis as directors were not valid. Primero was not validly elected as a director since he was not a stockholder. Upon the death of Pedro and Juan, only two remained as duly elected directors,

namely: Segundo and Tercero. The agreement between these two remaining directors obviously could not have permitted the due election of other to fill the vacancies.

When the number of directors is increased, the new position can only be filled by the stockholders in an election duly conducted.

Prescinding from all the foregoing, Tercero was not duly elected as the new President of the corporation. (BAR 1986)

## 7. Compensation

1. **After many difficult years, which called for sacrifices on the part of the company's directors, ABC Manufacturing Inc. was finally earning substantial profits. Thus, the President proposed to the Board of Directors that the directors be paid a bonus equivalent to 15% of the company's net income before tax during the preceding year. The President's proposal was unanimously approved by the Board. A stockholder of ABC questioned the bonus. Does he have grounds to object?**

**Answer:**

Yes, the stockholder has a valid and legal ground to object to the payment to the directors of a bonus equivalent to 15% of the company's net income. The law provides that the total annual compensation of directors, in the preceding year, cannot exceed 10% of the company's net income before income tax. (BAR 1991)

2. **Victor was employed in MAIA Corporation. He subscribed to P1,500 shares of the corporation at P100 per share or a total of P150,000. He made an initial down payment of P37,500. He was appointed President and General Manager. Because of his disagreement with the Board of Directors, he resigned and demanded payment of his unpaid salaries, his cost of living allowance, his bonus, and reimbursement of his gasoline and representation expenses.**

**MAIA Corporation admits that it owed Victor P40,000 but told him that this will be applied to the unpaid balance of his subscription in the amount of P100,000. There was no call or notice for the payment of the unpaid subscription. Victor questioned the set-off.**

1. **May MAIA set-off unpaid subscription with Victor's claim for salaries?**
2. **Would your answer be the same if indeed there had been a call for the unpaid subscription?**

**Answer:**

1. No. MAIA cannot set-off the unpaid subscription with Victor's claim for salaries. The unpaid subscription is not yet due as there is no call.
2. Yes. The reason is that Victor is entitled to the payment of his salaries which MAIA has no right to withhold in payment of unpaid subscription. To do so would violate Labor Laws. (BAR 1994)

## 8. Fiduciaries Duties and Liability Rules

1. **What is the so-called "doctrine of corporate opportunity"? What is the underlying philosophy upon which such doctrine rests?**

**Answer:**

The so-called "doctrine of corporate opportunity" is a recognition by the courts that the fiduciary standards could not be upheld where the fiduciary is acting for two entities with competing interests.

This doctrine rests fundamentally on the unfairness, in particular circumstances, of an officer or director taking advantage of an opportunity for his own personal benefit when the interest of the corporation justly needs protection. (BAR 1985)

2. **X subscribed and aid for P10,000 worth of shares of stock of Rainbow Mines, Inc. as an incorporator and original subscriber. He was employed as the mine superintendent and as such, made the design of certain equipment used in its mines. Due to some technical error in the design, the corporation suffered a loss of P1 M. The Board accused X of infidelity and breach of trust, and confiscated his shares. Is the action of the Board legal?**

**Answer:**

1) The action of the Board is not legal. The rights and liabilities of X as the Mine Superintendent (or as an Officer) are apart from his rights and liabilities arising from being likewise a stockholder. In general, in order that directors and officers may be held personally accountable they must have voted or assented to a patently illegal act, or are guilty of bad faith or gross negligence, or are in conflict of interest with the corporation. A mere technical error committed by X in the design of an equipment used by the company, absent fault or negligence, would not warrant liability on his part even as an employee. (BAR 1989)

3. **ABC Piggery, Inc. is engaged in raising and selling hogs in the local market. Mr. De Dios, one of its directors, while travelling abroad, met a leather goods manufacturer who was interested in buying pig skins from the Philippines. Mr. De Dios set up a separate company and started exporting pig skins to his foreign contact but the pig skins exported were not sourced from ABC. His fellow directors in ABC complained that he should have given his business to ABC. How would you decide this matter?**

**Answer:**

I would decide in favor of Mr. De Dios. ABC, Inc., is engaged in raising and selling hogs in the local market. The company that Mr. De Dios had set up was to engage, as it did, in the export of pig skins. There is thus no conflict of interest situation under the law. (BAR 1991)

4. **A, B and C are shareholders of XYZ Company. A has an unpaid subscription of P100,000, B's shares are fully paid up, while C owns only nominal but fully paid up shares and is a director and officer. XYZ Company becomes insolvent, and it is established that the insolvency is the result of fraudulent practices within the company. If you were counsel for a creditor of XYZ Company, would you advice legal action against C?**

**Answer:**

An action can be filed against C, not as a stockholder because he has already paid up the shares, but in his capacity as director and officer because of the corporation's insolvency being the result of fraudulent practices within the company. Directors are liable jointly and severally for damages sustained by the corporation, stockholders or other persons resulting from gross negligence or bad faith in directing the affairs of the corporation. (BAR 1997)

5. **Suppose that the by-laws of "X" Corporation, a mining firm, provides that "The directors shall be relieved from all liability for any contract entered into by the corporation with any firm in which the directors may be interested." Thus, director "A" acquired claims which overlapped with "X's" claims and where necessary for the development and operation of "X's" mining properties.**

**What happens if director "A" is able to consummate his mining claims over and above that of the corporation's claims?**

**Answer:**

"A" should account to the corporation for the profits which he realized from the transaction. He grabbed the business opportunity from the corporation. (BAR 2001)

6. **Malyn, Schiera and Jaz are directors of Patio Investments, a close corporation formed to run the Patio Café, an al fresco coffee shop in Makati City. In 2000, Patio Café began experiencing financial reverses, consequently, some of the checks it issued to its beverage distributors and employees bounced.**

**In October 2003, Schiera informed Malyn that she found a location for a second café in Taguig City. Malyn objected because of the dire financial condition of the corporation.**

**Sometime in April 2004, Malyn learned about Fort Patio Café located in Taguig City and that its development was undertaken by a new corporation known as Fort Patio, Inc., where both Schiera and Jaz are directors. Malyn also found that Schiera and Jaz, on behalf of Patio Investments and personally guaranteed by Schiera and Jaz.**

**Malyn then filed a corporate derivative action before the RTC of Makati City against Schiera and Jaz, alleging that the two directors had breached their fiduciary duties by misappropriating money and assets of Patio Investments in the operation of Fort Pation Café.**

- a) **Did Schiers and Jaz violate the principle of corporate opportunity? Explain.**

**Answer:**

- a) **Schiera and Jaz violated the principle of corporate opportunity, because they used Patio Investments to obtain a loan, mortgaged its assets and used the proceeds of the loan to acquire a coffee shop through a corporation they formed. (BAR 2005)**

7. **Briefly discuss the doctrine of corporate opportunity.**

**Answer:**

**The doctrine of corporate opportunity means that if the director acquired for himself a business opportunity that should belong to the corporation, he must account to the corporation for all the profits he obtained, unless his act was ratified by at least 2/3 of the stockholders. (BAR 2005)**

8. **The Board of Directors of XYZ Corp. unanimously passed a resolution approving the taking of steps that in reality amounted to willful tax evasion. On discovering this, the government filed tax evasion charges against the company's members of the board of directors. The directors invoked the defense that they have no personal liability, being mere directors of a fictional being. Are they correct?**

- a. **No, since as a rule only natural persons like the members of the board of directors can commit corporate crimes.**
- b. **Yes, since it is the corporation that did not pay the tax and it has a personality distinct from its directors.**
- c. **Yes, since the directors officially and collectively performed acts that are imputable only to the corporation.**
- d. **No, since the law makes directors of the corporation solidarily liable for gross negligence and bad faith in the discharge of their duties.**

**Answer:**

**d. No, since the law makes directors of the corporation solidarily liable for gross negligence and bad faith in the discharge of their duties. (BAR 2011)**

9. **A, B, C, D, E, are all duly elected members of the Board of Directors of XYZ Corporation. F, the general manager, entered into a supply contract with an American firm. The contract was duly approved by the**

**Board of Directors. However, with the knowledge and consent of F, no deliveries were made to the American firm. As a result of the non-delivery of the promised supplies, the American firm incurred damages. The American firm would like to file a suit for damages. The American firm would like to file a suit for damages. Can the American firm sue:**

- a) The members of the Board of Directors individually, because they approved the transaction?**
- b) The corporation?**
- c) F, the general manager, personally, because the non-delivery was with his knowledge and consent?**
- d) Explain the rules on liabilities of a corporation for the act of its corporation officers and the liabilities of the corporate officers and Board of Directors of a corporation acting in behalf of the corporation.**

**Answer:**

- a) No. in approving the transaction, the directors were not acting in their personal capacities but rather on behalf of XYZ Corporation exercising the powers of the corporation and conducting its business. The problem contains no facts that would indicate that the directors acted otherwise.
- b) Yes. The Board approved the supply contract and the General Manager entered into the contract, both of them acting on behalf of the XYZ Corporation.
- c) Yes, F could be sued in his personal capacity because he knowingly consented to the non-delivery of the promised supplies contrary to the contract that was duly approved by the Board of Directors. The problem does not indicate any circumstance that would excuse or favorably explain the action of F.
- d) A corporation would be liable for the acts of its Board of Directors and officers if the said acts were performed by them in accordance with the powers granted to them under the Corporation Code, the articles of incorporation and by-laws of the corporation, the laws and regulations governing the business of, or otherwise applicable to, the corporation, and, in the case of officers, the resolution approved by the Board of Directors.

As the directors have a personality separate from that of the corporation, they would be personally liable only if they acted willfully and knowingly vote for or assent to a patently unlawful act of the corporation, or when they are guilty of gross negligence or bad faith in directing the affairs of the corporation, or when they acquire any personal or pecuniary interest in conflict with their duty as directors, which acts result in damages to the corporation, its stockholders or other persons, when they agree to hold themselves personally and solidarily liable with the corporation, or when they are made, by a specific provision of law, to personally answer for the corporate action. (BAR 2012)

## **9. Responsibility for Crimes**

### **1. When may a corporate director, trustee or officer be held personally liable with the corporation?**

**Answer:**

A corporate director, trustee or officer be held personally liable with the corporation under the following circumstances:

- 1. When he assents to a patently unlawful act of the corporation;
- 2. When he acts in bad faith or with gross negligence in directing the affairs of the corporation, or in conflict with the interest of the corporation, its stockholders or other persons;
- 3. When he consents to the issuance of watered stocks or who, having knowledge thereof, does not forthwith file with the corporate secretary his written objection thereto;
- 4. When he agrees to hold himself personally and solidarily liable with the corporation; or
- 5. When he is made, by specific provision of law, to personally answer for the corporate action. (BAR 1996)

## 10. Inside Information

### 11. Contracts

#### a. By Self-Dealing Directors with the Corporation

1. **Chito Santos is a director of both Platinum Corporation (PLATINUM) and KWIK Silver Corporation (KWIK). He owns 1% of the outstanding capital stock of PLATINUM and 40% of KWIK. PLATINUM plans to enter into a contract with KWIK that will make both companies earn very substantial profits. The contract is presented at the respective board meetings of PLATINUM and KWIK.**

1. **In order that the contract will not be voidable, what conditions will have to be complied with? Explain.**
2. **If these conditions are not met, how may this contract be ratified? Explain.**

**Answer:**

1. At the meeting of the Board of Directors of PLATINUM to approve the contract, Chito Santos would have to make sure that:

- a) His presence as director at the meeting is not necessary to constitute a quorum for such meeting;
- b) His vote is not necessary for the approval of the contract; and
- c) The contract is fair and reasonable under the circumstances.

At the meeting of the Board of Directors of KWIK to approve the contract, Chito would have to make sure that:

- a) There is no fraud involved; and
- b) The contract is fair and reasonable under the circumstances.

2. If the conditions relating to quorum and required number of votes are not met, the contract must be ratified by the vote of stockholders representing at least 2/3 of the outstanding capital stock in a meeting called for the purpose. Furthermore, the adverse interest of Chito in the contract must be disclosed and the contract is fair and reasonable. (BAR 1995)

2. **Which of the following corporate acts are valid, void, or voidable? Indicate your answer by writing the paragraph number of the query, followed by your corresponding answer as “valid”, “void” or “voidable”, as the case may be. If your answer is “void”, explain your answer. In the case of a “voidable” answer, specify what conditions must be present or complied with to make the corporate act valid.**

2) XL Foods Corporation, which is engaged in the fastfood business, entered into a contract with its President Jose Cruz, whereby the latter would supply the corporation with its meat and poultry requirements.

**Answer:**

2) Voidable—A contract of the corporation with one or more of its directors or trustees or officers is voidable, at the option of such corporation.(BAR 2002)

3. **Pedro owns 70% of the subscribed capital stock of a company which owns an office building. Paolo and Juan own the remaining stock equally between them. Paolo also owns a security agency, a janitorial company and a catering business. In behalf of the office building company, Paolo engaged his companies to render their service to the office building. Are the service contracts valid? Explain.**

**Answer:**

The service contracts are voidable at the option of office building company as provided in Section 32 of the Corporation Code, viz:

“Sec. 32. Dealing of directors, trustees or officers with the corporation.— A contract of the corporation with one or more of its directors or trustees or officers is voidable, at the option of such corporation, unless all the following conditions are present:

1. That the presence of such director or trustee in the board meeting in which the contract was approved was not necessary to constitute a quorum for such meeting;
2. That the vote of such director or trustee was not necessary for the approval of the contract;
3. That the contract is fair and reasonable under the circumstances; and
4. That in case of an officer, the contract has been previously authorized by the board of directors.

Where any of the first two conditions set forth in the preceding paragraph is absent, in the case of a contract with a director or trustee, such contract may be ratified by the vote of the stockholders representing at least 2/3 of the outstanding capital stock or of at least 2/3 of the members in a meeting called for the purpose: Provided, that full disclosure of the adverse interest of the directors or trustees involved is made at such meeting: Provided, however, that the contract is fair and reasonable under the circumstances.” (BAR 2008)

### **b. Between Corporations with Interlocking Directors**

- 1. Leonardo is the Chairman and President, while Raphael is a Director of NT Corporation. On one occasion, NT Corporation, represented by Leonardo, and A Enterprises, a single proprietorship owned by Raphael, entered into a dealership agreement whereby NT Corporation appointed A Enterprises as exclusive distributor of its products in Northern Luzon.**

**Is the dealership agreement valid? Explain.**

**Answer:**

The dealership agreement is voidable at the option of NT inasmuch as the facts do not indicate that the same was approved by the Board of Directors of NT Corporation before it was signed or, assuming such approval, that it was approved under the following conditions:

1. That the presence of Raphael, the owner of A Enterprises, in the meeting of the Board of Directors at which the agreement was approved was not necessary to constitute a quorum for such meeting;
2. That the vote of Raphael was not necessary for the approval of the agreement;
3. That the agreement is fair and reasonable under the circumstances. (BAR 1996)

- 2. The Corporation Code sanctions a contract between two or more corporations which have interlocking directors, provided there is no fraud that attends it and it is fair and reasonable under the circumstances. The interest of an interlocking director in one corporation may be either substantial or nominal. It is nominal if his interest:**

- a. Does not exceed 25% of the outstanding capital stock.**
- b. Exceeds 25% of the outstanding capital stock.**
- c. Exceeds 20% of the outstanding capital stock.**
- d. Does not exceed 20% of the outstanding capital stock.**

**Answer:**

d. Does not exceed 20% of the outstanding capital stock. (BAR 2011)

**c. Management Contracts**

**12. Officers and Executive Committee**

**1. X is a Filipino immigrant residing in Sacramento, California. Y is a Filipino residing Quezon City. Z is a resident alien residing in Makati City. GGG Corporation is a domestic corporation—40% owned by foreigners and 60% owned by Filipinos, with T as authorized representative. CCC Corporation is a foreign corporation registered with the Philippines SEC, KKK Corporation is a domestic corporation (100%) Filipino owned. S is a Filipino, 16 years of age, and daughter of Y.**

- d) Who are qualified to act as Treasurer of the company?**
- e) Who can be appointed Corporate Secretary?**

**Answer:**

d) The Corporation Code does not impose any nationality or residency requirement in respect of the Treasurer. Any such requirement or any other reasonable requirement may be adopted by the corporation and reflected in its by-laws, or required by the law(s) governing the business of the corporation or a law of general application (e.g., the Anti-Dummy Law which applies to all nationalized businesses). Accordingly, anybody with the qualifications required under the by-laws of the corporation or under the law(s) governing the business of the corporation, could be elected Treasurer by the Board of Directors. However, the Treasurer could not be President at the same time.

e) The Secretary is required to be both a resident and a citizen of the Philippines. (BAR 2012)

**2. X, the President of ZZZ Corporation, was authorized by the Board of Directors of ZZZ Corporation to obtain a loan from YYY Bank and to sign documents in behalf of the corporation. X personally negotiated for the loan and got the loan at very low interest rates. Upon maturity of the loan, ZZZ Corporation was unable to pay. Which statement is most accurate?**

- e) Because X was personally acting in behalf of the Corporation, he can be held personally liable;**
- f) X, as President, cannot be personally held liable for the obligation of the corporation even though he signed all the loan documents, because the loan was authorized by the Board;**
- g) YYY Bank can choose as to who it wants to hold liable for the loan;**
- h) If ZZZ Corporation cannot pay, X can be held subsidiarily liable.**

**Answer:**

d) X, as President, cannot be personally held liable for the obligation of the corporation even though he signed all the loan documents, because the loan was authorized by the Board. (BAR 2012)

**3. Pursuant to its By-Laws, Soei Corporation's Board of Directors created an Executive Committee to manage the affairs of the corporation in between board meetings. The Board of Directors appointed the following members of the Executive Committee: the President, Sarah L; the Vice-President, Jane L; and a third member from the board, Juan Riles. On December 1, 2013, the Executive Committee, with Sarah L and Jane L present, met and decided on the following matters:**

- 1. Purchase of a delivery van for use in the corporation's retail business;**
- 2. Declaration and approval of the 13<sup>th</sup> month bonus;**
- 3. Purchase of an office condominium unit at the Fort; and**
- 4. Declaration of P10.00 per share cash dividend.**

**Are the actions of the Executive Committee valid?**

**Answer:**

The action of the Executive Committee with regard to the purchase of a delivery van for use in the corporation's retail business, declaration and approval of the 13<sup>th</sup> month bonus, purchase of an office condominium unit at the Fort, and the declaration of P10.00 per share cash dividend is valid, as such matters were taken by a majority vote of all its members, on such matters within the competence of the board and as delegated to it in the by-laws. (BAR 2014)

4. **Guetze and his wife have 3 children: Neymar, 25, who is now based in Rio de Janeiro, Brazil; Muelter, 23, who has migrated to Munich, Germany; and James, 21, who resides in Bogota, Colombia. Neymar and Muelter have since renounced their Philippine citizenship in favor of their country of residence. Nearing 70 years old, Guetze decided to incorporate his business in Binondo, Manila. He asked his wife and 3 children to act as incorporators with 1 share of stock each, while he owned 999,996 shares of the 1,000,000 shares of the capital stock.**
- a. **Being the control freak and micro-manager that he is, Guetze asked you—his astute legal adviser—if he can serve as Chairman of the Board of Directors, as President, and as General Manager of the corporation, all at the same time. Please advise Guetze.**

**Answer:**

- a. Yes, Guetze can serve as Chairman, as President, and as General Manager of the corporation all at the same time. Section 25 of the Corporation Code provides that "two or more positions may be held concurrently by the same person, except that no one shall act as president and secretary or as president and treasurer at the same time." Such case does not fall within the exception under the aforesaid Section. (BAR 2014)

**13. Meetings**

**a. Regular or Special**

**i. When and Where**

1. **Under the Articles of Incorporation of Manila Industrial Corporation, its principal place of business shall be in Pasig, Metro Manila. The principal corporate offices are at the Ortigas Center, Pasig, Metro Manila while its factory processing leather products is in Manila. The corporation holds its annual stockholder's meeting at the Manila Hotel in Manila and, its board of directors' meeting at a hotel in Makati, Metro Manila. The by-laws are silent as to the place of meetings of the stockholders and the directors.**

**Can the same stockholder question the validity of the resolutions adopted by the board of directors at the meeting held in Makati?**

**Answer:**

No. The law allows the Board of Directors to hold its meeting anywhere in the Philippines. The holding of the board meeting in Makati was proper and the validity of the resolution adopted by the Board in that meeting cannot be questioned. (BAR 1992)

**ii. Notice**

**b. Who Presides**

1. **Under the Articles of Incorporation of Manila Industrial Corporation, its principal place of business shall be in Pasig, Metro Manila. The principal corporate offices are at the Ortigas Center, Pasig, Metro**

**Manila while its factory processing leather products is in Manila. The corporation holds its annual stockholder's meeting at the Manila Hotel in Manila and, its board of directors' meeting at a hotel in Makati, Metro Manila. The by-laws are silent as to the place of meetings of the stockholders and the directors.**

**Who shall preside at the meeting of the directors?**

**Answer:**

The President presides over the meeting of the directors, if there is no position of Chairman provided in the By-Laws. If there is the position of Chairman provided in the By-Laws, the Chairman presides over the meeting of the Directors. (BAR 1993)

- c. Quorum
- d. Rule on Abstention

**J. Stockholders and Members**

**1. Rights of a Stockholder and Members**

**1. What are the rights of a stockholder?**

**Answer:**

The rights of a stockholder are as follows:

1. The right to vote, including the right to appoint a proxy;
2. The right to share in the profits of the corporation, including the right to declare stock dividends;
3. The right to proportionate share of the assets of the corporation upon liquidation;
4. The right of appraisal;
5. The preemptive right to shares;
6. The right to inspect corporate books and records;
7. The right to elect directors;
8. Such other rights as may contractually be granted to the stockholders by the corporation or by special law. (BAR 1996)

**a. Doctrine of Equality of Shares**

**2. Participation in Management**

- a. Proxy
- b. Voting Trust

**1. A, as owner of a certain number of shares of stock in X Corporation, entered into a voting trust agreement with B. on the basis of the voting trust agreement, B announced his desire to run for a seat in the Board of Directors of X Corporation. C, another stockholder, objected and questioned the eligibility of B to be a director of X Corporation.**

**Is C's contention correct? Why?**

**Answer:**

C's contention is correct. The voting trust involves a much more complete surrender of all legal rights and remedies by the shareholders than any other control device. By it, the beneficial owner ceases to be recognized as a shareholder of record and may be deprived not only of any right any right to vote for directors, but also of any right to inspection; notice or information as against the corporation or any voice in making most fundamental changes, such as mergers and consolidation, sales of entire assets, increase and reduction of capital and by law and charter amendments which may adversely affect him.

Virtually ceasing to be recognized as a shareholder of record, B is therefore ineligible to be a director of X Corporation. In this connection Sec. 23 of the Corporation Code states: "Every director must own at least 1 share of the capital stock of the corporation of which he is a director, which share shall stand in his name on the books of the corporation. Any director who ceases to be the owner of at least 1 share of the capital stock of the corporation of which he is a director shall thereby cease to be a director. x x x" (BAR 1977)

**2. What is a "voting trust" and what are the legal limitations of the "voting trust agreement"?**

**Answer:**

A "voting trust" is an arrangement in writing and notarized, whereby the stockholders, or a portion of them, transfer their shares of stock to a trustee, who thereby acquires the right to vote and other rights pertaining to the shares, for a period not exceeding 5 years at any one time, and in return trust certificates are given to the shareholders, these certificates being transferrable, like stock certificates are, subject, however, to the trust agreement.

The legal limitations of the "voting trust agreement" are: No "voting trust agreement " shall be entered into (1) for the purpose of circumventing the laws against monopolies and illegal combinations in restraint of trade, or (2) for purposes of fraud. (BAR 1985)

**3. A distressed company executed a voting trust agreement for a period of 3 years over 60% of its outstanding paid-up shares in favor of a bank to whom it was indebted, with the Bank named as trustee. Additionally, the Company mortgaged all its properties to the Bank.**

**Because of the insolvency of the Company, the Bank foreclosed the mortgaged properties, and as the highest bidder, acquired said properties and assets of the Company.**

**The 3-year period prescribed in the Voting Trust Agreement having expired, the company demanded the turnover and transfer of all its assets and properties, including the management and operation of the Company, claiming that under the Voting Trust Agreement, the bank was constituted as trustee of the management and operations of the Company.**

**Does the demand of the Company tally with the concept of a Voting Trust Agreement? Explain briefly.**

**Answer:**

No. The demand of the Company does not tally with the concept of a Voting Trust Agreement. The Voting Trust Agreement merely conveys to the trustee the right to vote the shares of grantor/s. the consequence of the foreclosure of the mortgaged properties would be alien to the Voting Trust Agreement and its effects. (BAR 1992)

**c. Cases When Stockholders' Action is Required**

- i. By a Majority Vote**
- ii. By a Two-Thirds Vote**

1. In 1999, Corporation "A" passed a board resolution removing "X" from his position as manager of said corporation. The by-laws of "A" corporation provides that the officers are the president, vice-president, treasurer and secretary. Upon complaint filed with the SEC, it held that a manager could be removed by mere resolution of the board of directors. On motion for reconsideration, "X" alleged that could only be removed by the affirmative vote of the stockholders representing 2/3 of the outstanding capital stock. Is "X's" contention legally tenable. Why?

**Answer:**

No. Stockholders' approval is necessary only for the removal of the members of the Board. For the removal of a corporate officer or employee, the vote of the Board of Directors is sufficient for the purpose. (BAR 2001)

### iii. By Cumulative Voting

### 3. Proprietary Rights

#### a. Right to Dividends

1. Ace Cruz subscribed to 100,000 shares of stock of JP Development Corporation, which has a par value of P1 per share. He paid P25,000 and promised to pay the balance before December 31, 2008. JP Development Corporation declared a cash dividend on October 15, 2008, payable on December 1, 2008.

**For how many shares is Ace Cruz entitled to be paid cash dividends? Explain.**

**Answer:**

Ace is entitled to be paid cash dividends for 100,000 shares of stock. Although he has not fully paid for his shares of stock, he is not delinquent and is therefore entitled to all the rights of a stockholder. (BAR 2008)

2. On September 15, 2007, XYZ Corporation issued to Paterno 800 preferred shares with the following terms:

*"The Preferred Shares shall have the following rights, preferences, qualifications, and limitations, to wit:*

3. *The right to receive a quarterly dividend of 1% cumulative participating;*
4. *These shares may be redeemed, by drawing of lots, at any time after 2 years from date of issue, at the option of the Corporation; x x x."*

**Today, Paterno sues XYZ Corporation for specific performance, for the payment of dividends on, and to compel the redemption of, the preferred shares, under the terms and conditions provided in the stock certificates. Will the suit prosper? Explain.**

**Answer:**

No. the suit will not prosper. Paterno cannot compel XYZ Corporation to pay dividends, which have to be declared by the Board of Directors and the latter cannot do so, unless there are sufficient unrestricted retained earnings. Otherwise, the corporation will be forced to use its capital to make said payments in violation of the trust fund doctrine. Likewise, redemption of shares cannot be compelled. While the certificate allows such redemption, the option and discretion to do so are clearly vested in the Corporation. (BAR 2009)

## **b. Right of Appraisal**

- 1. What are the rights of the minority stockholders who do not want to divert the corporate funds into a secondary purpose?**

**Answer:**

The appraisal right may be exercised by any stockholder who shall have voted against the proposed corporate action, by making written demand on the corporation within 30 days after the date on which the vote was taken for payment of the fair value of his shares: Provided, that failure to make the demand within such period shall be deemed a waiver of the appraisal right. If the proposed corporate action is implemented or affected, the corporation shall pay to such stockholder, upon surrender of the certificate/s of stock representing his shares, the fair value thereof as of the day prior to the date the vote was taken, excluding any appreciation or depreciation in anticipation of such corporate action.

If within a period of 60 days from the date the corporate action was approved by the stockholders, the withdrawing stockholder and the corporation cannot agree on the fair value of the shares, it shall be determined and appraised by 3 disinterested persons, one of whom shall be named by the stockholder, another by the corporation, and the third by the two thus chosen. The findings of the majority of the appraisers shall be final, and their award shall be paid by the corporation within 30 days after such award is made: Provided, that no payment shall be made to any dissenting stockholder unless the corporation has unrestricted retained earnings in its books to cover such payment: and Provided, further, that upon payment by the corporation of the agreed awarded price, the stockholder shall forthwith transfer his shares to the corporation. (Sec. 82, Corporation Code) (BAR 1977)

- 2. The stockholders of People Power, Inc. (PPI) approved the following two resolutions in a special stockholder's meeting: (i) Resolution increasing the authorized capital stock of PPI, and (ii) Resolution authorizing the Board of Directors to issue for cash payment the new shares from the proposed capital stock increase in favor of outside investors who are non-stockholders. The foregoing resolutions were approved by stockholders representing 99% of the total outstanding capital stock. The sole dissenter was Jose Estrada who owned the rest 1% of the stock.**

**What remedies, if any, are available to Estrada?**

**Answer:**

Estrada, the dissenting stockholder, may avail himself of the appraisal rights by claiming that since the resolutions appear to favor outside investors, as against incumbent stockholders, on the increase in capital stock, he may demand the payment of the appraised value of his shares. (BAR 1987)

- 3. ABC Corporation has an authorized capital stock of P1 M divided into 50,000 common shares and 50,000 preferred shares.**

**At its inception, the Corporation offered for subscription all the common shares. However, only 40,000 shares were subscribed.**

**Recently, the directors thought of raising additional capital and decided to offer to the public all the authorized shares of the Corporation at their market value.**

**Assuming a stockholder disagrees with the issuance of new shares and the pricing for the shares, may the stockholder invoke his appraisal rights and demand payment for his shareholdings?**

**Explain your answer.**

**Answer:**

No, the stockholder may not exercise appraisal right because the matter that he dissented from is not one of those where right of appraisal is available under the Corporation Code. (BAR 1999)

**4. In a stockholder's meeting, S dissented from the corporate act converting preferred voting shares to non-voting shares. Thereafter, S submitted his certificates of stock for notation that his shares are dissenting. The next day, S transferred his shares to T to whom new certificates were issued. Now, T demands from the corporation the payment of the value of his shares.**

- a) What is the meaning of stockholder's appraisal right?**
- b) Can T exercise the right of appraisal? Reason briefly.**

**Answer:**

a) Appraisal right is the right of a stockholder, who dissents from a fundamental or extraordinary corporate action, to demand payment of the fair value of his shares. It is the right of a stockholder to withdraw from the corporation and demand payment of the fair value of his shares after dissenting from certain corporate acts involving fundamental changes in the corporate structure.

b) No, T cannot exercise the right of appraisal in this case. When S transferred his shares to T and T was issued new stock certificates, the appraisal right of S ceased, and T acquired all the rights of a regular stockholder. The transfer of shares from S to T constitutes an abandonment of the appraisal right of S. All that T acquired from the issuance of new stock certificates was the rights of a regular stockholder. (BAR 2007)

**5. In case of disagreement between the corporation and a withdrawing stockholder who exercises his appraisal right regarding the fair value of his shares, a three-member group shall by majority vote resolve the issue with finality. May the wife of the withdrawing stockholder be named to the three-member group?**

- a. No, the wife of the withdrawing shareholder is not a disinterested person.**
- b. Yes, since she could best protect her husband's shareholdings.**
- c. Yes, since the rules do not discriminate against wives.**
- d. No, since the stockholder himself should sit in the three-member group.**

**Answer:**

b. No, the wife of the withdrawing shareholder is not a disinterested person. (BAR 2011)

**6. The rule is that valuation of the shares of a stockholder who exercises his appraisal rights is determined as of the day prior to the date on which the vote was taken. This is true-**

- a. Regardless of any depreciation or appreciation in the share's fair value.**
- b. Regardless of any appreciation in the share's fair value.**
- c. Regardless of any depreciation in the share's fair value.**
- d. Only if there is no appreciation or depreciation in the share's fair value.**

**Answer:**

c. Regardless of any depreciation or appreciation in the share's fair value. (BAR 2011)

**c. Right to Inspect**

1. **X filed a complaint with the SEC alleging that Redfield, Inc. had violated the provisions of the Corporation Law. The SEC seeks to inspect the books of the Corporation. Redfield, Inc. objected to the inspection of its books by the SEC on the ground that X, the complainant, is not a stockholder of the corporation. Decide with reasons.**

**Answer:**

The SEC may inspect the books of any corporation under its jurisdiction in the course of any investigation it may consider necessary for the enforcement of the Corporation Law. It can do this even on its own initiative, and thus it should not matter whether the complainant is a stockholder or not.

2. **A owns 100 out of 10,000 shares in the Manufacturer's Bank. He filed a suit against B for damages due to an alleged breach of contract. A secures a favorable judgment against B but fails to obtain full satisfaction thereof.**

**A receives a tip that B has a big time deposit with Manufacturer's Bank. B is not aware that A is a stockholder in the said bank. A goes to the bank and demands the right to inspect the records of the bank to find out whether B has indeed such a time deposit and how much. The bank manager refuses to accede to his demand. A threatens to sue him on the ground that as a stockholder of the corporation, he is given by the Corporation Code the right to inspect all the books of the corporation.**

**Is A entitled to look at such records? Explain.**

**Answer:**

No. under the Secrecy of Bank Deposits Law, all bank deposits of whatever nature are considered as absolutely confidential in nature and may not be inquired into by any person except under specified circumstances. This case does not come under any of these exceptions. The deposit is not the subject matter of the action against B. Although it is true that under the Corporation Code a stockholder has the right to inspect all the business records of his corporation, such right must give way to the limitations set forth under the special law mentioned, which was intended to encourage deposits in banking institutions. Furthermore, the right of inspection should be exercised in connection with the interest of the stockholder in the corporation and not in relation to such an extraneous matter as the case in question. (BAR 1983)

3. **Section 51 of Act No. 1459 (Old Corporation Law) in part provides as follows:**

**"The record of all business transactions of the corporation and minutes of any meeting shall be open to the inspection of any director, member or stockholder of the corporation at reasonable hours."**

**Discuss the scope of this right (of a stockholder, to inspect and examine the books and records of the corporation) under BP 68, otherwise known as the Corporation Code of the Philippines.**

**Answer:**

Under BP 68, the right of inspection given to any director, trustee, member or stockholder of the Corporation at reasonable hours is on business days throughout the whole year, and not merely during the period of a few days or months. (BAR 1984)

4. **Petitioner who is a stockholder of Bilmoko Corporation wanted to examine the books and records of a foreign subsidiary wholly owned by Bilmoko Corporation. The books and records of the foreign subsidiary were in the possession of Bilmoko Corporation. The latter's board of directors refused to allow the petitioner to examine said books and records, contending that the foreign subsidiary is a separate and distinct corporation domiciled in another country; hence, the petitioner was not within the class of persons having an interest in the operations of the foreign subsidiary.**

**a) Decide the case.**

**b) What are the limitations on a stockholder's rights to inspect corporation books and records?**

**Answer:**

- a) The statutory right of a stockholder to inspect the books and records of a corporation extends—in consonance with equity, good faith and fair dealing—to a foreign subsidiary wholly owned by the corporation.
- b) The right of inspection does not allow the stockholder to improperly use any information that is secured thereby. The stockholder must exercise the right in good faith and for a legitimate purpose only. (BAR 1988)

**d. Pre-Emptive Right**

1. **X Corporation is in need of land on which to construct an additional factory to be used in the expansion of its business. Jose Cruz owns a piece of land in Tagaytay, Rizal, which is ideal for the purpose, and the corporation offers to buy it at a fair price. Jose is willing to part with the land on condition that he be paid in shares of stocks of the corporation. The Board of Directors decides to accept the terms of Jose, but since the authorized capital stock of the corporation has been fully subscribed, it proposes to increase the capital stock so that it can consummate the sale of the land. The proposal, including the purchase of Jose's land in exchange for the new shares was submitted to the stockholders in a meeting called for the purpose.**

**Pedro Reyes, who has 100 shares in the corporation, alleging that he and all other stockholders have a preemptive right to the new shares, insists that the corporation issue to him his proportionate quota of the new shares which he offers to buy in cash. Holders of 80% of the outstanding capital stock are in favor of the proposal to increase the capital stock, including the exchange of Jose's land for new shares of stock.**

**Is Pedro Reyes within his rights in claiming a preemptive right? Explain.**

**Answer:**

Pedro Reyes, who has 100 shares in the corporation, has no preemptive right in this case. Under the Corporation Code (Sec.39), all stockholders shall enjoy the preemptive right to subscribe to all issues of shares in proportion to their respective shareholdings. However, under the same provisions, such preemptive right does not exist when shares are issued in exchange for property needed for corporate purposes, provided stockholders representing 2/3 of the subscribed capital stock approve such issuance. Therefore, since more than 2/3 of the stocks favored the proposal, Pedro Reyes cannot insist on the preemptive right, otherwise he will in effect make it impossible for the corporation to acquire Jose Cruz's land which it needs for its new factory. (BAR 1983)

2. **XYZ Corporation has an authorized capital stock of P100,000, divided into 10,000 shares, each with a par value of P10. The subscribed capital stock is P50,000 or 5,000 shares. At the time of incorporation, S subscribed to 1,000 shares or P10,000.**

**In need of additional funds, XYZ Corporation proposes to offer the unsubscribed 5,000 shares to new stockholders at P15 per share or an aggregate amount of P75,000.**

**Explain whether or not S has a right to subscribe to any of the 5,000 shares and, if so, at what price?**

**Answer:**

S has a preemptive right to subscribe to 1,000 shares of the 5,000 shares being offered since he is at present a stockholder with 1,000 shares of the 5,000 outstanding shares of the corporation.

All stockholders of a stock corporation shall enjoy preemptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings, unless such right is denied by the articles of incorporation. As the law uses the phrase "all issues or disposition of shares of any class", the preemptive right of stockholders under the Corporation Code covers unissued shares which form part of the authorized capital stock.

The preemptive right of S is satisfied if the shares are offered to him at the same price as that to be offered to the new stockholders, which is P15 per share. (BAR 1984)

3. **ABC Corporation has an authorized capital stock of P1 M divided into 50,000 common shares and 50,000 preferred shares.**

**At its inception, the Corporation offered for subscription all the common shares. However, only 40,000 shares were subscribed.**

**Recently, the directors thought of raising additional capital and decided to offer to the public all the authorized shares of the Corporation at their market value.**

- a) **Would Mr. X, a stockholder holding 4,000 shares, have pre-emptive rights to the remaining 10,000 shares?**
- b) **Would Mr. X have pre-emptive rights to the 50,000 preferred shares?**
- c) **Assuming that the existing stockholders are entitled to pre-emptive rights, at what price will the shares be offered?**

**Explain your answers.**

**Answer:**

- a) Yes. Mr. X, a stockholder holding 4,000 shares, has pre-emptive right to the remaining 10,000 shares. All stockholders of a stock corporation shall enjoy preemptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings. The ruling in Benito v. Datu and Tan v. SEC to the effect that preemptive right applies only to issuance of shares in connection with an increase in capital is no longer a valid rule under the Corporation Code. The facts in those cases happened during the regime of the old Corporation Law.
  - b) Yes. Mr. X would have pre-emptive rights to the 50,000 preferred shares. All stockholders of a stock corporation shall enjoy pre-emptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings.
  - c) The shares will be offered to existing stockholders, who are entitled to pre-emptive right, at a price fixed by the Board of Directors, which shall not be less than the par value of such shares. (BAR 1999)
4. **Suppose that "X" Corporation has already issued the 1000 originally authorized shares of the corporation so that its Board of Directors and stockholders wish to increase "X's" authorized capital stock. After complying with the requirements of the law on increase of capital stock, "X" issued an additional 1000 shares of the same value.**
- a) **Assume that the stockholder "A" presently holds 200 out of the 1000 original shares. Would "A" have a preemptive right to 200 of the new issue of 1000 shares? Why?**
  - b) **When should stockholder "A" exercise the preemptive right?**

**Answer:**

- a) Yes, "A" would have a preemptive right to 200 of the new issue of 1000 shares. "A" is a stockholder of record holding 200 shares in "X" Corporation. According to the Corporation Code, each stockholder has the preemptive right to all issues of shares made by the corporation in proportion to the number of share he holds on record in the corporation.
- b) Preemptive right must be exercised in accordance with the Articles of Incorporation or the By-Law. When the Articles of Incorporation and By-Laws are silent, the Board may fix a reasonable time within which the stockholders may exercise the right. (BAR 2001)

**5. The Board of Directors of ABC, Inc., a domestic corporation, passed a resolution authorizing additional issuance of shares of stocks without notice nor approval of the stockholders.**

**DX, a stockholder, objected to the issuance, contending that it violated his right of pre-emption to the unissued shares. Is his contention tenable? Explain briefly.**

**Answer:**

Yes. DX/s contention is tenable. Under Section 39 of the Corporation Code, all stockholders of ABC, Inc. enjoy preemptive right to subscribe to all issues of shares of any class, including the reissuance of treasury shares in proportion to their respective shareholdings. (BAR 2004)

**6. So that ABC Corporation could venture into more projects, it needed to raise funds by issuing new shares to increase its capitalization. X, Y, Z, J and G are the 5 existing shareholders of the company. They hold 20% each. How will the additional shares be divided among the existing shareholders?**

- a) **The existing shareholders can subscribe to the new shares equivalent to their existing shareholdings because the Corporation Code provides that each of the existing stockholders will have preemptive rights to the extent of their existing shareholdings;**
- b) **The existing shareholders' preemptive rights is equivalent to the percentage that they want;**
- c) **Each of the existing shareholder can exercise their right of first refusal against each other;**
- d) **Preemptive rights and right of first refusal are one and the same.**

**Answer:**

- a) The existing shareholders can subscribe to the new shares equivalent to their existing shareholdings because the Corporation Code provides that each of the existing stockholders will have preemptive rights to the extent of their existing shareholdings. (BAR 2012)

**e. Right to Vote**

**1. X subscribed to 700 shares of stock in a single subscription to a corporation but paid only for 400 shares, for which he was issued fully paid certificates for 400 shares.**

**Is he entitled to vote the paid up shares notwithstanding the fact that he has not paid the remaining 300 shares? Explain.**

**Answer:**

Yes. In this regard Section 64 of the Corporation Code provides that "No certificate of stock shall be issued to a subscriber until the full amount of his subscription together with interest and expenses (in case of delinquent shares), if any is due, has been paid. As may readily be seen, the said provision requires as a condition before a shareholder can vote his shares, that his full subscription be paid in the case of the no par value stock; and in case of stock corporation with par value (as in the present case), the stockholder can vote the shares fully paid by him only, irrespective of the unpaid delinquent shares. (*Baltazar v. Lingayen Guild Electric Power Co., Inc.*, 14 SCRA 522) (BAR 1977)

2. **A group of individuals, desiring to organize a corporation, asked for your advice on the following proposals:**

a) **As to voting rights.—All shares shall have the same voting rights except that the common shares shall not vote on any proposed increase or decrease of the authorized capital stock.**

**What features of the foregoing proposals are not permitted by law?**

**Answer:**

The following features violate certain prescriptions set forth in Section 6 of the Corporation Code on the Classification of shares:

a) As to voting rights—

- 1) No shares may be deprived of voting rights except those classified and issued as “preferred” or “redeemable”.
- 2) The holders of shares, even non-voting shares in the cases allowed by the Corporation Code, shall nevertheless be entitled to vote on an increase or decrease of capital stock. (BAR 1984)

3. **Mercy subscribed to 1,000 shares of stock of Rosario Corporation. She paid 25% of said subscription. During the stockholders’ meeting, can mercy vote all her subscribed shares? Explain your answer.**

**Answer:**

Yes, Mercy can vote all her subscribed shares. Section 72 of the Corporation Code state that holders of subscribed shares not fully paid which are not delinquent shall have all the rights of a stockholder. (BAR 1990)

4. **The By-laws of the ABC Corporation is silent as to when a stockholder can be qualified to attend the meeting of the stockholders. The Corporate Secretary sent out the notice of the stockholders meeting 2 days before the meeting and at that time X was not yet a stockholder. On the day of the meeting, however, X became a shareholder which was duly recorded in the stock and transfer book. Which statement is most accurate?**

- a) **X is a stockholder of ABC Corporation as of the time of meeting of the stockholders for the purpose of electing the members of the board;**
- b) **X is not qualified to elect members of the board because at the time the notice of the meeting was sent, she was not yet a stockholder;**
- c) **Qualifications as to who are considered as stockholders on record for purposes of being able to elect members of the board are to be determined by the By-laws alone;**
- d) **None of the above.**

**Answer:**

a) X is a stockholder of ABC Corporation as of the time of meeting of the stockholders for the purpose of electing the members of the board. (BAR 2012)

5. **Dennis subscribed to 10,000 shares of XYZ Corporation with a par value of 100 per share. However, he paid only 25% of the subscription or P250,000. No call has been made on the unpaid subscription.**

**How many shares is Dennis entitled to vote at the annual meeting of the stockholders of XYZ?**

- a) **10,000 shares;**
- b) **2,500 shares;**
- c) **100 shares;**

- d) 0 shares;
- e) None of the above.

**Answer:**

a) 10,000 shares (BAR 2013)

f. Right of First Refusal

#### 4. Remedial Rights

a. Individual Suit

1. **A group of stockholders of Sesame Corporation filed a court suit against the members of the Board of Directors to make good to the shareholders, in proportion to their shareholdings, the losses incurred by the corporation because of the defendant Board of Directors' management.**

**Will the action prosper? Reasons.**

**Answer:**

The action will not prosper since the right belongs to the Corporation. Until the corporation is dissolved and the liquidation of assets shall have been made, the shareholders have no right over any specific asset of the corporation. The suit should have been filed instead by and in the name of the corporation. (BAR 1988)

b. Representative Suit

c. Derivative Suit

1. **A small stockholder of a Bank filed a suit praying for an injunction to prevent the approval of the appointments of two persons whom he claimed were being appointed to their positions only for the purpose of shielding from criminal prosecution the controlling stockholder, alleged to be committing fraud in the bank affairs. Defendants were the Board of Director of the Bank, the two persons, whose appointments were being questioned, and the controlling stockholder of the Bank. These defendants moved to dismiss the suit on the ground that a mere stockholder is not allowed to question the appointments because they were corporate acts. Should the case be dismissed?**

**Answer:**

The case should not be dismissed. Although as a general rule, it is only the board of directors and not a mere stockholder who can act on behalf of the corporation in questioning the validity of corporate acts, where the directors themselves are the persons responsible for the act questioned and can thus not be expected to nullify it, a stockholder can bring a derivative suit on behalf of the corporation. It would be futile for him to ask the board to bring the suit and since there is no other remedy, the derivative suit is recognized. The stockholder in this case falls squarely within this rule and therefore, the case should not be dismissed. (BAR 1975)

2. **A became a stockholder of prime Real Estate Corporation (PREC) on July 10, 1991, when he was given one share by another stockholder to qualify him as a director. A was not re-elected director in the July 1, 1992 annual meeting but he continued to be a registered shareholder of PREC.**

**When he was still a director, A discovered that on January 5, 1991, PREC issued free of charge 10,000 shares to X, a lawyer who assisted in a court case involving PREC.**

1. **Can A now bring an action in the name of the corporation to question the issuance of the shares to X without receiving any payment?**

**2. Can X question the right of A to sue him in behalf of the corporation on the ground that A has only one share in his name?**

**Answer:**

1. As a general rule, A cannot bring a derivative suit in the name of the corporation concerning an act that took place before he became a stockholder. However, if the act complained of is a continuing one, A may do so.
2. No. In a derivative suit, the action is instituted/ brought in the name of a corporation and the reliefs are prayed for therein for the corporation and reliefs are prayed for therein for the corporation, by a minority stockholder. The law does not qualify the term "minority" in terms of the number of shares owned by a stockholder bringing the action in behalf of the corporation. (BAR 1993)

**3. The stockholders of People Power, Inc. (PPI) approved two resolutions in a special stockholders' meeting:**

- a) Resolution increasing the authorized capital stock of PPI; and
- b) Resolution authorizing the Board of Directors to issue, for cash payment, the new shares from the proposed capital stock increase in favor of outside investors who are non-stockholders.

**The foregoing resolutions were approved by stockholders representing 99% of the total outstanding capital stock. The sole dissenter was Jimmy Morato who owned 1% of the stock. What remedies, if any, are available to Morato?**

**Answer:**

Jimmy can petition the SEC to declare the 2 resolutions, as well as any and all actions taken by the Board of Directors thereunder, null and void. (BAR 1998)

**4. AA, a minority stockholder, filed a suit against BB, CC, CC, and EE, the holders of majority shares of MOP Corporation, for alleged misappropriation of corporate funds. The complaint averred, inter alia, that MOP Corporation is the corporation in whose behalf and for whose benefit the derivative suit is brought. In their capacity as members of the Board of Director, the majority stockholders adopted a resolution authorizing MOP Corporation to withdraw the suit. Pursuant to said resolution, the corporate counsel filed a Motion to Dismiss in the name of the MOP Corporation.**

**Should the motion be granted or denied? Reason briefly.**

**Answer:**

No. All the requisites for a valid derivative suit exist in this case. First, AA was exempt from exhausting his remedies within the corporation, and did not have to make a demand on the Board of Directors for the latter to sue. Here, such a demand would be futile, since the directors who comprise the majority (namely, BB, CC, DD and EE) are the ones guilty of the wrong complained of. Second, AA appears to be stockholder at the time the alleged misappropriation of corporate funds. Third, the suit is brought on behalf and for the benefit of MOP Corporation. In this connection, it was held in *Conmart (Phils.) Inc. v. Securities and Exchange Commission*, 198 SCRA 73 (1991) that to grant to the corporation concerned the right of withdrawing or dismissing the suit, at the instance of the majority stockholders and directors who themselves are the persons alleged to have committed the breach of trust against the interest of the corporation would be to emasculate the right of minority stockholders to seek redress for the corporation. Filing such action as a derivative suit even by a lone stockholder is one of the protections extended by law to minority stockholders against abuses of the majority. (BAR 2004)

5. **Malyn, Schiera and Jaz are directors of Patio Investments, a close corporation formed to run the Patio Café, an al fresco coffee shop in Makati City. In 2000, Patio Café began experiencing financial reverses, consequently, some of the checks it issued to its beverage distributors and employees bounced.**

**In October 2003, Schiera informed Malyn that she found a location for a second café in Taguig City. Malyn objected because of the dire financial condition of the corporation.**

**Sometime in April 2004, Malyn learned about Fort Patio Café located in Taguig City and that its development was undertaken by a new corporation known as Fort Patio, Inc., where both Schiera and Jaz are directors. Malyn also found that Schiera and Jaz, on behalf of Patio Investments and personally guaranteed by Schiera and Jaz.**

**Malyn then filed a corporate derivative action before the RTC of Makati City against Schiera and Jaz, alleging that the two directors had breached their fiduciary duties by misappropriating money and assets of Patio Investments in the operation of Fort Patio Café.**

- b) Was it proper for Malyn to file a derivative suit with a prayer for injunctive relief? Explain.**
- c) Assuming that a derivative suit is proper, may the action continue if the corporation is dissolved during the pendency of the suit? Explain.**

**Answer:**

- b) It was proper for Malyn to file a derivative suit with a prayer for injunction, because Schiera and Jaz diverted the assets of the corporation for their own personal benefit.
- c) The case should be allowed to continue so that the assets and claims should be administered for the benefit of all concerned, as they should have been administered before the dissolution of the corporation. (BAR 2005)

6. **Atlantis Realty Corporation (ARC), a local firm engaged in real estate development, plans to sell one of its prime assets—a 3-hectare land valued at about P100 M. for this purpose, the board of directors of ARC unanimously passed a resolution approving the sale of the property for P75 M to Shangrila Real Estate Ventures (SREV), a rival realty firm. The resolution also called for a special stockholders meeting at which the proposed sale would be up for ratification.**

**Atty. Edric, a stockholder who owns only 1 share in ARC, wants to stop the sale. He then commences a derivative suit for and in behalf of the corporation from approving the sale.**

- a) Can Atty. Edric, who owns only 1 share in the company, initiate a derivative suit? Why or why not?**

**Answer:**

Yes, Atty. Edric can initiate a derivative suit, otherwise known as the minority stockholders' suit. It is allowed by law to enable the minority stockholder/s to protect the interest of the corporation against illegal or disadvantageous act/s of its officers or directors, the people who are supposed to the corporation.

- b) Will the suit prosper? Why or why not?**

**Answer:**

No. The suit will not prosper. There is no requisite demand on the officers and directors concerned. There is, therefore, no exhaustion of administrative remedies. (BAR 2009)

7. **X is a minority stockholder of CCC Corporation. Y is a member of the Board of Directors of CCC Corporation and at the same time he is the President. X believes that Y is mismanaging CCC Corporation hence, as a stockholder and in behalf of the other stockholders, he wanted to sue Y. which statement is most accurate?**
- a) **X can institute a derivative suit in behalf of himself as a stockholder;**
  - b) **A derivative suit must be instituted in behalf of the corporation;**
  - c) **Derivative suit is an exclusive remedy that X can institute;**
  - d) **Derivative suit is not the remedy in this situation.**

**Answer:**

b) A derivative suit must be instituted in behalf of the corporation. (BAR 2012)

8. **In the November 2010 stockholder's meeting of Greenville Corporation, 8 directors were elected to the board. The directors assumed their posts in January 2011. Since no stockholders' meeting was held in November 2011, the 8 directors served in a holdover capacity and thus continued discharging their powers.**

**In June 2012, 2 of Greenville Corporation's directors—Director A and Director B—resigned from the board. Relying on Section 29 of the Corporation Code, the remaining 6 directors elected 2 new directors to fill in the vacancy caused by the resignation of Directors A and B.**

**Stockholder X questioned the election of the new directors, initially, through a letter-complaint addressed to the board, and later (when his letter-complaint went unheeded), through a derivative suit filed with the court. He claimed that the vacancy in the board should be filled up by the vote of the stockholders of Greenville Corporation. Greenville Corporation's directors defended the legality of their action, claiming as well that Stockholder X's derivative suit was improper.**

**Rule on the issued raised.**

**Answer:**

The remaining directors cannot elect new directors to fill in the two vacancies. The board of directors may fill up vacancy only if the ground is not due to expiration of term, removal or increase in the number of board seats. In this case, the term of the two directors expired after 1 year. They remained in office in a hold-over capacity only until their resignation. The hold-over period is not part of their term. The vacancies should be filled up by election by the stockholders.

The derivative suit was improper. In a derivative suit, the corporation, not the individual stockholder, must be the aggrieved party and that the stockholder is suing on behalf of the corporation. What stockholder X is asserting is his individual right as a stockholder to elect the two directors. The case partakes more of an election contest under the rules on intra-corporate controversy. (BAR 2013)

9. **A, B, C, D and E were members of the 2003-2004 Board of Directors of FLP Corporation. At the election for the 2004-2005 Board of Directors, not one of them was elected. They filed in court a derivative suit on behalf of FLP Corporation against the newly-elected members of the Board of Directors. They questioned the validity of the election as it was allegedly marred by lack of quorum, and prayed for the nullification of the said election. The 2004-2005 Board of Directors moved to dismiss the complaint because the derivative suit is not proper. Decide.**

**Answer:**

The derivative suit is not proper. The party-in-interest are the petitioners as stockholders, who were members of the 2003-2004 Board of Directors of FLP Corporation. The cause of action devolves on the petitioners, not on FLP Corporation, which did not have the right to vote. Hence, the complaint filed by A, B, C, D and E is a direct

action by the petitioners, who were the members of the Board of Directors of the corporation before the election, against respondents, who are the newly-elected Board of Directors. Under the circumstances, the derivative suit filed by petitioners in behalf of FLP is improper. (BAR 2014)

5. **Obligation of a Stockholder**

6. **Meetings**

a. **Regular or Special**

i. **When and Where**

1. **Under the Articles of Incorporation of Manila Industrial Corporation, its principal place of business shall be in Pasig, Metro Manila. The principal corporate offices are at the Ortigas Center, Pasig, Metro Manila while its factory processing leather products is in Manila. The corporation holds its annual stockholder's meeting at the Manila Hotel in Manila and, its board of directors' meeting at a hotel in Makati, Metro Manila. The by-laws are silent as to the place of meetings of the stockholders and the directors.**

**Can Ting, a stockholder, who did not attend the stockholder' annual meeting in Manila, question the validity of the corporate resolutions passed at such meeting?**

**Answer:**

No. The law provides that the annual stockholders' meeting shall be held in the city or municipality where the principal office of the Corporation is located. For this purpose, the law also provides that Metro Manila is considered a city or municipality. Since the principal place of business of MIC is Pasig, Metro Manila, the holding of the annual stockholders' meeting in Manila is proper. (BAR 1993)

ii. **Notice**

1. **At least 2/3 of the stockholders of Solar Corporation, meeting upon the recommendation of the Board of Directors, declared a 50% stock dividend during their annual meeting. The notice of the annual stockholders' meeting did not mention anything about a stock dividend declaration. The matter was taken up only under the item "Other Business" in the agenda of the meeting. C.K. Senwa, a stockholder, who received his copy of the notice but did not attend the meeting, subsequently learned about the 50% stock dividend declaration. He desires to have the stock dividend declaration cancelled and set aside, and wishes to retain your services as a lawyer for the purpose.**

**Will you accept the case? Discuss with reasons.**

**Answer:**

I will not accept the case. Section 43 of the Corporation Code states that no stock dividend shall be issued without the approval of the stockholders representing not less than 2/3 of the outstanding capital stock at a regular or special meeting duly called for that purpose. Conformably with Section 50 of the Corporation Code, a written notice of the holding of the regular meeting sent to the shareholders will suffice. The notice itself specifies the said subject matter. (BAR 1990)

b. **Who Calls the Meetings**

c. **Quorum**

1. **Triple A Corporation (Triple A) was incorporated in 1960, with 500 founder's shares and 78 common shares as its initial capital stock subscription. However, Triple A registered its stock and transfer books only in 1978, and recorded merely 33 common shares as the corporation's issued and outstanding shares.**

**In 1982, Juancho, the sole heir of one of the original incorporators filed a petition with the SEC for the registration of his property rights over 120 founder's shares and 12 common shares. The petition was supported by a copy of the Articles of Incorporation indicating the incorporators' initial capital stock subscription.**

**On May 6, 1992, a special stockholders' meeting was held. At this meeting, what would have constituted a quorum? Explain.**

**Answer:**

A quorum consists of the majority of the totality of the shares which have been subscribed and issued. Thus the quorum for such meeting would be 289 shares or a majority of the 576 shares issued and outstanding as indicated in the articles of incorporation. This includes the 33 common shares reflected in the stocks and transfer book, there being no mention or showing of any transaction effected from the time of Triple A's incorporation in 1960 up to the said meeting. (BAR 2009)

#### **d. Minutes of the Meetings**

### **K. Capital Structure**

1. **As a result of perennial business losses, a corporation's net worth has been wiped out. In fact, it is now in negative territory. Nonetheless, the stockholders did not like to give up.**

**Creditor-banks, however, do not share the confidence of the stockholders and refuse to grant more loans.**

**What tools are available to the stockholders to replenish capital?**

**Answer:**

In the face of the refusal of the creditor-banks to grant more loans, the following are tools available to the stockholders to replenish capital, to wit: (1) additional subscription to shares of stock of the corporation by stockholders or by investors; (2) advances by the stockholders to the corporation; (3) payment of unpaid subscription by the stockholders. (BAR 1999)

1. **Subscription Agreements**
2. **Consideration for Stocks**

1. **Janice rendered some consultancy work for XYZ Corporation. Her compensation included shares of stock therein.**

**Can XYZ Corporation issue shares of stock to pay for the service of Janice as its consultant? Discuss your answer.**

**Answer:**

The corporation can issue shares of stock to pay for actually performed services to the corporation, but not for future services or services yet to be performed. (BAR 2005)

### 3. Shares of Stock

#### a. Nature of Stock

1. **PR Corporation owns a beach resort with several cottages. Jaime, the President of PR, occupied one of the cottages for residential purposes. After Jaime's term expired, PR wanted to recover possession of the cottage. Jaime refused to surrender the cottage, contending that as a stockholder and former President, he has a right to possess and enjoy the properties of the corporation.**

**Is Jaime's contention correct? Explain.**

**Answer:**

Jaime's contention is not correct. Jaime may own shares of stock in PR Corporation but such ownership does not entitle him to the possession of any specific property of the corporation or a definite portion thereof. Neither is he a co-owner of a corporate property. Properties registered in the name of the corporation are owned by it as an entity separate and distinct from its stockholders.

Stockholders like Jaime only own shares of stock in the corporation. Such shares of stock do not represent specific corporate property. (BAR 1996)

#### b. Subscription Agreements

1. **Mr. Balimbing signed a written subscription for 100 shares of stock of Laban and Co., paying 25% of the amount thereof. The corporation subsequently became insolvent due to a series of financial reverses. Mr. Balimbing demanded from the Corporate Secretary the stock certificates corresponding to 25 shares which he claimed was already paid. Since the corporation was insolvent, Mr. Balimbing refused to pay for his remaining unpaid subscription.**

**Is Mr. Balimbing correct in refusing to pay for the remaining shares, the Company being already insolvent? Reasons.**

**Answer:**

The refusal of Mr. Balimbing to pay is not correct. The obligation to pay for unpaid subscription is a liability of Mr. Balimbing that has not yet been discharged, but is instead entrenched under the trust fund doctrine upon the insolvency of the corporation. (BAR 1988)

2. **A, B and C are shareholders of XYZ Company. A has an unpaid subscription of P100,000, B's shares are fully paid up, while C owns only nominal but fully paid up shares and is a director and officer. XYZ Company becomes insolvent, and it is established that the insolvency is the result of fraudulent practices within the company. If you were counsel for a creditor of XYZ Company, would you advise legal action against A, B and C?**

**Answer:**

- a) An action can be brought against A for P100,000 which is the amount of his unpaid subscription. Since the corporation is insolvent, the limit of a stockholder's liability to the creditor is only up to the extent of his unpaid subscription.
- b) There is no cause of action against B because he has already fully paid for his subscription. As stated earlier, the limit of the stockholder's liability to the creditor of the corporation, when the latter becomes insolvent, is the extent of his subscription.

c) An action can be filed against C, not as a stockholder because he has already paid up the shares, but in his capacity as director and officer because of the corporation's insolvency being the result of fraudulent practices within the company. fDirectors are liable jointly and severally for damages sustained by the corporation, stockholders or other persons resulting from gross negligence or bad faith in directing the affairs of the corporation. (BAR 1997)

**3. It is settled that neither par value nor book value is an accurate indicator of the fair value of a share of stock of a corporation. As to unpaid subscriptions to its shares of stock, as they are regarded as corporate assets, they should be included in the**

- a. Capital value.
- b. Book value
- c. Par value.
- d. Market value.

**Answer:**

b. Book value. (BAR 2011)

**4. The BIR assessed ABC Corp. for deficiency income tax for taxable year 2010 in the amount of P26,731,208.00, inclusive of surcharge and penalties.**

The BIR can \_\_\_\_\_.

- a) Run after the directors and officers of the ABC Corp. to collect the deficiency tax and their liability will be solidary;
- b) Run after the stockholders of ABC Corp. and their liability will be joint;
- c) Run after the stockholders of ABC Corp. and their liability will be solidary;
- d) Run after the unpaid subscriptions still due to ABC Corp., if any;
- e) None of the above choices is correct'

**Answer:**

d) Run after the unpaid subscriptions still due to ABC Corp., if any. (BAR 2013)

### c. Consideration for Shares of Stock

**1. A group of individuals, desiring to organize a corporation, asked for your advice on the following proposals:**

b) As to authorized capital stock—P1 M divided into 500,000 no par value shares of preferred stock to be offered at an issue value of P1.00 per share, and 500,000 shares of common stock, with par value of P1.00 per share.

**What features of the foregoing proposals are not permitted by law?**

**Answer:**

The following features violate certain prescriptions set forth in Section 6 of the Corporation Code on the Classification of shares:

b) As to authorized capital stock—

- 1) Preferred shares of stock may be issued only with a stated par value.

- 2) Shares without par value may not be issued for a consideration less than the value of P5.00 per share. (BAR 1984)

**d. Watered Stock**

**i. Definition**

1. A became a stockholder of prime Real Estate Corporation (PREC) on July 10, 1991, when he was given one share by another stockholder to qualify him as a director. A was not re-elected director in the July 1, 1992 annual meeting but he continued to be a registered shareholder of PREC.

When he was still a director, A discovered that on January 5, 1991, PREC issued free of charge 10,000 shares to X, a lawyer who assisted in a court case involving PREC.

Can not the shares issued to X be considered as watered stock?

**Answer:**

No. Watered shares are those sold by the corporation for less than the par/ book value. In the instant case, it will depend upon the value of services rendered in relation to the total par value of the shares. (BAR 1993)

**ii. Liability of Directors for Watered Stocks**

**iii. Trust Fund Doctrine for Liability for Watered Stocks**

**e. Situs of the Shares of Stock**

**f. Classes of Shares of Stock**

1. The capital stock of ABC Corporation is divided into common shares and preferred shares. Preferred shares are preferred as to dividends and common shares are those shares which have the regular and ordinary attributes of a share of a corporation. Which statement is most accurate?
- a) This kind of classification may not be allowed or else it will violate the Doctrine of Equality of shares;
  - b) Classifications of shares may be allowed for as long as it is clearly stated as such in the Articles of Incorporation of the Corporation;
  - c) Classifications of shares is mainly for business purpose to attract investors;
  - d) Classifications of shares may be allowed with the approval of the stockholders and the Board of Directors.

**Answer:**

- b) Classifications of shares may be allowed for as long as it is clearly stated as such in the Articles of Incorporation of the Corporation. (BAR 2012)

2. A corporation generally can issue both par value stock and no par value stock. These are all fixed in the Articles of Incorporation of the corporation. Which of the following corporations may not be allowed to issue no par value shares?
- a) Insurance companies;
  - b) Banks;
  - c) Trust Companies;
  - d) All of the above.

**Answer:**

b) Banks. (BAR 2012)

**3. Preferred shares cannot vote on the proposal \_\_\_\_.**

- a) To include other corporate officers in the corporation's by-laws;
- b) To issue corporate bonds;
- c) All of the above;
- d) None of the above.

**Answer:**

e) None of the above. (BAR 2013)

**4. ABC Corp. issued redeemable shares. Under the terms of the issuance, the shares shall be redeemed at the end of 10 years from date of issuance, at par value plus a premium of 10%.**

**Choose the correct statement relating to these redeemable shares.**

- a) ABC Corp. would need unrestricted retained earnings to be able to redeem the shares;
- b) Corporations are not allowed to issue redeemable shares; thus, the issuance by ABC Corp. is ultra vires;
- c) Holders of redeemable shares enjoy a preference over creditors;
- d) ABC Corp. may redeem the shares at the end of 10 years without need for unrestricted retained earnings provided that, after the redemption, there are sufficient assets to cover its debts;
- e) All of the above are incorrect.

**Answer:**

d) ABC Corp. may redeem the shares at the end of 10 years without need for unrestricted retained earnings provided that, after the redemption, there are sufficient assets to cover its debts. (BAR 2013)

#### **4. Payment of Balance of Subscription**

##### **a. Call by Board of Directors**

**1. A subscribed to 100 shares of stock of corporation X with par value of P100.00 each, paying P2,500.00 on his subscription. Subsequently, A asked B, the president of the corporation, to release him from his subscription. B consented provided that A forfeits to the company what he already paid. A agreed and B gave him a certificate of release. Not long afterwards, X went into insolvency and an assignee was appointed. The assignee now seeks to collect from A the unpaid balance of his subscription. Decide the dispute with reasons.**

**Answer:**

The assignee of the insolvent X corporation may collect from A the unpaid balance of his subscription. The president of a corporation has no legal capacity to release as subscriber from his unpaid subscription. The insolvency of X corporation makes all subscription payable on demand without call and recoverable in an action instituted by the assignee. (*Velasco v. Poizat*, 37 Phil. 802) (BAR 1979)

**2. Victor was employed in MAIA Corporation. He subscribed to P1,500 shares of the corporation at P100 per share or a total of P150,000. He made an initial down payment of P37,500. He was appointed President and General Manager. Because of his disagreement with the Board of Directors, he resigned**

and demanded payment of his unpaid salaries, his cost of living allowance, his bonus, and reimbursement of his gasoline and representation expenses.

MAIA Corporation admits that it owed Victor P40,000 but told him that this will be applied to the unpaid balance of his subscription in the amount of P100,000. There was no call or notice for the payment of the unpaid subscription. Victor questioned the set-off.

**May MAIA set-off unpaid subscription with Victor's claim for salaries?**

**Answer:**

No. MAIA cannot set-off the unpaid subscription with Victor's claim for salaries. The unpaid subscription is not yet due as there is no call. (BAR 1994)

- b. Notice Requirement
- c. Sale of Delinquent Shares

- i. Effect of Delinquency

1. The Board of Directors of a corporation, by a vote of ten in favor and one against, declared due and payable all unpaid subscription to the capital stock. The lone dissenting director failed to pay on due date, i.e., September 19, 1997, his unpaid subscription. Other than the shares wherein he was unable to complete payment, he did not own any share in the corporation. On September 23, 1997, he was informed by the Board of Directors that, unless due payment is meanwhile received, he
  - a) Could no longer serve as a director of the corporation forthwith;
  - b) Would not be entitled to the cash and stock dividends which were declared and payable on September 24, 1997; and
  - c) Could not vote in the stockholders meeting scheduled to take place on September 26, 1997.

**Was the action of the Board of Directors on each of the foregoing matters valid?**

**Answer:**

- a) No. the period 30 days within which the stockholder can pay the unpaid subscription had not yet expired.
- b) No. The delinquency did not deprive the stockholder of his right to receive dividends declared. However, the cash dividend declared may be applied by the corporation to the unpaid subscription.
- c) No. the period of 30 days within which the stockholder can pay the unpaid subscription had not yet expired. (BAR 1997)

- ii. Call by Resolution of the Board of Directors
- iii. Notice of Sale
- iv. Auction Sale and the Highest Bidder

## 5. Certificate of Stock

- a. Nature of the Certificate
- b. Uncertificated Shares
- c. Negotiability

i. Requirements for Valid Transfer of Stocks

d. Issuance

i. Full Payment

1. **Mr. Balimbing signed a written subscription for 100 shares of stock of Laban and Co., paying 25% of the amount thereof. The corporation subsequently became insolvent due to a series of financial reverses. Mr. Balimbing demanded from the Corporate Secretary the stock certificates corresponding to 25 shares which he claimed was already paid. Since the corporation was insolvent, Mr. Balimbing refused to pay for his remaining unpaid subscription.**

**Can the Corporate Secretary validly refuse to issue stock certificates in the name of Mr. Balimbing for 25 shares despite the payment of 25% of the subscription of 100 shares? Reasons.**

**Answer:**

Yes, the Corporation Code expressly provides that no certificate of stock shall be issued unless the full amount of the subscription is paid. This is to say that a partial payment of the subscription amount is allocated or apportioned to the entire number of the subscribed shares and, therefore, each share subscribed by Mr. Balimbing would be paid only to the extent of 25% thereof. (BAR 1988)

2. **Ace Cruz subscribed to 100,000 shares of stock of JP Development Corporation, which has a par value of P1 per share. He paid P25,000 and promised to pay the balance before December 31, 2008. JP Development Corporation declared a cash dividend on October 15, 2008, payable on December 1, 2008.**

**On December 1, 2008, can Ace Cruz compel JP Development Corporation to issue to him the stock certificate corresponding to the P25,000 paid by him?**

**Answer:**

No, Ace cannot compel JP to issue to him a stock certificate corresponding to P25,000 paid by him. (BAR 2008)

3. **X subscribed 10,000 shares in the capital stocks of AAA Corporation. He paid 50% of the 10,000 shares. X asked the Corporate Secretary to issue him the corresponding stock certificate representing the 50% of what he already paid. The Corporate Secretary of the corporation refused. Was the Corporate Secretary correct?**

- a) **The Corporate Secretary is correct because the Corporation Code provides that no certificate of stock shall be issued to a subscriber until the shares as subscribed have been fully paid;**
- b) **The Corporate Secretary cannot refuse because a Stock Certificate can be issued corresponding to the percentage of shares which were paid;**
- c) **The Corporation Secretary cannot refuse because a certificate of Stock can be issued provided it is indicated in the Certificate the actual percentage of what has been paid;**
- d) **The Corporate Secretary cannot refuse because it is his legal duty to issue a stock certificate corresponding to the number of shares actually subscribed regardless of the actual payment.**

**Answer:**

- a) **The Corporate Secretary is correct because the Corporation Code provides that no certificate of stock shall be issued to a subscriber until the shares as subscribed have been fully paid. (BAR 2012)**

ii. Payment Pro-Rata

1. After subscribing to 3,000 shares of corporate stock with a par value of P100 each, a stockholder paid for 1,000 shares or a total sum of P100,000.00 he then asked for the issuance to him of certificate of stock for the P1,000 paid-up shares so that he may have voting rights but the corporation refused. In the trial court, the judge resolved the case against the stockholder, ruling that—"in the absence of special agreement to the contrary, a subscriber for a certain number of shares of stock does not, upon payment of one-third of the subscription price, become entitled to the issuance of certificates for one-third of the number of shares subscribed for; the subscriber's right consists only in equity entitling him to a certificate upon payment of the remaining portion of the subscription price." Comment on the said ruling, with reasons.

**Answer:**

Although the general rule is as stated by the trial court, the Supreme Court held in the case of *Baltazar v. Lingayen Gulf Electric Power Co.* that the stockholder was entitled to the issuance of certificates of stock for the 1000 shares paid by him. The court considered the fact that it was the practice of this corporation to issue certificates of stock partially paid subscriptions by applying the payment, not pro rata to each share, but as consideration for whole shares. The case therefore fell under the exception in the *Fua Cun v. Summer* case: "In the absence of an agreement to the contrary."

Commenting on the *Fua Cun* ruling, I would say that it is sound because a stockholder will feel bound to pay for all his subscription, lest all his shares be declared delinquent if he fails to pay. Prorating the payment means that not one of his shares is fully paid, and any failure on his part to pay when demanded will render all his shares delinquent. On the other hand, if the *Baltazar v. Lingayen* case is followed in all cases, a stockholder, if he believes that the corporate business will be a failure, will just let the other unpaid shares become delinquent. Anyway he has the certificate for his fully paid shares.

These two cases can be reconciled by considering the *Baltazar v. Lingayen Gulf* case as an exception to the *Fua Cun* principle. In other words, as a general rule, partial payment on a subscription of shares should be prorated among all the shares and will not entitle the subscriber to a certificate of stock representing the number of shares which the partial payment can cover. He is entitled to the certificate only upon full payment of his subscription. However, where the agreement between the corporation and the subscriber is otherwise, or the corporation's practice has been to so issue certificates instead of prorating payment, then the subscriber is entitled to a certificate of stock representing the number of shares already paid for. (BAR 1975)

**e. Lost or Destroyed Certificates**

1. "A" is the registered owner of Stock Certificate No. 000011. He entrusted the possession of said certificate to his best friend "B" who borrowed the said endorsed certificate to support B's application for passport (or for a purpose other than transfer). But "B" sold the certificate to "X", a bona fide purchaser who relied on the endorsed certificates and believed him to be the owner thereof.
  - a) Can "A" claim the shares of stocks from "X"? Explain.
  - b) Would your answer be the same if "A" lost the stock certificate in question or if it was stolen from him?

**Answer:**

- a) No. Assuming that the shares were already transferred to "B". "A" cannot claim the shares of stock from "X" the certificate of stock covering said shares have been duly endorsed by "A" and entrusted by him to "B". by his said acts "A" is now estopped from claiming said shares from "X", a bona fide purchaser who relied on the endorsement by "A" of the certificate of stock.
- b) Yes. In the case where the certificate of stock was lost or stole from "A", "A" has a right to claim the certificate of stock from the thief who has no right or title to the same. "One who has lost any movable or

has been unlawfully deprived thereof, may recover it from the person in possession of the same.” (BAR 2001)

## 6. Stock and Transfer Book

### 1. What is a stock and transfer book?

**Answer:**

a stock and transfer book is a book which records all stocks in the name of the stockholders alphabetically arranged; the installments paid or unpaid on all stocks for which subscription has been made and the date of payment of any installment, a statement of every alienation, sale or transfer of stock made, the date thereof, and by and to whom made; and such other entries as the by-laws may prescribe. (BAR 2009)

- a. Contents
- b. Who May Make Valid Entries

1. Four months before his death, PX assigned 100 shares of stock registered in his name in favor of his wife and his children. They then brought the deed of assignment to the proper corporate officers for registration with the request for the transfer in the corporation’s stock and transfer books of the assigned shares, the cancellation of the stock certificates in PX’s name, and the issuance of new stock certificates in the names of his wife and his children as the new owners. The officers of the Corporation denied the request on the ground that another heir is contesting the validity of the deed of assignment.

**May the Corporation be compelled by mandamus to register the shares of stock in the names of the assignees? Explain briefly.**

**Answer:**

Yes. The corporation may be compelled by mandamus to register the shares of stock in the name of the assignee. The only legal limitation imposed by Section 63 of the Corporation Code is when the Corporation holds any unpaid claim against the shares intended to be transferred. The alleged claim of another heir of PX is not sufficient to deny the issuance of new certificates of stock to his wife and children. It would be otherwise if the transferee’s title to the shares has no prima facie validity or is uncertain. (BAR 2004)

## 7. Disposition and Encumbrance of Shares

- a. Allowable Restrictions on the Sale of Shares
- b. Sale of Partially Paid Shares
- c. Sale of a Portion of Shares Not Fully Paid
- d. Sale of All of Shares Not Fully Paid
- e. Sale of Fully Paid Shares
- f. Requisites of a Valid Transfer

1. “A”, stockholder of “X Corporation”, assigns his shares of stock to “B” for a valuable consideration. The certificate of stock was thereupon delivered to “B”. A few days later, “A” died. The heirs of “A”, in a Deed of Extra-Judicial Partition, adjudicated his shares of stock to his son “C”.

**In the meantime, “X Corporation” declared cash dividends and sent the corresponding notice to “A’s” address; “A”, being the registered owner of the shares of stock in the books of the corporation.**

**“C” received the notice and by virtue of the aforestated deed of partition claimed payment of the dividend. “B” likewise claimed payment asserting ownership of the shares by virtue of the assignment made by “A”.**

**Who has the better right? Explain briefly.**

**Answer:**

“C” has a better right. A transferee cannot maintain an action for a dividend not until the shares are transferred in his name in the books of the corporation. The corporation is not bound to look beyond its books to determine who is entitled to dividends, but may safely pay them to the registered shareholders. (BAR 1981)

- 2. Mr. Cruz purchased from Mr. Guzman shares of stock of a mining corporation, which shares were covered by several certificates indorsed in blank by Mr. Virgilio Malic in whose name the same were registered in the books of the corporation. It was later discovered that the said shares had never been sold or otherwise disposed of by Mr. Virgilio Malic, but had been stolen from where they were kept.**

**Who is entitled to said shares, Mr. Cruz or Mr. Malic? Reason.**

**Answer:**

Mr. Malic is entitled to said shares. According to the Corporation Code, no transfer of the shares of stock shall be valid, except as between the parties, until the transfer is recorded in the books of the corporation. No such entry in the name of Mr. Cruz having been made, it follows that the transfer allegedly effected by Mr. Guzman to Mr. Cruz, is valid between themselves, but it does not bind Mr. Malic, who is not a party to said alleged transaction. In other words, the same is absolutely void, insofar as Mr. Malic is concerned. (*Sec. 63, Corporation Code; De Los Santos v. McGrath, L-4818, Feb. 28, 1955*) (BAR 1982)

- 3. Arnold has in his name 1,000 shares of the capital stock of ABC Corporation as evidenced by a stock certificate. Arnold delivered the stock certificate to Steven who now claims to be the real owner of the shares, having paid for Arnold’s subscription. ABC refused to recognize and register Steven’s ownership.**

**Is the refusal justified? Explain.**

**Answer:**

ABC’s refusal to recognize and register Steven’s ownership is justified. The facts indicate that the stock certificate for the 1,000 shares in question is in the name of Arnold. Although the certificate was delivered to Steven or that the procedure for the effective transfer of shares of stock set out in the by-laws of ABC Corporation, if any, was observed. Since the certificate was not endorsed in favor of Steven (or anybody else for that matter), the only conclusion could be no other than that the shares in question still belong to Arnold. (BAR 1996)

- 4. “A” is the registered owner of Stock Certificate No. 000011. He entrusted the possession of said certificate to his best friend “B” who borrowed the said endorsed certificate to support B’s application for passport (or for a purpose other than transfer). But “B” sold the certificate to “X”, a bona fide purchaser who relied on the endorsed certificates and believed him to be the owner thereof.**

**c) Can “A” claim the shares of stocks from “X”? Explain.**

**Answer:**

- c) No. Assuming that the shares were already transferred to “B”. “A” cannot claim the shares of stock from “X” the certificate of stock covering said shares have been duly endorsed by “A” and entrusted by him to “B”. by his said acts “A” is now estopped from claiming said shares from “X”, a bona fide purchaser who relied on the endorsement by “A” of the certificate of stock. (BAR 2001)

5. Four months before his death, PX assigned 100 shares of stock registered in his name in favor of his wife and his children. They then brought the deed of assignment to the proper corporate officers for registration with the request for the transfer in the corporation's stock and transfer books of the assigned shares, the cancellation of the stock certificates in PX's name, and the issuance of new stock certificates in the names of his wife and his children as the new owners. The officers of the Corporation denied the request on the ground that another heir is contesting the validity of the deed of assignment.

May the Corporation be compelled by mandamus to register the shares of stock in the names of the assignees? Explain briefly.

**Answer:**

Yes. The corporation may be compelled by mandamus to register the shares of stock in the name of the assignee. The only legal limitation imposed by Section 63 of the Corporation Code is when the Corporation holds any unpaid claim against the shares intended to be transferred. The alleged claim of another heir of PX is not sufficient to deny the issuance of new certificates of stock to his wife and children. It would be otherwise if the transferee's title to the shares has no prima facie validity or is uncertain. (BAR 2004)

1. Claude, the registered stockholder of 1,000 shares in ABC Corp., pledged the shares to Conrad by endorsement in blank of the covering stock certificates and, execution of a Deed of Assignment of Shares of Stock, intended as collateral for a loan of P1 M that was also supported by a separate promissory note.

1.1. Under these facts, is there a valid pledge of the shares of stock to Conrad?

- a) No, because shares of stocks are intangible personal properties whose possession cannot be delivered and, hence, cannot be the subject of a pledge;
- b) No, because the pledge of shares of stock requires double registration with the Register of Deeds of the principal place of business of the corporation and of the residence of the pledgor;
- c) Yes, because endorsement and delivery of the certificates of stock is equivalent to the transfer of possession of the covered shares to the pledge.
- d) Yes, because the execution of the Deed of Assignment of Shares of Stock is equivalent to a lawful pledge of the shares of stock.

**Answer:**

d) Yes, because the execution of the Deed of Assignment of Shares of Stock is equivalent to a lawful pledge of the shares of stock. (BAR 2013)

1.2. After Claude defaulted on the loan, Conrad sought to have the shares registered in his name in the books of the corporation. If you are the Corporate Secretary of ABC Corporation, would you register the shares in the name of Conrad without any written instruction from Claude?

- a) Yes, since the endorsement and delivery of the certificates of stock executed by Claude constitute the legal authority to cancel the shares in his name and to place them in Conrad's name;
- b) Yes, since the execution of the Deed of Assignment by Claude would constitute the legal authority to cancel the shares in his name and place them in Conrad's name;
- c) No, because corporate officers can only take direct instructions from the registered owners on the proper disposition of shares registered in their names;
- d) No, because the corporation has a primary lien on the shares covering the unpaid subscription.

**Answer:**

None of the answers is correct. The pledge must be foreclosed. Conrad cannot just appropriate the shares of stock. (BAR 2013)

### g. Involuntary Dealings with Shares

#### L. Dissolution and Liquidation

- 1. The SEC approved the amendment of the articles of incorporation of GHQ Corporation shortening its corporate life to only 25 years in accordance with Section 120 of the Corporation Code. As shortened, the corporation continued its business operations until May 30, 1997, the last day of its corporate existence. Prior to said date, there were a number of pending civil actions, of varying nature but mostly money claims filed by creditors, none of which was expected to be completed or resolved within 5 years from May 30, 1997.**

**If the creditors had sought your professional help at that time about whether or not their cases could be pursued beyond May 30, 1997, what would have been your advice?**

**Answer:**

The cases can be pursued even beyond May 30, 1997, the last day of the corporate existence of GHQ Corporation. The Corporation is not actually dissolved upon the expiration of its corporate term. There is still the period for liquidation or winding up. (BAR 2000)

- 2. AAA Corporation is a bank. The operations of AAA Corporation as a bank were not doing well. So, to avert any bank run, AAA Corporation, with the approval of the Monetary Board, sold all its assets and liabilities to BBB Banking Corporation which includes all deposits accounts. In effect then, BBB Corporation will service all deposits of AAA Corporation.**
  - a) Will the sale of all assets and liabilities of AAA Corporation to BBB Banking Corporation automatically dissolve or terminate the corporate existence of AAA Corporation? Explain your answer.**
  - b) What are the legal requirements in order that a corporation may be dissolved?**

**Answer:**

- a) No, the sale of all the assets and liabilities of AAA Corporation to BBB Banking Corporation will not result in the automatic dissolution or termination of the existence of the former. A decision to dissolve AAA Corporation or to terminate its corporate existence would require a separate approval by a majority of the Board of Directors of AAA Corporation and its stockholders holding at least 2/3 of the total outstanding capital stock, as well as the separate approval by the Monetary Board.
- b) A corporation may be dissolved voluntarily under Section 118 (where no creditors are affected) or under Section 119 (where creditors are affected) or by shortening of the corporate term under Section 120, or involuntarily by the SEC under Section 122, all of the Corporation Code. Dissolution under Sections 118, 119, and 120 require the same corporate approvals stated in (a) above.

The SEC has the authority under Section 6 of PD 902-A to revoke the certificate of registration of a corporation upon any grounds provided by law, including the aforementioned Section 6-A. (BAR 2012)

### 1. Modes of Dissolution

**1. Name 3 methods by which a stock corporation may be voluntarily dissolved. Explain each method.**

**Answer:**

The 3 methods by which a stock corporation may be voluntarily dissolved are:

- a. Voluntary dissolution where no creditors are affected. This is done by a majority vote of the directors, and resolution of at least 2/3 vote of stockholders, submitted to the SEC.
- b. Voluntary dissolution where creditors are affected. This is done by a petition for dissolution which must be filed with the SEC, signed by a majority of the members of the board of directors, verified by the president or secretary, and upon affirmative vote of stockholders representing at least 2/3 of the outstanding capital stock.
- c. Dissolution by shortening of the corporate term. This is done by amendment of the articles of incorporation. (BAR 2002)

**a. Voluntary**

- i. Where No Creditors Are Affected
- ii. Where Creditors Are Affected
- iii. By Shortening of Corporate Term

**b. Involuntary**

- i. By Expiration of Corporate Term

- 1. XYZ Corporation entered into a contract of lease with ABC, Inc., over a piece of real estate for a term of 20 years, renewable for another 20 years, provided that XYZ's corporate term is extended in accordance with law. Four years after the term of XYZ Corporation expired, but still within the period allowed by the lease contract for the extension of the lease period, XYZ Corp. notified ABC Inc., that it is exercising the option to extend the lease. ABC Inc. objected to the proposed extension, arguing that since the corporate life of XYZ Corp. had expired, it could no longer opt to renew the lease. XYZ Corp. countered that withstanding the lapse of its corporate term it still has the right to renew the lease because no *quo warranto* proceedings for involuntary dissolution of XYZ Corp. has been instituted by the Office of the Solicitor General.**

**Is the contention of XYZ Corp. meritorious? Explain briefly.**

**Answer:**

XYZ Corporation's contention is not meritorious. Based on the ruling of the Supreme Court in *Philippine National Bank v. CFI of Rizal*, 209 SCRA (1992). XYZ Corp. was dissolved ipso facto upon the expiration of its original term. It ceased to be a body corporate for the purpose of continuing the business for which it was organized, except only for purposes connected with its winding up or liquidation. Extending the lease is not an act to wind up or liquidate XYZ Corp.'s affairs. It is contrary to the idea of winding up the affairs of the corporation. (BAR 2004)

- 2. The term of GGG Corporation in accordance with its Articles of Incorporation ended last January 30, 2012. The term was not extended. What will happen to the corporation?**

- a) The corporation is dissolved ipso facto;
- b) There is a need to pass a board resolution to formally dissolve the corporation;
- c) The Board of Directors must pass a resolution for the corporation to formally go into liquidation;
- d) The stockholders must pass a resolution to dissolve the corporation.

**Answer:**

a) The corporation is dissolved ipso facto. (BAR 2012)

ii. **Failure to Organize and Commence Business Within 2 Years from Incorporation**

1. **In the articles of incorporation of T Corporation, 11 members were named to constitute the board of directors. These 11 elected from among themselves a secretary-treasurer but did not elect a president. The board used to hold meetings to transact business which was done through the secretary-treasurer. In a proceeding to forfeit its charter, the question was posed as to whether the corporation may be considered to have formally organized. Resolve the question.**

**Answer:**

Yes, the T Corporation may be considered to have formally organized. It appearing that the corporation, from the very day of its formation, had its governing board, which directed its affairs, as well as a treasurer and clerk, and that, through these instrumentalities, it actually functioned and engaged in the business for which it was organized, said corporation cannot be held to have forfeited its charter simply because it has no president. (*Perez v. Balamaceda*, 40 Off. Gaz., 5<sup>th</sup>, Suppl. 196) (BAR 1979)

iii. **Legislative Dissolution**

iv. **Dissolution by the SEC on Grounds under Existing Laws**

2. **Methods of Liquidation**

a. **By the Corporation Itself**

1. **“X” Corporation shortened its corporate life by amending its articles of incorporation. It has no debts but owns a prime property located in Quezon City. How would the said property be liquidated among the five stockholders of said corporation? Discuss two methods of liquidation**

**Answer:**

The prime property of “X” Corporation can be liquidated among the five stockholders after the property has been conveyed by the corporation to the five stockholders, by dividing or partitioning it among themselves in any two of the following ways:

1. By physical division or partition based on the proportion of the values of their stockholdings; or
2. Selling the property to a third person and dividing the proceeds among the five stockholders in proportion to their stockholdings; or
3. After the determination of the value of the property, by assigning or transferring the property to one stockholder with the obligation on the part of said stockholder to pay the other four stockholders the amount/s in proportion to the value of the stockholding of each. (BAR 2001)

b. **Conveyance to a Trustee within a Three-Year Period**

c. **By Management Committee or Rehabilitation Receiver**

d. **Liquidation after Three Years**

1. On February 15, 1970, “Acme Corporation” filed a complaint for collection against “D”. While the case was pending, “Acme Corporation” amended its Articles of Incorporation to shorten its term of existence up to December 31, 1970. The SEC approved the amendment.

The Trial Court, however, was not notified thereof, so that proceedings therein continued until May 5, 1974, when “D” learning of the dissolution, questioned the personality of the corporation to continue prosecuting the case. “D” alleged that since the corporation had already been dissolved but had not taken steps to wind up its affairs and transfer its assets to a trustee or assignee within the 3-year period as provided under Secs. 77 and 78 of the Corporation Law (now Sec. 122 of the Corporation Code), it had ceased to exist for all purposes.

**Decide the case, with reasons.**

**Answer:**

“D’s” allegation is untenable. Where a corporation was dissolved during the pendency of an action in court and the 3 years passed already after said dissolution, having no trustee appointed according to law (Sec. 122, Corporation Code), its counsel who prosecuted and represented the interest of the corporation may be considered a trustee of said corporation may be considered a trustee of said corporation, at least to the matter in litigation, to continue the said litigation. (*Gelano v. Court of Appeals, L-39050, Feb. 24, 1981*) (BAR 1981)

2. The corporation, once dissolved, thereafter continues to be a body corporate for 3 years for purposes of prosecuting and defending suits by and against it and of enabling it to settle and close its affairs, culminating in the final disposition and distribution of its remaining assets. If the 3-year extended life expires without a trustee or receiver being designated by the corporation within that period and by that time (expiry of the 3-year extended term), the corporate liquidation is not yet over, how, if at all, can a final settlement of the corporate affairs be made?

**Answer:**

The liquidation can continue with the winding up. The members of the Board of Directors can continue with the winding of the corporate affairs until final liquidation. They can act as trustees or receivers for this purpose. (BAR 1997)

## **M. Other Corporations**

### **1. Close Corporations**

#### **a. Characteristics of a Close Corporation**

1. Ten classmates, all graduates of Class '78 of the Los Banos School of Agriculture and Husbandry, decided to form “Gatas Atbp., Inc.”, the principal purpose of which is to produce, package, and sell carabao’s milk. The Articles of Incorporation provided, among others, that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors and restricts the transfer of shares to outsiders.

One of the ten classmates, Mr. Sakit-ulo, disgruntles at the way the affairs of the corporation was being handled, demanded that all the ten stockholders meet to elect directors, citing Section 50 of the Corporation Code. Meanwhile, Sakit-tiyan, sued all the ten classmates-stock-holders for damages for violation of the Food, Drugs Cosmetics Act- a cockroach was found in the milk she drank, the package bearing the inscription “produced, packaged and sold by Gatas Atbp., Inc.”

- a) Can Mr. Sakit-ulo demand that a stockholders meeting be called to elect directors of the corporation?
- b) Does Ms. Sakit-tiyan have a cause of action against all the ten classmates-stockholders, albeit no negligence has been proven?

**Answer:**

- a) "Gatas Atbp, Inc." is a close corporation, and its Articles of Incorporation can, as it did, provide that the business of the corporation be managed by the stockholders rather than by a board of directors. The presence of this provision in the Articles of Incorporation, precludes Sakit-ulo from demanding that the stockholders meet in order to elect directors of the company.
- b) Ms. Sakit-tiyan has a cause of action against the stockholders who, under the law, are deemed to be directors and subject to liabilities as such. Said stockholders are made personally liable for corporate torts unless the corporation has obtained reasonably adequate liability insurance. Negligence need not be proven to warrant liability by manufacturers of foodstuffs for death or injury caused by any obnoxious or harmful substance used. (BAR 1988)

- b. Validity of Restrictions on Transfer of Shares
- c. Issuance or Transfer of Stock in Breach of Qualifying Conditions

1. Rafael inherited from his uncle 10,000 shares of Sta. Ana Corporation, a close corporation. The shares have a par value of P10.00 per share. Rafael notified Sta. Ana that he was selling his shares at P70 per share. There being no takers among the stockholders, Rafael sold the same to his cousin Vicente (who is not a stockholder) for P700,000.

The Corporate Secretary refused to transfer the shares in Vicente's name in the corporate books because Alberto, one of the stockholders, opposed the transfer on the ground that the same violated the by-laws. Alberto offered to buy the shares at P12.50 per share, as fixed by the by-laws or a total price of P125,000 only.

While the by-laws of Sta. Ana provides that the right of first refusal can be exercised "at a price not exceeding 25% more than the par value of such shares, the Articles of Incorporation simply provides that the stockholders of record" shall have preferential right to purchase the said shares." It is silent as to pricing.

**Answer:**

Yes. In a close corporation, the restriction as to the transfer of shares has to be stated/ annotated in the Articles of Incorporation, the By-Laws and the certificate of stock. This serves as notice to the person dealing with such shares like Rafael in this case. With such notice, he is bound by the pricing in the By-Laws. (BAR 1994)

- d. When Board Meeting is Unnecessary or Improperly Held
- e. Pre-Emptive Right
- f. Amendment of Articles of Incorporation
- g. Deadlocks

1. Robert, Rey and Ben executed a joint venture agreement to form a close corporation under the Corporation Code the outstanding capital stock of which the 3 of them would equally own. They also provided therein that any corporate act would need the vote of 70% of the outstanding capital stock. The terms of the agreement were accordingly implemented and the corresponding close corporation was incorporated. After 3 years, Robert, Rey and Ben could not agree on the business in which to invest the funds of the corporation. Robert wants the deadlock broken.

1. What are the remedies available to Robert under the Corporation Code to break the deadlock? Explain.
2. Are there any remedies to prevent the paralyzation of the business available to Robert under PD 902-A while the petition to break the deadlock is pending litigation? Explain.

**Answer:**

1. Robert can petition the SEC to arbitrate the dispute, with such powers as provided in the Corporation Code.
2. The SEC can appoint a rehabilitation receiver or a management committee. (BAR 1995)

## 2. Non-Stock Corporations

1. The number of the Board of Trustees of a non-stock, non-profit education institution be—
  - a) 5 only;
  - b) Any number for as long as it is not less than 5 and no more than 11;
  - c) Any number in multiples of 5, for as long as it is not less than 5 and no more than 15;
  - d) Not less than 5 nor more than 10 in multiples of 5.

**Answer:**

- c) Any number in multiples of 5, for as long as it is not less than 5 and no more than 15. (BAR 2012)

- a. Definition
- b. Purposes
- c. Treatment of Profits

1. The AB Memorial Foundation, Inc. was incorporated as a non-profit, non-stock corporation in order to establish and maintain a library and museum in honor of the deceased parents of the incorporators. Its Articles of Incorporation provide for a board of trustees composed of the 5 incorporators, which is authorized to admit new members. The Articles of Incorporation also allow the Foundation to receive donations from members. As of January 30, 1993, 60 members had been admitted by the board of trustees.
  1. Can the Foundation use the funds donated to it by its members for the purchase of food and medicine for distribution to the victims of the Pinatubo eruption?
  2. Can the Foundation operate a specialty restaurant that caters to the general public in order to augment its funds?

**Answer:**

1. Yes, Sec. 36 (9) of the Corporation Code provides that as long as the amount of donation is reasonable.

2. If the purposes of the corporation are limited to the establishment and maintenance of the library and museum as stated in the problem, the foundation cannot operate a specialty restaurant that caters to the general public. In such case, the action of the foundation will be ultra vires. (BAR 1993)

2. **“X” company is a stock corporation composed of the Reyes family engaged in real estate business. Because of the regional crisis, the stockholders decided to convert their stock corporation into a charitable non-stock and non-profit association by amending the articles of incorporation.**

c) **Could this be legally done? Why?**

d) **Would your answer be the same if at the inception, “X” company is a non-stock corporation? Why?**

**Answer:**

c) Yes, it can be legally done. In converting the stock corporation to a non-stock corporation by a mere amendment of the Articles of Incorporation, the stock corporation is not distributing any of its assets to the stockholders. On the contrary, the stockholders are deemed to have waived their right to share in the profits of the corporation which is a gain not a loss to the corporation.

d) No, my answer will not be the same. In a non-stock corporation, the members are not entitled to share in the profits of the corporation because all present and future profits belong to the corporation. In converting the non-stock corporation to a stock corporation by a mere amendment of the Articles of Incorporation, the non-stock corporation is deemed to have distributed an asset of the corporation—i.e. its profits, among its members, without a prior dissolution of the corporation. Under Section 122, the non-stock corporation must be dissolved first. (BAR 2001)

#### d. Distribution of Assets upon Dissolution

### 3. Religious Corporations – Exclude

1. **Petitioner is a corporation sole organized and existing in accordance with Philippine Laws, with Msgr. Trudeau, in a Canadian citizen, as actual incumbent. It presented for registration a deed of sale to the Register of Deeds of Cebu who denied it for lack of proof that at least 60% of the capital, property or assets of the corporation sole is owned or controlled by Filipino citizens.**

**Was the action of the Register of Deeds correct? Give reasons for your answer?**

**Answer:**

No. the action of the Register of Deeds was not correct. The requirement of at least 60% of Filipino capital was never intended to apply to corporations sole, because:

(1) Corporation sole is composed of only person;

(2) The corporation sole is only the administrator and not the owner of the temporalities;

(3) Said temporalities belong to the faithful; and

(4) Corporation sole has no nationality. (*Roman Catholic Apostolic Adm. Of Davao, Inc. v. Land Reg. Co.*, G.R. L-8451, December 20, 1957) (BAR 1978)

2. **What is a corporation sole?**

**Answer:**

Section 10 of the Corporation Code defines a “corporation sole” as one formed for the purpose of administering and managing, as trustee, the affairs, property and temporalities of any religious denomination, sect or church.

It is formed by the chief archbishop, bishop, priest, minister, rabbi or other presiding elder of such religious denomination, sect or church. (BAR 2004)

3. **Father X, an American priest who came from New York, registered the Diocese of Bacolod of the Roman Catholic Church which was incorporated as a corporation sole. There were years when the head of the Diocese was a Filipino, but there were more years when the heads were foreigners. Today, the head is an American again. Y donated a piece of land located in Bacolod City for use as a school. Which statement is most accurate?**
- a) **The Register of Deed of Bacolod City can refuse to register and transfer the title because the present head of the corporation sole is not a Filipino;**
  - b) **The nationality of a corporation sole depends upon the nationality of the head at any given time;**
  - c) **A corporation sole, regardless of the nationality of the head, can acquire real property either by sale or donation;**
  - d) **A corporation sole is not legally allowed to own real property.**

**Answer:**

c) A corporation sole, regardless of the nationality of the head, can acquire real property either by sale or donation. (BAR 2012)

#### 4. Foreign Corporations

##### a. Bases of Authority over Foreign Corporations

- i. Consent
- ii. Doctrine of “Doing Business” (related to definition under the Foreign Investments Act, R.A. No. 7042)

#### 1. When is a foreign corporation deemed to be “doing business in the Philippines?”

**Answer:**

A foreign corporation is deemed to be “doing business in the Philippines” if it is continuing the body or substance of the business or enterprise for which it was organized.

It is the intention of an entity to continue the body of its business in the country. The grant and extension of 90-day credit terms by a foreign corporation to a domestic corporation for every purchase shows an intention to continue transacting with the latter (BAR 1998)

#### 2. A. What is the legal test for determining if an unlicensed foreign corporation is doing business in the Philippines?

**B. Give at least 3 examples of the acts or activities that are specifically identified under our foreign investment laws as constituting “doing business” in the Philippines.**

**Answer:**

- A. The test is whether or not the unlicensed foreign corporation has performed an act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of, commercial gain or of the purpose and object of the business organization.

B. Any three of the following acts or activities constitute “doing business” in the Philippines under our foreign investment laws:

1. Soliciting orders
2. Opening offices by whatever name
3. Participating in the management, supervision or control of any domestic entity
4. Entering into service contracts
5. Appointing representatives or distributor, operating under the control of the foreign entity, who is domiciled in the Philippines or who stays in the country for a period totaling at least 180 days in any calendar year. (BAR 2002)

3. **Equity Online Corporation (EOL), a New York corporation, has a securities brokerage service on the Internet after obtaining all requisite U.S. licenses and permits to do so. EOL’s website ([www.eonline.com](http://www.eonline.com)), which is hosted by a server in Florida, enables Internet users to trade on-line in securities listed in the various stock exchanges in the U.S. EOL buys and sells U.S.-listed securities for the accounts of its clients all over the world, who convey their buy and sell instructions to EOL through the Internet. EOL has no offices, employees or representatives outside the U.S. The website has icons for many countries, including an icon “For Filipino Traders” containing the day’s prices of U.S.—listed securities expressed in U.S. dollars and in their Philippine peso equivalent. Grace Gonzales, a resident of Makati, is a regular customer of the website and has been purchasing and selling securities through EOL with the use of her American Express credit card. Grace has never traveled outside the Philippines. After a series of erroneous stock picks, she had incurred a net indebtedness of US\$30,000 with EOL, at which time she cancelled her American Express credit card. After a number of demand letters sent to Grace, all of them unanswered, EOL, through a Makati law firm, filed a complaint for collection against Grace with the RTC of Makati. Grace, through her lawyer, filed a motion to dismiss on the ground that EOL (a) was doing business in the Philippines without a license and was therefore barred from bringing suit and (b) violated the SRC by selling or offering to sell securities within the Philippine SEC and thus came to court “with unclean hands”. EOL opposed the motion to dismiss, contending that it had never established a physical presence in the Philippines, and that all of the activities related to plaintiffs trading in U.S. securities all transpired outside the Philippines. If you are the judge, decide the motion to dismiss by ruling on the respective contentions of the parties on the basis of the facts presented above.**

Answer:

- 1) The grounds of the motion to dismiss are both untenable. EOL is not doing business in the Philippines, and it did not violate the Securities Act, because it was not selling securities in the country.
- 2) The contention of EOL is correct, because it never did any business in the Philippines. All its transactions in question were consummated outside the Philippines (BAR 2002)

4. **Gawsensit Corp. is a corporation incorporated in Singapore. It invested in Bumblebee Corp., a Philippine corporation, by acquiring 30% of its shares. As a result, Gawsensit Corp. nominated 30% of the directors of the Bumblebee Corp., all of whom are Singaporeans and officers of Gawsensit Corp.**

**Choose the correct statement relating to Gawsensit Corp.**

- a) **Gawsensit Corp. is doing business in the Philippines and requires a license from the SEC;**
- b) **Gawsensit Corp. is not doing business in the Philippines by its mere investment in a Philippine corporation and does not need a license from the SEC;**
- c) **Gawsensit Corp. has to appoint a resident agent in the Philippines;**
- d) **Gawsensit Corp. cannot elect directors in Bumblebee Corp.;**
- e) **All of the above choices are incorrect.**

Answer:

b) Gawsensit Corp. is not doing business in the Philippines by its mere investment in a Philippine corporation and does not need a license from the SEC. (BAR 2013)

**b. Necessity of a License to Do Business**

**i. Requisites for Issuance of a License**

**ii. Resident Agent**

1. AAA Corporation is a foreign corporation that wants to operate a representative office in the Philippines. As required by the Corporation Code, there is a need to appoint a Resident Agent as a condition precedent to the issuance of a license to transact business in the Philippines. After 2 years, AAA Corporation removed its Resident Agent and did not appoint anyone anymore. Which statement is the most accurate?

- a) This can be a ground for revocation or suspension of its license to do business;
- b) There is no more effect in the license because anyway at the time of registration, a resident agent was appointed;
- c) This can be a ground for suspension only;
- d) This will result in automatic revocation of its license to do business in the Philippines.

**Answer:**

a) This can be a ground for revocation or suspension of its license to do business. (BAR 2012)

**c. Personality to Sue**

1. "G" Corporation, organized under Philippine laws is the owner of the trademark "Jumbo" under Registry No. 50025 issued on February 15, 1979 by the Philippine Patent Office, for assorted kitchen ware. On June 10, 1980, the Jumbo Cookware Corporation, organized and existing under the U.S. laws, filed a petition with the Philippine Patent Office for the cancellation of the trademark "Jumbo" registered in the name of "G" Corporation alleging ownership and prior use in the Philippines since 1949 of said trademark on the same kind of goods, which use it had not abandoned.

"G" Corporation moved to dismiss the petition alleging that the Jumbo Cookware Corporation, being foreign entity, which is not licensed to do and is not doing business in the Philippines has no personality under the Philippine laws to maintain such petition.

**Is "G's" contention meritorious?**

**Who is entitled to the use of the trademark "Jumbo"?**

**Explain each of your answers.**

**Answer:**

"G's" contention is not meritorious. *First alternative reason*—A foreign corporation is not transacting business in the Philippines may sue in the Philippines (*Pacific Vegetable Oil Corp. v. Singzon, Apr. 29, 1965*); thus, it is well settled that if a foreign corporation is not engaged in business in the Philippines, it may not be denied the right to file an action in the Philippine Courts (*Aetna Casualty & Surety Co. v. Pacific Star Line, Dec. 29, 1977; 80 SCRA 635*). Since Jumbo Cookware Corporation is not transacting business in the Philippines but merely exporting its goods to the Philippines; therefore, its trademark shall be protected also in the Philippines. (*Western Equipment & Supply Co. v. Reyes, 51 Phil 115*).

*Second alternative reason*—Under the Trademark Law, a foreign corporation may bring an action for unfair competition in the Philippines, whether or not it has been licensed to do business in the Philippines, provided that the country of which the said foreign corporation is a citizen or in which it is domiciled, by treaty or law grants a similar privilege to corporation of the Philippines; and this is granted in the “Convention of Paris” and by law in the United States of America. (*Converse Rubber Corp. v. Jacinto Rubber and Plastics Co. Inc.*, April 28, 1980; 97 SCRA 158)

Jumbo Cookware Corporation of U.S.A. is entitled to use of the trademark “Jumbo” for being the first user of said trademark in the Philippines. (*Asri Yoko Co., Ltd., v. Kee Boc*, Jan. 20, 1961; 1 SCRA 1). Also, it is well settled that one may be declared unfair competitor even if his competing mark is registered. (*Parke, Davis & Co. v. Kiu Foo & Co.*, 60 Phil. 928) (BAR 1981)

2. **In 1979, Smash Manufacturing Company, a foreign corporation registered in New York, but not doing business in the Philippines, filed a complaint for unfair competition against Nilo Malakas. The plaintiff alleged that since 1939, it had been exporting tennis rackets under the trademark “Smash Mfg. Co.”, and that after the trademark and tradename became familiar to Filipino consumers, defendant Malakas began manufacturing similar products under the same trademark and tradename which he registered with the Philippine Patent Office. Actually, after 1948, Smash Tennis rackets produced by the foreign corporation were no longer imported in the Philippines.**

**The complaint failed to allege that its trademark or tradename has been registered with the Philippine Patents Office or that the State of New York grants Philippine corporations the privilege to bring an action for unfair competition in that State. Claiming that these are conditions *sine qua non* before a foreign corporation may file suit in the Philippines, defendant Malakas filed a motion to dismiss the complaint.**

- a) **How would you decide the motion to dismiss? State your reasons.**

**Answer:**

- a) The motion of Malakas to dismiss the complaint of Smash Manufacturing Company shall be sustained. A foreign corporation may bring an action for infringement or unfair competition, provided as conditions *sine qua non* that the trademark or tradename of the suing foreign corporation be registered in the Philippine Patent Office or, in the least, that it be an assignee of such registered trademark or tradename, and that the country of which the plaintiff foreign corporation is a citizen or domicillary, grants to Filipino corporation the same reciprocal treatment, either thru treaty, convention or law. But said conditions *sine qua non* were not even stated in the complaint of the plaintiff. (BA 1982)
3. **Prince Manufacturing Co., Inc. filed a complaint for unfair competition under section 21-A of R.A. 166 against Prince Industries, Inc. the complaint substantially alleges that plaintiff is a foreign corporation organized under the laws of California, USA., with offices in San Francisco; that defendant Prince Industries, Inc. is a corporation organized under the laws of the Philippines with principal office at Sucat Road, Paranaque, Metro Manila; that plaintiff, founded in 1920 by Iver Prince, is the largest manufacturer of ball bearings with the trademark “Prince” and the tradename “Prince Manufacturing Co., Inc.” had been exported to the Philippines since 1960; that due to the superior quality and widespread use of its products by the public, the same are well known to Filipino consumers under the tradename “Prince Manufacturing Industries, Inc.” and trademark “Prince”; that long after the commencement of the use of plaintiff’s trademark and tradename in the Philippines, defendant began manufacturing and selling ball bearings under the trademark “Prince” and tradename “Prince Industries, Co.”; that defendant has registered with the Philippine Patent Office the trademark “Prince”, which registration is contrary to Sec. 4 of RA 166, as amended, and violative of plaintiff’s right to the trademark “Prince”; that the defendant not only uses the trademark “Prince” but likewise has copied the design used by plaintiff in distinguishing its trademark; and that the use thereof by defendant on its**

**products would cause confusion in the minds of the consumers and likely deceive them as to the source or origin of the goods, thereby enabling the defendant to pass off their products as those of plaintiff.**

**Invoking the provisions of Sec. 21 A of RA 166, as amended, plaintiff prayed for damages. It also sought the issuance of a writ of injunction to prohibit defendants from using the tradename "Prince Industries Co." and the trademark "Prince".**

- a) If you were the counsel for the defendant Prince Industries Co., what grounds would you invoke to have the complaint dismissed?**

**Answer:**

- a) Defendant should file a motion to dismiss for failure to state a cause of action, drawing attention to plaintiff's failure to allege in the complaint its capacity to sue.

Plaintiff cannot sue under Section 21-A of RA 166 because it has not complied with the requirement that (1) its trademark has been registered with the Patent Office or in the least, that plaintiff is the assignee of such registered trademark and (2) that the country of which the foreign corporation is a citizen or domiciliary grants to Filipino corporations the same reciprocal treatment, either thru treaty, convention, or law, to bring an action for unfair competition.

The mere allegation by the plaintiff that it is a foreign corporation is not sufficient. Such bare averment not only fails to comply with Section 21-A but violates as well the directive of Section 4, Rule 8 of the Rules of Court that "facts showing the capacity of a party to sue and be sued in a representative capacity or the legal existence of an organized association of persons that is made a party, must be averred." (*Levitan Industries v. Salvador*, 114 SCRA 420 [1982]) (BAR 1984)

- 5. Okura International, Ltd. (OIL), a Japanese company, obtained a license from the SEC to set up a regional headquarters in the Philippines. OIL has a substantial investment in a Philippine joint venture company, JAPIL, Inc., which OIL manages under an existing management contract. In fact, the Manager of OIL's regional office in Manila doubles as the General Manager of JAPIL. Because of an intracorporate dispute in JAPIL, OIL filed suit before the Philippine SEC against its fellow stockholders in JAPIL.**

**Will such suit prosper? Reasons.**

**Answer:**

The suit will not prosper. Under R.A. 5455, OIL would be prohibited from entering into a management contract without having the license therefore. The license that OIL had obtained from the SEC was merely for setting up regional headquarters in the Philippines. Without an appropriate license, a foreign corporation engaged in business in the Philippines cannot sue judicially or administratively. (BAR 1987)

#### **d. Suability of Foreign Corporations**

- 1. After disposing of his last opponent in only two rounds in Las Vegas, the renowned boxer Sonny Bachao arrived at the NAIA met by thousands of hero-worshipping fans and hundreds of media photographers. The following day, a colored photograph of Sonny wearing a black polo short embroidered with the 2-inch Lacoste crocodile logo appeared on the front page of every Philippine newspaper.**

**Lacoste International, the French firm that manufactures Lacoste apparel and owns the Lacoste trademark, decided to cash in on the universal popularity of the boxing icon. It reprinted the photographs, with the permission of the newspaper publishers, and went on a world-wide blitz of print commercials in which Sonny is shown wearing a Lacoste shirt alongside the phrase "Sonny Bachao just loves Lacoste".**

**When Sonny sees the Lacoste advertisements, he hires you as a lawyer and asks you to sue Lacoste International before a Philippine court:**

- a) XXX
- b) XXX
- c) XXX
- d) **Can Lacoste International validly invoke the defense that it is not a Philippine company and, therefore, Philippine courts have no jurisdiction? Explain.**

**Answer:**

No. Philippine courts have jurisdiction over it, if it is doing business in the Philippines. Moreover, under Section 133 of the Corporation Code, while a foreign corporation doing business in the Philippines without license to do business, cannot sue or intervene in any action, it may be sued or proceeded against before our courts or administrative tribunal. (BAR 2009)

2. **South China Airlines is a foreign airline company. South China Airlines tickets are sold in the Philippines though PAL as their general agent. South China Airlines is not registered to do business as such with the Philippine SEC. which statement is most accurate?**
- a) **Although unlicensed to do business in the Philippines, South China Airlines can sue before the Philippine Courts and can also be sued;**
  - b) **South China Airlines can sue but cannot be sued;**
  - c) **South China Airlines cannot sue and cannot be sued also;**
  - d) **South China Airlines can be sued in the Philippine Courts but it cannot sue.**

**Answer:**

d) South China Airlines can be sued in the Philippine Courts but it cannot sue. (BAR 2012)

#### **e. Instances When Unlicensed Foreign Corporations May Be Allowed to Sue Isolated Transactions**

1. **“G” Corporation, organized under Philippine laws is the owner of the trademark “Jumbo” under Registry No. 50025 issued on February 15, 1979 by the Philippine Patent Office, for assorted kitchen ware. On June 10, 1980, the Jumbo Cookware Corporation, organized and existing under the U.S. laws, filed a petition with the Philippine Patent Office for the cancellation of the trademark “Jumbo” registered in the name of “G” Corporation alleging ownership and prior use in the Philippines since 1949 of said trademark on the same kind of goods, which use it had not abandoned.**

**“G” Corporation moved to dismiss the petition alleging that the Jumbo Cookware Corporation, being foreign entity, which is not licensed to do and is not doing business in the Philippines has no personality under the Philippine laws to maintain such petition.**

- a) **Is “G’s” contention meritorious?**

**Answer:**

“G’s” contention is not meritorious. *First alternative reason*—A foreign corporation is not transacting business in the Philippines may sue in the Philippines (*Pacific Vegetable Oil Corp. v. Singzon, Apr. 29, 1965*); thus, it is well settled that if a foreign corporation is not engaged in business in the Philippines, it may not be denied the right to file an action in the Philippine Courts (*Aetna Casualty & Surety Co. v. Pacific Star Line, Dec. 29, 1977; 80*

SCRA 635). Since Jumbo Cookware Corporation is not transacting business in the Philippines but merely exporting its goods to the Philippines; therefore, its trademark shall be protected also in the Philippines. (*Western Equipment & Supply Co. v. Reyes*, 51 Phil 115).

*Second alternative reason*—Under the Trademark Law, a foreign corporation may bring an action for unfair competition in the Philippines, whether or not it has been licensed to do business in the Philippines, provided that the country of which the said foreign corporation is a citizen or in which it is domiciled, by treaty or law grants a similar privilege to corporation of the Philippines; and this is granted in the “Convention of Paris” and by law in the United States of America. (*Converse Rubber Corp. v. Jacinto Rubber and Plastics Co. Inc.*, April 28, 1980; 97 SCRA 158) (BAR 1981)

2. **In 1979, Smash Manufacturing Company, a foreign corporation registered in New York, but not doing business in the Philippines, filed a complaint for unfair competition against Nilo Malakas. The plaintiff alleged that since 1939, it had been exporting tennis rackets under the trademark “Smash Mfg. Co.”, and that after the trademark and tradename became familiar to Filipino consumers, defendant Malakas began manufacturing similar products under the same trademark and tradename which he registered with the Philippine Patent Office. Actually, after 1948, Smash Tennis rackets produced by the foreign corporation were no longer imported in the Philippines.**

**The complaint failed to allege that its trademark or tradename has been registered with the Philippine Patents Office or that the State of New York grants Philippine corporations the privilege to bring an action for unfair competition in that State. Claiming that these are conditions *sine qua non* before a foreign corporation may file suit in the Philippines, defendant Malakas filed a motion to dismiss the complaint.**

**b) How would you decide the motion to dismiss? State your reasons.**

**Answer:**

- b) The motion of Malakas to dismiss the complaint of Smash Manufacturing Company shall be sustained. A foreign corporation may bring an action for infringement or unfair competition, provided as conditions *sine qua non* that the trademark or tradename of the suing foreign corporation be registered in the Philippine Patent Office or, in the least, that it be an assignee of such registered trademark or tradename, and that the country of which the plaintiff foreign corporation is a citizen or domiciliary, grants to Filipino corporation the same reciprocal treatment, either thru treaty, convention or law. But said conditions *sine qua non* were not even stated in the complaint of the plaintiff. (BAR 1982)

#### f. Grounds for Revocation of License

#### N. Mergers and Consolidations

1. **XXX Bank Corporation and ZZZ Corporation were merged into XX ZZ Bank Corporation. So as not to create any unnecessary conflict, all the former directors of both banks wanted to be appointed/elected as members of the Board of Directors of the merged bank. Each bank used to have 11 members of the board. The maximum number of directors of the merged bank is—**

- a) 15;
- b) 22;
- c) 21;
- d) 11.

**Answer:**

- a) 21. (BAR 2012)

1. Definition and Concept
  2. Constituent vs. Consolidated Corporation
  3. Plan of Merger or Consolidation
  4. Articles of Merger or Consolidation
  5. Procedure
  6. Effectivity
2. **XXX Corporate and YYY Corporation have agreed to be merged into one corporation. To facilitate the merger, both corporations agreed that the merger be made effective on May 31, 2012. The SEC approved the Articles of Merger on June 30, 2012. Which statement is most accurate?**
- a) The effective date of merger is May 31, 2012, the date stipulated by the parties as the effective date;
  - b) The effective date of the merger is always the date of the approval of the Articles of Merger by the SEC;
  - c) The effective date of the merger would be the date approved by the Board of Directors and the stockholders;
  - d) The stockholders and the Board of Directors can set the effective date of the merger anytime after the approval of the SEC.

**Answer:**

- b) The effective date of the merger is always the date of the approval of the Articles of Merger by the SEC.  
(BAR 2012)

1. Limitations
2. Effects

1. **Two corporations agreed to merge. They then executed an agreement specifying the surviving corporation and the absorbed corporation. Under the agreement of merger dated November 5, 1998, the surviving corporation acquired all the rights, properties and liabilities of the absorbed corporation.**
- a) **What would happen to the absorbed corporation? Must the absorbed corporation undertake dissolution and the winding up procedures? Explain your answer.**
  - b) **Pending the approval of the merger by the SEC, may the surviving corporation already institute suits to collect all receivables due to the absorbed corporation from its customers? Explain your answer.**
  - c) **A case was filed against a customer to collect on the promissory note issued by him after the date of the merger agreement. The customer raised the defense that while the receivables as of the date of the merger agreement were transferred to the surviving corporation, those receivables which were created after the merger agreement remained to be owned by the absorbed corporation. These receivables would be distributed to the stockholders conformably with the dissolution and liquidation procedures under the New Corporation Code? Discuss the merits of this argument.**

**Answer:**

- a) No. There is no need for the absorbed corporation to undertake dissolution and winding up procedure. As a result of the merger, the absorbed corporation is automatically dissolved and its assets and liabilities are acquired and assumed by the surviving corporation.

- b) No. The merger does not become effective until and unless approved by the SEC. before the approval by the SEC of the merger, the surviving corporation has no legal personality with respect to receivables due to the absorbed corporation.
- c) Whether the receivable was incurred by the absorbed corporation before or after the merger agreement, or before or after the approval thereof by the SEC, the said receivable would still belong to the surviving corporation under Section 80 of the Corporation Code which does not make any distinction as to the assets and liabilities of the absorbed corporation that the surviving corporation would inherit. (BAR 1999)

## O. **\*\*JURISDICTION**

### 1. **Intra-corporate Controversies**

1. **“XYZ” is a Condominium Corporation within the meaning of R.A. 4726, the Condominium Law. It built condominium units within Manila and offered the same for sale. “A” bought one unit on installment basis under a Contract to Buy and Sell, which provided that “A”, upon full payment of the contract price, shall be entitled to the ownership of the unit so purchased and to shares of stock pertaining thereto in the condominium corporation. “A” defaulted in the payment of his installments and “XYZ” filed a case in Court for collection of overdue accounts.**

**“A” filed a motion to dismiss the case on the ground that the controversy between him and “XYZ” arose out of intracorporate relations between stockholders, he being a stockholder of “XYZ” already and, therefore, the controversy is within the jurisdiction of SEC under P.D. No. 902-A.**

**The court dismissed the case and directed the parties to ventilate their controversy before the SEC.**

**Is the Order of the Court correct? Explain.**

**Answer:**

*First Alternative Answer:* The order of the court is not correct. This is not a case of intra-corporate controversy within the provisions of P.D. No. 902-A, since this is a case of “XYZ Corporation”, as owner of the condominium in question, suing “A”, a buyer of one unit on installment basis, for breach of the contract to “Buy and Sell”, which is within the jurisdiction of Courts of justice.

*Second Alternative Answer:* The order of the court is not correct. “A” is not yet entitled to the ownership of the unit he is buying, and therefore, he has yet no shares of stock on the condominium corporation of which his unit is a part (not “XYZ Condominium Corporation”), and therefore “A” may not be considered as a stockholder even of the corporation of the condominium property which he was buying a unit of. (BAR 1981)

2. **ABC Corporation is engaged in the business of manufacturing soft drinks. For the past 10 years, it has bought all its bottles from XYZ Corporation. Considering the volume of its production, it now finds that it will be more economical to manufacture its own bottles.**

***The Board of Directors, after studying and discussing the matter thoroughly, decides to set aside the amount of 1 Million for this project. Most of this amount will go to the cost of equipment and materials.***

***M is a stockholder of ABC Corporation and is against this investment in the bottling project and would like to withdraw from the corporation by exercising his appraisal right if the project goes through. He therefore demands that the project be submitted to the stockholders for approval, but the board refuses to do so on the ground that there is no need for such approval and that the calling of a special stockholder’s meeting would entail too much expenses.***

***M thus cannot have the opportunity to exercise his appraisal right. He wants to sue the board to compel it to submit the matter to the stockholders and to enjoin it from pursuing the project until the stockholders shall have approved it.***

**b) Before whom should M file his suit? Why?**

**Answer:**

*b) A should bring his case before the SEC which, under PD 902-A, has original and exclusive jurisdiction to hear and decide cases involving controversies arising out of intracorporate relations between any stockholders and the corporation. Under this law, the SEC can issue injunctions, whether prohibitory or mandatory, in all cases in which it has jurisdiction. The regular courts have therefore no jurisdiction over the case. (BAR 1983) (JURISDICTION NOW TRANSFERRED TO RTC)*

- 3. June Roco purchased from Maharlika Subdivision a 1,000-sq.m. parcel of lot. Annotated at the back of the Certificate of Title issued to him are restrictions regarding the nature and specifications of the construction of a residential house that may be constructed thereon and a statement making the purchaser an automatic member of Maharlika Village Association, a registered non-stock, non-profit corporation. Two years thereafter, Roco applied for a building permit to construct a three-storey edifice on the said place. Upon being informed and learning of the said construction, the Maharlika Village Association advised him to stop the said construction since it violated the restrictions contained at the back of his title. Despite said admonition, Roco proceeded with the construction compelling Maharlika to file an action before the RTC of the place for "Injunction with Damages".**

***Roco moved to dismiss on the ground that the case is a corporate controversy which therefore falls within the exclusive jurisdiction of the SEC pursuant to Section 5 of PD 902-A.***

**Resolve Roco's motion to dismiss.**

**Answer:**

*June Roco's motion to dismiss the action filed against him in the RTC by the Maharlika Village Association, a registered non-stock and non-profit corporation of which June is a member, for "Injunction with Damages", is meritorious. The SEC has the original and exclusive jurisdiction to hear and decide the said case, a controversy arising out of intracorporate relations between a member and the corporation. The question of damages is merely incidental to the main issue. (BAR 1985) (JURISDICTION NOW TRANSFERRED TO RTC)*

- 4. On December 6, 1988, A, an incorporator and the General Manager of the PAJE Multi-Farms Corp., resigned as General Manager and sold the corporation his shares of stocks in the corporation for P300,000, the book value thereof, payable as follows: (a) P100,000 as down payment; (b) P100,000 on or before September 30, 1989. A promissory note, with an acceleration clause, was executed by the corporation for the unpaid balance.**

**The corporation failed to pay the first installment on due date. A then sued PAJE Mult-Farms Corp. on the promissory note in the RTC.**

**a) Does said court have jurisdiction over the case?**

**Answer:**

*The RTC has no jurisdiction over the case. In *Boman Environmental Development Corporation v. Court of Appeals* (G.R. No. 77860, November 22, 1988), the Supreme Court observed that a corporation may only buy its own shares of stock if it has enough surplus profits therefor. On an issue involving the trust fund doctrine, the SEC would be in better position than ordinary courts to make an assessment and judgment on the matter.*

**b) Would your answer be the same if A instead sold his shares to his friend Mabel and the latter filed a case with the RTC against the corporation to compel it to register the sale and to issue new certificates of stock in her name?**

**Answer:**

My answer would be the same. An action to compel a corporation to register a sale and to issue new certificates of stock is itself an intracorporate matter exclusively lies with the SEC to take cognizance. (BAR 1991)

**5. Because of disagreement with the Board of Directors and a threat by the Board to expel her for misconduct and inefficiency, Carissa offered in writing to resign as President and Member of the Board of Directors, and to sell to the company all her shares therein for P300, 000. Her offer to resign was "effective as soon as my shares are fully paid". At its meeting, the Board of Directors accepted Carissa's resignation, approved her offer to sell back her shares of stock to the company, and promised to buy the stocks on a staggered basis. Carissa was informed of the Board Resolution in a letter agreement to which she affixed her consent. The Company's new President signed the promissory note. After paying P100, 000, the company defaulted in paying the balance of P200, 000.**

**Carissa wants to sue the Company to collect the balance. If you were retained by Carissa as her lawyer, where will you file the suit? (a) Labor Arbiter; (b) RTC; or (c) SEC?**

**Answer:**

a) No. the Labor Arbiter has no jurisdiction. This is not a labor case, involving employer-employee relationship.

b) No. The RTC has no jurisdiction over this case which involves intra-corporate controversy.

c) Yes. The SEC has jurisdiction over this case. The case is between a stockholder and a corporation of which he is a stockholder, and the dispute arose out of such relationship. Moreover, the question whether or not the transaction falls under the right of appraisal so as to make the withdrawal legal, properly falls under the SEC jurisdiction. (BAR 1994)

**6. Jennifer and Gabriel owned the controlling stocks in MFF Corporation and CLO, Inc., both family corporations. Due to serious disagreements, Jennifer assigned all her shares in MFF Corporation to Gabriel, while Gabriel assigned all his shares in CLO, Inc. to Jennifer. Subsequently, Jennifer and CLO, Inc., filed a complaint against Gabriel and MFF Corporation in the SEC, seeking to recover the corporate records and funds of CLO, Inc., which Gabriel allegedly refused to turn over, and which remained in the offices of MFF Corporation.**

**Is there an intra-corporate controversy in this case? Explain.**

**Answer:**

Yes, there is an intra-corporate controversy in this case. The fact that, when the complaint against Gabriel and MFF Corporation was filed with the SEC, Jennifer and CLO, Inc. were no longer stockholders of MFF Corporation did not divest the SEC of its jurisdiction over the case inasmuch as Jennifer was a former stockholder of MFF Corporation and the controversy arose out of this relation. (BAR 1996)

**7. In 1970, Magno joined AMD Corporation as a Junior Accountant. He steadily rose from the ranks until he became AMD's Executive VP. Subsequently, however, because of his involvement in certain anomalies, the AMD Board of Directors considered him resigned from the company due to loss of confidence.**

**Aggrieved, Magno filed a complaint in the SEC, questioning the validity of hi termination, and seeking reinstatement to his former position, with back wages, vacation and sick leave benefits, 13<sup>th</sup> month pay and Christmas bonus, plus moral and exemplary damages, attorney's fees and costs. AMD filed a motion to dismiss, arguing that the SEC has no jurisdiction over cases of illegal dismissal, and has no power to award damages.**

**Should the motion to dismiss be granted? Explain.**

**Answer:**

The motion to dismiss should be denied. The dismissal of Magno is a corporate act as it resulted in his non-reelection to his position, and his non-acceptance of such dismissal is an intra-corporate controversy. The fact that Magno sought payment of his back wages and other benefits, as well as moral and exemplary damages and attorney's fees in his complaint for illegal dismissal, does not operate to prevent the SEC from exercising its jurisdiction under PD 902-A. While the affirmative reliefs and monetary claims sought by Magno may, at first glance, mislead one into placing the case under the jurisdiction of the Labor Arbiter, a closer examination reveals that they are actually part of the prerequisites of his elective position, hence, intimately linked with his relations with the corporation. (BAR 1996)

**8. Juan was a stockholder of X Corporation. He owned a total of 500 shares evidenced by Certificate of Stock No. 1001. He sold the shares to Pedro. After getting paid, Juan indorsede and delivered said certificate of Stock No. 1001 to Pedro. The following day, Juan went to the offices of the corporation and claimed that his Certificate of Stock No. 1001 was lost and that, despite diligent efforts, the certificate could not be located. The formalities prescribed by law for the replacement of the "lost" certificate, Certificate of Stock No. 2002. Juan forthwith transferred for valuable consideration the new certificate to Jose who knew nothing of the previous sale to Pedro. In time, the corporation was confronted with the conflicting claims of Pedro and Jose. The Board of Directors of X Corporation invited you to enlighten them on these questions; viz:**

- a) If a suit were to be initiated in order to resolve the controversy between Pedro and Jose, should the matter be submitted to SEC or to the regular courts?**
- b) Between Pedro and Jose, whom should the corporation so recognize as the rightful stockholder?**

**How would you respond to the above queries?**

**Answer:**

- a) The matter should be submitted to the regular court. The controversy between Pedro and Jose is not an intra-corporate controversy.
- b) If there is no over-issuance of shares resulting from the two transactions of Juan, the corporation should recognize both Pedro and Jose as rightful stockholders. This is without prejudice to the right of the corporation to claim against Juan for the value of the shares which Juan sold to Jose. (BAR 1997)

**9. What is an intra-corporate controversy?**

**Answer:**

An intra-corporate controversy is a dispute between a stockholder and the corporation of which he is a stockholder, or between a stockholder and another stockholder of the same corporation, where the subject of the dispute or controversy arose out of such relationship. (BAR 2006)

**10. Is the SEC the venue for actions involving intra-corporate controversies?**

**Answer:**

No. Actions involving intra-corporate controversies are cognizable by the RTC, designated by the Supreme Court under SC Adm. Memo No. 00-11-03, which has jurisdiction over the principal office of the corporation, partnership or association concerned. (BAR 2006)

- 11. Atlantis Realty Corporation (ARC), a local firm engaged in real estate development, plans to sell one of its prime assets—a 3-hectare land valued at about P100 M. for this purpose, the board of directors of ARC unanimously passed a resolution approving the sale of the property for P75 M to Shangrila Real Estate Ventures (SREV), a rival realty firm. The resolution also called for a special stockholders meeting at which the proposed sale would be up for ratification.**

**Atty. Edric, a stockholder who owns only 1 share in ARC, wants to stop the sale. He then commences a derivative suit for and in behalf of the corporation from approving the sale.**

- c) If such a suit is commenced, would it constitute an intra-corporate dispute? If so, why and where would such a suit be filed? If not, why not?**

**Answer:**

Yes, such suit would constitute an intra-corporate dispute as it is a suit initiated by a stockholder against other stockholders who are officers and directors of the same corporation. Such suit should be filed in the RTC designated by the Supreme Court as a corporate or commercial court.

- d) Will the suit prosper? Why or why not?**

**Answer:**

No. The suit will not prosper. There is no requisite demand on the officers and directors concerned. There is, therefore, no exhaustion of administrative remedies. (BAR 2009)

- 12. DC is a unit owner of Medici Condominium located in Pasig City. On September 7, 2011, Medici Condominium Corp. (Medici) demanded from DC payment for alleged unpaid association dues and assessments amounting to P195,000. DC disputed the claim, saying that he paid all dues as shown by the fact that he was previously elected as Director and President of Medici. Medici, on the other hand, claimed that DC's obligation was a Construction Corporation. Consequently, DC was prevented from exercising his right to vote and be voted for during the 2011 election of Medici's Board of Directors. This prompted DC to file a complaint for damages before the Special Commercial Court of Pasig City. Medici filed a motion to dismiss on the ground that the court has no jurisdiction over the intra-corporate dispute which the HLURB has exclusive jurisdiction over. Is Medici correct?**

**Answer:**

No. Medici is not correct. A controversy between the condominium corporation and its members-unit owners for alleged unpaid association dues and assessments and the prevention of DC from exercising his right to vote and be voted for during the 2011 election of the Medici's Board of Directors, partakes of the nature of an intra-corporate dispute which does not fall within the jurisdiction of the HLURB despite its expansive jurisdiction. It is considered as an intra-corporate controversy falling within the jurisdiction of the Regional Trial Court designated as special commercial court. (BAR 2014)

## **VII. Securities Regulation Code (R.A. No. 8799)**

- 1. Philippine Palaces Realty (PPR) had been representing itself as a registered broker of securities, duly authorized by the SEC. On October 6, 1996, PPR sold to spouses Leon and Carina one timeshare of Palacio del Boracay for US\$7,500. However its Registration Statement became effective only on February 11, 1998 after the SEC issued a resolution declaring that PPR was authorized to sell securities, including timeshares**

On March 30, 1998, Leon and Carina wrote PPR rescinding their purchase agreement and demanding the refund of the amount they paid, because the Palacio del Boracay timeshare was sold to them by PPR without the requisite license or authority from the SEC. PPR contended that the grant of the SEC authority had the effect of ratifying the purchase agreement (with Leon and Carina) of October 6, 1996.

**Is the contention of PPR correct? Explain.**

**Answer:**

The contention of PPR is not correct. It is settled that no securities shall be sold or offered for sale or distribution in the Philippines without a registration duly filed and approved by the Commission. Corporate registration is one of the requirements under Section 8 of BP Blg. 178. (BAR 2009)

- 2. TRUE or FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**The *Howey Test* that there is an investment contract when a person invests money in a common enterprise and is led to expect profits primarily from the efforts of others.**

**Answer:**

False. The *Howey Test* requires a transaction, contract, or scheme whereby a person makes an investment of money in a common enterprise with the expectation of profits to be derived solely, not primarily from efforts of others. (BAR 2009)

- 3. What procedure must be followed under the SRC to authorize the sale or offer for sale or distribution of an investment contract?**

**Answer:**

Before the investment contract is sold or offered for sale or distribution to the public in the Philippines, it should be registered with the SEC in accordance with Section 8 of the SRC.

**What are the legal consequences of failure to follow this procedure?**

**Answer:**

The failure to follow this procedure has criminal consequences (i.e., upon conviction, a fine P50,000 to P5 M and/or imprisonment of 7-12 years). It carries also civil liabilities in that the purchaser can recover from the seller (i) the consideration paid with interest thereon, less the amount of any income received on the purchased securities, upon the tender of such securities, or (ii) damages if the purchaser no longer owns such securities. Furthermore, the SEC may issue a cease and desist order. (BAR 2010)

- 4. Andante Realty, a marketing company that promotes and facilitates sales of real property through leverage marketing, solicits investors who are required to be a Business Center Owner (BCO) by paying an enrollment fee of \$250. The BCO is then entitled to recruit two other investors who pay \$250 each. The BCO receives \$90 from the \$250 paid by each of his recruits and is credited a certain amount for payments made by investors through the initial efforts of his Business Center. Once the accumulated amount reaches \$5,000, the same is used as down payment for the real property chosen by BCO.**

**Does the multi-level marketing scheme constitute an “investment contract” under the SRC? Define an “investment contract”.**

**Answer:**

Yes. The multi-level marketing scheme constitutes an “investment contract” under the SRC. An “investment contract” is a contract, transaction or scheme:

- a. Involving an investment of money,
- b. In a common enterprise,
- c. With expectation of profits,
- d. Primarily from the efforts of others. (BAR 2010)

### A. State Policy, Purpose

#### 1. What is the principal purpose of laws and regulations governing securities in the Philippines?

**Answer:**

The principal purpose of laws and regulations governing securities in the Philippines is to protect the public against nefarious practices of unscrupulous brokers and salesmen in selling securities. (BAR 1998)

### B. Securities Required to Be Registered

#### 1. Securities

#### 1. (1) What is meant by “Over-the-Counter Markets” as provided in the Revised Securities Act?

**(2) X has the following plans:**

- a. Organized the Tagaytay Country Club, Incorporated.
- b. Let the club buy a 10 hectare land for P10 M which will be developed into a sports and health club complete with an Olympic size swimming pool, tennis and pelota courts, bowling lanes, pool rooms, etc.
- c. Five of the P10 M needed to develop the club will be raised thru the sale of certificates of membership.
- d. The certificate of membership shall give the purchaser the right to use all club facilities, and shall be transferable. It shall not, however, give the purchaser any right in the income or assets of the club. The purchaser must also pay monthly dues.

**X wants to know whether the certificate of membership is an investment contract and hence, a security within the meaning of the Revised Securities Act. What is your opinion?**

**Answer:**

- 1) The term “Over-the-Counter Markets” refers to markets made or created for the purchase and sale of securities other than on a security exchange. The SEC may provide rules and regulations of transactions therein, a violation of which renders the same or the trading therein unlawful.
- 2) The certificate of membership, although not providing for a right of income or right over club assets, gives, however, to the holder thereof privileges on the use of club facilities, that are of value and transferable. The certificate is thus a security within the meaning of the Revised Securities Act. (BAR 1982)

#### 2. Define securities.

**Answer:**

Stocks, bonds, notes, convertible debentures, warrants or other documents that represent a share in a company or debt owed by a company or government entity. Evidences of obligations to pay money or rights to participate in earnings and distribution of corporate assets. Instruments giving to their legal holders rights to money or other property; they are therefore instruments which have intrinsic value and are recognized and used as such in the regular channels of commerce. (BAR 1996)

#### 3. “Securities” issued to the public are required by law to be registered with—

- a) **The Banko Sentral ng Pilipinas;**
- b) **The Philippine Stock Exchange;**
- c) **The Securities and Exchange Commission;**
- d) **The Securities and Exchange Commission and the Philippine Stock Exchange.**

**Answer:**

c) The Securities and Exchange Commission. (BAR 2012)

## 2. Exempt Securities

1. **Assume that Greater Manila Telephone and Telegraph Company, Incorporated has 10,000 employees. It has a policy of encouraging stock ownership among its employees. Its Board of Directors, intends to sell P2 M worth of common stocks to either (a) its managerial employees only numbering about 1,000 or (b) indiscriminately to all its 10,000 employees. In case it decides to sell to its managerial employees only, does it have to register its securities? How about if the intended sale is to all employees?**

**Answer:**

Exempt transactions are those that do not require registration either because the law itself exempts them therefrom or the SEC finds that the enforcement of the registration requirement is not necessary in the public interest and for the protection of investors by reason of the amount involved or the limited character of the public offering. The proposed sales stated in the problem do not strictly fall under any of the exempt transactions in the law itself. Accordingly, if the corporation would want to exempt the sale from registration, it must file an application with the SEC for such exemption which may then act in accordance with the rule above-stated. (BAR 1989)

2. **What are the so-called exempt securities under the SRC?**

**Answer:**

Under Sec. 9 of the SRC, the so-called exempt securities are:

- a. Those issued or guaranteed by the government of the Philippines or any of its political subdivisions or agencies;
- b. Those issued or guaranteed by the government of any foreign country with which the Philippines has diplomatic relations, or any other state on the basis of reciprocity, although the SEC may require compliance with the form and content of disclosures;
- c. Those issued by the receiver or by the trustee in a bankruptcy duly approved by the proper adjudicatory board;
- d. Those involving the sale or transfer which is by law, under the regulation of the OIC, HLURB, BIR; and
- e. Those issued by banks, except its own shares. (BAR 2009)

## 3. Exempt Transactions

### B. Registration

1. **Philippine Chromite, Inc., after registration of its securities, sold P10 M worth of common stocks to the public at P.01 per share. In its registration statement, it alleged that it holds a perfected mining claim on 100 hectares of chromite land in Botolan, Zamabales. X, a Botolan resident, bought P50,000 worth of stocks of the corporation from the stock exchange. After its public offering, the value of the stock dropped to half its price. X made some investigations and discovered that the mining claims of the**

**corporation had not been perfected at the time of the issuance of its securities. The stock, however, rallied and after 2 years, commanded a price of 1 ½ centavo per share. On its third year, the company collapsed and its stocks became totally valueless. What is the remedy of X?**

**Answer:**

The remedy of X for damages is lost by prescription. Any suit therefore must be filed within 2 years after the discovery of the facts constituting the cause of action (but not beyond 5 years after such cause of action accrued). 2 years having already elapsed since the time that X had discovered the misrepresentation in the registration statement of the corporation, the latter's civil liability has prescribed. X, however, is not prevented from invoking SEC's regulatory powers against the corporation.

## **2. Under the SRC, what is the Margin Trading Rule?**

**Answer:**

Under the Margin Trading Rule, no registered broker or dealer, or member of an exchange shall extend credit on any security an amount greater than whichever is higher of:

- a) 65% of the current market price of the security;
- b) 100% of the lowest market price of the security during the preceding 36 calendar months, but not more than 75% of the current market price.

The purpose of the Margin Trading Rule is to prevent excessive use of credit for the purchase of securities it is a counter to broker's desire to generate more sales by encouraging clients to buy securities on credit. (BAR 2009)

### **C. Prohibitions on Fraud, Manipulation and Insider Trading**

#### **1. Manipulation of Security Prices**

- 1. Suppose "A" is the owner of several inactive securities. To create an appearance of active trading for such securities, "A" connives with "B" by which "A" will offer for sale some of his securities and "B" will buy them at certain fixed price, with the understanding that although there would be an apparent sale, "A" will retain the beneficial ownership thereof.**

- a) **Is the arrangement lawful?**
- b) **If the sale materializes, what is it called?**

**Answer:**

- a) No. the arrangement is not lawful. It is an artificial manipulation of the price of securities. This is prohibited by the Securities Regulation Code.
- b) If the sale materializes, it is called a wash sale or simulated sale. (BAR 2001)

#### **2. Short Sales**

#### **3. Fraudulent Transactions**

#### **4. Insider Trading**

- 1. A, B and C are directors of XYZ Mining Corporation whose shares of stock are listed in the Manila Stock Exchange. On February 1, 1984, A, B and C each purchased thru a stockbroker 1,000 shares of XYZ Mining Corporation at the then market price of P4 a share. On May 1, 1984, B left for abroad for a medical check-up and a vacation.**

**At the board meeting held on May 15, 1984, at which B was absent but which A and C attended, the directors were apprised of an important discovery in an area covered by one XYZ Mining Corporation's mining leases. After the discovery was duly publicized in the morning dailies, the market price of XYZ Mining Co. started to rise. When it hit P8 per share on May 28, 1984, A sold all his 1,000 shares.**

**Upon his return to Manila in the middle of June, 1984, B sold 500 shares at P8 per share, just enough to cover the cost of the 1,000 shares he acquired in February, believing that the stock would continue to rise. The price, however, started to drop.**

**On August 15, 1984, when the price was P5 a share, C sold 1,000 shares of XYZ Mining Co.**

**What are the rights of XYZ Mining Co. against A, B and C? Explain your answer.**

**Answer:**

For the purpose of preventing the unfair use of information which may have been obtained by a director by reason of his relationship to the issuer, any profit realized by him from any purchase, of any equity security of such issuer within any period of less than 6 months shall inure to and be recoverable by the issuer, irrespective of any intention of holding the security purchased or of not repurchasing the security sold for a period exceeding 6 months. Suit to recover such profit may be instituted in any court of competent jurisdiction of the issuer in the name and in behalf of the issuer.

As the issuer, XYZ Mining Corporation can recover from B, a director, the amount of P2,000, the profit realized by B from the purchase and sale of the shares of the issuer within the period of February 1 to the middle of June.

XYZ Mining Co. cannot recover from C, a director, since C sold his shares after the lapse of 6 months from February 1, 1984, when he acquired the shares.

In the case of A and B it is immaterial whether or not they actually used inside information in buying and selling the stock. Any profit they made during the 6 month period from a purchase and sale within such period inures to the benefit of the issuer, XYZ Mining Corporation. (BAR 1984)

- 2. Give a case where a person who is not an issuing corporation, director or officer thereof, or a person controlling, controlled by or under common control with the issuing corporation, is also considered an "insider".**

**In Securities Law, what is a "shortswing" transaction.**

**In "insider trading", what is a "fact of special significance"?**

**Answer:**

1. It may be a case where a person, whose relationship or former relationship to the issuer gives or gave him access to a fact of special significance about the issuer or the security that is not generally available, or a person, who learns such a fact from any of the insiders, with knowledge that the person from whom he learns the fact, is such an insider.
2. A "shortswing" is a transaction where a person buys securities and sells or disposes of the same within a period of 6 months.
3. In "insider trading", a "fact of special significance" is, in addition to being material, such fact as would likely, on being made generally available, to affect the market price of a security to a significant extent, or which a reasonable person would consider as especially important under the circumstances in determining his

course of action in the light of such factors as the degree of its specificity, the extent of its difference from information generally available previously, and its nature and reliability. (BAR 1994)

3. **Under the Revised Securities Act, it is unlawful for an insider to sell or buy a security of the issuer if he knows a fact or special significance with respect to the issuer or the security that is not generally available, without disclosing such fact to the other party.**
- What does the term “insider” mean as used in the Revised Securities Act?**
  - When is a fact considered to be “of special significance” under the same Act?**
  - What are the liabilities of a person who violates the pertinent provisions of the Revised Securities Act regarding the unfair use of inside information?**

**Answer:**

a) “Insider” means (1) the issuer, (2) a director or officer of or a person controlling, controlled by, or under common control with, the issuer, (3) a person whose relationship or former relationship to the issuer gives or gave him access to a fact of special significance about the issuer or the security that is not generally available, or (4) a person who learns such a fact from any of the foregoing insiders with knowledge that the person from whom he learns the facts is such an insider.

b) It is one which, in addition to being material, would be likely to affect the market price of a security to a significant extent on being made generally available, or one which a reasonable person would consider especially important under the circumstances in determining his course of action in the light of such factors as the degree of its specificity, the extent of its difference from information generally available previously, and its nature and reliability.

c) The person may be liable to (1) a fine of not less than P5,000 nor more than P500,000, or (2) imprisonment of not less than 7 years nor more than 21 years, (3) or both such fine and imprisonment in the discretion of the court.

If the offender is a corporation, partnership, association or other juridical entity, the penalty shall be imposed upon the officers of the corporation, etc. responsible for the violation. And if such an officer is an alien, he shall, in addition to the penalties prescribed, be deported without further proceedings after service of sentence. (BAR 1995)

4. **Ms. OB was employed in MAS Investment Bank. WIC, a medical drug company, retained the Bank to assess whether it is desirable to make a tender offer for DOP company, a drug manufacturer. OB overheard in the course of her work the plans of WIC. By herself and thru associates, she purchased DOP stocks available at the stock exchange price at P20 per share. When WIC’s tender offer was announced, DOP stocks jumped to P30 per share. Thus OB earned a sizable profit.**

**Is OB liable for breach and misuse of confidential or insider information gained from her employment? Is she also liable for damages to sellers or buyers with whom she traded? If so, what is the measure of such damages? Explain briefly.**

**Answer:**

OB is an insider (as defined in Subsection 3.8(3) of the SRC) since she is an employee of the Bank, the financial adviser of DOP, and this relationship gives her access to material information about the issuer (DOP) and the latter’s securities (shares), which information is not generally available to the public. Accordingly, OB is guilty of insider trading under Section 27 of the SRC, which requires disclosure when trading in securities.

OB is also liable for damages to sellers or buyers with whom she traded. Under Subsection 63.1 of the SRC, the damages awarded could be an amount not exceeding triple the amount of the transaction plus actual damages. Exemplary damages may also be awarded in case of bad faith, fraud, malevolence or wantonness in the

violation of the SRC or its implementing rules. The court is also authorized to award attorney's fees not exceeding 30% of the award. (BAR 2004)

**5. Grand Gas Corporation, a publicly listed company, discovered after extensive drilling a rich deposit of natural gas along the coast of Antique. For 5 months, the company did not disclose the discovery so that it could quietly and cheaply acquire neighboring land and secure mining rights to the land. Between the discovery and its disclosure of the information to the SEC, all the directors and key officers of the company bought shares in the company at very low prices. After the disclosure, the price of the shares went up. The directors and officers sold their shares at huge profits.**

- a) **What provision of the SRC did they violate, if any? Explain.**
- b) **Assuming that the employees of the establishment handling the printing work of Grand Gas Corporation saw the exploration reports which were mistakenly sent to their establishment together with other materials to be printed. They too bought shares in the company at low prices and later sold them at huge profits. Will they be liable for violation of the SRC? Why?**

**Answer:**

a) They violated Sec. 27 of the SRC, on insider's duty to disclose when trading, to wit:

"It shall be unlawful for an insider to sell or buy securities of the insurer, while in possession of material information with respect to the issuer or the security that is not generally available to the public, unless:

- 1. The insider proves that the information was not gained from such relationship; or
- 2. If the other party selling to or buying from the insider (or his agent) is identified, the insider proves:
  - 2.1. That he disclosed the information to the other party, or
  - 2.2. That he has reason to believe that the other party otherwise is also in possession of the information."

b) Yes, the employees of the establishment handling the printing job of the corporation are also liable for violation of the prohibition against insider trading. These employees fall within the classification of an "insider" under subsection 3.8 (c) of the SRC, to wit: "a person whose relationship or former relationship to the issuer gives or gave him access to material information about the issuer or the security that is not generally available to the public." (BAR 2008)

**6. X, who is the Executive VP of ABC Corporation, a listed company, can be held liable or guilty of insider trading if, he—**

- a) **Bought shares of ABC Corporation when it was planning to acquire another company to improve its asset base, the news of which increased the price of the shares in the Stock Exchange.**
- b) **Bought shares of XYZ Corporation, a sister company of ABC Corporation when he learned that XYZ Corporation was about to also list its share in the Philippine Stock Exchange;**
- c) **Bought shares of ZZZ Corporation when he learned that ABC Corporation would acquire ZZZ Corporation;**
- d) **All of the above.**

**Answer:**

d) All of the above. (BAR 2012)

**7. You are a member of the legal staff of a law firm doing corporate and securities work for Coco Products Inc., a company with unique products derived from coconuts and whose shares are traded in the Philippine Stock Exchange. A partner in the law firm, Atty. Buenexito, to whom you report, is the Corporate Secretary of Coco Products. You have long been investing in Coco Products stocks even before you became a lawyer.**

While working with Atty. Buenixito on another file, he accidentally gave you the Coco products file containing the company's planned corporate financial rehabilitation. While you knew you had the wrong file, your curiosity prevailed and you browsed through the file before returning it. Thus, you learned that a petition for financial rehabilitation is imminent, as the company could no longer meet its obligations as they fell due.

Soon after, your mother is rushed to the hospital for an emergency operation, and you have to raise money for her hospital bills. An immediate option for you is to sell your Coco Products shares. The sale would be very timely because the price of the company's stocks are still high.

Would you sell the shares to raise the needed funds for your mother's hospitalization? Take into account legal and ethical considerations.

**Answer:**

The sale of the shares does not constitute insider trading. Although Atty. Buenixito, as corporate secretary of Coco products, Inc. was an insider, I did not obtain the information regarding the planned corporate rehabilitation by a communication from him. He just accidentally gave the wrong file.

It would be unethical to sell the shares. Rule 1.01 of the Code of Professional Responsibility provides, "A lawyer shall not engage in unlawful, dishonest, immoral or deceitful conduct."

A lawyer should not only refrain from performing unlawful acts. He should also desist from engaging in unfair deceitful conduct to conceal from the buyer of the shares the planned corporate rehabilitation. (BAR 2013)

#### **D. Protection of Investors**

1. a) State at least five features of the Revised Securities Act (B.P. No. 178) intended to protect the investing public.

b) What are the classes of securities under the Revised Securities Act?

**Answer:**

a) At least five features (not exclusive) of the Revised Securities Act intended to protect the investing public include:

1. The law requires the registration of, and permit to sell, securities before the same may be sold or offered for sale;
2. The law limits exempt securities only to non-speculative shares;
3. The law confines exempt transactions when the amount involved or the public offering is limited in character;
4. The law provides for possible recovery of damages in favor of investors who are prejudiced by parties responsible for non-disclosure or misdisclosure of material facts; and
5. The law provides for criminal liability for violation of the Act.

b) The Revised Securities Act classifies securities into:

1. Those which, in general, are required to be registered and permitted to be sold;
2. Those which are exempt from such registration and licensing requirements because of their non-speculative nature and are thereby called exempt securities; and
3. Those which are covered by exempt transactions because of the limited character of their offering. (BAR 1988)

#### **1. Tender Offer Rule**

2. **A. What is a tender offer?**  
**B. In what instances is a tender offer required to be made?**

**Answer:**

- A. Tender offer is a publicly announced intention of a person acting alone or in concert with other persons to acquire equity securities of a public company. It may also be defined as a method of taking over a company by asking stockholders to sell their shares at a price higher than the current market price and on a particular date.
- B. Instances where tender offer is required to be made:
1. The person intends to acquire 15% or more of the equity share of a public company pursuant to an agreement made between or among the person and one or more sellers.
  2. The person intends to acquire 30% or more of the equity shares of a public company within a period of 12 months.
  3. The person intends to acquire equity shares of a public company that would result in ownership of more than 50% of the said shares. (BAR 2002)

3. **Union Mines, Inc. has a total asset of P60 M with 210 stockholders holding at least 100 shares each.**

**The company has two principal stockholders, ABC which owns 60% of the shares of stock, and XYZ which owns 17%.**

**ABC in turn is owned to the extent of 21.31% by Acme, Inc.; 29.69% by Golden Boy, Inc; 9% by XYZ; and the rest by individual stockholders.**

**None of the parties is a publicly-listed company.**

**XYZ now proposes to buy Acme's and Golden Boy's shares in ABC, which would give it direct control of ABC and indirect control of Union Mines.**

**Is the proposed acquisition by XYZ subject to the mandatory tender offer and when is it mandatory?**

**Answer:**

Yes, the proposed acquisition is subject to mandatory tender offer rule. A tender offer is a publicly announced intention by a person (acting alone or in concert with other persons) to acquire shares of a public company. A tender offer is meant to protect minor stockholders against any scheme that dilutes the share value of their investments. It gives them the chance to exit the company under the same terms offered to the majority stockholders.

Under the SRC and its implementing rules, a mandatory tender offer is required:

- a. When at least 35% of the outstanding shares of a public company is to be acquired in one transaction or a series of transaction during a 12-month period, or
- b. Even if any acquisition is less than 35% threshold but the result thereof is the ownership of more than 51% of the total outstanding shares of a public company. The mandatory offer rule also applies to share acquisition meeting the threshold, which is done at the level of the holding or parent corporation controlling a public company

In this case, Union Mines is clearly a public company, since it has a total asset of P60 M with 210 stockholders holding at least 100 shares each. A public company is defined as a corporation listed on the stock exchange, or a

corporation with assets exceeding P50 M and with 200 or more stockholders at least 200 of them holding not less than 100 share of such corporation.

XYZ's acquisition of shares of Acme, Inc. and Golden Boy, Inc., taken separately, does not reach 35% threshold. If taken collectively, the two acquisitions total only 50%. However, when the acquisitions are added to XYZ's existing shares in Union Mines, they meet the more-than-51% threshold for mandatory tender offer. (BAR 2010)

**4. The purpose of the "Tender Offer" Rule is to—**

- a) **Ensure an even playing field for all shareholders of a company in term of opportunity to sell their shareholdings;**
- b) **Ensure that minority shareholders in a publicly listed company are protected in the sense that they will equally have the same opportunity as the majority shareholders in terms selling their shares;**
- c) **Ensure that the shareholders who would also want to sell their shareholdings will have the opportunity for a better price;**
- d) **All of the above.**

**Answer:**

d) All of the above. (BAR 2012)

- 2. **Rules on Proxy Solicitation**
- 3. **Disclosure Rule**

- E. **Civil Liability**
- F. **Jurisdiction**

**1. What is the original and exclusive jurisdiction of the SEC?**

**Answer:**

The SEC has original and exclusive jurisdiction over case involving:

- 1. Devices or schemes amounting to fraud and misrepresentation;
- 2. Controversies arising out of intra-corporate or partnership relations;
- 3. Controversies in the election or appointment of directors, officers, etc.;
- 4. Petitions to be declared in the state of suspension of payment. (BAR 1996)

**VIII. Banking Laws**

**A. The New Central Bank Act (R.A. No. 7653)**

- 1. **State Policies**
- 2. **Creation of the Bangko Sentral ng Pilipinas (BSP)**

**1. The government agency granted with the power of supervision and examination over banks and non-bank financial institutions performing quasi-banking functions, to ensure that the conduct of its business is on a sound financial basis that will provide continued solvency and liquidity is—**

- a) The Philippine Deposit Insurance Corporation;
- b) The Bangko Sentral ng Pilipinas;
- c) The Anti-Money Laundering Council;
- d) The Securities and Exchange Commission.

**Answer:**

- b) The Bangko Sentral ng Pilipinas. (BAR 2012)

### 3. Responsibility and Primary Objective

#### 1. What are the responsibilities and primary objectives of the Bangko Sentral ng Pilipinas?

**Answer:**

The Bangko Sentral ng Pilipinas shall provide policy directions in the areas of money, banking and credit. It shall have supervision over the operations of banks and exercise such regulatory powers as provided in the Central Bank Act and other pertinent laws over the operations of finance companies and non-bank financial institutions performing quasi-banking functions, such as quasi-banks and institutions performing similar functions. The primary objective of the BSP is to maintain price stability conducive to a balanced and sustainable growth of the economy. It shall also promote and maintain monetary stability and convertibility of the Peso. (BAR 1998)

#### 2. The government agency granted with the power of supervision and examination over banks and non-bank financial institutions performing quasi-banking functions, to ensure that the conduct of its business is on a sound financial basis that will provide continued solvency and liquidity is—

- e) The Philippine Deposit Insurance Corporation;
- f) The Bangko Sentral ng Pilipinas;
- g) The Anti-Money Laundering Council;
- h) The Securities and Exchange Commission.

**Answer:**

- c) The Bangko Sentral ng Pilipinas. (BAR 2012)

- 4. Monetary Board—Powers and Functions
- 5. How the BSP Handles Banks in Distress

#### a. Conservatorship

#### 1. A 10-year old commercial bank during the past year committed the following acts: (1) it opened letters of credit banned items of importation; (2) for the second consecutive year, there was a deficiency in their reserve requirements; (3) the total amount of clean loans granted (loans without collateral) exceeded substantially that which they normally grant in one year; (4) the total liabilities of one private company to the bank exceed 15% of the unimpaired capital and surplus of the bank; and (5) the bank officers delayed submission of reports required by law to the Central Bank.

- (a) Assuming that the above facts did not result in any liquidity problem or did not affect the financial condition of the bank, what administrative sanctions may be imposed by the Monetary Board?
- (b) Assuming that the above acts were done in good faith but they nevertheless resulted in financial difficulties to the bank and in fact affected the country's monetary stability due to a run on the bank, what administrative sanctions or remedies may be taken by the Monetary Board?

**Answer:**

- (a) Based on the above stated facts, the Monetary Board may appoint a conservator to take charge of the assets, liabilities and the management of that banking institution.
- (b) If the Monetary Board would have determined that the condition of that bank is one of insolvency, or that its continuance in business would involve probable loss to its depositors or creditors, then the Monetary Board shall designate a receiver to immediately take charge of the assets and liabilities, exercising all the powers necessary for these purposes. (BAR 1982)

**2. Distinguish between the role of a conservator and that of a receiver of a bank.**

**Answer:**

The role of a conservator is to restore the viability of the bank. The role of a receiver is to determine whether or not a bank can be rehabilitated. (BAR 2006)

**b. Closure**

**1. Give the basic requirements to be complied with by the Central Bank before the Monetary Board can declare a bank insolvent, order it closed and forbid it from doing further business in the Philippines.**

**Answer:**

Before the Monetary Board can declare a bank insolvent, order it closed and forbid it from doing further business in the Philippines, the following basic requirements must be complied with by the Central Bank, to wit:

- a) There must be an examination by the head of the Department of Supervision or his examiners or agents into the condition of the bank.
- b) The examination discloses that the condition of the bank is one of insolvency, or that its continuance in business would involve probable loss to creditors or depositors.
- c) The head of said Department shall inform in writing the Monetary Board of such facts.
- d) Upon finding said information or statement to be true, the Monetary Board shall appoint a receiver to take charge of the assets and liabilities of the bank.
- e) Within 60 days, the Monetary Board shall determine and confirm if the bank is insolvent, and public interest requires, to order the liquidation of the bank. (BAR 1997)

**2. Maharlikang Pilipino Banking Corporation (MPBC) operates several branches of Maharlikang Pilipino Rural Bank in Eastern Visayas. Almost all the branch managers are close relatives of the members of the Board of Directors of the corporation. Many undeserving relatives of the branch managers were granted loans. In time, the branches could not settle their obligations to depositors and creditors.**

**Receiving reports of these irregularities, the Supervising and Examining Department (SED) of the Monetary Board prepared a detailed report (SED Report) specifying the facts and the chronology of events relative to the problems that beset MPBC rural bank branches. The report concluded that the bank branches were unable to pay their liabilities as they fell due, and could not possibly continue in business without incurring substantial losses to its depositors and creditors.**

**May the Monetary Board order the closure of the MPBC rural banks relying only on the SED Report, without need of an examination? Explain.**

**Answer:**

Yes. Upon receipt of the report of the SED, the Monetary Board is authorized to take any of the actions enumerated under Sec. 30, RA No. 7653, otherwise known as the New Central Bank Act, leading to the

receivership and liquidation of a bank or quasi-bank. There is no requirement that an examination be first conducted before a banking institution may be placed under receivership. (BAR 2009)

**c. Receivership**

**1. Distinguish between the role of a conservator and that of a receiver of a bank.**

**Answer:**

The role of a conservator is to restore the viability of the bank. The role of a receiver is to determine whether or not a bank can be rehabilitated. (BAR 2006)

**2. Due to growing financial difficulties, Z Bank was unable to finish construction of its 21-storey building on a prime lot located in Makati City. Inevitably, the Bangko Sentral ordered the closure of Z Bank and consequently placed it under receivership. In a bid to save the bank's property investment, the President of Z Bank entered into a financing agreement with a group of investors for the completion of the construction of the 21-storey building in exchange for a 10-year lease and the exclusive option to purchase the building.**

**a) Is the act of the President valid? Why or why not?**

**b) Will a suit to enforce the exclusive right of the investors to purchase the property prosper? Reason briefly.**

**Answer:**

a) No, the bank president's act is not valid. He had no authority to enter into the financing agreement. Z Bank was ordered closed and placed under receivership. Control over the properties of Z Bank passed to the receiver. The appointment of a receiver operates to suspend the authority of the bank and its officers over the bank's assets and properties, such authority being reposed in the receiver.

b) No, the exclusive option granted to the investors, having been entered into by one without authority to do so, is unenforceable. The bank, therefore, cannot be compelled to sell the property. Under Section 30 of the R.A. No. 7653, New Central Bank Act, the properties of Z Bank should be administered for the benefit of its creditors. The property in question can be disposed of only for the purpose of paying the debts of Z Bank. (BAR 2007)

**3. TRUE OR FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**A bank under a receivership can still grant new loans and accept new deposits.**

**Answer:**

False. During the receivership, the assets and properties of the corporation are being gathered for conversion into cash in preparation for distribution to creditors. Granting new loans and accepting new deposits would constitute doing business for the bank in the ordinary course of business which is contrary to the purpose and nature of a receivership proceeding. (BAR 2009)

**4. A bank can be placed under receivership when, if allowed to continue in business, its depositors or creditors would incur**

**a. Probable losses**

**b. Inevitable losses**

**c. Possible losses**

**d. A slight chance of losses**

**Answer:**

b. Probable losses (BAR 2011)

**d. Liquidation**

- 1. Family Bank was placed under statutory receivership and subsequently ordered liquidated by the Central Bank (CB) due to fraud and irregularities in its lending operations which rendered it insolvent. Judicial proceedings for liquidation were thereafter commenced by the CB before the RTC. Family Bank opposed the petition.**

**Shortly thereafter, Family Bank filed in the same court a special civil action against the CB seeking to enjoin and dismiss the liquidation proceeding on the ground of grave abuse of discretion by the CB. The court was poised to: (1) restrain the CB from closing Family Bank; and (2) authorize Family Bank to withdraw money from its deposits during the pendency of the case.**

**If you were the judge, would you issue such orders? Why?**

**Answer:**

No. the RTC has no authority to restrain the monetary board of the Central Bank from statutory authority to undertake receivership and ultimate liquidation of a bank. Any opposition to such an action could be made to the court itself where assistance is sought.

The action of the RTC where the proceeding is pending appeal have to be made in the Court of Appeals. (BAR 1992)

**e. Remedy**

- 1. Maharlikang Pilipino Banking Corporation (MPBC) operates several branches of Maharlikang Pilipino Rural Bank in Eastern Visayas. Almost all the branch managers are close relatives of the members of the Board of Directors of the corporation. Many undeserving relatives of the branch managers were granted loans. In time, the branches could not settle their obligations to depositors and creditors.**

**Receiving reports of these irregularities, the Supervising and Examining Department (SED) of the Monetary Board prepared a detailed report (SED Report) specifying the facts and the chronology of events relative to the problems that beset MPBC rural bank branches. The report concluded that the bank branches were unable to pay their liabilities as they fell due, and could not possibly continue in business without incurring substantial losses to its depositors and creditors.**

**If the MPBC hires you as a lawyer because the Monetary Board has forbidden it from carrying on its business due to its imminent insolvency, what action will you institute to question the Monetary Board's order? Explain.**

**Answer:**

The order of the Monetary Board may be questioned on a petition for certiorari on the ground that the action taken was in excess of jurisdiction or with grave abuse of discretion amounting to lack or excess of jurisdiction. The petition of certiorari may only be filed by the stockholders of record representing the majority of the capital stock within 10 days from receipt by the board of directors of the MPBC of the order directing receivership, liquidation or conservatorship. (BAR 2009)

## 6. How the BSP Handles Exchange Crisis

### a. Legal Tender Power

1. **Can a creditor be compelled to accept payment all in 25-centavo Central Bank coins of a forty (P40.00) peso debt? Explain briefly.**

**Answer:**

Under the Central Bank Act, the creditor in this case can be compelled to accept payment because it is made in legal tender. For denominations from 10 centavos to one peso, coins shall be legal tender up to P50.00.

Note: Coins are legal tender only up to certain amount. For denominations from P1.00 and above, coins shall be legal tender up to P1,000. For denominations from 25 centavos and below, coins shall be legal tender up to P100. (BAR 1975)

2. **Interlink Trading Company extends a loan to “G” for his medical expenses abroad in the sum of US\$10,000.00, with interest at the rate of 14% per annum, payable 120 days from date thereof, subject to the condition that “G” pays Interlink Trading Company upon maturity in the same currency, that is, US dollars.**

**“G” would like to pay his indebtedness in Philippine currency because he has no US dollars to pay off the obligation. The company insists, however, that “G” pays them in US dollars as stipulated.**

**Whose position would you uphold?**

**Answer:**

I would uphold the position of G. If there would be a stipulation in any domestic obligation to pay in a currency other than the Philippine currency, said stipulation is null and void as contrary to public policy, and therefore to be paid in Philippine currency. The problem does not fall within any of the exceptions provided for by the law. (BAR 1980)

3. **After many years of shopping in the Metro Manila area, housewife HW has developed the sound habit of making cash purchases only, none on credit. In one shopping trip to Mega Mall, she got the shock of her shopping life for the first time, a store’s smart salesgirl refused to accept her coins in payment for a purchase worth not more than P100. HW was paying P70 in 25-centavo coins and P25 in 10-centavo coins. Strange as it may seem, the salesgirl told HW that her coins were not “legal tender”. Do you agree with the salesgirl in respect of her understanding of “legal tender”? Explain.**

**Answer:**

No. The salesgirl’s understanding that coins are not legal tender is not correct. Coins are legal tender in amounts not exceeding P50 for denominations from 25-centavos and above, and in amounts not exceeding P20 for denominations 10-centavos and less. (BAR 2000)

### b. Rate of Exchange

## IX. Uniform Currency Act (Republic Act 529)

- 1. In all the transactions between X and Y it is so stipulated that payment of the domestic obligations shall be made in equivalent pesos at the rate of exchange of the American dollar at the time of payment. Is the stipulation valid? Reason.**

**Answer:**

No, the stipulation is not valid. By express provisions of Section 1 of R.A. No. 529, any obligation contracted in the Philippines which provisions purport to give the obligee the right to require payment in gold or in a particular kind of coin or currency other than Philippine currency or in an amount of money of the Philippines measured thereby is declared against public policy and is null and void. (BAR 1976)

- 2. On September 21, 1984, Pedro Cruz borrowed US\$10,000 from Johnny Reyes, a balikbayan, in Manila and promised to repay the loan in American dollars in Manila on September 21, 1985. The loan agreement was signed in Manila and the parties even had it notarized by a notary public.**

**a) Is the stipulation for payment in American dollars enforceable? Explain.**

**b) Does the obligation to pay subsist? Explain.**

**Answer:**

a) The stipulation for payment in American dollars is not enforceable. That is declared null and void and of no effect by the law.

b) The obligation to pay, however, subsists. What the law specifically prohibits is payment in currency other than legal tender. It does not defeat a creditor's claim for payment, which shall be discharged in currency which is legal tender in the Philippines, at the current rate of exchange at the time of payment. (BAR 1985)

- 3. Jose Villa leased his house in Dasmariñas Village to Peter Booth, an executive of a New York company with a branch office here. The lease contract, which had a term of 3 years, stipulated that rentals shall be payable in U.S. dollars in New York to the lessor's son who happened to be residing in Manhattan. On the second year of the lease, Peter Booth resigned from his company but decided to remain in the country and continue the lease. Since the company was no longer paying his rentals, Booth informed his landlord, Villa, that he would henceforth be paying his rentals in Philippine pesos out of his local earnings. Villa refused to accept payment in pesos and insisted on the provisions of the lease contract stipulating payment of rentals in U.S. dollars.**

**Is there a legal basis for the landlord's position? Explain your answer.**

**Answer:**

There is no legal basis for the landlord's position. The Uniform Currency Act prohibits and renders void a stipulation requiring payment of money obligations in foreign currency or in gold or in Philippine currency measured in foreign currency or in gold. There are, to be sure, an expressed exception from the rule-the instant case, however, does not fall under any of those exceptions. (BAR 1987)

- 4. Mars Trading, Inc. (MTI) imported various construction materials from Japan, under a letter of credit-trust receipt (LC/TR) line provided by Filipinas Bank. When the goods arrived in Manila, the same were released to MTI upon the latter's execution of a trust receipt whereby MTI undertook to hold the goods in trust for the bank. The trust receipt further provided that upon sale of the goods, the entrustee (MTI) will turn over the proceeds of the sale to the entrusting bank to the extent of the amount of U.S. \$100,000 owed by MTI to the bank on account of its importation, which amount shall be paid in Philippine currency based on the rate of exchange prevailing at the time of payment. MTI sold the goods 6 months later, during which the time the peso-dollar rate of exchange deteriorated substantially. MTI refused to pay Filipinas Bank contending that:**

- a) **The trust receipt stipulation to pay the peso equivalent of \$100,000 violated the Uniform Currency Act, rendering the trust receipt void, and**
- b) **Assuming arguendo that such stipulations were enforceable, MIT should pay only on the basis of the rate of exchange prevailing on the date when the goods were released.**

**Decide with reasons.**

**Answer:**

- a) MIT is liable since only the stipulation requiring payment on foreign currency is violative of the Uniform Currency Act. The obligation itself under the law subsists, which can be discharged by a payment in Philippine currency.
  - b) The basis of payment would be the rate of exchange prevailing at the time of payment since the obligation was incurred in foreign currency. Had the obligation been incurred in Philippine currency then the rate of exchange at the time the obligation was incurred would have been the basis of payment. (BAR 1987)
5. **On October 10, 1981, B borrowed from C the sum of P1.5 M. To hedge against the depreciation of the Philippine Peso, it was stipulated in the promissory note executed by B in favor of C that the loan shall be paid in US dollars at the exchange rate prevailing on the date the obligation was incurred, plus interest at 12% per annum.**

**1. Is the stipulation valid? Explain.**

**2. Assuming that the stipulation is invalid, does the obligation to pay subsist? How should it be discharged?**

**Answer:**

1. No. The obligation was incurred in the Philippines. Hence, the Uniform Currency Law, which requires payment in the Philippine currency, applies.
2. Yes. It should be discharged in Philippine pesos at the rate of exchange prevailing at the time of payment. (BAR 1993)

**X. Law on Secrecy of Bank Deposits (R.A. No. 1405, as amended)**

**A. Purpose**

**B. Prohibited Acts**

1. **The City Fiscal of Manila required the Manila Banking Corporation to produce at a hearing the records of bank deposits of Alfredo Santos. The Manila Banking Corporation refused, alleging that disclosure of bank deposits is prohibited by R.A. No. 1405. Threatened with prosecution, the Corporation filed an action for declaratory judgment. May the court compel the Manila Banking Corporation to disclose the bank deposits of Alfredo Santos?**

**Answer:**

Under the law, all deposits with banks are absolutely confidential and may not be inquired into by any government official except upon written permission of the depositor, or in cases of impeachment, or upon order of a competent court in cases of bribery, dereliction of duty of public officials, or in cases where the money deposited is the subject matter of litigation. Unless the case of Alfredo Santos comes under one of these exceptions, the court cannot compel the Manila Banking Corp., to disclose his bank deposits. (Section 2, R.A. 1405) (BAR 1976)

2. **A bought some goods from a Department Store and paid with his personal check. When the Department Store deposited the check of A, the bank dishonored it. On the assumption that the Department Store did not know who A was, the store manager inquired from the check's drawee bank the name of the dishonored check. The drawee bank refused to disclose the name of such drawer in view of R.A. No. 1405 which governs the Secrecy of Bank Deposits.**

**Is the bank justified in not divulging the name of the drawer to the store manager? Why?**

**Answer:**

The bank is not justified in not divulging the name of the drawer to the store manager. The store manager is merely inquiring as to the name of the drawer of the dishonored check. To divulge the same would not in anyway amount to disclosure of any information concerning his deposits, if any, in said bank. Moreover, the inquiry is not an investigation of any balance in favor of the depositor. To include such disclosure within the ambit of the prohibition embodied in R.A. No. 1405 would be unduly straining and stretching the meaning of the said Act. The prohibition under Sec. 2 of R.A. No. 1405 concerns merely with the examination, inquiry or looking into all deposits of whatever nature with banks or banking institutions. (BAR 1977)

3. **"K" borrows P200,000.00 from Eternity Banking Corporation which, in accordance with its credit criteria, grants the loan against the security of a plush condominium unit with an appraised value of P1.5 Million.**

**ABC Credit Services Inc., a corporation engaged in the gathering of credit information, sends a letter to the bank inquiring about any property of "K" which the bank holds and, if any, to furnish the description of the property. Jose Santos, Vice-president of the bank, in his reply thereto, discloses the details of the property mortgaged.**

**Did the bank officer violate any existing legal provision?**

**Answer:**

The bank officer, Jose Santos, did not violate any existing legal provision. The Republic Act prohibiting disclosure of, or inquiry into, deposits with any banking institution, and the General Banking Act do not prohibit such disclosure on the details of the property mortgaged with a bank. (BAR 1980)

4. **A owns 100 out of 10,000 shares in the Manufacturer's Bank. He filed a suit against B for damages due to an alleged breach of contract. A secures a favorable judgment against B but fails to obtain full satisfaction thereof.**

**A receives a tip that B has a big time deposit with Manufacturer's Bank. B is not aware that A is a stockholder in the said bank. A goes to the bank and demands the right to inspect the records of the bank to find out whether B has indeed such a time deposit and how much. The bank manager refuses to accede to his demand. A threatens to sue him on the ground that as a stockholder of the corporation, he is given by the Corporation Code the right to inspect all the books of the corporation.**

**Is A entitled to look at such records? Explain.**

**Answer:**

No. under the Secrecy of Bank Deposits Law, all bank deposits of whatever nature are considered as absolutely confidential in nature and may not be inquired into by any person except under specified circumstances. This case does not come under any of these exceptions. The deposit is not the subject matter of the action against B. Although it is true that under the Corporation Code a stockholder has the right to inspect all the business records of his corporation, such right must give way to the limitations set forth under the special law mentioned, which was intended to encourage deposits in banking institutions. Furthermore, the right of

inspection should be exercised in connection with the interest of the stockholder in the corporation and not in relation to such an extraneous matter as the case in question. (BAR 1983)

5. **Don Mariano was able to secure a favorable judgment against Nestor Pe for recovery of sum of money and the said judgment had become final and executory. Don Mariano was informed by someone that Nestor Pe might have a sizeable savings deposit with Xena Commercial Bank, of which Don Mariano was a stockholder, with 1 share registered in his name. Immediately, he rushed to the Bank and demanded from the Bank Manager that he be shown the bank records to see if Nestor Pe really had such savings deposit. When the Bank Manager refused and invoked R.A. No. 1405, Don Mariano cited his right as a stockholder to inspect corporate records.**

- a) **Is the stand of the Bank Manager legally tenable? Explain.**
- b) **What remedy is available to Don Mariano? Explain.**

**Answer:**

- a) Yes, the stand of the Bank Manager of Xena Commercial Bank, of which Don Mariano is a stockholder, with 1 share, is legally tenable. Although as a general rule in the Corporation Code, a stockholder may inspect the books of a corporation, yet it is subject to a special law, like R.A. No. 1405, which operates as exception to the general rule, and shall be strictly construed. The case of Don Mariano does not fall under any of the exceptions.
- b) The only remedy of Don Mariano, his judgment for a sum of money against Nestor Pe being already final and executor, is to ask the court to require the cashier of the said bank to inform the court whether or not Nestor Pe has a deposit in the bank for purposes of garnishment, to insure satisfaction of the judgment. (BAR 1985)

6. **Manosa, a newspaper columnist, while making a deposit in a bank, overheard a pretty bank teller informing a co-employee that Gigi, a well-known public official, has just a few hundred pesos in her bank account and that her next check will in all probability bounce. Manosa wrote this information in his newspaper column. Thus, Gigi filed a complaint with the Office of the City Fiscal of Manila for unlawfully disclosing information about her bank account. Will the said suit prosper? Explain your answer.**

**Answer:**

- a) The Secrecy of Bank Deposits Act prohibits, subject to its exclusionary clauses, any person from examining, inquiring or looking into all deposits of whatever nature with banks or banking institutions in the Philippines which by law are declared "absolutely confidential" in nature. Manosa, who merely overheard what appeared to be vague remark of a Bank employee to a co-employee and writing the same in his newspaper column is neither the inquiry nor disclosure contemplated by the law. (BAR 1990)

7. **An insurance company is deluded into releasing a check to A for P35 M to pay for T-bills which A claims to be en route on board an armoured truck from a government bank. The check is delivered to A who deposits it to his account with XYZ Bank before the insurance company realized it is a scam. Upon such realization, the insurance company files an action against A for recovery of the amount defrauded and obtains a writ of preliminary attachment. In addition to the writ, the bank is also served a subpoena to examine the account records of A. the bank declines to provide any information in response to the writ and moves to quash the subpoenas invoking secrecy of bank deposits under RA 1405, as amended. Can the Bank justifiably invoke RA 1405 and (a) not respond to the writ and (b) quash for examination?**

**Answer:**

Yes. Whether the transaction is considered a sale or money placement does not make the money subject matter of litigation within the meaning of Sec. 2 of RA 1405 which prohibits the disclosure or inquiry into bank

deposits except “in cases where the money deposited or invested is the subject matter of litigation” nor will it matter whether the money was “swindled”. (BAR 1998)

8. **GP is a suspected jueteng lord who is rumored to be enjoying police and military protection. The envy of many drug lords who had not escaped the dragnet of the law, GP was summoned to a hearing of the Committee on Racketeering and Other Syndicated Crimes of the House of Representatives, which was conducting a congressional investigation “in aid of legislation” on the involvement of police and military personnel, and possibly even of local government officials, in the illegal activities of suspected gambling and drug lords. Subpoenaed to attend the investigation were officers of certain identified banks with a directive to them to bring the records and documents of bank deposits of individuals mentioned in the subpoenas, among them GP. GP and the banks opposed the production of the banks records of deposits on the ground that no such inquiry is allowed under the Law on Secrecy of Bank Deposits. (RA 1405). Is the opposition of GP and the bank valid? Explain.**

**Answer:**

Yes. The opposition is valid. GP is not a public official. The investigation does not involve one of the exceptions to the prohibition against disclosure of any information concerning bank deposits under the Law on Secrecy of Bank Deposits. The Committee conducting the investigation is not a competent court or the Ombudsman authorized under the law to issue a subpoena for the production of the bank record involving such disclosure. (BAR 2000)

9. **TRUE OR FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**If the Ombudsman is convinced that there is a violation of law after investigating a complaint alleging illicit bank deposits of public officer, the Ombudsman may order the bank concerned allow in camera inspection of bank records and documents.**

**Answer:**

False. The Bank Secrecy Law prohibits the inspection of a bank account unless the permission of the account holder is obtained, or upon lawful order of the court or when the deposit is the subject matter of litigation. Investigation by the Ombudsman is not considered as a pending litigation to allow the examination of the bank records and documents. (BAR 2009)

10. **From his first term in 2007, Congressman Abner has been endorsing his pork barrel allocations to Twin Rivers in exchange for a commission of 40% of the face value of the allocation. Twin Rivers is a non-governmental organization whose supporting papers, after audit, were found by the COA to be fictitious. Other than to prepare and submit falsified papers to support the encashment of the pork barrel checks, Twin Rivers does not appear to have done anything on the endorsed projects and Congressman Abner likewise does not appear to have bothered to monitor the progress of the progress of the projects he endorsed. The congressman converted most of the commissions he generated into US dollars, and deposited these in a foreign currency account with Banco de Plata (BDP)**

**Based on amply-supported tips given by a congressman from another political party, the AMLC sent BDP an order: (1) to confirm Cong. Abner’s deposits with the bank and to provide details of these deposits; and (2) to hold all withdrawals and other transactions involving the congressman’s bank accounts.**

**As counsel for BDP, would you advise the bank to comply with the order?**

**Answer:**

I shall advise BDP not to comply with the order of the AMLC. It cannot inquire into the deposits of Congressman Abner, regardless of currency, without a bank inquiry order from a competent court, because crimes involved

are not kidnapping for ransom, violations of the Dangerous Drugs act, hijacking and other violations of R.A. No. 6235, destructive arson, murder, and terrorism and conspiracy to commit terrorism.

The AMLC cannot order BDP to hold all withdrawals and other transactions involving the accounts of Congressman Abner. It is the Court of Appeals which has the power to issue a freeze order over that accounts upon petition of the AMLC. (BAR 2013)

### C. Deposits Covered

1. **An employee of a large manufacturing firm earns a salary which is just a bit more than what he need for a comfortable living. He is thus able to still maintain a P10,000 savings account, a P20,000 checking account, a P30,000 money market placement and a P40,000 trust fund in a medium-size commercial bank.**

**State which of the above accounts are covered by the Law on Secrecy of Bank Deposits.**

**Answer:**

The P10,000 savings account and the P20,000 checking account are covered by the Law on Secrecy of Bank Deposits. (BAR 1997)

2. **Hi Yielding Corporation filed a complaint against 5 of its officers for violation of Section 31 of the Corporation Code. The corporation claimed that the said officers were guilty of advancing their personal interests to the prejudice of the corporation, and that they were grossly negligent in handling its affairs. Aside from documents and contracts, the corporation also submitted in evidence records of the officers' U.S. Dollar deposits in several bank overseas—Boston Bank, Bank of Switzerland, and Bank of New York.**

**For their part, the officers filed a criminal complaint against the directors of Hi Yielding Corporation for violation of RA No. 6426, otherwise known as Foreign Currency Deposit Act of the Philippines. The officers alleged that their bank deposits were illegally disclosed for want of a court order, and that such deposits were not even the subject of the case against them.**

- a) **Will the complaint filed against the directors of Hi Yielding Corporation prosper? Explain.**
- b) **Was there a violation of the Secrecy of Bank Deposits Law (RA 1405)? Explain.**

**Answer:**

- a) No. Section 2 of RA No. 6426, as amended, speaks of deposit with such Philippine banks in good standing, as may be designated by the Central Bank for the purpose, and is inapplicable to the foreign currency account in question.
- b) No. Section 2 of RA No. 1405 or the Bank Secrecy Law covers only “deposits of whatever nature with banks or banking institutions in the Philippines xxx”, hence, cannot be made to apply to foreign banks. (BAR 2005)

### D. Exceptions

1. **“T”, a branch manager of a bank, in response to a notice of garnishment, discloses to the Sheriff of Pasig the outstanding deposit balance of judgment debtor Roy Sevilla with the bank as of the date of receipt of the aforementioned garnishment notice.**

**Roy Sevilla files a criminal complaint with damages against the bank for disclosing his depository balance without his consent in violation of R.A. 1405, which absolutely prohibits the disclosure of any information concerning bank deposits.**

**Would the complaint prosper?**

**Answer:**

No, the criminal complaint against the bank by Roy Sevilla would not prosper. The prohibition against examination of, or inquiry into, a bank deposit, does not preclude its being garnished to insure satisfaction of a judgment. Indeed, there is no real inquiry in such a case, and if the existence of the deposit is disclosed, the disclosure is purely incidental to the execution process. (BAR 1980)

2. **“A” obtained a money judgment against “B”. To satisfy the judgment, “A” sought the garnishment of “B’s” bank deposit. Accordingly, a notice of garnishment was issued and served on his bank through its cashier. In reply, the cashier called the attention of the sheriff to the provisions of R.A. 1405, which prohibits the disclosure of any information relative to bank deposits.**

**Can the cashier be compelled to disclose the existence of “B’s” deposit? Why?**

**Answer:**

Yes, the cashier of the bank may be compelled to disclose the existence of “B’s” deposit. The prohibition against examination of, or inquiry into, a bank deposit, does not preclude its being garnished to insure satisfaction of a judgment. Indeed, there is no real inquiry in such a case, and if the existence of the deposit is disclosed, the disclosure is purely incidental to the execution process. (*China Banking Corporation v. Ortega, Jan. 31, 1973; 49 SCRA 355*) (BAR 1981)

3. **A secured a judgment by default against B for a sum of money. To satisfy the judgment, A sought the garnishment of the bank deposit of B with China Bank. The Bank refused.**

**a) What are the exceptions to the prohibition against disclosure of bank deposits?**

**Answer:**

a) The exceptions to the prohibitions against disclosure of bank deposits include—

1. Upon written permission of the depositor;
2. In cases of impeachment;
3. Upon order of a competent court in cases of bribery or dereliction of duty or where the money deposited or invested is the subject matter of litigation;
4. In anti-graft cases;
5. When authorized by the Monetary Board if it has reasonable ground to believe that such account is being used or was used to commit bank fraud. (BAR 1988)

4. **X, a public official, is charged with violation of the Anti-Graft Law for unexplained wealth. The prosecuting official learned that X maintains safety deposit boxes at Union Bank. May the officials of the bank be subpoenaed and examined about the safety deposit boxes?**

**Answer:**

Yes, the officials of the bank may be subpoenaed and examined about the safety deposit boxes. The prohibition against the inquiry or disclosure of bank accounts under the Secrecy of Bank Deposits Law does not apply to the case.

Even if the safety deposit box is not considered a bank deposit, the answer is still in the affirmative because the law provides that one of the exception to the secrecy of bank deposits is upon order of the court in cases of bribery or dereliction of duty of public officials.

Also, in the case of *Banco Filipino v. Purisima*, 161 SCRA 576, the Supreme Court said that the Anti-Graft and Corruption Practices Act intends to provide an additional ground for the examination of bank deposits without violating the Secrecy of Bank Deposits Law by allowing inquiry into “illegally” or “not legitimately” acquired property. (BAR 1989)

5. **Manosa, a newspaper columnist, while making a deposit in a bank, overheard a pretty bank teller informing a co-employee that Gigi, a well-known public official, has just a few hundred pesos in her bank account and that her next check will in all probability bounce. Manosa wrote this information in his newspaper column. Thus, Gigi filed a complaint with the Office of the City Fiscal of Manila for unlawfully disclosing information about her bank account. Supposing that Gigi is charged with unlawfully acquiring wealth under RA No. 1379 and that the fiscal issued a subpoena duces tecum for the records of the issuance on the ground that the same violates the law on secrecy of bank deposits? Explain your answer.**

**Answer:**

Among the instances excepted from the coverage of the Secrecy of Bank Deposits Act are anti-graft cases. Hence, Gigi may not validly oppose the issuance of a subpoena duces tecum for the bank records on her. (BAR 1990)

6. **The law (RA No. 6832) creating a Commission to Conduct a Thorough Fact-Finding Investigation of the Failed Coup D’Etat of December 1989, Recommended Measures to Prevent The Occurrence of Similar Attempts at a Violent Seizure of Power and for Other Purposes, provides that the Commission may ask the Monetary Board to disclose information on and/or grant authority to examine any bank deposits, trust or investment funds, or banking transactions in the name of and/or to grant authority to examine any bank deposits, trust or investment funds, or banking transactions in the name of and/or utilized by a person, natural or juridical, under investigation by the Commission, in any bank or banking institution in the Philippines, when the Commission has reasonable ground to believe that said deposits, trust or investment funds, or banking transactions have been used in support or in furtherance of the objectives of the said coup d’etat.**

**Does not the above provision violate the Law on Secrecy of Bank Deposits (RA No. 1405)?**

**Answer:**

The law on Secrecy of Bank Deposits is itself merely a statutory enactment, and it may, therefore, be modified, or amended (such as by providing further exceptions therefrom), or even repealed, expressly or impliedly, by a subsequent law. The Secrecy of Bank Deposits Act did not amount to a contract between the depositors and depositary banks within the meaning of the non-impairment clause of the Constitution. Even if it did, the police power of the State is superior to the non-impairment clause. RA No, 6832, creating a commission to conduct an investigation of the failed 1989 coup d’etat and to recommend measures to prevent similar attempts to seize power is a valid exercise of police power. (BAR 1991)

7. **Socorro received \$10,000 from a foreign bank although she was entitled only to \$1,000. In an apparent plan to conceal the erroneously sent amount, she opened a dollar account with her local bank, deposited the \$10,000 and issued 4 checks in the amount of \$2,000 and 1 check for \$1,000 each payable to different individuals who deposited the same in their respective dollar accounts with different local banks.**

**The sender bank then brought a civil suit before the RTC for the recovery of the erroneously sent amount. In the course of the trial, the sender presented testimonies of the bank officials to show that the funds were, in fact, deposited in a bank by Socorro and paid out to several persons, who participated in the concealment and dissipation of the amount that Socorro had erroneously received.**

**Socorro moved to strike out said testimonies from the record invoking the law on secrecy of bank deposits.**

**If you were the Judge, would you issue an order to strike them out? Why?**

**Answer:**

No. I will not strike out the testimonies from the record. The testimonies of bank officials indicating where the questioned dollar accounts were opened in depositing misappropriated sums must be considered as likewise involved in litigation—one which is among the excepted cases under the Secrecy of Bank Deposits Act. (BAR 1992)

- 8. Miguel, a special customs agent is charged before the Ombudsman with having acquired property out of proportion to his salary, in violation of the Anti-Graft and Corrupt Practices Act. The Ombudsman issued a subpoena duces tecum to the Banco de Cinco commanding its representative to furnish the Ombudsman records of transactions by or in the name of Miguel, his wife and children. A second subpoena was issued expanding the first by including the production of records of friends of Miguel in said bank and in all its branches and extension offices, specifically naming them.**

**Miguel moved to quash the subpoenas arguing that they violate the Law on Secrecy of Bank Deposits. In addition, he contends that the subpoenas are in the nature of “fishing expedition” or “general warrants” and are constitutionally impermissible with respect to private individuals who are not under investigation.**

**Is Miguel’s contention tenable?**

**Answer:**

No. Miguel’s contention is not tenable. The inquiry into illegally acquired property extends to cases where such property is concealed by being held by or recorded in the name of other persons. To sustain Miguel’s theory and restrict the inquiry only to property held by or in the name of the government who illegally acquire property an easy means of evading prosecution. All they have to do would be to simply place the property in the name of persons other than their spouses and children. (BAR 1994)

- 9. Michael withdrew authority funds of the partnership in the amounts of P500,000 and used US\$50,000 for services he claims he rendered for the benefit of the partnership. He deposited the P500,000 in his personal peso current account with Prosperity Bank and the US\$50,000 in his personal foreign currency savings account with Eastern Bank.**

**The partnership instituted an action in court against Michael, Prosperity Bank and Eastern Bank to compel Michael to return the subject funds to the partnership and pending litigation to order both banks to disallow any withdrawal from his accounts.**

**At the initial hearing of the case the court ordered Prosperity Bank to produce the records of Michaels’s peso current account, and Eastern Bank to produce the records of his foreign currency savings account.**

**Can the court compel Prosperity Bank and Eastern Bank to disclose the bank deposits of Michael? Discuss fully.**

**Answer:**

Yes, as far as the peso account is concerned. Section 2 of RA No. 1405 allows the disclosure of bank deposits in case where the money deposited is the subject matter of the litigation. Since the case filed against Michael is aimed at recovering the amount he withdrew from the funds of the partnership, which amount he allegedly deposited in his account, a disclosure of his bank deposits would be proper.

No, with respect to the foreign currency account. Under the Foreign Currency Law, the exemption to the prohibition against disclosure of information concerning bank deposits is the written consent of the depositor. (BAR 1995)

**10. The Law on Secrecy of Bank Deposits provides that all deposits of whatever nature with banks or banking institutions are absolutely confidential in nature and may not be examined, inquired or looked into by any person, government official, bureau or office. However, the law provides exceptions in certain instances.**

**Which of the following may not be among the exceptions:**

- 1. In cases of impeachment.**
- 2. In cases involving bribery.**
- 3. In cases involving BIR inquiry.**
- 4. In cases of anti-graft and corrupt practices.**
- 5. In cases where the money involved is the subject of litigation.**

**Explain your answer or choice briefly.**

**Answer:**

Under Section 6(F) of the NIRC, the Commissioner of Internal Revenue can inquire into the deposits of a decedent for the purpose of determining the gross estate of such decedent. Apart from this case, a BIR inquiry into bank deposits cannot be made. Thus, exception 3 may not always be applicable.

Turning to exception 4, an inquiry into bank deposits is possible only in prosecutions for unexplained wealth under the Anti-Graft and Corrupt Practices Act, according to the Supreme Court in the cases of *Philippine National Bank v. Gancayco*, 15 SCRA 91 (1965) and *Banco Filipino Savings and Mortgage Bank v. Purisima*, 161 SCRA 576 (1988). However, all other cases of anti-graft and corrupt practices will not warrant an inquiry into bank deposits. Thus, exception, it must be interpreted strictly.

Exceptions 1, 2, and 5, on the other hand, are provided expressly in the Law on Secrecy of Bank Depositor. They are available to depositor at all times. (BAR 2004)

**11. Under RA No. 1405 (The Bank Secrecy Law), bank deposits are considered absolutely confidential and may not be examined, inquired or looked into by any person, government official, bureau or office.**

**What are the exceptions?**

**Answer:**

The following are the exceptions to the Bank Secrecy Law under Section 2 of RA No. 1405, viz:

1. Upon written permission of the depositor;
2. In cases of impeachment;
3. In cases where the money deposited or invested is the subject matter of litigation; and
4. Upon order of a competent court in cases of bribery or dereliction of duty of public officials.

The following circumstances also constitute exceptions to the secrecy of bank deposits:

1. Upon order of the court in cases of unexplained wealth under Section 8 of the Anti-Graft and Corrupt Practices Act.
2. Upon order of the Commissioner of the Internal Revenue with respect to the bank deposits of a decedent for the purpose of determining the decedent's gross estate.

3. Upon the order of the Commissioner of the Internal Revenue with respect to the bank deposits of a taxpayer who has filed an application for compromise of his tax liability under Section 204(A)(2) of the NIRC by reason of financial incapacity to pay his tax liability.
4. In the case of unclaimed balances.
5. Without need of court order, if the AMLC determines that a particular deposit or investment with any banking institution is related to any one of the following unlawful activities:
  - a. Kidnapping for ransom under Art.267 of Act No. 3815 (RPC);
  - b. Violations of Sections 4, 5, 6, 8, 9, 10, 12, 13, 14, 15, and 16 of RA No. 9165 (Comprehensive Dangerous Drugs Act of 2002);
  - c. Hijacking and other violations under RA No. 6235; destructive arson and murder, as defined under the RPC, as amended, including those perpetrated by terrorists against non-combatant persons and similar targets;
  - d. Upon order of the court, if the AMLC determines that a particular deposit or investment with any banking institution is related to any one of the unlawful activities under Sec. 3(i), except those referred to in Section 3(i)[1],[2] and [12] of RA No. 9160 or a money laundering offense under Section 4 (Sec.11, RA 9160); and
  - e. Inquiry into or examination of nay deposit or investment with any banking institution when the examination is made by the Bangko Sentral ng Pilipinas to insure compliance with the Anti-Money Laundering Law in the course of a periodic or special examination of the BSP (Sec.11, RA 9160; see also Sec.4, RA 8791).
6. When the examination is made in the course of a special or general examination of a bank and is specially authorized by the Monetary Board after being satisfied that there is reasonable ground to believe that a bank fraud or serious irregularity has been or is being committed and that it is necessary to look into the deposit to establish such fraud or irregularity;
7. When examination is made by an independent auditor hired by the bank to conduct its regular audit provided that examination is for audit purposes only and the results thereof shall be for the exclusive use of the bank;
8. Upon order of the court in cases filed by the Ombudsman and upon the latter's authority to examine and have access to bank accounts and records. (BAR 2006)

**12. The Bank Secrecy Law (RA 1405) prohibits disclosing any information about deposit records of an individual without court order except—**

- a) In an examination to determine gross estate of a decedent;
- b) In an investigation for violation of Anti-Graft and Corrupt Practices;
- c) In an investigation by the Ombudsman;
- d) In an impeachment proceeding.

**Answer:**

- a) In an examination to determine gross estate of a decedent. (BAR 2012)

**13. X is being charged for violation of Anti-Graft and Corrupt Practices because he is suspected of having accumulated unexplained wealth. X maintains deposit accounts with ABC Bank. The Ombudsman filed criminal cases against X before the Sandiganbayan. Can the court issue subpoena against ABC Bank to produce all documents pertaining to all the deposit accounts of X?**

- a) Yes, because there is already a pending case and provided the subpoena must be specific as to which account;
- b) Yes, it is enough that the specific bank is identified;
- c) No, because the issuance of the subpoena has no real legal basis;

**d) Even without a subpoena, information about the deposit accounts of X can be submitted to the Sandiganbayan because it will be used in a pending case.**

**Answer:**

a) Yes, because there is already a pending case and provided the subpoena must be specific as to which account. (BAR 2012)

### **E. Garnishment of Deposits, including Foreign Deposits**

**1. A secured a judgment by default against B for a sum of money. To satisfy the judgment, A sought the garnishment of the bank deposit of B with China Bank. The Bank refused.**

**b) May a writ of garnishment be issued against the bank deposit of B? Reasons.**

**Answer:**

b) Yes, a writ of garnishment may be issued against the bank deposit of B with China Bank. The Law on Secrecy of Bank Deposits is merely against inquiry or disclosure of information relative to the funds or property in the custody of the bank. (BAR 1988)

**2. The Law on Secrecy of Bank Deposits, otherwise known as RA 1405, is intended to encourage people to deposit their money in banking institutions and also to discourage private hoarding so that the same may be properly utilized by banks to assist in the economic development of the country. Is a notice of garnishment served on a bank at the instance of a creditor of a depositor covered by the said law? State the reason/s for your answer.**

**Answer:**

No. The notice of garnishment served on a bank at the instance of a creditor of a depositor is not covered by the Law on Secrecy of Bank Deposits. Garnishment is just a part of the process of execution. The moment a notice of garnishment is served on a bank and there exists a deposit by the judgment debtor, the bank is directly accountable to the sheriff, for the benefit of the judgment creditor, for the whole amount of the deposit. In such event, the amount of the deposit becomes, in effect, a subject of the litigation. (BAR 2001)

**3. CDC maintained a savings account with CBank. On orders of the MM RTC, the Sheriff garnished P50,000 of his account, to satisfy the judgment in favor of his creditor, MO. CDC complained that the garnishment violated the Law on the Secrecy of Bank Deposits because the existence of his saving account was disclosed to the public.**

**Is CDC's complaint meritorious or not? Reason briefly**

**Answer:**

No. CDC's complaint is not meritorious. It was held in China Banking Corporation v. Ortega, 49 SCRA 355 (1973) that peso deposits may be garnished and the depository bank can comply with the order of garnishment without violating the Law on the Secrecy of Bank Deposits. Execution is the goal of litigation as it is its fruit. Garnishment is part of the execution process. Upon service of the notice of garnishment on the bank where the defendant deposited funds, such funds become part of the subject matter of litigation. (BAR 2004)

### **XI. Foreign Currency Deposit Act**

1. Which of the following is an exception to the secrecy of bank deposits which are in the Philippine Pesos, but NOT an exception to the secrecy of foreign currency deposits?
- a) Upon BSP inquiry into or examination of deposits or investments with any bank, when the inquiry or examination is made in the course of the BSP's periodic special examination of said bank to ensure compliance with the AMLA;
  - b) Upon PDIC and BSP inquiry into examination of deposit accounts in case there is a finding of unsafe or unsound banking practice;
  - c) Upon inquiry in cases of impeachment;
  - d) Upon inquiry by the Commissioner of Internal Revenue in the event a taxpayer files an application to compromise his tax liabilities on the ground of financial incapacity.

**Answer:**

a) Upon inquiry in cases of impeachment. (BAR 2012)

2. X, a private individual, maintains a dollar deposit with ABC Bank. X is suspected to be the leader of a Kidnap for Ransom Gang and he is suspected of depositing all ransom money in said deposit account which are all in US Dollars. The police want to open said account to know if there are really deposits in big amounts. Which statement is most accurate?
- a) The same rules under the Secrecy of Bank Deposit Act will apply;
  - b) An approval from the Monetary Board is necessary to open the account;
  - c) Because the deposit is in US Dollars, it is covered by the Foreign Currency Deposit Act which allows disclosure only upon the written permission of the depositor;
  - d) Approval from the court is necessary to order disclosure of the account.

**Answer:**

a) The same rules under the Secrecy of Bank Deposit Act will apply. (BAR 2012)

## XII. General Banking Law of 2000 (R.A. No. 8791)

### A. Definition and Classification of Banks

1. ABC Investment Corp is engaged in the purchase of accounts receivables or specifically, installment papers of purchasers of cars and truck. As a source of its funding, ABC investment Corp sells its bonds from time to time to the public. The proceeds of the sale of its bonds are utilized by the ABC Investment Corp in its financing operations. On the basis of these facts, the Legal Counsel of the Central Bank rendered an opinion to the effect that ABC Investment Corp is a banking institution within the purview of Sec 2 of the General Banking Act.

**Is this correct? Give reasons for your answer.**

**Answer:**

No. the opinion of the Legal Counsel of the Central bank to the effect that ABC Investment Corporation is a banking institution within the purview of the General Banking Act, is not correct.

Reason: Said Corporation does not fall within the definition of a bank. A bank, as defined in the General Banking Act, is one which is engaged in the receipt of deposits of any kind. Another reason which may be sufficient—ABC Corporation, being a financing corporation, has not been considered expressly by our law as banking institution. (BAR 1978)

2. **The Mahal Building and Loan Association was organized for the main purpose of encouraging savings and construction of homes among its members. As a matter of policy, it extends financial assistance to its members in the form of loans with funds deposited by them. The depositors are called participating members and funds deposited are referred to as savings. Anybody can be a depositor or become a participating member. To qualify for loan, a member must, among others, have sufficient collateral and deposit equal to ½ of the loan granted. The power to grant building loans is placed under the exclusive authority of the Board controlled by Andreas Family. Participating members are denied the right to vote or be voted for. The association is open to the public for ordinary demand deposit accounts so as to augment the funds to be granted as building Loans. Further, the Association, as another source for its funding for its financial operations, sells its own bonds to the public.**

**Does the Mahal Building and Loan Association violate the law on building and loan associations? Is it in fact operating as banking institution? Explain.**

**Answer:**

Yes, the Mahal Building and Loan Association violated the law on building and loan associations. Said association is not considered as a banking institution, duly authorized by the Monetary Board of the Central Bank, yet it engages in the lending of funds obtained from the public through the receipt of deposits of any kind, which only banks may do so. (BAR 1982)

3. **Fatima Investment Corporation is engaged in the purchase of accounts receivables or specifically, installment papers of purchasers of cars and trucks. As a source of its funding, it sells its bonds from time to time to the public. The proceeds of the sale of its bonds are utilized by Fatima Investment Corporation in its financing operations.**

- a) **Is Fatima Investment Corporation a banking institution within the purview of the General Banking Act?**  
b) **What is the effect if a corporation engages in illegal banking?**

**Answer:**

- a) Fatima in a strict sense is not a banking institution, but a financial intermediary. Under the General Banking Act, banking institutions, and financial intermediaries are considered financial institutions subject to and governed by that law.  
b) The General Banking Act, as well as the Central Bank Act, provides for civil and criminal liabilities, not only on the corporation, but likewise on the officers and directors thereof in proper cases, when a corporation engages in illegal banking. (BAR 1988)

4. **There are 6 classes of banks identified in the General Banking Law of 2000. Name at least 4 of them and explain the distinguishing characteristic or function of each one.**

**Answer:**

Any 4 of the following 6 classes of banks identified in the GBL of 2002, to wit:

- 1) **Universal Banks**—these are those which used to be called expanded commercial banks and the operations of which are now primarily governed by the GBL of 2000. They can exercise the powers of an investment house and invest in non-allied enterprises. They have the highest capitalization requirement.  
2) **Commercial Banks**—these are ordinary or regular commercial banks, as distinguished from a universal bank. They have a lower capitalization requirement than universal banks and cannot exercise the powers of an investment house and invest in non-allied enterprises.

- 3) **Thrift banks**—these banks (such as savings and mortgage banks, stock savings and loan associations, and private development banks) may exercise most of the powers and functions of a commercial bank except that they cannot, among others, open current or check accounts without prior Monetary Board approval, and they cannot issue letter of credit. Their operations are governed primarily by the Thrift Banks Act of 1995 (RA No, 7906)
- 4) **Rural Banks**—these are those which are organized primarily to extend loans and other credit facilities to farmers, fishermen or farm families, as well as cooperatives, merchants, and private and public employees and whose operations are primarily governed by the Rural Banks Act of 1992 (RA No. 7353)
- 5) **Cooperative Banks**—these are those which are organized primarily to provide financial and credit services to cooperatives and whose operations are primarily governed by the Cooperative Code of the Philippines (RA No. 6938)
- 6) **Islamic Banks**—these are those which are organized primarily to provide financial and credit services in a manner or transaction consistent with the Islamic Shari'a. at present, only the Al Amana Islamic Investment Bank of the Philippines has been organized as an Islamic bank. (BAR 2002)

**5. Briefly describe the following types of banks:**

**1. Universal bank**

**Answer:**

A universal bank is a commercial bank with 2 additional powers, namely:

- a. The power of an investment house; and
- b. The power to invest in non-allied enterprises.

**2. Commercial bank**

**Answer:**

A commercial bank is a bank that can:

- a. Accept drafts;
- b. Issue letters of credit;
- c. Discount and negotiate promissory note, bills of exchange, and other evidence of debt;
- d. Accept or create demand deposits;
- e. Receive other types of deposits, as well as deposit substitutes;
- f. Buy and sell foreign exchange, as well as gold or silver bullion;
- g. Acquire marketable bonds and other debts securities; and
- h. Extend credit, subject to such rules promulgated by the Monetary Board.

**3. Thrift bank**

**Answer:**

A thrift bank is one established as a savings and mortgage bank, a stock savings and loan association, or a private development bank, for the purpose of:

- a. Accumulating the savings of depositors and investing them in outlets determined by the Monetary Board as necessary in the furtherance of national economic objectives;
- b. Providing short-term working capital, medium and long-term financing, to business engaged in agriculture, services, industry and housing; and
- c. Providing diversified financial and allied services for its chosen market and constituencies especially for small and medium enterprises and individuals.

**4. Rural bank**

**Answer:**

A rural bank is one established to provide credit facilities to farmers and merchants or their cooperatives and, in general, to the people of the rural communities.

**5. Cooperative bank**

**Answer:**

A cooperative bank is organized under the Cooperative Code to provide financial and credit services to cooperatives. It may perform any or all the services offered by a rural bank, including the operation of a Foreign Currency Deposit Unit subject to certain conditions. (BAR 2010)

**6. May a publicly listed universal bank own 100% of the voting stocks in another universal bank and in a commercial bank?**

- a. Yes, if with the permission of the Bangko Sentral ng Pilipinas.
- b. No, since it has no power to invest in equities.
- c. Yes, as there is no prohibition on it.
- d. No, since under the law, the 100% ownership on voting stocks must be in either bank only.

**Answer:**

d. No, since under the law, the 100% ownership on voting stocks must be in either bank only. (BAR 2011)

**B. Distinction of Banks from Quasi-Banks and Trust Entities**

**1. XYZ Corporation is engaged in lending funds to small vendors in various public markets. To fund the lending, XYZ Corporation raised funds through borrowings from friends and investors. Which statement is most accurate?**

- a) XYZ Corporation is a bank;
- b) XYZ Corporation is a quasi-bank;
- c) XYZ Corporation is an Investment Company;
- d) XYZ is none of the above.

**Answer:**

b) XYZ Corporation is a quasi-bank. (BAR 2012)

**C. Bank Powers and Liabilities**

- 1. Corporate Powers
- 2. Banking and Incidental Powers

**1. MN and OP rented a safety deposit box at SIBANK. The parties signed a contract of lease with the conditions that: the bank is not a depository of the contents of the safe and has neither the possession nor control of the same; the bank assumed no interest in said contents and assumes no liability in connection therewith. The safety deposit box had two keyholes: one for the guard key which remained with the bank; and the other for the renter's key. The box can be opened only with the use of both keys.**

**The renters deposited certificates of title in the box. But later, they discovered that the certificates were gone. MN and OP now claim for damages from SIBANK. Is the bank liable? Explain briefly.**

**Answer:**

The bank is liable, based on the decision of the Supreme Court in *CA Agro-Industrial Development Corp. v. Court of Appeals*, 219 SCRA 426 (1993) and *Sia v. Court of Appeals*, 222 SCRA 24 (1993). In those cases, the Supreme Court ruled that the renting out of safety deposit boxes is a “special kind of deposit” wherein the bank is the depository. In the absence of any stipulation prescribing the degree of diligence required, that of a good father of a family is to be observed by the depository. Any stipulation exempting the depository from any liability arising from the loss of the thing deposited would be void for being contrary to law and public policy. The deposit box is located in the bank premises and is under the absolute control of the bank. (BAR 2004)

**2. How do you characterize the legal relationship between a commercial bank and its safety deposit box client?**

**Answer:**

The relationship between a commercial bank and its safety deposit box client is that of a bailee and bailor, the bailment being for hire and mutual benefit.

**Alternative Answer:**

The legal relationship of the bank and its safety deposit box client is that of a lessor and lessee. (BAR 2010)

**3. Is a stipulation in the contract for the use of a safety deposit box relieving the bank of liability in connection with the use thereof valid?**

**Answer:**

The stipulation relieving the bank of liability in connection with the use of the safety deposit box is void as it is against law and public policy. (BAR 2010)

**4. XXX Bank Corporation and ZZZ Corporation were merged into XX ZZ Bank Corporation. So as not to create any unnecessary conflict, all the former directors of both banks wanted to be appointed/elected as members of the Board of Directors of the merged bank. Each bank used to have 11 members of the board. The maximum number of directors of the merged bank is—**

- e) 15;
- f) 22;
- g) 21;
- h) 11.

**Answer:**

- c) 21. (BAR 2012)

- D. Diligence Required of Banks — Relevant Jurisprudence
- E. Nature of Bank Funds and Bank Deposits

**1. Differentiate “bank deposits” from bank substitutes”.**

**Answer:**

Bank deposits are funds obtained by a bank from the public which are lent by such bank to its own borrowers. Deposit substitutes are alternative forms of obtaining funds from the public, other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the own account of the borrower, for the purpose of relending or purchasing of receivables and other obligations. These instruments may include, but need not be limited to, bankers acceptances, promissory notes, participations, certificates of assignment and similar instruments with recourse, and repurchase agreements. (BAR 2010)

2. **Why are banks required to maintain reserves against their deposits and deposit substitutes? State one of three purposes for these reserves.**

**Answer:**

Any one of the following 4 purposes for requiring banks to maintain reserves against their deposits and deposit substitutes will suffice:

- a. One of the purposes of the requirement to maintain bank reserves is to control the volume of money created by the credit operations of the banking system;
- b. It is to enable the banks to answer any withdrawal;
- c. To help Government to finance its operation;
- d. To help Government control money supply. (BAR 2010)

**F. Stipulation on Interests**

1. **B borrowed in a written instrument from C, a friend, the sum of P1,000 with a diamond ring given in pledge as security for the debt. How much is the maximum interest per annum that C can charge B for the loan of money? Reason.**

**Answer:**

The maximum interest per annum that C can charge B for the loan of money with a pledge is 14%, since C is merely a friend and not a pawnbroker. (BAR 1975)

Note: The Usury Law has been legally non-existent pursuant to CB Circular 905; hence, interest can now be as lender and borrower may agree upon.

2. **X applied for a letter of credit with the Bank of America in favor of an export company located in Paris, France. The application provides that the draft must be drawn and presented not later than May 31, 1978, and X agreed to pay at maturity any amount that might be drawn or paid upon the faith of the applicant's credit and to reimburse the bank in said manner. On May 30, 1978, a draft was negotiated by the Bank of America's correspondent bank in Paris against X's credit; this was then paid by the Bank of America at the rate prevailing. The date of maturity of the draft was August 26, 1978. Before the date of maturity but after the correspondent bank had paid the draft, the French franc devaluated. At what rate should X pay the Bank of America in Philippine pesos, at the rate of the franc prevailing on May 30, 1978, or at its devaluated rate on August 26, 1978? Reason.**

**Answer:**

X should pay the Bank of America at the rate of the franc prevailing on May 30, 1978, the date when the Bank of America's correspondent bank in Paris, France, paid the letter of credit to the export company in French Franc, the letter of credit having been consummated at that time. (*Belman Cia., Incorprada v. Central Bank of the Philippines*, L-10195, Nov. 29, 1958) (BAR 1979)

3. **Borrower obtained a loan from a money lending enterprise for which he issued a promissory note undertaking to pay at the end of a period of 30 days the principle plus interest at the rate 5.5% per month plus 2% per annum as service charge.**

**On maturity of the loan, borrower failed to pay the principal debt as well as the stipulated interest and service charge. Hence, he was sued.**

- a. **How would you dispose of the issues raised by the borrower?**
- b. **That the stipulated interest rate is excessive and unconscionable?**

**Answer:**

- a. The rate of interest of 5.5% per month is excessive and unconscionable.
- b. The interest cannot be considered usurious. The Usury Law has been suspended in its application, and the interest rates are made "floating". (BAR 1999)

**G. Grant of Loans and Security Requirements**

1. **May rural banks grant loans on the security of lands without Torrens Titles and which are neither homesteads or free patents lands? Explain. May they open checking accounts? Explain.**

**Answer:**

Under the Rural Bank Act as amended, a rural bank may grant loans on the security of lands without Torrens Title provided the owner can show 5 years or more of continuous, peaceful, and uninterrupted possession in the concept of an owner.

Although under the Rural Bank Act, a rural bank may open checking accounts when authorized by the Monetary Board, this provision has been amended by Presidential Decree no. 71 which amends Section 20 of the General Banking Act. Under this amendment, only commercial banks may open checking accounts. However, any other bank (including a rural bank) which had been theretofore authorized by the Central Bank to accept checking account deposits may continue accepting check deposits at the discretion of the Monetary Board. (BAR 1975)

2. **"X" Corporation owns 55% of "Y" Corporation, which has an outstanding loan accommodation of P30 Million with ABC Banking Corporation. "X" Corporation, which has no outstanding loan, applies for a loan of P10 Million with ABC Banking Corporation to finance its expansion program. The officers of "X" and "Y" Corporation are not the same; neither are the stockholders of each corporation identical. The unimpaired capital and surplus of ABC Banking Corporation is P200 Million.**

**Could the bank grant the loan under existing banking laws?**

**Answer:**

No. ABC Banking Corporation may not grant the loan of P10 Million to X Corporation. Although X Corporation owns 55% of Y Corporation which has an outstanding loan accommodation of P30 Million with ABC Banking Corporation, yet such loan accommodation belong exclusively to Y Corporation, and not to X Corporation, each one of them having separate and distinct juridical personality from other. Under the banking law, there must be sufficient security for any loan to be made. (BAR 1980)

3. **ABC Commercial Bank extends a loan to A, one of its stockholders. As security for the repayment of the loan, A pledges his ABC Commercial Bank shares of stocks. Is the loan valid? Why?**

**Answer:**

The loan is invalid, contrary to Sec. 24 of the General Banking Act, which provides that no commercial bank shall make any loan on the security of shares of its own capital stock, unless such security is necessary to prevent loss upon a debt previously contracted in good faith. (BAR 1984)

4. Andrew is engaged in the business of the building low-cost housing units under contracts with real estate developers. He applied for a loan of P3 M from Ready Credit Bank (the Bank), which required Andrew to provide collateral security for it. Andrew offered to assign to the Bank his receivables amounting to P4 M from Home Builders Development Corporation (the Obligor).

The Bank accepted the offer. Accordingly, Andrew obtained the loan and he executed a promissory note undertaking to pay the loan in full in one lump sum on September 1, 2002, together with interest thereon at the rate of 20% per annum. At the same time, Andrew executed a Deed of Assignment in favor of the Bank, assigning to the Bank his receivables from the Obligor. The Deed of Assignment read:

"I, Andrew Lee, hereby assign, transfer and convey, absolutely and unconditionally, to Ready Credit Bank (hereinafter called the Bank) all my right, title and interest in and to my accounts receivable from Home Builders Development Corporation (hereinafter called the Obligor) arising from delivery of housing units with a total contract price of P4 M, the description and contract value of which are attached hereto as Annex A (hereinafter called the Receivables).

In the event that I shall be unable to pay my outstanding indebtedness owed to the Bank, the Bank shall have the right, without any further formality or act on its part, to collect the Receivables from the Obligor and to apply the proceeds thereof toward payment of my said indebtedness.

Andrew failed to pay the loan on its due date on September 1, 2002. When the Bank attempted to collect from the Obligor, the Bank discovered that the latter had already closed operations and liquidated its assets. The Bank sued Andrew for collection, but Andrew moved to dismiss the complaint on the ground that the debt had already been paid by reason of his execution of the aforesaid Deed of Assignment which, being absolute and unconditional, was in essence a dacion en pago. The Bank opposed the motion, contending that the Deed of Assignment was only a security for the loan.

If you were the judge, how would you resolve the motion to dismiss filed by Andrew? Explain.

**Answer:**

The motion to dismiss should be granted. The simple absolute and unconditional conveyance embodied in the deed of assignment would be operative, and the assignment would constitute essentially a mode of payment or dacion en pago (BAR 2002)

5. As part of the safeguards against imprudent banking, the General Banking Law imposes limits or restrictions on loans and credit accommodations which may be extended by banks. Identify at least 2 of these limits or restrictions and explain the rationale of each of them.

**Answer:**

Any 2 of the following limits or restrictions on loan and credit transaction which may be extended by banks, as part of the safeguard against imprudent banking, to wit:

- 1) SBL Rules—SBL (i.e., single borrower's limit) rules are those promulgated by the BSP, upon the authority of Section 35 of the General Banking Law (GBL) of 2000, which regulate the total amount of loans, credit accommodations and guarantees that may be extended by a bank to any person, partnership, association, or corporation or other entity. The rules seek to protect a bank from making excessive loans to a single borrower by prohibiting it from lending beyond a specified ceiling.
- 2) DOSRI Rules—These are rules promulgated by the BSP, upon authority of Section 5 of the GBL of 2000, which regulate the amount of credit accommodations that a bank may extend to its directors, officers, stockholders and their related interests. Generally, a bank's credit accommodations to its DOSRI must be in the regular course of business and on terms not less favorable to the bank than those offered to non-DOSRI borrowers.

- 3) No commercial bank shall make any loan or discount on the security of shares of its own capital stock. (BAR 2002)
6. **X maintains a savings deposit in the amount of P1 M with ABC Bank Corporation. X also has obtained a loan from ABC Bank Corporation in the amount of P1 M. in case of default:**
- a) **ABC Bank can set-off the loan from the savings account being maintained by X with ABC Bank;**
  - b) **Set-off is not possible because legal compensation is not allowed in banking transaction;**
  - c) **Deposit accounts are usually earmarked for specific purpose hence off-setting is not legally possible;**
  - d) **Off-setting is not possible because the obligation of X is a “simple loan”.**

**Answer:**

- d) ABC Bank can set-off the loan from the savings account being maintained by X with ABC Bank. (BAR 2012)

### 1. Ratio of Net Worth to Total Risk Assets

1. **A bank may acquire real property \_\_\_\_\_.**

- a) **By purchase at a public sale of properties levied to satisfy tax delinquencies;**
- b) **By purchase from a real estate corporation in the ordinary course of the bank’s business;**
- c) **Through *dacion en pago* in satisfaction of a debt in favor of a bank;**
- d) **In exchange for the purchase of shares of stocks of the bank;**
- e) **All of the above;**
- f) **None of the above.**

**Answer:**

- b) **By purchase from a real estate corporation in the ordinary course of the bank’s business;**
- c) **Through *dacion en pago* in satisfaction of a debt in favor of a bank;**
- d) **In exchange for the purchase of shares of stocks of the bank; (BAR 2013)**

### 2. Single Borrower’s Limit

### 3. Restrictions on Bank Exposure to DOSRI (Directors, Officers, Stockholders and their Related Interests)

1. **The President of Matibay Bank obtained a P100,000 clean loan from the Tagumpay Banking Corporation. In turn and at about the same time, the President of the Tagumpay Banking Corporation secured a P50,000 loan from the Matibay Bank, with the latter’s President expediting the loan for his friend and colleague.**

**Are there any legal consequences as far as the borrowers are concerned? If there are any, what are the bases and the reasons for these consequences?**

**Answer:**

The prohibition on bank officers and directors against the borrowing or securing of loans is confined to financial accommodations given by a bank in which they are directors or officers. It may thus be said under the problem that neither of the two bank presidents committed an infraction of that prohibition. The mere fact that the President of Matibay Bank helped his friend and colleague in expediting the loan should not be considered as having produces an adverse legal consequence. (BAR 1986)

2. **The Monetary Board of the Bangko Sentral closed Urban Bank after it encountered crippling financial difficulties that resulted in a bank run. X, one of the members of the Board of Directors of the bank, attended and stayed throughout the entire meeting of the Board that was held well in advance of the bank run and before news had begun to trickle to the business community about the dire financial pit the bank had fallen into. Immediately after the meeting, X caused the preparation and issuance of a manager's check payable to himself in the sum of P5 M equivalent to the amount placed or invested in the bank by a business acquaintance. He now claims that he is keeping the funds in trust for the owner and that he had committed no violation of the General Banking Act for which he should be punished. Do you agree that there has been no violation of the statute?**

**Answer:**

No. I do not agree that there is no violation of the statute. X violated Section 85 when he caused the preparation and issuance of a manager's check payable to himself in the sum of P5 M. This is paying out or permitting to be paid out funds of the bank after the latter became insolvent. This act is penalized by fine of not less than P1,000 nor more than P10,000 and by imprisonment for not less than 2 nor more than 10 years. (BAR 2000)

3. **As part of the safeguards against imprudent banking, the General Banking Law imposes limits or restrictions on loans and credit accommodations which may be extended by banks. Identify at least 2 of these limits or restrictions and explain the rationale of each of them.**

**Answer:**

Any 2 of the following limits or restrictions on loan and credit transaction which may be extended by banks, as part of the safeguard against imprudent banking, to wit:

- 1) SBL Rules—SBL (i.e., single borrower's limit) rules are those promulgated by the BSP, upon the authority of Section 35 of the General Banking Law (GBL) of 2000, which regulate the total amount of loans, credit accommodations and guarantees that may be extended by a bank to any person, partnership, association, or corporation or other entity. The rules seek to protect a bank from making excessive loans to a single borrower by prohibiting it from lending beyond a specified ceiling.
- 2) DOSRI Rules—These are rules promulgated by the BSP, upon authority of Section 5 of the GBL of 2000, which regulate the amount of credit accommodations that a bank may extend to its directors, officers, stockholders and their related interests. Generally, a bank's credit accommodations to its DOSRI must be in the regular course of business and on terms not less favorable to the bank than those offered to non-DOSRI borrowers.
- 3) No commercial bank shall make any loan or discount on the security of shares of its own capital stock. (BAR 2002)

4. **Pio is the president of Western Bank. His wife applied for a loan with the said bank to finance an internet café. The loan officer told her that her application will not be approved because the grant of loans to related interests of bank directors, officers, and stockholders is prohibited by the General Banking Law.**

**Explain whether the loan officer is correct.**

**Answer:**

No. the loan officer should have advised the wife to ask her husband to secure the approval of the bank's Board of Directors for the intended loan and to limit the same in an amount not to exceed its unencumbered deposits and book value of its paid-up capital contribution in the bank; if the intended loan should exceed the foregoing limit, the borrower should have the same secured by a non-risk assets as determined by the Monetary Board, unless the loan shall be in the form of a fringe benefit. (BAR 2006)

5. All senior officers of ABC Bank are entitled to obtain a housing loan. X is an Executive VP for Operations of ABC Bank. She obtained a housing loan with the ABC Bank. Which statement is most accurate?
- a) The housing loan of X required a guarantor from somebody who is not connected with the bank;
  - b) The housing loan of X requires the approval of the Board of Directors of the bank;
  - c) The housing loan of X, being a benefit for employees does not require (a) but will require (b);
  - d) The housing loan of X, being a benefit for employees, will not require (a) and (b).

**Answer:**

d) The housing loan of X, being a benefit for employees, will not require (a) and (b). (BAR 2012)

#### H. Ownership of Banks

1. (a) How much of the capital stock of any banking institution organized in the Philippines may be owned by qualified natural persons and their relatives within the 3<sup>rd</sup> civil degree?
- (b) How much of the capital stock of such Philippine banking institution may be owned by a qualified corporation including its fully owned or majority owned subsidiary?
- (c) In the case of corporation which is wholly owned or the majority stock of which is owned by any one person or persons related to each other within the 3<sup>rd</sup> degree of consanguinity or affinity, how much may such corporation own of the voting stock of any bank?
- (d) How much of the capital stock of any Philippine banking institution must be owned by citizens of the Philippines?
- (e) Are all your answers to the above questions applicable to rural bank? (Explain your answers)

**Answer:**

- (a) In commercial banks, the stockholdings of any persons related to each other within the third degree of consanguinity or affinity, cannot exceed 20% of the voting stocks. This limitation does not apply to thrift banks. (*Sec. 12-B, Gen. Banking Act, as inserted by P.D. No. 71*)
- (b) The total voting stocks which any corporation, including its wholly or majority owned subsidiaries, may own in any bank, shall not exceed 30% of the voting stock of that bank. (*Sec. 12-B, Gen. Banking Act, as inserted by P.D. No. 71*)
- (c) In the case of a corporation which is wholly owned or the majority of the voting stock of which is owned by any one person or by persons related to each other within the 3<sup>rd</sup> degree of consanguinity or affinity, that corporation may own not more than 20% of the voting stock of any bank. (*Sec. 12-B, Gen. Banking Act, as inserted by P.D. No. 71*)
- (d) At least 70% of the voting stock of any banking institution shall be owned by citizens of the Philippines. (*Sec. 12, Gen. Banking Act*)
- (e) Yes, except the above answers in letters (a) and (d) which are not applicable to rural banks. Letter (a) is only applicable to commercial banks and not to thrift banks, like rural banks. Letter (d) is also not applicable since the capital stock of any rural bank shall be owned and held wholly by the citizens of the Philippines. (*Sec. 12-B, Gen. Banking Act; Sec. 4, Rural Bank Act*) (BAR 1982)

### XIII. Intellectual Property Code (Exclude Implementing Rules & Regulations)

#### A. Intellectual Property Rights in General

1. Intellectual Property Rights
2. Differences between Copyrights, Trademarks and Patent

1. **Can an article of commerce serve as a trademark and at the same time enjoy patent and copyright protection? Explain and give an example.**

**Answer:**

A stamped or marked container of goods can be registered as a trademark. An original ornamental design or model for articles of manufacturer can be copyrighted. An ornamental design cannot be patented, because aesthetic creations cannot be patented. However, it can be registered as an industrial design. Thus, a container of goods which has an original ornamental design can be registered as a trademark, can be copyrighted, and can be registered as an industrial design. (BAR 2010)

#### 3. Technology Transfer Arrangements

1. **Enumerate 3 stipulations that are prohibited in technology transfer agreements.**

**Answer:**

The following stipulations are prohibited in technology transfer agreements:

- a. Those that contain restrictions regarding the volume and structure of production;
- b. Those that prohibit the use of competitive technologies in no-exclusive agreement; and
- c. Those that establish a full or partial purchase option in favor of the licensor. (BAR 2010)

2. **What contractual stipulations are required in all technology transfer agreements?**

**Answer:**

The following stipulations are required in all technology transfer agreements:

- a. The laws of the Philippines shall govern its interpretation and in the event of litigation, the venue shall be the proper court in the place where the licensee has its principal place of business;
- b. Continued access to improvements in techniques and processes related to the technology shall be made available during the period of the technology transfer arrangement;
- c. In case it shall provide for arbitration, the Procedure of Arbitration of the Arbitration Law of the Philippines or the Arbitration Rules of the International Chamber of Commerce (ICC) shall apply and the venue of arbitration shall be the Philippines or any neutral country;
- d. The Philippine taxes on all payments relating to the technology transfer agreement shall be borne by the licensor. (BAR 2010)

#### B. Patents

- 1. Can an article of commerce serve as a trademark and at the same time enjoy patent and copyright protection? Explain and give an example.**

**Answer:**

A stamped or marked container of goods can be registered as a trademark. An original ornamental design or model for articles of manufacturer can be copyrighted. An ornamental design cannot be patented, because aesthetic creations cannot be patented. However, it can be registered as an industrial design. Thus, a container of goods which has an original ornamental design can be registered as a trademark, can be copyrighted, and can be registered as an industrial design. (BAR 2010)

### 1. Patentable Inventions

- 1. X invented a method of improving the tenderness of meat by injecting an enzyme solution into the live animal shortly before a slaughter. Is the invention patentable?**

**Answer:**

To be patentable, the invention must be new and should consist in a useful machine, manufactured product or process. Among those that cannot be patented are processes which are not directed to making or improving a commercial product. Viewed from the above light, X may lawfully patent his invention. (BAR 1989)

- 2. Laberge, Inc. manufactures and markets after-shave lotion, shaving cream, deodorant, talcum powder and toilet soap, using the trademark "PRUT", which is registered with the Philippine Patent Office. Laberge does not manufacture briefs and underwear and these items are not specified in the certificate of registration.**

**JG, who manufactures briefs and underwear, wants to know whether, under our laws, he can use and register the trademark "PRUTE" for his merchandise. What is your advice?**

**Answer:**

Yes. The trademark registered in the name of Laberge, Inc. covers only after-shave lotion, shaving cream, deodorant, talcum powder and toilet soap. It does not cover briefs and underwear.

The limit of the trademark is stated in the certificate issued to Laberge, Inc. It does include briefs and underwear which are different products protected by Laberge's trademark.

JG can register the trademark "PRUTE" to cover its briefs and underwear. (BAR 1994)

- 3. Cezar works in a car manufacturing company owned by Joab. Cezar is quite innovative and loves to tinker with things. With the materials and parts of the car, he was able to invent a gas-saving device that will enable cars to consume less gas. Francis, a co-worker, saw how Cezar created the device and likewise, came up with a similar gadget, also using scrap materials and spare parts of the company. Thereafter, Francis filed an application for registration of his device with the Bureau of Patents. 18 months later, Cezar filed an application for registration his device with the Bureau of Patents.**

**Is the gas-saving device patentable? Explain.**

**Answer:**

It is patentable because it is new, it involves an inventive step and it is industrially applicable. (BAR 2005)

4. Dr. Nobel discovered a new method of treating Alzheimer's involving a special method of diagnosing the disease, treating it with a new medicine that has been discovered after long experimentation and field testing, and novel mental isometric exercises. He comes to you for advice on how he can have his discoveries protected. Can he legally protect his new method of diagnosis, the new medicine, and the new method of treatment? If no, why? If yes, how?

**Answer:**

Dr. Nobel can be protected by a patent for the new medicine as it falls within the scope of Section 21 of the Intellectual Property Code. But no protection can be legally extended to him for the method of diagnosis and method of treatment which are expressly non-patentable. (BAR 2010)

## 2. Non-Patentable Inventions

1. X invented a bogus coin detector which can be used exclusively on self-operating gambling devices otherwise known as one-armed bandits. Can X apply for a patent?

**Answer:**

X may not apply for the patent since the gambling device mentioned in the problem itself is prohibited and against public order. But if the machine is used in legalized gambling such as in cases of exclusive use of casinos established by the government, such device can be patented. (BAR 1989)

2. Supposing that Albert Einstein were alive today and he filed with the Intellectual Property Office (IPO) an application for patent for his theory of relativity expressed in the formula  $E=mc^2$ . The IPO disapproved Einstein's application on the ground that his theory of relativity is not patentable.

Is the IPO's action correct?

**Answer:**

Yes. The IPO's action is correct that the theory of relativity is not patentable. Under Section 22.1 of the Intellectual Property Code (RA 8293), "Discoveries, scientific theories and mathematical methods" are not patentable. (BAR 2006)

## 3. Ownership of a Patent

1. X works as a research computer engineer with the Institute of Computer Technology, a government agency. When not busy with his work, but during office hours, he developed a software program for law firms that will allow efficient monitoring of the cases, which software program is not at all related to his work. Assuming the program is patentable, who has the right over the patent?

- a) X;
- b) Institute of Computer Technology;
- c) Neither X nor the Institute Computer Technology can claim patent right over the invention;
- d) X and the employer of X will jointly have the rights over the patent.

**Answer:**

- a) X. (BAR 2012)

### a. Right to a Patent

1. **Che-che invented a device that can convert rainwater to automobile fuel. She asked Macon, a lawyer, to assist in getting her invention patented. Macon suggested that they form a corporation with other friends and have the corporation apply for a patent, 80% of the shares of stock thereof to be subscribed by Che-Che and 5% by Macon. The corporation was formed and the patent application was filed. However, Che-che died 3 months later of a heart attack.**

**Franco, the estranged husband of Che-che, contested the application of the corporation of the corporation and filed his own patent application of the corporation and filed his own patent application as the sole surviving heir of Che-che. Decide the issue with reasons.**

**Answer:**

The estranged husband of Che-che cannot successfully contest the application. The rights over inventions accrue from the moment of creation and as a right it can lawfully be assigned. Once the title thereto is vested in the transferee, the latter has the right to apply for its registration. The estranged husband of Che-che, if not disqualified to inherit, merely would succeed to the interest of Che-che. (BAR 1990)

2. **Cezar works in a car manufacturing company owned by Joab. Cezar is quite innovative and loves to tinker with things. With the materials and parts of the car, he was able to invent a gas-saving device that will enable cars to consume less gas. Francis, a co-worker, saw how Cezar created the device and likewise, came up with a similar gadget, also using scrap materials and spare parts of the company. Thereafter, Francis filed an application for registration of his device with the Bureau of Patents. 18 months later, Cezar filed an application for registration his device with the Bureau of Patents.**

**Supposing Joab got wind of the inventions of his employees and also laid claim to the patents, asserting that Cezar and Francis were using his materials and company time in making the devices, will his claim prevail over those of his employees? Explain.**

**Answer:**

The claim of Joab will not prevail over those of his employees, even if they used his materials and company time in making the gas-saving device. The invention of the gas-saving device is not part of their regular duties as employees. (BAR 2005)

- b. First-to-File Rule
- c. Inventions Created Pursuant to a Commission
- d. Right of Priority

- 4. Grounds for Cancellation of a Patent
- 5. Remedy of the True and Actual Inventor

1. **Basilio invents and secures registration of patent of a mini-threshing machine which he manufactures. Rudy, his employee, assisted him in the actual making of the machine. Later, after resigning from his employment with Basilio, Rudy bought tools and equipments to manufacture similar mini-threshing machine which he sold for his own benefit.**

**What legal steps will you take if you were hired as counsel of Basilio to protect his rights?**

**Answer:**

As counsel for Basilio, I will institute the following steps:

“Within 4 years from the commission of acts of infringement, I will bring a civil action for infringement of patent before the proper court to recover from the infringer damages sustained by reason of the infringement.

In the same civil action I will secure an injunction to enjoin the infringer from the use of such patented invention.”

“If after a final judgment is rendered by the Court against the infringer, he repeated the infringement, I will again institute a civil action for damages with a prayer for the issuance of a writ of injunction, as well as criminal action for repetition of infringement.” (BAR 1977)

2. **“I” has invented a certain device, which when attached to the engine of a motor vehicle would cut the consumption of gasoline by 50%. Without securing a patent therefore, he started manufacturing the gadget in large quantities and promoted it sales.**

**An ingenious “J” bought one gadget, dismantled and studied it, and in due time was himself manufacturing an identical device. Before offering it for sale, “J” secured a patent for his device which he called “Gasopid”.**

**“I” learns of the patent and desires to secure his own patent but fearing that he might be sued for infringement of patent, seeks your legal advice.**

**How can you help him? Explain briefly.**

**Answer:**

It depends. “I” may still apply for a patent of his invention, he being the first true and actual inventor, and have the patent of “J” be cancelled, for having been issued to one who is not the true and actual inventor; provided that “I” shall file the application for patent within 1 year from the time of his sale of his said device in the Philippines; otherwise, without those requirements above-stated, “I” may no longer apply for a patent on his said invention. (*Secs. 9, 10 and 28 Patent Law*) (BAR 1981)

3. **Ferdie is a patent owner of a certain invention. He discovered that his invention is being infringed by Johann.**

**What are the remedies available to Ferdie against Johann?**

**Answer:**

The following are the remedies available to Ferdie against Johann:

- a. Seize and destroy
- b. Injunction
- c. Damages in such amount may have been obtained from the use of the invention if properly transacted which can be more than what the infringer (Johann) received.
- d. Attorney’s fees and costs. (BAR 1993)

4. **Cezar works in a car manufacturing company owned by Joab. Cezar is quite innovative and loves to tinker with things. With the materials and parts of the car, he was able to invent a gas-saving device that will enable cars to consume less gas. Francis, a co-worker, saw how Cezar created the device and likewise, came up with a similar gadget, also using scrap materials and spare parts of the company. Thereafter, Francis filed an application for registration of his device with the Bureau of Patents. 18 months later, Cezar filed an application for registration his device with the Bureau of Patents.**

**Assuming that it is patentable, who is entitled to the patent? What, if any, is the remedy of the losing party?**

**Answer:**

Francis is entitled to the patent, because he had the earlier filing date. The remedy of Cezar is to file a petition in Court for the cancellation of the patent of Francis on the ground that he is the true and actual inventor, and ask for his substitution as patentee. (BAR 2005)

## 6. Rights Conferred by a Patent

1. **Nestor Dionisio invented a space age revolutionary mini room air-conditioner and was able to secure the registration patent and issuance of patent certificate for said invention by the Philippines' Patent Office. He immediately went into commercial production and sale of his invention. Later, Carlos Asistio, who used to be Nestor's plant manager, organized his own company, and engaged in the manufacture of exactly the same mini-room air-conditioners for his own outfit and which he sold for his own benefit.**

**As counsel of Dionisio, what legal steps would you take to protect his rights and interests? Discuss.**

**Answer:**

As counsel of Nestor Dionisio, the registrant of a patent for an air-conditioner, I may file with the RTC the action for infringement of patent against Carlos Asistio. My client, being the patentee, has the exclusive right to make, use and sell his invention, and he is entitled to recover damages and even injunction against the infringer. (BAR 1985)

2. **For years, Y has been engaged in the parallel importation of famous brands, including shoes carrying the foreign brand MAGIC. Exclusive distributor X demands that Y cease importation because of his appointment as exclusive distributor of MAGIC shoes in the Philippines.**

**Y countered that the trademark MAGIC is not registered with the Intellectual Property Office as a trademark and therefore no one has the right to prevent its parallel importation.**

1. **Who is correct? Why?**

**Answer:**

X is correct. His rights under his exclusive distributorship agreement are property rights entitled to protection. The importation and sale by Y of MAGIC shoes constitutes unfair competition. Registration of the trademark is not necessary in case of an action for unfair competition.

2. **Suppose the shoes are covered by a Philippine patent issued to the brand owner, what would your answer be? Explain.**

**Answer:**

A patent for a product confers upon its owner the exclusive right of importing the product. The importation of a patented product without authorization of the owner of a patent constitutes infringement of the patent. X can prevent the parallel importation of such shoes by Y without its authorization. (BAR 2010)

## 7. Limitations of Patent Rights

### a. Prior User

1. X invented a device which, through the use of noise, can recharge a cellphone battery. He applied for and was granted a patent on his device, effective within the Philippines. As it turns out, a year before the grant of X's patent, Y, also an inventor, invented a similar device which he used in his cellphone business in Manila. But X files an injunctive suit against Y to stop him from using the device on the ground of patent infringement. Will the suit prosper?
  - a. No, since the correct remedy for X is a civil action for damages.
  - b. No, since Y is a prior user in good faith.
  - c. Yes, since X is the first to register his device for patent registration.
  - d. Yes, since Y unwittingly used X's patented invention.

**Answer:**

b. No, since Y is a prior user in good faith. (BAR 2011)

### b. Use by the Government

### 8. Patent Infringement

1. In an action for infringement of patent, the alleged infringer defended himself by stating (1) that the patent issued by the Patent Office was not really an invention which was patentable; (2) that he had no intent to infringe so that there was no actionable case for infringement; and (3) that there was no exact duplication of the patentee's existing patent but only a minor improvement.

**With those defenses, would you exempt the alleged violator from liability? Why?**

**Answer:**

I would not exempt the alleged violator from liability for the following reasons:

1. A patent once issued by the Patent Office raises a presumption that the article is patentable; it can, however be shown otherwise. A mere statement or allegation is not enough to destroy that presumption.
2. An intention to infringe is not necessary nor an element in a case for infringement of a patent.
3. There is no need of exact duplication of the patentee's existing patent such as when the improvement made by another is merely minor. To be independently patentable, an improvement of an existing patented invention must be a major improvement. (BAR 1992)

### a. Tests in Patent Infringement

#### i. Literal Infringement

1. Nestor Dionisio invented a space age revolutionary mini room air-conditioner and was able to secure the registration patent and issuance of patent certificate for said invention by the Philippines' Patent Office. He immediately went into commercial production and sale of his invention. Later, Carlos Asistio, who used to be Nestor's plant manager, organized his own company, and engaged in the manufacture of exactly the same mini-room air-conditioners for his own outfit and which he sold for his own benefit.

**As counsel of Dionisio, what legal steps would you take to protect his rights and interests? Discuss.**

**Answer:**

As counsel of Nestor Dionisio, the registrant of a patent for an air-conditioner, I may file with the RTC the action for infringement of patent against Carlos Asistio. My client, being the patentee, has the exclusive right to make, use and sell his invention, and he is entitled to recover damages and even injunction against the infringer. (BAR 1985)

## ii. Doctrine of Equivalentents

### b. Defenses in Action for Infringement

1. **Ferdie is a patent owner of a certain invention. He discovered that his invention is being infringed by Johann.**

**If you were the lawyer of Johann in the infringement suit, what are the defenses that your client can assert?**

**Answer:**

These are the defenses that can be asserted in an infringement suit:

- a. Patent is invalid
- b. Patent is not new or patentable
- c. Specification of the invention does not comply with Sec.14
- d. Patent was issued not to the true and actual inventor, designer or author of the utility model or the plaintiff did not derive his rights from the true and actual inventor, designer or author of the utility model. (BAR 1993)

## 9. Licensing

- a. Voluntary
- b. Compulsory

1. **Compulsory Licensing of Inventions which are duly patented may be dispensed with or will be allowed exploitation even without agreement of the patent owner under certain circumstances, like national emergency, for reason of public interest, like national security, etc. The person who can grant such authority is—**

- a) **The Director General of the Intellectual Property Office;**
- b) **The Director of Legal Affairs of the Intellectual Property Office;**
- c) **The owner of the Patent right;**
- d) **Any agent of the owner of the Patent right.**

**Answer:**

b) The Director of Legal Affairs of the Intellectual Property Office. (BAR 2012)

## 10. Assignment and Transmission of Rights

1. **Che-che invented a device that can convert rainwater to automobile fuel. She asked Macon, a lawyer, to assist in getting her invention patented. Macon suggested that they form a corporation with other friends and have the corporation apply for a patent, 80% of the shares of stock thereof to be subscribed**

by Che-Che and 5% by Macon. The corporation was formed and the patent application was filed. However, Che-che died 3 months later of a heart attack.

Franco, the estranged husband of Che-che, contested the application of the corporation of the corporation and filed his own patent application of the corporation and filed his own patent application as the sole surviving heir of Che-che. Decide the issue with reasons.

**Answer:**

The estranged husband of Che-che cannot successfully contest the application. The rights over inventions accrue from the moment of creation and as a right it can lawfully be assigned. Once the title thereto is vested in the transferee, the latter has the right to apply for its registration. The estranged husband of Che-che, if not disqualified to inherit, merely would succeed to the interest of Che-che. (BAR 1990)

### C. Trademarks

1. (a) What is the objective of the law in protecting trademarks?  
(b) What are the territorial limits of a trademark?

**Answer:**

(a) The purpose of the law in protecting trademarks is two-fold object: to protect the owners in his property and to protect the public from being deceived by reason of a misleading claim.

(b) Trademarks acknowledge no territorial boundaries of states or nations, but extends to every market where the trader's goods have become known and identified by the use of his mark. (BAR 1982)

2. Can an article of commerce serve as a trademark and at the same time enjoy patent and copyright protection? Explain and give an example.

**Answer:**

A stamped or marked container of goods can be registered as a trademark. An original ornamental design or model for articles of manufacturer can be copyrighted. An ornamental design cannot be patented, because aesthetic creations cannot be patented. However, it can be registered as an industrial design. Thus, a container of goods which has an original ornamental design can be registered as a trademark, can be copyrighted, and can be registered as an industrial design. (BAR 2010)

1. Definition of Marks, Collective Marks, Trade Names
2. Acquisition of Ownership of Mark

1. S Development Corporation sued Shangrila Corporation for using the "S" logo and the tradename "Shangrila". The former claims that it was the first to register the logo and the tradename in the Philippines and that it had been using the same in its restaurant business.

Shangrila Corporation counters that it is in an affiliate of an international organization which has been using such logo and tradename "Shangrila" for over 20 years.

However, Shangrila Corporation registered the tradename and logo in the Philippines only after the suit was filed.

- a) Which of the 2 corporations has a better right to use the logo and the tradename? Explain.
- b) How does the international affiliation of Shangrila Corporation affect the outcome of the dispute? Explain.

**Answer:**

- a) S Development Corporation has a better right to use the logo and tradename, since it was the first to register the logo and tradename.
- b) Since Shangrila Corporation is not the owner of the logo and tradename but is merely an affiliate of the international organization which has been using them it is not the owner and does not have the rights of an owner. (BAR 2005)

### 3. Acquisition of Ownership of Trade Name

1. S Development Corporation sued Shangrila Corporation for using the “S” logo and the tradename “Shangrila”. The former claims that it was the first to register the logo and the tradename in the Philippines and that it had been using the same in its restaurant business.

Shangrila Corporation counters that it is in an affiliate of an international organization which has been using such logo and tradename “Shangrila” for over 20 years.

However, Shangrila Corporation registered the tradename and logo in the Philippines only after the suit was filed.

- c) Which of the 2 corporations has a better right to use the logo and the tradename? Explain.
- d) How does the international affiliation of Shangrila Corporation affect the outcome of the dispute? Explain.

**Answer:**

- c) S Development Corporation has a better right to use the logo and tradename, since it was the first to register the logo and tradename.

2. “Eagleson Refillers, Co.,” a firm that sells water to the public, opposes the trade name application of “Eagleson Laundry, Co.,” on the ground that such trade name tends to deceive trade circles or confuse the public with respect to the water firm’s registered trade name. Will the opposition prosper?
  - a. Yes, since such use is likely to deceive or confuse the public.
  - b. Yes, since both companies use water in conducting their business.
  - c. No, since the companies are not engaged in the same line of business.
  - d. No, since the root word “Eagle” is a generic name not subject to registration.

**Answer:**

- c. No, since the companies are not engaged in the same line of business. (BAR 2011)

### 4. Non-Registrable Marks

1. X applies for registration in his favor the tradename “Loving Care” for a hair dye on the ground that he has been using said tradename for almost 3 years before filing his application. Y opposes the application on the ground that he has been using the tradename “Loving Care” with the same design for hair pomade which is registered in his name since 1963. X replied that although the said trademark was registered in Y’s name it was however, for a different article. Can X’s application be sustained? Reasons.

**Answer:**

X's application cannot be sustained. Although the trademark he applied for is for a different article, hair dye and hair pomade are both preparations for hair grooming, and the use of the same mark for both is likely to confuse or deceive purchasers as to the origin and source of the goods. (BAR 1976)

2. In 1988, the FDA approved the labels submitted by Turbo Corporation for its new drug brand name, "Axilon". Turbo is now applying with the Bureau of Patents, Trademarks and Technology Transfer for the registration of said brand name. It was subsequently confirmed that "Accilonne" is a generic term for a class of anti-fungal drugs and is used as such by the medical professional and the pharmaceutical industry, and that it is used as generic chemical name in various scientific and professional publications. A competing drug manufacturer asks you to contest the registration of the brand name "Axilon" by Turbo.

**What will be your advice?**

**Answer:**

The application for registration by Turbo Corporation may be contested. The Trademark Law would not allow the registration of a trademark which, when applied to or used in connection with his products, is merely descriptive or deceptively misdescriptive of them. Confusion can result from the result from the use of "Axilon" as the generic product itself. (BAR 1990)

3. After disposing of his last opponent in only two rounds in Las Vegas, the renowned boxer Sonny Bachao arrived at the NAIA met by thousands of hero-worshipping fans and hundreds of media photographers. The following day, a colored photograph of Sonny wearing a black polo short embroidered with the 2-inch Lacoste crocodile logo appeared on the front page of every Philippine newspaper.

Lacoste International, the French firm that manufactures Lacoste apparel and owns the Lacoste trademark, decided to cash in on the universal popularity of the boxing icon. It reprinted the photographs, with the permission of the newspaper publishers, and went on a world-wide blitz of print commercials in which Sonny is shown wearing a Lacoste shirt alongside the phrase "*Sonny Bachao just loves Lacoste*".

When Sonny sees the Lacoste advertisements, he hires you as a lawyer and asks you to sue Lacoste International before a Philippine court:

e) XXX

f) XXX

g) For injunction in order to stop Lacoste International from featuring him in their commercials.

**Will these actions prosper?**

**Answer:**

The complaint for injunction to stop Lacoste International from featuring him in its advertisements will prosper. This is a violation of subsection 123.4© of the IPC and Art. 169 in relation to Article 170 of the RPC. (BAR 2008)

4. **Jinggy went to Kluwer University (KU) in Germany for his doctorate degree (Ph.D.). He completed his degree with the highest honors in the shortest time. When he came back, he decided to set-up his own graduate school in his hometown in Zamboanga. After seeking free legal advice from his high-flying lawyer-friends, he learned that the Philippines follows the territoriality principle in trademark law, i.e., trademark rights are acquired through valid registration in accordance with the law. Forthwith, Jinggy named his school the Kluwer Graduate School of Business of Mindanao and immediately secured registration with the Bureau of Trademarks. KU did not like the unauthorized use of its name by its top alumnus no less. KU sought your help. What advice can you give KU?**

**Answer:**

I will advice KU to seek for the cancellation of the Kluwer Graduate School of Business of Mindanao with the Bureau of Trademarks. Jinggy's registration of the mark "Kluwer" should not have been allowed because the law prohibits the registration of the mark "which may disparage or falsely suggests a connection with persons, living or dead, institutions, beliefs". Moreover, the Philippines is a signatory to the Paris Convention for the Protection of Intellectual Property (Paris Convention), it is obligated to assure nationals of countries of the Paris Convention that they are afforded an effective protection against violation of their intellectual property rights in the Philippines. Thus, under the Philippine law, a trade name of a national of a State that is a party to the Paris Convention, whether or not the trade name forms part of a trademark, is protected "without the obligation of filing or registration". (BAR 2014)

**5. Prior Use of Mark as a Requirement**

1. **Does the owner of a trademark have a right of property to prevent others from manufacturing, producing, or selling the same article to which it is attached?**

**Answer:**

No. The basis of registration is actual use in commerce in the Philippines (not less than 2 months) before an application for its registration can be filed in the Patent Office, except when the Philippines is a party to a trademark treaty, in which case the trademark sought to be registered need not be in use in the Philippines. (BAR 1982)

2. **Rubberworld, Inc. sought registration of the trademark "Juggler" for its casual rubber shoes in Inter Pater case No. 602 filed with the Patent Office. The registration was opposed by a Belgian Corporation which alleges that it owns and has not abandoned the trademark "Juggler" although it admits that it has no license to do business in the Philippines, it is not presently selling footwear under the trademark "Juggler" in the Philippines, and it has not been licensed nor does it have any agreement with any local entity or firm to sell any of its product in the Philippines.**

**At the trial, it was established that Rubberworld had spent a considerable amount and effort in popularizing said trademark in the Philippines, had been using the same since 1969 and had built up enormous goodwill.**

**Acting on the petition, the Patent Office dismissed the opposition and ordered the registration of the trademark "Juggler" in the name of Rubberworld.**

**Discuss the validity of the aforesaid decision.**

**Answer:**

The action of the Patent Office in dismissing the opposition of the Belgian Corporation and ordering the registration of the trademark "Juggler" in the name Rubberworld, Inc. is valid. One of the requisites of registration is actual use in commerce of not less than 2 months of the mark or name, in the Philippines, of

which Rubberworld, Inc., has complied with and spending even considerable amount and effort in popularizing said trademark in the Philippines; while, on the other hand, the Belgian Corporation, the oppositor, according to facts, has not even been selling in the Philippines the footwear under the trademark “Juggler”. (*Pagasa Industrial Corp. vs. Court of Appeals, Nov. 19, 1982; 118 SCRA 526*) (BAR 1984)

## 6. Tests to Determine Confusing Similarity between Marks

### a. Dominancy Test

#### 1. What is the “test of dominancy”?

**Answer:**

The test of dominancy requires that if the competing trademark contains the main or essential features of another and confusion and deception is likely to result, infringement takes place. Duplication or imitation is not necessary; nor is it necessary that the infringing label should suggest an effort to imitate. Similarity in size, form and color, while relevant, is not conclusive. (BAR 1996)

#### 2. The “test of dominancy” in the Law on Trademarks, is a way to determine whether there exists an infringement of a trademark by—

- a) Determining if the use of the mark has been dominant in the market;
- b) Focusing on the similarity of the prevalent features of the competing marks which might create confusion;
- c) Looking at the mark whether they are similar in size, form or color;
- d) Looking at the mark whether there is one specific feature that is dominant.

**Answer:**

b) Focusing on the similarity of the prevalent features of the competing marks which might create confusion. (BAR 2012)

#### 3. Skechers Corporation sued Inter-Pacific for trademark infringement claiming that Inter-Pacific used Skechers’ registered “S” logo mark on Inter-Pacific’s shoe products without its consent. Skechers has registered the trademark “SKECHERS” and the trademark “S” (with an oval design) with the Intellectual Property Office (IPO).

In its complaint, Skechers points out the following similarities: the color scheme of the blue, white and gray utilized by Skechers. Even the design and “wave-like” pattern of the mid-sole and outer sole of Inter-Pacific’s shoes are very similar to Skechers’ shoes, if not exact patterns thereof. On the side of Inter-Pacific’s shoes, near the upper part, appears the stylized “S” placed in the exact location as that of the stylized “S” the Skechers shoes. On top of the “tongue” of both shoes, appears the stylized “S” in practically the same location and size.

In its defense, Inter-Pacific claims that under the Holistic Test, the following dissimilarities are present: the mark “S” found in Strong shoes is not enclosed in an “oval design”; the word “Strong” is conspicuously placed at the backside and insoles; the hang tags labels attached to the shoes bear the word “Strong” for Inter-Pacific and Skechers U.S.A.” for Skechers; and, Strong shoes modestly priced compared to the cost of Skechers shoes.

Under the foregoing circumstances, which is the proper test to be applied—Holistic or Dominancy Test? Decide.

**Answer:**

The proper test to be applied is the dominancy test. Applying the dominancy test, there is a confusing similarity “Skechers” rubber shoes and “Strong” rubber shoes. The use of the stylized “S” by Inter-Pacific in its Strong Shoes infringes on the trademark “Skechers” already registered by Skechers U.S.A. with the IPO. While it is undisputed that Skechers U.S.A. stylized “S” is within an oval design, the dominant feature of the trademark is stylized “S” as it is precisely the stylized “S” which catches the eye of the purchaser. (BAR 2014)

**b. Holistic Test**

**7. Confusion of Goods and Confusion of Services**

- 1. The trademark LOTUS is already registered in favor of ABC for its product, edible oil. DEF applied for the registration of the same trademark for its own product, soy sauce, assuming that the trademark applied for is in smaller type, colored differently of much smaller size, and set on a background which is dissimilar, as to yield a distinct appearance, may the application be denied on the ground that its grant would likely to cause confusion or mistake on the part of the buying public? Decide. Give reasons.**

**Answer:**

Yes. The application of DEF of the trademark LOTUS for soy sauce should be granted, although the trademark LOTUS is already registered in favor of ABC for its product, edible oil. The rule is not whether the challenging mark would actually cause confusion, but whether the use of such mark would likely cause confusion on the part of the buying public. There is quite a difference between soy sauce and edible oil; hence, it can be said that DEF’s trademark LOTUS on soy sauce would likely not cause confusion on the part of the buying public. (*Acoje Mining Co., Inc. v. Director of Patents*, 38 SCRA 480) (BAR 1978)

- 2. Company X sold its wine under the brand “Rose” Brandy, and it became very popular. So, X registered the trademark “Rose” for its brandy. Subsequently, Company Y manufactured bicycles and sold it under the name of “Rose”. Company X now sues Company Y for violation of the Trademark Law. Rule on the dispute.**

**Answer:**

No, there is no violation of the Trademark Law. Company X’s registered trademark “Rose” is on its brandy (wine), while Company Y’s on its bicycle. There is quite a difference between brandy (wines) and bicycles; hence, it can be said that Company Y’s trademark “Rose” on bicycles would not likely cause confusion on the part of the buying public. (1979)

**8. Well-Known Marks**

**9. Rights Conferred by Registration**

- 1. Does the owner of a trademark have a right of property to prevent others from manufacturing, producing, or selling the same article to which it is attached?**

**Explain all answers.**

**Answer:**

No. The owner of a trademark has no right of property to prevent others from manufacturing, producing or selling the same article to which it is attached. In other words, the trademark confers no exclusive rights in the goods to which the mark has been applied. (BAR 1982)

**10. Use by Third Parties of Names, etc. Similar to Registered Mark**

1. T is the registered trademark owner of “CROCOS” which he uses on his ready-to-wear clothes. Banking on the popularity of T’s trademark, B came up with his own “CROCOS” mark, which he then used for his “CROCOS” burgers. T now sues B for trademark infringement but B argues that his product is a burger, hence, there is no infringement. Is B correct?
  - a. No, since the owner of a well-known mark registered in the Philippines has rights that extends even to dissimilar kinds of goods.
  - b. Yes, since the right of the owner of a well-known mark registered in the Philippines does not extend to goods which are not of the same kind.
  - c. Yes, as B was in bad faith in coming up with his own “CROCOS” mark.
  - d. No, since unlike T, he did not register his own “CROCOS” mark for his product.

**Answer:**

- a. No, since the owner of a well-known mark registered in the Philippines has rights that extends even to dissimilar kinds of goods. (BAR 2011)

## 11. Infringement and Remedies

### a. Trademark Infringement

1. SONY is a registered trademark for TV, stereo, radio, cameras, betamax and other electronic products. A local company, Best Manufacturing, Inc., produced electric fans which it sold under the trademark’s SONY without the consent of SONY. SONY sued Best Manufacturing for infringement. Decide the case.

**Answer:**

In order that a case for infringement of trademark can prosper, the products on which the trademark is used must be of the same kind. The electric fans produced by Best Manufacturing cannot be said to be similar to such products as TV, stereo and radio sets or cameras or betamax products of SONY. (BAR 1991)

2. What is the distinction between infringement and unfair competition?

**Answer:**

The distinction between infringement (presumably of trademark) and unfair competition are as follows:

1. Infringement of a trademark is the unauthorized use of a trademark, whereas unfair competition is the passing off of one’s goods as those of another;
  2. Fraudulent intent is unnecessary in infringement of trademark, whereas fraudulent intent is essential in unfair competition;
  3. The prior registration of the trademark is a prerequisite to an action for infringement of trademark, whereas registration of the trademark is not necessary in unfair competition. (BAR 1996)
3. After disposing of his last opponent in only two rounds in Las Vegas, the renowned boxer Sonny Bachao arrived at the NAIA met by thousands of hero-worshipping fans and hundreds of media photographers. The following day, a colored photograph of Sonny wearing a black polo short embroidered with the 2-inch Lacoste crocodile logo appeared on the front page of every Philippine newspaper.

Lacoste International, the French firm that manufactures Lacoste apparel and owns the Lacoste trademark, decided to cash in on the universal popularity of the boxing icon. It reprinted the photographs, with the permission of the newspaper publishers, and went on a world-wide blitz of print commercials in which Sonny is shown wearing a Lacoste shirt alongside the phrase “*Sonny Bachao just loves Lacoste*”.

When Sonny sees the Lacoste advertisements, he hires you as a lawyer and asks you to sue Lacoste International before a Philippine court:

**h) For trademark infringement in the Philippines because Lacoste International used his image without his permission**

**Answer:**

Sonny Bachao cannot sue for infringement of trademark. The photographs showing him wearing a Lacoste shirt were not registered as a trademark. (BAR 2009)

- 4. In intellectual property cases, fraudulent intent is not an element of the cause of action except in cases involving:**
- a. Trademark infringement**
  - b. Copyright infringement**
  - c. Patent infringement**
  - d. Unfair competition**

**Answer:**

a. Trademark infringement (BAR 2014)

- b. Damages
- c. Requirement of Notice

## **12. Unfair Competition**

- 1. Ashley Manufacturing Company, a manufacturer in France of a certain brand of cigarette paper, appoints “X” Company the exclusive agent to sell its paper in the Philippines. Among its customers are well-known cigarette manufacturers in the Philippines.**

“Y” Company imports from a dealer in France the same cigarette paper which Ashley Manufacturing Company produces, and sells it to several outlets. The dealer in France has no restriction whatsoever from the manufacturer regarding the sale of such paper for export, nor did “Y” Company have any dealings with “X” Company. Nonetheless, “Y” Company is fully aware of the exclusive right of “X” Company to handle the distributorship of the said cigarette paper in the Philippines.

**Is “Y” Company liable for unfair competition under the Trademark Law, as amended, and could it be enjoined from selling said cigarette paper?**

**Answer:**

No, Y Company is not liable for unfair competition under the Trademark Law. *First Alternative Reason*—If X Company has suffered any damage, it is merely the indirect result of legitimate competition in business, from which no right of action can arise. (W.E. Olsen & Co., Inc. v. Lambert, 42 Phil 633) *Second Alternative Reason*—the requisites of unfair competition in the Trademark Law are not present. (BAR 1980)

- 2. For the past 10 years, Rubberworld Co. has been using the tradename FORMIDAS for its rubber shoes and slippers, but has never registered it in the Patent Office. Its business has flourished and it is now exporting its products to other countries.**

**The Philippine Knitting Mills Co., a new enterprise, is now selling socks manufactured by it with the label FORMIDAS, without having registered the same either as a trademark or a trade name.**

**Rubberworld Co. wants to stop Philippine Knitting Mills from using the tradename FORMIDAS, but it entertains some misgivings about its right to do so because firstly, it has not registered the tradename, and secondly, its products and those of Philippine Knitting Mills are different and; therefore, not competing items.**

**Are the doubts of Rubberworld Co. well-founded? Why?**

**Answer:**

No. Although Rubberworld has not registered the tradename, it has already acquired a goodwill and the use by another of such name would likely confuse the consuming public as to the source of the goods, especially in this case where the tradename is used on socks which like shoes and slippers are footwear. By using the well-known tradename of Rubberworld, Philippines, Knitting Mills is taking advantage of the reputation of Rubberworld, and may even adversely affect such reputation if its goods are inferior quality. The consumers may likely identify the shoes, slippers and socks as coming from one and the same source, they are all footwear. Philippine Knitting Mills is therefore guilty of unfair competition, and can thus be enjoined from using the tradename FORMIDAS. (BAR 1981)

3. **“G” Corporation, organized under Philippine laws is the owner of the trademark “Jumbo” under Registry No. 50025 issued on February 15, 1979 by the Philippine Patent Office, for assorted kitchen ware. On June 10, 1980, the Jumbo Cookware Corporation, organized and existing under the U.S. laws, filed a petition with the Philippine Patent Office for the cancellation of the trademark “Jumbo” registered in the name of “G” Corporation alleging ownership and prior use in the Philippines since 1949 of said trademark on the same kind of goods, which use it had not abandoned.**

**“G” Corporation moved to dismiss the petition alleging that the Jumbo Cookware Corporation, being foreign entity, which is not licensed to do and is not doing business in the Philippines has no personality under the Philippine laws to maintain such petition.**

**Is “G’s” contention meritorious?**

**Explain each of your answers.**

**Answer:**

“G’s” contention is not meritorious. *First alternative reason*—A foreign corporation is not transacting business in the Philippines may sue in the Philippines (*Pacific Vegetable Oil Corp. v. Singzon, Apr. 29, 1965*); thus, it is well settled that if a foreign corporation is not engaged in business in the Philippines, it may not be denied the right to file an action in the Philippine Courts (*Aetna Casualty & Surety Co. v. Pacific Star Line, Dec. 29, 1977; 80 SCRA 635*). Since Jumbo Cookware Corporation is not transacting business in the Philippines but merely exporting its goods to the Philippines; therefore, its trademark shall be protected also in the Philippines. (*Western Equipment & Supply Co. v. reyes, 51 Phil 115*).

*Second alternative reason*—Under the Trademark Law, a foreign corporation may bring an action for unfair competition in the Philippines, whether or not it has been licensed to do business in the Philippines, provided that the country of which the said foreign corporation is a citizen or in which it is domiciled, by treaty or law grants a similar privilege to corporation of the Philippines; and this is granted in the “Convention of Paris” and by law in the United States of America. (*Converse Rubber Corp. v. Jacinto Rubber and Plastics Co. Inc., April 28, 1980; 97 SCRA 158*) (BAR 1981)

4. In 1979, Smash Manufacturing Company, a foreign corporation registered in New York, but not doing business in the Philippines, filed a complaint for unfair competition against Nilo Malakas. The plaintiff alleged that since 1939, it had been exporting tennis rackets under the trademark "Smash Mfg. Co.", and that after the trademark and tradename became familiar to Filipino consumers, defendant Malakas began manufacturing similar products under the same trademark and tradename which he registered with the Philippine Patent Office. Actually, after 1948, Smash Tennis rackets produced by the foreign corporation were no longer imported in the Philippines.

The complaint failed to allege that its trademark or tradename has been registered with the Philippine Patents Office or that the State of New York grants Philippine corporations the privilege to bring an action for unfair competition in that State. Claiming that these are conditions *sine qua non* before a foreign corporation may file suit in the Philippines, defendant Malakas filed a motion to dismiss the complaint.

- c) How would you decide the motion to dismiss? State your reasons.  
d) Regardless of how you decide the motion to dismiss, how would you decide the merits of the case? Does the foreign corporation have other administrative remedies?

**Answer:**

- c) The motion of Malakas to dismiss the complaint of Smash Manufacturing Company shall be sustained. A foreign corporation may bring an action for infringement or unfair competition, provided as conditions *sine qua non* that the trademark or tradename of the suing foreign corporation be registered in the Philippine Patent Office or, in the least, that it be an assignee of such registered trademark or tradename, and that the country of which the plaintiff foreign corporation is a citizen or domiciliary, grants to Filipino corporation the same reciprocal treatment, either thru treaty, convention or law. But said conditions *sine qua non* were not even stated in the complaint of the plaintiff.
- d) *First suggested answer:* This is still a case of unfair competition, although Malakas had the trademark "Smash" registered in the Philippine Patent Office, all the requisites of unfair competition being present. Its remedy is the administrative cancellation of the registration of the trademark "Smash" in the Philippine patent Office, for having obtained the registration contrary to trademark law. (Law Parke Davis & Co. v. Kiu Foo & Co., 60 Phil 928)

*Second suggested answer:* Smash manufacturing Company may have no more remedy, since its trademark "Smash" had been already abandoned for more than 30 years. (Bata Industries, Ltd. V. C.A., May 31, 1982; 114 SCRA 318) (BAR 1982)

5. **Prince Manufacturing Co., Inc. filed a complaint for unfair competition under section 21-A of R.A. 166 against Prince Industries, Inc. the complaint substantially alleges that plaintiff is a foreign corporation organized under the laws of California, USA., with offices in San Francisco; that defendant Prince Industries, Inc. is a corporation organized under the laws of the Philippines with principal office at Sucat Road, Paranaque, Metro Manila; that plaintiff, founded in 1920 by Iver Prince, is the largest manufacturer of ball bearings with the trademark "Prince" and the tradename "Prince Manufacturing Co., Inc." had been exported to the Philippines since 1960; that due to the superior quality and widespread use of its products by the public, the same are well known to Filipino consumers under the tradename "Prince Manufacturing Industries, Inc." and trademark "Prince"; that long after the commencement of the use of plaintiff's trademark and tradename in the Philippines, defendant began manufacturing and selling ball bearings under the trademark "Prince" and tradename "Prince Industries, Co."; that defendant has registered with the Philippine Patent Office the trademark "Prince", which registration is contrary to Sec. 4 of RA 166, as amended, and violative of plaintiff's right to the trademark "Prince"; that the defendant not only uses the trademark "Prince" but likewise has copied the design used by plaintiff in distinguishing its trademark; and that the use thereof by defendant on its products would cause confusion in the minds of the consumers and likely deceive them as to the source or origin of the goods, thereby enabling the defendant to pass off their products as those of plaintiff.**

**Invoking the provisions of Sec. 21 A of RA 166, as amended, plaintiff prayed for damages. It also sought the issuance of a writ of injunction to prohibit defendants from using the tradename "Prince Industries Co." and the trademark "Prince".**

**If you were the counsel for the plaintiff, what administrative remedy would you advise your client to pursue in the event the court action fails?**

**Answer:**

Administrative cancellation of the trademark under Section 17 of RA 166 as amended. Such remedy is available to a foreign corporation as said section does not require that the trademark of the foreign corporation alleged to have been infringed should have been registered in the Philippine Patent Office (*General Garments v. Directors of Patents, 41 SCRA 50 [1971]*) (BAR 1984)

6. **X, a dealer of low grade oil, to save on expenses, uses the containers of different companies. Before marketing to the public his low grade oil, X totally obliterates and erases the brands or marks stenciled on the containers.**

**Y brings an action against X for unfair competition upon its discovery that its containers have been used by X for his low grade oil.**

**Is there unfair competition? State briefly your reasons.**

**Answer:**

**There is no unfair competition, unfair competition is passing off of one's goods as those of another and requires fraudulent intent on the part of the user. These elements are not present in the problem. (BAR 1988)**

7. **N Corporation manufactures rubber shoes under the trademark "Jordann" which hit the Philippine Market in 1985, and registered its trademark with the Bureau of Patents, Trademarks and Technology Transfer (BPTTT) in 1990. PK Company also manufactures rubber shoes with the trademark "Javorski" which it registered with the BPTTT in 1978.**

**In 1992, PK Company adopted and copied the design of N Corporation's "Jordann" rubber shoes, both as to shape and color, but retained the trademark "Javorski" on its products.**

**May PK Company be held liable to N Corporation? Explain.**

**Answer:**

PK may be held liable for unfairly competing against N Corporation. By copying the design, shape and color of N's "Jordann" rubber shoes and using the same in its rubber shoes trademarked "Javorski", PK is obviously trying to pass off its shoes for those of N. It is of no moment that the trademark "Javorski" was registered ahead of the trademark "Jordann". Priority in registration is not material in an action for infringement of trademark. The basis of an action for unfair competition is confusing and misleading similarity in general appearance, not similarity of trademarks. (BAR 1996)

**8. What is the distinction between infringement and unfair competition?**

**Answer:**

The distinction between infringement (presumably of trademark) and unfair competition are as follows:

1. Infringement of a trademark is the unauthorized use of a trademark, whereas unfair competition is the passing off of one's goods as those of another;
2. Fraudulent intent is unnecessary in infringement of trademark, whereas fraudulent intent is essential in unfair competition;
3. The prior registration of the trademark is a prerequisite to an action for infringement of trademark, whereas registration of the trademark is not necessary in unfair competition. (BAR 1996)

13. Trade Names or Business Names

14. Collective Marks

**D. Copyrights**

**1. Can an article of commerce serve as a trademark and at the same time enjoy patent and copyright protection? Explain and give an example.**

**Answer:**

A stamped or marked container of goods can be registered as a trademark. An original ornamental design or model for articles of manufacturer can be copyrighted. An ornamental design cannot be patented, because aesthetic creations cannot be patented. However, it can be registered as an industrial design. Thus, a container of goods which has an original ornamental design can be registered as a trademark, can be copyrighted, and can be registered as an industrial design. (BAR 2010)

1. Basic Principles, Sections 172.2, 175 and 181

**1. Jose Santos has written many poems, some of which have been published in Panorama Magazine but never registered with the Copyright Office. Among his published works was the poem entitled "In a Rose Garden." About a year from its publication, Jose was surprised to hear over the radio a song whose lyrics were copied from his poem. It appears that music sheets of the song have been published and sold under the name of the composer, without any acknowledgment in favor of Jose.**

**Jose wants to know what his rights are and whether he can secure an injunction against the composer and/or the publisher, perhaps with damages. How will you advise him? Explain.**

**Answer:**

I would tell Santos that he has a right to file injunction proceedings to restrain the composer and/or his publisher from further committing any act of infringement of his copyright. Under the present law, copyright is acquired from the moment of the creation of the work. Registration and deposit of the work are no longer necessary for its acquisition. The moment Santos wrote his poem, he acquired the right to restrain any infringement on his copyright, as well as the right to have the infringing copies and devices impounded. However, what Santos cannot demand without such registration and deposit are damages resulting from the infringement. He is therefore not entitled to such damages. (BAR 1981)

## 2. Copyrightable Works

### a. Original Works

1. Under the Intellectual Property Code, lectures, sermons, addresses or dissertations prepared for oral delivery, whether or not reduced in writing or other material forms, are regarded as
  - a. Non-original works.
  - b. Original works.
  - c. Derivative works.
  - d. Not subject to protection.

Answer:

- b. Original works. (BAR 2011)

### b. Derivative Works

## 3. Non-Copyrightable Works

1. TRUE OR FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.

The *Denicola Test* in intellectual property law states that if design elements of an article reflect a merger of aesthetic and functional considerations, the artistic aspects of the work cannot be conceptually separable from the utilitarian aspects; thus, the article cannot be copyrighted.

Answer:

True. Applying the *Denicola Test* in *Brandir International, Inc. v. Cascade Pacific Lumber Co.* (834 F.2d 1142, 1988 Copr.L.Dec. P26), the United State Court of Appeals for the Second Circuit held that if there is any aesthetic element which can be separated from the utilitarian elements, then the aesthetic element may be copyrighted. (BAR 2009)

2. X, an amateur astronomer, stumbled upon what appeared to be massive volcanic eruption in Jupiter while peering at the planet through his telescope. The following week, X, without notes, presented a lecture on his findings before the Association of Astronomers of the Philippines. To his dismay, he later read an article in a science journal written by Y, a professional astronomer, repeating exactly what X discovered without any attribution to him. Has Y infringed on X's copyright, if any?
  - a. No, since X did not reduce his lecture in writing or other material form.
  - b. Yes, since the lecture is considered X's original work.
  - c. No, since no protection extends to any discovery, even if expressed, explained, illustrated, or embodied in a work.
  - d. Yes, since Y's article failed to make any attribution to X.

**Answer:**

c. No, since no protection extends to any discovery, even if expressed, explained, illustrated, or embodied in a work. (BAR 2011)

3. **X came up with a new way of presenting a telephone directory in a mobile phone, which he dubbed as the “iTel” and which uses lesser time for locating names and telephone numbers. May X have his “iTel” copyrighted in his name?**
- a. **No, because it is a mere system or method.**
  - b. **Yes, because it is an original creation.**
  - c. **Yes, because it entailed the application of X’s intellect.**
  - d. **No, because it did not entail any application of X’s intellect.**

**Answer:**

d. No, because it is a mere system or method. (BAR 2011)

**4. Rights of Copyright Owner**

1. **Jose Santos has written many poems, some of which have been published in Panorama Magazine but never registered with the Copyright Office. Among his published works was the poem entitled “In a Rose Garden.” About a year from its publication, Jose was surprised to hear over the radio a song whose lyrics were copied from his poem. It appears that music sheets of the song have been published and sold under the name of the composer, without any acknowledgment in favor of Jose.**

**Jose wants to know what his rights are and whether he can secure an injunction against the composer and/or the publisher, perhaps with damages. How will you advise him? Explain.**

**Answer:**

I would tell Santos that he has a right to file injunction proceedings to restrain the composer and/or his publisher from further committing any act of infringement of his copyright. Under the present law, copyright is acquired from the moment of the creation of the work. Registration and deposit of the work are no longer necessary for its acquisition. The moment Santos wrote his poem, he acquired the right to restrain any infringement on his copyright, as well as the right to have the infringing copies and devices impounded. However, what Santos cannot demand without such registration and deposit are damages resulting from the infringement. He is therefore not entitled to such damages. (BAR 1981)

2. **The widow of a former President commissioned Matalino to write a biography of her late husband for a fee. Upon completion of the work, the widow paid Matalino the agreed price. The biography was copyrighted. The widow, however, changed her mind upon reading the book and decided not to have it published.**
- a) **Can the President’s widow sell the property without the consent of Matalino? Explain.**
  - b) **Can the President’s widow transfer the copyright without the consent of Matalino?**

**Answer:**

a) The President’s widow can sell the property without the consent of Matalino. The widow was the owner of the work that was done by Matalino pursuant to their agreement.

- b) Since the copyright is likewise owned by the widow, the transfer thereof may be effected even without the consent of Matalino. Of course, Matalino, as the creator, retains certain moral rights but consent on transfer is not among such rights. (BAR 1986)

### 3. What intellectual property rights are protected by copyright?

**Answer:**

Section 5 of PD 49 provides that Copyright shall consist the exclusive right:

- a) To print, reprint, publish, copy, distribute, multiply, sell and make photographs, photo engravings, and pictorial illustrations of the works;
- b) To make any translation or other version or extracts or arrangements or adaptation thereof; to dramatize if it be a non-dramatic work; to convert it into a non-dramatic work if it be a drama; to complete or execute if it be a model or design;
- c) To exhibit, perform, represent, produce, or reproduce the work in any manner or by any method whatever for profit or otherwise; if not reproduced in copies for sale, to sell any manuscripts or any record whatsoever thereof;
- d) To make any other use or disposition of the work consistent with the laws of the land. (BAR 1995)

4. In 1999, Mocha Warm, an American musician, had a hit rap single called Warm Warm Honey which he himself composed and performed. The single was produced by a California record company, Galactic Records. Many noticed that some passages from Warm Warm Honey sounded eerily similar to parts of Under Hassle, a 1978 hit song by the British rock band Majesty. A copyright infringement suit was filed in the United States against Mocha Warm by Majesty. It was later settled out of court, with Majesty receiving attribution as co-author of Warm Warm Honey as well as share in the royalties.

By 2002, Mocha Warm was nearing bankruptcy and he sold his economic rights over Warm Warm Honey to Galactic Records for \$10,000.

In 2008, Planet Films, a Filipino movie producing company, commissioned DJ Chef Jean, a Filipino musician, to produce an original re-mix of Warm Warm Honey for use in one of its latest films, Astig!. DJ Chef Jean remixed Warm Warm Honey with a salsa beat, and interspersed as well a recital of a poetic stanza by John Blake, a 17<sup>th</sup> century Scottish poet. DJ Chef Jean died shortly after submitting the remixed Warm Warm Honey to Planet Films.

Prior to the release of Astig!, Mocha Warm learns of the remixed Warm Warm Honey and demands that he be publicly identified as the author of the remixed song in all the CD covers and publicity releases of Planet Films.

- a) Who are the parties or entities entitled to be credited as author of the remixed Warm Warm Honey? Reason out your answers.
- b) Who are the particular parties or entities who exercise copyright over the remixed Warm Warm Honey? Explain.

**Answer:**

- a) Mocha Warm, Majesty and Chef Jean are entitled to be credited as authors of the remixed Warm Warm Honey, because it is their joint work. Mocha Warm retained his moral right to be credited as an author of the remixed Warm Warm Honey despite the sale of his economic rights to Galactic Records, because his moral rights exist independently of his economic rights. John Blake cannot be credited for the use of his work because copyright extends only during the lifetime of the author and 50 years after his death. (BAR 2008)

5. **Eloise, an accomplished writer, was hired by Petong to write a bimonthly newspaper column for Diario de Manila, a newly-established newspaper of which Petong was the editor-in-chief. Eloise was to be paid P1,000 for each column that was published. In the course of 2 months, Eloise submitted 3 columns which, after some slight editing, were printed in the newspaper. However, Diario de Manila proved unprofitable and closed only after 2 months. Due to the minimal amounts involved, Eloise chose not to pursue any claim for payment from the newspaper, which was owned by New Media Enterprises.**
- a) **Does Eloise have to secure authorization from New Media Enterprises to be able to publish her Diario de Manila columns in her own anthology? Explain fully.**
  - b) **Assume that New Media Enterprises plans to publish Eloise's columns in its own anthology entitled, "The Best of Diario de Manila". Eloise wants to prevent the publication of her columns in that anthology since she was never paid by the newspaper. Name one irrefutable legal argument Eloise could cite to enjoin New Media Enterprises from including her columns in its anthology.**

**Answer:**

- a) Eloise does not have to secure the authorization of New Media, because as the author, she owns the copyright to her columns.
  - b) Eloise could invoke that under the Intellectual Property Code, as the owner of the copyright to the columns, she can either "authorize or prevent" reproduction of the work, including the public distribution of the original and each of the work "by sale or other forms of transfer of ownership". While the anthology as a derivative work is protected as a new work, it does not affect the force of the copyright of Eloise upon her columns and does not imply any right to New Media to use the columns without the consent of Eloise. (BAR 2008)
6. **Apart from economic rights, the author of a copyright also has moral rights which he may transfer by way of assignment. The term of these moral rights shall last**
- a. **During the author's lifetime and for 50 years after his death.**
  - b. **Forever.**
  - c. **50 years from the time the author created his work.**
  - d. **During the author's lifetime.**

**Answer:**

- c. During the author's lifetime and for 50 years after his death. (BAR 2011)

## 5. Rules on Ownership of Copyright

1. **If today a person is granted a copyright for a book, for how long will the copyright be valid? If said person uses a pseudonym, how would this affect the length of the copyright?**

**Answer:**

A copyright endures during the lifetime of the creator and for 50 years after his death.

In case he uses pseudonym, the copyright shall last until the end of 50 years following the date of the first publication of the work. (BAR 1975)

2. **The widow of a former President commissioned Matalino to write a biography of her late husband for a fee. Upon completion of the work, the widow paid Matalino the agreed price. The biography was copyrighted. The widow, however, changed her mind upon reading the book and decided not to have it published.**

**Can the President's widow sell the property without the consent of Matalino? Explain.**

**Answer:**

The President's widow can sell the property without the consent of Matalino. The widow was the owner of the work that was done by Matalino pursuant to their agreement. (BAR 1986)

3. **Felix copyrighted the oil painting showing the oath taking of Pres. C. Aquino and Vice-President S. Laurel after the EDSA revolution. Val engaged an artist to paint the same scene for use as picture postcards. Val then started sending the picture postcards to his friends abroad. Is there a violation of Felix's copyright? Reasons.**

**Answer:**

While Felix can have a copyright on his own painting which is expressive of his own artistic interpretation of the event he has portrayed, the scene or the event itself however, is not susceptible to exclusive ownership. Accordingly, there would be no violation of Felix's copyright if another painter were to do the similar work. (BAR 1989)

4. **Solid Investment House (SOLID) commissioned Mon Blanco and his son Steve, both noted artist, to paint a mural for the Main Lobby of the new building of SOLID for a contract price of P2 M.**

- a) **Who owns the mural? Explain.**  
b) **Who owns the copyright of the mural? Explain.**

**Answer:**

a) SOLID owns the mural. SOLID was the one who commissioned the artists to do the work and paid for the work in the sum of P2 M.

b) Unless there is a stipulation to the contrary in the contract, the copyright shall belong in joint ownership to SOLID and Mon Blanco and his son Steve. (BAR 1995)

5. **BR and CT are noted artists whose paintings are highly prized by collectors. Dr. DL commissioned them to paint a mural at the main lobby of his new hospital for children. Both agreed to collaborate on the project for a total fee of P2 M to be equally divided between them. It was also agreed that Dr. DL had to provide all the materials for the painting and pay for the wages of technicians and laborers needed for the work on the project.**

**Assume that the project is completed and both BR and CT are fully paid the amount of P2 M as artists' fee by DL. Under the law on intellectual property, who will own the mural? Who will own the copyright in the mural? Why?**

**Answer:**

Under Section 178.4 of the Intellectual Property Code, in case of commissioned work, the creator (in the absence of a written stipulation to the contrary) owns the copyright, but the work itself belongs to the person who commissioned its creation. Accordingly, the mural belongs to DL. However, BR and CT own the copyright, since there is no stipulation to the contrary. (BAR 2004)

6. In 1999, Mocha Warm, an American musician, had a hit rap single called Warm Warm Honey which he himself composed and performed. The single was produced by a California record company, Galactic Records. Many noticed that some passages from Warm Warm Honey sounded eerily similar to parts of Under Hassle, a 1978 hit song by the British rock band Majesty. A copyright infringement suit was filed in the United States against Mocha Warm by Majesty. It was later settled out of court, with Majesty receiving attribution as co-author of Warm Warm Honey as well as share in the royalties.

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Prior to the release of Astig!, Mocha Warm learns of the remixed Warm Warm Honey and demands that he be publicly identified as the author of the remixed song in all the CD covers and publicity releases of Planet Films.

Who are the particular parties or entities who exercise copyright over the remixed Warm Warm Honey? Explain.

**Answer:**

The copyright over the remixed Warm Warm Honey belongs to Galactic records, Majesty, and Chef Jean. The copyright of Mocha Warm belongs to Galactic Records, because he assigned it to Galactic Records. Majesty also has a copyright, because it is a co-author. The copyright of Chef Jean belongs to him even if his work was commissioned by Planet Firm, because the copyright remained with him. (BAR 2008)

7. While vacationing in Boracay, Valentino surreptitiously took photographs of his girlfriend Monaliza in her skimpy bikini. 2 weeks later, her photograph appeared in the Internet and in a national celebrity magazine.

Monaliza found out that Valentino had sold the photograph to the magazine and, adding insult to injury, uploaded them to his personal blog on the Internet.

1. Monaliza filed a complaint against Valentino for damages based on, among other grounds, violation of her intellectual property rights. Does she have any cause of action? Explain.

**Answer:**

No. Monaliza cannot sue Valentino for violation of her intellectual property rights, because she was not the one who took the pictures. She may sue Valentino instead for violation of her right to privacy. He surreptitiously took photographs of her and then sold the photographs to a magazine and uploaded them to his personal blog in the Internet.

2. Valentino's friend Francesco stole the photographs and duplicated them and sold them to a magazine publication. Valentino sued Francesco for infringement and damages. Does Valentino have any cause of action? Explain.

**Answer:**

No. Valentino cannot sue Francesco for infringement, because he has already sold the photographs to a magazine.

**3. Does Monaliza have any cause of action against Francesco? Explain.**

**Answer:**

Yes. Monaliza can also sue Francesco for violation of her right to privacy. (BAR 2010)

- 8. T, an associate attorney in XYZ Law Office, wrote a newspaper publisher a letter disputing a columnist's claim about an incident in the attorney's family. T used the law firm's letterhead and its computer in preparing the letter. T also requested the firm's messenger to deliver the letter to the publisher. Who owns the copyright to the letter?**
- a. T, since he is the original creator of the contents of the letter.**
  - b. Both T and the publisher, one wrote the letter to the other who has possession of it.**
  - c. The law office since it was an employee and he wrote it on the firm's letterhead.**
  - d. The publisher to whom the letter was sent.**

**Answer:**

b. T, since he is the original creator of the contents of the letter. (BAR 2011)

- 9. Rudy is a fine arts student in a university. He stays in a boarding house with Bernie as his roommate. During his free time, Rudy would paint and leave his finished works lying around the boarding house. One day, Rudy saw one of his works—an abstract painting entitled Manila Traffic Jam—on display at the university cafeteria. The cafeteria operator said he purchased the painting from Bernie who represented himself as its painter and owner.**

**Rudy and the cafeteria operator immediately confronted Bernie. While admitting that he did not do the painting, Bernie claimed ownership of its copyright since he had already registered it in his name with the National Library as provided in the Intellectual Property Code.**

**Who owns the copyright to the painting? Explain.**

**Answer:**

Rudy owns the copyright to the painting because he was the one who actually created it. His rights existed from the moment of its creation. The registration of the painting by Bernie with the National Library did not confer copyright upon him. The registration is merely for the purpose of completing the records of the National Library. (BAR 2013)

**6. Limitations on Copyright**

**a. Doctrine of Fair Use**

- 1. Jose Molina, Jr. inherited the musical works of his talented father, Jose Molina, Sr., who, before his death, had composed a number of well-known songs. When he was alive, the senior Molina never took the precaution of procuring copyright for his compositions, but his son, Molina Jr, who appears to be more practical-minded, succeeded in having his father's intellectual creations registered under the Copyright Law. One such composition was a song entitled "Habang Buhay", which had been popularly sung and had in fact received international acclaim long before the senior Molina's demise.**

**Vilma Aunor, a popular singer, was requested to sing "Habang Buhay" in a free cultural presentation at the Luneta Park.**

**Jose Molina, Jr. sued Vilma Aunor for infringement of copyright.**

## **How would you decide the case?**

### **Answer:**

I would rule in favor of Wilma Aunor. There is no infringement of copyright where the performance is “in a free cultural presentation”. Additionally, the problem speaks of a musical composition that had been popularly sung and had received international acclaim long before the creator’s demise, indicating that the composition must have been during the regime of the then copyright law where registration of the copyright (within 30 days in the case of Manila and 60 days elsewhere) from publication was required; otherwise, the creation under that law would thereby become public property. (BAR 1987)

2. **X copyrighted a scientific research paper consisting of 50 pages dealing with the Tasadays. Y wrote a 100-page review of X’s paper criticizing X’s findings and dismissing X’s story as a hoax. Y’s review literally reproduced 90% of X’s paper. Can X sue Y for infringement of his copyright?**

### **Answer:**

The Copyright Law provides that to an external compatible with fair practice and justified by scientific, critical, informatory or educational purpose, it is permissible to make quotations or excerpts from a work already made accessible to the public. Such quotations may be utilized in their original form or in translation. Viewed from the foregoing, a review by another that “literally reproduced 90%” of the research work done by X may no longer be considered as fair play, and X can sue Y for the violation of the copyright. (BAR 1989)

3. **May a person have photocopies of some pages of the book of Professor Rosario made without violating the copyright law?**

### **Answer:**

Yes. The private reproduction of a published work in a single copy, where the reproduction is made by a natural person exclusively for research and private study, is permitted, without the authorization of the owner of the copyright in the work. (BAR 1998)

4. **In a written legal opinion for a client on the difference between apprenticeship and learnership, Liza quoted without permission a labor law expert’s comment appearing in his book entitled “Annotations on the Labor Code.”**

**Can the labor law expert hold Liza liable for infringement of copyright for quoting a portion of his book without his permission?**

### **Answer:**

No. the labor law expert cannot hold Liza liable for infringement of copyright. Under Section 184.1(k) of the Intellectual Property Code, “Any use made of a work for the purpose of any judicial proceeding or for giving of professional advice by a legal practitioner” shall not constitute infringement of a copyright. (BAR 2006)

5. **The Fair Use Doctrine allows others to utilize copyrighted works under certain conditions. The factors to consider whether use is fair or not would be the purpose and character of the use, nature of the copyrighted work, amount and substantially of the portions used, and else?**

- a) **Effect of the use upon the creator of the work;**
- b) **Effect upon the potential market of the work;**
- c) **Effect of the use upon the public in general;**
- d) **Effect of the use upon the class in which the creator belongs.**

### **Answer:**

b) Effect upon the potential market of the work. (BAR 2012)

## b. Copyright Infringement

1. **X wrote and published a story exactly similar to an unpublished copyrighted story of A. A sues X for infringement of Copyright. It was, however, conclusively proven that X was not aware that the story of A was protected by copyright. Is X liable? Answer with reasons.**

**Answer:**

X is liable for infringement of copyright. As defined, infringement of a copyright consists in the doing by any person, without the consent of owner of the copyright, of anything the sole right to which is conferred by the statute on the owner of the copyright.

Evidently, the *animus furandi*, or intention to pirate, is not an essential element of infringement; and ignorance of the copyright, or honest intention, affords no defense to an action for infringement. The author's property is absolute when perfected by copyright, and the intent of purpose of an invasion is nowhere made an excuse for it. (BAR 1977)

2. **"Q", a well-known artist, designs for "P" a personalized Christmas card with an artistic motif depicting a Philippine rural Christmas scene with a woman and a child, a nipa hut adorned with star-shaped lanterns and a man astride a carabao beside a tree. Underneath the design appears the name "Q". "R" orders from "Q" 500 of such Christmas cards and distributes them to his friends.**

**A year later, "X" copies and prints the same design for his album of Christmas cards intended for sale to the general public. Several customers order Christmas cards from "X" with the same design as that printed for "R".**

**"Q" files a suit against "X" claiming damages under the Copyright Law despite his failure to copyright the work mentioned above. He further claims that the printing or publication of the design he prepared for "R" was special and limited.**

**Decide the case.**

**Answer:**

No, Q's suit against X claiming for damages *under the former Copyright Law* cannot prosper due to his failure to copyright his work. Failure to copyright a work renders the intellectual creation public property and the author loses the exclusive right to control subsequent publication by others. (*Santos v. McCullough Printing Co.*, Oct. 31, 1964; 12 SCRA 322) (Note: Artistic and Literary works are now protected by its mere creation under the new Copyright Law) (BAR 1980)

3. **Miss Solis wrote a script for Regal Films for the movie "One Day—Isang Araw". Ms. Badiday, while watching the movie in Ermita Theatre, discovered that the story of the movie is exactly similar to an unpublished copyrighted autobiography which she wrote. Ms. Badiday sued Miss Solis for infringement of copyright. It was however, conclusively proven that Miss Solis was not aware that the autobiography of Ms. Badiday was protected by a copyright.**

**Is Miss Solis liable? State briefly your reasons.**

**Answer:**

Yes, Miss Solis may be held liable. *Animus furandi* or intention to pirate is not an element of infringement; hence, an honest intention is no defense to an action for infringement. (BAR 1988)

4. **The Victoria Hotel chain reproduces videotapes, distributes the copies thereof to its hotels and makes them available to hotel guests for viewing in the hotel guest rooms. It charges a separate normal fee for the use of the videotape player.**
1. **Can the Victoria Hotel be enjoined for infringing copyrights and held liable for damages?**
  2. **Would it make any difference if Victoria Hotel does not charge any fee for the use of the videotape?**

**Answer:**

1. Yes. Victoria Hotel has no right to use such video tapes in its hotel business without the consent of the creator/owner of the copyright.
  2. No. The use if the videotapes are for business and not merely for home consumption. (BAR 1994)
5. **In an action for damages on account of an infringement of a copyright, the defendant (the alleged pirate) raised the defense that he was unaware that what he had copied was a copyright material. Would this defense be valid?**

**Answer:**

No. An intention to pirate is not an element of infringement. Hence, an honest intention is no defense to an action for infringement. (BAR 1997)

6. **Juan Xavier wrote and published a story similar to an unpublished copyrighted story of Manoling Santiago. It was, however, conclusively proven that Juan Xavier was not aware that the story of Manoling Santiago was protected by copyright. Manoling Santiago sued Juan Xavier for infringement of copyright. Is Juan Xavier liable?**

**Answer:**

Yes. Juan is liable for infringement of copyright. It is not necessary that Juan is aware that the story of Manoling was protected by copyright. The work of Manoling is protected from the time of its creation. (BAR 1998)

7. **Diana and Piolo are famous personalities in showbusiness who kept their love affair secret. They use a special instant messaging service which allows them to see one another's typing on their own screen as each letter key is pressed. When Greg, the controller of the service facility, found out their identities, he kept a copy of all the messages Diana and Piolo sent each other and published them. Is Greg liable for copyright infringement? Reason briefly.**

**Answer:**

Yes, Greg is liable for copyright infringement. Letters are among the works which are protected from the moment of their creation. The publication of the letters without the consent of their writers constitutes infringement of copyright. (BAR 2007)

8. **After disposing of his last opponent in only two rounds in Las Vegas, the renowned boxer Sonny Bachao arrived at the NAIA met by thousands of hero-worshipping fans and hundreds of media photographers. The following day, a colored photograph of Sonny wearing a black polo shirt embroidered with the 2-inch Lacoste crocodile logo appeared on the front page of every Philippine newspaper.**

Lacoste International, the French firm that manufactures Lacoste apparel and owns the Lacoste trademark, decided to cash in on the universal popularity of the boxing icon. It reprinted the photographs, with the permission of the newspaper publishers, and went on a world-wide blitz of print commercials in which Sonny is shown wearing a Lacoste shirt alongside the phrase "*Sonny Bachao just loves Lacoste*".

**When Sonny sees the Lacoste advertisements, he hires you as a lawyer and asks you to sue Lacoste International before a Philippine court:**

- i) XXX,**
- j) For copyright infringement because of the unauthorized use of the published photographs.**

**Answer:**

Sonny Bachao cannot sue for infringement of copyright for the unauthorized use of the photographs showing him wearing a Lacoste shirt. The copyright to the photographs belong to the newspaper which published them inasmuch as the photographs were the result of the performance of the regular duties of the photographers. Moreover, the newspaper publishers authorized the reproduction of the photographs. (BAR 2009)

- 9. X's painting of Madonna and Child was used by her mother to print some personalized gift wrapper. As part of her mother's efforts to raise funds for Bantay Bata, the mother of X sold the wrapper to friends. Y, an entrepreneur, liked the painting in the wrapper and made many copies and sold the same through National Bookstore. Which statement is most accurate?**
- a) Y can use the painting for his use because this is not a copyrightable material;**
  - b) X can sue Y for infringement because artistic works are protected from the moment of creation;**
  - c) Works of art need to be copyrighted also to get protection under the law;**
  - d) Y can use the drawing even though not copyrighted because it is already a public property having been published already.**

**Answer:**

b) X can sue Y for infringement because artistic works are protected from the moment of creation. (BAR 2012)

- 10. KK is from Bangkok, Thailand. She studies medicine in the Pontifical University of Santo Tomas (UST). She learned that the same foreign books prescribed in UST are 40-50% cheaper in Bangkok. So she ordered 50 copies of each book for herself and her classmates and sold the books at 20% less than the price in the Philippines. XX, the exclusive licensed publisher of the books in the Philippines, sued KK for copyright infringement. Decide.**

**Answer:**

KK did not commit copyright infringement. Under the "first sale" doctrine, the owner of a particular copy or phonorecord lawfully made is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord. Hence, there is no infringement by KK since the said doctrine permitted importation and resale without the publisher's further permission. (BAR 2014)

#### **E. Rules of Procedure for Intellectual Property Rights Cases (A.M. No. 10-3-10-SC)**

#### **XIV. Special Laws**

#### **XV. Anti-Money Laundering Act (R.A. No. 9160, as amended by R.A. No. 9194)**

- 1. Rudy is jobless but is reputed to be a jueteng operator. He has never been charged or convicted of any crime. He maintains several banks accounts and has purchased 5 houses and lots for his children from the Luansing Realty, Inc. since he does not have any visible job, the company reported his purchases to the AMLC. Thereafter, AMLC charged him with violation of the Anti-Money Laundering Law. Upon request of the AMLC, the bank disclosed to it Rudy's bank deposits amounting to P100 M. Subsequently, he was charged in court for violation of the Anti-Money Laundering Law.**

**1. Can Rudy move to dismiss the case on the ground that he has no criminal record?**

**Answer:**

No. As with any crime, the absence of a criminal record is not a defense against a charge for violation of the Anti-Money Laundering Law. Moreover, having a criminal record is not an element of Money Laundering Offense defined under Section 4 of the Anti-Money Laundering Law.

**2. To raise funds for his defense, Rudy sold the houses and lots to a friend. Can Luansing Realty, Inc. be compelled to transfer to the buyer ownership of the houses and lots?**

**Answer:**

Yes. In the absence of a freeze order on the subject houses and lots pending criminal proceedings against Rudy, the ownership thereof may be validly transferred to another, and Luansing Realty, Inc. can be compelled to recognize the rights of the buyer as the new owner. Section 7(6) in relation to Section 10 of the Anti-Money Laundering Law required an Order from the Court of Appeals for the freezing of any money or property believed to be the proceeds of any unlawful activity.

**3. In disclosing Rudy's bank accounts to the AMLC, did the bank violate any law?**

**Answer:**

Yes. The bank violated RA No. 1405 (Secrecy of Bank Deposits Act), which considers all deposits of whatever nature with banks or banking institutions as absolutely confidential and may not be examined, inquired or looked into by any person, government officials, bureau or office except upon depositor's written permission; in cases of impeachment; upon order of a competent court in cases of bribery of, or dereliction of duty by public official; and in cases where the money deposited or invested is the subject matter of the litigation. The disclosure was made before Rudy was charged in court for violation of the Anti-Money Laundering Law. Hence, his deposits were technically not yet the subject matter of litigation.

Moreover, under RA No. 9160, the AMLC may inquire into or examine any particular deposit or investment with any banking institution upon order of any competent court for violation of the said Act. In the case at bar, the AMLC merely requested the disclosure; it did not secure the requisite court order. The bank, therefore, was under no obligation to disclose Rudy's deposits.

**4. Supposing the titles of the houses and lots are in possession of the Luansing Realty, Inc., is it under obligation to deliver the titles to Rudy?**

**Answer:**

Yes. There being no freeze order over the subject houses and lots, Luansing Realty, Inc., is obliged to deliver the titles to Rudy who is the owner thereof. (BAR 2006)

- A. Policy of the Law
- B. Covered Institutions
- C. Obligations of Covered Institutions

**1. Under the Anti-Money Laundering Law, a covered institution is required to maintain a system of verifying the true identity of their clients as well as persons purporting to act on behalf of**

- a. Those doing business with such clients.
- b. Unknown principals.
- c. The covered institution.
- d. Such clients.

**Answer:**

d. Such clients. (BAR 2011)

**2. The Anti-Money Laundering Law is a law that seeks to prevent money laundering activities by providing for more transparency in the Philippine Financial System, hence the following institutions are covered by the law, except:**

- a) Bank and any financial institutions;
- b) Pawnshops;
- c) Casino operators;
- d) All of the above.

**Answer:**

c) Casino operators. (BAR 2012)

**D. Covered Transactions**

**E. Suspicious Transactions**

**1. For purposes of determining violation of the provisions of the Anti-Money Laundering Law, a transaction is considered as a "Suspicious Transaction" with "Covered Institutions" regardless of the amount involved, where which the following circumstances exists?**

- a) The amount involved is not commensurate with the client's business or financial capacity;
- b) There is no underlying legal or trade obligation, purpose or economic justification;
- c) Client is not properly identified;
- d) All of the above.

**Answer:**

d) All of the above. (BAR 2012)

**F. When Is Money Laundering Committed**

**G. Unlawful Activities or Predicate Crimes**

**1. Name at least 5 predicate crimes to money laundering.**

**Answer:**

- a. Kidnapping for ransom under Article 267 of Act no. 3815, otherwise known as the RPC, as amended;
- b. Sections 3,4,5,7,8, and 9 of Article Two of R.A. No. 6425, as amended, otherwise known as the Dangerous Drugs Act of 1972;
- c. Section 3 paragraphs B,C,E,G,H, and I of R.A. No. 3019, as amended, otherwise known as the Anti-Graft and Corrupt Practices Act;
- d. Plunder under R.A. No. 7080, as amended;
- e. Robbery and extortion under Articles 294, 295, 296, 300, 301, and 302 of the RPC, as amended;
- f. Jueteng and Masiao punished as illegal gambling under PD No. 1602;

- g. Piracy on the high seas under the RPC, as amended and PD No. 532;
- h. Qualified theft under Article 310 of the RPC, as amended;
- i. Swindling under Article 315 of the RPC, as amended;
- j. Smuggling under R.A. Nos. 455 and 1937;
- k. Violations under RA No. 8792, otherwise known as the Electronic Commerce Act of 2000;
- l. Hijacking and other violations under RA No. 6235; destructive arson and murder, as defined under the RPC, as amended, including those perpetrated by terrorists against non-combatant persons and similar targets;
- m. Fraudulent practices and other violations under RA No. 8799, otherwise known as the SRC of 2000;
- n. Felonies or offenses of a similar nature that are punishable under the penal laws of other countries.

**H. Anti-Money Laundering Council**

**I. Functions**

**J. Freezing of Monetary Instrument or Property**

**1. Under AMLA, a depositor's bank account may be frozen.**

- a) By the bank when the account is the subject of a suspicious or covered transaction report;**
- b) By the AMLC when the account belongs to a person already convicted of money laundering;**
- c) By the RTC, upon *ex parte* motion by the AMLC, in a criminal prosecution for money laundering pending before it;**
- d) By the Court of Appeals *motu proprio* in an appeal from a judgment of conviction of a criminal charge for money laundering;**
- e) None of the above.**

**Answer:**

e) None of the above. (BAR 2013)

**K. Authority to Inquire Into Bank Deposits**

**XVI. Foreign Investments Act (R.A. No. 7042)**

**A. Policy of the Law**

**B. Definition of Terms**

- 1. Foreign Investment
- 2. "Doing Business" in the Philippines
- 3. Export Enterprise
- 4. Domestic Market Enterprise

- C. Registration of Investments on Non-Philippine Nationals
- D. Foreign Investments in Export Enterprise
- E. Foreign Investments in Domestic Market Enterprise

1. A foreign delegation of business man and investment bankers called on your law firm to discuss the possibilities of investing in various projects in the Philippines, and wanted your thoughts on certain issues regarding foreign investments in the Philippines.

The delegation asked: aside from Filipino citizens, what entities would fall under the definition of "Philippine National" under FIA '91?

You replied that the definition of "Philippine National" under FIA '91 covers \_\_\_\_.

- a) Domestic partnership wholly composed of Filipino citizens;
- b) Domestic corporations 60% of whose capital stock, outstanding and entitled to vote, are owned and held by Filipino citizens;
- c) Foreign corporations considered as doing business in the Philippines under the Corporation Code, 100% of whose capital stock, outstanding and entitled to vote, are wholly-owned by Filipino citizens;
- d) All of the above, because the law considers the juridical personality, whether domestic or foreign, as a mere medium; the test of nationality is on the individuals who control the medium;
- e) None of the above, because the term Philippine national can only cover individuals and not juridical entities.

**Answer:**

d) All of the above, because the law considers the juridical personality, whether domestic or foreign, as a mere medium; the test of nationality is on the individuals who control the medium. (BAR 2013)

1.3. The delegation heard that foreigners can invest up to 100% of the equity in "export oriented enterprises" and you were asked exactly what the term covers.

You replied that an "export oriented enterprises" under FIA '91 is an enterprise that \_\_\_\_\_.

- a) Only engages in the export of goods and services, and does not sell goods or services to the domestic market;
- b) Exports consistently at least 40% of its goods or services, and sells at least 60% of the rest to the domestic market;
- c) Exports consistently at least 60% of the goods or services produced, and sells at least 40% of the rest to the domestic market;
- d) Exports consistently at least 60% of its goods or services produced, and can sell goods or services to the domestic market;
- e) None of the above.

**Answer:**

e) None of the above. (BAR 2013)

1.4. As a last question and by way of a concrete example, a delegation member finally inquired—which of the following corporations or businesses in the Philippines may it invest and up to what extent?

- a) A lifestyle magazine publication corporation up to 40% equity;
- b) An advertising corporation, up to 100% equity;
- c) A commercial bank, up to 60% equity;
- d) A jeepney manufacturing corporation, up to 100% equity;
- e) A real estate development corporation, up to 60% equity.

**Answer:**

d) A jeepney manufacturing corporation, up to 100% equity. (BAR 2013)

#### **F. Foreign Investment Negative List**

1. The main feature of the Foreign Investment Act of 1991 is to introduce the concept of “Negative Lists”. Under the said law, what is a “Negative List”?
  - a) It is a list of business activities or enterprises in the Philippines that foreigners are disqualified to engage in;
  - b) It is a list of business activities or enterprises in the Philippines that foreigners are qualified to engage in;
  - c) It is a list of business activities or enterprises that are open to foreign investments provided it is with the approval of the Board of Investment.
  - d) It is a list of business activities or enterprises that are open to foreign investments provided it is with the approval of the SEC.

**Answer:**

a) It is a list of business activities or enterprises in the Philippines that foreigners are disqualified to engage in. (BAR 2012)

2. A foreign delegation of business man and investment bankers called on your law firm to discuss the possibilities of investing in various projects in the Philippines, and wanted your thoughts on certain issues regarding foreign investments in the Philippines.

The delegation has been told about the Foreign Investments Act of 1991, as amended (FIA '91), and they asked what exactly is the law’s essential thrust regarding foreign investments in Philippine business and industries.

You replied that FIA '91 essentially reflects \_\_\_\_\_.

- a) The “Filipino First Policy”;
- b) The “Foreign Investments Positive Lists” concept;
- c) The “Foreign Investments Negative Lists” concept;
- d) The “Control Test” concept;
- e) All of the above.

**Answer:**

c) The “Foreign Investments Negative Lists” concept. (BAR 2013)

#### **XVII. Truth In Lending Act (R.A. No. 3765)**

- 1. Embassy Appliance sells home theater components that are designed and customized as entertainment centers for consumers within the medium-to-high price bracket. Most, if not all, of these packages are sold on installment basis, usually by means of credit cards allowing a maximum of 36 equal monthly payments. Preferred credit cards of this type are those issued by banks, which regularly hold mall-wide sales blitzes participated in by appliance retailers like Embassy Appliances. The salesclerk who is attending to you simply swipes your credit card on the electronic approval machine (which momentarily prints out your charge slip since you have unlimited credit), tears the slip from the machine, hands the same over to you for your signature, and without more, proceeds to arrange the delivery and installation of your new home theatre system. You know you will receive a statement on your credit card purchases from the bank containing an option to pay only a minimum amount, which is usually 1/36 of the total price you were charged for your purchase. Did Embassy Appliance comply with the provisions of the Truth in Lending Act?**

**Answer:**

There is no need for Embassy Appliances to comply with the Truth in Lending Act. The transaction is not a sale on installment basis. Embassy Appliances is a seller on cash basis. It is the credit card company which allows the buyer to enjoy the privilege of paying the price on installment basis. (BAR 2000)

**A. Disclosure Requirement**

- 1. Without going into unnecessary details, discuss the legal consequences of a creditor's failure to comply with the Truth in Lending Act, including the effect on the validity or enforceability of the contract or transaction involved.**

**Answer:**

The failure of a creditor to comply with the Truth in Lending Act would result in the debtor being allowed to recover the interest payment from the creditor but the validity of the contract or transaction itself is not adversely affected. (BAR 1986)

- 2. Dana Gianina purchase on a 36-month installment basis the latest model of the NISSAN Sentra Sedan car from the Jobel Cars, Inc. In addition to the advertised selling price, the latter imposed finance charges consisting of interests, fees and service charges. It did not, however, submit to Dana a written statement setting forth therein the information required by the Truth in Lending Act (RA No. 3765). Nevertheless, the conditional deed of sale which the parties executed mentioned that the total amount indicated therein included such finance charges.**

**a) Has there been substantial compliance of the aforesaid Act?**

**Answer:**

No. there was no substantial compliance with the Truth in Lending Act. The law provides that the creditor must make a full disclosure of the credit cost. The statement that the total amount due includes the principal and the financial charges, without specifying the amounts due on each portion thereof would be insufficient and unacceptable.

**b) If your answer to the foregoing question is in the negative, what is the effect of the violation on the contract?**

**Answer:**

A violation of the Truth in Lending Act will not adversely affect the validity of the contract itself.

**c) In the event of a violation of the Act, what remedies may be availed of by Dana?**

**Answer:**

The violation of the Truth in Lending Act would allow Dana to refuse payment of financial charges or, if already paid, to recover the same. Dana may also initiate criminal charges against the creditor. (BAR 1991)

3. **TRUE or FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**A loan agreement which provides that the debtor shall pay interest at the rate determined by the bank's branch manager violates the disclosure requirement of the Truth in Lending Act.**

**Answer:**

True. This is contrary to the duty of the creditor to disclose in detail the interests, charges and other figures indicating in detail the cost of the credit granted to the debtor. (BAR 2009)

4. **XYZ Corporation bought 10 units of Honda Civic from CCC Corporation. ABC Bank granted a loan to XYZ Corporation which executed a financing agreement which provided for the principal amount, the installment payments, the interest rates and the due dates. On due dates of the installment payments, XYZ Corporation was asked to pay for some handling charges and other fees which were not mentioned in the financing Agreement. Can XYZ Corporation refuse to pay the same?**

- a) **No, because handling charges and other fees are usual in certain banking transactions;**
- b) **Yes, because ABC Bank is required to provide XYZ Corporation not only the amount of the monthly installments but also the details of the finance charges as required by the Truth in Lending Act;**
- c) **No, because the Financing Agreement is a valid document to establish the existence of the obligation;**
- d) **Yes, because legally, finance charges are never allowed in any banking transaction.**

**Answer:**

b) Yes, because ABC Bank is required to provide XYZ Corporation not only the amount of the monthly installments but also the details of the finance charges as required by the Truth in Lending Act. (BAR 2012)

**XVIII. Other Special Laws**  
**XIX. PDIC Law**

1. **X, a bank depositor has a P15,000 savings deposit and a P20,000 time deposit with a bank. If the bank becomes insolvent, and is closed by the Government, how much if any, is the guaranteed amount he can obtain as a matter of right for the two accounts? Explain.**

**Answer:**

He can only obtain P10,000 as a matter of right, by way of guarantee. Under the Philippine Deposit Insurance Act, the maximum amount covered by insurance is P10,000. And by express provision of law, this includes all kinds of deposits—savings current as well as time deposits—in the name of or for the benefit of one person. (BAR 1975)

Note: The term “insured deposits” means the amount due to any bona fide depositor for legitimate deposits in an insured bank net of any obligation of the depositor to the insured bank as of the date of the closure but not to exceed P500,000. (Sec.4 (g), RA 9302)

2. **The Deposit Insurance Law insures deposits up to P10,000.00 per depositor. X has three separate deposits in a single bank, namely, P15,000.00—Savings Deposit; P15,000.00—Current Deposit (checking account). Later on, the bank ran into financial trouble and was ordered by the Central Bank to close and liquidate.**

**How much may X recover? Answer with reasons.**

**Answer:**

X may recover only up to P10,000.00. According to Sec. 3(f) of the Deposit Insurance Corporation Act 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 or thrift account or which is evidenced by its certificate of deposit, and trust funds held by such bank x x x. “The fact therefore that X has savings, time, and current deposits in the same bank is immaterial. They all came under the same heading of deposit”

In Sec. 3(g) of the same Act, the term “insured deposit” is defined as the net amount due to any depositor for deposits in an insured bank (after deducting offset) less any part thereof of which is in excess of P10,000.00 x x x. Likewise, Sec. 10(a) thereof, insofar as pertinent provides: “That the maximum amount of the insured deposit of any depositor shall be P10,000.00”. Evidently, irrespective of kinds of deposits of a particular depositor and the total amount corresponding to the same, he is entitled to recover only up to P10,000.00 in case of closure and liquidation of the bank. (BAR 1977)

3. **When Oriental Bank was ordered close by Central Bank on May 15, 1985, Elizabeth Diaz had 3 separate deposit accounts in her name with the same bank, namely: P200,000 in time deposit; P100,000 in current deposit; and P50,000 in savings deposit.**

**Under the PDIC law, how much, if any, could she recover from each of the 3 separate accounts? Explain.**

**Answer:**

Under the PDIC law, Elizabeth Diaz, although having 3 separate deposit accounts in her name, totaling P350,000, in the Oriental Bank which was ordered close by the Central Bank, can recover only the aggregate amount of P40,000 because the maximum amount of the insured deposit of any depositor, not for every account of a depositor in the bank, is only P40,000.

Note: Section 4 (g) of RA No. 9302 provides that the term “insured deposits” means the amount due to any bona fide depositor for legitimate deposits in an insured bank net of any obligation of the depositor to the insured bank as of the date of the closure but not to exceed P500,000.00. (BAR 1985)

4. **An employee of a large manufacturing firm earns a salary which is just a bit more than what he need for a comfortable living. He is thus able to still maintain a P10,000 savings account, a P20,000 checking account, a P30,000 money market placement and a P40,000 trust fund in a medium-size commercial bank.**

**State which of the four accounts are deemed insured by the PDIC?**

**Answer:**

The P10,000 savings account and the P20,000 checking account are deemed insured by the PDIC. (BAR 1997)

5. **When OCCIDENTAL Bank folded up to insolvency, Manuel had the following separate deposits in his name; P200,000 in savings deposit; P250,000 in time deposit; P50,000 in a current account; P1 M in a trust account; and P3 M in money market placement. Under the PDIC Act, how much could Manuel recover?**

**Answer:**

Manuel can recover P500,000 because this is the total of his savings deposit, time deposit and current account. The trust account and the money market placements are not included in the insured deposits. (BAR 2010)

6. X is a depositor of AAA Bank. She has 3 deposit accounts all under her name. One, in checking account, one in saving account and another one in time deposit account. Each account has a balance of P250,000. AAA Bank became insolvent. PDIC closed the Bank. X therefore is unable to withdraw from all of the accounts. She then filed her claims with the PDIC. Which statement is most accurate?
- a) X can claim a total of P500,000 for all 3 accounts;
  - b) X can only claim from 1 account of P250,000;
  - c) X can claim a total of P750,000 from all 3 accounts;
  - d) X cannot claim anything from any of the deposit accounts.

**Answer:**

- a) X can claim a total of P500,000 for all 3 accounts. (BAR 2012)

**XX. Warehouse Receipts Law**

- A. Definitions
- B. Three Functions of Documents of Title
- C. Negotiability of Warehouse Receipts
- D. Formalities
- E. Negotiation of Warehouse Receipts

**1. By Delivery**

1. Maingat deposited her personal computer (PC) machine in the warehouse of Bodeguero, who issued a negotiable receipt undertaking the delivery of the computer to Mayaman or bearer.

Mayaman entrusted the receipt to Secretario, his secretary, who, in turn, delivered the receipt to Bumibili, a purchaser for value and in good faith. Secretario needed the money to pay his gambling debts.

- a) Who has a better title to the computer, Mayaman or Bumibili?

**Answer:**

- a) Bumibili has a better title to the computer than Mayaman. A bearer negotiable document of title can pass ownership thereof by means of mere delivery to one who acquires the document for value and in good faith. (BAR 1986)

2. For a fee, X deposited 1,000 sacks of corn in the warehouse owned by Y. Y is in the business of warehousing. Y issued a warehouse receipt as proof of the possession of the 1,000 sacks of corn. The warehouse receipt states as follows: "Deliver to X or bearer 1,000 sacks of corn." X wanted to use the warehouse receipt as payment of his debt in favor of Z. how can the ownership of the goods covered by the warehouse receipt be transferred?

- a) Negotiate the warehouse receipt by just delivering the warehouse receipt to Z.
- b) Assign the warehouse receipt to Z to transfer ownership of the goods.
- c) Negotiate the warehouse receipt by specifically indorsing it to Z.
- d) The warehouse receipt in this case is non-negotiable.

**Answer:**

b) Negotiate the warehouse receipt by just delivering the warehouse receipt to Z. (BAR 2012)

## 2. By Indorsement

1. **Maingat deposited her personal computer (PC) machine in the warehouse of Bodeguero, who issued a negotiable receipt undertaking the delivery of the computer to Mayaman or bearer.**

Mayaman entrusted the receipt to Secretario, his secretary, who, in turn, delivered the receipt to Bumibili, a purchaser for value and in good faith. Secretario needed the money to pay his gambling debts.

b) **if by terms of Bodeguero's receipt, the computer is deliverable to the order of Mayaman? Explain.**

**Answer:**

b) Mayaman would have had a better right than Bumibili had the document of title been so worded as to make the article deliverable to the order of Mayaman. Without an indorsement of Mayaman, Bodeguero's receipt could not have been negotiated to Bumibili, sufficient for the latter to acquire title there over as against Mayaman, who was unlawfully deprived of it. (BAR 1986)

## F. Effects of Negotiation of Warehouse Receipt

1. **A, owner of negotiable warehouse receipt for tobacco, sold and indorsed it (the receipt) to B, with the understanding that B would pay after 2 days. Thereafter, B pledged it to C by indorsement, to secure a previous debt to C, who did not know that B had not paid A. Before B could pay A, B died. A now sues C to recover the value of the unpaid receipt. Decide the case with brief reason.**

**Answer:**

A's action cannot prosper. The negotiable warehouse receipt, being duly indorsed and negotiated, C had a perfect right to accept the said warehouse receipt from B in security of pre-existing debts. (Sec. 47, Warehouse receipts Law; and *Siy Cong Bieng & Co., Inc. v. Hongkong & Shanghai Banking Corp.*, 56 Phils. 598). (BAR 1979)

2. **Mr. Bakal deposited with a warehouseman two crates of goods for which he received two warehouse receipts (one for each crate)—one being a negotiable warehouse receipt and the other a non-negotiable warehouse receipt. Title to both warehouse receipts were transferred on December 1, 1985 to Mr. Tigas. The warehouseman was not notified of the transfer of the receipts. Meanwhile, Mr. Tapang, a judgment creditor of Mr. Bakal, served a notice of levy over the goods on the warehouseman.**

a) **Between Mr. Tigas and Mr. Bakal, who would have preference over the goods covered by the negotiable warehouse receipt? Reasons.**

**Answer:**

a) Mr. Tigas would have preference over the goods covered by the negotiable warehouse receipt (assuming that there was proper negotiation to him). In negotiation, the transferee's rights over the goods vests from the very moment of transfer and the transferee there upon acquires the direct obligation of the warehouseman to hold the goods for him. (BAR 1988)

3. **A purchased from S 150 cavans of palay on credit. A deposited the palay in W's warehouse. W issued to A a negotiable warehouse receipt in the name of A. thereafter, A negotiated the receipt to B who purchased the said receipt for value and in good faith.**

## **When can the warehouseman be obliged to deliver the palay to A?**

### **Answer:**

The warehouseman can be obliged to deliver the palay to A if B negotiates back the receipt to A. In that case, A becomes a holder again of the receipt, and A can comply with Sec. 8 of the Warehouse Receipts Law. (BAR 1993)

- 4. Jojo deposited several cartons of goods with SN Warehouse Corporation. The corresponding warehouse receipt was issued to the order of Jojo. He endorsed the warehouse receipt to EJ who paid the value of the goods deposited. Before EJ could withdraw the goods, Melchor informed SN Warehouse Corporation that the goods belonged to him and were taken by Jojo without his consent. Melchor wants to get the goods, but EJ also wants to withdraw the same.**

### **Who has the better right to the goods? Why?**

#### **Answer:**

EJ has better right to the goods. The goods are covered by a negotiable warehouse receipt which was indorsed to EJ for value. The negotiation to EJ was not impaired by the fact that Jojo took the goods without the consent of Melchor, as EJ had no notice of such fact. Moreover, EJ is in possession of the warehouse receipt and only he can surrender it to the warehouseman. (BAR 2005)

#### **G. Warranties**

#### **H. Non-negotiable Receipts**

- 1. Mr. Bakal deposited with a warehouseman two crates of goods for which he received two warehouse receipts (one for each crate)—one being a negotiable warehouse receipt and the other a non-negotiable warehouse receipt. Title to both warehouse receipts were transferred on December 1, 1985 to Mr. Tigas. The warehouseman was not notified of the transfer of the receipts. Meanwhile, Mr. Tapang, a judgment creditor of Mr. Bakal, served a notice of levy over the goods on the warehouseman.**

- b) Who would have preference over the goods covered by the non-negotiable warehouse receipt? Reasons.**

#### **Answer:**

- b) Mr. Tapang, in this case, would have preference over the goods since the transferee of a non-negotiable warehouse receipt merely acquires (1) rights no better than those of the transferor and (b) the direct obligation of the warehouseman only upon notice to him of the transfer. (BAR 1988)**

#### **I. Warehouseman's defenses for Non-delivery or Misdelivery**

- 1. A stole 5 bales of hemp from the pier and stored them in W Warehouse. The latter issued a negotiable warehouse receipt under the terms of which the hemp is deliverable to A or order. A indorsed the receipt in blank to B, who paid value for it without knowing about the theft.**

**In the meantime, M, the owner of the hemp, with the help of the police, was able to trace the hemp to X Warehouse and demanded delivery of the same. X Warehouse, after being satisfied that M was the real owner of the hemp, delivered the same to him despite the fact that the negotiable warehouse receipt was outstanding and was not in M's possession, and therefore could not be surrendered or cancelled.**

**Subsequently, B demanded delivery of the hemp and, since he could not obtain it, now claim damages from X warehouse on the ground that he, B, was the only one entitled to the delivery because he was the holder for value in good faith of the negotiable warehouse receipt covering the hemp.**

**Is X Warehouse liable to B for damages? Explain.**

**Answer:**

No, X Warehouse is not liable for such damages. Under Sec.41 of the Warehouse Receipts Law, a person to whom a negotiable receipt has been negotiated acquires only such title to the goods as the person negotiating the receipt to him had or had ability to convey to a purchaser in good faith for value. Since A who negotiated the receipt to B was a thief and thus had no title to the goods covered by the receipt, there was no title which he could transfer to B. Therefore, B has no right to delivery as against the true owner, M, and X Warehouse cannot be held liable to him for failure to deliver. (BAR 1981)

- 2. When is a warehouseman bound to deliver the goods upon a demand made either by the holder of a receipt for the goods or by the depositor?**

**Answer:**

The warehouseman is bound to deliver the goods upon demand made either by the holder of the receipt for the goods or by the depositor if the demand is accompanied by (a) an officer to satisfy the warehouseman's lien, (b) an offer to surrender the receipt, if negotiable, with such indorsements as would be necessary for the negotiation thereof, and (c) readiness and willingness to sign when the goods are delivered if so requested by the warehouseman. (BAR 1991)

- 3. Luzon Warehouse Corporation received from Pedro 200 cavans of rice for deposit in its warehouse for which a negotiable warehouse receipt was issued. While the goods were stored in the said warehouse, Cicero obtained a judgment against Pedro for the recovery of a sum of money. The sheriff proceeded to levy upon the goods on a writ of execution and directed the warehouseman to deliver the goods. Is the warehouseman under obligation to comply with the sheriff's order?**

**Answer:**

No. There was a valid negotiable receipt as there was a valid delivery of 200 cavans of rice for deposit. In such case, the warehouseman (LWC) is not obliged to deliver the 200 cavans of rice deposited to any person, except to one who can comply with Section 8 of the Warehouse Receipts law, namely: (1) surrender the receipt of which he is a holder; (2) willing to sign a receipt for the delivery of the goods; and (3) pays the warehouseman's liens, that is, his fees and advances, if any.

The sheriff cannot comply with these requisites, especially the first, as he is not the holder of the receipt. (BAR 1998)

- 4. The warehouseman, by issuing the warehouse receipt, acknowledges that the goods are in possession, but he can refuse to deliver the goods to the holder of the warehouse receipt covering the goods if—**
- a) The warehouse receipt covering the goods is not presented;**
  - b) The lien of the warehouseman is not satisfied;**
  - c) The said holder presents a materially altered warehouse receipt;**
  - d) All of the above.**

**Answer:**

d) All of the above. (BAR 2012)

## J. Loss of the Receipt

1. **To guarantee the payment of a loan obtained from a bank, Raoul pledged 500 bales of tobacco deposited in a warehouse to said bank and endorsed in blank the warehouse receipt. Before Raoul could pay for the loan, the tobacco disappeared from the warehouse.**

**Who should bear the loss—the pledgor or the bank? Why?**

**Answer:**

The pledgor should bear the loss. In the pledge of a warehouse receipt the ownership of the goods remain with depositor or his transferee. Any contract or real security, among them a pledge, does not amount to or result in an assumption of risk of loss by the creditor. The Warehouse Receipts Law did not deviate from this rule. (BAR 1992)

## K. Warehouseman's Liability

1. **X Co. was an operator of customs bonded warehouse. By virtue of a forged permit to deliver imported goods, purportedly issued by the Bureau of Customs, A was able to obtain delivery of 100 bales of cotton worth P60,000 from X Co. Due to wrong delivery, X Co. filed against A a complaint for recovery of the value of the cotton and damages. Will the suit prosper? Decide and give reasons.**

**Answer:**

No. the suit will not prosper. X Co. had yet no cause of action against A, since the real parties interested in the bales of cotton (who were the depositor, consignee, or shipper with respect to bales of cotton, and the Commissioners of Customs and Internal Revenue with respect to the duties and taxes) have not yet sued X Co. for damages or for recovery of the bales of cotton or the corresponding duties and taxes. (*Consolidated Terminals, Inc. v. Artex Development Co., Inc.* 63 SCRA 46) (BAR 1978)

2. **When may a warehouseman be liable for any loss or injury to the goods stored in his warehouse although he is not negligent?**

**Answer:**

He may be liable in the following cases:

- (1) Where he has expressly agreed to be liable for any loss even where he is not negligent; or
- (2) If the warehouseman has violated the contract, like when he agrees to store the goods in a particular place and stores them in another place; or
- (3) Where the loss takes place after the warehouseman converted the goods. (BAR 1976)

3. **A warehouseman having in his possession certain goods, for which he has issued a negotiable receipt, receives a court order of garnishment pursuant to an attachment directing him to sell said goods. Disregarding the order, he delivers them to a third person who produces the warehouse receipt. Is the warehouseman liable to the attaching creditor for the value of the goods? Why?**

**Answer:**

Yes, the warehouseman is liable. According to Sec.10 of the Warehouse Receipts Law, insofar as pertinent, "x x x, and though he delivered the goods as authorized by (subdivisions (b) and (c) of Section 9) he shall be so liable, if prior to such delivery he had either:

- (a) Been requested, by or on behalf of the person lawfully entitled to a right of property or possession in the goods, not to make such delivery, or

- (b) Hold information that the delivery about to be made was to one not lawfully entitled to the possession of the goods.

The delivery of the goods by a warehouseman to the depositor after receiving notice of the adverse claim or title of a third person renders the warehouseman liable for conversion if such claim or title is good.

In the instant case, his receipt of a notice of garnishment should have sufficiently warned him that there is an adverse claim on the goods, and when, notwithstanding such legal process, he delivered the same to a third person, he may be liable for conversion if such claim or title is good. (BAR 1977)

4. **Jaime Locsin deposits with Rock Warehouse Company several goods stolen from Maria Lim. The company issues a warehouse receipt to the order of Jaime Locsin. The latter then endorses and delivers the warehouse receipt to Juan Bilog for value. The latter has no notice of the infirmity in the ownership of the goods.**

**Before delivery of the goods to Juan Bilog, the company receives notice from Maria Lim that she owns the goods and that they should not be delivered to Juan Bilog. On the strength of the warehouse receipt, the company ignores the claim of Maria Lim and delivers the goods to Juan Bilog.**

**Is the company liable for the misdelivery?**

**Answer:**

Yes, the Rock Warehouse Company is liable to Maria Lim, the true owner of the goods. *First Alternative Reason*—Under the Warehouse Receipts Law, where a warehouseman delivers goods to one who is not in fact lawfully entitled to the possession of them, after being requested by or on behalf of the person lawfully entitled to a right of property in the goods, not to make such delivery, the warehouseman shall be liable for conversion or damages to all having a right of property to goods so delivered. *Second Alternative Reason*—Where the warehouseman has information as to the claim of other person other than the holder of the receipt, the warehouseman shall not deliver the goods but shall within reasonable time ascertain the validity of the adverse claim or to bring legal proceedings to compel all claimants to interplead. (BAR 1980)

5. **Last July 20, 1982, “A” sold to “B” his negotiable warehouse receipt covering 100 sacks of rice stored in “X” Warehouse, Inc. In payment thereof, “B” issued a check for P10,000, dated July 22, 1982, in favor of “A”. On the same date, the check was dishonored by the bank for lack of funds. “A” immediately instructed “X” Warehouse in writing not to deliver the 100 sacks of rice to anyone. On July 23, 1982, an employee of “X” Warehouse, unaware of the written instruction received by its president, delivered the 100 sacks of rice to “B”. State the cause or causes of action, if any, which “A” may have against “X” Warehouse and “B”. Give reasons.**

**Answer:**

A may make X Warehouse, Inc. liable for damages, the warehouseman having been instructed already in writing not to make delivery of the sacks of rice to anyone. The X Warehouse, Inc. is liable for the act of his employee, its agent, and for its negligence in not duly informing its employee/agent. B, on the other hand, will be liable with the X Warehouse, Inc. for said rice; besides his liability for estafa, the check having been dishonored by the drawee bank for lack of funds. (Sec. 10, Warehouse Receipts Law; B.P. 22) (BAR 1982)

6. **X deposited 1,000 sacks of wheat flour with Luzon Warehouse Company, for which he was issued a negotiable receipt. Y was able to get hold of the receipt, forged the signature of X, presented the receipt to Luzon Warehouse and was able to withdraw the wheat flour. What are the rights of X?**

**Answer:**

If under the terms of the negotiable warehouse receipt, the goods are deliverable to the depositor or to his order, X may proceed against Luzon Warehouse and/or Y. Without the valid indorsement of X to the holder or in blank, the warehouseman is liable to X for conversion in the misdelivery.

If however, by the terms of the negotiable warehouse receipt, the goods are deliverable to bearer (either because it is so expressed in the warehouse receipt or because of a blank indorsement by the person to whose order the goods are deliverable, X may only proceed against Y. the Warehouseman is not liable for conversion where the goods are delivered to a person in possession of a bearer negotiable warehouse receipt. (BAR 1989)

7. **S stored hardware materials in the bonded warehouse of W, a licensed warehousemen under the General Bonded Warehouse Law (Act 3893 as amended). W issued the corresponding warehouse receipt in the form he ordinarily uses for such purpose in the course of his business. All the essential terms required under Section 2 of the Warehouse Receipts Law (Act 2137 as amended) are embodied in the form. In addition, the receipt issued to S contains a stipulation that W would not be responsible for the loss of all or any portion of the hardware materials covered by the receipt even if such loss is caused by the negligence of W or his representatives or employees. S endorsed and negotiated the warehouse receipt to B, who demanded delivery of the goods. W could not deliver because the goods were nowhere to be found in his warehouse. He claims he is not liable because of the free-from-liability clause stipulated in the receipt. Do you agree with W's contention? Explain.**

**Answer:**

No. I do not agree with the contention of W. the stipulation that W would not be responsible for the loss of all or any portion of the hardware materials covered by the receipt even if such loss is caused by the negligence of W or his representative or employees is void. The law requires that a warehouseman should exercise due diligence in the care and custody of the things deposited in his warehouse. (BAR 2000)

8. **The authorized alteration of a warehouse receipt which does not change its tenor renders the warehouseman liable according to the term of the receipt.**
- In its original tenor if the alteration is material.**
  - In its original tenor.**
  - As altered if there is fraud.**
  - As altered.**

**Answer:**

b. In its original tenor. (BAR 2011)

### **L. Warehouseman's Lien**

1. **TRUE or FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.**

**Under the Warehouse Receipts Law, a warehouseman loses his lien upon the goods when he surrenders possession thereof.**

**Answer:**

True. A lien is dependent on possession. When a warehouseman surrenders possession, he thereby loses his lien on the goods over which he no longer has possession. (BAR 2009)

2. X, warehouseman, sent a text message to Y, to whom X had issued a warehouse receipt for Y's 500 sacks of corn, notifying him of the due date and time to settle the storage fees. The message stated also that if Y does not settle the warehouse charges within 10 days, he will advertise the goods for sale at a public auction. When Y ignored the demand, X sold 100 sacks of corn at a public auction. For X's failure to comply with the statutory requirement of written notice to satisfy his lien, the sale of the 100 sacks of corn is
- Voidable.
  - Rescissible.
  - Unenforceable.
  - Void.

Answer:

d. Void. (BAR 2011)

### M. Adverse Claimant

1. In a case where three persons claim the right to possession of certain goods stored in a warehouse, what should the warehouseman do?

**Answer:**

He should require the claimants to interplead, either in an action brought against him for non-delivery or in an original suit brought by him. (Section 17, Warehouse Receipts Law). (BAR 1976)

2. Jaime Locsin deposits with Rock Warehouse Company several goods stolen from Maria Lim. The company issues a warehouse receipt to the order of Jaime Locsin. The latter then endorses and delivers the warehouse receipt to Juan Bilog for value. The latter has no notice of the infirmity in the ownership of the goods.

Before delivery of the goods to Juan Bilog, the company receives notice from Maria Lim that she owns the goods and that they should not be delivered to Juan Bilog. On the strength of the warehouse receipt, the company ignores the claim of Maria Lim and delivers the goods to Juan Bilog.

Is the company liable for the misdelivery?

**Answer:**

Yes, the Rock Warehouse Company is liable to Maria Lim, the true owner of the goods. *First Alternative Reason*—Under the Warehouse Receipts Law, where a warehouseman delivers goods to one who is not in fact lawfully entitled to the possession of them, after being requested by or on behalf of the person lawfully entitled to a right of property in the goods, not to make such delivery, the warehouseman shall be liable for conversion or damages to all having a right of property to goods so delivered. *Second Alternative Reason*—Where the warehouseman has information as to the claim of other person other than the holder of the receipt, the warehouseman shall not deliver the goods but shall within reasonable time ascertain the validity of the adverse claim or to bring legal proceedings to compel all claimants to interplead. (BAR 1980)

3. A purchased from S 150 cavans of palay on credit. A deposited the palay in W's warehouse. W issued to A a negotiable warehouse receipt in the name of A. thereafter, A negotiated the receipt to B who purchased the said receipt for value and in good faith.

Who has a better right to the deposit, S, the unpaid vendor, or B, the purchaser of the receipt for value and in good faith? Why?

**Answer:**

B has a better right than S. the right of the unpaid seller, S, to the goods was defeated by the act of A in endorsing the receipt to B. (BAR 1993)

4. **A Warehouse Company received for safekeeping 1000 bags of rice from a merchant. To evidence the transaction, the Warehouse Company issued a receipt expressly providing that the goods be delivered to the order of said merchant.**

**A month after, a creditor obtained judgment against the said merchant for a sum of money. The sheriff proceeded to levy on the rice and directed the Warehouse Company to deliver to him the deposited rice.**

**Assuming that a week prior to the levy, the receipt was sold to a rice mill on the basis of which it filed a claim with the sheriff. Would the rice mill have better rights to the rice than the creditor? Explain your answer.**

**Answer:**

Yes. The rice mill, as a holder for value of the receipt, has a better right to the rice than the creditor. It is rice mill that can surrender the receipt which is in its possession and can comply with the other requirements which will oblige the warehouseman to deliver the rice, namely, to sign a receipt for the delivery of the rice, and to pay the warehouseman's lien and fees and other charges (BAR 1999)

5. **Jojo deposited several cartons of goods with SN Warehouse Corporation. The corresponding warehouse receipt was issued to the order of Jojo. He endorsed the warehouse receipt to EJ who paid the value of the goods deposited. Before EJ could withdraw the goods, Melchor informed SN Warehouse Corporation that the goods belonged to him and were taken by Jojo without his consent. Melchor wants to get the goods, but EJ also wants to withdraw the same.**

**If SN Warehouse Corporation is uncertain as to who is entitled to the property, what is the proper recourse of the corporation? Explain.**

**Answer:**

Since there is a conflicting claim of ownership or title, SN Warehouse Corporation should file a complaint in interpleader requiring EJ and Melchor to interplead. The matter involves a judicial question as to whose claim is valid. (BAR 2005)

6. **002-38-0001 G, a grocery goods supplier, sold 100 sacks of rice to H who promised to pay once he has sold all the rice. H, in the meantime, delivered the goods to W, a warehouseman, who issued a warehouse receipt. Without the knowledge of G and W, H negotiated the receipt to P who acquired it in good faith and for value. P then claimed the goods from W, who released them. After the rice was loaded on a ship bound for Manila, G invokes his right to stop the goods in transit due to his unpaid lien. Who has a better right to the rice?**

- a. **P, since he has superior rights as a purchaser for value and in good faith.**
- b. **P, regardless of whether or not he is a purchaser for value and in good faith.**
- c. **G, since as an unpaid seller, he has the right of stoppage in transitu.**
- d. **W, since it appears that the warehouse charges have not been paid.**

**Answer:**

- c. **P, since he has superior rights as a purchaser for value and in good faith. (BAR 2011)**

7. X, creditor of Y, obtained a judgment in his favor in connection with Y's unpaid loan to him. The court's sheriff then levied on the goods that Y stored in T's warehouse, for which the latter issued a warehouse receipt. A month before the levy, however, Z bought the warehouse receipt for value. Who has a better right over the goods?
- T, being the warehouseman with a lien on the goods.
  - Z, being a purchaser for value of the warehouse receipt.
  - X, being Y's judgment creditor.
  - Y, being the owner of the goods.

**Answer:**

- b. Z, being a purchaser for value of the warehouse receipt. (BAR 2011)

8. T delivers two refrigerators to the warehouse of W who then issues a negotiable receipt undertaking the delivery of the refrigerators to "T or bearer". T entrusted the receipt to B for safekeeping only. B negotiated it, however, to F who bought it in good faith and for value. Who is entitled to the delivery of the refrigerators?
- T, since he is a real owner of the refrigerators.
  - F, since he is a purchaser in good faith and for value.
  - B, since T entrusted the receipt to him.
  - W, since he has as a warehouseman a lien on the goods.

**Answer:**

- c. F, since he is a purchaser in good faith and for value. (BAR 2011)

9. The legal remedy of the warehouseman in case of conflicting claims is to—
- File an action for interpleader;
  - Give the goods to the first one who first presented the warehouse receipt;
  - Use his discretion as to who he believes has the prior right;
  - Keep the goods and appropriate them to himself.

**Answer:**

- b) File an action for interpleader. (BAR 2012)

#### **N. Attachment or Levy**

1. On January 5, 1984, Juan delivered 6 crates of goods to Acme Warehousing Co. and received a non-negotiable warehouse receipt. On January 4, 1984, Juan transferred for value the receipt to Manuel.

In the meanwhile, Jose obtained a judgment against Juan for an unpaid debt. A writ of execution followed, by virtue of which the sheriff on June 18, 1984 levied on the 6 crates of goods covered by the above receipt.

What are the obligations of Acme Warehousing Co. under the circumstances? Would your answer be the same if Juan had instead received a negotiable warehouse receipt which he indorsed to Manuel? Support your answers with reasons.

**Answer:**

- a) It depends. If either Juan or Manuel had, prior to the levy by the sheriff on June 18, 1984, notified Acme of the transfer of the receipt to Manuel, then Acme has no obligation to comply with the sheriff's order. If they did not make such notification, then Acme must comply with the order of the sheriff.

Section 42 of the Warehouse Receipts law provides that prior to the notification of the warehouseman by the transferor or transferee (in this case, Manuel) to the goods and the right to acquire the obligation of the warehouseman (to hold possession of the goods for Manuel according to the terms of the receipt) may be defeated by the levy of an attachment or execution of the goods by a creditor of the transferor Juan.

- b) If Juan had received a negotiable receipt which he then negotiated to Manuel, the obligation of the Acme to hold the goods in trust for Manuel, the person to whom the receipt was negotiated, would arise as of June 14, 1984 without need of notice to Acme and Manuel would have already acquired the rights of a person to whom a receipt has been negotiated, including the direct obligation of the warehouseman to hold possession of the goods for him according to the terms of the receipt as fully as if Acme had contracted directly with him.

Under the facts, Acme need not comply with the sheriff's order as the goods cannot, while in the possession of Acme, be levied upon under an execution unless the negotiable receipt be first surrendered to it or its negotiation enjoined. The warehouseman shall in no case be compelled to deliver the actual possession of the goods until the receipt is surrendered to him or impounded by the court. (*Sec. 25, Warehouse Receipts Law*) (BAR 1984)

2. **"XYZ" Warehousing Corporation receives from "A" 30 bales of cotton for deposit in said warehouse for which a negotiable receipt was issued. While the goods were stored in said warehouse, "C" obtains judgment against "A" for the recovery of a sum of money. The sheriff proceeded to levy upon the goods upon a writ of execution and directed the warehouseman to deliver the goods.**

**Is the warehouseman under obligation to comply with the sheriff's order? Why?**

**Answer:**

No, the warehouseman is not under obligation to comply with the sheriff's order. If goods are delivered to a warehouseman by the owner or by a person whose act would bind the owner, and a negotiable receipt is issued for them, they cannot thereafter, while in the possession of the warehouseman, be attached by garnishment or otherwise, or be levied upon under execution, unless the receipt be first surrendered to the warehouseman, or its negotiation enjoined. (*Sec. 25, Warehouse Receipts Law.*) (BAR 1981)

3. **On January 5, 1984, Juan delivered 6 crates of goods to Acme Warehousing Co. and received a non-negotiable warehouse receipt. On January 4, 1984, Juan transferred for value the receipt to Manuel.**

**In the meanwhile, Jose obtained a judgment against Juan for an unpaid debt. A writ of execution followed, by virtue of which the sheriff on June 18, 1984 levied on the 6 crates of goods covered by the above receipt.**

**What are the obligations of Acme Warehousing Co. under the circumstances? Would your answer be the same if Juan had instead received a negotiable warehouse receipt which he indorsed to Manuel? Support your answers with reasons.**

**Answer:**

- a) It depends. If either Juan or Manuel had, prior to the levy by the sheriff on June 18, 1984, notified Acme of the transfer of the receipt to Manuel, then Acme has no obligation to comply with the sheriff's order. If they did not make such notification, then Acme must comply with the order of the sheriff.

Section 42 of the Warehouse Receipts law provides that prior to the notification of the warehouseman by the transferor or transferee (in this case, Manuel) to the goods and the right to acquire the obligation of the warehouseman (to hold possession of the goods for Manuel according to the terms of the receipt) may be defeated by the levy of an attachment or execution of the goods by a creditor of the transferor Juan.

- b) If Juan had received a negotiable receipt which he then negotiated to Manuel, the obligation of the Acme to hold the goods in trust for Manuel, the person to whom the receipt was negotiated, would arise as of June 14, 1984 without need of notice to Acme and Manuel would have already acquired the rights of a person to whom a receipt has been negotiated, including the direct obligation of the warehouseman to hold possession of the goods for him according to the terms of the receipt as fully as if Acme had contracted directly with him.

Under the facts, Acme need not comply with the sheriff's order as the goods cannot, while in the possession of Acme, be levied upon under an execution unless the negotiable receipt be first surrendered to it or its negotiation enjoined. The warehouseman shall in no case be compelled to deliver the actual possession of the goods until the receipt is surrendered to him or impounded by the court. (*Sec. 25, Warehouse Receipts Law*) (BAR 1984)

- 4. Luzon Warehouse Corporation received from Pedro 200 cavans of rice for deposit in its warehouse for which a negotiable warehouse receipt was issued. While the goods were stored in the said warehouse, Cicero obtained a judgment against Pedro for the recovery of a sum of money. The sheriff proceeded to levy upon the goods on a writ of execution and directed the warehouseman to deliver the goods. Is the warehouseman under obligation to comply with the sheriff's order?**

**Answer:**

No. There was a valid negotiable receipt as there was a valid delivery of 200 cavans of rice for deposit. In such case, the warehouseman (LWC) is not obliged to deliver the 200 cavans of rice deposited to any person, except to one who can comply with Section 8 of the Warehouse Receipts law, namely: (1) surrender the receipt of which he is a holder; (2) willing to sign a receipt for the delivery of the goods; and (3) pays the warehouseman's liens, that is, his fees and advances, if any.

The sheriff cannot comply with these requisites, especially the first, as he is not the holder of the receipt. (BAR 1998)

- 5. A Warehouse Company received for safekeeping 1000 bags of rice from a merchant. To evidence the transaction, the Warehouse Company issued a receipt expressly providing that the goods be delivered to the order of said merchant.**

**A month after, a creditor obtained judgment against the said merchant for a sum of money. The sheriff proceeded to levy on the rice and directed the Warehouse Company to deliver to him the deposited rice.**

**What advice will you give the Warehouse Company? Explain your answer.**

**Answer:**

The 1000 bags of rice were delivered to the Warehouse Company by a merchant, and a negotiable receipt was issued therefore. The rice cannot thereafter, while in possession of the Warehouse Company, be attached by garnishment or otherwise, or be levied upon under an execution unless the receipt be first surrendered to the warehouseman, or its negotiation enjoined. The Warehouse Company cannot be compelled to deliver the actual possession of the rice until the receipt is surrendered to it or impounded by the court.

6. **Alex deposited goods for which Billy, a warehouseman, issued a negotiable warehouse receipt wherein the goods were deliverable to Alex or order. Alex negotiated the receipt to Caloy. Thereafter, Dario, a creditor, secured judgment against Alex and served notice of levy over the goods on the warehouseman.**
- a) **To whom should the warehouseman deliver the goods upon demand?**
  - b) **Would your answer be the same if the warehouseman issued a non-negotiable warehouse receipt? Reason briefly.**

**Answer:**

- a) The warehouseman should deliver the goods upon demand to Caloy who is a holder of the receipt in good faith and for value. The goods cannot be levied upon by the creditor of Alex after it was negotiated to Caloy (Section 25, NIL).
- b) No, my answer would not be the same if the warehouseman issued a non-negotiable warehouse receipt. In such case, the warehouseman should deliver the goods to Dario, if the notice of levy was served on the warehouseman prior to the notification of the warehouseman by Alex or Caloy of the transfer of the non-negotiable receipt. In such case, the title of Caloy would be defeated by the notice of levy by Dario (Section 42, Warehouse Receipts Law). (BAR 2007)

**XXI. Financial Rehabilitation and Insolvency Act (FRIA)**

1. **Whom does the assignee in solvency represent—the debtor, the creditors, the court, etc? Can said assignee in insolvency take possession of the assets of the conjugal partnership?**

**Answer:**

The assignee in insolvency represents the insolvent debtor, the unsecured creditors, and secured creditors who as allowed to prove their claims and the court which has control over him. Provision of the Civil Code 2238 states that: 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 obligation, except insofar as the latter have redounded to the benefit of 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. (BAR 1975)

2. **On September 6, 1978, A convened his principal creditors, including B, and informed them that he was in a state of insolvency. Knowing of this, B immediately transferred his credit against the property of A located in another jurisdiction to C, a close relative, who immediately filed action in said jurisdiction against A and attached the property of A. Later, a petition for insolvency was filed by A, and D was appointed assignee. Learning of the transfer, D now sues B for damages. Can D recover? Give reasons.**

**Answer:**

D may not sue B for damages. Under the Insolvency Law, D may have the attachment made by C dissolve if levied within one month next preceding the commencement of the insolvency proceedings. (Sec. 32, Insolvency Law.) (BAR 1979)

3. **“Y” Company convenes its principal creditors in an informal meeting and informs them that it is in a state of insolvency. “Z”, one of the creditors attending the meeting, finds out that in the balance sheet distributed, mention is made of a C-54 plane owned by the company in the United States. Thereupon, “Z” executes a deed of assignment, transferring his credits or receivables from “Y” company to a subsidiary in the U.S. The latter, in a proper legal action, attaches and disposes of the plane to answer for credit assigned by “Z”. Subsequently, “Y” Company files a petition for voluntary insolvency.**

**Has “Z” violated any provision of the Insolvency Law thereby making it liable for damages for having disposed of his credit or receivables from the company in favor of a subsidiary in the U.S.?**

**Answer:**

Z who is a creditor, may not be liable for damages, under the Insolvency Law. The assignee may, however, under the powers granted to him by the insolvent debtor and take possession thereof, within the limits provided by law. (*Sec. 36, Insolvency Law*) (BAR 1980)

4. **The Blue Star Corporation filed with the RTC a petition for rehabilitation on the ground that it foresaw the impossibility of paying its obligations as they fall due. Finding the petition sufficient in form and substance, the court issued an Order appointing a rehabilitation receiver and staying the enforcement of all claims against the corporation.**

**What is the rationale for the Stay Order?**

**Answer:**

The stay order is a recognition that all assets of a corporation under rehabilitation are held in trust for the equal benefit of all creditors under the doctrine of “equality is equity”. As all the creditors ought to stand on equal footing, not any one of them should be paid ahead of others. Furthermore, the stay order will enable the management committee or the rehabilitation receiver to effectively exercise its or his powers free from judicial or extrajudicial interference that might unduly hinder or prevent the “rescue” of the distressed company, rather than to waste its/his time, effort and resources in defending claims against the corporation. (BAR 2006)

5. **DMP Corporation (DMP) obtained a loan of P20 M from National Bank (NB) secured by a real estate mortgage over a 63,380-square meter land situated in Cabanatuan City. Due to the Asian Economic Crisis, DMP experienced liquidity problems disenabling it from paying its loan on time. For that reason, NB sought the extrajudicial foreclosure of the said mortgage by filing a petition for sale on June 30, 2003. On September 4, 2003, the mortgaged property was sold at public auction, which was eventually awarded to NB as the highest bidder. That same day, the Sheriff executed a Certificate of Sale in favor of NB.**

**On October 21, 2003, DMP filed a Petition for Rehabilitation before the RTC. Pursuant to this, a Stay Order was issued by the RTC on October 27, 2003.**

**On the other hand, NB caused the recording of the Sheriff’s certificate of Sale on December 3, 2003 with the Register of Deeds of Cabanatuan City. NB executed an Affidavit of Consolidation of Ownership and had the same annotated on the title of DMP. Consequently, the Register of Deeds cancelled DMP’s title and issued a new title in the name of NB on December 10, 2003.**

**NB also filed on March 17, 2004 an Ex-Parte Petition for Issuance of Writ of Possession before the RTC of Cabanatuan City. After hearing, the RTC issued on September 6, 2004 an Order directing the Issuance of the Writ of Possession, which was issued on October 4, 2004.**

**DMP claims that all subsequent actions pertaining to the Cabanatuan property should have been held in abeyance after the Stay Order was issued by the rehabilitation court. Is DMP correct?**

**Answer:**

No. DMP is not correct. Since the foreclosure of the mortgage and the issuance of the certificate of sale in favor of the mortgagee were done prior to the appointment of a Rehabilitation Receiver and the issuance of the Stay Order, all the actions taken with respect to the foreclosed mortgaged property which were subsequent to the issuance of the Stay Order were not affected by the Stay Order. Thus, after the redemption period expired without the mortgagor redeeming the foreclosed property, the mortgagee becomes the absolute owner of the property and it was within its right to ask for consolidation of title and the issuance of new title in its favor. The writ of possession procured by the mortgagee despite the subsequent issuance of Stay Order in the rehabilitation proceeding instituted is also valid. (BAR 2014)

**A. Liquidation of Insolvent Juridical Debtors**

**a. Voluntary Liquidation**

**1. Act No. 1956, more popularly known as The Insolvency Law, deals with XXX voluntary insolvency and involuntary insolvency.**

**Briefly discuss the said subjects and outline the procedure that will have to be undertaken in connection therewith.**

**Answer:**

1) *Requisites for Voluntary Insolvency*—Voluntary insolvency shall be instituted under the following requisites:

- a) Petition: To be filed by an insolvent debtor,
  - a.1) Owing debts exceeding in the amount the sum of P1,000, and
  - a.2) Setting forth in his petition:
    - His place of residence
    - The period of his residence therein immediately prior to filing said petition
    - His inability to pay, all his debts in full
    - His willingness to surrender all his property, estate and effects not exempt from execution for the benefit of his creditors, and
    - An application to be adjudged an insolvent
  - a.3) To be verified by the petitioner.
- b) Documents to accompany the petition:
  - b.1) Verified schedule
  - b.2) Verified inventory
- c) Venue: RTC of the province or city in which the debtor has resided for 6 months next preceding the filing of such petition. (BAR 1985)

**2. Is the issuance of an order, declaring a petitioner in a Voluntary Insolvency proceeding insolvent, mandatory upon the court?**

**Answer:**

Assuming that the petition was in due form and substance and that the assets of the petitioner are less than his liabilities, the court must adjudicate the insolvency. (BAR 1991)

**3. What are the effects of a judgment in insolvency in Voluntary Insolvency cases?**

**Answer:**

The adjudication or declaration of insolvency by the court, after hearing or default, shall have the following effects:

1. Forbid the payment to the debtor of any debt due to him and the delivery to him of any property belonging to him;
2. Forbid the transfer of any property by him; and
3. Stay of all civil proceedings against the insolvent but foreclosure may be allowed. (BAR 1991)

**4. Distinguish between voluntary insolvency and involuntary insolvency.**

**Answer:**

In voluntary insolvency, it is the debtor himself who files the petition for insolvency, while in involuntary insolvency, at least 3 creditors are the ones who file the petition for insolvency against the insolvent debtor. (BAR 1995)

**5. a) Can a distressed corporation file a petition for corporate rehabilitation after the dismissal of its earlier petition for insolvency? Why?**

**b) Can the corporation file a petition for rehabilitation first, and after it is dismissed file a petition for insolvency? Why?**

**c) Explain the key phrase “equality is equity” in corporate rehabilitation proceedings.**

**Answer:**

a) Yes, the dismissal of a petition for insolvency does not preclude the distressed corporation from filing a petition for corporate rehabilitation. The dismissal of the petition for insolvency only means that the corporation may still be restored to solvency.

b) Yes, the dismissal of a petition for rehabilitation means that the corporation can no longer be restored to solvency. Hence, it can file a petition for insolvency.

c) All assets of a corporation under rehabilitation receivership are held in trust for the equal benefit of all creditors, precluding one from obtaining an advantage or preference over another by the expediency of attachment, execution or otherwise. Once the corporation is taken over by a receiver, all the creditors stand on equal footing and no one may be paid ahead of the others. This is precisely the reason for suspending all pending claims against the corporation under receivership. This is called the “pari passu principle”. (BAR 2008)

**6. Under the Financial Rehabilitation and Insolvency Act (FRIA), the filing of a petition for voluntary rehabilitation must be approved by:**

**a. A majority vote of the Board of Directors and authorized by the vote of the stockholders representing at least a majority of the outstanding capital stock.**

**b. A majority vote of the Board of Directors and authorized by the vote of the stockholders representing at least 2/3 of the outstanding capital stock.**

**c. 2/3 vote of the Board of Directors and authorized by the vote of the stockholders representing at least a majority of the outstanding capital stock.**

**d. 2/3 vote of the Board of Directors and authorized by the vote of the stockholders representing at least 2/3 of the outstanding capital stock.**

**Answer:**

b. A majority vote of the Board of Directors and authorized by the vote of the stockholders representing at least 2/3 of the outstanding capital stock. (BAR 2014)

## **b. Involuntary Liquidation**

1. **Act No. 1956, more popularly known as The Insolvency Law, deals with XXX involuntary insolvency.**

**Briefly discuss the said subjects and outline the procedure that will have to be undertaken in connection therewith.**

**Answer:**

- 2) *Requisites for Involuntary Insolvency*—Involuntary insolvency shall be instituted under the following requisites:
- a) Petition: To be filed,
    - a.1) By 3 or more creditors, residents of the Philippines, and none of them has become a creditor by assignment within 30 days prior to the filing of the petition,
    - a.2) Said creditors with credits accrued in the Philippines and in the aggregate amount not less than P1,000, and
    - a.3) Setting forth in the petition one or more acts of insolvency mentioned in Section 20 of the Insolvency Law; and
    - a.4) To be verified by at least 3 of the petitioning creditors.
  - b) Document to accompany the petition: A bond, approved by the court, with at least two (2) sureties, in such penal sum as the court shall direct.
  - c) Venue: RTC of the province or city in which the debtor resides or has principal place of business (no need of 6 months residence). (BAR 1985)

2. **Distinguish between voluntary insolvency and involuntary insolvency.**

**Answer:**

In voluntary insolvency, it is the debtor himself who files the petition for insolvency, while in involuntary insolvency, at least 3 creditors are the ones who file the petition for insolvency against the insolvent debtor. (BAR 1995)

- c. Conversion by the Court into Liquidation Proceedings**
- d. Powers of the SEC**

1. **One day Jerry Haw, doing business under the name Starlight Enterprises, a sole proprietorship, finds himself short on cash and unable to pay his debts as they fall due although he has sufficient property to cover such debts. He asks you, as his retained counsel, for advice on the following queries:**

- a) Should he file a petition with the SEC to be declared in a state of suspension of payments in view of the said financial condition he faces? Explain your answer.**
- b) Should he sell profit participation certificates to his 10 brothers and sisters in order to raise cash for his business? Explain your answer.**

**Answer:**

- a) I would counsel Jerry Haw to file the Petition for Suspension of Payment with the ordinary courts, rather than the SEC. SEC's jurisdiction over such cases is confined only to petitions filed by corporations and partnerships under its regulatory powers.
- b) Instead of selling profit participation certificates, I would urge Jerry Haw to enter into a partnership or to incorporate in order to raise cash for his business. (BAR 1990)

2. Debtor Corporation and its principal stockholders filed with the SEC a petition for rehabilitation and declaration of a state of suspension of payments under P.D. 902-A. The objective was for SEC to take control of the corporation and all its assets and liabilities, earnings and operations and rehabilitating the company for the benefit of investors and creditors.

Generally, the unsecured creditors had manifested willingness to cooperate with Debtor Corporation. The secured creditors, however, expressed serious objections and reservations.

First Bank had already initiated judicial foreclosure proceedings on the mortgage constituted on the factory of Debtor Corporation.

Second Bank had already initiated foreclosure proceedings on a third-party mortgage constituted on certain assets of the principal stockholders.

Third Bank had already filed a suit against the principal stockholders who had held themselves liable jointly and severally for the loans of Debtor Corporation with said Bank.

After hearing, the SEC directed the appointment of a rehabilitation receiver and ordered the suspension of all actions and claims against the Debtor Corporation as well as against the principal stockholders.

- a) Discuss the validity of the SEC order of suspension?
- b) Discuss the effects of the SEC order of suspension on the judicial foreclosure proceedings initiated by First Bank.
- c) Would the order of suspension have any legal effect on the foreclosure proceedings initiated by Second Bank? Explain.
- d) Would the order of suspension have any effect on the suit filed by Third Bank? Explain.
- e) What are the legal consequences of a rehabilitation receivership?
- f) What measures may the receiver take to preserve the assets of Debtor Corporation?

**Answer:**

- a) The SEC order of suspension of payment is valid with respect to the debtor corporation, but not with respect to the principal stockholder. The SEC has jurisdiction to declare suspension of payments with respect to corporations, partnership or associations, but not with respect to individuals.
- b) The SEC order of suspension of payment suspended the judicial proceedings initiated by First Bank. According to the Supreme Court in a line of cases, the suspension order applies to secured creditors and to the action to enforce the security against the corporation regardless of the stage thereof.
- c) The order of suspension of payments suspended the foreclosure proceedings initiated by the Second Bank. While the foreclosure is against the property of a third party, it is in reality an action to collect the principal obligation owed by the corporation. During the time that the payment of the principal obligation is suspended, the debtor corporation is considered to be not in default and, therefore, even the right to enforce the security, whether owned by the debtor-corporation or of a third party, has not yet arisen.
- d) For the same reason as in (c), the order of suspension of payments suspended the suit filed by Third Bank against the principal stockholders.
- e) Under PD 902-A, the appointment of a rehabilitation receiver will suspend all actions for claims against the corporation and the corporation will be placed under rehabilitation in accordance with a rehabilitation plan approved by the Commission.

- f) To preserve the assets of the Debtor Corporation, the receiver may take custody of, and control over, all the existing assets and property of the corporation; evaluate existing assets and liabilities, earnings and operations of the corporation; and determine the best way to salvage and protect the interest of the investors and creditors. (BAR 1999)

## B. Insolvency of Individual Debtors

### 1. May the following be declared insolvent?

- (1) Married woman;
- (2) Partnership;
- (3) Insane person

**Explain your answer.**

**Answer:**

- (1) Yes, a married woman may be declared insolvent in respect to her own debts.
- (2) Under the Insolvency Law, a partnership may be declared insolvent, either in a voluntary or involuntary insolvency proceeding.
- (3) An insane person can be declared insolvent in involuntary proceedings as long as his interests are protected by a duly appointed guardian. He cannot however file a petition for voluntary insolvency because he lacks legal capacity to act. (BAR 1976)

### 2. On May 15, 1980, "A" obtained a final judgment from the Court of Appeals ordering "B" to pay him the sum of P5,000 as overtime compensation. The case was remanded to the lower court so that "B" could present evidence of overtime compensation already paid to "A".

During the pendency of the case, "B" filed a petition for voluntary insolvency in another court, submitting a schedule of creditors, which did not include "A".

"A" learned of the petition and in due time filed a motion to dismiss the insolvency proceedings. "B" contended that as "A's" claim is merely inchoate, the same not being finally decided, it cannot be included in a schedule of creditors and liabilities.

**Is "B's" contention tenable? Why?**

**Answer:**

"B's" contention is not tenable. Under the circumstances, "B" acted in gross bad faith in the filing of petition for insolvency, in violation of the purpose for which Insolvency Law was enacted. The decision of the Court of Appeals ordering "B" to pay "A" the sum of P5,000 on overtime compensation was already a final judgment, and, therefore, no longer inchoate. The inclusion of "A" in the Schedule will completely vitiate the insolvency proceedings. (*In Re: Estate of Mindanao Motor Line, Inc., May 28, 1974; 57 SCRA 98*) (BAR 1981)

### 3. a) Distinguish insolvency from suspension of payment.

b) Horacio opened a coffee shop using money borrowed from financial institutions. After 3 months, Horacio left for the USA with the intent of defrauding his creditors. While his liabilities are P1.2 M, his assets, however are worth P1.5. M. May Horacio be declared insolvent?

**Answer:**

- a) In insolvency, the liabilities of the debtor are more than his assets, while in suspension of payments, assets of the debtor are more than his liabilities.

In insolvency, the assets of the debtor are to be converted into cash for distribution among his creditors, while in suspension of payments, the debtor is only asking for time within which to convert his frozen assets into liquid cash with which to pay his obligations when the latter fall due.

- b) No. Horacio may not be declared insolvent. His assets worth P1.5 M are more than his liabilities worth P1.2 M. (BAR 1998)

**a. Suspension of Payments**

4. **1. Distinguish between “suspension of payments” and “insolvency”.**  
**2. Who has jurisdiction over suspension of payments filed by corporations, partnerships, or association?**

**b) A debtor who has been adjudged insolvent is given his discharge by the court after his properties have been applied to his debts. A year later, with those debts still not fully paid, he wins in the sweepstakes and comes into a large fortune. His creditors sue him for the balance.**

**Would the suit prosper? Reasons.**

**Answer:**

- a) 1. Suspension of payment is a legal scheme whereby a debtor, who has sufficient assets but who may be unable to meet his obligations as when they fall due, may petition for more time within which to settle such obligations. The debtor’s proposal, or a modification thereof, can be sustained if it is approved by at least 2/3 of the creditors representing at least 3/5 of the total liabilities of the debtor. Insolvency, upon the other hand, may be petitioned when the assets of the debtor are less than, or insufficient to answer for, his total liabilities. Whereas, a suspension of payment may be initiated only by the debtor, an insolvency petition may be filed by either by the debtor (voluntary insolvency) or at least three of his creditors whose aggregate credit is not than PH= 1,000 (involuntary insolvency). There is no discharge in suspension of payment, but such discharge is possible in insolvency proceedings.

2. In the case of corporations, partnerships or associations, a suspension of payment (but not insolvency) now falls under the exclusive jurisdiction of the SEC.

- b) The suit will not prosper on debts that are properly discharged in insolvency. Those that are not discharged, assuming that a discharge can be obtained, include:

1. Taxes and assessments due the government, national or local;
2. Obligation arising from embezzlement or fraud;
3. Obligations of any person liable to the insolvent debtor for the same debt;
4. Alimony or claim for support;
5. In general, debts that are not provable against the estate of the insolvent or not listed in the schedule submitted by the insolvent debtor. (BAR 1988)

5. **One day Jerry Haw, doing business under the name Starlight Enterprises, a sole proprietorship, finds himself short on cash and unable to pay his debts as they fall due although he has sufficient property to cover such debts. He asks you, as his retained counsel, for advice on the following queries:**

**c) Should he file a petition with the SEC to be declared in a state of suspension of payments in view of the said financial condition he faces? Explain your answer.**

**d) Should he sell profit participation certificates to his 10 brothers and sisters in order to raise cash for his business? Explain your answer.**

**Answer:**

- c) I would counsel Jerry Haw to file the Petition for Suspension of Payment with the ordinary courts, rather than the SEC. SEC's jurisdiction over such cases is confined only to petitions filed by corporations and partnerships under its regulatory powers.
- d) Instead of selling profit participation certificates, I would urge Jerry Haw to enter into a partnership or to incorporate in order to raise cash for his business. (BAR 1990)

**6. Distinguish between suspension of payments and insolvency.**

**Answer:**

In suspension of payments, the debtor is not insolvent. He only needs time within which to convert his asset/s into cash with which to pay his obligations when they fall due. In the case of insolvency, the debtor is insolvent, that is, his assets are less than his liabilities. (BAR 1995)

**i. Petition**

**7. Act No. 1956, more popularly known as The Insolvency Law, deals with (1) suspension of payments, xxx.**

**Briefly discuss the said subjects and outline the procedure that will have to be undertaken in connection therewith.**

**Answer:**

- 3) *Requisites for Suspension of Payments.*—Petition for suspension of payments shall be made under the following requisites:
  - a) Petition to be filed by a debtor:
    - a.1) Possessing sufficient property to cover all his debts
    - a.2) Foreseeing the impossibility of meeting them when they respectively fall due, and
    - a.3) Petitioning that he be declared in the state of suspension of payments. (Petition need not be verified)
  - b) Documents to accompany the petition:
    - b.1) Verified schedule
    - b.2) Verified inventory
    - b.3) The proposed agreement he requested of his creditors
  - c) Venue: Court of First Instance of the province or city in which the debtor has resided for 6 months next preceding the filing of such petition. (BAR 1985)

**ii. Action on the Petition**

**iii. Actions suspended; Suspension Order**

**1. A brought an action against B for sum of money. Subsequently B was declared insolvent in an insolvency proceeding. You are a creditor of B, what should you do in connection with the action brought by A against B to protect your interest? Reasons.**

**Answer:**

I would file an application for the suspension of the proceedings of the case brought by A against B, since the claim is unsecured. (Section 18, Insolvency Law) (BAR 1976)

**iv. Creditors' Meeting**

- v. Persons who may refrain from voting
- vi. Rejection of the proposed agreement
- vii. Objections
- viii. Effects of approval of proposed agreement
- ix. Failure of individual debtor to perform agreement
- b. Voluntary Liquidation

**1. Distinguish between voluntary insolvency and involuntary insolvency.**

**Answer:**

In voluntary insolvency, it is the debtor himself who files the petition for insolvency, while in involuntary insolvency, at least 3 creditors are the ones who file the petition for insolvency against the insolvent debtor. (BAR 1995)

**i. 2.2.1 Application**

**1. Act No. 1956, more popularly known as The Insolvency Law, deals with XXX voluntary insolvency and involuntary insolvency.**

**Briefly discuss the said subjects and outline the procedure that will have to be undertaken in connection therewith.**

**Answer:**

4) *Requisites for Voluntary Insolvency*—Voluntary insolvency shall be instituted under the following requisites:

- d) Petition: To be filed by an insolvent debtor,
  - a.1) Owing debts exceeding in the amount the sum of P1,000, and
  - a.2) Setting forth in his petition:
    - His place of residence
    - The period of his residence therein immediately prior to filing said petition
    - His inability to pay, all his debts in full
    - His willingness to surrender all his property, estate and effects not exempt from execution for the benefit of his creditors, and
    - An application to be adjudged an insolvent
  - a.3) To be verified by the petitioner.
- e) Documents to accompany the petition:
  - b.1) Verified schedule
  - b.2) Verified inventory
- f) Venue: RTC of the province or city in which the debtor has resided for 6 months next preceding the filing of such petition. (BAR 1985)

**2. Is the issuance of an order, declaring a petitioner in a Voluntary Insolvency proceeding insolvent, mandatory upon the court?**

**Answer:**

Assuming that the petition was in due form and substance and that the assets of the petitioner are less than his liabilities, the court must adjudicate the insolvency. (BAR 1991)

**3. What are the effects of a judgment in insolvency in Voluntary Insolvency cases?**

**Answer:**

The adjudication or declaration of insolvency by the court, after hearing or default, shall have the following effects:

4. Forbid the payment to the debtor of any debt due to him and the delivery to him of any property belonging to him;
5. Forbid the transfer of any property by him; and
6. Stay of all civil proceedings against the insolvent but foreclosure may be allowed. (BAR 1991)

- ii. 2.2.2 Liquidation Order
- c. Involuntary Liquidation

**1. Distinguish between voluntary insolvency and involuntary insolvency.**

**Answer:**

In voluntary insolvency, it is the debtor himself who files the petition for insolvency, while in involuntary insolvency, at least 3 creditors are the ones who file the petition for insolvency against the insolvent debtor. (BAR 1995)

- 2. ON June 16, 1995, Vicente obtained a writ of preliminary attachment against Carlito. The levy on Carlito's property occurred on June 25, 1995. On July 29, 1995, another creditor filed a petition for involuntary insolvency against Carlito. The insolvency court gave due course to the petition. In the meantime, the case filed by Vicente proceeded, and resulted in a judgment award in favor of Vicente.**

**May the judgment obtained by Vicente be enforced independently of the insolvency proceedings? Explain.**

**Answer:**

The judgment obtained by Vicente can be enforced independently of the insolvency proceedings. Under Section 32 of the Insolvency Law, the assignment to the assignee of all the real and personal property, estate and effects of the debtor made by the clerk of court shall vacate and set aside any judgment entered in any action commenced within 30 days immediately prior to the commencement of insolvency proceedings. In this case, however, the action filed by Vicente against Carlito was commenced by Vicente not later than June 16, 1995 (the facts on this point are not clear) when Vicente obtained a writ of preliminary attachment against Carlito or more than 30 days before the petition for involuntary insolvency was filed against Carlito by his other creditors. (BAR 1996)

- i. 2.3.1 The Petition

- 1. Act No. 1956, more popularly known as The Insolvency Law, deals with XXX involuntary insolvency.**

**Briefly discuss the said subjects and outline the procedure that will have to be undertaken in connection therewith.**

**Answer:**

*Requisites for Involuntary Insolvency*—Involuntary insolvency shall be instituted under the following requisites:

- a) Petition: To be filed,
  - a.1) By 3 or more creditors, residents of the Philippines, and none of them has become a creditor by assignment within 30 days prior to the filing of the petition,
  - a.2) Said creditors with credits accrued in the Philippines and in the aggregate amount not less than P1,000, and

- a.3) Setting forth in the petition one or more acts of insolvency mentioned in Section 20 of the Insolvency Law; and
- a.4) To be verified by at least 3 of the petitioning creditors.

- b) Document to accompany the petition: A bond, approved by the court, with at least two (2) sureties, in such penal sum as the court shall direct.
- c) Venue: RTC of the province or city in which the debtor resides or has principal place of business (no need of 6 months residence). (BAR 1985)

**2. Aaron, a well-known architect, is suffering from financial reverses. He has 4 creditors with a total claim of P26 M. Despite his intention to pay these obligations, his current assets are insufficient to cover all of them. His creditors are about to sue him. Consequently, he was constrained to file a petition for insolvency.**

- a) Since Aaron was merely forced by circumstances to petition the court to declare him insolvent, can the judge properly treat the petition as one for insolvency? Explain.
- b) If Aaron is declared an insolvent by the court, what would be the effect, if any, of such declaration on his creditors? Explain.
- c) Assuming that Aaron has guarantors for his debts, are the guarantors released from their obligations once Aaron is discharged from his debts? Explain.
- d) What remedies are available to the guarantors in case they are made to pay the creditors? Explain.

**Answer:**

- a) The petition cannot be treated as one of the involuntary insolvency, because it was filed by Aaron himself, the debtor, and not by his creditors. To treat it as one of involuntary insolvency would unduly benefit Aaron as a debtor, because he would not be subject to the limitation of time within which he is subject in the case of voluntary insolvency for purposes of discharge.
- b) Actions for unsecured claims cannot be filed, because the claims should be filed in the insolvency proceeding. Actions for secured claims may be commenced with leave of the insolvency court.
- c) The guarantors are not discharged, because the discharge is limited to Aaron only.
- d) Their remedy is to prove in the insolvency proceeding that they paid the debt and that they substitute for the creditors, if the creditors have not proven their claims. (BAR 2005)

**ii. 2.3.2 Acts of Insolvency**

**1. "X", owner of a general merchandise store, departed from the Philippines with intent to defraud her creditors and has remained absent from the country. While she has liabilities totaling P100,000, her assets, however, are worth P120,000.**

- (a) May "X" be declared an insolvent? Reason.
- (b) Assuming that "X" is declared an insolvent but all her assets consisting of general merchandise and office equipment were sold only for P60,000 how would you distribute said amount in the order and proportion established by law among the following creditors whose claims are indicated hereunder:

- (1) Creditor for a loan to the insolvent.....P20,000.00
- (2) Assignee's fees and legal expenses.....P10,000.00
- (3) Creditor by virtue of a final judgment.....P10,000.00

- (4) Land taxes due to city government.....P3,000.00
- (5) Rental of the store for 6 months before insolvency.....P20,000.00
- (6) Amounts due to employees entitled to indemnity  
Under the law.....P7,000.00
- (7) For merchandise sold to insolvent and disposed  
of before insolvency.....P30,000.00

**Answer:**

(a) Yes, X may be declared insolvent. Under the Insolvency Law, although the debtor has more than sufficient property to pay all his creditors, yet if she would commit any act of insolvency, she should be declared insolvent. One of the acts of insolvency out of the 13 enumerated by the Insolvency Law, is: that being absent from the Philippines, with intent to defraud his/her creditors, he/she remains absent. (*Sec. 20, Insolvency Law*)

(b) (Note: The question in letter (b) calls for the classification and preference of creditors which are exclusively governed by the new Civil Code and already excluded from the coverage of Insolvency Law, for purposes of Bar Examination.) (BAR 1982)

- iii. 2.3.3 Order to Individual Debtor to Show Cause
- iv. 2.3.4 Default
- v. 2.3.5 Absent individual debtor
- vi. 2.3.6 All property held for all creditors; Appeal bonds; Exemptions to sureties
- vii. 2.3.7 Sale under execution

**C. Common provisions**

1. **An insolvent debtor, after a lawful discharge following an adjudication of insolvency, is released from, generally, all debts, claims, liabilities and demands which are or have been proved against his estate. Give 5 obligations of the insolvent debtor that survive.**

**Answer:**

The 5 obligations of the insolvent debtor that survive are as follows:

1. Taxes and assessments due the government, national or local;
2. Obligations arising from embezzlement or fraud;
3. Obligation of any person liable with the insolvent debtor for the same debt, either as a solidary co-debtor, surety, guarantor, partner, indorser or otherwise;
4. Alimony or claim for support; and
5. Debts not payable against the estate (such after-incurred obligations) of, or not included in the schedule submitted by, the insolvent debtor. (BAR 1997)

**a. Determination of Claims**

1. **As of June 1, 2002, Edzo Systems Corporation (Edzo) was indebted to the following creditors:**
  1. **Ace Equipment Supplies- for various personal computers and accessories sold to Edzo on credit amounting to P300,000.**
  2. **Handyman Garage- for mechanical repairs (parts and service) performed on Edzo’s company car amounting to P10,000.**
  3. **Joselyn Reyes- former employee of Edzo who sued Edzo for unlawful termination of employment and was able to obtain a final judgment against Edzo for P100,000.**
  4. **BIR- for unpaid VAT amounting to P30,000.**

5. Integrity Bank- which granted Edzo a loan in 2001 in the amount of P500,000. The loan was not secured by any asset of Edzo, but it was guaranteed unconditionally and solidarily by Edzo's President and controlling stockholder, Eduardo Z. Ong, as accommodation surety.

The loan owed to Integrity Bank fell due on June 15, 2002. Despite pleas for extension of payment by Edzo, the bank demanded immediate payment. Because the bank threatened to proceed against the surety, Eduardo Z. Ong, Edzo decided to pay up all of its obligations to Integrity Bank. On June 20, 2002, Edzo paid to Integrity Bank the full principal amount of P500,000, plus accrued interests amounting to P55,000. As a result, Edzo has hardly any cash left for operations and decided to close its business. After paying the unpaid salaries of its employees, Edzo filed a petition for insolvency on July 1, 2002.

In the insolvency proceedings in court, the assignee in insolvency sought to invalidate the payment made by Edzo to Integrity Bank for being a fraudulent transfer because it was made within 30 days before the filing of the insolvency petition. In defense, Integrity Bank asserted that the payment to it was for a legitimate debt that was not covered by the prohibition because it was "a valuable pecuniary consideration made in good faith," thus falling within the exception specified in the Insolvency Law.

As judge in the pending insolvency case, how would you decide the respective contentions of the assignee in insolvency and of Integrity Bank? Explain.

**Answer:**

The contention of the assignee in insolvency is correct. The payment made by Edzo to Integrity Bank was a fraudulent preference or payment, being made within 30 days before the filing of the insolvency petition.

Based on the same facts as stated in the preceding question, how would you, as judge in the insolvency proceedings, rank the respective credits or claims of the 5 creditors mentioned above in terms of preference or priority against each other?

**Answer:**

The claim of the Handyman Garage for P10,000 has a specific lien on the car repaired.

The remaining 4 claims have preference or priority against each other in the following order:

1. No. 4- claim of the BIR for unpaid VAT;
  2. No. 3- claim of Joselyn Reyes for unlawful termination;
  3. No. 1- claim of Ace Equipment Supplies as an unpaid seller; and
  4. No. 5- claim of Integrity Bank. (BAR 2002)
2. PA Assurance (PA) was incorporated in 1980 to engage in the sale of pre-need educational plans. It sold open-ended educational plans which guaranteed the payment of tuition and other fees to planholders irrespective of the cost at the time of availment. It also engaged in the sale of fixed value plans which guaranteed the payment of a pre-determined amount to planholders. In 1982, PA was among the country's top corporations. However, it subsequently suffered financial difficulties.

On September 8, 2005, PA filed a Petition for Corporate Rehabilitation before the RTC of Makati City. On October 17, 2005, 10 plan holders filed an Opposition and Motion to Exclude Planholders from Stay Order on the ground that planholders are not creditors as they (planholders) have a trust relationship with PA. Are the planholders correct?

**Answer:**

No. The planholders is not correct. On November 21, 2000, the Court approved the Interim Rules of Procedure on Corporate Rehabilitation of 2000 (Interim Rules), which took effect on December 15, 2000. The Interim Rules apply to petitions for rehabilitation filed by corporations, partnerships, and associations pursuant to PD 902-A, as amended. Under the Interim Rules, "claim" shall include "all claims or demands of whatever nature or

character against the debtor or its property, whether for money or otherwise.” “Creditor” shall mean “any holder of a claim.” Hence, the claim of the planholders from PA is included in the definition of “claims” under the Interim Rules. (BAR 2014)

**3. a) What are the preferred claims that shall be satisfied first from the assets of an insolvent corporation?**

**b) How shall the remaining non-preferred creditors share in the estate of the insolvent corporation above?**

**Answer:**

a) Under the Insolvency Law necessary funeral expenses of the debtor is the most preferred claim. However, this is an insolvent corporation, thus, claims shall be paid in the following order:

1. Debts due for personal services rendered the insolvent by employees, laborers, or domestic servants immediately preceding the commencement of proceedings in insolvency;
2. Compensation due to the laborers or their dependents under the provisions of Act Numbered 3428, known as the Workmen’s Compensation Act, as amended by Act Numbered 3812 and under the provisions of Act Numbered 1874, known as the Employees’ Liability Act, and of other laws providing for payment of indemnity for damages in cases of labor accidents;
3. 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;
4. Debts, taxes, and assessments due the Insular Government;
5. Debts, taxes and assessments due to any province/s of the Philippine Islands;
6. Debts, taxes and assessments due to any municipality or municipalities of the Philippine Islands.

b) The remaining non-preferred creditors, whose debts are duly proved and allowed, shall be entitled to share pro-rata in the assets, without priority or preference whatsoever. (BAR 2007)

- i. Registry of Claims
- ii. Right of Set-off
- iii. Opposition or Challenge to Claims

**1. A final decision promulgated by the Court of Appeals affirmed the payment by M Line, Inc. of the overtime compensation to its 50 employees in the amount of P150,000.00. The case was remanded by the CFI, Bohol, so that the Company may present evidence of overtime compensation already paid by it to said 50 employees. The Bohol court set the case for hearing, but the same was postponed several times on motions of the Company. Meanwhile, said Company filed a petition for voluntary insolvency in CFI, Cebu. The schedule annexed to the petition named only two creditors, X for P102,000.00 and Y for P80,000.00. its 50 employees, to whom it was already ordered by a final decision of the Court of Appeals to pay overtime compensation, were not included in the Shedule. After adjudication of insolvency and election of assignee in the CFI, Cebu, the said 50 employees were allowed to intervene. They then moved to dismiss the insolvency proceedings. Decide with reasons.**

**Answer:**

Yes, the motion of the 50 employees to dismiss the voluntary insolvency proceedings filed by M Line, Inc., in the CFI in Cebu, shall be granted. Under the circumstances, the M Line, Inc., acted in gross bad faith in the filing of the petition for insolvency, in violation of the purpose for which the Insolvency Law was enacted. The non-inclusion of its said 50 employees in the schedule completely vitiated the insolvency proceedings. (*See In re: Estate of Mindanao Motor Line, Inc.*, 57 SCRA 98) (BAR 1978)

- iv. Submission of Disputed to the Court

## b. Avoidance Proceedings

### XXII. Retail Trade Law

1. **X, a naturalized Filipino and owner of a retail grocery store, takes 2 Chinese employees on monthly salary basis—namely, Y as purchaser and Z as salesman. Their functions have nothing to do with the management or control of the business. The Ministry of Trade questioned the employment of Y and Z by X. Decide. Give your reasons.**

**Answer:**

Yes, the Ministry of Trade may question the employment of Y and Z (Chinese) by X, in the latter's retail grocery store. The Retail trade Law is complemented by the Anti-Dummy Law, and therefore the employment of a person who is not a Filipino citizen, even in a minor or non-control position in retail business, is prohibited. (*King v. Hernaez*, L-15859, March 31, 1962) (BAR 1978)

2. **The articles of Partnership of four aliens engaged in the retail business of auto supply provided for a term of 10 years, extendible by mutual agreement. After the Retail Business Law (Rep. Act 1180) was enacted, the term of existence was about to expire, and the partners desiring to continue its existence amended its articles to extend its life for another 10 years, and applied to register its amended articles. Should its application prosper? Reason.**

**Answer:**

No, the application cannot prosper. Being a partnership engaged in retail business but the capital of which is not wholly owned by citizens of the Philippines, it can be allowed to continue to engage in said business only for a period of 10 years from the date of approval of the Retail Business Law (1954), or until the expiration of the term of the partnership, whichever event comes first. (BAR 1979)

3. **"F", a naturalized Filipino citizen, acquired ownership of a grocery store engaged in wholesale and retail business wherein fifteen persons are employed, three of whom are Chinese, long employed by the previous owners. Pursuant to the Anti-Dummy Law, "F" requests the permission of the President of the Philippines, through the Ministry of Trade, to allow him to retain the three Chinese. "F" contends that their employment is not prohibited by the Retail Trade Law which merely restricts the ownership of retail trade business to Filipinos; neither does the Anti-Dummy Law ban employment of aliens to positions which do not relate to the management, operation, administration or control of enterprise. In other words, "F" maintains that these aliens are occupying non-control positions in the firm. Besides, "F" contends that being a Filipino owner of the business, he is not covered by the provisions of the Retail Trade Law. How valid are "F's" arguments?**

**Answer:**

F's arguments are untenable. The Anti-Dummy Law is a complement of the Retail Trade Act in the sense that it is designed to make effective its aims and purposes, and both tend to accomplish the same objective, either by excluding aliens from owning any retail trade or by banning their employment if the trade is owned by Filipinos, and the employment of a person who is not a Filipino citizen, even in a minor or clerical or non-control position is prohibited. The reason is obvious: to plug the loophole or close any avenue that an unscrupulous alien may resort to flout the law or defeat its purpose. (*King v. Hernaez*, March 31, 1962; 4 SCRA 804) (BAR 1980)

4. **Phil-Hong, Inc. (PHI) is a joint venture corporation organized in the Philippines, 60% of which is owned by Filipino citizens and 40% by Hong Kong residents who are British nationals. PHI owns and operates the Lancelot Hotel in Makati. PHI decides to expand into the restaurant business and so, with the requisite approval of its Board of Directors and stockholders, PHI sets up a wholly-owned subsidiary, Guinevere Bistro, Inc. (GBI) and proceeds to set up an adjunct restaurant in the Lancelot Hotel and another one in a rented space in SM City along EDSA, Quezon City.**

**PHI consults you for legal advice on whether or not it is legal for GBI to operate the Guinevere Bistro:**

- a) **In the Lancelot Hotel and**
- b) **In SM City**

**How would you answer the query? Explain.**

**Answer:**

- a) GBI may operate the Guinevere Bistro in the Lancelot Hotel. The Retail Trade Act, nationalizing retail trade, exempts keepers of restaurants included in, or incidental to, the hotel business.
  - b) It is not legal for GBI to operate the restaurant business in SM City since the latter is not a hotel; hence, the restaurant operation will not fall under the exemption clause of the Retail Trade Law. (BAR 1980)
5. **“A” a naturalized Filipino, owns and operates a supermarket. He has two Japanese friends, both permanent residents of the Philippines, whom he wants to employ in his supermarket, one of them as purchaser, and the other as bookkeeper. Can “A” employ them under our laws?**

**Answer:**

“A” cannot employ his two Japanese friends in his supermarket which is a retail business. The Anti-Dummy Law which is a complement of the Retail Business Law, prohibits the employment of aliens, even in minor or clerical or non-control position, in the retail business. (*King v. Hernaez*, March 31, 1962; 4 SCRA 804) (BAR 1981)

6. **A softdrinks company uses big quantities of gasoline and diesel fuel, buying the same from an American oil company in big container or drums.**

- a) **May the American company sell the gasoline and diesel fuel directly to the softdrinks company for the latter’s use in its delivery trucks?**
- b) **May the American company sell the gasoline and diesel fuel directly to the softdrinks company for use by the latter in the manufacture of softdrinks which are sold by the softdrinks company to the public?**

**Answer:**

The law excludes from the coverage of the “Retail Trade Act” the sale to manufacturers or processors selling to industrial and commercial user or consumers who use the product to render service to the general public and/or to produce or manufacture goods which are, in turn, sold by them. Accordingly:

- a) The American company cannot directly sell gasoline and fuel oil to the softdrinks company for the latter’s use in its delivery trucks since this service is to serve the requirements of the user (softdrinks company) itself and not to serve the general public (such as that rendered by common carriers).
- b) The answer is also in the negative under the end-user test. The fuel is consumed by the softdrinks company. Hence, the sale of the fuel by the American company to the softdrinks company is retail business. The fact that the softdrinks company uses or consumes the fuel in the manufacturer of softdrinks which are

sold by the softdrinks company to the public is of no moment. What is prohibited is the sale of the fuel by the American company to the softdrinks company. (BAR 1981)

**7. Acme Trading Company, Inc. (Acme), a trading company wholly owned by foreign stockholders, was persuaded by Paulo Alva, a Filipino, to invest in 20% of the outstanding shares of stock of a corporation he is forming which will engage in the department store business (the "department store corporation"). Paulo also urged Acme to invest in 40% of the outstanding shares of stock of the realty corporation he is putting up to own the land on which the department store will be built (the "realty corporation").**

- a) May Acme invest in the said department store corporation? Explain your answer.**
- b) May Acme invest in the realty corporation? Discuss with reasons.**

**Answer:**

- a) Acme may not invest in the department store corporation since the Retail Trade Act allows, in the case of corporations, only 100% Filipino-owned companies to engage in retail trade.
- b) Acme may invest in the realty corporation, on the assumption that the balance of 60% of ownership of the latter corporation is Filipino-owned since the law merely required 60% Filipino holding in land corporate ownership. (BAR 1990)

**8. ABC Manufacturing, Inc., a company wholly owned by foreign nationals, manufactures typewriters which ABC distributes to the general public in 2 ways:**

- a) ABC consigns its typewriters to independent dealers who in turn sell them to the public; and,**
- b) Through individuals, who are not employees of ABC, and who are paid strictly on a commission basis for each sale.**

**Do these arrangements violate the Retail Trade Law?**

**Answer:**

- a) The first arrangement would not be in violation of the Retail Trade Law. The law applies only when the sale is direct to the general public. A dealer buys and sells for and in his own behalf and, therefore, the sale to the general public is made by the dealer and not by the manufacturer.
- b) The second arrangement would be violative of the Retail Trade Law, since the sale is done through individuals being paid strictly on a commission basis. The said individuals would then be acting merely as agents of the manufacturer. Sales, therefore, made by such agents are deemed direct sales by the manufacturer itself. (BAR 1991)

**9. A Cooperative purchased from "Y" Corporation on installments a rice mill and made a down payment therefor. As security for the payment of the balance, the Cooperative executed a chattel mortgage in favor of Y Corporation. Y Corporation, in turn, assigned its rights to the chattel mortgage to Z, Inc., a 5% foreign-owned company doing business in the Philippines. The cooperative thereafter made installment payment to Z, Inc.**

**Because the Cooperative was unable to meet its obligations in full, Z, Inc. filed against it a court suit for collection. The Cooperative resisted contending that Z, Inc. was illegally engaged in the retail trade business for having sold a consumer good as opposed to a producer item. The Cooperative also alleged that Z, Inc had violated the Anti-Dummy Law.**

**Is Z, Inc. guilty of violating the Retail Trade Law and the Anti-Dummy Law? Why?**

**Answer:**

Z, Inc. is not guilty of violating the Retail Trade Law and the Anti-Dummy Law. The term “retail” under the Retail Trade Act requires that the seller must be habitually engaged in selling to the general public consumption goods. By consumption goods are meant “personal, family and household” purposes. A Rice Mill does not fall under that category. Neither does it appear that Z, Inc, is habitually engaged in selling to the general public that commodity. Since there is no violation of the Retail Trade Law, there would likewise be no violation of the Anti-Dummy Law. (BAR 1992)

**10. A foreign firm is engaged in the business of manufacturing and selling rubber products to dealers who in turn sell them to others. It also sells directly to agricultural enterprises, automotive assembly plants, public utilities which buy them in large bulk, and to its officers and employees.**

- 1. Is there a violation of the Retail Trade Law? Explain.**
- 2. May said firm operate a canteen inside the premises of its plant exclusive for its officials and employees without violating the Retail Trade Act? Explain.**

**Answer:**

1. On the assumption that the foreign firm is doing business in the Philippines, the sale to the dealers of agricultural enterprises, automotive assembly plants, and public utilities is wholesale and, therefore, not in violation of the Retail Trade Act.
2. Yes. The operation of the canteen inside the premises exclusively for its officers and employees, would amount to an input in the manufacturing process and, therefore, does not violate the Retail Trade Act. (BAR 1993)

**11. Celeste, a domestic corporation wholly owned by Filipino citizens, is engaged in trading and operates as general contractor. It buys and resells the products of Matilde, a domestic corporation, 90% of whose capital stock is owned by aliens. All of Matilde’s goods are made in the Philippines from materials found or produced in the Philippines.**

**On the other hand, ECQ Integrated is a 100% Filipino-owned corporation and manufacturer of asbestos products.**

**Celeste and ECQ took part in a public bidding conducted by MWSS for its asbestos pipe requirements. Celeste won the bid, having offered 13% lower than that offered by ECQ; and MWSS awarded the contract to supply its asbestos pipes to Celeste. ECQ sought to nullify the award in favor of Celeste.**

- 1. Is Celeste barred under the Flag Law from taking part in bidding to supply the government?**
- 2. Did Celeste and Matilde violate the Retail Trade Nationalization Law? Explain.**

**Answer:**

1. No. The materials offered in the bids submitted are made in the Philippines from articles produced or grown in the Philippines, and the bidder, Celeste, is a domestic entity. The Flag Law does not apply. It can be invoked only against a bidder who is not a domestic entity, or against a domestic entity who offers imported materials.
2. Matilde did not violate the Retail Trade Law since it does not sell its products to consumers, but to dealers who resell them. Neither did Celeste violate the Retail Trade Law since, in the first place, it is not prohibited to engage in retail trade. Besides, Matilde’s sale of the asbestos products to Celeste, being wholesale, the transaction is not covered by the Retail Trade Law. (BAR 1994)

**12. With a capital of P92,000, Maria operates a stall in the public market. She manufactures soap that she sells to the general public. Her common law husband, Ma Lee, who has a pending petition for naturalization, occasionally finances the purchase of goods for resale, and assist in the management of business.**

**Is there a violation of the Retail trade Law? Explain.**

**Answer:**

No, there is no violation of the Retail Trade Law. Maria is a manufacturer who sells to the general public, through her stall in the public market, the soap which she manufactures. Inasmuch as her capital does not exceed P5,000 then she is considered under Sec.4 (a) of the Retail Trade Law as not engaged in the "retail business". Inasmuch as Maria's business is not a "retail business," then the requirement in Section 1 of the Retail Trade Law that only Philippine nationals shall engage, directly or indirectly, in the retail business is inapplicable. For this reason, the participation of Ma Lee in the management of the business would not be a violation of the Retail Trade Law in relation to the Anti-Dummy Law.

**13. EL, Inc., a domestic corporation with the foreign equity, manufactures electric generators, and sells them to the following customers: (a) government offices which use the generators during brownouts to render public service, (b) agricultural enterprises which utilize the generators as back up in the processing of goods, (c) factories, and (d) its own employees.**

**Is EL engaged in retail trade? Explain.**

**Answer:**

The sale by EL of generators to government offices agricultural enterprises and factories are outside the scope of the term "retail business" and may, therefore, be made by the said corporation. However, sales of generators by EL to its own employees constitute retail sales and are proscribed. Under the amendment to the Retail Trade Law introduced by PD 714, the term "retail business shall not include a manufacturer (such as EL) selling to industrial and commercial users or consumers who use the products bought by them to render service to the general public (e.g. the government offices) and/or to produce or manufacture goods which are in turn sold by them (e.g., the agricultural enterprises and factories). (BAR 1996)

### **XXIII. Bulk Sales Law**

**1. Without complying with the requirements of the Bulk Sales Act, a merchants sells all or substantially all of his machineries and equipment to an innocent purchaser for value.**

- a) Discuss the validity of the transfer as between the purchaser and the seller?**
- b) Discuss the validity of the transfer as between the purchaser and the creditors of the seller, specifying the remedies of the credits, if any.**

**Answer:**

- a) The Bulk Sales Law does not in any way affect the validity of the transfer between immediate parties thereto. A sale not in compliance with the Bulk Sales Law is valid as against all persons other than the creditors of the seller.
- b) A purchaser in violation of the Bulk Sales Law acquired no rights in the property purchased as against the creditors of the seller. His status is that of trustee or receiver for the benefit of all creditors of the seller. The creditors may subject the said goods to the payment of their credits, such as execution, attachment or garnishment, as remedies. (BAR 1980)

2. In the annual meeting of the “XYZ” Corporation, the stockholders unanimously adopted a resolution proposed by the Board of Directors to sell substantially all the fixtures and equipment used in and about its business. The President of the Corporation approached you and asked for legal assistance to effect the sale.

1. What steps should you take so that the sale may be valid?
2. What are two instances when the sale, transfer, mortgage or assignment of stock of goods, wares, merchandise, provision, or materials otherwise than in the ordinary course of trade and the regular prosecution of the business of the vendor are not deemed to be a sale or transfer in bulk?

**Answer:**

1. The requirements of the Bulk Sales Law must be complied with. The seller delivers to the purchaser a list of his creditors and the purchaser in turn notifies such creditors of the proposed sale at a stipulated time in advance.
  2. If the sale and transfer is made (1) by vendor, mortgagor, transferor or assignor who produces and delivers a written waiver of the provisions of the Bulk Sales Law from his creditors as shown by verified statement; and (2) by a vendor, mortgagor, receiver, assignee in insolvency, or public officer acting under judicial process, the sale or transfer is not covered by the Bulk Sales Law. (BAR 1993)
3. Stanrus, Inc., a department store with outlets in Makati, Mandaluyong and Quezon City, is contemplating to refurbish and renovate its Makati store in order to introduce the most modern and state of the art equipment in merchandise display. To carry out its plan, it intends to sell ALL of the existing fixtures and equipment (display cases, wall decoration, furniture, counters, etc.) to Crossroads Department Store. Thereafter, it will buy and install new fixtures and equipment and continue operations.

Crossroads wants to know from you, as counsel:

1. Whether the intended sale is “bulk sale”.
2. How can it protect itself from future claims of creditors of Stanrus.

**Answer:**

1. Yes. The sale involves all fixtures and equipment, not in the ordinary course of trade and the regular prosecution of business of Stanrus, Inc.
  2. Crossroads should require from Stanrus, Inc. submission of a written waiver of the Bulk Sales Law by the creditors as shown by verified statements or to comply with the requirements of the Bulk Sales Law, that is, the seller must notify his creditors of the terms and conditions of the sale, and also, before receiving from the vendee any part of the purchase price, deliver to such vendee a written sworn statement of the names and addresses of all his creditors together with the amount of indebtedness due to each. (BAR 1994)
4. The sole proprietor of a medium-size grocery shop, engaged in both wholesale and retail transactions, sells the entire business “lock, stock barrel” because of his plan to emigrate abroad with his family. Is he covered by the provisions of the Bulk Sales Law? In the affirmative, what must be done by the parties so as to comply with the law?

**Answer:**

Yes. This is a sale of all the stock of goods, fixtures and entire business, not in the ordinary course of business or trade of the vendor. Before receiving from the vendee any part of the purchase price, the vendor must deliver to such vendee a written statement, duly sworn, of the names and addresses of all creditors to whom said

vendor may be indebted, together with the amount of indebtedness due or owing, on the account of the goods, fixtures or business subject matter of the bulk sale. (BAR 1997)

5. **Company X, engaged in the business of manufacturing car parts and accessories, operates a factory with equipment, machinery and tools for this purpose. The manufactured goods are sold wholesale to distributors and dealers throughout the Philippines. Company X was among the business entities adversely hit by the 1997 Asian business crisis. Its sales dropped with the decline in car sales and its operating costs escalated, while its creditor banks and other financial institutions tightened their loan portfolios. Company X was faced with the dismal choice of either suspending its operations or selling its business. It chose the latter. Having struck a deal with Company Z, a more viable entity engaged in the same business, Company X sold its entire business to the former without much fanfare or any form of publicity. In fact, evidence exists that the transaction was furtively entered into to avoid the prying eyes of Company X's creditors. The creditor banks and other financial institutions sued Company X for violation of the Bulk Sales Law. Decide.**

**Answer:**

Company X violated the Bulk Sales Law when it sold its entire business to Company Z furtively to avoid the prying eyes of its creditors. Its manufactures goods are sold wholesale to distributors and dealers. The sale of all or substantially all of its stocks, not in the ordinary course of business, constitutes bulk sale. The transaction being a bulk sale, entering into such transaction without complying with the requirements of the Bulk Sales law, Company X violated said law. (BAR 2000)

6. **"A" is a merchant engaged in the sale of a variety of goods and merchandise. Because of the economic crisis, he incurred indebtedness to "X", "Y" and "Z". thereafter, "A" sold to "B" all the stock of goods and merchandise.**
- a) **What steps should "A" undertake to effect a valid sale in bulk of his goods to "B".**
  - b) **Suppose "A" submitted a false statement on the schedule of his creditors. What is the effect of such false statement as to vendee "B".**
  - c) **What is the right of creditors "X", "Y", and "Z" if "A" failed to comply with the procedure/steps required by law under question letter a) hereof?**

**Answer:**

- a) "A" must prepare an affidavit stating the names of all his creditors, in this case, "X", "Y" and "Z", their addresses, the amount of their credits and their maturity. "A" should give the affidavit to "B" who, in turn, should furnish a copy to each creditor and notify the creditors that there is a proposed bulk sale in order to enable the latter to protect their interest.
- b) If the vendee does not have knowledge of the falsity of the schedule, the sale is valid. However, if the vendee has knowledge of such falsity, the sale is void because he is in bad faith.
- c) The recourse of "X", "Y" and "Z" is to question the validity of the sale from "A" to "B" so as to recover the goods and merchandise to satisfy their credits. (BAR 2001)

7. **Divine Corporation is engaged in the manufacture of garments for export. In the course of its business, it was able to obtain loans from individuals and financing institutions. However, due to the drop in the demand for garments in the international market, Divine Corporation could not meet its obligations. It decided to sell all its equipment such as sewing machines, perma-press machines, high speed sewers, cutting tables, ironing tables, etc., as well as it supplies and materials to Top Grade Fashion Corporation, its competitor.**

**How would you classify the transaction?**

**Answer:**

The sale is a sale in bulk, because it is a sale of all or substantially all of the fixtures used in and about the business of the vendor, a garments manufacturer. (BAR 2005)

8. Pursuant to a writ of execution issued by the RTC in “Express Bank v. Don Rubio,” the sheriff levied and sold at public auction 8 photocopying machines of Don Rubio. Is the sheriff’s sale covered by the Bulk Sales Law?

**Answer:**

No. The sheriff’s sale is not covered by the Bulk Sales Law. If the sale and transfer in bulk is made by a public officer, acting under judicial process, as is true in this case, said sale or transfer is not covered by the Bulk Sales Law. (BAR 2006)

9. Seeking to streamline its operations and to bail out its losing ventures, the stockholders of X Corporation unanimously adopted a proposal to sell substantially all of the machineries and equipment used in and about its manufacturing business and to sink the proceeds of the sale for the expansion of its cargo transport services.

- a) Would the transaction be covered by the provisions of the Bulk Sales Law?
- b) How would X Corporation effect a valid sale?

**Answer:**

a) No, the transaction is not covered by the provisions of the Bulk Sales Law. Bulk Sales Law applies only to retail merchants, traders and dealers. It does not apply to manufacturers. X Corporation is engaged in the manufacturing business.

b) To effect a valid sale, X Corporation must prepare an affidavit stating the names of all its creditors, their addresses, the amount of their credits and their maturities. X Corporation should give the affidavit to the buyer who, in turn, should furnish a copy to each creditor and notify the creditors of the proposed bulk sale to enable them to protect their interest. (BAR 2007)

10. TRUE OR FALSE. Answer TRUE if the statement is true, or FALSE if the statement is FALSE. Explain your answer in not more than 2 sentences.

**Even if the seller and the buyer in a sale in bulk violate the Bulk Sales Law, the sale would still be valid.**

**Answer:**

False. When the Bulk Sale Law is violated, the sale is null and void. When the provision of the said law have not been complied with, the sale is considered as being “fraudulent and void” and even when coupled with delivery, the title over the goods does not transfer to the buyer. However, the civil liabilities arising from the transaction remain enforceable between the parties thereto. (BAR 2009)

11. XXX Corporation (XXX) and its sister company, YYY Corporation (YYY), are both under judicial receivership. The receiver has the option to sell all or substantially all of the properties of YYY to XXX, or simply merge the two corporations. Under either option, the requirements under the Corporation Code have to be complied with.

**The receiver seeks your advice on whether the Bulk Sales Law will apply to either, or both, options. What will your advice be?**

**Answer:**

I will advice the receiver that the Bulk Sales Law does not apply to both options. Section 8 of the Bulk Sales Law expressly provides that it will not apply to executors, administrators, receivers, and assignees in insolvency, or

public officers, acting under judicial process. In this case, the receiver is acting under judicial process. (BAR 2009)

- 12. Venezia is a famous international fashion chain outlets in Makati, Ortigas, and Manila. It has complied with the minimum capitalization required under the Retail Trade Nationalization Act and carries on retail business worth more than \$3 M for each outlets. As its Manila outlet is not doing very well, it decides to sell all of its business there consisting of remaining inventory, furniture and fixtures and other assets to its competitor.**

**Venezia's Manila outlet constitutes 1/3 of its total business. Should it comply with the requirements of the Bulk Sales Law? Why or why not?**

**Answer:**

Venezia need not comply with the requirements of the Bulk Sales Law as its Manila outlet constitutes only 1/3 of its total business and, therefore, it would not be a sale of all or substantially all of the business conducted by Venezia. Moreover, the requirements of the Bulk Sales Law reflected in Sections 3, 4, 5, and 9, by the express language of said provisions, apply only to the first type of bulk sales, i.e., to any sale, transfer, mortgage or assignment of a stock of goods, wares, merchandise, provisions or materials otherwise than in the ordinary course of trade and the regular prosecution of business of the vendor, mortgagor, transferor, or assignor, and not to the second type (as in the sale described in the problem) or the third type (i.e., sale, etc. Of all or substantially all of the fixtures and equipment used in and about the business). As the Bulk Sales Law is penal in nature, it should be interpreted strictly against the State.

**If instead of selling its Manila outlet, Venezia merely mortgages its assets there, would it need to comply with the requirements of the Bulk Sales Law?**

**Answer:**

For the same reasons stated in the answer to (1) above, Venezia need not comply with the requirements of the Bulk Sales Law. The second type of bulk sales also includes the mortgage of all or substantially all of the business of the mortgagor.

- 13. What are the legal consequences of a failure to comply with the requirements of a Bulk Sales Law?**

**Answer:**

Failure to comply with the requirements of a Bulk Sales Law renders the sale, transfer, mortgage, or assignment fraudulent and void, and makes any person found guilty of violating any provision of the Bulk Sales Law punishable by imprisonment for not less than 6 months nor more than 5 years, or a fine in an amount not exceeding P5,000, or both such imprisonment and fine in the discretion of the court. (BAR 2010)

#### **XXIV. Anti-Dummy Law**

- 1. Acme Trading Company, Inc. (Acme), a trading company wholly owned by foreign stockholders, was persuaded by Paulo Alva, a Filipino, to invest in 20% of the outstanding shares of stock of a corporation he is forming which will engage in the department store business (the "department store corporation"). Paulo also urged Acme to invest in 40% of the outstanding shares of stock of the realty corporation he is putting up to own the land on which the department store will be built (the "realty corporation").**

- c) May the President of Acme, a foreigner, sit in the Board of Directors of the said department store corporation? Discuss with reasons.**

**d) May the Treasurer of Acme, another foreigner, occupy the same position in the said department store corporation? May he be the treasurer of the said realty corporation? Explain your answers?**

**Answer:**

c) The Anti-Dummy Law allows board representation to the extent of actual and permissible foreign investments in corporations. Accordingly, the President of Acme may not sit in the Board of Directors of the department store corporation but can do so in the realty corporation.

d) The Treasurer of Acme may not hold that position either in the department store corporation or in the realty corporation since the Anti-Dummy Law prohibits the employment of aliens in such nationalized areas of business except those that call for highly technical qualifications. (BAR 1990)

**2. Is the Filipino common-law wife of a foreigner is not barred from engaging in retail business. On the assumption that she acts for and in her own behalf, and absent a violation of the Anti-Dummy Law which prohibits a foreigner from being either the real proprietor or an employee of a person engaged in the retail trade, she should be violating the Retail Trade Act.**

**Answer:**

It is possible that the examinee would have responded on the basis of the basis of the Anti-Dummy Law exclusively in which case the engagement by the common-law wife may, by presumption, be considered as having violated the law. (BAR 1991)

**3. A Cooperative purchased from "Y" Corporation on installments a rice mill and made a down payment therefor. As security for the payment of the balance, the Cooperative executed a chattel mortgage in favor of Y Corporation. Y Corporation, in turn, assigned its rights to the chattel mortgage to Z, Inc., a 5% foreign-owned company doing business in the Philippines. The cooperative thereafter made installment payment to Z, Inc.**

**Because the Cooperative was unable to meet its obligations in full, Z, Inc. filed against it a court suit for collection. The Cooperative resisted contending that Z, Inc. was illegally engaged in the retail trade business for having sold a consumer good as opposed to a producer item. The Cooperative also alleged that Z, Inc had violated the Anti-Dummy Law.**

**Is Z, Inc. guilty of violating the Retail Trade Law and the Anti-Dummy Law? Why?**

**Answer:**

Z, Inc. is not guilty of violating the Retail Trade Law and the Anti-Dummy Law. The term "retail" under the Retail Trade Act requires that the seller must be habitually engaged in selling to the general public consumption goods. By consumption goods are meant "personal, family and household" purposes. A Rice Mill does not fall under that category. Neither does it appear that Z, Inc, is habitually engaged in selling to the general public that commodity. Since there is no violation of the Retail Trade Law, there would likewise be no violation of the Anti-Dummy Law. (BAR 1992)

**4. "A" invested P500,00 in a security agency on October 30, 1990. He was charged with being a dummy of his friend, a foreigner. If you were the prosecutor, what evidence can you present to prove violation of the Anti-Dummy Law?**

**Juana de la Cruz, a common-law wife of a foreigner wrested the control of a television firm. At the instance of the minority group of the firm, she was charged with violation of the Anti-Dummy Law. May she be convicted by the mere fact that she is a common-law wife of a foreigner? Explain.**

**Answer:**

“A” allows or permits the use or exploitation or enjoyment of a right, privilege or business, the exercise of enjoyment of which is expressly reserved by the Constitution or the laws to citizens of the Philippines, by the foreigner not possessing the requisites prescribed by the Constitution or the laws of the Philippines. The prosecutor should prove the above elements of the crime and also the facts that “A” does not have the means and resources to invest P500,000 in the security agency.

No. The mere fact of being a common-law wife of a foreigner does not bring her within the ambit of the Anti-Dummy law. (BAR 1993)

5. **Celeste, a domestic corporation wholly owned by Filipino citizens, is engaged in trading and operates as general contractor. It buys and resells the products of Matilde, a domestic corporation, 90% of whose capital stock is owned by aliens. All of Matilde’s goods are made in the Philippines from materials found or produced in the Philippines.**

**On the other hand, ECQ Integrated is a 100% Filipino-owned corporation and manufacturer of asbestos products.**

**Celeste and ECQ took part in a public bidding conducted by MWSS for its asbestos pipe requirements. Celeste won the bid, having offered 13% lower than that offered by ECQ; and MWSS awarded the contract to supply its asbestos pipes to Celeste. ECQ sought to nullify the award in favor of Celeste.**

**Did Celeste and Matilde violate the Anti-Dummy Law?**

**Answer:**

No, since Celeste is merely a dealer of Matilde and not an alter ego of the latter. Celeste buys and sells on its own account the products of Matilde. (BAR 1994)

## XXV. Other Questions

### A. 1976 BAR EXAMINATION

1. **(1) What is an unclaimed balance within the meaning of the Unclaimed Balance Law?  
(2) What is the duty of the bank with respect to the unclaimed balances?  
(3) In general, what should the government do with respect to the unclaimed balances?**

**Answer:**

(The Unclaimed Balances Law was excluded from the scope of the examination questions, by express statement in the circular sent to all deans.)

### B. 1977 BAR EXAMINATION

1. **Maria, 22 years of age, wife of Jaime, wants to embark in the production and export of handicrafts with a capital of P200,000.00 and name the business “Maria’s House of Handicrafts”. May Maria lawfully engage in commerce and put the House of Handicrafts?**

**Answer:**

Yes, Maria may lawfully engage in commerce and put up the House of Handicrafts. Although, at first glance, it would seem that her husband’s authorization appearing in a public instrument is necessary, pursuant to

Section 6 of the Code of Commerce which states that: "A married woman having reached 21 years of age, may engage in commerce with her husband's authorization appearing in a public instrument which shall be registered in the mercantile registry," the said provision of the New Civil Code:

1. "Art. 39. A married woman, 21 years of age or over, is qualified for all acts of civil life, except in cases specified by law"
2. "Art. 117. The wife may exercise any profession or occupation or engage in business. However, the husband may object, provided:
  - a. His income is sufficient for the family, according to its social standing, and
  - b. His opposition is founded on serious and valid grounds.

In case of disagreement on this question, the parents and grandparents as well as the family counsel, if any, shall be consulted. If no agreement is still arrived at, the court will decide whatever may be proper and in the best interest of the family.

3. "Art. 113. The husband must be joined in all suits by or against the wife, except:

x x x

(8) If the litigation is incidental to the profession occupation or business in which she is engaged."

**May Jaime, Maria's husband, interpose any objection, and on what grounds?**

**Answer:**

Yes, Jaime may interpose objections, but only on the grounds provided by Art. 11 of the Civil Code. According to Art. 117 of the New Civil Code: "The wife may exercise any profession or occupation or engage in business. However, the husband may object, provided:

- (1) His income is sufficient for the family, according to its social standing, and
- (2) His opposition is founded on serious and valid grounds.

**The business failed and resulted in losses. If Jaime voluntarily consented to Maria's business activity, what properties shall answer for her obligations?**

**Answer:**

Jaime, having voluntarily consented to Maria's business activity, her paraphernal properties, as well as those of their conjugal partnership or absolute community, shall be liable for the losses resulting from the failure of Maria's business.

**If Jaime opposed the business venture, what properties are liable?**

**Answer:**

If Jaime has objected to his wife's engagement in business and his objection, being based on serious and valid grounds and/or on the sufficiency of his income for the family according to its social standing, has been judicially upheld by the court, then only Maria's paraphernal properties will be liable, and not those of their conjugal partnership or absolute community, except insofar as her obligations have redounded to the benefit of the family, and to that extent only.

1. Lita, 26 years old, wife of Jimmy, wants to put up a betamax rental outlet with a capital of P200,000 using the name "Genta Beta ni Lita"
  - a) May Lita lawfully engage in commerce and put up betamax outlet? Can Jimmy object?
  - b) Because most of Lita's customers were her friends and relatives and did not pay rentals for the betamax tapes, the business failed and resulted in losses. If Jimmy opposed the business ventures, what properties shall answer for Lita's obligations?

**Answer:**

- a) Yes, the law allows either spouse to exercise any legitimate business or activity without the consent of the other. The latter may object only on valid, serious, and moral grounds.
- b) Obligations that accrued before the objection was made by Jimmy are enforceable against the community or conjugal property as the case may be; obligations accruing thereafter shall be borne by the separate property of Lita.

**D. 1995 BAR EXAMINATION**

1. House of Pizza (PIZZA) is the owner and operator of a nationwide chain of pizza outlets. House of Liquor (LIQUOR) is a retailer of all kinds of liquor.

House of Foods (FOODS) has offered to purchase all of the outlets, equipment, fixtures and furniture of PIZZA. FOODS also offered to purchase from LIQUOR all of its moderately priced stock constituting 50% of its total inventory.

Both PIZZA and LIQUOR have creditors. What legal requirements must PIZZA and LIQUOR comply with in order for FOODS to consummate the transactions? Discuss fully.

**Answer:**

PIZZA and LIQUOR must prepare an affidavit stating the names of all their creditors, their addresses, the amounts of their credits and their respective maturities. PIZZA and LIQUOR must submit said affidavit to FOODS which, in turn, should notify the creditors about the transaction which is about to be concluded with PIZZA and LIQUOR.

2. Global KL Malaysia (GLOBAL), a 100% Malaysian-owned corporation, desires to build a hotel beach resort in Samal Island, Davao City, to take advantage of the increased traffic of tourists and boost the tourism industry of the Philippines.

1. Assuming that GLOBAL has US\$100 Million to invest in a hotel beach resort in the Philippines, may it be allowed to acquire the land on which to build the resort? If so, under what terms and conditions may GLOBAL acquire the land? Discuss fully.
2. May GLOBAL be allowed to manage the hotel beach resort? Explain.
3. May GLOBAL be allowed to operate restaurants within the hotel beach resort? Explain.

**Answer:**

1. GLOBAL can secure a lease on the land. As a corporation with a Malaysian nationality, GLOBAL cannot own the land.
2. Yes, GLOBAL can manage the hotel beach resort. There is no law prohibiting it from managing a resort.
3. GLOBAL may be allowed to operate restaurants within the beach resort. This is part of the operation of the resort. (BAR 1995)

### E. 1999 BAR EXAMINATION

- 1. Government plans to impose an additional duty on imported sugar on top of the current tariff rate. The intent is to ensure that the landed cost of sugar shall not be lower than P800 per bag. This is the price at which locally produced sugar would be sold in order to enable sugar producers to realize reasonable profits. Without this additional duty, the current low price of sugar in the world, the current low price of sugar in the world market will surely pull the domestic price—a situation that could spell the demise of the Philippine sugar industry.**
  - a) Discuss the validity of this proposal to impose an additional levy on imported sugar.**
  - b) Would the proposal be consistent with the tenets of the World Trade Organization (WTO)**

**Answer:**

- a) The proposal to impose an additional duty on imported sugar on top of the current tariff rate is valid, not being prohibited by the Constitution. It would enable producers to realize reasonable profits, and would allow the sugar industry of the country to survive.
- b) No. The proposal would not be consistent with the tenets of the WTO which call for the liberalization of trade. However, such proposal may be acceptable within the allowable period under the WTO for adjustment of the local industry.

### F. 2004 BAR EXAMINATION

- 1. What is the difference between government deregulation and privatization of an industry? Explain.**

**Answer:**

Government deregulation is the relaxation or removal of regulatory constraints on firms or individuals, with a view to promoting competition and market-oriented approaches toward pricing, output, entry, and other related economic decisions.

Privatization of an industry refers to the transfer of ownership and control by the government of assets, firms and operations in an industry to private investors.

- 2. In its exercise of police power and business regulation, the legislature of LVM State passed a law prohibiting aliens from engaging in domestic timber trade. Violators including dummies would, after proper trial, be fined and imprisoned or deported. Mrs. BC, a citizen of LVM but married to ZC, an alien merchant of PNG, filed suit to invalidate the law or exempt from its coverage their timber business.**

She contended that the law is, inter alia, gravely oppressive and discriminatory. It violated the Universal Declaration of Human Rights (UDHR) passed in 1948 by the United Nations, of which LVM is a member, she said, as well as the reciprocity provisions of the World Trade Organization (WTO) Agreement of 1994, of which PNG and LVM are parties. Aside from denying them equal protection, according to BC, the law will also deprive her family their livelihood without due process nor just compensation.

Assuming that the legal system of LVM is similar to ours, would Mrs. BC's contention be tenable or not? Reason.

**Answer:**

Mrs. BC's contention is not tenable. First, the UDHR does not purport to limit the right of states (like LVM) to regulate domestic trade. Second, the WTO Agreement involves international trade between states or governments, not domestic trade in timber or other commodities. Third, nationality is an accepted norm for making classifications that do not run counter to the equal protection of law clause of the Constitution. Fourth, there is no impairment of due process here because violators of the law will be punished only after "proper trial". Fifth, the issue of "just compensation" does not arise, because the property of Mrs. BC is not being expropriated. On the contrary, as a citizen of LVM, Mrs. BC is freely allowed to engage in domestic timber trade in LVM.

- 3. The Collector of Customs ordered the seizure and forfeiture of new electronic appliances shipped by TON Corp. from Hong Kong for violation of customs law because they were falsely declared as used office equipment and then undervalued for purposes of customs duties. TON filed a complaint before the MM RTC for replevin, alleging that the Customs officials erred in the classification and valuation of its shipment, as well as in the issuance of the warrant of seizure. The Collector moved to dismiss the suit for lack of jurisdiction on the part of the trial court.**

Should the Collector's motion be granted or denied?

Answer:

The Collector's motion should be granted. Under Section 602(g) of the Tariff and Customs Code, the Bureau of Customs has exclusive original jurisdiction over seizure and forfeiture cases under the tariff and customs laws.

### G. 2006 BAR EXAMINATION

- 1. In several addresses extensively covered by media since his appointment on December 21, 2005, Chief Justice Artemio V. Panganiban vowed to leave a judiciary characterized by "four Ins" and to focus in solving the "four ACID" problem that corrode the administration of justice in our country.**

**Explain this "four Ins" and "four ACID" problems.**

**Answer:**

Chief Justice Artemio V. Panganiban's vision for the judiciary is characterized by four "Ins" as follows: (1) Independence; (2) Integrity; (3) Industry; and (4) Intelligence. He vows to focus in solving the four ACID problem corroding the administration of justice as follows: (1) limited Access to justice by the poor; (2) Corruption; (3) Incompetence; and (d) delay in the Delivery of quality judgments.

- 2. The Chief Justice also said that the judiciary must "safeguard the liberty" and "nurture the prosperity" of our people. Explain the philosophy. Cite the Decisions of the Supreme Court implementing each of these twin beacons of the Chief Justice.**

**Answer:**

The philosophies of "safeguard the liberty" and "nurture the prosperity" of our people are goals which the judiciary must achieve. These twin beacons of Liberty and Prosperity are founded on the faith that our people enjoy the inalienable right to be free from the bondage of fear, and that they possess a boundless capacity to redeem themselves from misery, to respond positively to opportunities as they arise, and to soar above the challenges of fear and want.

Decisions implementing these twin beacons include:

- a) Senate of the Philippines v. Executive Secretary Ermita, G.R. Nos. 169777, 169659, 169660, 169667, 169834 and 171246, April 20, 2006, on the validity of E.O. No. 464 which barred officials from testifying in congressional investigations without the express approval of the president (deferential interpretation of laws and executive issuances);
- b) Bayan v. Executive Secretary Ermita, G.R. Nos. 169838, 169848 and 169881, April 25, 2006 on the validity of the so-called preemptive response policy of the Executive Department (deferential interpretation of laws and executive issuances);
- c) Prof. Randy S. David v. Pres. Gloria Macapagal-Arroyo, G.R. No. 171396, 171409, 171485, 171483, 171400, 171489 and 171424, May 3, 2006, on the validity of Pres. Proclamation No. 1017 (“heightened” scrutiny or “strict” review of actions and policies of the government).

#### **H. 2009 BAR EXAMINATION**

- 1. Cecilio is planning up a grocery store in the subdivision where he and his family reside. To promote this proposed business venture, he told his wife and 3 children to send out promotional text messages to all the residents in the subdivision. Cecilio’s family members did as instructed, and succeeded in reaching, through text messages, more than 80% of the residents in the subdivision.**

**Is Cecilio habitually engaged in commerce even if the grocery store has yet to be established? Explain your answer.**

**Answer:**

Yes. Even if the grocery store has yet to be established, Cecilio already habitually engaged in commerce, when per his instruction the members of his family contacted more than 80% the residents of the subdivision where they reside. According to Article 3 of the Code of Commerce, “legal presumption of habitually engaging in commerce shall exist from the moment the person who intends to engage therein announced through circulars, newspapers, handbills, posters exhibited to the public, or in any other manner whatsoever, an establishment which has for its object some commercial operation.” Text messages may qualify to be equivalent to electronic documents.

--End--