COMMERCIAL LAW

Bar Operations Head  |  Arianne Reyes
Academics Head      |  Henry Aguda
                      |  Ryan Balisacan
Subject Head         |  Henry Aguda
                      |  Tere Licaros

Subject Committee    |  Lynn Ramos * Johaira Wahab
                      |  Ruby Alberto * Dianne Capco
Information Management Committee |  Chino Baybay [Head] * Simoun Salinas [Deputy] * Rania Joya
                                      |  Madamba * Des Mayoralgo * Jillian De Dumo * Mike
                                      |  Ocampo * Abel Maglanque * Edan Marri R. Cañete * Carmie
                                      |  Rome Cargo
# Commercial Law

## TABLE OF CONTENTS

| I. Corporation Law | 3 |
| II. Negotiable Instruments Law | 88 |
| III. Insurance Code | 125 |
| IV. Transportation Law | 203 |
| V. Code of Commerce | 255 |
| VI. Banking Law | 275 |
| VII. Intellectual Property Law | 327 |
1. The Corporation as a Legal Concept

1.1 Corporation Defined

A Corporation is an artificial being created by operation of law, having the right of succession and the powers, attributes, and properties expressly authorized by law or incident to its existence. (§2)

A corporation is a creature of:

1. A general enabling statute (requirements of the law must be complied with); and
2. The agreement of individuals who seek to incorporate (internal contractual arrangements: articles of incorporation and by-laws).

1.2 Four attributes of a corporation

An artificial being:

1. a juridical person capable of having rights and obligations, w/ a personality separate and distinct from its members or stockholders
2. hence, stockholders are not personally liable for corp. obligations and cannot be held liable to third persons who have claims against the corp. beyond their agreed contribution to the corporate capital (paid-up capital and unpaid subscriptions) This is known as the doctrine of limited liability.

1.3. Advantages of the Corporate Organizations

1) Separate juridical personality – personality separate and distinct from individual stockholders and members

2) Limited liability to investors – stockholders are liable only to the extent of their contribution

   - General rule: Where a corporation buys all the shares of another corporation, this will not operate to dissolve the other corporation and as the two corporations still maintain their separate corporate entities, one will not answer for the debts of the other. [Nell v Pacific Farms (15 SCRA 415), Nov. 23, 1965]

   - Exceptions:
     o If there is an express assumption of liabilities;
     o There is a consolidation or merger;
     o If the purchase was in fraud of creditors;
     o If the purchaser becomes a continuation of the seller;
     o If there are unpaid subscriptions (stockholder is liable for the unpaid balance).

3) Free transferability of units of ownership – stockholders hold their shares as personal property with rights to dispose, assign or encumber them as they may desire (§63)

4) Centralized Management – all corporate powers are exercised by the board of directors (§23)

1.4 Partnership vs. Corporation

1. Extent of Liability—partners are personally liable for the debts of the partnership; stockholders cannot be made to personally answer to corporate creditors

2. Creation—mere agreement of the parties, w/c can be composed of just 2 persons, gives rise to the juridical personality of the partnership, whether or not registered w/ the SEC (Art. 1768, NCC); a corp., w/ a minimum of 5 incorporators, derives its juridical personality from the certificate issued by the SEC (§19)

3. Management—In most cases, all the owners in a partnership actively participate in management, w/ capacity to bind it by any usual contract (Art. 1818, NCC); in a corp., management is centralized in the board of directors w/c has exclusive power to bind the corp. (§23)

4. Nature of Relationship—partnership is based on mutual trust and confidence (delectus personae) so that its existence is precarious because of the facility w/ which it can be dissolved (i.e. through the death or unilateral act of a partner); a corp. has more stability as it enjoys the right of succession and is not affected by the death or insolvency of a stockholder; also, dissolution before a corp.’s term requires a
2/3rds vote of the stock (Secs. 118 and 119, Corp. Code), always subject to SEC intervention

5. Powers—a corporation has only such powers as are expressly granted to it and such as are necessary to the exercise of the powers so granted or for the accomplishment of its purpose (sec.2, 36 (11), and 45); In a partnership, as long as the parties have agreed to it, the partnership can perform any act as long as it does not violate any law or right of others.

1.5 Government Regulation of Corporations

By the Legislature

Basis: police power of the state (Northern Ry Co. v. State of Washington, 300 U.S. 154) and the fact that corporations owe their existence to the state

Manner: by amending or repealing the Corp. Code or any part thereof

NDC v Phil Veterans Bank (1990)

PD 1717 ordered the rehabilitation of the Agrix Group of Companies to be administered by NDC. Sec 4(1) provides that all mortgages and liens presently attached be extinguished, and that all accrued obligations shall not bear interest. Among those ordered extinguished was a lien in favor of Phil Veterans Bank over prop in LB. NDC filed to foreclose the mortgage.

HELD: New Agrix was created by special decree even if 1973 Consti mandates that Batasang Pambansa, except by general law, provide for formation, organization and regulation of private corps, unless for GOCCs.

NDC was only mandated to extend loan and to manage company. New Agrix was entirely private and should have been organized under Corp Law.

By the SEC

Basis: Sec. 3, PD 902-A and Sec 5.1(a), RA8799. The Commission shall have absolute jurisdiction, supervision and control over all corporations, partnerships or associations, who are the grantees of primary franchises and/or licenses or permits granted by the government, to operate in the Philippines; xxx

Note: Under Sec. 5.2 of RA8799, SEC’s jurisdiction over all cases enumerated under Sec. 5, PD 902-A has jurisdiction over the principal office of the corporation, partnership or association concerned.

According to the Interim Rules of Procedure for Intra-Corporate Controversies (A.M. No. 01-2-04-SC), which took effect on April 1, 2001, the Regional Trial Court has jurisdiction over cases involving the following:

1. Devices or schemes employed by, or any act of, the BOD, business associates, officers or partners, amounting to fraud or misrepresentation which may be detrimental to the interest of the public and/or of the stockholders, partners or members of any corporation, partnership, or association;

2. Controversies arising out of intra-corporate, partnership, or association relations, between and among stockholders, members or associates; and between, any or all of them and the corporation, partnership, or association of which they are stockholders, members or associates, respectively;

3. Controversies in the election or appointment of directors, trustees, officers, or managers of corporations, partnerships, or associations;

4. Derivative suits; and

5. Inspection of corporate books.

Morato v CA (2004)

Petitioners, stockholders of TF Ventures, Inc, filed a petition with the SEC against private respondents for the declaration of nullity of stockholders’ and directors’ meetings and damages. They assail the validity of the notice and stockholders’ meeting of TF Ventures, Inc. and the organizational meeting of the members of the BOD. The petition was referred to the Securities Investigation and Clearing Department (SICD) of the SEC for investigation and resolution.

Meanwhile, one of the private respondents (Matsura, Chairman of the BOD), wrote a letter to the Examiners and Appraisers Dept of the SEC, requesting for an examination of the basis for the capital increase of T.F. Ventures, Inc. from P10,000,000 to P100,000,000, alleging the commission of devices, schemes and criminal acts.

The letter was forwarded by the SEC to the Prosecution and Enforcement Dept (PED). Petitioners contended that with the filing of the letter-petition with the PED, Matsura resorted to forum shopping.

HELD: Matsura is not guilty of forum shopping. There is no identity of causes of action or identity of rights asserted by the parties in both cases. In this case, SEC Case is pending before the SICD, which has exclusive jurisdiction to investigate and resolve intra-corporate disputes. The respondent’s letter-petition, on the other hand, was referred by the SEC to the PED and is pending before the Prosecution and Enforcement Department of the SEC.

Section 8 of P.D. No. 902-A, as amended, provides:

SECTION 8. The Prosecution and Enforcement Department shall have, subject to the Commission’s control and supervision, the exclusive authority to investigate, on complaint or motu proprio, any act or omission of the Board of Directors/Trustees of corporations, or of partnerships, or other associations, or of their stockholders, officers or partners, including any fraudulent devices, schemes or representations, in violation of any law or rules and regulations administered and enforced by the Commission; to file and prosecute in accordance with law and rules and regulations issued by the Commission in appropriate cases, the
corresponding criminal or civil case before the Commission or the proper court or body upon prima facie finding of violation of any laws or rules and regulations administered and enforced by the Commission; and to perform such other powers and functions as may be provided by law or duly delegated to it by the Commission.

Prosecution under this Decree or any Act, Law, Rules and Regulations enforced and administered by the Commission shall be without prejudice to any liability for violation of any provision of the Revised Penal Code.

Under the said provision, the SEC, through the PED, is vested with authority to investigate, either motu proprio or upon complaint, any act or omission, fraudulent schemes, devices or misrepresentations in violation of any law, rules or regulations, administered and enforced by the SEC, and to file and prosecute appropriate civil or criminal cases upon a prima facie finding of violation of such laws, rules or regulations. The petitioners, in the SEC case, sought the nullification of the Notice for the Annual Stockholders’ Meeting, the stockholders’ meeting and organizational meeting held on September 22, 1997, on their claim that the holding of the same was in violation of the Corporation Code and the By-Laws of the petitioner corporation. In his answer to the petition, the respondent asserted the validity of the said meeting and prayed, by way of counterclaim, for the nullification of the October 20, 1997 meeting of the petitioners, and for damages. In contrast, the respondent alleged in his letter-petition in the PED case that the petitioners were engaged in fraudulent schemes, devices or misrepresentations in violation of the law, and SEC rules and regulations. The complainant Matsuura asked the PED to investigate the complaint and file the corresponding administrative, civil or criminal cases before the SEC, the proper court or body, for violation of the laws, rules or regulations administered and enforced by the SEC. The fact that the SICD has not yet resolved the SEC case does not constitute a bar to the resolution of the PED case. The proceedings in the said cases are independent and separate of each other and may thus proceed separately.

Note that while this case was pending in the SC, RA 8799, Securities Regulation Code, took effect on August 8, 2000. Section 5.2 of the law provides that SEC’s jurisdiction over all cases under Sec 5 of PD 902-A is transferred to the RTCs.

Among the powers and functions of the SEC which were transferred to the RTC include the following: (a) jurisdiction and supervision over all corporations, partnerships or associations who are the grantees of primary franchises and/or a license or permit issued by the Government; (b) the approval, rejection, suspension, revocation or requirement for registration statements, and registration and licensing applications; (c) the regulation, investigation or supervision of the activities of persons to ensure compliance; (d) the supervision, monitoring, suspension or take over the activities of exchanges, clearing agencies and other SRO’s; (e) the imposition of sanctions for the violation of laws and the rules, regulations and orders issued pursuant thereto; (f) the issuance of cease-and-desist orders to prevent fraud or injury to the investing public; (g) the compulsion of the officers of any registered corporation or association to call meetings of stockholders or members thereof under its supervision; and, (h) the exercise of such other powers as may be provided by law as well as those which may be implied from, or which are necessary or incidental to the carrying out of, the express powers granted to the Commission to achieve the objectives and purposes of these laws.

However, Section 8 of P.D. No. 902-A, as amended, has already been repealed, as provided for in Section 76 of RA 8799.

Thus, under the new law, the PED ceased to exist. However, the SEC retains jurisdiction to continue with its investigation of the letter-petition of respondent Matsuura.

When RA 8799 took effect, the SEC case had not yet been submitted for decision by the SEC. Hence, the said case should be transferred to the RTC of Makati City, to be raffled to the appropriate branch thereof assigned to try such cases. Despite the repeal of Section 8 of P.D. No. 902-A and the abolition of the PED, the SEC may continue with its investigation of the letter-petition of respondent Matsuura.

- The Sandiganbayan has jurisdiction over presidents, directors or trustees, or managers of government-owned or controlled corporations organized and incorporated under the Corporation Code for purposes of the provisions of RA 3019, otherwise known as the Anti-Graft and Corrupt Practices Act. Basis: Sec 4, RA 8249 (People v Sandiganbayan, 2005)

Union Bank v. Danilo Concepcion
GR No. 160727 June 26, 2007

EYCO Group of Companies filed a petition for suspension of payment, appointment of receiver/committee and approval of rehabilitation plan with alternative prayer for liquidation and dissolution of corporations. Suspension was granted by the SEC Hearing Panel. Union Bank became part of the ManCom which represented the creditor banks but later on broke away without notifying the group. It filed a slew of cases with the Makati RTC and applied for preliminary attachment. Union Bank filed a motion to dismiss the case pending with the SEC, and when the SEC issued an order appointing regular members of the ManCom, Union Bank filed a petition of certiorari with the CA seeking the nullification of the SEC Order and again assailing the jurisdiction of the SEC. It alleged that the jurisdiction over a basic petition for suspension of payments was with the RTC under Act No. 1956 (Insolvency Law). The CA and later on the SC ruled that the jurisdiction is with the SEC pursuant to PD 902-A. The proceeding in the RTC was thus suspended. Concepcion was later appointed as liquidator by the SEC en banc and he filed a motion to intervene and set aside order of attachment in the said RTC case. The SEC en banc approved of the liquidation plan that Concepcion submitted but his motion to intervene with the RTC was denied for lack of standing. The RTC also declared EYCO in default in the said case, proceeded to receive...
evidence ex parte and later rendered partial judgment ordering EYCO to pay P400M to Union Bank. Concepcion appealed the decision and was sustained by the CA, which modified the partial judgment of the RTC. Union Bank now comes to the SC assailing the CA’s order.

HELD: Denied. CA Order AFFIRMED. What is being assailed is the validity of the appointment of Concepcion as liquidator and his standing to intervene in the RTC case. Albeit jurisdiction over a petition to declare a corporation in a state of insolvency strictly lies with regular courts, the SEC possessed, during the period material, ample power under P.D. No. 902-A as amended, to declare a corporation insolvent as an incident of and in continuation of its already acquired jurisdiction over the petition to be declared in the state of suspension of payments in the two instances provided in Section 5(d) thereof. Said Section 5(d) vests the SEC with exclusive and original jurisdiction over petitions for suspension of payments which may either be: (a) a simple petition for suspension of payments based on the provisions of the Insolvency Law, i.e., the petitioning corporation has sufficient assets to cover all its debts, but foresees the impossibility of meeting the obligations as they fall due, or (b) a similar petition filed by an insolvent corporation accompanied by a prayer for the creation of a management committee and/or rehabilitation receiver based on the provisions of P.D. No. 902-A, as amended by P.D. No. 1758. The petition of EYCO in this case was a mix of both situations. EYCO’s petition for suspension for payment was, for all intents and purposes, still pending with the SEC as of June 30, 2000. Accordingly, the SEC’s jurisdiction thereon, by the express terms of R.A. No. 8999, still subsists “until [the suspension of payment case and its incidents are] finally disposed.”

Viva Footwear v. SEC
GR No. 163235 April 27, 2007
Petitioner Viva Footwear Manufacturing Corporation is a domestic corporation engaged in the manufacture of rubber footwear. Respondents Philippine National Bank (PNB) and Philippine Bank of Communications (PBCom) are two of petitioner’s creditors. The SEC, upon petition by Viva, declared the latter to be in a state of suspension of payments. The petition for rehabilitation was eventually dismissed because it was not viable to do so as it was not financially sound. Viva now claims that its right to due process was violated when the SEC referred the rehabilitation plan to the Financial Analysis and Audit Division without notice to petitioner.

HELD: NO MERIT. DISMISSED. In administrative proceedings, due process simply means an opportunity to seek a reconsideration of the order complained of; it cannot be fully equated to due process in its strict jurisprudential sense. It is the administrative order, not the preliminary report, which is the basis of any further remedies the losing party in an administrative case may pursue. Thus, petitioner has no right to be notified of the preliminary report by the Financial Analysis and Audit Division of the SEC.

Petitioner’s claim that the SEC’s referral of the petition for rehabilitation to the said division violated its right to due process deserves no consideration. Petitioner’s right to administrative due process only entitles it to an opportunity to be heard and to a decision based on substantial evidence. No more, no less.

Chapter II
CLASSIFICATION OF PRIVATE CORPORATIONS

1. General Classification under §3:

1.1 Stock corporation
- One which has a capital stock divided into shares and is authorized to distribute to the holders of such shares dividends or allotments of the surplus profits (i.e., retained earnings on the basis of the shares held (§3)
- It is organized for profit.
- The governing body of a stock corporation is usually the Board of Directors (Except in certain instances for close corporations)

1.2 Non-stock corporation
- All other corporations are non-stock corporations (§3)
- One where no part of the income is distributable as dividends to its members, trustees, or officers, subject to the provisions of the Code on dissolution. Provided that any profit which a non-stock corporation may obtain as an incident to its operation shall whenever necessary or proper be used for the furtherance of the purpose or purposes for which the corporation was organized. (§87)
- Not organized for profit.
- Its governing body is usually the Board of Trustees.

CIR vs. Club Filipino, Inc de Cebu (1962)
Club Filipino is a civic corporation organized to develop and cultivate sport of all class and denomination for the healthful recreation and entertainment of its SH and members. Its AOI and by-laws are silent as to dividends and their distribution but it was provided that upon its dissolution, the Club’s remaining assets after paying debts shall be donated to a charitable Phil. Institution.

HELD: Club Filipino is a non-stock corporation. According to Section 3 of the Corporation Code, there are two elements for a stock corporation to exist: 1) capital stock divided into shares, and 2) an authority to distribute to the holders of such
shares, dividends or allotments of the surplus profits on the basis of shares held. Nowhere in Club Filipino’s AOI or BL could be found an authority for the distribution of its dividends or surplus profits.

2. Other kinds of corporations

1. Public corporation - One formed or organized for the government or a particular state. Its purpose is for the general good and welfare.

2. Private corporation - One formed for some private purpose, benefit, aim or end

3. Close corporation (§96) – One whose Articles of Incorporation provide that:
   a) all of the corporation’s issued stock of all classes, exclusive of treasury shares, shall be held of record by no more that a specified number of persons, not exceeding 20
   b) all of the issued stock of all classes shall be subject to one or more specified restrictions on transfer permitted by the Code
   c) the corporation shall not list in any stock exchange or make any public offering of any of its stock of any class
   d) at least 2/3 of its voting stock must not be owned or controlled by another corporation which is not a close corporation
   e) must not be a mining or oil company, stock exchange, bank, insurance company, public utility, educational institution or corporation vested with public interest.

4. Educational corporation (§106) - Those corporations which are organized for educational purposes. This type of corporation is governed by Section 106 of the Corporation Code.

5. Religious sole and aggregate (§110, 111 (2), 123)
   - A corporation sole is one formed for the purpose of administering and managing, as trustee, the affairs, property and temporalities of any religious denomination, sect, or church, by the chief archbishop, bishop, priest, rabbi, or other presiding elder of such religious denomination, sect or church. (§110)
   - The corporation sole is an exception to the general rule that at least five (5) members are required for a corporation to exist. Here, there is only one (1) incorporator. This is applicable to religious communities that administer and manage their properties according to the regulations of which provide that the community’s properties are to be placed in the name of the head and administered by him. (§111(2))
   - A corporation aggregate is a religious corporation incorporated by more than one person.

6. Eleemosynary corporation - One organized for a charitable purpose

7. Domestic corporation – A domestic corporation is one formed, organized, or existing under the laws of the Philippines

8. Foreign corporation – One formed, organized or existing under any laws other than those of the Philippines and whose law allows Filipino citizens and corporations to do business in its own country and state. (§123)

9. Corporation created by special laws or charter (§4)
   - Corporations which are governed primarily by the provisions of the special law or charter creating them (§4)
   - Corporation Code is suppletory in so far as they are applicable (Ibid)

10. Subsidiary corporation – one in which control, usually in the form of ownership of majority of its shares, is in another corporation (the parent corporation)

11. Parent corporation – its control lies in its power to elect the subsidiary’s directors thus controlling its management policies.

Chapter III
FORMATION AND ORGANIZATION OF CORPORATION

1. Who May Form a Corporation

1.1 Incorporators

Any number of natural persons not less than five (5) but not more than fifteen (15), all of legal age and a majority of whom are residents of the Philippines, may form a private corporation for any lawful purpose or purposes. Each of the incorporators of a stock corporation must own or be a subscriber to at least one (1) share of capital stock of the corporation. (§10)

1) Natural persons
   - Corporations and partnerships cannot be incorporators, but may be stockholders. This prevents “layering” which may harbour criminals and will make the corporation a tool for defrauding the public.
   - Incorporators are those stockholders or members mentioned in the articles as originally forming and composing the corporation and who are signatories thereof.
   - Corporators are stockholders or members who join the corporation after its incorporation.
   - Original subscribers are persons whose names are mentioned in the Articles, but not as incorporators. They do not sign the Articles.

2) At least five incorporators but not more than fifteen
   - They must sign the articles of incorporation.
   - GENUINE INTEREST: Each incorporator must own or subscribe to at least one share of stock of the corporation.

3) Majority of the incorporators must be residents of the Philippines.
• General rule: need not be a citizen

• Exceptions: public utilities (Art XII, Sec 11, Consti), schools (Art XIV, Sec 4(2), Consti), banks (General Banking Act), retail trade (RA 1180), savings and loan associations (RA 3799), investment houses (Sec 5, PD 129), and other areas of investment as congress may by law provide (Art XII, Sec. 10, Consti).

• Even though there are no legal restrictions as to alien ownership, where > 40% of the outstanding capital stock will be owned and controlled by aliens, must get written authorization from BOI before it can register with SEC. (purpose is to enable BOI to determine whether such corporation wherein aliens own a substantial number of shares would contribute to the sound and balanced development of the national economy)

4) Incorporators must be of legal age

2. Conditions Precedent for Incorporation

2.1 Consent or agreement of at least 5 natural persons with respect to:

1. Compliance with the Corp Code;

2. Contribution/pooling of resources – delivered to and held in trust by a designated trustee;

3. Governance of:
   • Contributions;
   • Distribution of contributions;
   • Division of profits/sharing of losses;
   • Pursuit of purpose/objectives;
   • Corporate combination; and
   • Transactions with third parties; and

4. Continuity or termination of existence.

2.2 Mandatory Requirements of the Code:

• 1. Execution of constitutive documents (AOI, By-laws);

• 2. Payment/delivery of contributions – delivered to and held in trust by a designated trustee;

• 3. Submission of constitutive documents to SEC for review or evaluation; and

• 4. SEC action – issuance of certificate of registration.

Note that once contributions are made before incorporation, such subscriptions are irrevocable for a period of 6 months (general rule).

• Exceptions:
  1. When all of the other subscribers consent to the revocation; or
  2. When the incorporation fails to materialize (Sec. 61)

3. Steps in the formation of a corporation

3.1. PROMOTION

• The “promoter” brings together persons interested in the business enterprise and sets in motion the machinery that leads to the formation of the corporation.

• “Promoter” is a person who, acting alone or with others, takes initiative in founding and organizing the business or enterprise of the issuer and receives consideration therefor.¹

3.2. DRAFTING OF ARTICLES OF INCORPORATION

These constitute the charter of the corporation

1. CORPORATE NAME

• No corporate name may be allowed by the SEC if the proposed name is identical or deceptively or confusingly similar to that of any existing corporation or to any other name already protected by law or is patently deceptive, confusing or contrary to existing laws. (§18)

• A corporate name is essential to the corporation’s acquisition of juridical personality

• Change of corporate name shall require the approval of the SEC. SEC will issue amended certificate of incorporation under the amended name (Ibid)

• A change in corporate name involves an amendment of the Articles, which requires a majority vote of the board and the vote or written assent of stockholders holding 2/3 of the outstanding capital stock (§16) Note: Does not include the non-voting stock.

• It is the sole means of identifying the corporation from its members or stockholders, and from other entities and corporations

• Amendment in a corp’s AOI changing its corporate name does not extinguish the personality of the original corporation. The corp upon such change of its name, is in no sense a new entity, nor the successor of the original corp. it is the same corp with a different name, and its character is not changed. Consequently, the “new” corp is still liable for the debts and obligations of the “old” corp (Republic Planters Bank v CA, 1992)

• This is essential because through it, corporation can sue and be sued

• SEC may allow incorporators to reserve the name for a particular period

• To distinguish from partnerships and other business orgs, the law requires corporations to append the word “Corporation” or “Inc” to its chosen name.

• A corporation should transact business only through its chosen name

Philips Export BV (PEBV) v CA (1992)

PEBV is a foreign corp under the law of Netherlands, although not engaged in business in the Phils. It is the registered owner of the Philips trademark, and owns two local companies with the name Philips also.

PEBV asked the cancellation of the word Philips from Standard Philips, a local manufacturer,

¹ Sec. 3.10, The Securities Regulation Code (RA 8799)
alleging infringement of its exclusive right to use the same. SEC and CA ruled for Std Philips, saying there was no confusion (unlike in Converse case).

Held:
Corporation’s right to use its corp and trade name is a property right, a right in rem.

General Rule: Corp must have a name by which it is to sue and be sued and do all legal acts.

A corporation may not be formed for a purpose which is or which is incidental to such conferred or limited powers which a corporation may not be extended to another 50 years at any time.

Reasons for purpose clause:
- so that a stockholder contemplating an investment will know what lines of business his money is to be risked
- so that management will know what lines of business it is authorized to act
- so that anyone who transacts with the corporation may ascertain whether a transaction he is entering is one with the general authority of the management

Under Sec 14(2) a corporation can have as many purposes as it wants provided:
- AOI specify the corporation’s primary and secondary purposes which need not be related to each other
- Corporation for which special provisions are made can only have the purpose peculiar to them
- Purposes must be lawful
- If purpose is lawful, SEC is not authorized to inquire whether corporation has hidden motives and mandamus will lie to compel it to issue certificate
- PD 902-A, Sec 6(h) gives SEC, after consultation with BOI, NEDA, or other appropriate government agency, the power to refuse or deny the application for registration of any corporation if its establishment, organization, operation, will not be consistent with the declared national economic policies
- A corporation may not be formed for the purpose of practicing a profession

3. PRINCIPAL OFFICE
- Must be within the Philippines (§14 (3))
- AOI must specify both province or city or town where it is located
- Important in (1) determining venue in an action by or against the corporation (2) determining the province where a chattel mortgage of shares should be registered (Chua Gan v Samahang Magasakasa)
- The statement of the principal office establishes the residence of the corporation

4. TERM OF EXISTENCE
- When a corporation is organized, the maximum life that can be stipulated in the AOI is 50 years. But during the life of the corporation, the life or term can be extended to another 50 years at any one instance (§11)
- But such extension of the life of a corporation cannot be made earlier than 5 years before the end of its original term. Exception: where there are justifiable reasons for an earlier extension as may be determined by the SEC. (Ibid)
- Exception: Condominium corporations can be organized for a period of 200 years
- Extension involves an amendment of the AOI. Thus, the requisites under §16 must be complied with. Any dissenting stockholder may exercise his appraisal right (§37).

5. INCORPORATORS AND DIRECTORS; NUMBER AND QUALIFICATIONS
- “Directors” is used for stock corporations, while “trustees” is used for stock corporations.
- GENERAL RULE: not less than 5 but not more than 15

EXCEPTIONS:
i) Non-stock corporations – articles or by-laws may provide for more than 15 trustees (§92).
   - Exception: Educational non-stock corporations – trustees may not exceed 15. However, the number of trustees shall be in multiples of 5 (§108)

ii) Merger of banks – new board is allowed to have such number of directors as is equivalent to the total number of directors of the merging banks, though it may exceed fifteen (General Banking Act, as amended).

- Incorporators and directors of a stock corporation must own at least one share of stock of the corporation. In a non-stock corporation, a trustee must be a member thereof.

- In incorporations, aliens may be directors of a corporation only in such number as may be proportional to their allowable ownership of shares, e.g. if the articles provide for 10 directors, and alien ownership is limited to 40% of the capital, then aliens may occupy a maximum of 4 board seats.

6. CAPITAL STOCK; SUBSCRIPTION; PAYMENT

Capital stock

- Capital stock is the amount fixed in the AOI, to be subscribed and paid in or secured to be paid in by the shareholders of a corporation, either in money or property, labor or services, at the organization of the corporation or afterwards and upon which is to conduct its operation. (Fletcher)

- The capital stock limits the maximum amount or number of shares that may be issued by the corporation without formal amendment of the AOI. It remains the same even though the actual value of the shares as determined by the assets of the corporation is diminished or increased.

Authorized capital stock

- ACS is synonymous with capital stock where the shares of the corporation have par value. If the shares of stock have no par value, the corporation has no ACS, but it has capital stock the amount of which is not specified in the AOI and cannot be determined until all the shares have been issued. In this case, the two terms are not synonymous (De Leon)

- State the authorized capital stock in lawful money of the Philippines, the number of shares into which the ACS is divided, and the par value of each par value shares (§14(8), §15(7))

- Stock corporations are not required to have any minimum authorized capital stock except when special laws provide otherwise (§12)

Subscribed capital stock

- It is the amount of the capital stock subscribed whether fully paid or not. It connotes an original subscription contract for the acquisition by a subscriber of unissued shares in a corporation (§60.61)

- At least 25% of authorized capital stock must be subscribed (§13)

- Subscription – mutual agreement of the subscribers to take and pay for the stock of a corporation

- Pre-incorporation subscription – amount which each incorporator or shareholder agrees to contribute to a proposed corporation

Outstanding capital stock

- It is the portion of the capital stock which is issued and held by persons other than the corporation itself. Under §137, it is the total shares of stock issued under the binding subscription agreements to subscribers or stockholders, whether or not fully or partially paid, except treasury shares. It is thus broader than “subscribed” capital stock

- The terms “subscribed capital stock” and “issued” or “outstanding” capital stock are used synonymously since subscribed capital stock, as distinguished from the certificate of stock, can be issued even if not fully paid. But while every subscribed share (assuming there is a binding subscription agreement) is an outstanding share, an issued share may not have the status of outstanding share (as in the case of treasury shares)

Paid-up capital

- 25% of subscribed capital stock must be paid-up for the purpose of incorporation, but in no case shall be less than P 5 000 (§13)

- Portion of the authorized capital stock which has been subscribed and paid. Not all funds or assets received by the corporation can be considered paid-up capital, for this term has a technical signification in corporation law. Such must from part of the authorized capital stock of the corporation, subscribed and then actually paid-up. [MSCI-NACUSIP Local Chapter v. National Wages and Productivity Commission]

- Must be in the form of (a) cash deposited in a bank or (b) property which may be used or actually needed by the corporation in its operations

- Capital can’t consist or be invested in money market placement

- Corporations with more stringent capital requirements:
  - Insurance corporations – must have paid-up capital stock of at least P 5 M (Insurance Code, Sec 188)
  - Banks – monetary board fixes minimum paid-up capital requirements for the different classes of banks (Central Bank Act and General Banking Act).
Unissued capital stock
- It is that portion of the capital stock that is not issued or subscribed. It does not vote and draws no dividends.

Legal capital
- It is the amount equal to the aggregate par value and/or issued value of the outstanding capital stock. When par value shares are issued above par, the premium or excess is not to be considered as part of the legal capital. (Cf§43.) In the case of no par value shares, the entire consideration received forms part of legal capital and shall not be available for distribution of dividends (§6, par 3).

Capital
- It is used broadly to indicate the entire property or assets of the corporation. It includes the amount invested by the stockholders plus the undistributed earnings less losses and expenses.
- In the strict sense, it refers to that portion of the net assets paid by the stockholders as consideration for the shares issued to them, which is utilized for the prosecution of the business of the corporation (De Leon).

7. TREASURER-IN TRUST
   The person elected by the subscribers as Treasurer of the corporation at the time of the incorporation who is named as such in the AOI and who has been authorized to receive for and in the name and for the benefit of the corporation, all subscriptions, fees, contributions or donations paid or given by the subscribers or members.

8. TREASURER’S AFFIDAVIT
   The sworn statement of the Treasurer elected by the subscribers stating at least 25% of the authorized capital stock of the corporation has been subscribed and that at least 25% of the total subscription has been fully paid to him in actual cash and/or property, the fair valuation of which is equal to at least 25% of the said subscription, such paid-up capital being not less than 5,000.00 (§14).

9. OTHER MATTERS
   - Classes of shares, as well as the preferences or restrictions on any such class (§6)
   - Denial or restriction of pre-emptive right (§39)
   - Prohibition against transfer of stock which would reduce stock ownership to less than the required minimum in the case of a nationalized business or activity (§15(11))

3.3. FILING OF ARTICLES AND PAYMENT OF FEES

- Corporations governed by special laws have to submit a recommendation from the appropriate government agency to the effect that such articles are in accordance with law.

3.4 EXAMINATION OF ARTICLES BY SEC: APPROVAL OR REJECTION

- The SEC may reject any AOI thereto if the same is not in compliance with the requirements of this Code (§17).
- The SEC shall give the incorporators a reasonable time within which to correct or modify the objectionable portions of the articles or amendment. (§17)

4. Grounds for disapproving articles of incorporation (§17)

- AOI does not substantially the form prescribed
- Purpose is patently unconstitutional, illegal, immoral, contrary to government rules and regulations
- Treasurer’s Affidavit concerning the amount of capital subscribed and paid is false
- Percentage requirement of ownership of Filipino citizens as required by the Constitution not complied with.
- After consulting with BOI, NEDA, appropriate government agency, SEC may deny registration of any corporation if its establishment will not be consistent with declared national policies.
- Certificate of authority required of the following:
  - Insurance Companies- Insurance Commissioner
  - Banks, Building and Loan Associations, Finance Companies-Monetary Board
  - Educational Institutions- Secretary of Education
  - Public Utilities- Board of Power, Board of Transportation, National
Telecommunication Commission, etc.

- Remedy in case of rejection of AOI: by petition for review in accordance with the Rules of Court (§6, last par., PD 902-A)

ISSUANCE OF CERTIFICATE OF INCORPORATION

- A private corporation formed or organized under this Code commences to have corporate existence and juridical personality and is deemed incorporated from the date the Securities and Exchange Commission issues a certificate of incorporation under its official seal (§19)
- Thereupon the incorporators, stockholders/members and their successors shall constitute a body politic and corporate under the name stated in the articles of incorporation for the period of time mentioned therein, unless said period is extended or the corporation is sooner dissolved in accordance with law. (Ibid)
- If incorporators are found guilty of fraud in procuring Certificate of Incorporation, SEC may revoke the same after proper notice and hearing (§6(I), PD 902-A)

S. Defective Attempts to Incorporate

5.1 DE FACTO CORPORATIONS — a corporation where there exists a flaw in its incorporation

Requisites of a de facto corporation (Ballantine as cited in Campos)

a) Valid statute — there is an apparently valid statute under which the corporation with its purposes may be formed. There can be no de facto corporation under a statute subsequently declared unconstitutional

Municipality of Malabang vs. Benito (1969)

The municipality of Balabagan was created by EO 386 of President Garcia out of barrios and sitios of Malabang. The petitioners seek to nullify the EO. They rely on the Pelaez ruling that the President’s power to create municipalities under Sec. 68 of the Administrative Code is unconstitutional. Respondents argue that the Pelaez ruling is inapplicable because Balabagan is a de facto corporation.

HELD: The Municipality of Balabagan was not a de facto corporation. The color of authority requisite to a de facto municipal corporation may be an unconstitutional law, valid on its face, which has either:

- Been upheld for a time by the courts; or
- Not yet been declared void; provided that a warrant for its creation can be found in some other valid law or in the recognition of its potential existence in the general constitution of the state.

The mere fact that Balabagan was organized before the statute was invalidated cannot make it a de facto corporation because, independently of the Administrative Code, there is no other valid statute to give color of authority to its creation. This doesn’t mean that the acts done by Balabagan in the exercise of its corporate powers are a nullity. The existence of EO 386 is an “operative fact which cannot be justly ignored.”

b) User of corporate powers — there has been some user of corporate powers, the transaction of business in some way as if it were a corporation

- not necessary that dealings between the parties should have been on a corporate basis
- election of directors and officers would not be user of corporate powers since these acts are just indicative of a mere association
- taking subscriptions to and issuing shares of stock, buying , lot, constructing, and leasing a building on it will constitute sufficient user of corporate powers to constitute a de facto corporation

c) Substantial or Colorable compliance — there has been colorable compliance with legal requirements in GOOD FAITH

- while the corporation is still in the process of incorporation, it is quite clear that there can be no substantial or colorable compliance and therefore it cannot be at such a stage a de facto corporation

A corporation which has not yet been issued a certificate of incorporation cannot claim “in good faith” to be a corporation. Thus, it cannot be a de facto corporation [Hall v. Piccio 86 Phil 603]

- Compliance with the above conditions would make the corporation de facto whose incorporation cannot be attacked collaterally. It may only be attacked directly by the State in a quo warranto proceeding (§20)
- De facto doctrine grew out of the necessity to promote the security of business transactions and to eliminate quibbling over irregularities
- The de facto doctrine is the exception to the general rule that when there is no corp entity to talk about, it is the natural persons who are liable

Where corporations are neither de jure or de facto, associates may be held liable as partners unless estoppel applies (§ 21)

No articles and no by-laws: no de facto corp. There’s no colorable compliance at all

De facto corp is like a de jure corp, has all the powers and liabilities of de facto corp

THE ONLY DIFF: its incorporation can be attacked by State in quo warranto action

Ratio: Only State can give it legal existence, so only the State is wronged

5.2 CORPORATION BY ESTOPPEL

- It is a status acquired by persons who assume to act as a corporation knowing it to be without authority. Such persons shall be liable as general partners for all debts, liabilities and damages incurred or arising as a result thereof. (§21)
When such an ostensible corporation is sued on any transaction entered by it as a corporation or any tort committed by it as such, it shall not be allowed to use as a defense as lack of corporate personality (§21).

One who assumes the obligation to an ostensible corporation as such, cannot resist performance thereof on the ground that there was in fact no corporation (§21).

Note that an unincorporated corporation is not barred from transacting business before the commencement of corporate existence. Limit: personal liability. Complication: when the corporation did not come about.

Against whom will estoppel lie? Who committed the active misrepresentation?

Where a person convinces other parties to invest money for the formation of a corporation, but which has never duly incorporated, there can be no resulting partnership among them, and the mere passive investors cannot be held liable to share in the losses suffered by the business enterprise (Pioneer Surety v CA, 1989)

When applicable:
1. Persons assuming to act as corp are liable as gen partners;
2. 3rd party who had dealt with an unincorporated association as a corp may be precluded from denying its corporate existence on a suit brought by the alleged corp – person deemed to have admitted the existence of the corp;
3. alleged corp that has entered into a contract by virtue of which it has received advantages and benefits.

However, if business associates fraudulently misrepresented the existence of a corp, 3rd party can sue them as gen partners. 3rd party is not estopped from asserting their liability because he had recognized the corporation’s existence. Ratio: They cannot profit by their own misrepresentation.

Hence, if associates did not know of the defective incrop, they can’t be personally held liable by innocent 3rd party (Cf. Salvaierra v Garlitos, 1958)

But if 3rd party knew of defects of corp, he is estopped from recovering from individual associates, but must recover only from corp assets.

6. Internal Organization of the Corporation

6.1 APPROVAL OF BY-LAWS

1. Definition of by-laws
   - These are regulations, ordinances, rules or laws adopted by an association or corporation or the like for its internal governance. By-laws define the rights and obligations of various officers, persons or groups within the corporate structure and provide rules for routine matters such as calling meetings.
   - Every corporation under this code shall have the power and capacity: to adopt by-laws not contrary to law, morals, or public policy, and to amend or repeal the same in accordance with this code (§36 (5))
   - These are subordinate to the AOI, Corp Code, and other statutes. (Fleischer vs. Nolasco(1925))

2. When to adopt by-laws (§46)
   - Every corporation formed under this code must within 1 month after receipt of official notice of the issuance of its certificate of incorporation by the SEC adopt a code of by-laws for its government not inconsistent with this code.
   - May be adopted and filed prior to incorporation, in such case, shall be approved and signed by all.

Lozano vs. delos Santos (1997)

This case involved two incorporated drivers’ associations that decided to unite and elect one set of officers to be given authority to collect the daily dues of the drivers who are members of the consolidated association.

HELD: Doctrine of estoppel applies when persons assume to form a corporation and exercise corporate functions and enter into business relations with third persons. Where there are no third persons involved and the conflict arises only among those assuming to form a corporation, who therefore know that it has not been registered, there is no corporation by estoppel.

International Express Travel v. CA (2000)

The doctrine of corporation by estoppel may apply to:
- a third party - a 3rd party who had dealt with an unincorporated association as a corporation may be precluded from denying its corporate existence on a suit brought by the alleged corporation on the contract even if he did not know of the defective incorporation. 3rd party is considered to have admitted the existence of a corporation by the fact that he dealt with it as a corporation.
- the alleged corporation - when a third person has entered into a contract with an association which represented itself to be a corporation, the association is estopped from denying its corporate capacity in a suit against it by such 3rd person. It cannot allege lack of personality to be sued to evade responsibility on a contract it has entered into and by virtue of which it has received advantages and benefits.
- associates as partners - when business associates fraudulently misrepresented the existence of a corporation and the 3rd party contacts with the association as a corporation without knowing the serious defects in its incorporation, such 3rd party may sue associates as general partners. Where both the associates and the 3rd party were ignorant of the defective incorporation, 3rd party cant hold the associates liable since they were in good faith. If 3rd party knew of defects in incorporation and still dealt with the corporation, he must be deemed to have chosen to deal with the corporation as such and should be limited in his recovery to the corporate assets.
incorporators submitted to SEC together with AOI

Failure to file By-laws on time:

Loyola Grand Villas Homeowners Assn v. CA (1997)

The Supreme Court held that although the Corporation Code requires the filing of by-laws within one month after the issuance of the Certificate of Incorporation, it does not expressly provide for the consequences of non-filing within the said period. Failure to file the by-laws within that period does not imply the "demise" of the corporation. By-laws may be required by law for an orderly governance and management of corporations but they are not essential to corporate birth. Therefore, failure to file them within the period required by law by no means tolls the automatic dissolution of a corporation.

3. How filed (§46)
   • Must be approved by the affirmative vote of the stockholders representing the majority of the outstanding capital stock or majority of members (if filed prior to incorporation, must be approved and signed by all incorporators)
   • Must be signed by the stockholders or members voting for it
   • Must be filed with the SEC certified by the majority of directors/trustees and countersigned by the secretary of the corporation which shall be attached to original AOI

4. Where kept (§46)
   • Must be kept in the principal office of the corporation; subject to inspection of stockholder or member during office hours (CF §74)

5. Effectivity of by-laws
   • In all cases, the by-laws shall be effective only from the issuance of SEC of certification that bylaws are not inconsistent with the Code
   • Cannot bind stockholders or corporation pending approval
   • By-laws or any amendment thereto of any bank, banking institution, building and loan association, trust company, insurance company, public utility, educational institution or other special corporations governed by special laws must be accompanied by a certificate of the appropriate gov't agency to the effect that such by-laws are in accordance with law
   • By-laws, like AOI are contracts of adhesion. They will bind the corporation and stockholders including those who vote against as well as those who became members after approval
   • Contracts entered into without strict compliance with by-laws, may be binding on the corporation due to long acquiescence and usage (Board of Liquidators vs. Kalaw (1967))

• By-laws are mere internal rules among stockholders and cannot affect or prejudice 3rd persons who deal with the corporation unless they have knowledge of the same (China Banking Corp v CA, 1997)

6. Contents (§47)
   • Subject to the provisions of the Constitution, this Code, other special laws, and the articles of incorporation, a private corporation may provide in its by-laws for:
     a) The time, place and manner of calling and conducting regular or special meetings of the directors or trustees;
     b) The time and manner of calling and conducting regular or special meetings of the stockholders or members;
     c) The required quorum in meetings of stockholders or members and the manner of voting therein;
     d) The form for proxies of stockholders and members and the manner of voting them; By laws may not prohibit the use of proxies; Peoples' Home Savings Bank vs. Superior Court, cited in Campos
     e) The qualifications, duties and compensation of directors or trustees, officers and employees;
     f) The time for holding the annual election of directors of trustees and the mode or manner of giving notice thereof;
     g) The manner of election or appointment and the term of office of all officers other than directors or trustees;
     h) The penalties for violation of the by-laws;
     i) In the case of stock corporations, the manner of issuing stock certificates; and
     j) Such other matters as may be necessary for the proper or convenient transaction of its corporate business and affairs.
   • The contents may be subdivided into two major headings:
     a) Management and control of the corporate entity; and
     b) Rights and obligations of stockholders

7. Amendment or repeal (§48)
   • Majority vote of the members of the Board and majority vote of the outstanding capital stock or majority of members, in a meeting duly called for the purpose; or
   • 2/3 of the outstanding capital stock or members may delegate to the BOD the power to amend or repeal any by-laws or adopt new by-laws (such power may be revoked by majority vote only)
   • In all other respects, the procedure for adopting the original by-laws shall be the same in amending or repealing by-laws or adoption of a new set of by-laws
6.2 ELECTION OF DIRECTORS – discussed in Chapter VII

6.3 COMMENCEMENT OF BUSINESS

7. Effects of non-use of charter/continuous inoperation (§ 22)

1. Non-user for 2 years (non-use of charter)- when the corporation does not formally organize and commence the transaction of its business or the construction of its works within 2 years from the date of its incorporation, its corporate powers cease and the corporation shall be deemed dissolved (automatic)
   • Formal organization – may consist in the election of new board of directors or trustees and corporate officer
   • Commencement of business – may take the form of contracting for lease or sale of properties to be used as business site of the corporation and other preparatory acts geared towards fulfillment of the purpose for which the corporation was established

2. Non-user for 5 years (continuous inoperation)- when the corporation has commenced the transaction of its business but subsequently becomes continuously inoperative for a period of at least 5 years. The same shall be a ground for the suspension or revocation of its corporate franchise or Certificate of Incorporation (not automatic). Notice and hearing before SEC is required.

3. Exception: cause or non-use or operation was due to causes beyond the control of the corporation as determined by SEC (ex. Mineral lands to be developed by the corporation as per its purpose are the object of court litigation and a court injunction against the corporate activities has been issued)

ANNUAL FINANCIAL STATEMENTS – filed with SEC annually (SEC Rule, Nov. 20, 1980)

Chapter IV

THE CORPORATE ENTITY

1. Doctrine of separate juridical personality

- A corporation has a personality separate and distinct from that of its stockholders and members and is not affected by the personal rights, obligations, and transactions of the latter. Since corporate property is owned by the corporation as a juridical person, the stockholders have no claim on it as owners, but have merely an expectancy or inchoate right to the same should any of it remain upon dissolution of the corporation after all corporate creditors have been paid. Such right is limited only to their equity interest (doctrine of limited liability).
- Although stockholder’s interest in the corp may be attached by his personal creditor, corp property cannot be used to satisfy his claim (Wise & Co. vs. Man Sun Lung, 1940)
- General Rule: Separate personality is vested to a corporate entity when it is issued the certificate of incorporation by the SEC. The exceptions are:
  a. de facto corporation
  b. corporation by estoppel
- As a separate juridical personality, a corporation can be held liable for torts committed by its officers for corporate purpose (PNB v CA, 1978)
- It can’t be held criminally liable for a crime committed by its officers (People v Tan Boon Kong, 1930)
- Corporate entities are entitled to the following constitutional rights: due process, equal protection, and protection against unreasonable searches and seizures. However, a corp is not entitled to the privilege against self-incrimination (Bataan Shipyard & Eng’g Co. v PCGG, 1987)
- A corporation is not entitled to moral damages (LBC Express, Inc v CA)
- Juridical personality of the corporation ends when liquidation ends (payment of debts and distribution of assets) and inchoate rights or expectancies of stockholders are realized. Until such conveyance is made, title over the assets remains with the corporation.

2. Piercing the veil of corporate fiction

2.1 Nature of the piercing doctrine

- Piercing the veil of corporate entity requires the court to see through the protective shroud which exempts its stockholders from liabilities that ordinarily they could be subject to, or distinguishes one corporation from a seemingly separate one, were it not for the existing corporate fiction [Lim v. CA, 2000]. But to do this, the court must be sure that the corporate fiction was misused, to such an extent that injustice, fraud or crime was committed upon another, disregarding, their, his, her or its
rights. It is the protection of the interests of innocent third persons dealing with the corporate entity which the law seeks to protect by this doctrine. [Traders Royal Bank v. CA, 1997]

- Whether the existence of the corporation should be pierced depends on questions of facts, appropriately pleaded. Mere allegation that a corporation is the alter ego of the individual stockholders is insufficient. The presumption is that the stockholders or officers are distinct entities. The burden of proving otherwise is on the party seeking to have the court pierce the veil of corporate entity. [Ramoso v. VA, 2000]

- Piercing the veil of corporate entity is merely an equitable remedy, and may be awarded only in cases when the corporate fiction is used to defeat public convenience, justify wrong, protect fraud or defend crime or where the corporation is a mere alter ego or business conduit of a person.

- When it comes to applying the doctrine, the first point to consider is the liability of obligation of the individual (the one who is being sought to be liable). Without such liability, everything would have been in compliance with statutes (U.S vs. Milwaukee, 1905; Umali vs. CA, 1990).

- In case of wholly-owned corporations, corporations with common stockholders, or corporations having a parent-subsidiary relationship, the following are the “inevitable consequences”:
  a) Control and management of the corporation;
  b) Interlocking directors;
  c) Common access to the use of resources, services, and 3rd-party providers; and
  d) Intra-corporate dealings.

In the above consequences, there is no necessity for applying the doctrine of piercing the corporate veil unless there is a particular act by the corporation, stockholder, or BOD that gives rise to a liability. If there’s a liability to speak of, such consequences may be considered as a means of evading such thus the need for the piercing.

- In applying the doctrine, determine:
  1. the rights and obligations of the parties.
  2. the possibility of non-enforcement of such rights and obligations because of the shield or veil.
  3. look into the circumstances and underlying purpose of putting up the corporation

2.3 Illustrative Cases where piercing the veil is allowed

- If done to defraud the government of taxes due it
- If done to evade payment of civil liability
- If done by a corporation which is merely a conduit or alter ego of another corporation
- If done to evade compliance with contractual obligations
- If done to evade financial obligation to its employees

2.4 Parent-subsidiary relationship

- The mere fact that a corporation owns all or substantially all of the stocks of another corporation is not sufficient to justify their being treated as one entity. If used to perform legitimate functions, the subsidiary’s separate existence may be respected. However, to prevent abuses of the separate entity privilege, the court will pierce the veil of corporate entity and regard the two corporations as one.

- Circumstances which if present in the proper combination renders the subsidiary an instrumentality:
  a) The parent corporation owns all or most of the subsidiary’s capital stock
  b) The parent and subsidiary corporations have common directors or officers
  c) The parent corporation finances the subsidiary
  d) The parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation
  e) The subsidiary has grossly inadequate capital
  f) The parent corporation pays the salaries and other expenses or losses of the subsidiary
  g) The subsidiary has substantially no business except with parent corporation or no assets except those conveyed to or by the parent corporation
  h) In the papers of the parent corporation or in the statements of its officers, the subsidiary is described as a department or division of the parent corporation or its business or financial responsibility is referred to as the parent corporation’s own
  i) The parent corporation uses the property of the subsidiary as its own
  j) The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter’s interest
  k) The formal ledger requirements of the subsidiary are not observed (PNB v Ritratto Group, 2001).

- The subsidiary cannot be considered a mere instrumentality of the parent corporation just by the combination of the 11 signs listed above. For the veil of corporate entity of the subsidiary to be pierced so that it is considered just an instrumentality, the act questioned must have an illegal or unfair purpose which
results to prejudice to third persons who may seek redress from the corporate entity

De Leon vs. NLRC (2001)

FACTS: FISI contracted with FTC for security services. Subsequently, the stockholders of FISI sold all their participation in the corporation to a new set of stockholders which renamed the corporation MISI. Afterwards, FTC preterminated its contract of security services with MISI causing petitioner security guards to lose their employment and file ULP case against FTC, FISI and MISI.

HELD: There was ER-EE relationship between FTC and petitioners. It was shown that FISI was a mere adjunct of FTC. Records show that FISI and FTC have the same owners and business address, and FISI provided security services only to FTC. The purported sale of the shares of the former stockholders to a new set of stockholders who changed the name of the corporation to Misi appears to be part of a scheme to terminate the services of FISI's security guards posted at the premises of FTC and bust their newly-organized union which was then beginning to become active in demanding the company's compliance with Labor Standards laws. Under these circumstances, the Court cannot allow FTC to use its separate corporate personality to shield itself from liability for illegal acts committed against its employees.

Francisco vs. Mejia (2001)

With specific regard to corporate officers, the general rule is that the officer cannot be held personally liable with the corporation, whether civilly or otherwise, for the consequences of his acts, if he acted for and in behalf of the corporation, within the scope of his authority and in good faith. In such cases, the officer's acts are properly attributed to the corporation. However, if it is proven that the officer has used the corporate fiction to defraud a third party, or that he has acted negligently, maliciously or in bad faith, then the corporate veil shall be lifted and he shall be held personally liable for the particular corporate obligation involved.

3. Nationality of the Corporation

3.1 The place of incorporation test.

- The corporation is a national of the country under whose laws it is organized or incorporated (§123):
  - Domestic corporations – organized and governed under and by Philippine laws
  - Foreign corporations – organized under laws other than those of the Philippines and can operate only in the territory of the state under whose laws it was formed. However, they may be licensed to do business here.

3.2 Nationality of the Corporation as determined by the "Control Test"

- Exploitation of Natural Resources - Section 2, Art. XII CONST. “only Filipino Citizens or Corporations whose capital stock are at least 60% owed by Filipinos can qualify to exploit natural resources.”

- Public Utilities - Sec. 11, Art XII, CONST. “xxx no franchise, certificate or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least 60% of whose capital is owned by such citizens.”

- War-time Test - If the controlling stockholders are enemies, then the nationality of the corporation will be base on the citizenship of the majority stockholders in times of war (Filipinas Compania de Seguros v Christian Huenfeld, 1951).

- Investment Test - Sec. 3(a) and (b), Foreign Investments Act of 1991 (RA7042). It considers for purpose of investment a “Philippine National” as a corporation organized under the laws of the Philippines of which at least 60% of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines, or a trustee of the funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least 60% of the fund will accrue to the benefit of Philippine nationals.

3.3 Grandfather rule

Used to determine the nationality of a corporation by which the percentage of Filipino equity in corporations engaged in nationalized and/or partly nationalized areas of activities, provided for under the constitution and other nationalization laws, is computed, in cases where corporate shareholders are present in the situation, by attributing the nationality of the second or even subsequent tier of ownership to determine the nationality of the corporate stockholder. (Villanueva, 2003)

- SEC formula: SEC Letter Opinion
  “Shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership is less than 60% only the number of shares corresponding to such percentage shall be considered as of Philippine nationality.”
Chapter V
PROMOTERS’ CONTRACTS PRIOR TO INCORPORATION

1. Functions of Promoters

- Organize and establish corporation
- Solicit or pool capital contributions
- Exercise/identify/consummate opportunities
- Make available capital contributions/investments (underwrite)
- Manage/control
- Note: may be done prior or after incorporation. Complications arise if performed prior to incorporation. For whom was the promoter acting in behalf of? (no juridical entity yet)

2. What are Promoter’s Contracts?

- Contracts prior to existence of corporation thus the corporation could not have been a party to it.
- However, the corporation may make the contracts its own and may become bound on such contracts if after incorporation, it adopts or ratifies the same, or accepts its benefits with knowledge of the terms thereof.
- Adoption or ratification need not be by express resolution of the board and may be implied from the acts of responsible officers of the corporation.

3. Liability of Corporation for Promoter’s Contracts

Rules on the liability of the corp. on promoters’ contracts:

3.1 General Rule
Corp. is not bound by the contract – Since the corp. did not yet exist at the time of the contract, it could not have had an agent who could legally bind it.

3.2 Exception:
Corp. may be bound by the contract if it makes the contract its own: How?
- Adoption or ratification
  - By express resolution
  - Implied from the acts of responsible officers of the corp.
  * The corp. cannot adopt only the part of the contract which may be beneficial to it & then discard the part that is burdensome.
  * The contract to be capable of adoption or ratification, must be one within the powers of the corp. to enter.
- Acceptance of benefits under the contract with knowledge of the terms thereof.

4. Personal Liability of Promoter on Pre-Incorporation Contracts

There are three possible situations intended by the promoter and the other party in pre-incorp. contracts:

1. Promoter takes a continuing OFFER on behalf of the corp, which if accepted by the corp. becomes a contract \( \Rightarrow \) Promoter does not assume any personal liability, whether or not the offer is accepted by the corp.
2. Promoter makes a contract at the time binding himself with the UNDERSTANDING that if the corp., once formed, accepts or adopts the contract, the promoter will be relieved of all responsibilities
3. Promoter binds himself PERSONALLY & assumes the responsibility of looking to the proposed corp. for reimbursement

In the absence of any express or implied agreement to the contrary, the 3rd situation will be presumed and the promoter will be considered personally liable for the contracts. Thus, the corp.’s adoption or ratification of the contract will not release the promoter from personal liability unless a novation was intended. (Wells vs. Fay & Egan Co., 143 Ga. 732, 87 S.E 873, 1915) Exception: Quaker v Hill case. In this case, Quaker looked to the unincorporated entity when making a contract. Thus, the promoter was not liable. (Quaker Hill Inc. vs. Parr, 148 Colo. 45, 364 P. 2d 1056, 1961)

5. Compensation of Promoters

Gen rule – the corporation is not liable to pay compensation because this would be an imposition on innocent investors. (Ballantine)

Exceptions:
- if after it is formed, corporation expressly promises to do so (Ballantine; Indianapolis Blue Print & Manufacturing Co. v. Kennedy et. al., 215 Ind. 409, 19 N.E 2d 554, 1939)
- Services done partly before and partly after incorporation and the corporation takes the benefits thereof

The Corp. Code does not contain any provision as to the compensation of promoters. But the Securities Act authorizes a promotion fee IF it is provided for in the registration statement of the securities involved.

6. Fiduciary Relationship between Corporation & Promoter

The promoters, being responsible for the financing & organization of the corp., are under duty to exercise good faith & fairness in all their acts & transactions.

Example: Promoters often have to take options or title to property in their name but for the benefit of the corp. In such cases, they should not make secret profits in passing title to the corp. If they do, they would have to account for all such profits to the corp. when formed. (Old Dominion Mining and Smelting Corp., 203 Mass. 159, 89 N.E 193, 1909)
Chapter VI
CORPORATE POWERS

1. General powers of corporations
(§36)

a. To sue and be sued in its corporate name;
b. Succession by its corporate name for the period of
time stated in the articles of incorporation and
the certificate of incorporation;
c. To adopt and use a corporate seal;
d. To amend its articles of incorporation in
accordance with the provisions of this Code;
e. To adopt by-laws, not contrary to law, morals,
or public policy, and to amend or repeal the
same in accordance with this Code;
f. In case of stock corporations, to issue or sell
stocks to subscribers and to sell stocks to
subscribers and to sell treasury stocks in
accordance with the provisions of this Code;
and to admit members to the corporation if it
be a non-stock corporation;
g. To purchase, receive, take or grant, hold,
convey, sell, lease, pledge, mortgage and
otherwise deal with such real and personal
property, including securities and bonds of
other corporations, as the transaction of the
lawful business of the corporation may
reasonably and necessarily require, subject to
the limitations prescribed by law and the
Constitution;
h. To enter into merger or consolidation with
other corporations as provided in this Code;
i. To make reasonable donations, including those
for the public welfare or for hospital, charitable,
cultural, scientific, civic, or similar purposes:
Provided, That no corporation, domestic or
foreign, shall give donations in aid of any
political party or candidate or for purposes of
partisan political activity;
j. To establish pension, retirement, and other
plans for the benefit of its directors, trustees,
officers and employees; and
k. To exercise such other powers as may be
essential or necessary to carry out its purpose
or purposes as stated in the articles of
incorporation. (in the purpose clause)

• Sources of express power (Villanueva)
  o Section 36 (Corp Code and other applicable
    statutes)
  o Purpose clause (AOI, supplemented by by-
    laws)

• Sec 38 par 11 grants such power as are
  essential or necessary to carry out its purpose
  or purposes as stated in the AOI. A corporation
  is presumed to act within its powers and when
  a contract is not on its face necessarily beyond
  its authority, it will, in the absence of proof to
  the contrary, presumed valid

• The general powers are to be exercised by the
  BOD. However, the power to amend AOI is to
  be exercised by the stockholders or members

• 2 general restrictions on the power of the
corporation to acquire and hold properties:
  o that the property must be reasonably and
    necessarily required by the transactions of
    its lawful business
  o that the power shall be subject to the
    limitations prescribed by other special laws
    and the constitution (corporation may not
    acquire more than 30% of voting stocks of
    a bank; corporations are restricted from
    acquiring public lands except by lease of
    not more than 1000 hectares)

2. Specific Powers - TCB PDA IDM
(DIP CAB MDT)

• Extend or shorten the corporate Term (§37)
• Increase or decrease Capital stock (§38)
• Incur, create or increase Bonded indebtedness
  (§38)
• Deny Preemptive right (§39)
• Sell or otherwise Dispose of substantially all its
  assets
• Acquire its own shares (§41)
• Invest in another corporation or business (§42)
• Declare dividends (§43)
• Enter into Management contracts (§44)

3. Implied Powers

These implied powers are deemed to exist because of
the following provisions:
1. except such as are necessary or incidental to
   the exercise of the powers so conferred (§36)
2. such powers as are essential or necessary to
   carry out its purpose or purposes as stated in
   the AOI - catch-all phrase (§45)

Remember: (Coleman vs. Hotel de France Co., 29
Phil. 323, 1915)
1. A corporation is presumed to act within its
   powers.
2. When a contract, entered into by the
   corporation, is not on its face necessarily
   beyond its authority, it will be presumed valid.

4. The Ultra Vires
Doctrine (§45)

Definition – These are acts which a corporation is
not empowered to do or perform because they are
not based on the powers conferred by its AOI or
by the Corporation Code on corporations in
general, or because they are not necessary or
incidental to the exercise of the powers so
conferred.

Rule – No Corporation under this Code shall
possess or exercise any corporate powers except
those conferred by this Code or by its articles of
incorporation and except such as are necessary or
incidental to the exercise of the powers so
conferred.

An ultra vires act, if not illegal, can be remedied
(by ratification)

Atrium v. CA (2001)

Atrium Management Corporation filed with
RTC an action for collection of the 4
postdated checks issued by the Hi-cement
Corporation, though its signatories de Leon,
treasurer, and delas Alas, chairman of the
corporation to a certain ET Henry, and Co,
which the latter endorsed to Atrium for
rediscing.

HELD: The act of issuing was well within the ambit of a valid corporate act, for it was for securing a loan to finance the activities of the corporation, hence, not an ultra vires act. An ultra vires act is distinguished from illegal act, the former being voidable which may be enforced by performance, ratification, or estoppel, while the latter is void and cannot be validated. SC however, held de Leon negligent.

**NAPOCOR v Vera (1989)**

NAPOCOR has a pier at its coal plant in Batangas. It did not renew its stevedoring contract at the plant, but instead, took over the services itself. RTC Judge issued preliminary injunction against NAPOCOR, saying that it was not empowered by its Charter to engage in stevedoring and arrastre services.

**Republic of the Philippines vs. Acoje Mining Co. (1963)**

Acoje Mining requested the Director of Posts to open a post office in its mining camp for the benefit of its employees and their families. In a resolution, Acoje agreed to be directly responsible for the "dishonesty, carelessness, or negligence of the employee it assigns". Acoje's employee, Sanchez, was designated as the postmaster but he later disappeared with 13K of post office funds. Acoje denied liability on the ground that the resolution was ultra vires-BOD had no authority to act on the matter.

HELD: The company is estopped from denying liability on the ground that the board resolution is ultra vires. Assuming arguendo that the resolution is an ultra vires act, the same is not void for it was approved not in contravention of law, customs, public order and public policy. The term ultra vires should be distinguished from an illegal act for the former is merely voidable which may be enforced while the latter is void and cannot be validated.

**Pirovano v De la Rama Steamship (1954)**

Stocks are owned by Don de la Rama, his 2 daughters, and their EEs with nominal shares. One of the daughters was married to the company president, Enrico Pirovano. While the business grew, the father distributed his stocks among his 5 daughters and his wife. NDC was also represented in the BoD because the corp had a debt to it. To secure the debt, all assets were mortgaged to NDC. Debt was later converted to stock, such that NDC now held 4 of 9 seats in BoD. Such conversion released the mortgaged assets.

Enrico Pirovano died, so the BOD passed a resolution converting insurance proceeds on his life to stocks for each of his minor children. Approved by SHs.

However, the other SHs realized that they would actually be donating 1.44 M. instead of the 400K they inteded (since the value of the stocks increased), and that Mrs. Pirovano would now have 2x voting power as her sisters.

BOD later changed donation into cash, but would be retained by the company as a loan, and the interest payable to the children, both amounts to be paid to the children after debt to NDC paid, and later, when company is in position to meet obligations. Mrs. Pirovano formally accepted the donation. BOD later approved release of some funds held in trust for Mrs. Pirovano to buy house in NY. SHs formally ratified the donation.

SEC later gave opinion that donation was void because it was beyond the scope of the corp's powers. SHs later voted to revoke the donation to the Pirovano children.

**General consequences of ultra vires acts**

1. On corporation itself-Corporation may be dissolved under a quo warranto proceeding but in most cases, the court merely enjoins the
corporation from commission of the ultra vires acts (Campos)

-Certificate of Registration may be suspended or revoked by SEC

2. On immediate parties- Parties to the ultra vires contract, if executory on both sides, neither party can ask for specific performance. Will be left as they are if the contract has been fully executed on both sides. If one party has performed his part, the contract will be enforced provided it is not illegal

- Contract proceeding from an ultra vires act is voidable (Republic v. Acoje Mining Co., GR L-18062, Feb. 28, 1963; 7 SCRA 361)

3. On the rights of stockholders- Any stockholder may bring either an individual or derivative suit to enjoin a threatened ultra vires act or contract. If act or contract has already been performed, a derivative suit for damages may be filed against the directors, but their liability will depend on whether they acted in good faith and with reasonable diligence in entering into contracts. When based on tort, cannot set-up the defense of ultra vires against injured party who had no knowledge that such was ultra vires

May become binding by the ratification of all stockholders unless third parties are prejudiced thereby or unless the acts are illegal (Pirovano v. de la Rama Steamship Co. 96 Phil. 335; 1954)

Chapter VII
CONTROL AND MANAGEMENT OF CORPORATIONS

1. Allocation of power and control (Campos)

3 levels of control in the corporate hierarchy:

1. the Board of Directors or Trustees
   - responsible for corporate policies and the general management of the business and affairs of the corporation
2. the Officers
   - in theory, execute the policies laid down by the board
   - in practice, often have wide latitude in determining the course of business operations
3. The stockholders or members
   - have residual power of fundamental corporate changes

NOTE: BOD can delegate its function to the officers and also to committees appointed by it (Executive Committee, § 35)

2. Who Exercises Corporate Powers

2.1 BOARD OF DIRECTORS

1) Authority: repository of corporate powers
   - The board of directors or trustees are responsible for corporate policies and general management of the business affairs of the corporation
   - Directors have a fiduciary duty to the corp and to the SHs
   - General Rule: once elected, SHs have no right to interfere with the BOD. Exceptions: removal of directors (§28), amendments of AOI (§16), fundamental changes (§6), declaration of stock dividends (§43), entering into management contracts (§44), fixing of compensation of directors (§30)
   - Unless otherwise provided in the Corp Code, the Board of Directors control and exercise:
     o the corporate powers of corporation
     o all business conducted,
     o all property of such corporation
   - The board exercises almost all corporate powers, lays down all business policies and is responsible for the efficiency of management. The stockholders have no right to interfere with the board’s exercise of its powers and functions except where the law expressly gives them the final say, in cases of removal of a director, amendment of articles of incorporation, and other major changes (Cf §6, 42, 43).
   - Limitations on the BOD’s authority or powers:
     1. Action by SHs in order to elect a BOD
     2. Certain act of the corp that require joint action of the SHs and BOD
   - Their resolutions on matters other than the exceptions are legally not effective nor binding and may be treated as merely advisory or may be totally disregarded. (Ramirez v. Orientalist Co. et. al., 38 Phil. 634; 1918); Wolfson v. Manila Stock Exchange, 72 Phil. 492; 1941)
   - “Unless Otherwise Provided” – may pertain to instances where a management contract is entered hence corporate powers are exercised by the managing company and not the board
   - Authority of BOD can be delegated to agents/officers/committees (AOI, statutes, by-laws, resolutions) (YU Chuck v Kong Li Po, 46 Phil 608). Delegation may be explicit, implicit, or based on exigencies of the business (cf. Board of Liquidators v Kalaw)
   - The BOD may delegate its corporate powers to either an executive committee or officials or contracted managers. The delegation, except for the executive committee, must be for specific purposes. The delegation makes the officers agents of the corporation. For such officers to be deemed fully clothed by the corporation to exercise a power of the BOD, the latter must specially authorize them to do so. (ABS-CBN Broadcasting Corp v CA, 1999)
   - The directors or trustees shall not act individually nor separately but as a
body in a lawful meeting. Contracts entered into without a formal board resolution does not bind the corporation except when majority of the board has knowledge of the contract and the contract benefited the corporation. (ratification)

- Directors owe their duties to corporation as a whole rather than to individual shareholders of classes of shareholders
- Business Judgment Rule
  - Sec 23 embodies the essence of the "business judgment rule," that unless otherwise provided in the Code, all corp powers and prerogatives are vested directly in the BOD. Consequently, the rule has two consequences:
  - The resolution, contracts and transactions of the BOD, cannot be overturned or set aside by the SHs or members and not even by the courts under the principle that the business of the corp has been left to the hands of the BOD; and
  - Directors and duly authorized officers cannot be held personally liable for acts or contracts done with the exercise of their business judgment.

Exceptions:
- When the Corp Code expressly provides otherwise;
- When the directors or officers acted with fraud, gross negligence or in bad faith; and
- When directors or officers act against the corp in conflict-of-interest situation

1) Requirements
- Qualifying share (§23) - Every director must own at least one (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 one (1) share of the capital stock of the corporation of which he is a director shall thereby cease to be a director.

**Lee vs. CA (1992)**

Summons was served upon Lee and Lacdao, president and vice president of ALFA. The two, however contended that they are no longer corporate officers of the corporation because of the voting trust agreement executed to DBP, hence, not authorized to receive summons. Summons must be served upon DBP

Held:
Execution of a voting trust creates a dichotomy between equitable or beneficial ownership of the corporate shares of a stockholder and legal title thereto. The change from the old code to the new code with respect to qualifying shares of directors is the omission of the phrase "in his own right" pertaining to beneficial ownership of shares. In the new corpo code, persons may be directors if they are stockholders although not "in their own right" hence includes trustees. There is clear indication that to be a director, what is material is legal title and not beneficial ownership. With the execution of the voting trust agreement, Lee and Lacdao were divested of their legal title to their shares hence can no longer be directors and are no longer corporate officers. Because of this, they are not authorized to receive summons

2) How elected (§24)
- Manner of election:
  - There must be present in person or by representative majority of the outstanding capital stock / member.
  - In any form; or must be by ballot when requested by any voting stock holder or member
  - Voting may be in person or by proxy
  - At all elections of directors or trustees, there must be present owners of a majority of the outstanding capital stock, or if there be no capital stock, a

- Requirements/Disqualifications:
  - Residence (§23) - a majority of the directors or trustees of all corporations organized under this Code must be residents of the Philippines
  - Nationality - no requirement for citizenship of a director or trustee so even an alien may be elected as such excepts in business activities totally closed to aliens
  - Disqualification of directors, trustees or officers (§27):
    - Convicted by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years, or
    - Violation of this Code committed within five (5) years prior to the date of his election or appointment
    - By-laws may provide for additional qualifications/disqualifications as long as such additions to the qualifications/disqualifications shall not modify requirements as prescribed in the corporation code or be in conflict with such prescribed requirements (§47(5))
  - Note: To sit on the BOD is not a vested right. Ownership of shares does not automatically equate to a seat in the BOD
  - In widely-held corporations, SEC mandates the presence of at least 2 or 20% of its board size, whichever is lesser, independent directors (Securities Regulation Code, §38 and Guidelines on the Nomination and Election of Independent Directors, Memo Circ No. 16, 2002)

- Term: Directors shall hold office for 1 year. However, incumbent directors shall continue to be directors/trustees until their successors have been elected and qualified (§23)
majority of the members entitled to vote.
- Every stockholder entitled to vote shall have the right to vote the number of shares of stock outstanding, at the time fixed in the by-laws, in his own name on the stock books of the corporation, or where the by-laws are silent, at the time of the election
- Time to determine voting right
  - As per share standing in one's name at the time fixed by the By-Laws
  - Where By-laws silent, at time of election
- Cumulative voting - A system of voting designed to increase the voting power of minority stockholders in the election of corporate directors when more than one director is to be elected.
  - A stockholder shall have as many votes as he has number of shares times the number of directors up for election
  - Cumulative voting is allowed for election of members of the Board in a stock corporation. Members of the Board in a Non-stock Corporation shall not be voted cumulatively unless specifically provided for in the By-laws.
  - The total number of votes cast by a stockholder shall not exceed the number of shares owned by him as shown in the books of the corporation multiplied by the whole number of directors to be elected
  - Gives the minority an opportunity to elect a representative to the BOD. Cannot itself give the minority control of corporate affairs but may affect and limit the extent of a majority's control
  - Theoretically, this allows the minority block to dominate the election of BOD. However, the minority still needs the majority in order to constitute a quorum.
  - By-laws cannot provide against cumulative voting since this right is mandated in §24 (mandatory in a stock corporation - statutory right of SHs)
  - In determining how many shares are needed to vote for the desired # of directors (necessary when one campaigns for proxies), the following formula may be followed: \[ \text{outstanding shares} \times \text{desired # of directors} + 1 \] / \[ \text{total # of directors} + 1 \]
  - Unless otherwise provided in the AOI or in the by-laws, members of corporations which have no capital stock may cast as many votes as there are trustees to be elected but may not cast more than one vote for one candidate.
- Candidates receiving the highest number of votes shall be declared elected.
- Any meeting of the stockholders or members called for an election may adjourn from day to day or from time to time but not sine die or indefinitely if:
  - For any reason, no election is held, or
  - If there are SHs not present or represented by proxy at the meeting, the owners of a majority of the outstanding capital stock, or if there be no capital stock, a majority of the member entitled to vote.
- Since the provision requires presence, meeting of stockholders is required

3) How Removed (§28)
- Any director or trustee of a corporation may be removed from office by a vote of the stockholders holding or representing 2/3 of the outstanding capital stock, or if the corporation be a Non-stock Corporation, by a vote of 2/3 of the members entitled to vote (with or without cause).
- Note: Such removal shall take place either at a regular meeting or at a special meeting called for the purpose of removal of Directors or Trustees, with previous notice of the time and place of such meeting, as well as the intention to propose such removal. If the officers refuse to call a meeting to consider the removal of the Director, it may be called at the instance of any stockholder or member, but with due notice.
- Removal without cause may not be used to deprive minority stockholders or members of the right of representation to which they may be entitled to under Section 24
- The board cannot remove a director or trustee as member of the board

Roxas v Dela Rosa (1926)
Binalbagan Estate Inc is engaged in the mfg of raw sugar from canes. Possessors of majority of shares formed a voting trust composed of 3 trustees. Trustees now controlled 3,000 out of 5,500 shares.

Voting trust was able to vote BOD, without opposition from minority.

Trustees soon wanted to remove the directors they had elected, even if their terms had not yet expired. Voting trust caused SEC to issue notice for a special gen mtg to elect a new BOD.

Held: Under the law, directors can only be removed by vote of SHs representing at least 2/3 of the subscribed capital stock entitled to vote. When the purpose is to remove directors, it must be stated in call for meeting. But vacancies in BOD can be filled by mere majority vote.

Trust does not have clear 2/3 majority. Voting trust should have stated in notice that purpose was to remove present BOD. Meeting called by trustees enjoined.

In this case, removal was sought to be done by replacing directors

BUT can't remove thru election of new officers because directors have fixed term of office
Note: §28 need not be resorted to in all instances. If removal is for cause (mismanagement or abuse of powers, the remedy of SHs shall be:

a) Receivership;
b) Injunction if the act has not yet been done;
c) Dissolution if abuse amounts to a ground for quo warranto but Sol Gen refuses to act;
d) Derivative suit or complaint filed with the RTC;
e) Criminal action

4) Vacancies (§29)
Vacancies in the Board of Directors or Trustees MAY be filled by a vote of at least a majority of the remaining directors or trustees; if still constituting a quorum

In the following cases, the stockholders or members shall fill the vacancy (REAQ):

a. When the remaining directors or trustees do not constitute a quorum;
b. If the vacancy is caused by the removal of a director or trustee;
c. If the vacancy is caused by the expiration of term; and

d. In case of increase in the number of directors or trustees as a result of an amendment of the articles authorizing such increase

5) Compensation (§30)

- In the absence of any provision in the By-laws fixing their compensation, the directors shall not receive any compensation, except for reasonable per diems.
- Any such compensation (other than per diems) may be granted to the directors by the vote of the stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholders meeting.
- Limit: In no case shall the total yearly compensation of directors, as such directors, exceed 10% of the net income before income tax of the corporation during the preceding year.

6) How corporate powers exercised - Board must act as a body in a meeting

Requisites of board meetings

- Meeting of the Board duly assembled
- Existence of quorum

- Decision of the majority of the quorum duly assembled (EXCEPTION: Election of directors – requires a vote of majority of all the members of the board)

WHEN? (§53)

- Regular meetings of directors or trustees shall be held monthly, unless the by-laws provide otherwise.
- Special meetings of the board of directors or trustees may be held at any time upon the call of the president or as provided in the by-laws.

WHERE? (§53)

Meetings of directors or trustees of corporations may be held anywhere in or outside of the Philippines, unless the by-laws provide otherwise.

WHO MAY ATTEND?
The members of the Board themselves; directors in Board meetings cannot be represented or voted by proxies.

WHO PRESIDES? (§54)
The president shall preside at all meetings of the directors or trustee, unless the by-laws provide otherwise.

NOTICE REQUIREMENTS (§53)

- Notice of regular or special meetings stating the date, time and place of the meeting must be sent to every director or trustee at least one (1) day prior to the scheduled meeting, unless otherwise provided by the by-laws.
- A director or trustee may waive this requirement, either expressly or impliedly

QUORUM REQUIREMENTS (§25)

Unless the articles of incorporation or the by-laws provide for a greater majority, a majority of the number of directors or trustees as fixed in the articles of incorporation shall constitute a quorum for the transaction of corporate business, and every decision of at least a majority of the directors or trustees present at a meeting at which there is a quorum shall be valid as a corporate act, except for the election of officers which shall require the vote of a majority of all the members of the board.

Western Institute of Technology v Salas

In a meeting of the Board of Trustees of Western Institute of Technology, a resolution was passed granting monthly compensation to officers respondents who are members of the Board. The resolution is valid. The prohibition with respect to granting compensation to corporate directors/trustees under Section 30 of the Corporation Code is not violated since the compensation is being given to private respondents in their capacity as officers of WIT and not as board members.

Filipinas Port Services Inc., represented by stockholders, Eliodoro C. Cruz v. Victoriano S. Go, et al.
GR No. 161886
March 16, 2007
Cruz, a stockholder of the corporation, filed a derivative suit against the members of the board questioning the creation of certain positions. Cruz thus prayed that the respondent members of the board of directors be made to pay Pilport, jointly and severally, the sums of money variedly representing the damages incurred as a result of the creation of the offices/positions complained of and the aggregate amount of the questioned increased salaries.
HELD: The board’s creation of the positions of Assistant Vice Presidents for Corporate Planning, Operations, Finance and Administration, and those of the Special Assistants to the President and the Board Chairman, was in accordance with the regular business operations of Filport as it is authorized to do so by the corporation’s by-laws, pursuant to the Corporation Code. Besides, the determination of the necessity for additional offices and/or positions in a corporation is a management prerogative which courts are not wont to review in the absence of any proof that such prerogative was exercised in bad faith or with malice.

2.2 CORPORATE OFFICERS AND AGENTS

1. Minimum set of officers and Qualification (§25)
   - Immediately after their election, the directors of a corporation must formally organize the election of:
     a. A president, who shall be a director
     b. A treasurer who may or may not be a director (SEC opinion that the treasurer must be a resident and citizen of the Phil.)
     c. A secretary who shall be a resident and citizen of the Philippines, and
     d. Such other officers as may be provided for in the by-laws
   - Any two (2) 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.
   - Additional qualifications of officers may be provided for in the by-laws (§47(5))

People’s Aircargo vs. CA (1998)

Corporate President Punsalan solicited a proposal from respondent Sano for the preparation of a feasibility study. Sano prepared feasibility study and was paid for it. Another proposal for the preparation of operations manual was solicited from Sano and was accepted by Punsalan. Manual was prepared and approved by Commissioner of Bureau of Customs, seminar-workshops conducted but payment was not made

HELD: Corporation is liable to Sano for services rendered. General rule is that absent the authority from the Board of Directors, no person, not even its officers, can bind the corporation. However, acts of person in behalf of the corporation may be ratified. When corporation previously allowed First Contract, it gave president apparent authority to execute in its behalf the other contract, and is estopped from denying such authority. Corporation accepted operations manual and the seminars and have already benefited from the contract. This ratifies the act of the president and makes it binding upon the corporation. President is presumed to have authority to act within the domain of the general objectives of the corporation.

Rural Bank of Milaor vs. Ocfemia (2000)

When a bank, by its acts and failure to act, has clearly clothed its manager with apparent authority to sell an acquired asset in the normal course of business, it is legally obliged to confirm the transaction by issuing a board resolution to enable the buyers to register the property in their names. It has a duty to perform necessary and lawful acts to enable the other parties to enjoy all benefits of the contract which it had authorized.

2.3 BOARD COMMITTEES

(SEC opinion—requiring all members must be members of the board)
   - The by-laws of a corporation may create an executive committee, composed of not less than three members of the board, to be appointed by the board. (§35)
   - Said committee may act, by majority vote of all its members, on such specific matters within the competence of the board, as may be delegated to it in the by-laws or on a majority vote of the board, except with respect to:
     o Approval of any action for which shareholders’ approval is also required;
     o The filling of vacancies in the board;
2.4 STOCKHOLDERS OR MEMBERS

Stockholders action is needed in major changes (§56) in the corporation which would affect their contract with the corporation and although such action is usually initiated by the board, it is not sufficient to give them effect. Stockholders or members approval expressed in a meeting duly called and held for the purpose is still necessary. Exception:

- Corporations may be bound by unanimous agreement of its stockholders although expressed elsewhere than at a meeting.

7) Requirements of stockholders’ or members meeting (notice and quorum)

WHEN? (§50)

Regular meetings of stockholders or members shall be held annually on a date fixed in the by-laws, or if not so fixed, on any date in April of every year as determined by the board of directors or trustees.

WHERE?

- Stockholder’s or member’s meetings, whether regular or special, shall be held in the city or municipality where the principal office of the corporation is located, and if practicable in the principal office of the corporation: Provided, That Metro Manila shall, for purposes of this section, be considered a city or municipality. (§51)
- Members of non-stock corporations may provide in by-laws that meetings may be held any place even outside the place where the principal office is located provided proper notice is sent and that it is within the Philippines. (§93)

WHO MAY ATTEND AND VOTE?

Stockholders may attend and vote in person, or by proxy.

a. Pledgor, mortgagor, executors, receivers and administrators. (§55)
- In case of pledged or mortgaged shares in stock corporations, the pledgor or mortgagor shall have the right to attend and vote at meetings of stockholders.
  o UNLESS, the pledgee or mortgagee is expressly given by the pledgor or mortgagor such right in writing.
- The amendment or repeal of by-laws or the adoption of new by-laws;
- The amendment or repeal of any resolution of the board which by its express terms is not so amendable or repealable; and
- A distribution of cash dividends to the shareholders.
- Cannot go as far as to render the BOD powerless and free from all responsibilities imposed on it by law (Campos).
- Must be provided in the by-laws and must be composed of not less than 3 members of the board.
- Essential the executive committee acts by majority vote of all the members.

- Executors, administrators, receivers, and other legal representatives duly appointed by the court may attend and vote in behalf of the stockholders or members without need of any written proxy.

b. Joint owner of stocks (§56)

The consent of all the co-owners shall be necessary in order to vote, UNLESS there is a written proxy, signed by all the co-owners, authorizing one or some of them or any other person to vote such share or shares PROVIDED, That when the shares are owned in an "and/or" capacity by the holders thereof, any one of the joint owners can vote said shares or appoint a proxy therefor.

c. Treasury shares (Cit §41, 57, 68)

- Definition (§9): These are shares of stock which have been issued and fully paid for but subsequently re-acquired by the issuing corporation by purchase, redemption, donation or through some other lawful means. Such shares may again be disposed of for a reasonable price fixed by the BOD.
- Treasury shares shall have no voting rights as long as such shares remain in the Treasury. (§57)

WHO PRESIDES?

- The president shall preside at all meetings of of the stockholders or members, unless the by-laws provide otherwise. (§54)
- When there is no person authorized to call a meeting, the SEC, upon petition of a stockholder or member on a showing of good cause therefor, may issue an order to the petitioning stockholder or member directing him to call a meeting of the corporation by giving proper notice required by this Code or by the by-laws. (§50)
- The petitioning stockholder or member shall preside thereat until at least a majority of the stockholders or members present have been chosen one of their number as presiding officer. (§50)

NOTICE REQUIREMENTS (§50)

- Written notice of regular meetings shall be sent to all stockholders or members of record at least two (2) weeks prior to the meeting, unless a different period is required by the by-laws.
- Written notice of special meetings shall be sent at least one (1) week prior to the meeting, unless otherwise provided in the by-laws.
- Notice of any meeting may be waived, expressly or impliedly, by any stockholder or member.
- Failure to give notice would render a meeting voidable at the instance of an absent stockholder, who was not
notified of the meeting (Board v. Tan, 105 Phil. 426(1959)).  
- Attendance to a meeting despite want of notice will be deemed implied waiver. (Campos)  
- All proceedings had and any business transacted at any meeting of the stockholders or members, if within the powers or authority of the corporation, shall be valid even if the meeting be improperly held or called, provided all the stockholders or members of the corporation are present or duly represented at the meeting. (§51)

**QUORUM REQUIREMENTS (§52)**
- Unless otherwise provided for in the Code or in the by-laws, a quorum shall consist of the stockholders representing a majority of the outstanding capital stock or a majority of the members in the case of non-stock corporations.
- By-laws may provide for a greater or lesser quorum (§47(3))
- Where quorum is present at the start of a lawful meeting, stockholders present cannot without justifiable cause break the quorum by walking out from said meeting so as to defeat the validity of any act proposed and approved by the majority (Johnston v Johnston, 1965 CA decision)

WHY ATTEND MEETINGS?
- To make substantial changes
- To exercise control
- To be apprised of events
- To elect BOD
- To confirm actions requiring confirmation

8) Corporate Acts Requiring Approval of ALL Stockholders (including non-voting shares)

a. AMENDMENT OF ARTICLES OF INCORPORATION – discussed in Chapter XIV

b. EXTEND OR SHORTEN CORPORATE TERM – discussed in Chapter XIV

c. INCREASE OR DECREASE OF CAPITAL STOCK – discussed in Chapter XIV

d. INCURRING, CREATING OR INCREASING BONDED INDEBTEDNESS – discussed in Chapter XI

e. SALE, LEASE, MORTGAGE OR OTHER DISPOSITION OF SUBSTANTIALLY ALL CORPORATE ASSETS – discussed in Chapter XVII

f. INVESTMENT OF FUNDS IN ANOTHER CORPORATION OR BUSINESS (§42)
   - A private corporation may invest its funds in any other corporation or business or for any purpose other than the primary purpose for which it was organized
   - Approval, voting and notice requirement

1) Majority of the board of directors or trustees and
2) Ratified by the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or by at least two thirds (2/3) of the members in the case of non-stock corporations, at a stockholder’s or member’s meeting duly called for the purpose.
3) Written notice of the proposed investment and the time and place of the meeting shall be addressed to each stockholder or member 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.
   - Appraisal right - any dissenting stockholder shall have appraisal right
   - When SH approval not necessary-where the investment by the corporation is reasonably necessary to accomplish its primary purpose as long as there’s 2/3 vote. Rules in case a corporation will invest its funds in another corporation
   o If it is the same purpose or incidental or related to its primary purpose, the board can invest the corporate fund without the consent of the stockholders. What is required is only the vote of the majority of the BOD. No appraisal right
   o If the investment is in another corporation of different business or purpose, the affirmative vote of majority of the board consented by 2/3 OS capital stock is required
   o Apparent conflict: §36(7) limits corp powers to those reasonably and necessarily required. But §42 implies that can invest in another business as long as there’s 2/3 vote. Campos says that §42 should be subject to §36.
   o Accdg to Campos, if articles of incorp provide that can invest in another business, only 2/3 vote needed. Otherwise, should amend articles first.

2. ADOPTION, AMENDMENT AND REPEAL OF BY-LAWS (§48)
   - Voting Requirement: BOD or BOT by a majority vote and the owners of at least a majority of the outstanding capital stock, or majority of the members of a non-stock corporation, at a regular or special meeting duly called for the purpose, may amend or repeal any by-laws or adopt new by-laws
   - Delegation of power to amend the BOD: The owners of two-thirds (2/3) of the outstanding capital stock or two-thirds (2/3) of the
members in a non-stock corporation may delegate to the board of directors or trustees the power to amend or repeal any by-laws or adopt new by-laws

- Revocation of the delegation of power to amend: Any power delegated to the board of directors or trustees to amend or repeal any by-laws or adopt new by-laws shall be considered as revoked whenever stockholders owning or representing a majority of the outstanding capital stock or a majority of the members in non-stock corporations, shall so vote at a regular or special meeting

- Whenever any amendment or new by-laws are adopted, such amendment or new by-laws shall be attached to the original by-laws in the office of the corporation, and a copy thereof, duly certified under oath by the corporate secretary and a majority of the directors or trustees, shall be filed with the SEC the same to be attached to the original articles of incorporation and original certificate of incorporation and shall be preserved by the corporation for as long as such certificate shall be in force.

- The amended or new by-laws shall only be effective upon the issuance by the Securities and Exchange Commission of a certification that the same are not inconsistent with this Code.

3. MERGER AND CONSOLIDATION – discussed in Chapter XVII

4. DISSOLUTION OF THE CORPORATION – discussed in Chapter XVI

5. Other instances requiring stockholders’ action (voting shares only)

a. DECLARATION OF STOCK DIVIDENDS – discussed in Chapter XIII

b. MANAGEMENT CONTRACTS (§44) – any contract whereby a corporation undertakes to manage or operate all or substantially all of the business of another corporation, whether such contracts are called service contracts, operating agreements or otherwise

Approval and Voting Requirement: (§44)

- Approval by the board of directors, and
- Approval by stockholders owning at least the majority of the outstanding capital stock, or by at least a majority of the members of both the managing and the managed corporation (at meeting duly called)
- 2/3 vote required of the managed corporation when:
  - Where a stockholder or stockholders representing the outstanding capital stock or manage the corporation own or control more than one-third (1/3) of the total outstanding capital stock entitled to vote of the managing corporation; or
  - Where a majority of the members of the BOD of the managing corporation also constitute a majority of the members of the BOD of the managed corporation

Term of management contract: not longer than five years

c. FIXING CONSIDERATION OF NO-PAR SHARES (§62) – The issued price of no-par value shares may be fixed in the AOI or by the BOD pursuant to authority conferred upon it by the AOI or the by-laws, or in the absence thereof, by the stockholders at a meeting duly called for the purpose representing at least a majority of the outstanding capital stock.

d. FIXING COMPENSATION OF DIRECTORS (§30) – Any such compensation (other than per diems) may be granted to the directors by the vote of the stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholder’s meeting.

6. Appraisal right
One of the ways to get out of the corporation. It is an exception to the trust fund doctrine. The other way is to sell the shares of stock.

a. Definition (§81)
This is a remedy available to a stockholder who dissented and voted against certain extraordinary matters to withdraw or get out of the corporation by demanding payment of the value of his shares, as provided in the code.

b. Instances of appraisal right (§81)

  a) In case any amendment to the articles of incorporation which has the effect of (cf §16):
     - changing or restricting the rights of any stockholder or class of shares, or
     - authorizing preferences in any respect superior to those of outstanding shares of any class, or
     - extending or shortening the term of corporate existence (cf §37)

  b) In case of sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets as provided in the Code (cf §40); and

  c) In case of merger or consolidation

  d) In case of investment of corporate funds in another corporation or business or for any other purpose (§42)
c. What are the requirements for the successful exercise of appraisal right? (Section 82 and 86)
   - By making a written demand on the corporation within thirty (30) days after the date on which the vote was taken for payment of the fair value of his shares.
   - Failure to make the demand within such period shall be deemed a waiver of the appraisal right.
   - By surrendering the certificate or certificates of stock, the corporation shall pay the fair value thereof as of the day prior to the date on which the vote was taken, excluding any appreciation or depreciation in anticipation of such corporate action (provided that the proposed corporate action is implemented or affected).
   - If within a period of sixty (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 three (3) disinterested persons.
   - One of whom shall be named by the withdrawing stockholder, another by the corporation, and the third by the two thus chosen.
   - The findings of the majority of the appraisers shall be final.
   - The award shall be paid by the corporation within thirty (30) days after such award is made.
   - No payment shall be made to any dissenting stockholder unless the corporation has unrestricted retained earnings in its books to cover such payment (CF §41). Ratio: to protect the creditors and the remaining SHs.
   - Upon payment by the corporation of the agreed or awarded price, the stockholder shall forthwith transfer his shares to the corporation.

d. Effect of demand and termination of right (§83)
From the time of demand for payment of the fair value of a stockholder’s shares until either (1) the abandonment of the corporate action involving (2) the purchase of the said shares by the corporation, all rights accruing to such shares, including voting and dividend rights, shall be suspended, except the right of such stockholder to receive payment of the fair value thereof, provided that if the dissenting stockholder is not paid the value of his shares within 30 days after the award, his voting and dividend rights shall immediately be restored.

e. When right to payment of fair value of the shares ceases (§84)
   - No demand for payment may be withdrawn unless the corporation consents thereto.
   - Instances when right to payment ceases:
     1) If such demand for payment is withdrawn with the consent of the corporation.
     2) If the proposed corporate action is abandoned or rescinded by the corporation.
     3) If the proposed corporate action disapproved by the SEC where such approval is necessary.
     4) If the SEC determines that such stockholder is not entitled to the appraisal right.
   - In such instances, his status as a stockholder shall be restored, and all dividend distributions which would have accrued on his shares shall be paid to him.

f. Who bears costs of appraisal (§85)
   - Generally, it shall be borne by the corporation.
   - Exception: by the SH, when the fair value ascertained by the appraisers is approximately the same as the price which the corporation may have offered to pay the SH.
   - In the case of an action to recover such fair value, all costs and expenses shall be assessed against the corporation, unless the refusal of the SH to receive payment was unjustified.

g. Notation on certificates; rights of transferee (§86)
   - Within ten (10) days after demanding payment for his shares, a dissenting SH shall submit the certificates of stock representing his shares to the corporation for notation thereon that such shares are dissenting shares.
   - His failure to do so shall, at the option of the corporation, terminate his rights.
   - Effect of transfer of certificates bearing notation:
     1) The rights of the transferor as a dissenting stockholder shall cease;
     2) The transferee shall have all the rights of a regular stockholder; and
     3) All dividend distributions which would have accrued on such shares shall be paid to the transferee.

Note: right to vote is lost only if stock becomes delinquent (§71)

3. Devices Affecting Control

General Rule: Extent of control is proportional to the number of shares owned by the SH.
Exceptions: proxy device, voting trust agreements, pooling and voting agreements, cumulative voting,
classification of shares, restriction on transfer of shares, additional qualifications for directors, founder’s shares, management contracts, and unusual quorum and voting requirements

3.1 PROXY (§58, cf §20, Sec Regulation Code)
- Stockholders and members may vote in person or by proxy in all meetings of stockholders or members.
- Requirements of proxies:
  a. In writing (oral proxies are not valid)
  b. Signed by the stockholder or member
  c. Filed before the scheduled meeting with the corporate secretary
- By-laws can also impose additional requirements (ex. Must be notarized)
- Unless otherwise provided in the proxy, it shall be valid only for the meeting for which it is intended. No proxy shall be valid and effective for a period longer than five (5) years at any one time (continuing proxy).
- Right of proxy can be waived only for close corporations (§89)
- Senses of proxy:
  a. Person duly authorized by stockholder or member to vote in his behalf in a SHs’ or members’ meeting. Proxy is an agent for a special purpose thus the general rules of agency would normally apply to the relationship created by proxy
  b. Formal authority given by the holder of the stock who has the right to vote it to another to exercise the voting rights of the former.
- Instrument or document which evidences the authority of the agent.
- Failure to comply with requirements will render proxy void and ineffective.
- To what extent does the proxy holder exercise his discretion? Extent of authority given by the SH
- Proxy is irrevocable even when it is expressly provided to be irrevocable unless it is coupled with an interest. The Supreme Court has held that a proxy in favor of the corportee with reversionary interest may be revoked. (Perez vs. De Leon, 1943)
- Revocation may be made orally, in writing or implied:
  a. Appearance of the stockholder at the meeting will terminate the proxy
  b. Death of the stockholder will also terminate the proxy

3.2 VOTING TRUST AGREEMENT(§59)
- Definition: An arrangement created by one or more stockholders for the purpose of conferring upon a trustee or trustees the right to vote and other rights pertaining to the shares for a period not exceeding five (5) years at any time (Villanueva). The arrangement is embodied in a document called a voting trust agreement (VTA).
- A voting trust, which is specified required as a condition in a loan agreement, may be for a period exceeding five (5) years but shall automatically expire upon full payment of the loan
- Essence: separation of real ownership and voting rights
- Requirements of a VTA:
  a. In writing
  b. Notarized
  c. Shall specify the terms and conditions thereof
  d. Certified copy of such agreement shall be filed with the corporation and with the SEC
- OTHERWISE, said agreement is ineffective and unenforceable
- Procedure:
  a. The certificate or certificates of stock covered by the voting trust agreement shall be cancelled and new ones shall be issued in the name of the trustee or trustees stating that they are issued pursuant to said agreement.
  b. In the books of the corporation, it shall be noted that the transfer in the name of the trustee or trustees is made pursuant to said voting trust agreement.
  c. The trustee or trustees shall execute and deliver to the transferees voting trust certificates, which shall be transferable in the same manner and with the same effect as certificates of stock.
- Right to inspect VTA: The voting trust agreement filed with the corporation shall be subject to examination by any stockholder in the same manner as any other corporate book or record. The transferor and the trustee or trustees may exercise the right of inspection of all corporate books and records in accordance with the provisions of this Code.
- Any other stockholder may transfer his shares to the same trustee or trustees upon the terms and conditions stated in the voting trust agreement, and thereupon shall be bound by all the provisions of said agreement.
- Restriction: No VTA shall be entered into for the purpose of circumventing the law against monopolies and illegal combinations in restraint of trade or used for purposes of fraud.
- Automatic expiration of rights under the VTA: Unless expressly renewed, all rights granted in a voting trust agreement shall automatically expire at the end of the agreed period. The voting trust certificates as well as the certificates of stock in the name of the trustee or trustees shall thereby be deemed cancelled and new certificates of stock shall be reissued in the name of the transferees.
- The voting trustee or trustees may vote by proxy unless the agreement provides otherwise.
- Purpose – to make possible a unified control of the affairs of the corporation and consistent policy; to make possible for a majority group of shareholders to dispose of a beneficial interest in a large proportion of their shares and still retain control of the corporation through the voting trustee
- Under the prevailing view, a voting trust should have a legitimate business purpose to promote the best interests of the corporation, or even to protect the legitimate interests of others in the corporation (Ballantine, cited in Campos)
- No principal-agent relationship
The trustee has unlimited authority. The only limitation is that he should act for the benefit of the SH (fiduciary obligation).

Voting trust certificates – issued by the trustees (not the corp). These certificates confirm: (1) that a trustee has been constituted, (2) the extent of shares, and (3) the participation of the SH in the VTA.

The trustee can’t dispose of the block of shares/ receive dividends. Can only vote

The SH can revoke the VTA on the ground of breach of fiduciary obligations

Status of transferee and transferor:

a. Voting trustee is only a share owner vested with apparent legal title for the sole purpose of voting upon stocks that he does not own

b. Transferring stockholder retains the right of inspection of corporate books which he can exercise concurrently with the voting trustee

Powers and rights of voting trustees:

a. Right to vote and other rights pertaining to the shares in their names subject to terms and conditions of and for the period specified in the agreement

b. Vote in person or by proxy unless agreement provides otherwise

c. Rights of inspection of corporate books and records

d. Legal title holder – qualified to be a director

The clear intent is that in order to be eligible as director, what is material is the legal title to, not the beneficial ownership of, the stock as appearing on the books of a corporation. Therefore, a director who executes a voting trust agreement over all his shares, remains only a beneficial owner, and therefore is automatically disqualified from his directorship. (Lee v. CA, 1992)

Limitations on voting trust agreements:

a. should not exceed 5 years except if a condition in a loan agreement, shall automatically expire upon full payment of the loan

b. must not be for purposes of circumventing the law against monopolies and illegal combinations in restraint of trade

c. must not be used for purposes of fraud

d. must be in writing, notarized, specify the terms and conditions thereof

e. certified copy must be filed with corporation and SEC otherwise unenforceable

f. agreement is subject to examination by stockholder

g. shall automatically expire at the end of the agreed period

h. vote in person or by proxy unless agreement provides otherwise

i. rights of inspection of corporate books and records

Distinction between proxy and voting trust

<table>
<thead>
<tr>
<th>Proxy</th>
<th>VTA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revocability</td>
<td>Revocable unless coupled with interest</td>
</tr>
<tr>
<td>Extent of power</td>
<td>Can only act at a specified stockholder’s or member’s meeting</td>
</tr>
<tr>
<td>When to vote</td>
<td>Absence of the owner</td>
</tr>
<tr>
<td>Subject Matter</td>
<td>Voting rights</td>
</tr>
<tr>
<td>Duration</td>
<td>Usually shorter but can’t exceed 5 years</td>
</tr>
</tbody>
</table>

Nat’l Investment & Dev’t Corp v Aquino (1988)

Batjak, a Fil-Am corp, owed money to PNB. Its oil mills were also mortgaged to other banks. They further borrowed money from NIDC, a wholly owned subsidiary of PNB, to pay off the mortgages. In return, NIDC got preferred shares, convertible into common shares. Batjak executed a 1st mortgage on all its properties to PNB in exchange for a credit facility etc.

Next, a Voting Trust Agreement was executed in favor of NIDC by SHs representing 60% of Batjak. Period of 5 years, irrevocable. During this time, all dividends to be paid to SHs. When Batjak became insolvent, PNB foreclosed the mortgaged properties. When Batjak failed to redeem, it transferred ownership to NIDC

Batjak later sued NIDC, asking for the turn-over of all the assets and in the alternative, asked for receivership.

Held:

*Receiver is appointed if applicant has interest in property. But title of properties is now with NIDC.

*Batjak did not impugn validity of the foreclosure sales. Also, no evidence that prop is in danger of loss, removal or material injury if receiver not appointed.

What was assigned to NIDC was only power to vote shares of stock of Batjak. Such power includes authority to execute any agreement or doc necessary to express consent or assent to any matter by SHs.

Voting trust did not provide for transfer of assets. What was stipulated to be returned were only certifs of stock. Voting trust transfers only voting or other rights pertaining to shares or control over the stock.

3.3 POOLING AND VOTING AGREEMENTS

- Agreement between 2 or more stockholders to vote their shares in the same way
- There must be a valuable consideration for each party
- Usually relate to election of directors
- Parties often provide for arbitration in case of disagreement. Note: arbitrator is not
like a trustee. The former has no voting rights.

- Valid as long as they do not limit the discretion of the BOD in the management of corporate affairs or work any fraud against stockholders not party to the contract. Thus, it is void if it provides that directors, once elected, should vote for certain persons as officers. (McQuade v. Stoneham, 263 NY 323 (1934))

**EXCEPTION:** Close corps may provide that a VTA can interfere with discretion of the BOD.

- Does not involve a transfer of stocks but is merely a private agreement.
- No transfer of ownership and voting rights.
- Agreements by stockholders in close corporations (§100):
  - Agreements by and among stockholders executed before the formation and organization of a close corporation, signed by all stockholders, shall survive the incorporation of such corporation and shall continue to be valid and binding between and among such stockholders, if such be their intent, to the extent that such agreements are not inconsistent with the articles of incorporation, irrespective of where the provisions of such agreements are contained, except those required by this Title to be embodied in said articles of incorporation.
  - An agreement between two or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as therein provided, or as they may agree, or as determined in accordance with a procedure agreed upon by them.
  - No provision in any written agreement signed by the stockholders, relating to any phase of the corporate affairs, shall be invalidated as between the parties on the ground that its effect is to make them partners among themselves.
  - A written agreement among some or all of the stockholders in a close corporation shall not be invalidated on the ground that it so relates to the conduct of the business and affairs of the corporation as to restrict or interfere with the discretion or powers of the board of directors: Provided, That such agreement shall impose on the stockholders who are parties thereto the liabilities for managerial acts imposed by this Code on directors.
  - To the extent that the stockholders are actively engaged in the management or operation of the business and affairs of a close corporation, the stockholders shall be held to strict fiduciary duties to each other and among themselves. Said stockholders shall be personally liable for corporate torts unless the corporation has obtained reasonably adequate liability insurance.

<table>
<thead>
<tr>
<th>Principal – agent</th>
<th>Trustee- beneficiary</th>
<th>Consensual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proxy can’t exceed delegated authority</td>
<td>The only limit to his authority: must be for benefit of trustee (fiduciary obligation)</td>
<td>Merely an agreement to vote in the same way</td>
</tr>
<tr>
<td>Must be in writing</td>
<td>Must be in writing and notarized</td>
<td>No formalities required</td>
</tr>
<tr>
<td>Copy must be filed with corp sec</td>
<td>Copy must be filed with SEC</td>
<td>Merely a contract between SHs</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regular voting rights</th>
<th>Absolute voting rights, subj only to fiduciary duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Another person exercises voting rights only for a specific mtg (unless otherwise provided)</td>
<td>Another person exercises voting rights continuously</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Proxy cannot be director</th>
<th>Trustee can be director</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revocable at will, in any manner</td>
<td>Irrevocable, as long as no misconduct or fraud</td>
</tr>
<tr>
<td>EXC if coupled with an interest</td>
<td>Revocable by consent or mutual termination. If unilateral termination, liable for damages</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Max of 5 yrs at a time</th>
<th>Max of 5 yrs at a time (unless coterminus with loan)</th>
</tr>
</thead>
</table>

| SEC can pass on validity | |

**POOLING AND VOTING AGREEMENTS**

**PROXY**

**TRUSTEE**
1. Duties and Liabilities of Directors

1.1 Duties In General

<table>
<thead>
<tr>
<th>Duty</th>
<th>Violation under §31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obedience</td>
<td>Willfully and knowingly vote for or assent to patently unlawful acts of the corporation</td>
</tr>
<tr>
<td>Diligence</td>
<td>Guilty of gross negligence or bad faith in directing the affairs of the corporation</td>
</tr>
<tr>
<td>Loyalty</td>
<td>Acquire any personal or pecuniary interest in conflict with their duty as such directors or trustees</td>
</tr>
</tbody>
</table>

- Extent of liability: Directors or trustees shall be liable jointly and severally for all damages resulting therefrom suffered by the corporation, its stockholders, or members and other persons.
- Directors act as a body in formulating corp policies and exercise all powers of management. Hence, they are fiduciaries of the corp. It does not matter who elected them. Once elected, they must represent the interests of all SHs and of the corp as a whole.
- Directors must act only within the corp powers. If not, they will be liable for damages, unless they acted in GF and with due diligence.

1.2 Duty of diligence

- What are required and expected of directors:
  - To possess at least ordinary knowledge and skill to enable them to make sound business decision
  - To attend directors meetings with reasonable regularity
  - To exercise reasonable care in the management of the corporation
  - To keep themselves sufficiently informed about the general condition of the business
- The degree of care and diligence required is usually that which men prompted by self-interest, generally exercise in their own affairs. In determining whether reasonable diligence has been exercised, the particular circumstances of each case must be considered. The nature of the business is an important factor.

Business judgment rule

GEN RULE: Directors cannot be held liable for mistakes or errors in the exercise of their business judgment if they acted in good faith, with due care & prudence. Contracts intra vireis entered into by the board of directors are binding upon the corp. & courts will not interfere.

EXCEPTION: If the contracts are so unconscionable & oppressive as to amount to a wanton destruction of the rights of the minority.

Board of Directors has authority to modify the proposed terms of the contracts of the corporation for the purpose of making the terms more acceptable to the other contracting parties...The test to be applied is whether the act in question is the direct and immediate furtherance of the corporation's business, fairly incidental to the express powers and reasonably necessary to their exercise. If so, the corporation has the power to do it; otherwise not. [Montelibano v. Bacolod Murcia Milling Co. (1962)]

Steinberg vs. Velasco

Steinberg is the receiver of Sibugay Trading. Velasco (Pres) and other directors, approved and authorized unlawful purchases of company’s stock from Ganzon et al. Accdg to Steinberg, this diverted funds supposed to be paid to creditors.

Ganzon et al resigned as directors before the BoD approved the purchase of stocks from them, worth 3,300. At that time, corp owed 13K. The corp also declared dividends in favor of SHs, to be paid in installments so as “not to affect financial condition of the corp.” A/R’s which appeared on books were worthless, because receiver could not collect them.

HELD: If directors dispose of corp prop or pay away its money without authority, they will be required to make good the loss out of their private estates.

Directors are not liable for loss to corp from want of knowledge, or for mistakes of judgment, provided they were honest and fairly within the scope of the powers and discretion confided to mgt.

But acceptance of office of director implies a competent knowledge of the duties assumed, and directors cannot excuse imprudence bec of their ignorance or inexperience. If they commit error of judgment through mere recklessness or want of ordinary prudence or skill, they may be held liable for consequences.

Creditors of corp have right to assume that so long as there are outstanding debts and liabilities, BoD will not use assets of corp to purchase its own stock, and that it will not declare dividends to SHs when corp is insolvent.

Directors held liable.

- Stock purchases and dividends were funded out of remaining assets. But assets < liabilities.
- Ganzon et al were favored bec they were able to get money ahead of creditors
- Recipients of dividends can be held liable by receiver. Ratio: SHs are accessories. Remember, they were the ones who chose directors.
1.3 Duty of loyalty

The determination as to whether, in a given case, the duty of loyalty has been violated has ultimately to be decided by the court on the case’s own merits. The ff. are more common situations involving such conflict of interests:

a. Self-dealing director (§32)
   • A contract of the corporation with one or more of its directors or trustees is voidable, at the option of such corporation, unless all the following conditions are present:
     o 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;
     o That the vote of such director or trustee was not necessary for the approval of the contract;
     o That the contract is fair and reasonable under the circumstances; and
     o 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 two-thirds (2/3) of the outstanding capital stock or of at least two-thirds (2/3) of the members in a meeting called for the purpose
   • Full disclosure of the adverse interest of the directors or trustees involved must be made at such meeting provided, however, that the contract is fair and reasonable under the circumstances
   • The contract is voidable whether the corporation suffered damages or not
   • The burden of proving fairness is on the director

b. Fixing compensation of directors and officers (§30)
   • General rule: Directors are only entitled to per diems, which are reasonable
   • Exception: When AOI, by-laws, or an advance contract provides for compensation
   • Assuming compensation is intended, only SHs can fix the amount. In fact, the SHs should approve the granting of compensation because this entails a reduction of the amount that could be distributed to them as dividends
   • SH’s resolution to grant compensation can only refer to future services (Barreto v La Previsora Filipina (1932))

Western Institute of Technology v. Salas (1997)

The position of being chairman and Vice-Chairman, like that of treasurer and secretary, are not considered directorship positions but officership positions that would entitle the occupants to compensation. Likewise, the limitation placed under Sect. 30 of the Corporation Code that directors cannot receive compensation exceeding 10% of the net income of the corporation would not apply to the compensation given to such positions since it is being given in their capacity as officers of the corporation and not a board members.

Barreto v La Previsora Filipina (1932)

Barreto, et al. are directors of La Previsora Filipina, a mutual building and loan assoc. By-laws provide compensation of 1% of profits to each director. Compensation to apply retroactively.

Held: By-laws do not create a legal obli to pay life gratuity or pension out of its net profits => beyond powers of mutual bldg and loan assoc.

Corp Law authorizes compensation only for future services, and cannot authorize continuous compensation to particular directors after their employment has terminated for past services rendered gratuitously by them to the corp.

Building and loan associations are founded on strict mutuality and equality of benefits and obligations. Any contract or by-law in contravention of a statute is ultra vires and void. There is an implied contract with members that it shall not divert funds or powers to purposes other than for which it was created. All members must participate equally in profits and bear losses. Any diversion of funds to unauthorized purposes violates principle of mutuality between members.

Also, there was no valid consideration bec the past services were rendered gratuitously.

c. Interlocking directors (§33)
   • A contract between two or more corporations having interlocking directors shall not be invalidated on that ground alone, except cases of fraud.
   • The contract is fair and reasonable under the circumstances.
   • If the interest of the interlocking director in one corporation is substantial and his interest in the other corporation or corporations is merely nominal, he shall be subject to the provisions of the preceding section (§32) insofar as the latter corporation or corporations are concerned.
   • Stockholdings exceeding twenty (20%) percent of the outstanding capital stock shall be considered substantial for purposes of interlocking directors.
   • Requisites of a valid contract between the corporation and one or more of its directors, trustees or officers (§32):
     i. 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.
4. That in case of an officer, the contract with the officer has been previously authorized by the Board of Directors.

d. Seizing corporate opportunity: Disloyalty (§34)
- Where a director, by virtue of his office, acquires for himself a business opportunity which should belong to the corporation, thereby obtaining profits to the prejudice of such corporation, he must account to the latter for all such profits by refunding the same (§34) unless his act has been ratified by a vote of the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock.
  o Hence, a majority SH can actually compete with the corporation if he owns 2/3 of the OCS.
  o This provision shall be applicable, notwithstanding the fact that the director risked his own funds in the venture.
  o Requires prejudice. If there’s no prejudice to the corporation, the director or officer can still be held liable under §31.
  o §34 covers only directors. However, according to Campos, officers can be held liable under §31 (2nd par.).—“When a director, trustee or officer attempts to acquire or acquire, in violation of his duty, any interest adverse to the corporation in respect of any matter which has been reposed in him in confidence, as to which equity imposes a liability upon him to deal in his own behalf, he shall be liable as a trustee for the corporation and must account for the profits which otherwise would have accrued to the corporation.”

- The last paragraph of Section 31 and Section 34 contain the doctrine of corporate opportunity. In case of such conflict of interests, and the director acts against the good of the corporation, he shall be accountable for the profits he obtained, even if he had risked his own funds.

- Corporate right, opportunity or expectancy arises only when: (a) directors were negotiating on behalf of the corporation; (b) the corporation was in need of the particular business opportunity to the knowledge of the directors, or (c) the business opportunity was seized and developed at the expense and with the facilities of the corporation. (Litwin v Allen)

- Using inside information (Cf §3.8, 23.2, 27, 61, 71.2, Securities Regulation Code)

- The fiduciary position of insiders³, directors, and officers prohibits them from using confidential information relating to the business of the corporation to benefit themselves or any competitor corporation in which they may have a mere substantial interest.
- The liability of a director or officer guilty of using inside information is to the corporation and not to any individual stockholder.
- Since loss and prejudice to the corporation is not a requirement for liability, the corporation has a cause of action as long as there is unfair use of inside information.
- It is inside information if it is not generally available to others and is acquired because of the close relationship of the director or officer of the corporation.
- General rule: (Majority view) Directors owe no fiduciary duty to stockholders but they may deal with them at arm’s length. No duty to disclose facts known to the director or officer.
- Special facts doctrine (Strong v Regillo, 1909) Conceding the absence of a fiduciary relationship in the ordinary case, courts nevertheless hold that where special circumstances of facts are present which make it inequitable for the director to withhold information from the stockholder, the duty to disclose arises and concealment is fraud.

2. Duties and Liabilities of Officers

The provisions on seizing corporate opportunity and disloyalty (§31 1st and §34) shall also apply to corporate officers.

Note: Members of the BOD who are also officers are held to a more stringent liability because they are in-charge of day-to-day activities (Campos).

3. Duty of controlling interest

- A majority stockholder is subject to the duty of good faith when he acts by voting at a stockholders’ meeting with respect to a matter in which he has a personal interest.
- Controlling stockholders may dispose of their shares at any time and at such price as they choose provided they do not pervert these prerogatives by transferring office to persons who are known as intending to raid the corporate treasury or otherwise improperly benefit themselves.

³ “Insider” means: (a) the issuer; (b) a director or officer (or person performing similar functions) of, or a person controlling the issuer; (c) 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; (d) a government employee, or director, or officer of an exchange, clearing agency and/or self-regulatory organization who has access to material information about an issuer or a security that is not generally available to the public; or (e) a person who learns such information by a communication from any of the foregoing insiders (§3.8, Sec Regulations Code)
• It is fraudulent for a stockholder to buy from another stockholder without disclosing his identity.
• Principal stockholders are likewise prohibited from using inside information in the purchase and sale of equity security.

4. Remedies of stockholder in case of mismanagement or abuse of powers

- Receivership
- Injunction if the act has not been done
- Dissolution if the abuse amounts to a ground for quo warranto but the Solicitor General refuses to act
- Derivative suit a complaint filed with the RTC

Chapter IX
THE RIGHT OF INSPECTION

1. Basis of right

Reason of the law for granting stockholders the right to inspect the records of the corporation: As the beneficial owners of the business, the stockholders have the right to know

1. The financial condition of the corporation; and
2. How the corporate affairs are being managed by their elected directors.

PURPOSE:

So that if they find the conditions unsatisfactory, they may be able to take necessary measures to protect their investment.

The right of inspection is

1. Preventive – to a limited extent may serve as a deterrent to an ill-intentioned management to know that its acts may be scrutinized.
2. Remedial – a dissatisfied stockholder may resort to the right of inspection as a preliminary step to seeking more direct remedies against abuses committed by management (removal of directors or a derivative suit).

The right of inspection goes hand-in-hand with the right to vote. Through the former, the SH can gather information on how to vote.

2. What records covered; records required to be kept by corporation (§74)

- Books that record all business transactions of the corporation which shall include contract, memoranda, journals, ledgers, etc;
- Minute book for meetings of the SHs/members;
- Minute book for meetings of the board/trustees;
- Stock and transfer book.

Minutes of meetings without the signature of the corporate secretary have no probative value (NATU v Sec of Labor, 1991)

What is a stock transfer agent?

- A stock transfer agent is one engaged principally in the business of registering transfers of stocks in behalf of a stock corporation. No stock transfer agent shall be allowed to operate in the Philippines unless he secures a license from the SEC and pays a fee as may be fixed by the Commission, which shall be renewable annually.

- A stock corporation is not precluded from performing or making transfer of its own stocks, in which case all the rules and regulations imposed on stock transfer agents, except the payment of a license fee herein provided, shall be applicable.

Uichico, et al. vs. NLRC (1997)
The petitioners, who are officers and directors of Crispa, Inc., assailed the decision of the NLRC holding them solidarily liable with Crispa for the payment of separation pay and backwages to the private respondents. It was the contention of the petitioners that the award of separation pay and backwages is a corporate obligation and must therefore be assumed by Crispa alone.

Held: While the general rule is that obligations incurred by a corporation, acting through its directors, officers and employees, are its sole liabilities, there are times when solidarity liabilities may be incurred such as in this case where it is undisputed that petitioners had a direct hand in the illegal dismissal of respondent employees. They were the ones, who as high-ranking officers and directors of Crispa, signed the Board resolution retrenching the private respondents on the feigned ground of serious business losses that had no basis apart from an unsigned and unaudited profit and loss statement which had no evidentiary value whatsoever. This is indicative of bad faith on the part of petitioners for which they can be held jointly and severally liable with Crispa for all the money claims of the illegally terminated respondent employees.

Tramat Mercantile, Inc. vs. CA (1994)

Personal liability of a corporate director, trustee or officer along (although not necessarily) with the corporation may so validly attach, as a rule, only when:

- He assents (a) to a patently unlawful act of the corporation, or (b) for bad faith or gross negligence in directing its affairs, or (c) for conflict of interest, resulting in damages to the corporation, its stockholders or other persons;
- 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;
- He agrees to hold himself personally and solidarily liable with the corporation; or
- He is made, by a specific provision of law, to personally answer for his corporate action.

Reiterated in Atrium Management Corp. v. CA, 2001
Financial statements (§75)
- Within ten (10) days from receipt of a written request of any stockholder or member, the corporation shall furnish to him its most recent financial statement, which shall include a balance sheet as of the end of the last taxable year and a profit or loss statement for said taxable year, showing in reasonable detail its assets and liabilities and the result of its operations.
- At the regular meeting of stockholders or members, the BOD or BOT shall present to such stockholders or members a financial report of the operations of the corporation for the preceding year, which shall include financial statements, duly signed and certified by an independent certified public accountant.
- However, if the paid-up capital of the corporation is less than P50,000.00, the financial statements may be certified under oath by the treasurer or any responsible officer of the corporation.

### 3. Extent of and limitations on right

#### 3.1 Limitations as to time and place

- Only at reasonable hours on business days
  - By-laws cannot limit inspection to merely a few days during the year chosen by the directors [Pardo vs. Hercules Lumberm, 1924]
  - By-laws cannot provide that the inspection shall only be upon authority of the President of the corporation previously obtained in each case [Veraguth v. Isabela Sugar Co., 1932]
  - However, inspection should be made in such a manner as not to impede the efficient operations of the corporation (Duff v. Mutual Brewing Co., NYLJ, Oct. 3, 1892)
  - By-laws may adopt policies with respect to right to inspect (§47(10)-Such other matters as may be necessary for the proper or convenient transaction of its corporate business and affairs)

- Inspection shall be done in the place where the corporation keep all its records, which, as enjoined by law, is in the principal office
  - Stockholder cannot demand that he be allowed to take the corporate books out of the corporation’s principal office for the purpose of inspecting them [Veraguth, Supra]

#### 3.2 Limitation as to purpose

Is the stockholder’s purpose material? – YES. There is however a presumption that his purpose is a proper one and the corporation cannot refuse to grant him the right on its mere belief that his motive is improper.

- Otherwise, such refusal may open its guilty officers or directors to liability for damages, UNLESS they can successfully prove in their defense:
  - that the stockholder was not acting in good faith
  - that he improperly used the information obtained in the past
  - that he used the information for an illegitimate purpose

**Gonzales v. PNB (1983)**

Section 74 of the Corporation Code has been interpreted by the Supreme Court as no longer allowing the unqualified right of inspection of stockholder of corporate records and that the person making the demand has to show that he is acting in good faith and for a legitimate purpose.

- Burden of proving that the purpose is improper or illegal is on corporation and its officers.
- Good purposes: to investigate acts of management; to investigate financial conditions; fix value of shares; mailing list for proxies; information for litigation
- Not good and honest purposes: obtain corporate secrets (e.g., formula); nuisance suit; to embarrass the company

TEST to determine whether the purpose as proved by the corporation or as admitted by the stockholder is a legitimate one or not? – A legitimate purpose is one which is germane to the interests of the stockholder as such and not contrary to the interests of the corporation (Gokongwei v. SEC, 1979).

#### 4. Who may exercise right

- Director, trustee, stockholder, member, personally or through an agent
  - The right to inspect corporate books may be done with the assistance of technical men (e.g., lawyers and accountants) and it may be delegated. The right includes the right to copy or to take notes. (W.G. Philpotts v Philippine Mfg Co., 1919)
- The transferor of shares and the voting trustee, in accordance with Section 59
- Stockholders of a parent corporation with respect to subsidiary:
  - If two are legally separate and independent entity, no right of inspection. However, the SH of the parent corp can look at the books of the latter with respect to its investments to the subsidiary.
  - If they are practically one and the same in so far as management and control is concerned, and inspection is demanded because of gross mismanagement of subsidiary by the parent’s directors who are
also directors of subsidiary, who are also directors of the subsidiary, then the latter will be treated as a mere agent or instrumentality of the respondent parent corporation and the latter may be compelled to open the subsidiary’s books to its stockholders (Gokongwei v. SEC; Supra)

5. Remedies available if inspection refused

- **Mandamus**
  - The writ should be directed against the corporation, but the secretary thereof may be joined as party defendant since he is customarily charged with the custody of all corporate records and is presumably the person against whose order the order of the court will be made ineffective in case mandamus is granted.
  - And even the president of the corp. may be made respondent if necessary to the effectuation of the court’s order (Philpotts v. Phil. Manufacturing Co., 1919)
- **Injunction**
- **Action for damages** – any officer or agent of the corporation who shall refuse to allow any director, trustees, stockholder or member of the corporation to examine and copy excerpts from its records or minutes, in accordance with the provisions of this Code, shall be liable to such director, trustee, stockholder or member for damages.
- **File an action to impose a penal offense by fine and/or imprisonment**
  - Any officer or agent of the corporation who shall refuse to allow any director, trustees, stockholder or member of the corporation to examine and copy excerpts from its records or minutes, in accordance with the provisions of this Code, shall be guilty of an offense which shall be punishable under Section 144 of the Corporation Code.
  - If such refusal is made pursuant to a resolution or order of the board of directors or trustees, the liability under this section for such action shall be imposed upon the directors or trustees who voted for such refusal.
  - It shall be a defense to any action that the person demanding to examine and copy has improperly used any information secured through any prior examination of the records, or is not acting in good faith or for a legitimate purpose in making his demand (§74, par 3)
  - Other valid grounds for denying access to books or records: immediately prior to the annual SHs’ meeting; holder of books is unavailable; the books are being audited; on-going inventory count; computerization; moving out or change of business address.

Chapter X

**DERIVATIVE SUITS**

1. **Nature and Definition of a Derivative Suit**

**Definition**

Derivative suit – suits of stockholders based on wrongful or fraudulent acts of directors or other persons.

**Nature and basis/distinguish from other suits:**

- **INDIVIDUAL suit** if wrong done is personal to SH
- **CLASS suit** if wrong done is to a group of SH
- **DERIVATIVE suit** if wrong done is to the corporation itself.
  - In a derivative suit, the cause of action belongs to the corporation and not the stockholders but since the directors who are charged with mismanagement are the ones who will be sued or may not be willing to sue, then the corporation is left without redress, hence, SH is given the right to sue on behalf of the corporation.

2. **Requirements relating to derivative suit**

1. The stockholder or member bringing the suit must have exhausted his remedies within the corporation (Angeles v. Santos, 1937) (ex. He has made a demand on the directors or trustees and they have failed or refused to act on such demand. Note: demand is not necessary if it will be futile).
2. The stockholder or member must have been one at the time the transaction or act complained of took place, or in the case of a stockholder, the shares must have devolved upon him since by operation of law, unless such transaction or act continues and is injurious to the stockholder (Pascual v. Orozco, 1911)
   - Bonafide ownership by stockholder of stock in his own right suffices to invest him with standing to bring a derivative action for the benefit of the corporation. The number of shares owned by the SH is immaterial since he is not suing in his own behalf or for the protection or vindication of his own particular right or the redress of a wrong committed against him individually but in behalf and for the benefit of the corp. (San Miguel Corp. v. Khan, 1985)
3. Heirs of a SH can bring a derivative suit provided that the transaction took place during the lifetime of the SH (Denison v. Berderger, 1941)
4. Any benefit recovered by the stockholder or member as a result of bringing the derivative suit, whether by final judgment, by judicial compromise or by extra-judicial settlement, must be accounted for to the corporation, who is the real party in interest.
5. If the suit is successful, the plaintiff is entitled to reimbursement from the corporation for the reasonable expenses of litigation, including attorney’s fees.
Bitong v CA (1998)

In the absence of a special authority from the board of directors to institute a derivative suit for and in its behalf, the managing officer is disqualified by law to sue in her own name. The power to sue and be sued in any court by a corporation even as a stockholder is lodged in the BOD that exercises its corporate powers and not in the president or officer thereof. But where corporate directors are guilty of a breach of trust, not of mere error of judgment or abuse of discretion, and intra-corporate remedy is futile or useless, a SH may institute a derivative suit in behalf of himself and other SHs and for the benefit of the corporation, to bring about a redress of the wrong inflicted directly upon the corporation and indirectly upon the stockholders.

Lim vs. Lim-Yu (2001)
The suit of respondent cannot be characterized as derivative, because she was complaining only of the violation of her preemptive right under Section 39 of the Corporation Code. She was merely praying that she be allowed to subscribe to the additional issuances of stocks in proportion to her shareholdings to enable her to preserve her percentage of ownership in the corporation. She was therefore not acting for the benefit of the corporation. Quite the contrary, she was suing on her own behalf, out of a desire to protect and preserve her preemptive rights.


Cruz, a stockholder of the corporation, filed a derivative suit against the members of the board questioning the creation of certain positions. Cruz thus prayed that the respondent members of the board of directors be made to pay Filport, jointly and severally, the sums of money variedly representing the damages incurred as a result of the creation of the offices/positions complained of and the aggregate amount of the questioned increased salaries. The RTC found in his favor initially but the CA later dismissed the derivative suit.

HELD: T his is a valid derivative suit instituted by Cruz. the action below is principally for damages resulting from alleged mismanagement of the affairs of Filport by its directors/officers, it being alleged that the acts of mismanagement are detrimental to the interests of Filport. Thus, the injury complained of primarily pertains to the corporation so that the suit for relief should be by the corporation. Besides, the requisites before a derivative suit can be filed by a stockholder are present in this case, to wit:

a) the party bringing suit should be a shareholder as of the time of the act or transaction complained of, the number of his shares not being material;
b) he has tried to exhaust intra-corporate remedies, i.e., has made a demand on the board of directors for the appropriate relief but the latter has failed or refused to heed his plea; and

c) the cause of action actually devolves on the corporation, the wrongdoing or harm having been, or being caused to the corporation and not to the particular stockholder bringing the suit.

3. Requirements under the Interim Rules of Procedure for Intra-Corporate Controversies (Rule 8)

1. He was a stockholder or member at the time the acts or transactions subject of the action occurred and the time the action was filed;
2. He exerted all reasonable efforts, and alleges the same with particularity in the complaint, to exhaust all remedies available under the AOI, by-laws, laws or rules governing the corporation or partnership to obtain the relief he desires.
3. No appraisal rights are available for the act(s) complained of; and
4. The suit is not a nuisance or harassment suit.

Derivative suits are within the jurisdiction of the RTC (§5.2, Securities Regulation Code)

Chapter XI
FINANCING THE CORPORATION, CAPITAL STRUCTURE

1. Sources of Financing

3 main sources:
1. Contributions by stockholders (Equity)
2. Loans or advances from creditors (Borrowing)
3. Profits that the business may earn

2. Classification of Shares (§6)

- Shares of stock of stock corporations may be divided into classes or series of shares or both
- Each class or series of shares may have rights, privileges, restrictions, stated in the AOI
- No share may be deprived of voting rights, except:
  - Preferred or
  - Redeemable shares,
  - unless otherwise provided by the Code
- There shall always be a class/series of shares which have a COMPLETE VOTING RIGHTS
- EACH SHARE SHALL BE EQUAL IN ALL RESPECTS TO EVERY OTHER SHARE, except as otherwise provided in the AOI and as stated in the certificate of stock

2.1 Common

- A stockholder, owner of at least one common share, has the following rights:
  - right to vote at meetings
  - right to dividends
  - right to examine corporate books
- Most commonly issued
• Entitles owner to equal pro-rata division of profits after preference

2.2 Preferred
• Stocks which are given preference by the issuing corporation in dividends and the distribution of assets of the corporation in case of liquidation or such other preferences as may be stated in the AOI which are not violative of the Corporation Code. (§6)
• Limitations on preferred shares:
  o Preferred shares can only be issued with par value.
  o Preferred shares must be:
    a. Stated in the Articles of Incorporation and in the certificate of stock or
    b. May be fixed by the BOD where authorized by the AOI, provided:
      • such terms and conditions shall be effective upon filing of a certificate thereof with the SEC.
• Entitles holder to some preferences in dividends, distribution of assets upon liquidation or both:
  o preference as to dividends – dividends are payable only when profits are earned and as a general rule, even if there are existing profits, BOD has discretion to declare dividends or not
    a. Participating – after getting their fixed dividend preference ahead of CS, they share with the CS the rest of the dividends
   b. Cumulative – dividends in arrears accrue, must be paid first before common stock dividends are paid.
  c. Non cumulative – contract makes dividends depend upon existence of profits for the years.
    o as to voting rights – usually does not have voting rights; but unless clearly withheld, PS would have right to vote
      Note: even if deprived of voting rights, PS holders are entitled to vote on the matters enumerated under §6
  o preference upon liquidation – in the absence of provision, participate pro rata with common stock
  o not a creditor; there’s no assurance that you will get back investments but if the corporation profits, you participate in the profits

2.3 Par value
• These are shares with a stated value set out in the AOI. This remains the same regardless of the profitability of the corporation. This gives rise to financial stability and is the reason why banks, trust corporations, insurance companies and building and loan associations must always be organized with par value shares.
• One in the certificate of stock of which appears an amount in pesos as the nominal value of the shares
• Can’t be issued at less than par value. Otherwise, it would become a watered stock (§65, discussed in Chapter XII)
• Par value is minimum issue price of such share in the AOI which must be stated in the certificate

2.4 No-par value
• These are shares without a stated value. The Corporation upon their issuance will set their value, which shall not be less than P5.
• Shall be deemed fully paid and non-assessable and the holders of such shares shall not be liable to the corporation or to its creditors in respect thereto (§6)
• Entire consideration received by the corporation for its no-par value shares shall be treated as capital and shall not be available for distribution as dividends (Ibid)
• Cannot be issued as Preferred Shares (Ibid)
• AOI must state the fact that corp issues no-par shares and the number of shares
• Three ways of determining value of no par value shares (§62):
  o By majority vote of the outstanding shares (issued shares) in a meeting called for the purpose
  o By BOD pursuant to authority conferred upon it by the AOI
  o By amendment of the AOI
• Corporations which cannot issue no-par value shares (§6):
  o Banks
  o Insurance Companies
  o Trust Companies
  o Building and Loan Associations
  o Public utilities

2.5 Founder’s (§7)
• Those shares, classified as such in the AOI, which are given certain rights and privileges not enjoyed by the owners of other stocks. (§7)
• Where exclusive right to vote and be voted for in the election of directors is granted, such rights must be for a limited period not to exceed 5 years subject to approval by SEC. 5 year period shall commence from date of approval by SEC. (Ibid)

2.6 Redeemable
• Those shares, expressly so provided in the AOI, which may be purchased or taken up by the corporation upon the expiration of a fixed period regardless of the existence of unrestricted retained earnings in the books of the corporation and upon such terms and conditions stated in the AOI and in the certificate of stock (§8)
• Redemption is repurchase, a reacquisition of stock by a corporation which issued the stock in exchange for property, whether or not the acquired stock is cancelled, retired or held in the treasury. Essentially, the corporation gets back some of its stock, distributes cash or property to the shareholder in payment for the stock, and continues in business as before. The redemption of stock dividends previously issued is used as a veil for the constructive distribution of cash dividends. (CIR v CA, 1999)
• While redeemable shares may be redeemed regardless of the existence of unrestricted retained earnings, this is subject to the condition that the corporation has, after such redemption, assets in its books to
cover debts and liabilities inclusive of capital stock. Redemption, therefore, may not be made where the corporation is insolvent or if such redemption will cause insolvency or inability of the corporation to meet its debts as they mature. (Republic Planters Bank v Agana, 1997)

2.7 Treasury
- These are shares of stock which have been issued and fully paid for, but subsequently re-acquired by the issuing corporation by purchase, redemption, donation or through some other lawful means. Such shares may again be disposed of for a reasonable price fixed by the BOD. (§9)
- Note: delinquent stocks, which are stocks that have not been fully paid, may become treasury stocks upon bid of the corporation in absence of other bidders (§68)
- May be sold at less than par, regarded as corporate property
- In this manner, stocks can be retired gradually, even those which aren’t redeemable
- No limit as to how many shares can be retired

2.8 Convertible
A type of preferred stock that the holder can exchange for a predetermined number of the corporation’s common shares at a specified time

2.9 Non-voting shares (§6)
- Shares which have, generally, no voting rights; except in the following circumstances:
  - Amendment of the AOI
  - Adoption and amendment of by-laws
  - Sale, lease, exchange, other disposition of all or substantially all of the corporate property
  - Incurring, creating or increasing bonded indebtedness
  - Increase or decrease of capital stock
  - Merger and consolidation
  - Investment of corporate funds in another corporation or business
  - Dissolution of the corporation

3. Nature of Subscription Contract

3.1 Subscription Contract
- Any contract for the acquisition of unissued stock in an existing or a corporation still to be formed shall be deemed a subscription contract, notwithstanding the fact that the parties may refer to it as a purchase or some other contract. (§60)
- Transfer for consideration of treasury shares is a sale by the corporation (not subscription). A transfer of fully paid shares by a stockholder to a third person is a sale. But it seems that assignment by a subscriber of his unpaid subscription would require that the requisites for valid release from subscription must be complied with
- Shareholders are not creditors of the corporation with respect to their shareholdings thereto and the principle of compensation or set-off has no application
- Not necessarily required to be in writing
- Once subscription contract is perfected, SH becomes the debtor of the corporation. He is liable to pay any unpaid portion of the subscription. He can also be made personally liable to the creditors of the corporation to the extent of his unpaid subscription
- General Rule: SH is not liable to pay interest on his unpaid subscription. Exception: if required by the by-laws (§66)

3.2 Pre-incorporation subscription (§61)
- Pre-incorporation subscription is a subscription for shares of stock of a corporation still to be formed.
- It shall be irrevocable for a period of at least six (6) months from the date of subscription.
- It can only be revoked, when:
  - when all of the other subscribers consent to the revocation, or
  - when the incorporation of the corporation fails to materialize within six (6) months or within a longer period as may be stipulated in the contract of subscription.
- After the submission of the AOI to the SEC, no pre-incorporation subscription may be revoked.

4. Pre-emptive Right to Shares (Cf §39, 102)

4.1 Definition of pre-emptive rights - option privilege of an existing stockholder to subscribe to a proportionate part of shares subsequently issued by the corporation before the same can be disposed of in
favor of the others; includes all issues and disposition of shares of any class

- 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, unless such right is denied by the AOI or an amendment thereto.
- This is to prevent dilution in shareholding.
- Includes not only new shares in pursuance of an increase of capital stock but would cover the issue of previously unissued shares which form part of the existing capital stock as well as treasury shares.
- Where the shares are issued in exchange for property needed for corporate purposes or for debt previously granted, SH cannot demand his pre-emptive right for right may prejudice corporate interest (§39).

4.2 Limitation to exercise of pre-emptive right (§39):

a. Such pre-emptive right shall not extend to shares to be issued in compliance with laws requiring stock offerings or minimum stock ownership by the public.

b. Not extend to shares to be issued in good faith with the approval of the stockholders representing two-thirds (2/3) of the outstanding capital stock, in exchange for property needed for corporate purposes or in payment of a previously contracted debt.

c. Shall not take effect if denied in the AOI or an amendment thereto.

4.3 Remedies in case of unwarranted denial:

a. Injunction
b. Mandamus
- In any case, the suit should be individual and not derivative because the wrong done is to the stockholders individually.

c. SEC can cancel shares if the third party is not innocent.

Obligation to pay:

- Principal + Interest
- Security Interest over Property and Assets
- Preferences vis-à-vis SH

EQUITY INTEREST
(Shares of Stock, Inchoate Rights)

Return of Equity Interest:

- Dividends
- Proceeds realized from sale of shares
- Liquidity dividends

Chapter XII

CONSIDERATION FOR ISSUANCE OF SHARES

1. Form of consideration (§62)

- Stocks shall not be issued for a consideration less than the par or issued price thereof.
- Consideration for the issuance of stock may be any or a combination of any two or more of the following:
  a) Actual cash paid to the corporation;
  b) Property, tangible or intangible, actually received by the corporation and necessary or convenient for its use and lawful purposes at a fair valuation equal to the par or issued value of the stock issued;
  o Valuation of consideration other than actual cash, or consists of intangible property such as patents of copyrights – initially be determined by the incorporators or the board of directors, subject to approval by the SEC;
  o Note: Property should not be encumbered. Otherwise, it would impair the consideration;
  c) Labor performed for or services actually rendered to the corporation (must be capable of being valuated);
  d) Previously incurred indebtedness of the corporation;
  e) Amounts transferred from unrestricted retained earnings to stated capital (declaration of stock dividends); and
f) Outstanding shares exchanged for stocks in the event of reclassification or conversion.

- **Prohibited consideration:** Shares of stock shall not be issued in exchange for promissory notes or future service (because realization is uncertain).
- Future service may be used as consideration provided that certificates of stock will be issued only after the performance of such services.
- Same consideration applies for the issuance of bonds by the corporation.
- Fixing of issued price of no-par value shares: The issued price of no-par value shares may be fixed:
  
a) in the AOI or
b) by the BOD pursuant to authority conferred upon it by the AOI or the by-laws, or
c) in the absence thereof, by the SHs representing at least a majority of the outstanding capital stock at a meeting duly called for the purpose.

- The value of the consideration received must be equal to the issue price of the shares of stocks which in no case shall be less than par value.

2. Liability on watered stocks

**Watered stock** – shares issued as fully paid-up when in fact the consideration agreed to and accepted by the directors of the corporation was something known to be much less than the par value or issued value of the shares.

Water in stock refers to the difference between the fair market value at the time of the issuance and the par or issued value of said stock. Subsequent increase in the value of the property used in paying the stock does not do away with the water in the stock. The existence of such water is determined at the time of issuance of the stock.

- **Evils:** deprives corp of needed capital; dilutes proportionate interest of existing and future SH; injures present and future creditors because it reduces value of corp assets

- Any director or officer of a corporation consenting to the issuance of stocks or who, having knowledge thereof, does not forthwith express his objection in writing and file the same with the corporate secretary (§65)
- o for a consideration less than its par or issued value or
- o for a consideration in any form other than cash, valued in excess of its fair value,
- shall be solidarily liable with the stockholder concerned to the corporation and its creditors for the difference between the fair value received at the time of issuance of the stock and the par or issued value of the same.

3. How Payment of Shares Enforced

3.1 Delinquency sale

a. How do shares become delinquent (§67)
- Payment of any unpaid subscription or any percentage thereof, together with the interest accrued, if any, shall be made on the date specified in the contract of subscription or on the date stated in the call made by the board.

- Failure to pay on such date shall render the entire balance due and payable and shall make the stockholder liable for interest at the legal rate on such balance, unless a different rate of interest is provided in the by-laws, computed from such date until full payment.
- If within thirty (30) days from the said date no payment is made, all stocks covered by said subscription shall thereupon become delinquent and shall be subject to sale as hereinafter provided, unless the BOD orders otherwise.
- Despite the fact that the subscription is partially paid, the entire subscription becomes delinquent
- Subscriber is not barred from paying the balance plus the expenses incurred by the corp before the date of the delinquency sale (§68).

b. Procedure for delinquency sale (§68)
- The BOD must make a call by resolution demanding the payment of the balance of the subscription ("notice of call").
- The notice of call shall be served on each stockholder either personally or by registered mail. At this point, there is no need for publication.
- If the stockholder does not pay the amount on the date designated in the notice, the Board shall issue, by resolution, a "notice of delinquency.
- Notice of delinquency shall be served on the non-paying subscriber either personally or by registered mail, PLUS publication in a newspaper of general circulation in the province or city where the principal office of the corporation is located, once a week for two (2) consecutive weeks. The notice shall state the amount due on each subscription plus accrued interest, and the date, time and place of the sale which shall not be less than 30 days nor more than 60 days from the date the stocks become delinquent.
- The amount due in the notice must include all expenses: publication, legal, etc.
  o Note: the notices are jurisdictional.
- In the public auction, the highest bidder is one who is willing to pay the balance of the subscription for the least number of shares. The corporation will give the highest bidder the certificate of stock in the number of his bid; the remaining number will be issued a certificate of stock in favor of the subscriber as fully paid. If there are no bidders, the corporation must bid for the whole number of shares regardless of how much the SH has paid. Such stocks will pertain to the corporation as fully paid treasury stocks.

- No action to recover delinquent stock sold can be sustained upon the ground of irregularity or defect in the notice of
sale, or in the sale itself of the delinquent stock, unless the party seeking to maintain such action first pays or tenders to the party holding the stock the sum for which the same was sold, with interest from the date of sale at the legal rate; and

- No such action shall be maintained unless it is commenced by the filing of a complaint within six (6) months from the date of sale.

- Issuance of Certificate – Once full payment for the stocks have been tendered to the corporation in any of the valid forms of consideration for the issuance of stocks, the purchaser or the subscribers entitled to be issued the corresponding certificate of stock which evidences their ownership of shares in a particular corporation (§64)

### Apocada v NLRC

Apocada was employed in Intans Phil wherein he subscribed to 1500 shares. He subsequently resigned and instituted a complaint with NLRC against corporation for payment of unpaid wages, COLA, balance of gasoline and representation expenses, bonus. Corporation applied what is due to Apocada the balance of his unpaid subscription. HELD: Set-off is not proper. Unpaid subscriptions are not yet due and payable. They become due and payable when a call is made by the corporation. There is no such call yet. Set-off against wages is not valid under labor code.

#### 3.2 Court Action (§70)

Gen. Rule A valid call is a prerequisite to liability where court action is the remedy chosen (Da Silva v. Aboitiz, 1923).

Exceptions:
1. the subscription contract specifies a date of payment
2. the corp. has become insolvent → all unpaid subscriptions are immediately recoverable in a court action by the assignee in insolvency [Velasco vs. Poizat, 1918]

As a defense to a court action, the SH may contend that the subscription was induced by fraudulent misrepresentation, provided he is not barred by ratification, or guilty of laches.

Stockholders cannot escape liability on their unpaid subscription on the ground that these were induced by an unfulfilled commitment of the President of the Phil. that the Phil. government would invest P9.00 for every peso subscribed (PNB v. Bitulok Sawmill Inc., 1968)

### 4. Effect of Delinquency

- Any cash dividends due on delinquent stock shall first be applied to the unpaid balance on the subscription plus costs and expenses, while stock dividends shall be withheld until the delinquent stockholder has paid his unpaid subscription is fully paid. (§43)
- If no delinquent stock shall be: o voted for or o be entitled to vote or to o representation at any stockholder’s meeting, o nor shall the holder thereof be entitled to any of the rights of a stockholder (§71)
  - Except the right to dividends in accordance with the provisions of this Code,
  - until and unless he pays the amount due on his subscription with accrued interest, and the costs and expenses of advertisement, if any.
  - Note that the provision on dividends pertain to delinquent stock hence a call must have been made
  - Stock dividends on delinquent shares are not applied but are included in delinquency sale wherein it is liquidated

### 5. Rights and Obligations of Holders of Unpaid But Non-Delinquent Stock

- Holders of subscribed shares not fully paid which are not delinquent shall have ALL the rights of a stockholder. (§72)
- Subscribers for stock shall pay to the corporation INTEREST on all unpaid subscriptions from the date of subscription, if so required by, and at the rate of interest fixed in the by-laws. If no rate of interest is fixed in the by-laws, such rate shall be deemed to be the legal rate. (§66) General rule: unpaid subscriptions can not be charged with interest. Exception: when required by the by-laws.
- No certificate of stock shall be issued to a subscriber until the full amount of his subscription, together with the interest and expenses (in case of delinquent shares) if any is due, has been paid. (§64)
- No shares of stock against which the corporation holds any unpaid claim shall be transferable in the books of the corporation (§63).
- Attributes of a subscription contract: unconditional (obligation to pay must not be subject to any contingencies) and indivisible (as to the amount and transferability—Fua Cun v. Summers, 1923)

### 6. Issuance of Certificate

A certificate of stock is the best evidence of the rights and status of a SH (although not a condition precedent to the acquisition of such rights), and is convenient for the purposes of transfer (Campos).

Contents of a certificate:
- certifies that the person named is a holder or owner of a stated number of shares
- kind of shares issued
- date of issuance
- par value, if par value shares
- signed by the proper officer of the corp. (usually the pres., and the sec.)
- bears the corporate seal

Over-issue of shares occurs when certificates are issued for more than the number of shares authorized by the articles. Any share certificate w/c represents an over-issue would be void. No rights or liabilities can arise therefrom in favor or against
the holders and bona fide purchasers would have the right to damages for misrepresentation against the corp. but can't acquire the rights of stockholders.

General rule: entire subscription must be paid first before the certificates of stock can be issued. Partial payments are to be applied pro rata to each share of stock subscribed. (Nava v. Peers Mktg Corp and Fua Cun v Summers).

Exception: in the Baltazar v Lingayen Gulf Electric Power Co case, it was the practice of the corp to issue certificates of stock to its individual SHs for unpaid shares of stock and to give full voting power to shares fully paid.

7. Lost or Destroyed Certificate (§73)

Procedure for re-issuance in case of loss, stolen or destroyed certificates:

1. The registered owner of certificates of stock or his legal representative shall file with the corporation an affidavit setting forth as far as possible:
   a) the circumstances as to how the certificates were lost, stolen or destroyed;
   b) the number of shares represented by each certificate, the serial numbers of the certificates;
   c) the name of the corp which issued the same;
   d) such other information and evidence which he may deem necessary.

2. The corp shall publish a notice in a newspaper of general circulation published in the place where the corp has its principal office, once a week for 3 consecutive weeks at the expense of the owner of the certificate of stock, which has been lost, stolen or destroyed.

3. After the expiration of one (1) year from the date of the last publication and if no contest has been presented, the corp shall cancel in its books the certificate of stock and issue in lieu thereof new certificates;

- Limitation on the issue of stock dividends:
  o there must be unissued shares of the corporation. If there are none, there must be an increase in capital stock first, which requires an amendment of the AOI
  o there must be unrestricted retained earnings
  o cannot be issued to non-stockholders even for services rendered (Nielson v. Lepanto Consolidated Mines, 1968)

4. Even before the one year period expires, the new certificates may be issued if the registered owner files a bond or other security, running for a period of one (1) year for a sum in such form and with such sureties as may be satisfactory to the BOD. Provided, that if there is a pending contest regarding the ownership of said certificates, the issuance of new certificates shall be suspended until the final decision of the court regarding the ownership of the certificate of stock.

   o Note: Except in cases of fraud, bad faith, or negligence on the part of the corporation and its officers, no action may be brought against the corp which shall have issued certificates of stock in lieu of those lost, stolen or destroyed pursuant to the above procedure.

Chapter XIII
DIVIDENDS AND PURCHASE OF CORPORATION OF ITS OWN SHARES

1. Form of Dividends (§43)

1.1 CASH – most common form.

1.2 STOCK – a distribution to the stockholders of the company’s own stock. The corporate profits are transferred to capital stock and shares of stock representing the increase in capitalization are distributed.

   These do not represent income on the part of the SH. Investment and proportional interest in the corp remain the same

Lincoln Phil. Life v CA (1998)

Stock dividends are in the nature of shares of stock, the consideration for which is the amount of unrestricted retained earnings converted into equity in the corporation’s books. “A stock dividend of a corporation is a dividend paid in shares of stock instead of cash, and is properly only out of surplus profits. So, a stock dividend is actually two things: (1) a dividend: and (2) the enforced use of the dividend money to purchase additional shares of stock at par.”

2. Source of Dividends (§43)

“Unrestricted retained earnings” (URE) (definition by the SEC) the undistributed earnings of the corp. w/c have not been allocated for any managerial, contractual or legal purposes and which are free for distribution to the SHs as dividends.

→ The only fund out of w/c dividends can be legally paid.

→ Should there be any capital deficit, subsequent profits, if any, during succeeding periods must 1st be applied to cover the deficit, and only the profits remaining after eliminating the deficit, can be considered as URE.

Dividends can not be declared out of increase in valuation of existing assets. This is subject to fluctuation and is not yet realized.

3. Declaration of Dividends

3.1 How Dividends are declared

Approval & voting requirement:

a) Approval of BOD
b) In case of stock dividend: must be approved by SHs representing not less than two-thirds (2/3) of the outstanding capital stock at a regular or special meeting duly called for the purpose.

3.2 Dividend Declaration Discretionary with the Board

Gen. Rule WON there should be a distribution of dividends to the SHs in any given year & the form
of such dividends are matters addressed to the business judgment of the BOD

Exceptions:
1. When the decision is tainted w/ bad faith, fraud or gross negligence
2. If the court finds, upon complaint of a SH, that a surplus was unreasonably accumulated (profits accumulated in excess of 100% of the corp’s paid-in capital stock), it may order the corp. to distribute dividends

Exceptions to the exception (§43):
a. when justified by definite corporate expansion projects or programs approved by the board of directors; or
b. when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its/its consent, and such consent has not yet been secured; or
c. 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.

3.3 When Right to Dividends Vests
• General rule: as soon as the same have been lawfully declared by the BOD, becomes a debt owing to the SH. No revocation can be made

• Exceptions:
o. not yet announced or communicated to the public, revocable before announcement to SHs
o. when stock dividends are declared since these are not distributions but merely represent changes in the capital structure, may be revoked prior to actual issuance

• Rights of transferee to dividends – Right to dividends vests upon declaration so whoever owns the stock at time or stockholders of record also owns the dividend. Subsequent transfer of stock would not carry with it right to dividends UNLESS agreed upon by the parties

3.4 Liability for Illegal Dividends

Directors not personally liable ➔ if unintentionally declare illegal dividends, such as when the directors, in declaring dividends:
- rely on financial statements prepared by a dishonest EE whom they had no reason to suspect
- rely on advice of legal counsel that certain proceeds or profits are available for dividends

Directors liable under §31 ➔ if found negligent or in bad faith to the (1) corp; or (2) its creditors, if insolvent

in its books to cover the shares to be purchased or acquired
• Treasury shares are shares of stocks which have been issued and fully paid for, but subsequently reacquired by the issuing corporation by purchase, redemption, donation or through some other lawful means (§9)
• Treasury shares have no voting rights as long as such shares remain in the treasury (§57)
• May be issued as property dividends provided that the retained earnings has not been subsequently impaired by losses
• “Trust Fund doctrine” – the requirement of unrestricted retained earnings is because subscription to the capital of a corporation constitute a fund to which creditors have a right to look for the satisfaction of their claims (Phil. Trust Co. v. Rivera, 1923)
• Legitimate purpose includes:
  a) To eliminate fractional shares arising out of stock dividends:
  b) To collect or compromise an indebtedness to the corporation, arising out of unpaid subscription, in a delinquency sale, and to purchase delinquent shares sold during said sale; and
  c) To pay dissenting or withdrawing stockholders entitled to payment for their shares under the provisions of this Code (appraisal right, Cf §81).
• Improper purpose includes: raising of price of stock by making it appear that it is being actively traded (prohibited under Sec 24 of the Securities Regulations Code) and preferring some SHs to the prejudice of other SHs and creditors (may be viewed as early liquidation of the investment of some of the SHs)
• Remedies in case of improper purchase:
  a) Creditors prejudiced by the repurchase can go after the selling SHs to recover what was paid to them
  b) Directors who were negligent or in BF for approving the repurchase can also be held personally responsible
  c) Prejudiced SH can also go after BOD who approved purchase (when their dividends are reduced, remaining assets can't cover debts, etc)
• A corporation must have unrestricted retained earnings in acquiring own shares except:
  a) shares are acquired in the redemption of redeemable shares (§8)
  b) shares are re-acquired to effect a decrease in capital stock approved by the SEC (§38)

4. Purchase by the Corporation of its Own Shares (§41)

• A stock corporation shall have the power to purchase or acquire its own shares for a legitimate corporate purpose or purposes (treasury shares) provided, that the corporation has unrestricted retained earnings
Chapter XIV
AMENDMENTS OF CHARTER

1. Amendment of the Articles of Incorporation, Generally

1.1 Procedure for amendment of articles of incorporation (§16)

a) The amendment must be for a legitimate purpose; and must be approved by a majority vote of the Board; and vote (in a meeting) or mere written assent (no meeting) of 2/3 of the outstanding stock, or in case of a non-stock corporation, by the members of the corporation.

- Once the amendment is approved, dissenting stockholders may exercise their rights of appraisal if it involved diminishing of substantial rights previously granted or creating a new set of shares with priority rights.

b) The original and amended articles together shall contain all provisions required by law to be set out in the articles of incorporation. Such articles, as amended shall be indicated by underscoring the change or changes made.

c) A copy thereof duly certified under oath by the corporate secretary and a majority of the directors or trustees stating the fact that said amendment or amendments have been duly approved by the required vote of the stockholders or members, shall be submitted to the Securities and Exchange Commission.

d) The amendment of the Articles of Incorporation will be effective only upon approval of the SEC; but should no action be taken by the SEC within 6 months from the date of filing, then automatically, the amendment is deemed effective, provided that delay is not attributable to the corporation.

1.2 Grounds for disapproving amendment (§17)

- The SEC may disapprove any amendment thereto if the same is not in compliance with the requirements of this Code.
- The SEC shall give the incorporators a reasonable time within which to correct or modify the objectionable portions of the articles or amendment.
- The following are grounds for such disapproval:
  a) Amendment is not substantially with the form prescribed
  b) Purpose or purposes is/are patently unconstitutional, illegal, immoral, contrary to government rules and regulations
  c) Treasurer’s Affidavit concerning the amount of capital stock subscribed and/or paid is false
  d) Percentage requirement of ownership by Filipino citizens as required by the Constitution not complied with

2. Special Amendments

2.1 Increase or decrease of capital stock (§38)

Approval and Voting Requirement
a) Approved by a majority vote of the board of directors
b) Two-thirds (2/3) of the outstanding capital stock shall favor the increase or diminution of the capital stock at a meeting duly called for the purpose

Certificate of Filing
- A certificate in duplicate must be signed by the incorporators a) That the requirements of voting and notice have been complied with;
- The amount of the increase or diminution of the capital stock;
- If an increase of the capital stock, the amount of capital stock or number of shares of no-par stock thereof actually subscribed, the names, nationalities and residences of the persons subscribing, the amount of capital stock or number of no-par stock subscribed by each, and the amount paid by each on his subscription in cash or property, or the amount of capital stock or number of shares of no-par stock allotted to each stock-holder if such increase is for the purpose of making effective stock dividend therefor authorized;
- The amount of stock represented at the meeting; and
- The vote authorizing the increase or diminution of the capital stock

- One of the duplicate certificates shall be kept on file in the office of the corporation and the other shall be filed with the Securities and Exchange Commission and attached to the original articles of incorporation.

Approval of SEC
- Any increase or decrease in the capital shall require prior approval of the Securities and Exchange Commission.
- Decrease of capital stock: No decrease of the capital stock shall be approved by the Commission if its effect shall prejudice the rights of corporate creditors

Effectivity
From and after approval by the Securities and Exchange Commission and the issuance by the Commission of its certificate of filing, the capital stock shall stand increased or decreased

Treasurer’s Affidavit:
The Securities and Exchange Commission shall not accept for filing any certificate of increase of capital stock unless accompanied by the sworn statement of the treasurer of the corporation lawfully holding office at the time of the filing of the certificate, showing that at least twenty-five (25%) percent of such increased capital stock (should be understood as proposed increase-Campos) has been subscribed and that at least twenty-five (25%)
percent of the amount subscribed has been paid either in actual cash to the corporation or that there has been transferred to the corporation property the valuation of which is equal to twenty-five (25%) percent of the subscription

Appraisal right (§81¶1)
Appraisal right may be exercised where the increase in capital stock results in the creation of shares with preferences superior to those of existing ones.

Note: Proposing amendments is a way of easing out the minority stockholders because it compels them to exercise their appraisal rights

2.2 Reduction of capital stock
- Although the requirements in Section 38 have been met, no reduction of capital stock will be approved by the SEC if it will prejudice the rights of corporate creditors.
- There can be no reduction of capital stock which will in effect release the stockholders from the payment of the balance of their subscription if it will adversely affect the right of the creditors in collecting their claims (Phil. Trust Co. vs. Rivera (1923))
- Appraisal Right—Although Section 38 does not grant the appraisal right in case of reduction of capital stock, when it has the effect of altering the rights of any stockholder or class of stockholders, the appraisal right may be exercised under section 81 (1) (Campos)
- Except by decrease of capital stock and as otherwise allowed by this Coded, no corporation shall distribute any of the assets or property except upon lawful dissolution and after payment of all its debts and liabilities. (§122)
  o Campos—It seems that under the exception, a reduction surplus may be distributed as dividends to the stockholders, as long as SEC approval has been obtained and the rights of creditors is not prejudiced.

2.3 Change in corporate term (§37)

Approval and Voting Requirement
a) Approved by a majority vote of the board of directors or trustees and
b) Ratified at a meeting by the stockholders representing at least two-thirds (2/3) of the outstanding capital stock or by at least two-thirds (2/3) of the members in case of non-stock corporations.

Conflict in the availability of appraisal right
YES→ only for extension of corporate term (§37)
YES→ for both shortening and extension (§81)

Chapter XV
TRANSFER OF SHARES

1. Manner and Effectivity of Shares

1.2 Indorsement and delivery
• Shares of stock may be transferred as follows (§63):
  a) delivery of the certificate or certificates and
  b) indorsed by the owner or his attorney-in-fact or other person legally authorized to make the transfer

Rural Bank of Salinas v CA
Clemente, President of Rural Bank of Salinas and owner of shares in said corporation executed a Special Power of Attorney to his wife Melania giving her full power to sell or otherwise dispose of shares of stock of the Bank. Before death of Clemente, Melania, pursuant to said SPA, executed deed of Assignment of former’s shares. After death of Clemente, Melania presented to bank deed of assignment for registration which the bank refused. Mandamus filed by Melania to compel bank to register the transfer.

HELD: Transfer before death valid, stock not yet part of estate. Shares of stock are personal property and may be transferred by delivery. Registration in corporate books is not necessary. The transfer effected in this case is valid. The corporation may not impose any restriction on such transfer. The right of transferee/assignee to have stocks transferred to his name is inherent right, duty of the corporation to register the transfer is ministerial.

Rural Bank of Lipa v. CA (2001)
For the valid transfer of stocks, there must be strict compliance with the mode of transfer prescribed by law, which are:
  a) there must be delivery of the stock certificate;
  b) the certificate must be endorsed by the owner or his attorney-in-fact or other persons legally authorized to make the transfer; and
  c) to be valid against third parties, the transfer must be recorded in the books of the corporation.

Razon v IAC
Chudian was issued 1,500 shares at E Razon Inc with the corresponding stock certificate no 3. Said stock certificates were delivered to Enrique Razon allegedly because it was the latter who paid for all the subscription on the shares of stock in defendant corporation with the understanding that has was the owner of said shares of stock and was to have possession until such time as he was paid by other nominal incorporators/stockholders. Later on, parties delivered it for deposit with bank under the joint custody of the parties. Administrator of the estate of Chudian filed a complaint against Enrique Razon et al praying that the said stock certificates be delivered to estate of Chudian along with all cash and stock dividends and pre-emptive rights accruing thereto.

HELD: Chudian is still owner
  a) Shares of stock is transferred by delivery
and endorsement of the stock certificate
b) Such mode of transfer is not complied with in this case
c) In the books of the corporation, Chudian is still the owner of the stocks. He was even elected member of the board which proves that he is a stockholder
d) One who claims ownership should show that the same was transferred to him in accord with the valid mode of transfer. This petitioner failed to show Endorsement is a mandatory requirement of law for an effective transfer

Tan v SEC (1992)
Alfonso Tan is owner of 400 shares in Visayan Educational Supply Corp evidenced by certificate No. 2. Alfonso transferred 50 shares to Angel. Certificate No. 2 was cancelled and Certificate No. 6 was issued to Angel and Certificate No. 8 was issued to Alfonso. However, Alfonso did not make the proper endorsement and did not make delivery of certificate no. 2. Later on, Alfonso Tan elected to withdraw from the corporation. In exchange for his shares, he received stocks in trade. Certificate No. 8 was later on cancelled due to above. After several years, Alfonso Tan filed a case with Cebu SEC questioning the cancellation of his stock certificates despite non-endorsement and lack of delivery

HELD: Delivery and endorsement under Section 63 of the corporation code is not mandatory because of the use of the word may. Delivery is not essential where it appears that the persons sought to be held as stockholders are officers of the corporation and have custody of the stock book as in this case. To hold that cancellation of certificate of stock of Alfonso is null and void because of lack of delivery and endorsement of mother certificate of stock no. 2 which was deliberately withheld is to prescribe restrictions on the transfer of stock in violation of corporation law

1.2 Registration

- Purpose of registration
  a) enable the transferee to exercise all the rights of a stockholder
  b) to inform the corporation of any change in share ownership so that it can ascertain the persons (a) entitled to the rights (b) subject to the liabilities of a SH
c) until registration is accomplished, the transfer, though valid between the parties, cannot be effective against the corporation

- Effect of lack of registration:
  a) transferee cannot vote
  b) transferee cannot be voted for
  c) transferee cannot prevail over rights of a subsequent attaching creditor (Usong v. Diosomito, 1935)
d) transferee not entitled to dividends
e) stockholder on record has the right to participate in meetings.

No registration of transfer of unpaid shares
- If there is any unpaid balance on the stockholder’s subscription there can be no stock certificate on which indorsement can be made. The shares are thus not transferable on the corporate books. (§63)
- However, the stockholder can still transfer his interest in the corporation by way of a deed of assignment.

Sunset View Condominium Corp v Campos
Sunset View Condominium corporation filed suit against Aguilar-Bernares Realty and Lim Siu Leng for collection of assessments levied on their respective condominium units which they bought on installments and had not yet fully paid

HELD: Respondents not shareholders of condominium corporation because they are not yet fully paid
a) Sec 5 Condominium Act – shareholding in a condominium corporation will be conveyed only in a proper case
b) Sec 4 of Condominium Act leaves to Master Deed the determination of when shareholding will be transferred to purchaser of a unit
c) Master Deed provides that only owner of unit is a shareholder and that ownership of unit is acquired by purchaser subject to conditions and terms of the instrument conveying the unit to such purchaser.
d) Deed of Conveyance provide that ownership is conveyed only upon full payment of purchase price
e) Sec 10 Condominium Act – Membership in Condominium corporation shall not be transferable separately from condominium unit of which it is an appurtenance

Remedy if registration refused – Transferee may petition the court for a writ of mandamus to compel the corporation to do so (Price v. Sulu Development Corp., 1933)

Rivera v Florendo (1986)
Rivera is the registered owner of 4899 shares of stock of Fujiyama Hotel & Restaurant Inc. It is alleged that one Akasako is the real owner of the 4899 shares under Rivera’s name, and as such owner he sold 2550 shares to Milagros. Rivera refused to indorse the certificates to Milagros despite the assurance he gave to Milagros before the sale was consummated. The other incorporators also sold their shares to Milagros and one Jureidini. As regards these transfers, the certificates were properly indorsed by their respective owners. Milagros and Jureidini attempted to have all the certificates registered in their names but the corporation refused to do so.

HELD: Mandamus will not lie where the shares of stock are not even indorsed by the registered owner Rivera who is specifically resisting the registration thereof in the books of the corp. Even the shares of stock sold by the other incorporators cannot be also the subject of mandamus on the strength of the mere indorsement of the supposed owners of said shares in the absence of express instructions from them. The right of the parties will have to be threshed out in an ordinary action.

2. Restrictions on Transfer; Close
COURT MILL 2008

If it appears in the certificate, but NOT
it with apparent authority to deal
– ask the
Presumptions:
e persons who will be
a corporate
If the stock certificate CONSPICUOUSLY
Restrictions shall not be more onerous than
the certificate and filed the action
– presumed to have notice of the
in. If upon the expiration of
those
of
Restrictions on the right to transfer shares
COMMERCIAL LAW
pledge or
stock
that the person
chaser to determine that the
Subject to collateral transfers: Shares of
50
chaser
– the AOI have been properly
chattel mortgage.
all the stockholders have consented
351
Page

2.1 General Rule: Free transferability of shares
Shares are personal property – Shares of stock
so issued are personal property and may be transferred (§63)

2.2 Exception: In close corporations
Considering the special circumstances attending a close corporation (e.g. formed by
persons who know each other well, thus they
would want to choose the persons who will be
allowed in their group), it is justifiable and even imperative for its stockholders to protect
themselves from future conflicts by placing restrictions on the right of each one of them to
transfer his shares to an outsider (§97 & 98).

Validity of restrictions on transfer of shares (§98)

• Restrictions on the right to transfer shares must appear in the articles of incorporation
and in the by-laws as well as in the certificate of stock; otherwise, the same
shall not be binding on any purchaser thereof in good faith.
• Restrictions shall not be more onerous than
granting the existing stockholders or the
corporation the option to purchase the
shares of the transferring stockholder with
such reasonable terms, conditions or period
stated therein. If upon the expiration of
said period, the existing stockholders or the
corporation fails to exercise the option to
purchase, the transferring stockholder may
sell his shares to any third person.
• Presumptions:
  a. If the stock certificate CONSPICUOUSLY
shows the restriction, the purchaser or
transferee is conclusively presumed to
have notice of the restriction, provided
this appears in the AOI. He cannot
prove that he acted in good faith.
  Where a conclusive presumption of
notice arises, the corporation may, at
its option, refuse to register the
transfer, unless
  (1) all the stockholders have consented
to the transfer, or
  (2) the AOI have been properly
amended to remove the restriction.
  b. If it appears in the certificate, but NOT
CONSPICUOUSLY, then although he
may be presumed to have notice of the
restriction, he can prove the contrary.

3. Unauthorized Transfers

3.1 certificates indorsed in blank – where the
stockholder indorses his certificate in blank in such
a manner as to clothe whoever may be in
possession of it with apparent authority to deal
with the shares as the latter’s own, he will be
estopped from claiming the shares as against a
bonafide purchaser. This is called the theory of
quasi-negotiability (Santamaria v. Hongkong &
Shanghai Bank, 1951)

3.2 forged transfers – if the corporation should
issue a new certificate pursuant to a forged
transfer, it incurs no liability to the person in whose
favor it issued it and may demand its return for
cancellation (Hodges v. Lezama, 1965). It is
the duty of the purchaser to determine that the
indorsement was genuine. But with respect to a
subsequent purchaser in good faith and for value,
the corporation is estopped from denying the
validity of the newly issued certificate because by
issuing such, it has represented that the person
named therein is a stockholder of the corporation.
Except where recognition of the original and new
subscriber was result to an overissue of shares.
The new SH would now have right to damages
against the corporation and the latter against those
who made false representation.

4. Collateral Transfers

• Subject to collateral transfers: Shares of
stock being personal property, may be the
subject matter of
a. pledge or
b. chattel mortgage.
• Registration in corporate books not
necessary: Such collateral transfers are not
covered by Sec. 63 of the Code since such
provision applies only to absolute transfers
(Monserrat v. Ceron, 1933). Thus, the
registration in the corporate books of
pledges and chattel mortgages of shares
CANNOT have any legal effect.

Lim Tay v CA (1998)
Sy Guiok and Sy Lim pledged their shares in Go Fay and Co to Lim Tay. They endorsed their
respective shares in blank and delivered the same to Lim Tay. Sy Guiok and Sy Lim failed to pay hence
Lim Tay went to the corporate secretary to ask the
registration of the shares in his name. Corporate
secretary refused. Lim Tay instituted an action for
mandamus at SEC to compel corporate secretary to
register.

HELD: Corporate’s secretary cannot be compelled
to record transfer. The duty of a corporate
secretary to record transfers of stocks is
ministerial. However, he cannot be compelled to
do so when the transferees title to said shares has
no prima facie validity or is uncertain. Mandamus
will not issue to establish a right but only to
enforce one already established. Lim Tay failed to
establish a legal right to have the shares registered
in his name. Lim Tay failed to establish a legal
right. He is not owner of the shares without
foreclosure and purchase at auction. He is merely
a pledgee.

Attachment of shares

FACTS: Dico lost a collection case and the
Proprietary Ownership Certificate (POC) in the Cebu
Country Club in his name was levied on and
scheduled for public auction. Garcia claimed
ownership over the certificate and filed the action
for injunction to enjoin the auction. Dico had
executed a Deed of Transfer in favor of petitioner
which was furnished to The Club but the transfer
was not recorded in the books of the Club because petitioner failed to present proof of payment of the requisite capital gains tax.

HELD: The transfer of the subject certificate made by Dico to petitioner was not valid as to the judgment creditors, as the same still stood in the name of Dico, the judgment debtor, at the time of the levy on execution. In addition, as correctly ruled by the CA, the entry in the minutes of the meeting of the Club’s board of directors noting the resignation of Dico as proprietary member thereof does not constitute compliance with Section 63 of the Corporation Code. Said provision of law strictly requires the recording of the transfer in the books of the corporation, and not elsewhere, to be valid as against third parties.

Chapter XVI
DISSOLUTION

1. Causes of Dissolution

1.1 Expiration of original, extended or shortened term

- The term within which the corporation is to exist (which cannot be more than 50 years) must be stated in its AOI. Once such period expires, the corporation is automatically dissolved without any other proceeding and it cannot thereafter be considered a de facto corporation.

- A voluntary dissolution may be effected by amending the articles of incorporation to shorten the corporate term pursuant to the provisions of the Code. Upon approval of the amended articles of incorporation or the expiration of the shortened term, as the case may be, the corporation shall be deemed dissolved without any further proceedings (§120).

1.2 Voluntary dissolution when no creditors are affected (§118)

- Dissolution may be effected by majority vote of the board of directors or trustees, and by a resolution duly adopted by the affirmative vote of the stockholders owning at least two-thirds (2/3) of the outstanding capital stock or of at least two-thirds (2/3) of the members.

- Meeting to be held upon call of the directors or trustees after publication of the notice of time, place and object of the meeting for three (3) consecutive weeks in a newspaper published in the place where the principal office of said corporation is located; and if no newspaper is published in such place, then in a newspaper of general circulation in the Philippines, after sending such notice to each stockholder or member either by registered mail or by personal delivery at least thirty (30) days prior to said meeting.

- A copy of the resolution authorizing the dissolution shall be certified by a majority of the board of directors or trustees and countersigned by the secretary of the corporation.

- The Securities and Exchange Commission shall thereupon issue the certificate of dissolution. Thus, except for the expiration of its term, no dissolution can be effective without some act of the state (Daguhoy Enterprises v. Ponce, 1954).

1.3 Voluntary dissolution when creditors are affected (§119)

- Petition for dissolution shall be filed with the Securities and Exchange Commission.

- The petition shall be signed by a majority of its board of directors or trustees or other officers having the management of its affairs, verified by its president or secretary or one of its directors or trustees, and shall set forth all claims and demands against it, and shall its dissolution was resolved upon by the affirmative vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock or by at least two-thirds (2/3) of the members at a meeting of its stockholders or members called for that purpose.

- If the petition is sufficient in form and substance, the Commission shall, by an order reciting the purpose of the petition, fix a date on or before which objections thereto may be filed by any person, which date shall not be less than thirty (30) days nor more than sixty (60) days after the entry of the order. Before such date, a copy of the order shall be published at least once a week for three (3) consecutive weeks in a newspaper of general circulation published in the municipality or city where the principal office of the corporation is situated, or if there be no such newspaper, then in a newspaper of general circulation in the Philippines, and a similar copy shall be posted for three (3) consecutive weeks in three (3) public places in such municipality or city.

- Upon five (5) day’s notice, given after the date on which the right to file objections as fixed in the order has expired, the Commission shall proceed to hear the petition and try any issue made by the objections filed; and if no such objection is sufficient, and the material allegations of the petition are true, it shall render judgment dissolving the corporation and directing such disposition of its assets as justice requires, and may appoint a receiver to collect such assets and pay the debts of the corporation.

- In this method of dissolution, SEC may direct the manner in which the liquidation of the corporate assets should be made by assigning this task to the corporation itself, or if it deems proper, to a receiver appointed by it (Campos).

1.4 Dissolution by minority in close corporations Voluntary dissolution when creditors are affected (§105)
Any stockholder of a close corporation may, by written petition to the Securities and Exchange Commissions, compel the dissolution of such corporation whenever any of the acts of the directors, officers or those in control of the corporation is illegal, or fraudulent, or dishonest, or oppressive or unfairly prejudicial to the corporation or any stockholder or whenever corporate assets are being misapplied or wasted.

1.5 Failure to organize and commence business; cessation of business for 5 years (§22)

- Failure to formally organize and commence the transaction of its business or construction of its works within two years → its corporate powers shall cease and the corporation is deemed dissolved
  - Transacting business → implies a continuity of acts or dealings in the accomplishment of the purpose for which the corporation was formed (Mentholatum v. Mangaliman, 1946)
  - Formally organize includes not only the adoption of the by-laws but also the establishment of the body which will administer the affairs of the corporation and exercise its powers
- Commenced transaction of its business but subsequently becomes continuously inoperative for a period of at least five years → ground for suspension or revocation of its corporate franchise or certificate of incorporation

1.6 Involuntary dissolution

Revocation of certificate of registration by the SEC (§121)

- A corporation may be dissolved by the Securities and Exchange Commission upon filing of a verified complaint and after proper notice and hearing on grounds provided by existing laws, rules and regulations
- Grounds for revocation (Sec. 6, par i, PD 902-A)
  - Fraud in procuring its certificate of registration
  - Serious misrepresentation as to what the corporation can or is doing to the great prejudice of or damage to the general public
  - Refusal to comply or defiance of any lawful order of the Commission restraining commission of acts which would amount to a grave violation of its franchise
  - Continuous inoperation for a period of at least five years
  - Failure to file by-laws within the required period
  - Failure to file required reports in appropriate forms as determined by the Commission within the prescribed period
- Other grounds
  - Sec. 144 BP 68 – Violation by the corporation of any provision of the Corporation Code
  - Sec. 104 BP 68 – In case of a deadlock in a close corporation, and the SEC deems it proper to order the dissolution of the corporation as the only practical solution to the dispute

Quo Warranto Proceedings (Sec. 2, Rule 66 ROC)

- When it has offended against a provision of an Act for its creation and renewal
- When it has forfeited its privileges and franchises by nonuse
- When it has committed or omitted an act which amounts to a surrender of its corporate rights, privileges or franchise
- When it has misused a right, privilege, or franchise conferred upon it by law or when it has exercised a right, privilege or franchise in contravention of law

2. Effects of Dissolution; Winding-Up and Liquidation

2.1 Loss of juridical personality

- Corporation loses its juridical personality and can no longer lawfully continue its business except for the purpose of winding up. For this purpose, it may sue and be sued, although upon the expiration of three years, all pending actions by or against the dissolved corporation abate (National Abaca Corp. vs. Pore, 1961)
- Cannot even be a de facto corporation, hence subject to collateral attack (Buenaflor vs. Camarines Sur Industry Corp., 1960)
- Cannot enter into new contracts which would have the effect of continuing the business (Cebu Port Labor Union vs. States Marine Co, 1957)

2.2 Executory contracts

- No right or remedy in favor of or against any corporation, its stockholders, members, directors, trustees, or officers, nor any liability incurred by any such corporation, stockholders, members, directors, trustees, or officers, shall be removed or impaired either by the subsequent dissolution of said corporation or by any subsequent amendment or repeal of this Code or of any part thereof. ($145)

- The prevailing view is that executory contracts are not extinguished. However, some authorities make an exception of contracts for personal services such as employment contracts of officers and employees where the dissolution is involuntary or the result of merger or consolidation in which case the contracts are deemed terminated.

2.3 Winding-Up and Liquidation

- Definition: The winding up and turning assets of corporation into cash for distribution
• A liquidation proceeding is a proceeding in rem so that all other interested persons whether known to the parties or not may be bound by such proceedings (Chua vs. NLRC, 1990)

• For how long may the liquidation of a corporation be undertaken?
  o Every corporation whose charter expires by its own limitation or is annulled by forfeiture or otherwise, or whose corporate existence for other purposes is terminated in any other manner, shall nevertheless be continued as a body corporate for three (3) years after the time when it would have been so dissolved
  o However, in case the corporate assets are conveyed to a trustee or a receiver appointed by the SEC, the three year limitation will not apply (Sumera v. Valencia, 1939)
  o Although the three year period may have expired, it does not necessarily follow that a creditor who was unable to collect his claim before three years would lose his rights. It is still possible for him to sue the trustee, if there be one, or if the circumstances so warrant, to follow the assets in the hands of the stockholders who may have received the same as liquidating dividends (Tan Tiong Bio v. Comm. of Int. Rev., 1962)

Gelano v. CA (1981)

Even if no trustee is appointed or designated during the 3-year period of the liquidation of the corporation, a suit pending prior to the expiration of the period may still be prosecuted with the counsel of record being considered as the “trustee” required by law. Debtors of the corporation may not take advantage of the failure of the corporation to transfer its assets to a trustee; otherwise, it would constitute undue enrichment to dismiss the case as against the defendant.

• What could and should be done during the period of liquidation?
  o For the purpose of prosecuting and defending suits by or against it and enabling it to settle and close its affairs, to dispose of and convey its property and to distribute its assets, but not for the purpose of continuing the business for which it was established.
  o Except by decrease of capital stock and as otherwise allowed by this Code, no corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities.

• What happens if an asset cannot be distributed to the person entitled to it?
  o Upon the winding up of the corporate affairs, any asset distributable to any creditor or stockholder or member who is unknown or cannot be found shall be escheated to the city or municipality where such assets are located.

• Who may undertake the liquidation of a corporation (Methods of Liquidation)?
  o By the corporation itself through the board of directors - the board of directors serve as trustees
  o Conveyance of all corporate assets to trustees who will take charge of the liquidation. From and after any such conveyance by the corporation of its property in trust for the benefit of its stockholders, members, creditors and others. In interest, all interest which the corporation had in the property terminates, the legal interest vests in the trustees, and the beneficial interest in the stockholders, members, creditors or other persons in interest.
  o Liquidation by a receiver who may have been appointed by the SEC upon its decreeing the dissolution of the corporation (§119). 3-year period does not apply because the corporation is substituted by the receiver (Sumera v. - Valencia, Supra). However, the term of appointment of a receiver, without anything more does not result in the dissolution of the corporation nor bar it from the existence of its corporate rights (Leyte Asphalt & Mineral Oil Co. Ltd., v. Block Johnston & Breenbrawn, 1928).

• A corporation cannot distribute any of its assets or property except upon lawful dissolution and only after payment of all its debts and liabilities, after which the remaining assets must be distributed to the stockholders in proportion to their interest in the corporation.

Exceptions:
  ▶ decrease in c/s resulting in a surplus which can then be distributed to stockholders provided no creditors are prejudiced
  ▶ as otherwise allowed by the code:
    o Appraisal right
    o Deadlock in a close corporation
    o SH of a close corporation may compel corporation to buy his shares at fair value

• Corporation repurchases shares for any legitimate corporate purpose

Clemente, Et. Al. V. CA (1995):

The termination of the life of a juridical entity does not by itself cause the extinction or diminution of the rights and liabilities of such entity, nor those of its owners and creditors. If the three-year extended life has expired without a trustee or receiver having been expressly designated by the corporation within that period, the board of directors (or trustees) itself, may be permitted to so continue as "trustees" by legal implication to...
complete the corporate liquidation. Still in the absence of a board of directors or trustees, those having any pecuniary interest in the assets, including not only the shareholders but likewise the creditors of the corporation, acting for and in its behalf, might make proper representation with the Securities and Exchange Commission, which has primary and sufficiently broad jurisdiction in matters of this nature, for working out a final settlement of the corporate concerns.

Reburiano vs. CA, GR 102965, Jan 21, 1999

Corporation amended its AoI to shorten its corporate existence while the case was pending in court. SEC approved the amendment but the trial court was not notified. After the trial court rendered judgment against corporation, it filed motion to quash writ of execution because the corporation lacked juridical personality to sue or be sued.

SC held that it was erroneous to contend that a dissolved and non-existing corporation could no longer be represented by a lawyer and concomitantly a lawyer could not appear as counsel for a non-existing judicial person. A corporation that has a pending action and which cannot be terminated within the three-year period after its dissolution is authorized under Sec. 78 [now §122] of the Corporation Law to convey all its property to trustees to enable it to prosecute and defend suits by or against the corporation beyond the three-year period. Although private respondent did not appoint any trustee, yet the counsel who prosecuted and defended the interest of the corporation in the instant case and who in fact appeared in behalf of the corporation may be considered a trustee of the corporation at least with respect to the matter in litigation only.

Phil. Veterans Bank v. Employees Union (2001)

Liquidation, in corporation law, connotes a winding up or setting with creditors and debtors. It is the winding up of a corporation so that assets are distributed to those entitled to receive them. It is the process of reducing assets to cash, discharging liabilities and dividing surplus or loss.

On the opposite end of the spectrum is rehabilitation which connotes a reopening or reorganization. Rehabilitation contemplates a continuance of corporate life and activities in an effort to restore and reinstate the corporation to its former position of successful operation and solvency. It is crystal clear that the concept of liquidation is diametrically opposed or contrary to the concept of rehabilitation, such that both cannot be undertaken at the same time. To allow the liquidation proceedings to continue would seriously hinder the rehabilitation of the subject bank.

Chapter XVII
CORPORATE COMBINATION

1. Merger and Consolidation

1.1 What is a merger / consolidation?

- **Merger**
  - One of the constituent corporations remains as an existing juridical person, whereas the other corporation shall cease to exist. Merger is the disappearance of one of the corporations with the other corporation acquiring all the assets, rights of action, and assuming all the liabilities of the disappearing corporation.
  - Of course, there is an arrangement as to the shares of stocks that will be issued to the former stockholders of the two (2) corporations which were merged. Said stockholders are now stockholders of the corporation which survives. The proportion between the two (2) corporations will be the basis of the shares of stocks that will be issued to the stockholders under the surviving corporation.

- **Consolidation**
  - If there is consolidation, there will be disappearance of both the constituent corporations with the emergence of a new corporate entity, called the consolidated corporation, which shall obtain all the assets of the disappearing corporations, and likewise shall assume all their liabilities.
  - Also, the number of shares that will be issued to each of the stockholders under the new corporation is determined by the ration between the assets of the two (2) corporations.

1.2 What is a “constituent corporation”? A “consolidated corporation”? (§76)

Two or more corporations may merge into a single corporation which shall be one of the constituent corporations or may consolidate into a new single corporation which shall be the consolidated corporation.

1.3 What corporate approvals are required? (§77)

1. Approval by majority vote of each of the board of directors or trustees of the constituent corporations of the plan of merger or consolidation.
2. Approval by the stockholders or members of each of such corporations in separate meetings. The affirmative vote of stockholders representing at least two-thirds (2/3) of the outstanding capital stock of each corporation in the case of stock corporations or at least two-thirds (2/3) of the members in the case of non-
stock corporations shall be necessary for the approval of such plan

3. Notice of such meetings shall be given to all stockholders or members of the respective corporations, at least two (2) weeks prior to the date of the meeting, or personally, or by registered mail. Said notice shall state the purpose of the meeting and shall include a copy or a summary of the plan of merger or consolidation.

4. Any dissenting stockholder in stock corporations may exercise his appraisal right in accordance with the Code. Provided, that if after the approval by the stockholders of such plan, the board of directors decides to abandon the plan, the appraisal right shall be extinguished.

5. Amendment to the plan of merger or consolidation may be made by approval of the majority vote of the respective boards of directors or trustees of all the constituent corporations and ratified by the affirmative vote of stockholders representing at least two-thirds (2/3) of the outstanding capital stock or of two-thirds (2/3) of the members of each of the constituent corporations. Such plan, together with any amendment, shall be considered as the agreement of merger or consolidation.

1.4 What is a plan of merger or consolidation? (§76)

The board of directors or trustees of each corporation, party to the merger or consolidation, shall approve a plan of merger or consolidation setting forth the following:

- The names of the corporations proposing to merge or consolidate, hereinafter referred to as the constituent corporations;
- The terms of the merger or consolidation and the mode of carrying the same into effect;
- A statement of the changes, if any, in the articles of incorporation of the surviving corporation in case of merger; and, with respect to the consolidated corporation in case of consolidation, all the statements required to be set forth in the articles of incorporation for corporations organized under this Code; and
- Such other provisions with respect to the proposed merger or consolidation as are deemed necessary or desirable.

1.5 What are articles of merger or consolidation? (§78)

- After the approval by the stockholders or members, articles of merger or articles of consolidation shall be executed by each of the constituent corporations:
  1) to be signed by the president or vice-president and
  2) certified by the secretary or assistant secretary of each corporation

- The articles of merger or consolidation shall set forth:
  1) The plan of the merger or the plan of consolidation;
  2) As to stock corporations, the number of shares outstanding, or in the case of non-stock corporations, the number of members; and
  3) As to each corporation, the number of shares or members voting for and against such plan, respectively.

1.6 When is the effectivity of merger or consolidation? (§79)

- Effectivity: Upon issuance by the SEC of the certificate of merger and consolidation
- If the Commission is satisfied that the merger or consolidation of the corporations concerned is not inconsistent with the provisions of this Code and existing laws, it shall issue a certificate of merger or of consolidation, at which time the merger or consolidation shall be effective.
- The articles of merger or of consolidation shall be submitted to the Securities and Exchange Commission in quadruplicate for its approval.
- In the case of merger or consolidation of banks or banking institutions, building and loan associations, trust companies, insurance companies, public utilities, educational institutions and other special corporations governed by special laws, the favorable recommendation of the appropriate government agency shall first be obtained.
- If, upon investigation, the Securities and Exchange Commission has reason to believe that the proposed merger or consolidation is contrary to or inconsistent with the provisions of this Code or existing laws, it shall set a hearing to give the corporations concerned the opportunity to be heard. Written notice of the date, time and place of hearing shall be given to each constituent corporation at least two (2) weeks before said hearing. The Commission shall thereafter proceed as provided in this Code.

1.7 What are the effects of a merger or consolidation? (§80)

1) The constituent corporations shall become a single corporation which:

- In case of merger, shall be the surviving corporation designated in the plan of merger; and
- In case of consolidation, shall be the consolidated corporation designated in the plan of consolidation;

2) The existence of the constituent corporations shall cease, except that of the surviving or the consolidated corporation;

3) The surviving or the consolidated corporation shall possess all the rights, privileges, immunities and powers and shall be subject to all the duties and
liabilities of a corporation organized under this Code;
4) The surviving or the consolidated corporation shall thereupon and thereafter possess:
   • all the rights, privileges, immunities and franchises of each of the constituent corporations; and
   • all property, real or personal, and all receivables due on whatever account, including subscriptions to shares and other choses in action, and all and every other interest of, or belonging to, or due to each constituent corporation
   • these shall be deemed transferred to and vested in such surviving or consolidated corporation without further act or deed; and
5) The surviving or consolidated corporation shall:
   • be responsible and liable for all the liabilities and obligations of each of the constituent corporations in the same manner as if such surviving or consolidated corporation had itself incurred such liabilities or obligations; and
   • any pending claim, action or proceeding brought by or against any of such constituent corporations may be prosecuted by or against the surviving or consolidated corporation.
   • The rights of creditors or liens upon the property of any of such constituent corporations shall not be impaired by such merger or consolidation

Babst v. CA (2001)

It is settled that in the merger of two existing corporations, one of the corporations survives and continues the business, while the other is dissolved and all its rights, properties and liabilities are acquired by the surviving corporation.

ASSOCIATED BANK v. CA (1998)

Ordinarily, in the merger of two or more existing corporations, one of the combining corporations survives and continues the combined business, while the rest are dissolved and all their rights, properties and liabilities are acquired by the surviving corporation. Although there is dissolution of the absorbed corporations, there is no winding up of their affairs or liquidation of their assets, because the surviving corporation automatically acquires all their rights, privileges and powers, as well as their liabilities.

1.8 Procedure for Merger or Consolidation (Villanueva)

1) Board of each corporation shall draw up a plan of merger or consolidation, setting forth:
• names of corporations involved (constituent corporations)
• terms and mode of carrying it out
• statement of changes, if any, in the present articles of surviving corporation; or the articles of the new corporation to be formed in case of consolidation.
2) Plan for merger or consolidation shall be approved by majority vote of each board of the concerned corporations at separate meetings.
3) The same shall be submitted for approval to the stockholders or members of each such corporation at separate corporate meetings duly called for the purpose. Notice should be given to all stockholders or members at least two (2) weeks prior to date of meeting, either personally or by registered mail.
4) Affirmative vote of 2/3 of the outstanding capital stock in case of stock corporations, or 2/3 of the members of a non-stock corporation shall be required.
5) Dissenting stockholders may exercise the right of appraisal. But if Board abandons the plan to merge or consolidate, such right is extinguished.
6) Any amendment to the plan must be approved by the same votes of the board members of trustees and stockholders or members required for the original plan.
7) After approval, Articles of Merger or Articles of Consolidation shall be executed by each of the constituent corporations, signed by president or VP and certified by secretary or assistant secretary, setting forth:
   • plan of merger or consolidation
   • in stock corporation, the number of shares outstanding; in non-stock, the number of members
   • as to each corporation, number of shares or members voting for and against such plan, respectively
8) Four copies of the Articles of Merger or Consolidation shall be submitted to the SEC for approval. Special corporations like banks, insurance companies, building and loan associations, etc., need the prior approval of the respective government agency concerned.
9) If SEC is satisfied that the merger or consolidation is legal, it shall issue the Certificate of Merger or the Certificate of Incorporation, as the case may be.
10) If the SEC is not satisfied, it shall set a hearing, giving due notice to all the corporations concerned. (§76-79)

1.9 Limitation on the right to merge / consolidate

1) Should not create monopolies
2) Should not eliminate free and healthy competition
3) Act 3518 Sec 20 inhibits illegal combinations
1.10 **Appraisal right**: any dissenting stockholder may exercise his appraisal right under the conditions provided in the Code

### 2. Sale of substantially all assets (§40)

#### 2.1 Restrictions:
Subject to the provisions of existing laws on illegal combinations and monopolies

#### 2.2 Scope of power:
To sell, lease, exchange, mortgage, pledge or otherwise dispose of all or substantially all of its property and assets, including its goodwill, upon such terms and conditions and for such consideration, which may be money, stocks, bonds or other instruments for the payment of money or other property or consideration, as its board of directors or trustees may deem expedient.

- Meaning of disposition of substantially all of the corporate property and assets - if thereby the corporation would be rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated.

#### 2.3 Approval, voting and notice requirement:
- Majority vote of its board of directors or trustees,
- Authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or in case of non-stock corporation, by the vote of at least two-thirds (2/3) of the members, in a stockholder’s or member’s meeting duly called for the purpose.
- Written notice of the proposed action and of the time and place of the meeting shall be addressed to each stockholder or member 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.
  - When SH approval not necessary - If disposition is necessary in the usual and regular course of business of said corporation or if the proceeds of the sale or other disposition of such property and assets be appropriated for the conduct of its remaining business.
  - In non-stock corporations where there are no members with voting rights - the vote of at least a majority of the trustees in office will be sufficient authorization for the corporation to enter into any transaction authorized by this section.

#### 2.4 Appraisal right:
Any dissenting stockholder may exercise his appraisal right under the conditions provided in the Code

#### 2.5 Abandonment of the sale, lease...
After such authorization or approval by the stockholders or members, the board of directors or trustees may, nevertheless, in its discretion, abandon such sale, lease, exchange, mortgage, pledge or other disposition of property and assets, subject to the rights of third parties under any contract relating thereto, without further action or approval by the stockholders or members.

### 2.6 Compared to merger and consolidation

Advantage of merger and consolidation over sale:
- Furnish a short cut to the accomplishment of various transactions
- May avoid the difficulty, delay and expense which usually accompany dissolution, winding up and distribution of assets to its SH by a selling corp
- Automatic assumption of liabilities of the absorbed corp (in sale, there must be sufficient funds reserved by the absorbed corp to pay its liabilities, otherwise the sale may be attacked by Compared the creditors as a fraudulent conveyance)
- Transfer or exchange of shares is exempt from registration under Securities Act (in sale, registration with SEC required)

Advantage of sale of substantially all assets: Where the absorbing corp foresees problems in securing stockholders’ approval and in granting the appraisal right of dissenters, it may decide that its purchase of the assets of the absorbed corp would be more convenient and practical than merger.
Chapter XVIII  
FOREIGN CORPORATIONS

1. Definition (§123)

Foreign corporation is one formed, organized or existing under any laws other than those of the Philippines and whose laws allow Filipino citizens and corporations to do business in its own country or state.

2. “Doing business” (Sec. 3(d) RA 7042, Foreign Investments Act of 1991)

- Soliciting orders
- Service contracts
- Appointing representatives or distributors domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totaling 180 days or more
- Opening offices, whether called liaison offices or branches
- Establishing a factory, workshop or processing plant
- Undertaking building construction or erection projects
- Opening a store, whether wholesale or retail without prejudice to the provisions of the Retail Trade Act
- Maintaining or operating a warehouse for business purposes including the storage, display or delivery of its own products
- Participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines
- Any other act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to that extent the performance of acts or works or the exercise of the functions normally incident to and in the progressive prosecution of the purpose and object of its organization

It shall not include:

- Mere investment as a shareholder by a foreign entity in domestic corporations duly registered to do business and/or the exercise of such rights as such investor
- Having a nominee director or officer to represent its interests in such corporations
- Appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account
- The following acts by themselves shall not be deemed doing business in the Phil:
  - The publication of a general advertisement through newspapers, brochures or other publication media or through radio or television
  - Maintaining the stock of goods in the Phil solely for the purpose of having the same processed by another entity in the Phil.
  - Collecting information in the Phil.

Mentholatum Co., Inc., v. Mangaliman (1941)

No general rule or governing principle can be laid down as to what constitutes “doing” or “engaging” in or “transacting” business. Indeed, each case must be judged in the light of its peculiar environmental circumstances. The true test, however, seems to be whether the foreign corporation is continuing the body or substance of the business or enterprise for which it was organized, or whether it has substantially retired from it and turned it over to another. The term implies a continuity of commercial dealings and arrangements, and contemplates to that extent the performance of acts or works or the exercise of the functions normally incident to and in the progressive prosecution of the purpose and object of its organization.

Necessity of obtaining a license to do business:

The reason for the license is to subject the foreign corporation doing business in the Philippines to the jurisdiction of the courts, otherwise a foreign corporation illegally doing business here may successfully though unfairly plead such neglect or illegal act so as to avoid service and thereby impugn the jurisdiction of the local courts.

B Van Zuiden Bros. Ltd. v. GTVL Manufacturing

GR No. 147905  May 28, 2007
Zuiden, a foreign corporation not licensed to do business in the Philippines, filed a complaint for sum of money with the RTC of Paranaque against GTVL. The latter filed a motion to dismiss on the ground that petitioner has no legal capacity to sue and this was granted. The CA sustained the RTC ruling that the transactions were not isolated hence not falling within the exception. It relied on Eriks Pte. Ltd. v. CA where it held that what is material are the proponents to the transaction, as well as the parties to be benefited and obligated by the transaction.

HELD: To be doing or “transacting business in the Philippines” for purposes of Section 133 of the Corporation Code, the foreign corporation must actually transact business in the Philippines, that is, perform specific business transactions within the Philippine territory on a continuing basis in its own name and for its own account. An essential condition to be considered as “doing business” in the Philippines is the actual performance of specific commercial acts within the territory of the Philippines for the plain reason that the Philippines has no jurisdiction over commercial acts performed in foreign territories. Here, there is no showing that petitioner performed within the Philippine territory the specific acts of doing business mentioned in Section 3(d) of RA 7042. Petitioner did not also open an office here in the Philippines, appoint a representative or distributor, or manage, supervise or control a local business. While petitioner and
respondent entered into a series of transactions implying a continuity of commercial dealings, the perfection and consummation of these transactions were done outside the Philippines. The series of transactions between petitioner and respondent transpired and were consummated in Hong Kong. The SC found no single activity which petitioner performed here in the Philippines pursuant to its purpose and object as a business organization. Moreover, petitioner’s desire to do business within the Philippines is not discernible from the allegations of the complaint or from its attachments. Therefore, there is no basis for ruling that petitioner is doing business in the Philippines. The SC categorically stated its disagreement with the Court of Appeals’ ruling that the proponents to the transaction determine whether a foreign corporation is doing business in the Philippines, regardless of the place of delivery or place where the transaction took place. To accede to such theory makes it possible to classify, for instance, a series of transactions between a Filipino in the United States and an American company based in the United States as “doing business in the Philippines,” even when these transactions are negotiated and consummated only within the United States.

3. Requirements for the issuance of a license

3.1. Documentary requirements (§125)
- A foreign corporation applying for a license to transact business in the Philippines shall submit to the SEC:
  - Copy of its articles of incorporation and by-laws, certified in accordance with law
  - Their translation to an official language of the Philippines, if necessary.
- The application shall be under oath and, unless already stated in its articles of incorporation, shall specifically set forth the following:
  - The date and term of incorporation;
  - The address, including the street number, of the principal office of the corporation in the country or state of incorporation;
  - The name and address of its resident agent authorized to accept summons and process in all legal proceedings and, pending the establishment of a local office, all notices affecting the corporation;
  - The place in the Philippines where the corporation intends to operate;
  - The specific purpose or purposes which the corporation intends to pursue in the transaction of its business in the Philippines: Provided, That said purpose or purposes are those specifically stated in the certificate of authority issued by the appropriate government agency;
  - The names and addresses of the present directors and officers of the corporation;
  - A statement of its authorized capital stock and the aggregate number of shares which the corporation has authority to issue, itemized by classes, par value of shares, shares without par value, and series, if any;
  - A statement of its outstanding capital stock and the aggregate number of shares which the corporation has issued, itemized by classes, par value of shares, shares without par value, and series, if any;
  - A statement of the amount actually paid in; and
  - Such additional information as may be necessary or appropriate in order to enable the Securities and Exchange Commission to determine whether such corporation is entitled to a license to transact business in the Philippines, and to determine and assess the fees payable.
- Attached to the application for license shall be a duly executed certificate under oath by the authorized official or officials of the jurisdiction of its incorporation, attesting to the fact that:
  - The laws of the country or state of the applicant allow Filipino citizens and corporations to do business therein
  - The applicant is an existing corporation in good standing.
- If such certificate is in a foreign language, a translation thereof in English under oath of the translator shall be attached thereto.
- The application shall likewise be accompanied by a statement under oath of the president or any other person authorized by the corporation, showing to the satisfaction of the SEC and other governmental agency in the proper cases that the:
  - Applicant is solvent and in sound financial condition, and
  - Setting forth the assets and liabilities of the corporation as of the date not exceeding one (1) year immediately prior to the filing of the application.
- Foreign banking, financial and insurance corporations shall, in addition to the above requirements, comply with the provisions of existing laws applicable to them.
- In the case of all other foreign corporations, no application for license to transact business in the Philippines shall be accepted by the SEC without previous authority from the appropriate government agency, whenever required by law.

3.2 Deposit requirements (§126)
- Upon issuance of the license, such foreign corporation may commence to transact business in the Philippines and continue to do so for as long as it
retains its authority to act as a corporation under the laws of the country or state of its incorporation, unless such license is sooner surrendered, revoked, suspended or annulled in accordance with this Code or other special laws.

- Within sixty (60) days after the issuance of the license to transact business in the Philippines, the license, except foreign banking or insurance corporation, shall deposit with the SEC for the benefit of present and future creditors of the licensee in the Philippines, securities satisfactory to the SEC, consisting of:
  - Bonds or other evidence of indebtedness of the Government of the Philippines, its political subdivisions and instrumentalities, or of any government-owned or controlled corporations and entities,
  - Shares of stock in "registered enterprises" as this term is defined in Republic Act No. 5186,
  - Shares of stock in domestic corporations registered in the stock exchange, or
  - Shares of stock in domestic insurance companies and banks, or
  - Any combination of these kinds of securities,

- With an actual market value of at least one hundred thousand (P100,000.00) pesos;

- Provided, however, That within six (6) months after each fiscal year of the licensee, the SEC shall require the licensee to deposit additional securities equivalent in actual market value to two (2%) percent of the amount by which the licensee’s gross income for that fiscal year exceeds five million (P5,000,000.00) pesos.

- The SEC shall also require deposit of additional securities if the actual market value of the securities on deposit has decreased by at least ten (10%) percent of their actual market value at the time they were deposited.

- The SEC may at its discretion release part of the additional securities deposited with it if the gross income of the licensee has decreased, or if the actual market value of the total securities on deposit has increased, by more than ten (10%) percent of the actual market value of the securities at the time they were deposited.

- The SEC may, from time to time, allow the licensee to substitute other securities for those already on deposit as long as the licensee is solvent. Such licensee shall be entitled to collect the interest or dividends on the securities deposited.

- In the event the licensee ceases to do business in the Philippines, the securities deposited as aforesaid shall be returned, upon the licensee's application therefor and upon proof to the satisfaction of the SEC that the licensee has no liability to Philippine residents, including the Government of the Republic of the Philippines.

### 3.3 Appointment of resident agent (§128)

- A resident agent may be either an (§ 127):
  - Individual residing in the Philippines of good moral character and of sound financial standing
  - Domestic corporation lawfully transacting business in the Philippines:
  - The SEC shall require as a condition precedent to the issuance of the license to transact business in the Philippines by any foreign corporation that such corporation file with the SEC a written power of attorney:
    - Designating some person who must be a resident of the Philippines, on whom any summons and other legal processes may be served in all actions or other legal proceedings against such corporation, and
    - Consent ing that service upon such resident agent shall be admitted and held as valid as if served upon the duly authorized officers of the foreign corporation at its home office.

- Any such foreign corporation shall likewise execute and file with the SEC an agreement or stipulation, executed by the proper authorities of said corporation, in form and substance as follows:
  - "The (name of foreign corporation) does hereby stipulate and agree, in consideration of its being granted by the Securities and Exchange Commission a license to transact business in the Philippines, that if at any time said corporation shall cease to transact business in the Philippines, or shall be without any resident agent in the Philippines on whom any summons or other legal processes may be served, then in any action or proceeding arising out of any business or transaction which occurred in the Philippines, service of any summons or other legal process may be made upon the SEC and that such service shall have the same force and effect as if made upon the duly authorized officers of the corporation at its home office."

- Whenever such service of summons or other process shall be made upon the SEC, the Commission shall, within ten (10) days thereafter, transmit by mail a copy of such summons or other legal process to the corporation at its home or principal office.

- The sending of such copy by the Commission shall be necessary part of and shall complete such service. All expenses incurred by the Commission for such service shall be paid in advance by the party at whose instance the service is made.
• In case of a change of address of the resident agent, it shall be his or its duty to immediately notify in writing the SEC of the new address.

3.4 Summary: Requisites for the Issuance of License

• The SEC will issue a license to the foreign corporation to do business in the Philippines, provided the following conditions are met:
  o Appointment of a Resident Agent:
    ▶ Either a Filipino or domestic corporation; and
    ▶ Power of Attorney to SEC to receive process
  o Must prove that the foreign corporation’s country grants reciprocal rights to Filipinos and Philippine corporation.
  o Establish an office in the Philippines
  o Bring in its assets
  o Undertaking that Filipino creditors will be preferred in the event of insolvency
  o Notice of six (6) months should there be desire to terminate operations
  o Franchise and patents must remain in the Philippine, if this is possible
  o Must file a bond of P100,000 which may be in the following form:
    ▶ surety bond
    ▶ government securities
    ▶ securities of political subdivisions
    ▶ shares of stock of registered enterprises with the SEC
    ▶ shares of stock of any corporation being sold at the stock exchange
  o Provided, that within six (6) months after each fiscal year, the SEC shall require the deposit of additional securities equivalent to 2% of the amount in excess of P500,000 of the gross income. [Sec. 125, 126, Corporation Code]

4. What laws are applicable to foreign corporations licensed to transact business in the Philippines? (§129)

• Any foreign corporation lawfully doing business in the Philippines shall be bound by all laws, rules and regulations applicable to domestic corporations of the same class, EXCEPT such only as provide for the:
  o Creation, formation, organization or dissolution of corporations or
  o Those which fix the relations, liabilities, responsibilities, or duties of stockholders, members, or officers of corporations to each other or to the corporation.

• No foreign corporation transacting business in the Philippines without a license, or its successors or assigns, shall be permitted to maintain or intervene in any action, suit or proceeding in any court or administrative agency of the Philippines;

• Such corporation may be sued or proceeded against before Philippine courts or administrative tribunals on any valid cause of action recognized under Philippine laws.

• In addition, Sec. 134 makes it a ground for revocation of license when a foreign corporation transacts business in the Philippines as agent of or acting for and in behalf of any foreign corporation or entity not duly licensed to do business in the Philippines.

• Status of Contracts entered into without the requisite license
  o The failure to obtain a license by a foreign corporation doing business in the Philippines does not affect the validity of contracts entered into by such foreign corporation, but merely removes its legal standing to sue in local tribunals. However, the defect may be cured by subsequent registration by the foreign corporation to obtain the necessary license to do business in the Philippines. [Home Insurance Co. v. Eastern Shipping Lines, 123 SCRA 424 (1983)]
  o Although the law does not declare as void or invalid the contracts entered into by a foreign corporation with a local corporation without the former first securing a license or certificate to do business in the Philippines, the parties in this case cannot obtain relief on the contracts entered into because they are charged with the knowledge of the law at the time they entered into such contract and at the time it is to be operative. [Top-Weld Mfg. v. ECED, S.A., 138 SCRA 118 (1985)]
  o However, in the case of Merrill Lynch Futures, Inc. v. CA, 211 SCRA 824 (1992), the SC held that although the foreign corporation has engaged in business in the Philippines without a license, the dismissal of the suit would not be proper on the ground that if the local investors knew that the foreign corporation had no license to do business, then they are estopped from using the lack of license to avoid their obligations.

• Legal standing of foreign corporations to sue on their corporate names, trade names, and trademarks
  o A foreign corporation although not doing business in the Philippines has a personality to sue to oppose the registration of a trademark when it is shown that its products using such trademark are being imported and sold in the Philippines, pursuant to the terms of RA 166. [General Garments v. Director of Patents, 41 SCRA 50 (1971)]
  o A foreign corporation has a right to maintain an action in Philippine courts
even if it is not licensed to do business and is not actually doing business on its own therein to protect its corporate and trade names, since it is a property right in rem, which it may assert to protect against all the world, in any of the countries of the world—even in jurisdiction where it does not transact business—just the same as it may protect its tangible property, against trespass or conversion. This is in consonance with the Convention of the Union of Paris for the Protection of Industrial Property to which the Phils. is a party. Article 8 thereof provides, “A trade name shall be protected in all the countries of the Union without the obligation of filing or registration, whether or not it forms part of the trademark.” The mandate is contained in RA 166, or the Trademark Law. [Converse Rubber Corp. v. Universal Rubber Products, 147 SCRA 154 (1987)]

6. Application to existing foreign corporations (§148)

- Every foreign corporation which on the date of the effectivity of the Code is authorized to do business in the Philippines under a license issued to it, shall continue to have such authority under the terms and condition of its license, subject to the provisions of this Code and other special laws.

7. Amendments to articles of incorporation or by-laws of foreign corporations (§130)

- Within sixty (60) days after the amendment becomes effective, file with the SEC, and in the proper cases with the appropriate government agency, a duly authenticated copy of the articles of incorporation or by-laws, as amended, indicating clearly in capital letters or by underscoring the change or changes made, duly certified by the authorized official or officials of the country or state of incorporation.
- The filing thereof shall not of itself enlarge or alter the purpose or purposes for which such corporation is authorized to transact business in the Philippines.

8. Amended license (§131)

- A foreign corporation authorized to transact business in the Philippines shall obtain an amended license in the event it:
  - Changes its corporate name, or
  - Desires to pursue in the Philippines other or additional purposes.
- By submitting an application therefor to the SEC, favorably endorsed by the appropriate government agency in the proper cases.

9. Merger or consolidation involving a foreign corporation licensed in the Philippines (§132)

- One or more foreign corporations authorized to transact business in the Philippines may merge or consolidate with any domestic corporation or corporations if:
  - Such is permitted under Philippine laws and by the law of its incorporation
  - The requirements on merger or consolidation as provided in this Code are followed
- Whenever a foreign corporation authorized to transact business in the Philippines shall be a party to a merger or consolidation in its home country or state as permitted by the law of its incorporation, such foreign corporation shall, within sixty (60) days after such merger or consolidation becomes effective, file with the SEC, and in government agency, a copy of the articles of merger or consolidation duly authenticated by the proper official or officials of the country or state under the laws of which merger or consolidation was effected
- Provided, however, that if the absorbed corporation is the foreign corporation doing business in the Philippines, the latter shall at the same time file a petition for withdrawal of its license.

10. Revocation of license (§134)

- Without prejudice to other grounds provided by special laws, the license of a foreign corporation to transact business in the Philippines may be revoked or suspended by the SEC upon any of the following grounds:
  - Failure to file its annual report or pay any fees as required by this Code;
  - Failure to appoint and maintain a resident agent in the Philippines as required by this Title;
  - Failure, after change of its resident agent or of his address, to submit to the Securities and Exchange Commission a statement of such change as required by this Title;
  - Failure to submit to the Securities and Exchange Commission an authenticated copy of any amendment to its articles of incorporation or by-laws or of any articles of merger or consolidation within the time prescribed by this Title;
  - A misrepresentation of any material matter in any application, report, affidavit or other document submitted by such corporation pursuant to this Title;
  - Failure to pay any and all taxes, imposts, assessments or penalties, if any, lawfully due to the Philippine Government or any of its agencies or political subdivisions;
- Transacting business in the Philippines outside of the purpose or purposes for which such corporation is authorized under its license;
- Transacting business in the Philippines as agent of or acting for and in behalf of any foreign corporation or entity not duly licensed to do business in the Philippines; or
11. Issuance of certificate of revocation (§135)

- Upon the revocation of any such license to transact business in the Philippines, the Securities and Exchange Commission shall issue a corresponding certificate of revocation, furnishing a copy thereof to the appropriate government agency in the proper cases.
- The Securities and Exchange Commission shall also mail to the corporation at its registered office in the Philippines a notice of such revocation accompanied by a copy of the certificate of revocation.

12. Withdrawal by a foreign corporation (Section 136)

- If a foreign corporation duly licensed to do business desires to withdraw, it must file a petition for withdrawal, and must meet the following requirements:
  o All claims accrued in the Philippines must be settled
  o All taxes must be paid
  o Petition must be published once a week for three (3) consecutive weeks. (§136)

Doing business in the Philippines without a license:

Communications Materials vs. CA, (1996)

In determining whether a corporation does business in the Philippines or not, aside from their activities within the forum, reference may be made to the contractual agreements entered into by it with other entities in the country. A scrutiny of the different contracts and agreements entered into with various business contacts in the country indicate convincingly a purpose to convey to customers and the general public that they are dealing directly with the foreign corporation, and that foreign corporation is actively engaging in business in the country. These agreements also contain provisions which are highly restrictive in nature, reducing the local signatory to be a mere extension or instrument of the foreign corporation. Hence, the foreign corporation is deemed to be doing business in the Philippines without a license.

Nonetheless, petitioner is estopped from raising this fact to bar the foreign corporation from suing. One who has dealt with a corporation of foreign origin as a corporate entity is estopped to deny its corporate existence and capacity. And the doctrine of estoppel to deny corporate existence applies to a foreign as well as to domestic corporations. The principle will be applied to prevent a person contracting with a foreign corporation from later taking advantage of its noncompliance with the statutes chiefly in cases where such person has received the benefits of the contract.


The question whether or not a foreign corporation is doing business is dependent principally upon the facts and circumstances of each particular case, considered in the light of the purposes and language of the pertinent statute or statutes involved and of the general principles governing the jurisdictional authority of the state over such corporations.

CAB, the CA categorized as "doing business" petitioner’s participation under the “Assignment Agreement” and the "Deed of Assignment." This is simply untenable. The expression "doing business" should not be given such a strict and literal construction as to make it apply to any corporate dealing. At this early stage and with petitioner’s acts or transactions limited to the assignment contracts, it cannot be said that it had performed acts intended to continue the business for which it was organized. It may not be amiss to point out that the purpose or business for which petitioner was organized is not discernible in the records. No effort was exerted by the CA to establish the nexus between petitioner’s business and the acts supposed to constitute “doing business.” Thus, whether the assignment contracts were incidental to petitioner’s business or were continuation thereof is beyond determination.

Chapter XIX
SPECIAL CORPORATIONS

1. Close Corporations

1.1 What is a close corporation? (§96)

- A close corporation is one whose articles of incorporation provide that:
  o All the corporation’s issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than twenty persons, not exceeding twenty (20);
  o All the issued stock of all classes shall be subject to one or more specified restrictions on transfer permitted by this Title; and
  o The corporation shall not list in any stock exchange or make any public offering of any of its stock of any class.

- A corporation shall not be deemed a close corporation when at least two-thirds (2/3) of its voting stock or voting rights is owned or controlled by another corporation which is not a close corporation.

1.2 What entities may not be organized as closed corporations?

- Any corporation may be incorporated as a close corporation, except:
  o Mining
  o Oil companies
  o Stock exchanges
  o Banks
  o Insurance companies
  o Public utilities
1.3 Validity of restrictions on transfer of shares (§98)

- Restrictions on the right to transfer shares must appear in the:
  - Articles of incorporation
  - By-laws
  - Certificate of stock

- OTHERWISE, the same shall not be binding on any purchaser in good faith.

- Said restrictions shall not be more onerous than granting the existing stockholders or the corporation the option to purchase the shares of the transferring stockholder with such reasonable terms, conditions or period stated therein.

- If upon the expiration of said period, the existing stockholders or the corporation fails to exercise the option to purchase, the transferring stockholder may sell his shares to any third person.

1.4 Effects of issuance or transfer of stock in breach of qualifying conditions (§99)

- A person is conclusively presumed to have notice of the fact of ineligibility to be a stockholder:
  - If stock of a close corporation is issued or transferred to any person who is not entitled under any provision of the articles of incorporation to be a holder of record of its stock, and
  - If the certificate for such stock conspicuously shows the qualifications of the persons entitled to be holders of record thereof.

- A person to whom stock is issued or transferred is conclusively presumed to have notice of these facts:
  - If the articles of incorporation of a close corporation states the number of persons, not exceeding twenty (20), who are entitled to be holders of record of its stock, and
  - If the certificate for such stock conspicuously states such number, and
  - If the issuance or transfer of stock to any person would cause the stock to be held by more than such number of persons.

- If a stock certificate of any close corporation conspicuously shows a restriction on transfer of stock of the corporation, the transferee of the stock is conclusively presumed to have notice of the fact that he has acquired stock in violation of the restriction, if such acquisition violates the restriction.

- Whenever any person to whom stock of a close corporation has been issued or transferred has, or is conclusively presumed under this section to have, notice either:
  - That he is a person not eligible to be a holder of stock of the corporation, or
  - That transfer of stock to him would cause the stock of the corporation to be held by more than the number of persons permitted by its articles of incorporation to hold stock of the corporation, or
  - That the transfer of stock is in violation of a restriction on transfer of stock, the corporation may, at its option, refuse to register the transfer of stock in the name of the transferee.

- The provisions of subsection (4) shall not be applicable if the transfer of stock, though contrary to subsections (1), (2) or (3), has been consented to by all the stockholders of the close corporation, or if the close corporation has amended its articles of incorporation in accordance with this Title.

- The term "transfer", as used in this section, is not limited to a transfer for value.

- The provisions of this section shall not impair any right which the transferee may have to rescind the transfer or to recover under any applicable warranty, express or implied.

1.5 Agreements by stockholders (Section 100)

1. Agreements by and among stockholders:

   - Executed before the formation and organization of a close corporation,
   - Signed by all stockholders
   - Shall survive the incorporation of such corporation and shall continue to be valid and binding between and among such stockholders, if such be their intent,

   - To the extent that such agreements are not inconsistent with the articles of incorporation, irrespective of where the provisions of such agreements are contained, except those required by this Title to be embodied in said articles of incorporation.

2. An agreement between two or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as therein provided, or as they may agree, or as determined in accordance with a procedure agreed upon by them.

3. No provision in any written agreement signed by the stockholders, relating to any phase of the corporate affairs, shall be invalidated as between the parties on the ground that its effect is to make them partners among themselves.

4. A written agreement among some or all of the stockholders in a close corporation shall not be invalidated on the ground that it so relates to the

- Educational institutions
- Corporations declared to be vested with public interest in accordance with the provisions of this Code.
conduct of the business and affairs of the corporation as to restrict or interfere with the discretion or powers of the board of directors:
- Provided, That such agreement shall impose on the stockholders who are parties thereto the liabilities for managerial acts imposed by this Code on directors.

5. To the extent that the stockholders are actively engaged in the management or operation of the business and affairs of a close corporation, the stockholders shall be held to strict fiduciary duties to each other and among themselves. Said stockholders shall be personally liable for corporate torts unless the corporation has obtained reasonably adequate liability insurance.

1.6 Amendment of articles of incorporation (§103)

Any amendment to the articles of incorporation which seeks to delete or remove any provision required by this Title to be contained in the articles of incorporation or to reduce a quorum or voting requirement stated in said articles of incorporation shall not be valid or effective unless approved by the affirmative vote of at least two-thirds (2/3) of the outstanding capital stock, whether with or without voting rights, or of such greater proportion of shares as may be specifically provided in the articles of incorporation for amending, deleting or removing any of the aforesaid provisions, at a meeting duly called for the purpose.

1.7 Deadlocks

1. Deadlocks, Defined:
- Notwithstanding any contrary provisions in the articles of incorporation or by-laws or agreement of stockholders of a close corporation
- The directors or stockholders are so divided respecting the management of the corporation's business and affairs
- The votes required for any corporate action cannot be obtained
- The consequence is that the business and affairs of the corporation can no longer be conducted to the advantage of the stockholders generally

2. Resolution of deadlocks
- The SEC, upon written petition by any stockholder, shall have the power to arbitrate the dispute.
- In the exercise of such power, the Commission shall have authority to make such order as it deems appropriate, including an order:
  - Cancelling, altering or enjoining any resolution or act of the corporation or its board of directors, stockholders, or officers;
  - Directing or prohibiting any act of the corporation or its board of directors, stockholders, officers, or other persons part to the action;
  - Requiring the purchase at their fair value of shares of any stockholder, either by the corporation regardless of the availability of unrestricted retained earnings in its books, or by the other stockholders;
  - Appointing a provisional director;
  - Dissolving the corporation; or
  - Granting such other relief as the circumstances may warrant.

3. Provisional Director
- An impartial person who is neither a stockholder nor a creditor of the corporation or of any subsidiary or affiliate of the corporation, and whose further qualifications, if any, may be determined by the Commission.
- A provisional director is not a receiver of the corporation and does not have the title and powers of a custodian or receiver.
- A provisional director shall have all the rights and powers of a duly elected director of the corporation, including the right to notice of and to vote at meetings of directors, until such time as he shall be removed by order of the Commission or by all the stockholders.
- His compensation shall be determined by agreement between him and the corporation subject to approval of the Commission, which may fix his compensation in the absence of agreement or in the event of disagreement between the provisional director and the corporation.
San Juan Structural and Steel Fabricators vs. CA (1998)

Motorich entered into agreement with San Juan for the transfer of a parcel of land to latter. San Juan already paid downpayment. When San Juan was ready to pay the balance, Motorich refused to sell. Motorich contend that Nenita Gruenberg's, treasurer of Motorich, signature is not sufficient to bind Motorich, and that the signature of Reynaldo Gruenberg, president of Motorich is required. Nenita Gruenberg is the spouse of Reynaldo Gruenberg and both owns 99.866% of the shares of stock of the corporation.

HELD: Motorich is not a close corporation. The mere ownership by a single stockholder or by another corporation of all or nearly all of the capital stock of a corporation is not of itself sufficient ground for disregarding their separate personalities. A narrow distribution of ownership does not of itself make a close corporation. There are exceptional cases where an action by a director who is singly is the controlling stockholder may be considered as a binding corporate act and a board action is a mere formality. However, Nenita is not the sole controlling stockholder.

### CLOSE CORPORATIONS

1. **Management / Board Authority**
   - There can be classification of directors into one or more classes, each of whom may be voted for and elected solely by a particular class of stock; and
   - The articles of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors. So long as this provision continues in effect:
     1. No meeting of stockholders need be called to elect directors
     2. Unless the context clearly requires otherwise, the stockholders of the corporation shall be deemed to be directors for the purpose of applying the provisions of this Code
     3. The stockholders of the corporation shall be subject to all liabilities of directors.
   - The articles of incorporation may likewise provide that all officers or employees or that specified officers or employees shall be elected or appointed by the stockholders, instead of by the board of directors.

2. **Meetings**
   - Unless the by-laws provide otherwise, any action by the directors of a close corporation without a meeting shall nevertheless be deemed valid if:
     1. Before or after such action is taken, written consent thereto is signed by all the directors; or

### REGULAR CORPORATIONS

1. **Management / Board Authority**
   - There are no classification of board of directors
   - Corporate Powers devolved upon board of directors whose powers are executed by officers. Cannot provide that it be managed by stockholders
   - Board of directors must be elected in a stockholders meeting
   - Stockholders of a corporation are separate and distinct from directors
   - Officers must be elected by the Board of Directors

2. **Meetings**
   - The directors or trustees shall not act individually nor separately but as a body in a lawful meeting. They will act only after discussion and deliberation of matters before them. Contracts entered into without a formal board resolution does not bind the corporation except when ratified or when majority of the board has knowledge of the contract and the contract benefited the corporation.
   - Absence of a prompt objection in writing does
<table>
<thead>
<tr>
<th>CLOSE CORPORATIONS</th>
<th>REGULAR CORPORATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. All the stockholders have actual or implied knowledge of the action and make no</td>
<td>not ratify acts done by directors without a valid meeting. There must be express or implied</td>
</tr>
<tr>
<td>prompt objection thereto in writing; or</td>
<td>ratification.</td>
</tr>
<tr>
<td>3. The directors are accustomed to take informal action with the express or implied</td>
<td>• Express ratification may consist of a Board Resolution to that effect</td>
</tr>
<tr>
<td>acquiescence of all the stockholders; or</td>
<td>• Implied ratification may consist of acceptance of benefits from said unauthorized act while having knowledge of said act</td>
</tr>
<tr>
<td>4. All the directors have express or implied knowledge of the action in question and none of them makes prompt objection thereto in writing.</td>
<td>• Failure to give notice would render a meeting voidable.</td>
</tr>
<tr>
<td>• If a director’s meeting is held without proper call or notice, an action taken therein within the corporate powers is deemed ratified by a director who failed to attend, unless he promptly files his written objection with the secretary of the corporation after having knowledge thereof.</td>
<td>• Attendance to a meeting despite want of notice will be deemed implied waiver</td>
</tr>
<tr>
<td></td>
<td>• All proceedings had and any business transacted at any meeting of the stockholders or members, if within the powers or authority of the corporation, shall be valid even if the meeting be improperly held or called, provided all the stockholders or members of the corporation are present or duly represented at the meeting. (§51)</td>
</tr>
<tr>
<td>3. Voting / Quorum</td>
<td></td>
</tr>
<tr>
<td>• The AOI may provide for a classification of directors into one or more classes, each of which may be voted for and elected solely by a particular class of stock.</td>
<td>• No share may be deprived of voting rights, except Preferred or Redeemable shares, unless otherwise provided by the Code</td>
</tr>
<tr>
<td></td>
<td>• There shall always be a class/series of shares which have a COMPLETE VOTING RIGHTS</td>
</tr>
<tr>
<td></td>
<td>• EACH SHARE SHALL BE EQUAL IN ALL RESPECTS TO EVERY OTHER SHARE, except as otherwise provided in the AOI</td>
</tr>
<tr>
<td></td>
<td>• For Board of directors, the by-laws or AOI can provide for a greater majority in quorum</td>
</tr>
<tr>
<td></td>
<td>• For stockholders, the AOI can provide for a different percentage in quorum</td>
</tr>
<tr>
<td>4. Pre-emptive Right</td>
<td></td>
</tr>
<tr>
<td>• The pre-emptive right of stockholders in close corporations shall extend to all stock to be issued, including reissuance of treasury shares, whether for money, property or personal services, or in payment of corporate debts, unless the articles of incorporation provide otherwise.</td>
<td>• Limitations on the exercise of pre-emptive right:</td>
</tr>
<tr>
<td></td>
<td>a. Such pre-emptive right shall not extend to shares to be issued in compliance with laws requiring stock offerings or minimum stock ownership by the public;</td>
</tr>
<tr>
<td></td>
<td>b. Not extend to shares to be issued in good faith with the approval of the stockholders representing two-thirds (2/3) of the outstanding capital stock, in exchange for property needed for corporate purposes or in payment of a previously contracted debt</td>
</tr>
<tr>
<td></td>
<td>c. Shall not take effect if denied in the Articles of Incorporation or an amendment thereto.</td>
</tr>
<tr>
<td>5. Transferability</td>
<td></td>
</tr>
<tr>
<td>• Restrictions on the right to transfer shares must appear in the AI and in the by-laws as well as in the certificate of stock otherwise the same shall not be binding on any purchaser thereof in good faith</td>
<td>• Restrictions on the right to transfer not allowed</td>
</tr>
<tr>
<td>6. Withdrawal Right</td>
<td></td>
</tr>
</tbody>
</table>
CLOSE CORPORATIONS

- Any stockholder of a close corporation may, for any reason, compel the said corporation to purchase his shares at their fair value, which shall not be less than their par or issued value, when the corporation has sufficient assets in its books to cover its debts and liabilities exclusive of capital stock.

- Any stockholder of a close corporation may, by written petition to the SEC, compel the dissolution of such corporation whenever:
  - Any of acts of the directors, officers or those in control of the corporation is illegal, or fraudulent, or dishonest, or oppressive or unfairly prejudicial to the corporation or any stockholder, or
  - Corporate assets are being misapplied or wasted.

REGULAR CORPORATIONS

- Stockholders may require the corporation to buy-back their shares at fair value when the Corporation has unrestricted Retained Earnings:
  a. In case any amendment to the articles of incorporation which has the effect of:
     - changing or restricting the rights of any stockholder or class of shares, or
     - authorizing preferences in any respect superior to those of outstanding shares of any class, or
     - extending or shortening the term of corporate existence
  b. In case of sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets as provided in the Code; and
  c. In case of merger or consolidation
  d. Extension or shortening of the term of the corporation (§37)
  e. Diversion of funds of corporation from primary purpose to secondary purpose (§41)

- The corporation may buy-back shares of stockholders subject to the following limitations (Treasury shares):
  a. There must be unrestricted retained earnings
  b. Must be for a legitimate purpose

2. Educational Corporations

2.1 Incorporation

a. Governing Laws: Special Laws and the Corporation Code (§106)

b. Pre-requisites to Incorporation: Except upon favorable recommendation of the (Ministry of Education and Culture), the SEC shall not accept or approve the articles of incorporation and by-laws of any educational institution (§107)

2.2 Board of Trustees (§108)

a. Non-stock

1. Composition—not less than 5 nor more than 15 trustees, but always in multiples of five. Unless otherwise provided in the articles of incorporation or the by-laws, the board or trustees of incorporated schools, colleges, or other institutions of learning shall:
   a. So classify themselves that the term of office of one-fifth (1/5) of their numbers shall expire every year.
   b. Trustees thereafter elected to fill vacancies, occurring before the expiration of a particular term shall hold office only for the unexpired period.
   c. Trustees elected thereafter to fill vacancies caused by expiration of term shall hold office for five (5) years.

2. Quorum—Majority of the trustees

Powers and Authority of the trustees shall be defined in the by-laws.

b. Stock—The number and term of directors shall be governed by the provisions on stock corporations.

3. Religious Corporations

3.1 Classes of Religious Corporations (§ 109)

a. Corporation Sole

b. Religious Corporations—governed by the Corporation Code and the general provisions on non-stock corporations insofar as they may be applicable.

3.2 Corporation Sole (§ 110)

a. Who may form—The chief archbishop, bishop, priest, minister, rabbi or other presiding elder of such religious denomination, sect or church. (§110)

b. Filling of Vacancies (§114)

1. The successors in office concerned shall become the corporation sole on their accession to office and shall be permitted to transact business as such on the filing with the Securities and Exchange Commission of a copy of their commission, certificate of election, or letters of appointment, duly certified by any notary public.

2. During any vacancy in the office, the person or persons authorized and empowered by the rules, regulations or
discipline of the religious denomination, sect or church represented by the corporation sole to administer the temporalities and manage the affairs, estate and properties of the corporation sole during the vacancy shall exercise all the powers and authority of the corporation sole during such vacancy.

c. Purpose—For the purpose of administering and managing, as trustee, the affairs, property and temporalities of any religious denomination, sect or church. (§110)

d. The Articles of Incorporation must set forth that (§111):

1. The presiding elder of such religious denomination, sect or church is the chief archbishop, bishop, priest, minister, rabbi or presiding elder of his religious denomination, sect or church and that he desires to become a corporation sole;

2. The rules, regulations and discipline of his religious denomination, sect or church are not inconsistent with his becoming a corporation sole and do not forbid it;

3. As such chief archbishop, bishop, priest, minister, rabbi or presiding elder, he is charged with the administration of the temporalities and the management of the affairs, estate and properties of his religious denomination, sect or church within his territorial jurisdiction, describing such territorial jurisdiction;

4. The manner in which any vacancy occurring in the office of chief archbishop, bishop, priest, minister, rabbi or presiding elder, is to be filled, according to the rules, regulations or discipline of the religious denomination, sect or church to which he belongs; and

5. The place where the principal office of the corporation sole is to be established and located, which place must be within the Philippines.

The articles of incorporation may include any other provision not contrary to law for the regulation of the affairs of the corporation.

e. Filing/submission of the Articles of Incorporation (§112):

1. Verification before filing, by affidavit or affirmation of the chief archbishop, bishop, priest, minister, rabbi or presiding elder, as the case may be,

2. Accompanied by a copy of the commission, certificate of election or letter of appointment of such chief archbishop, bishop, priest, minister, rabbi or presiding elder, duly certified to be correct by any notary public.

f. Effect of the Filing of the Articles (§112):

1. Such chief archbishop, bishop, priest, minister, rabbi or presiding elder shall become a corporation sole.

2. All temporalities, estate and properties of the religious denomination, sect or church theretofore administered or managed by him as such chief archbishop, bishop, priest, minister, rabbi or presiding elder shall become a corporation sole, for the use, purpose, behalf and sole benefit of his religious denomination, sect or church, including hospitals, schools, colleges, orphan asylums, parsonages and cemeteries thereof.

g. Acquisition and Alienation of Property (§113):

1. Purpose for holding and purchasing the real and personal property, or receiving gifts and bequests—For its church, charitable, benevolent or educational purposes.

2. Conditions for sale or mortgage of real property held by it:

   i. By obtaining an order for that purpose from the Court of First Instance of the province where the property is situated upon proof made to the satisfaction of the court that:

   *notice of the application for leave to sell or mortgage has been given by publication or otherwise in such manner and for such time as said court may have directed, and that it is to the interest of the corporation that leave to sell or mortgage should be granted.

   ii. The application for leave to sell or mortgage must be made by petition, duly verified, by the chief archbishop, bishop, priest, minister, rabbi or presiding elder acting as corporation sole, and may be opposed by any member of the religious denomination, sect or church represented by the corporation sole:

3. When the Intervention of the Courts shall not be necessary—In cases where the rules, regulations and discipline of the religious denomination, sect or church, religious society or order concerned represented by such corporation sole regulate the method of acquiring, holding, selling and mortgaging real estate and personal property, such rules, regulations and discipline shall control.

h. Dissolution (§115):

1. A corporation sole may be dissolved and its affairs settled voluntarily by submitting to the Securities and Exchange Commission a verified declaration of dissolution.
2. The declaration of dissolution shall set forth:

   a. The name of the corporation;

   b. The reason for dissolution and winding up;

   c. The authorization for the dissolution of the corporation by the particular religious denomination, sect or church;

   d. The names and addresses of the persons who are to supervise the winding up of the affairs of the corporation.

3. Effect of approval of declaration of dissolution by the Securities and Exchange Commission—the corporation shall cease to carry on its operations except for the purpose of winding up its affairs.

3.3 Religious Societies (§ 116)

a. Who may form a Religious Society:

   Any religious society or religious order, or any diocese, synod, or district organization of any religious denomination, sect or church, unless forbidden by the constitution, rules, regulations, or discipline of the religious denomination, sect or church of which it is a part, or by competent authority.

b. Internal Requirement

   Upon written consent and/or by an affirmative vote at a meeting called for the purpose of at least two-thirds (2/3) of its membership,

c. SEC Requirement

   1. Filing with the Securities and Exchange Commission, articles of incorporation verified by the affidavit of the presiding elder, secretary, or clerk or other member of such religious society or religious order, or diocese, synod, or district organization of the religious denomination, sect or church.

   2. The Articles must set forth the ff:

      a. That the religious society or religious order, or diocese, synod, or district organization is a religious organization of a religious denomination, sect or church;

      b. That at least two-thirds (2/3) of its membership have given their written consent or have voted to incorporate, at a duly convened meeting of the body;

      c. That the incorporation of the religious society or religious order, or diocese, synod, or district organization desiring to incorporate is not forbidden by competent authority or by the constitution, rules, regulations or discipline of the religious denomination, sect, or church of which it forms a part;

      d. That the religious society or religious order, or diocese, synod, or district organization desires to incorporate for the administration of its affairs, properties and estate;

      e. The place where the principal office of the corporation is to be established and located, which place must be within the Philippines; and

      f. The names, nationalities, and residences of the trustees elected by the religious society or religious order, or the diocese, synod, or district organization to serve for the first year or such other period as may be prescribed by the laws of the religious society or religious order, or of the diocese, synod, or district organization, the board of trustees to be not less than five (5) nor more than fifteen (15).

d. Purpose of incorporation

   For the administration of its temporalities or for the management of its affairs, properties and estate.
b. THE SECURITIES REGULATION CODE (RA 8799)

Chapter I
OVERVIEW: THE FINANCIAL MARKETS

1. Capital Markets

The places to go if you want to raise new money

1.1 Equity Capital – for the investor, the stock market provides a variable return
   a. Stock Market –
      Security – eg, shares of stock

1.2 Debt Capital – for the lender, the money or bond market provides a fixed return
   b. Money Market – for short term debts, ie, those normally maturing within 1 year from date of issuance –
      Security – commercial paper (an unsecured IOU of a company, issued on a discount basis, promising to pay the holder the full face value thereof upon redemption)
   c. Bond Market – for long term debts, ie, those normally maturing after a year from date of issuance
      Security – junk bonds (high yield bonds having high interest rates and are issued by lower credit rated companies or companies with no credit rating)

2. Non-Capital Markets

The places to go if you want to hedge or mitigate the risks attached to holding capital assets

2.1 Commodity Market – The instruments traded in this market are not present assets like shares of stock, commercial papers or bonds but future contracts calling for delivery of an asset; for this reason, a commodity market is usually referred to as a futures market. (eg, agricultural products, metals and financial instruments)

Security – a futures contract (one which entitles the holder to buy or sell a specific amount of the underlying commodity represented by the contract in a prearranged, deliverable grade at a specific date in the future at a specified price.

2.2 Foreign Exchange Market – This market is an over-the-counter market conducted by international banks and does not have a central location

Security – a forward exchange contract

2.3 Options Market – It enables an investor to purchase an option giving him the right to buy or sell a specific number of shares at a future date, at a specific price. For this right, the investor either pays or receives money but (just like in a commodity market) the money involved is only a fraction of the market value of the shares concerned.

Security – call or put options

Chapter II
OVERVIEW OF THE LAW

1. State Policy (Sec.2)

The State shall establish a socially conscious, free market that regulates itself, encourages the widest participation of ownership in enterprises, enhances the democratization of wealth, promotes the development of the capital market, protect investors, ensures full and fair disclosure about securities, minimizes if not totally eliminates insider trading and other fraudulent or manipulative devices and practices which create distortions in the free market.

PSE vs. Court of Appeals (1997)

The Securities Act is designed not only to provide investors with adequate information upon which to base their decision to buy and sell securities, but also to protect legitimate business seeking to obtain capital through honest representation against competition from crooked promoters and prevent fraud in sale of securities.

The intended effects of the Securities Act are chiefly the following:

a. Prevention of excesses and fraudulent transactions, merely by requirement that their details be revealed;

b. Placing the market during the early stages of the offering of security a body of information, which operating indirectly through investment services and expert investors, will intend to produce a more accurate appraisal of a security.

The Code is self-executory, and failure of SEC to issue rules and regulations shall not in any manner affect its self-executory nature (Sec. 72.1)

2. Powers and Functions of the SEC (Sec. 5)
1. Have jurisdiction and supervision over all corporations, partnerships or associations who are the grantees of primary franchises and/or a license or permit issued by the Government;

2. Formulate policies and recommendations on issues concerning the securities market, advise Congress and other government agencies on all aspects of the securities market;

3. Approve, reject, suspend, revoke or require amendments to registration statements, and registration and licensing applications;

4. Regulate, investigate or supervise the activities of persons to ensure compliance;

5. Supervise, monitor, suspend or take over the activities of exchanges, clearing agencies and other SROs;

6. Impose sanctions for the violation of laws, rules, regulations and orders issued pursuant thereto;

7. Prepare, approve, amend or repeal rules, regulations and orders, and issue opinions and provide guidance on and supervise compliance with such rules, regulations and orders;

8. Enlist the aid and support of and/or deputize any and all enforcement agencies of the Government civil or military as well as any private institution, corporation, firm, association or person;

9. Issue cease and desist orders to prevent fraud or injury to the investing public;

10. Punish for contempt of the Commission, both direct and indirect;

11. Compel the officers of any registered corporation or association to call meetings of stockholders or members;

12. Issue subpoena duces tecum and summon witnesses to appear, order the examination, search and seizure of all documents, papers, files and records, tax returns, and books of accounts of any entity or person under investigation, subject to the provisions of existing laws;

13. Suspend, or revoke after proper notice and hearing, the franchise or certificate of registration of corporations, partnerships or associations, upon any of the grounds provided by law;

14. Such other powers as may be provided by law as well as those which may be implied from, or which are necessary or incidental to powers which are expressly granted to the Commission.

The Commission’s jurisdiction over all cases enumerated under Sec 5 of PD 902-A is hereby transferred to the Courts of general jurisdiction or the appropriate Regional Trial Court.

The Commission shall retain jurisdiction over pending cases involving intra-corporate disputes submitted for final resolution which should be resolved within 1 year from the enactment of this Code.

The Commission shall retain jurisdiction over pending suspension of payments/rehabilitation cases filed as of 30 June 2000 until finally disposed.

3. Definition of Terms

3.1 Securities - are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character. It includes:

(a) Shares of stock, bonds, debentures, notes, evidences of indebtedness, asset-backed securities;

(b) Investment contracts, certificates of interest or participation in a profit sharing agreement, certificates of deposit for a future subscription;

(c) Fractional undivided interests in oil, gas or other mineral rights;

(d) Derivatives like option and warrants;

(e) Certificates of assignments, certificates of participation, trust certificates, voting trust certificates or similar instruments;

(f) Proprietary or non proprietary membership certificates in corporations; and

(g) Other instruments as may in the future be determined by the Commission.

3.2 Issuer - the originator, maker, obligor, or creator of the security.

3.3 Broker - a person engaged in the business of buying and selling securities for the account of others.

3.4 Dealer - any person who buys and sells securities for his/her own account in the ordinary course of business.

3.5 Associated person of a broker or dealer - an employee thereof who, directly exercises control of supervisory authority, but does not include a salesman, or an agent or a person whose functions are solely clerical or ministerial.

3.6 Clearing Agency - any person who acts as intermediary in making deliveries upon payment to effect settlement in securities transactions.

3.7 Exchange - an organized marketplace or facility that brings together buyers and sellers and executes trades of securities and/or commodities.

3.8 Insider -

(a) the issuer;

(b) a director or officer (or person performing similar functions) of, or a person controlling the issuer;

(c) 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;

(d) a government employee, or director, or officer of an exchange, clearing
agency and/or self-regulatory organization who has access to material information about an issuer or a security that is not generally available to the public; or
(e) a person who learns such information in a communication from any of the foregoing insiders.

3.9 Pre-need plans – are contracts which provide for the performance of future services or the payment of future monetary consideration at the time of actual need, for which planholders pay in cash or installment at stated prices, with or without interest or insurance coverage and includes life, pension, education, interment, and other plans which the Commission may from time to time approve.

3.10 Promoter - a person who, acting alone or with others, takes initiative in founding and organizing the business or enterprise of the issuer and receives consideration therefor.

3.11 Registration statement – is the application for the registration of securities required to be filed with the Commission.

3.12 Salesman - a natural person, employed as such or as an agent, by a dealer, issuer or broker to buy and sell securities.

3.13 Uncertified Security – a security evidenced by electronic or similar records.

3.14 Underwriter - a person who guarantees on a firm commitment and/or declared best effort basis the distribution and sale of securities of any kind by another company.

4. Registration of Securities

Securities shall not be sold or offered for sale or distribution within the Philippines, without a registration statement duly filed with and approved by the Commission. (Sec. 8)

PSE vs. Court of Appeals (1997)

Under the policy of “full material disclosure,” all companies, listed or applying for listing, are required to divulge truthfully and accurately, all material information about themselves, and the securities they sell, for the protection of the investing public, and under the pain of administrative, criminal and civil sanctions. A fact is deemed material if it tends to induce or otherwise effect the sale or purchase or its securities.

A reading of the grounds give for rejection or registration reveals the intention of Congress to make the registration and issuance of securities dependent, to a certain extent, on the merits of the securities themselves, and of the issuer, to be determined by the SEC. Consequently, the absolute reliance on the full disclosure method is the registration of securities is, therefore, untenable.

Procedure (Sec.12)

4.1 Filing of Registration Statement

All securities shall be registered through the filing by the issuer in the main office of the Commission, of a sworn registration statement. The registration statement shall include any prospectus required or permitted to be delivered.

The information required for registration shall include, among others the effect of the securities issue on ownership, on the mix of ownership, especially foreign and local ownership.

The registration statement shall be signed by
- the issuer’s executive officer
- principal operating officer
- principal financial officer
- comptroller
- principal accounting officer
- corporate secretary or
- persons performing similar functions

Accompanied By a duly verified resolution of the board of directors of the issuer corporation.

The written consent of the expert named as having certified any part of the registration statement or any document used in connection therewith shall also be filed.

Where the registration statement includes shares to be sold by selling shareholders, a written certification by such selling shareholders as to the accuracy of any part of the registration statement contributed to by such selling shareholders shall also be filed.

4.2 Payment of Fee

The issuer shall pay to the Commission a fee of not more than 1/10 of 1% of the maximum aggregate price at which such securities are proposed to be offered. The Commission shall prescribe by rule diminishing fees in inverse proportion to the value of the aggregate price of the offering.

4.3 Notice of Filing

Notice of filing shall be immediately published by the issuer in 2 newspapers of general circulation in the Philippines, once a week for 2 consecutive weeks, or in such other manner as the Commission shall prescribe, reciting that:
- a registration statement for the sale of such security has been filed,
- the registration statement, as well as the papers attached thereto are open to inspection,
- copies shall be furnished to interested parties at such reasonable charge as the Commission may prescribe.
4.4 Withdrawal of Registration Statement

A registration statement may be withdrawn by the issuer only with the consent of the Commission. (Sec. 13)

4.5 Amendments to Registration Statement (Sec. 13)

If a registration statement is on its face incomplete or inaccurate in any material respect, the Commission shall issue an order directing the amendment of the registration statement. Upon compliance with such order, the amended registration statement shall become effective upon compliance with the procedure in Section 12.6.

An amendment filed prior to the effective date of the registration statement shall recommence the 45 day period within which the Commission shall act on a registration statement.

An amendment filed after the effective date of the registration statement shall become effective only upon such date as determined by the Commission.

If any change occurs in the facts set forth in a registration statement, the issuer shall file an amendment thereto setting forth the change.

4.6 Acceptance or Rejection by SEC

Within 45 days after the date of filing of the registration statement, or by such later date to which the issuer has consented, the Commission shall declare the registration statement effective or rejected, unless the applicant is allowed to amend the registration statement.

a) Acceptance

The Commission shall declare the registration statement to be effective if it finds that the registration statement together with all the other papers and documents attached thereto, is on its face complete and that the requirements have been compiled with.

b) Rejection / Revocation (Sec. 13)

The Commission may reject a registration statement and refuse registration of the security, or revoke the effectiveness of a registration statement and the registration of the security thereunder after due notice and hearing if it finds that:

- The issuer:
  - Has been judicially declared insolvent;
  - Has violated any of the provisions of this Code, the rules promulgated pursuant thereto, or any order of the Commission in connection with the offering for which a registration statement has been filed;
  - Has been or is engaged or is about to engage in fraudulent transactions;
  - Has made any false or misleading representation of material facts in any prospectus concerning the issuer or its securities;
  - Has failed to comply with any requirement that the Commission may impose as a condition for registration

- The registration statement is on its face incomplete or inaccurate in any material respect or includes any untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading; or
- The issuer, any officer, director or controlling person of the issuer, or any underwriter performing similar functions, or any person performing similar functions, or any underwriter has been convicted, by a competent judicial or administrative body, upon plea of guilty, or otherwise, of an offense involving moral turpitude and/or fraud or is enjoined or restrained by the Commission or other competent judicial or administrative body for violations of securities, commodities, and other related laws.

- If any issuer shall refuse to permit an examination to be made by the Commission, its refusal shall be ground for the refusal or revocation of the registration of its securities.

PSE vs. Court of Appeals (1997)

The SEC has no power to overturn the decision of the PSE Board to deny listing of securities. Questions of policy and management are left to the honest decision of officers and directors of a corporation, and courts are without authority to substitute their judgment for judgment of the Board of Directors. The Board is the business manager of the corporation, and as long as it acts in good faith, its orders are not reviewable by the courts. Also, as the primary market for securities, the PSE has established its name and goodwill, and it has the right to protect such goodwill by maintaining a reasonable standard of propriety in the entities who choose to transact through its facilities. It was reasonable for PSE, therefore, to exercise its judgment in the manner it deems appropriate for its business identity, as long as no rights are trampled upon and public welfare is safeguarded.

4.7 Oath of Issuer

Upon effectivity of the registration statement, the issuer shall state under oath in every prospectus that all registration requirements have been met and that all information are true and correct as represented by the issuer or the one making the statement.
Any untrue statement of fact or omission to state a material fact required to be stated or necessary to make the statement therein not misleading shall constitute fraud.

5. Suspension of Offer and Sale (Sec. 13)

- If the Commission deems it necessary, it may issue an order suspending the offer and sale of the securities pending any investigation. The order shall state the grounds for taking such actions, but such order of suspension, although binding upon persons notified thereof, shall be deemed confidential, and shall not be published.

- If, at any time, the Commission finds that a registration statement contains any false statement or omits to state any fact required to be stated therein or necessary to make the statements therein not misleading, the Commission may conduct an examination, and, after due notice and hearing, issue an Order suspending the effectiveness of the registration statement. (Sec. 14)

- Failure of the issuer, underwriter, or any other person to cooperate, or his obstruction or refusal to undergo an examination, shall be a ground for the issuance of a suspension order. (Sec. 14)

- If, at any time, the information contained in the registration statement filed is or has become misleading, incorrect, inadequate or incomplete in any material respect, or the sale or offering for sale of the security registered thereunder may work or tend to work a fraud, the Commission may require from the issuer such further information necessary to enable the Commission to ascertain whether the registration of such security should be revoked. The Commission may also suspend the right to sell and offer for sale such security pending further investigation. (Sec. 15)

- The refusal to furnish information required by the Commission may be a ground for the issuance of an order of suspension. (Sec. 15)

The order shall be deemed confidential, and shall not be published.

Upon the issuance of the suspension order, no further offer or sale of such security shall be made until the same is lifted or set aside by the Commission. Otherwise, such sale shall be void.

Notice of issuance of such order shall be given to the issuer and every dealer and broker who shall have notified the Commission of an intention to sell such security.

6. Securities and Transactions from Registration

6.1 Exempt Securities (Sec. 9)

(a) Any security issued or guaranteed by the Government of the Philippines, or by any political subdivision or agency thereof, or by any person acting as an instrumentality of said Government.

(b) Any security issued or guaranteed by the government of any country with which the Philippines maintains diplomatic relations, or by any state, province or political subdivision thereof on the basis of reciprocity.

(c) Certificates issued by a receiver or by a trustee in bankruptcy duly approved by the proper adjudicatory body.

(d) Any security or its derivatives the sale or transfer of which is under the supervision and regulation of the Office of the Insurance Commission, Housing and Land Use Regulatory Board, or the Bureau of Internal Revenue.

(e) Any security issued by a bank except its own shares of stock.

Union Bank vs. SEC (2001)

Although the shares of stock of banking institutions are exempt from registration requirements, a bank whose shares are listed in the stock market is covered by the RSA and the implementing rule on the reportorial requirements of listed companies. The RSA exempts from registration the securities issued by banking or financial institutions, but nowhere does its statute or even its by-laws exempt a bank as a listed corporation is exempt from complying with reports required by the RRRs.

The Commission may, by rule or regulation after public hearing, add to the foregoing any class of securities if it finds that the enforcement of this Code with respect to such securities is not necessary in the public interest and for the protection of investors.

6.2 Exempt Transactions (Sec. 10)

(a) At any judicial sale, or sale by an executor, administrator, guardian or receiver or trustee in insolvency or bankruptcy.

(b) By or for the account of a pledge holder, or mortgagee or similar lien holder selling or offering for sale or delivery in the ordinary course of business and not for the purpose of avoiding the provisions of this Code to liquidate a bona fide debt, a security pledged in good faith as security for such debt.

(c) An isolated transaction in which any security is sold, offered for sale, subscription or delivery is not being made in the course of repeated and successive transactions by the owner or his representative and such owner or representative not being the underwriter of such security.

(d) The distribution by a corporation to its stockholders or other security holders as a stock dividend or other distribution out of surplus.
(e) The sale of capital stock of a corporation to its own stockholders exclusively, where no commission or other remuneration is paid or given directly or indirectly in connection with the sale of such capital stock.

(f) The issuance of bonds or notes secured by mortgage upon real estate or tangible personal property, where the entire mortgage together with all the bonds or notes secured thereby are sold to a single purchaser at a single sale.

(g) The offer and delivery of any security in exchange for any other security of the same issuer pursuant to a right of conversion: Provided, That the security surrendered has been registered under this Code or was, when sold, exempt, and that the security delivered in exchange, if sold at the conversion price, would at the time of such conversion fall within the class of securities entitled to registration under this Code. Upon such conversion the par value of the security surrendered in such exchange shall be deemed the price at which the securities issued and delivered in such exchange are sold.

(h) Broker’s transactions, executed upon customer’s orders, on any registered Exchange or other trading market.

(i) Subscriptions for shares of the capital stock of a corporation prior to incorporation or in pursuance of an increase in its authorized capital stock, when no expense is incurred, or no commission, compensation or remuneration is paid or given, and only when the purpose for soliciting, giving or taking of such subscriptions is to comply with the requirements of such law as to the percentage of the capital stock which should be subscribed before it can be registered and duly incorporated, or its authorized capital increased.

(j) The exchange of securities by the issuer with its existing security holders exclusively, where no commission or other remuneration is paid.

(k) The sale of securities by an issuer to fewer than 20 persons in the Philippines during any twelve-month period.

(l) The sale of securities to any of the following qualified buyers:
   - Bank;
   - Registered investment house;
   - Insurance company;

   - Pension fund or retirement plan maintained by the Government or any political subdivision or managed by a bank or other persons authorized by the Bangko Sentral to engage in trust functions;
   - Investment company; or
   - Such other person as the Commission determine as qualified buyers, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial and business matters, or amount of assets under management.

The Commission may exempt other transactions, if it finds that the requirement of registration is not necessary in the public interest or for the protection of the investors such as by reason of the small amount involved or the limited character of the public offering.

Any person applying for an exemption of a transaction shall file with the Commission a notice identifying the exemption relied upon on such form and at such time as the Commission by rule may prescribe and with such notice shall pay to the Commission a fee equivalent to 1/10 of 1% of the maximum aggregate price or issued value of the securities.

7. Tender Offer and Proxy Solicitation

7.1 Tender Offers (Sec. 19)

Parties Required to make Tender Offer

(a) Any person or group of persons acting in concert who intends to acquire at least 15% of any class of any equity security of a listed corporation or of any class of any equity security of a corporation with assets of at least P50,000,000 and having 200 or more stockholders with at least 100 shares each or

(b) who intends to acquire at least 30% of such equity over a period of 12 months shall make a tender offer to stockholders by filing with the Commission a declaration to that effect; and furnish the issuer a statement containing such of the information as the Commission may prescribe.

Withdrawal of tender Offer

Securities deposited pursuant to a tender offer or request or invitation for tenders may be withdrawn by or on behalf of the depositor at any time throughout the period that the tender offer remains open and if the securities deposited have not been previously accepted for payment, and

Nestle Philippines vs. Court of Appeals (1991)

The language of the RSA exempting from registration “issuance of additional capital stock,” must be interpreted to cover only issuance of shares of stock as part of and in the course of increasing the authorized capital stock of a corporation. It does not cover issuances of shares from already authorized but still unissued capital stock.
at any time after 60 days from the date of the original tender offer or request or invitation, except as the Commission may otherwise prescribe.

Securities offered exceed required quantity
Where the securities offered exceed that which a person or group of persons is bound or willing to take up and pay for, the securities that are subject of the tender offer shall be taken up as nearly as may be pro rata, disregarding of fractions, according to the number of securities deposited by each depositor.

The provisions of this subsection shall also apply to securities deposited within 10 days after notice of an increase in the consideration offered to security holders is first published or sent or given to security holders.

Variations of Tender Offer
Where any person varies the terms of a tender offer or request or invitation for tenders before the expiration thereof by increasing the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder whose securities are taken up and paid for whether or not such securities have been taken up by such person before the variation of the tender offer or request or invitation.

7.2 Proxy Solicitations (Sec. 20)
Proxies must be
- in writing
- signed by the stockholder or his duly authorized representative and
- filed before the scheduled meeting with the corporate secretary.

Period of Validity
Unless otherwise provided in the proxy, it shall be valid only for the meeting for which it is intended. No proxy shall be valid and effective for a period longer than 5 years at one time.

No broker or dealer shall give any proxy, consent or authorization to a person other than the customer, without the express written authorization of such customer.

A broker or dealer who holds or acquires the proxy for at least 10% or such percentage as the Commission may prescribe of the outstanding share of the issuer, shall submit a report identifying the beneficial owner within 10 days after such acquisition, for its own account or customer, to the issuer of the security, to the Exchange where the security is traded and to the Commission.

7.3 Fees for Tender Offers and Certain Proxy Solicitations (Sec. 21)
At the time of filing with the Commission of any statement required for any tender offer or for proxy or consent solicitation, the Commission may require that the person making such filing pay a fee of not more than 1/10 of 1% of:
- The proposed aggregate purchase price in the case of a transaction under Sections 20 or 72.2; or
- The proposed payment in cash, and the value of any securities or property to be transferred in the acquisition, merger or consolidation, or the cash and value of any securities proposed to be received upon the sale or disposition of such assets in the case of a solicitation under Section 20.

8. Regulation of Transactions of Directors / Officers / Principal Stockholders (Sec. 23)

8.1 Filing of Statement
- Every person who is directly or indirectly the beneficial owner of more than 10% of any class of any equity security or
- who is a director or an officer of the issuer of such security, shall file, at the time either such requirement is first satisfied or within ten days after he becomes such a beneficial owner, director, or officer, a statement with the Commission and, if such security is listed for trading on an Exchange, also with the Exchange, of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten (10) days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall also file a statement indicating his ownership at the close of the calendar month and such changes as have occurred during such calendar month.

8.2 Recovery of Damages for Unfair Use of Information
a. For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer
- any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer within any period of less than six (6) months, unless such security was acquired in good faith in connection with a debt previously contracted,
- 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.
b. Suit to recover such profit may be instituted before the RTC by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within 60 days after request or shall fail diligently to prosecute the same thereafter. But;

No such suit shall be brought more than two years after the date such profit was realized.

It shall be unlawful for any beneficial owner, director, or officer to sell any equity security of such issuer if the person selling the security or his principal:

(a) Does not own the security sold; or
(b) If owning the security, does not deliver it against such sale within 20 days thereafter, or does not within 5 days after such sale deposit it in the mails or other usual channels of transportation;

But no person shall be deemed to have violated this subsection if he proves that notwithstanding the exercise of good faith he was unable to make such delivery or deposit within such time, or that to do so would cause undue inconvenience or expense.

The provisions of Subsection 23. 2 shall not apply to any purchase and sale, or sale and purchase and the provisions of Subsection 23.3 shall not apply to any sale, of an equity security not then or thereafter held by him in an investment account, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market, otherwise than on an Exchange, for such security.

9. Prohibitions

9.1 Manipulation of Security Prices

It shall be unlawful for any person acting for himself or through a dealer or broker, directly or indirectly:

(a) To create a false or misleading appearance of active trading in any listed security traded in an Exchange or any other trading market:

• By effecting any transaction in such security which involves no change in the beneficial ownership thereof;
• By entering an order or orders for the purchase or sale of such security with the knowledge that a simultaneous order or orders of substantially the same size, time and price, for the sale or purchase of any such security, has or will be entered by or for the same or different parties; or
• By performing similar act where there is no change in beneficial ownership.

(b) To effect, alone or with others, a series of transactions in securities that:

• Raises their price to induce the purchase of a security;
• Depresses their price to induce the sale of a security; or
• Creates active trading to induce such a purchase or sale through manipulative devices such as marking the close, painting the tape, squeezing the float, hype and dump, boiler room operations and such other similar devices.

(c) To circulate or disseminate information that the price of any security listed in an Exchange will or is likely to rise or fall because of manipulative market operations of any one or more persons conducted for the purpose of raising or depressing the price of the security for the purpose of inducing the purchase or sale of such security.

(d) To make false or misleading statement with respect to any material fact, which he knew or had reasonable ground to believe was so false or misleading, for the purpose of inducing the purchase or sale of any security listed or traded in an Exchange.

(e) To effect any series of transactions for the purchase and/or sale of any security traded in an Exchange for the purpose of pegging, fixing or stabilizing the price of such security, unless otherwise allowed by this Code or by rules of the Commission.

9.2 Insider Trading

Parties covered:

• Insider
• Insider’s spouse or relatives by affinity or consanguinity within the second degree, legitimate or common-law,

It shall be unlawful for an insider to sell or buy a security of the issuer, while in possession of material information with respect to the issuer or the security that is not generally available to the public, unless: (Sec. 27)

(a) The insider proves that the information was not gained from such relationship; or
(b) If the other party selling to or buying from the insider (or his agent) is identified, the insider proves:

• that he disclosed the information to the other party, or
• that he had reason to believe that the other party otherwise is also in possession of the information.

Presumption

A purchase or sale of a security of the issuer shall be presumed to have been effected while in possession of material
non-public information if transacted after such information came into existence but prior to dissemination of such information to the public and the lapse of a reasonable time for the market to absorb such information

This presumption shall be rebutted upon a showing by the purchaser or seller that he was not aware of the material non-public information at the time of the purchase or sale.

Material non-public information:

(a) It has not been generally disclosed to the public and would likely affect the market price of the security after being disseminated to the public and the lapse of a reasonable time for the market to absorb the information; or

(b) would be considered by a reasonable person important under the circumstances in determining his course of action whether to buy, sell or hold a security.

Communication of the Information

It shall be unlawful for any insider to communicate material non-public information about the issuer or the security to any person who, by virtue of the communication, becomes an insider, where the insider communicating the information knows or has reason to believe that such person will likely buy or sell a security of the issuer while in possession of such information.

Insider Trading in Relation to Tender Offers

a.) It shall be unlawful where a tender offer has commenced or is about to commence for:

- Any person (other than the tender offeror) who is in possession of material non-public information relating to such tender offer, to buy or sell the securities of the issuer that are sought or to be sought by such tender offer if such person knows or has reason to believe that
  - the information is non-public and
  - has been acquired directly or indirectly from the tender offeror, those acting on its behalf, the issuer of the securities, or any insider of such issuer; and

- Any tender offeror, those acting on its behalf, the issuer of the securities, and any insider to communicate material non-public information relating to the tender offer to any other person where such communication is likely to result in a violation of subsection 27.4.

10. Regulation of Market Professionals and Other Entities

10.1 Registration of Brokers, Dealers, Salesmen and Associated Persons

General Rule:

- No person shall engage in the business of buying or selling securities in the Philippines as a broker or dealer, or act as a salesman, or an associated person of any broker or dealer unless registered as such with the Commission.

- No registered broker or dealer shall employ any salesman or any associated person, and no issuer shall employ any salesman, who is not registered as such with the Commission.

- Nicolas vs CA (1998):

The futility of petitioner’s action became more pronounced by the fact that he traded securities for the account of others without the necessary license from the SEC. Clearly, such omission was in violation of Section 19 of the Revised Securities Act.

The purpose of the statute requiring the registration of brokers selling securities and the filing of data regarding securities which they propose to sell, is to protect the public and strengthen the securities mechanism.

American jurisprudence emphasizes the principle that:

"An unlicensed person may not recover compensation for services as a broker where a statute or ordinance requiring a license is applicable and such statute or ordinance is of a regulatory nature, was enacted in the exercise of the police power for the purpose of protecting the public, requires a license as evidence of qualification and fitness, and expressly precludes an unlicensed person from recovering compensation by suit, or at least manifests an intent to prohibit and render unlawful the transaction of business by an unlicensed person."

We see no reason not to apply the same rule in our jurisdiction. Stock market trading, a technical and highly specialized institution in the Philippines, must be entrusted to individuals with proven integrity, competence and knowledge, who have due regard to the requirements of the law.

Exception:
The Commission may conditionally or unconditionally exempt any
10.2 Qualifications of Market Professionals (Sec. 28.4)

The Commission shall promulgate rules and regulations prescribing the qualifications for registration of each category of applicant, which shall, among other things, require as a condition for registration that:

(a) If a natural person, the applicant satisfactorily pass a written examination as to his proficiency and knowledge in the area of activity for which registration

(b) In the case of a broker or dealer, the applicant satisfy a minimum net capital and provide a bond or other security as the Commission may prescribe

(c) If located outside of the Philippines, the applicant files a written consent to service of process upon the Commission pursuant to Sec. 65 hereof.

10.3 SEC Action (Sec. 28.8)

a. Within 30 days after the filing of any application, the Commission shall by order:

(a) Grant registration if it determines that the requirements of this Section and the qualifications for registration have been satisfied; or

(b) Deny said registration.

b. The names and addresses of all persons approved for registration and all orders of the Commission with respect thereto shall be recorded in a Register of Securities Market Professionals kept in the office of the Commission which shall be open to public inspection.

10.4 Continuing Requirements

- Every person registered shall file with the Commission information necessary to keep the application for registration current and accurate.
- Every person registered shall pay to the Commission an annual fee. Upon notice by the Commission that such annual fee has not been paid as required, the registration of such person shall be suspended until payment has been made.

10.5 Termination of Registration of Salesman or Associated Person

The registration of a salesman or associated person shall be automatically terminated upon the cessation of his affiliation with said registered broker or dealer, or with an issuer in the case of a salesman employed, appointed or authorized by such issuer.

The registered broker or dealer, or issuer, as the case may be, shall file with the Commission a notice of separation of such salesman or associated person.

10.6 Revocation, Refusal or Suspension of Registration of Brokers, Dealers, Salesmen and Associated Persons (Sec. 29)

If, after due notice and hearing, the Commission determines the applicant or registrant:

(a) Has willfully violated any provision of this Code, any rule, regulation or order made hereunder, or any other law administered by the Commission, or in the case of a registered broker, dealer or associated person has failed to supervise, with a view to preventing such violation, another person who commits such violation;

(b) Has willfully made or caused to be made a materially false or misleading statement in any application for registration or report filed with the Commission or a self-regulatory organization, or has willfully omitted to state any material fact that is required to be stated therein;

(c) Has failed to satisfy the qualifications or requirements for registration and the rules and regulations;

(d) Has been convicted by a competent judicial or administrative authority of an offense involving moral turpitude, fraud, theft, estafa, misappropriation, forgery, bribery, false oath, or perjury, or of a
violation of securities, commodities, banking, real estate or insurance laws;

(e) Is enjoined or restrained by a competent judicial or administrative body from engaging in securities, commodities, banking, real estate or insurance activities or from willfully violating laws governing such activities;

(f) Is subject to an order of a competent judicial or administrative body refusing, revoking or suspending any registration, license or other permit under this Code, the rules and regulations promulgated thereunder, any other law administered by the Commission;

(g) Is subject to an order of a self-regulatory organization suspending or expelling him from membership or participation therein or from association with a member or participation thereof;

(h) Has been found by a competent judicial or administrative authority, to have willfully violated any provisions of securities, commodities, banking, real estate or insurance laws, or has willfully aided, abetted, counseled, commanded, induced or procured such violation; or

(i) Has been judicially declared insolvent.

29.4. It shall be sufficient cause for refusal, revocation or suspension of a broker's or dealer's registration, if any associated person thereof or any juridical entity controlled by such associated person has committed any act or omission or is subject to any disability enumerated earlier.

Transactions and Responsibility of Brokers and Dealers (Sec. 30)

a. Prohibition against dealing or otherwise selling or buying, for its account of customers, securities listed on an Exchange issued by any corporation where any stockholder, director, associated person or salesman, or authorized clerk of said broker or dealer and all the relatives of the foregoing within the fourth civil degree of consanguinity or affinity, is at the time holding office in said issuer corporation as a director, president, vice-president, manager, treasurer, comptroller, secretary or any office or trust and responsibility, or is a controlling person of the issuer.

b. Prohibition against effecting any transaction in securities or induce or attempt to induce the purchase or sale of any security except in compliance with such rules and regulations as the Commission shall prescribe to ensure fair and honest dealings in securities and provide financial safeguards an other standards for the operation of brokers and dealers.

11. Regulation of Exchanges

11.1 Nature of Stock Exchanges

Lopez, et. al vs. Court of Appeals (1988)

An exchange is a voluntary association or corporation organized for the purpose of furnishing to its members a convenient and suitable place to transact their business of promoting uniformity in the customs and usages of merchants, of inculcating principles of justice and equity in trade, of facilitating the speedy adjustment of business disputes, of acquiring and dissemination valuable commercial and economic information and generally of securing to its members the benefits of co-operation in the furtherance of their legitimate pursuits.

Carolina Industries vs. CMS Stock Brokerage (1980)

The rules and regulations of the Exchange form part of the contract covering securities transacted within the facilities of Exchange.

Sec Opinion #11 (2003)

It is important to stress that the Securities Regulation Code (SRC) treats exchanges as a special specie of corporation and subjects them to rules not otherwise applicable to regular corporations.

The stock exchange performs a function vital to the national economy, a function vested with public interest. It is said that the economy moves on the basis of the rise and fall of the stocks traded and thus, the integrity of the exchange overseeing these transactions can never be over emphasized. It is for this reason that the SRC provides for stricter rules on exchange regulation. The SRC devotes a whole chapter on exchanges and other securities trading markets, and it is replete with provisions designed to professionalize the exchange, encourage greater public participation, ensure increased transparency, greater responsibility and improve corporate governance. These provisions are not found in the Corporation Code and are meant as additional legal requirements applicable only to exchanges.

It is thus incorrect to argue that the provisions of the Corporation Code alone govern the operation of exchanges. While the Corporation Code applies to corporations in general, the SRC is a special law that primarily governs the regulation of exchanges. As between a specific statute and a general statute, the former must prevail since it evinces the legislative intent more clearly than a general statute does.
Thus the SEC has the power of supervision over exchanges. Supervision entails overseeing or the power or authority to see that subordinate subject performs its duties. If the latter fails or neglects to fulfill them the former may take such action or step as prescribed by law to make them perform its duties. In this specific instance, the SEC can even take over the management of the exchange as authorized by the SRC.

11.2 Registration Procedure (Sec. 33)

Any Exchange may be registered as such with the Commission by filing an application for registration in such form and containing such information and supporting documents as the Commission by rule shall prescribe, including the following:

(a) An undertaking to comply and enforce compliance by its members with the provisions of this Code, its implementing rules or regulations and the rules of the Exchange;

(b) The organizational charts of the Exchange, rules of procedure, and a list of its officers and members;

(c) Copies of the rules of the Exchange; and

(d) An undertaking that in the event a member firm becomes insolvent or when the Exchange shall have found that the financial condition of its member firm has so deteriorated that it cannot readily meet the demands of its customers for the delivery of securities and/or payment of sales proceeds, the Exchange shall take over the operation of the insolvent member firm and immediately proceed to settle the member firm’s liabilities to its customers.

Registration of an Exchange shall be granted upon compliance with the following provisions:

(a) That the applicant is organized as a stock corporation;

(b) That the applicant is engaged solely in the business of operating an exchange: Provided, however, that the Commission may, upon application, exempt an Exchange organized as a stock corporation and owned and controlled by another juridical person from this restriction;

(c) When the Exchange is organized as a stock corporation, that no person may beneficially own or control, directly or indirectly, more than 5% of the voting rights of the Exchange and no industry or business group may beneficially own or control more than 20% of the voting rights of the Exchange: Provided, however, that the Commission may adopt rules, regulations or issue an order, upon application, exempting an applicant from this prohibition where it finds that such ownership or control will not negatively impact on the exchange’s ability to effectively operate in the public interest;

(d) The expulsion, suspension, or disciplining of a member and persons associated with a member for conduct or proceeding inconsistent with just and equitable principles of fair trade, and for violations of provisions of this Code or the rules of the Exchange;

(e) A fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking to be a member, the barring of any person from association with a member, and the prohibition or limitation of any person from access to services offered by the Exchange;

(f) That the brokers in the board of the Exchange shall comprise of not more than 49% of such board and shall proportionately represent the Exchange membership in terms of volume/value of trade and paid up capital, and that any natural person associated with a juridical entity that is a member shall himself be deemed to be a member for this purpose;

(g) For the board of the Exchange to include in its composition:

(i) the president of the Exchange, and

(ii) no less than 51% of the remaining members of the board to be comprised of 3 independent directors and persons who represent the interests of issuers, investors, and other market participants, who are not associated with any broker or dealer or member of the Exchange for a period of 2 years prior to his/her appointment.

No officer or employee of a member, its subsidiaries or affiliates or related interests shall become an independent director: Provided, however, that the Commission may by rule, regulation, or order upon application, permit the exchange organized as a stock corporation to use a different governance structure:

Provided, further, that the Commission is satisfied that the Exchange is acting in the public interest and is able to effectively operate as a self-regulatory organization under this Code.

(h) The president and other management of the Exchange to consist only of persons who are not members and are not associated in any capacity, directly or indirectly with any broker or dealer or member of listed company of the Exchange: Provided, that the Exchange may only appoint, and a
person may only serve, as an officer of the exchange if such person has not been a member or affiliated with any broker, dealer, or member of the Exchange for a period of at least 2 years prior to such appointment;

(i) The transparency of transactions on the Exchange;

(j) The equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which the Exchange operates or controls;

(k) Prevention of fraudulent and manipulative acts and practices, promotion of just and equitable principles of trade, and, in general, protection of investors and the public interest; and


11.3 Segregation and Limitation of Functions of Members, Brokers and Dealers (Sec. 34)

It shall be unlawful for any member-broker of an Exchange to effect any transaction on such Exchange for:

- its own account,
- the account of an associated person, or
- an account with respect to which it or an associated person thereof exercises investment discretion

Provided, however, That this section shall not make unlawful –

(a) Any transaction by a member-broker acting in the capacity of a market maker;
(b) Any transaction reasonably necessary to carry on an odd-lot transactions;
(c) Any transaction to offset a transaction made in error; and
(d) Any other transaction of a similar nature as may be defined by the Commission.

Sec Opinion #11 (2003)
The above-quoted Sec. 33.2. of the SRC is not found in the old Revised Securities Act, nor in the Corporation Code. Items (c), (f) and (g) thereof are all intended to encourage greater public participation, ensure increased transparency, greater responsibility and improve corporate governance.

Subsection (c) mandates that the ownership of the stocks of the exchange be broadened and democratized, thereby ensuring greater public participation.

On the other hand, Subsections (f) and (g) mandate a board composition where no more than 49% of the seats shall be occupied by brokers, and no less than 51% to be comprised of (3) independent directors and persons representing other sectors of the market. With respect to independent directors, their election in the Board is intended to ensure that the Board will faithfully discharge its fiduciary responsibilities to its stockholders.

These provisions aim for a more representative, democratic, independent Board of Directors that is autonomous from the control of any sector of the market.

12. Independent Directors

Any corporation with

- a class of equity securities listed for trading on an Exchange or
- with assets in excess of P50,000,000.00 and having 200 or more holders, at least 200 of which are holding at least 100 shares of a class of its equity securities or which has sold a class of equity securities to the public pursuant to an effective registration statement

Shall have at least 2 independent directors or such independent directors shall constitute at least 20% of the members of such board, whichever is the lesser.

An "independent director" shall mean a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

13. Self-Regulatory Organizations

13.1 Scope / Definition (Sec. 39)
The Commission shall have the power to register as a self-regulatory organization organizations whose operations are related to or connected with the securities market such as but not limited to

- associations of brokers and dealers,
- transfer agents,
- custodians,
- fiscal and paying agents,
- computer services,
- news disseminating services,
- proxy solicitors,
- statistical agencies,
- securities rating agencies, and
- securities information processors

Which are engaged in the business of:

(a) Collecting, processing, or preparing for distribution or publication, or assisting, participating in, or coordinating the distribution or publication of, information with respect to transactions in or quotations for any security; or
(b) Distributing or publishing on a current and continuing basis, information with respect to such transactions or quotations.
13.2 Registration

An association of brokers and dealers may be registered as a securities association by filing with the Commission an application for registration.

Such association shall not be registered unless the Commission determines that:

(a) The association is so organized and has the capacity to be able to carry out the purposes of the Code and to comply with, and to enforce compliance by its members and persons associated with its members with the provisions of this Code.

(b) The rules of the association, notwithstanding anything in the Corporation Code to the contrary, provide that:

- Any registered broker or dealer may become a member of the association;
- There exist a fair representation of its members to serve on the Board of Directors of the association and in the administration of its affairs, and that any natural person associated with a juridical entity that is a member shall himself be deemed to be a member for this purpose;
- The Board of Directors of the association includes in its composition: (a) The president of the association and (b) Persons who represent the interests of issuers and public investors and are not associated with any broker or dealer or member of the association; that the president and other management of the association not be a member or associated with any broker, dealer or member of the association;
- For the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which the association operates or controls;
- For the prevention of fraudulent and manipulative acts and practices, the promotion of just and equitable principles of trade, and the protection of investors and the public interest;
- That its members and persons associated with its members, be appropriately disciplined for violation of any provision of this Code;
- That a fair procedure for the disciplining of members, and the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the association of any person with respect to access to services offered by the association or a member thereof.

13.3 Denial of Membership / Employment (Sec. 39.4)

(a) A registered securities association shall deny membership to any person who is not a registered broker or dealer.

(b) A registered securities association may deny membership to, or condition the membership of, a registered broker or dealer if such broker or dealer:

- Does not meet the standards of financial responsibility, operational capability, training, experience, or competence that are prescribed by the rules of the association; or
- Has engaged, and there is a reasonable likelihood it will again engage, in acts or practices inconsistent with just and equitable principles of fair trade.

(c) A registered securities association may deny membership to a registered broker or dealer not engaged in a type of business in which the rules of the association require members to be engaged: Provided, however, That no registered securities association may deny membership to a registered broker or dealer by reason of the amount of business done by the broker or dealer.

(d) A registered securities association may bar a salesman or person associated with a broker or dealer from being employed by a member or set conditions for the employment of a salesman or associated if such person:

- Does not meet the standards of training, experience, or competence that are prescribed by the rules of the association; or
- Has engaged, and there is a reasonable likelihood he will again engage, in acts or practices inconsistent with just and equitable principles of fair trade.

14 Margin Trading

14.1 Margin Requirements (Sec. 48)
For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Commission, shall prescribe rules and regulations with respect to the amount of credit that may be extended on any security.

For the extension of credit, such rules and regulations shall be based upon the following standard:

An amount not greater than whichever is the higher of –
(a) 65% of the current market price of the security; or
(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.

14.2 Prohibited Credit Arrangements (Sec. 48.2)

No member of an Exchange or broker or dealer shall, directly or indirectly, extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer:

(a) On any security unless such credit is extended and maintained in accordance with the rules and regulations which the Commission shall prescribe;
(b) Without collateral or on any collateral other than securities, except
   • to maintain a credit initially extended in conformity with the rules and regulations of the Commission; and
   • in cases where the extension or maintenance of credit is not for the purpose of purchasing or carrying securities or of evading or circumventing the provisions of par (a) of this subsection.

14.3 Restrictions on Borrowings by Members, Brokers, and Dealers (Sec. 49)

It shall be unlawful for any registered broker or dealer, or member of an Exchange, directly or indirectly:

• To permit in the ordinary course of business his aggregate indebtedness including customers’ credit balances, to exceed such percentage of the net capital (exclusive of fixed assets and value of Exchange membership) employed in the business, but not exceeding in any case 2,000%, as the Commission may prescribe.

• To pledge, mortgage, or otherwise encumber any security carried for the account of any customer under circumstances:
   o That will permit the commingling of his securities, without his written consent, with the securities of any customer;
   o That will permit such securities to be commingled with the securities of any person other than a bona fide customer; or
   o That will permit such securities to be pledged, mortgaged or encumbered, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities.

   • To lend or arrange for the lending of any security carried for the account of any customer without the written consent of such customer or in contravention of such rules and regulations as the Commission shall prescribe.

14.4 Enforcement of Margin Requirements and Restrictions on Borrowing (Sec. 50)

To prevent indirect violations of the margin requirements, the broker or dealer shall require the customer in non-margin transactions to pay the price of the security within such period as the Commission may prescribe, which shall in no case exceed the prescribed settlement date.

Otherwise, the broker shall sell the security purchased starting on the next trading day but not beyond 10 trading days following the last day for the customer to pay such purchase price, unless such sale cannot be effected within said period for justifiable reasons.

The sale shall be without prejudice to the right of the broker or dealer to recover any deficiency from the customer. To prevent indirect violation of restrictions on borrowings under Section 49, the broker shall, unless otherwise directed by the customer, pay the net sales price of the securities sold for a customer within the same period as above prescribed by the Commission.

Provided, That the customer shall be required to deliver the instruments evidencing the securities as a condition for such payment upon demand by the broker.

15. Administrative Sanctions and Settlement Offers

15.1 Administrative Sanctions (Sec. 54)

If, after due notice and hearing, the Commission finds that:

(a) There is a violation of this Code, its rules, or its orders;
(b) Any registered broker or dealer, associated person thereof has failed reasonably to supervise another person subject to supervision, who commits any such violation;
(c) Any registrant or other person has, in a registration statement or in other reports, applications, accounts, records or documents...
made any untrue statement of a material fact, or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading;

(d) or, in the case of an underwriter, has failed to conduct an inquiry with reasonable diligence to insure that a registration statement is accurate and complete in all material respects; or

(e) Any person has refused to permit any lawful examinations into its affairs,

The imposition of administrative sanctions shall be without prejudice to the filing of criminal charges.

15.2 Settlement Offers (Sec. 55)

At any time, during an investigation or proceeding under this Code, parties being investigated and/or charged may propose in writing an offer of settlement with the Commission.

The Commission may consider the offer based on timing, the nature of the investigation or proceeding, and the public interest.

The Commission may only agree to a settlement offer based on its findings that such settlement is in the public interest. Any agreement to settle shall have no legal effect until publicly disclosed. Such decision may be made without a determination of guilt on the part of the person making the offer.

16. Civil Liabilities (Sec. 56)

16.1 On Account of False Registration Statement

Who may sue?

Any person

- acquiring a security, the registration statement of which or any part thereof contains an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make such statements not misleading, and
- who suffers damage

If the person who acquired the security did so after the issuer has made generally available to its security holders an income statement covering a period of at least 12 months, then the right of recovery shall be conditioned on proof that such person acquired the security relying upon such untrue statement.

Who may be sued?

(a) The issuer and every person who signed the registration statement;

(b) Every person who was a director or a partner in the issuer at the time of the filing of the registration statement or any part, supplement or amendment thereof;

(c) Every person who is named in the registration statement as being or about to become a director or a partner;

(d) Every auditor or auditing firm named as having certified any financial statements used in connection with the registration statement or prospectus.

(e) Every person who, with his written consent has been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement.

(f) Every selling shareholder who contributed to and certified as to the accuracy of a portion of the registration statement.

(g) Every underwriter with respect to each security.

Possible Defense:

Such person may allege that at the time of such acquisition he knew of no such untrue statement or omission:

16.2 On Account of Insider Trading (Sec. 61)

Who may be sued?

Any insider who violates Subsection 27.1 and any person in the case of a tender offer who violates Subsection 27.4 (a)(i), or any rule or regulation thereunder, by purchasing or selling a security while in possession of material information not generally available to the public, shall be liable in a suit brought by any investor who, contemporaneously with the purchase or sale of securities that is the subject of the violation, purchased or sold securities of the same class unless such insider, or such person in the case of a tender offer, proves that such investor knew the information or would have purchased or sold at the same price regardless of disclosure of the information to him.

An insider who communicates material non-public information, shall be jointly and severally liable with and to the same extent as, the insider, or person in the case of a tender offer.

17. Limitation of Actions (Sec. 62)

No action shall be maintained to enforce any liability created under Section 56 (false registration statement) or 57 (false prospectus. Communications, reports) unless brought within 2 years after the discovery of the untrue statement or the omission.

If the action is to enforce a liability created under Subsection 57.1(a) (registration of
securities), unless brought within 2 years after the violation upon which it is based.

In no event shall any such action be brought to enforce a liability created under Section 56 or Subsection 57.1 (a) more than 5 years after the security was bona fide offered to the public, or under Subsection 57.1 (b) (sale based on false prospectus, communications, reports) more than 5 years after the sale.

No action shall be maintained to enforce any liability created under any other provision of this Code unless brought:

- within 2 years after the discovery of the facts constituting the cause of action and
- within 5 years after such cause of action accrued.

### 18. Damages to be Awarded (Sec. 63)

#### 18.1 Amounts / Kinds of Damages

All suits to recover damages pursuant to Sections 56 (false registration statement), 57 (false prospectus, communications, reports), 58 (fraud in connection with securities transactions), 59 (manipulation of prices), 60 (commodity futures contracts and pre-need plans) and 61 (insider trading) shall be brought before the RTC, which shall have exclusive jurisdiction to hear and decide such suits.

The Court is hereby authorized to award damages in an amount not exceeding triple the amount of the transaction plus actual damages.

Exemplary damages may also be awarded in cases of bad faith, fraud, malevolence or wantonness in the violation of this Code, and rules and regulations promulgated hereunder.

The Court is also authorized to award attorney’s fees not exceeding 30% of the award.

#### 18.2 Persons liable to pay

The persons specified in Sections 56, 57, 58, 59, 60 and 61 hereof shall be jointly and severally liable for the payment of damages. However, any person who becomes liable for the payment of such damages may recover contribution from any other person who, if sued separately, would have been liable to make the same payment, unless the former was guilty of fraudulent representation and the latter was not.

All persons, including the issuer, held liable under the provisions of Sections 56, 57, 58, 59, 60 and 61 shall contribute equally to the total liability adjudged herein.

In no case shall the principal stockholders, directors and other officers, recover their contribution to the liability from the issuer. However, the right of the issuer to recover from the guilty parties the amount it has contributed shall not be prejudiced.


Any condition, stipulation, provision binding any person to waive compliance with any provision of this Code or of any rule of an Exchange as well as the waiver itself, shall be void.

### 20. Penalties

Any person who violates any of the provisions of this Code or any person who, in a registration statement makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall, upon conviction, suffer:

- a fine of not less than P50,000.00 nor more than P5,000,000.00 or
- imprisonment of not less than 7 years nor more than 21 years, or
- both in the discretion of the court.

If the offender is a corporation, partnership or association or other juridical entity, the penalty may be imposed upon such juridical entity and upon the officer or officers of the corporation, partnership, association or entity responsible for the violation. If such officer is an alien, he shall in addition to the penalties prescribed, be deported.
Negotiable Instruments Law
(Act No. 2031)

Chapter I.
INTRODUCTION

1. The Negotiable Instrument

- Written contract for the payment of money, by its form intended as substitute for money and intended to pass from hand to hand to give the HDC the right to hold the same and collect the sum due.
- Instruments are negotiable when they conform to all the requirements prescribed by the NIL (Act 2031, 03 February 1911).
- Although considered as medium for payment of obligations, negotiable instruments are not legal tender (Sec. 60, New Central Bank Act, R.A. 7653);
- Negotiable instruments shall produce the effect of payment only when they have been encashed or when through the fault of the creditor they have been impaired. (Art. 1249, CC) BUT a CHECK which has been cleared and credited to the account of the creditor shall be equivalent to a delivery to the creditor of cash.

2. Negotiable Instruments Law

- The NIL applies only to instruments which conform with the requisites laid down by Sec1 of the law. Should any of said requisites be absent, the instrument would not be negotiable and would therefore not be governed by the NIL but by the general law on contracts.
- TIP: It is advised that one memorizes the two most important provisions of the NIL : Sec. 1 (Forms of negotiable instruments) and Sec. 52 (What constitutes a holder in due course)


The Negotiable Instruments Law was enacted for the purpose of facilitating, not hindering or hampering transactions in commercial paper. Thus, the said statute should not be tampered with haphazardly or lightly. Nor should it be brushed aside in order to meet the necessities in a single case.

3. Life of a Negotiable Instrument

1. issue
2. negotiation
3. presentment for acceptance in certain bills
4. acceptance
5. dishonor by or acceptance
6. presentment for payment
7. dishonor by nonpayment
8. notice of dishonor
9. protest in certain cases
10. discharge

4. Kinds of Negotiable Instruments

4.1. Promissory note - a promise to pay money
- unconditional promise in writing made by one person to another signed by the maker
- engaging to pay on demand, or at a fixed or determinable future time a sum certain in money to order or to bearer
- where a note is drawn to the maker’s own order, not complete until indorsed by him (Sec. 184, NIL).

4.2. Bill of exchange - an order made by one person to another to pay money to a third person.
- 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 to bearer (Sec. 126, NIL).
- → Check: bill of exchange drawn on a bank payable on demand.

<table>
<thead>
<tr>
<th>Negotiable</th>
<th>Non-negotiable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contains all the requisites of Sec. 1 of the NIL</td>
<td>Does not contain all the requisites of Sec. 1 of the NIL</td>
</tr>
<tr>
<td>Transferred by negotiation</td>
<td>Transferred by assignment</td>
</tr>
<tr>
<td>HDC may have better rights than transferor</td>
<td>Transferee acquires rights only of his transferor</td>
</tr>
<tr>
<td>Prior parties warrant payment</td>
<td>Prior parties merely warrant legality of title</td>
</tr>
<tr>
<td>Transferee has right of recourse against intermediate parties</td>
<td>Transferee has no right of recourse</td>
</tr>
</tbody>
</table>

Promissory Note Bill of Exchange

| Unconditional promise | Unconditional order |
| Involves 2 parties | Involves 3 parties |
| Maker primarily liable | Drawer only secondarily liable |
| Only 1 presentment - for payment | Generally 2 presentments - for acceptance and for payment |

5. Parties

5.1. As regards promissory note:
1. Promissor/maker
2. Payee - person to whom the promise to pay is made.

5.2. As regards bill of exchange:
1. Drawer - person who gives the order to pay
2. Drawee - addressee of the order.
3. Payee - person to whom the payment is to be made.

- Indorser - the payee of an instrument who transfers it to another by signing it at the back thereof
COMMERCIAL LAW

1. Indorsee - person to whom the indorser negotiates the instrument, who, by such negotation, becomes the holder of the instrument.

Chapter II.
NEGOTIABILITY

1 Requisites of Negotiability

1.1. Must be in Writing and Signed by the Maker

1. No person liable on the instrument whose signature does not appear thereon.
2. One who signs in a trade or assumed name liable to same extent as if he had signed in his own name. (Sec. 18, NIL)
3. Signature of party may be made by duly authorized agent; no particular form of appointment necessary. (Sec. 19, NIL)
4. "In writing" - includes print; written or typed
5. Signature, binding so long it is intended or adopted as the signature of the signer or made with his authority.

1.2. Must contain an Unconditional Order or Promise to Pay

1. "ORDER OR PROMISE TO PAY"
   a. PROMISSORY NOTE:
      i. PROMISE TO PAY: should be express on the face of the instrument
      ii. Word "promise" is not absolutely necessary. Any expression equivalent to a promise is sufficient.
      iii. Mere acknowledgment of a debt insufficient
   b. BILLS OF EXCHANGE:
      i. Order - command or imperative direction; the instrument, by its nature, demanding a right.
      ii. Words which are equivalent to an order are sufficient.
      iii. A mere request or authority to pay does not constitute an order.
      iv. Although the mere use of polite words like "please" does not of itself deprive the instrument of its characteristics as an order, its language must clearly indicate a demand upon the drawee to pay.

2. "UNCONDITIONAL"
   a. The promise or order to pay, to be unconditional, must be unqualified.
   b. Sec. 3, NIL: "An unqualified order or promise to pay is unconditional...though coupled with:
      "An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount
      • UNCONDITIONAL: Mere indication of the particular fund

4 Suggested Mnemonics: UP MaSoCTs PaWN:
Unconditional order and Promise, payable in Money, Signed by maker, Certainty as to Time, Sum and Parties, in Writing, include words of Negotiability.

out of which reimbursement is to be made, or an indication of a particular account to be debited with the amount
"A statement of the transaction which gives rise to the instrument.
• UNCONDITIONAL: Mere recital of the transaction or consideration for which the instrument was issued
• However, the fact that the condition appearing on the instrument has been fulfilled will not convert it into a negotiable one.
But an order or promise to pay out of a particular fund is not unconditional
• CONDITIONAL: when reference to the fund clearly indicates an intention that such fund alone should be the source of payment.

METROPOLITAN BANK v. CA (1991)
The treasury warrants in question are not NIs. They are payable from a particular fund, to wit, Fund 501. The indication of Fund 501 as the source of the payment to be made on the treasury warrants makes the order or promise to pay "not unconditional" and the warrants themselves non-negotiable.

1.3. Sum Payable must be Certain

1. Sec. 2, NIL: The sum payable is a sum certain, even if:
   a. With interest;
   b. By stated installments;
   c. By stated installments with acceleration clause;
   d. With exchange, whether at a fixed rate or at the current rate; or
   e. With costs of collection or attorney's fee.
2. A sum is certain if from the face of the instrument it can be mathematically computed.
3. A stipulation to pay a higher rate of interest if the note is not paid or a lower rate if it is paid on or before maturity does not render the instrument non-negotiable.

1.4. Must be Payable in Money

1. Capable of being transformed into money.
2. NON NEGOTIABLE: an instrument which contains an order or promise to do an act in addition to the payment of money
3. BUT IF the order or promise gives the holder an election to require something to be done in lieu of payment of money, an instrument otherwise negotiable would not be affected thereby. (Sec. 5, NIL)
   → But if the option is with the maker or person primarily liable, instrument is NOT negotiable.
4. Kind of current money does not affect negotiability. Since the value of the note can by a simple mathematical computation be expressed in the value of the lawful money of the latter country (Incitti v Ferrante, 1933, US Jur)
5. Obligations in foreign currency may be discharged in Philippine currency based on
the prevailing rate at the time of payment, pursuant to RA 8183 (Asia World Recruitment v NLRC, 1999).

1.5. Time of Payment must be Certain

- Purpose: Informing the holder of the instrument of the date when he may enforce payment thereof.
- An instrument may be payable:

1. on demand (Sec. 7. NIL)
   1.) Expressed to be payable on demand, or at sight, or on presentation;
   2.) No time for payment is expressed;
   3.) Where an instrument is issued, accepted, or indorsed when overdue, it is, as regards the person so issuing, accepting, or indorsing it, payable on demand.

Demand instruments: Holder may call for payment any time; maker has an option to pay at any time, and the refusal of the holder to accept payment will terminate the running of interest, if any, but the obligation to pay the note remains.

2. at a fixed time
   - Only on the stipulated date, and not before, may the holder demand its payment.
   - Should he fail to demand payment, the instrument becomes overdue but remains valid and negotiable. It is merely converted to a demand instrument.

3. at a determinable future time
   - Determinable future time, if expressed to be payable (Sec. 4, NIL):
     1.) At a fixed period after date of sight;
     2.) On or before a fixed or determinable future time specified therein;
     3.) On or at a fixed period after the occurrence of a specified event which is certain to happen, though the time of happening be uncertain.
   - If payable upon a contingency, both negotiable, and the happening of the event does not cure the defect.

4. Effect of acceleration provisions
   - If option (absolute or conditional) to accelerate maturity is on the maker, still NEGOTIABLE.
     - Maker may pay earlier than the date fixed but this option, if exercised, would be a payment in advance of a legal liability to pay. It is still payable on the date fixed, and holder has no right to enforce payment against the maker before such date.
   - If option to accelerate is on the holder:
     - If option can be exercised only after the happening of a specified event/act over which he has no control (conditional), still NEGOTIABLE.
       - If option is unconditional, time of payment is rendered uncertain, NOT negotiable.
       - Other instances where instrument still NEGOTIABLE:
         - When option given to the holder to accelerate the maturity of an installment note upon failure of the maker to pay any installment when due.
         - Acceleration, automatic upon default.
         - Acceleration by operation of law.

5. Provisions extending time of payment
   - General rule: Negotiability not affected. Effect is similar with that of an acceleration clause at the option of the maker.
     - Negotiability not affected, even if the holder is given the option to extend time of payment by mere inaction or indulgence for an indefinite time depending on his will, because with or without this provision, the holder may always choose to be indulgent.
   - Exception: Where a note with a fixed maturity provides that the maker has the option to extend time of payment until the happening of contingency, instrument NOT negotiable. The time for payment may never come at all.

1.6. Must be Payable to Order or to Bearer/ Must contain Words of Negotiability

- words of negotiability - serve as an expression of consent that the instrument may be transferred.
- But the instrument need not follow the language of the law; any term which clearly indicates an intention to conform with the legal requirements is sufficient.

CALTEX V. CA (1992)

The negotiability or non-negotiability of an instrument is determined from the face of the instrument itself. The duty of the court in such case is to ascertain, not what the parties may have secretly intended but what is the meaning of the words they have used.

TRADERS ROYAL BANK V. CA (1997)

The language of negotiability which characterize a negotiable paper as a credit instrument is its freedom to circulate as a substitute for money. Hence, freedom of negotiability is the touchstone relating to the protection of holders in due course, and the freedom of negotiability is the foundation for the protection which the law throws around a holder in due course.

- Postal money order, not negotiable, because it does not contain words of negotiability.
- Where words "or bearer" printed on a check are cancelled by the drawer, instrument not negotiable.
• **Bearer instrument** may be negotiated by mere delivery.
  o When instrument is payable to bearer 
    *(Sec. 9, NIL)*:
    a. Expressed to be so payable - ex: "I promise to pay the bearer the sum..." 
    b. Payable to a person named therein or bearer – ex. "Pay to A or bearer."
    c. Payable to the order of a fictitious person or non-existing person, and such fact was known to the person making it so payable - ex: "Pay to John Doe or order."
    d. Name of payee does not purport to be the name of any person - ex: "Pay to cash;" "Pay to sundries."
    e. Only or last indorsement is an indorsement in blank.

**ANG TEK LIAN v. CA (1950)**

A check drawn payable to the order of cash is a check payable to bearer, and the bank may pay it to the person presenting it for payment without the drawer's indorsement.

A check payable to bearer is authority for payment to the holder. Where the check is in the ordinary form and is payable to bearer, so that no indorsement is required, a bank, to which it is presented for payment, need not have the holder identified, and is not negligent in failing to do so.

• **Order Instrument**, negotiation requires delivery and indorsement of the transferor.
  o When instrument is payable to order: 
    Drawn payable to the order of a specified person or to him or his order *(Sec. 8, NIL).*
  o Without the words "to order" or "to the order of," the instrument is payable only to the person designated therein and is therefore non-negotiable. 
    (Campos, as cited in Consolidated Plywood Industries v IFC Leasing, 1987)

**2 Provisions Not Affecting Negotiability, (Sec. 5)**

1. Authorizes sale of collateral securities;
2. Authorizes confession of judgment if instrument not paid at maturity;
3. Waives the benefit of any law intended for the advantage or protection of the obligor; or
4. Gives holder election to require something to be done in lieu of payment of money. (If in addition to money – not NI)

• **Negotiability affected**, when instrument contains a promise or order to do any act in addition to the payment of money.

**PNB v. MANILA OIL REFINING (1922)**

In this case, the note contains a provision that in case that it would not be paid at maturity, the "maker authorizes any attorney to appear and confess judgment thereon."

The Court ruled that said judgment note is illegal and inoperative as such is against public policy. It noted that it is in derogation of the constitutional safeguards (a day in court). Such judgment note can only be valid if given express legislative sanction.

In common law, two kinds of judgment by confession:
- Judgment by cognovit actionem
- Confession relicta verificatione

**3. Omissions Not Affecting Negotiability (Sec. 6)**

- A. Non-dating of the instrument
- B. Non-specification of value given, or that any value had been given
- C. Non-specification of place where it is drawn or place where it is payable
- D. Bears a seal
- E. Designation of particular kind of currency in which payment is to be made

**4. Rules of Construction (Sec.17)**

- A. Sum expressed in words takes precedence over sum in numbers; BUT where words are so ambiguous or uncertain, reference to the figures should be made
- B. Where interest is stipulated, without specification of the starting date, the interest runs from the date of the instrument, and if undated, from the issue thereof
- C. An undated instrument is considered dated as of time issued.
- D. Written provisions prevail over printed provisions
- E. Where the instrument is ambiguous as to whether it is a note or a bill, the holder may treat it as either at his election
- F. When the capacity of signatory is not clear, he is to be deemed an indorser

---

5. Suggested Mnemonic: **WEJyS**: Waives, gives holder Election, confession of Judgment, Sale of Securities
G. “I promise to pay” when signed by two or more persons is deemed to be jointly and severally signed

**EVANGELISTA V. MERCATOR FINANCE (2003)**

Where two promissory notes, both employing the terms “I promise to pay”, were each signed by two or more persons, a solidary (joint and several) liability on each note is created on the part of the signors.

**Chapter III.**

**TRANSFER**

3. Indorsement

- The indorsement must be written on the instrument itself or on a paper attached thereto (allonge). The signature of the indorser, without additional words, is sufficient indorsement. **(Sec.31, NIL)**

- Indorser generally enters into two contracts (Implied contracts by Indorser):
  1. sale or transfer of instrument
  2. to pay instrument in case of default of maker

- Indorsement must be of entire instrument (can't be indorsement of only part of amount payable, nor can it be to two or more indorsees severally. But okay to indorse residue of partially paid instrument) **(Sec. 32, NIL)**

3.1. Kinds of Indorsements (Sec. 33)

1. as to manner of future method of negotiation(Sec. 35, NIL):

   a. **special** – specifies the person to whom/to whose order the instrument is to be payable; indorsement of such indorsee is necessary to further negotiation.
      - A special indorser is liable to all subsequent holders, unless the instrument is an originally bearer instrument, in which case he is liable only to those who take title through his indorsement **(Sec 40, NIL)**

   b. **blank** – specifies no indorsee, instrument so indorsed is payable to bearer, and may be negotiated by delivery
      - a person who negotiates by mere delivery is liable only to his immediate transferee.
      - the holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement
      - An order instrument may be converted into a bearer instrument by means of a blank indorsement.
      - But a bearer instrument remains as such whether it has been indorsed specially or in blank. It is the liability of the indorser which is affected.

2. Negotiation

- When an instrument is transferred from one person to another as to constitute the transferee the holder thereof.
- If payable to Bearer, negotiated by delivery; if payable to Order, negotiated by indorsement of holder + delivery **(Sec.30, NIL)**

**SESBREÑO v. CA (1993)**

A NI may, instead of being negotiated, ALSO be assigned or transferred. A non-NI may not be negotiated; but it may be assigned or transferred, absent an express prohibition against assignment or transfer written in the face of the instrument.
2. as to kind of title transferred:

a. restrictive – such indorsement either:
   1) prohibits further negotiation of instrument,
      o In this kind of restrictive indorsement, the prohibition to transfer or negotiate must be written in express words at the back of the instrument, so that any subsequent party may be forewarned that ceases to be negotiable. However, the restrictive indorsee acquires the right to receive payment and bring any action thereon as any indorser, but he can no longer transfer his rights as such indorsee where the form of the indorsement does not authorize him to do so. (Gempesaw v CA 1993)
   2) constitutes indorsee as agent of indorser, or
   3) vests title in indorsee in trust for another
      o rights of indorsee in restrictive ind.: a) receive payment of inst. b) Bring any action thereon that indorser could bring c) Transfer his rights as such indorsee, but all subsequent indorsees acquire only title of first indorsee under restrictive indorsement

b. non-restrictive

3. as to kind of liability assumed by indorser

a. qualified
   • constitutes indorser as mere assignor of title (eg. "without recourse") (Sec. 38, NIL).
   • But this does not mean that the transferee only has the rights of an assignee. Transfer remains a negotiation and transferee can still be a holder capable of acquiring a title free from defenses of prior parties.
   • It relieves the qualified indorser of his liability to pay the instrument should the maker be unable to pay at maturity.

b. unqualified

4. as to presence/absence of express limitations put by indorser upon primary obligor’s privileges of paying the holder:

a. conditional – additional condition annexed to indorser’s liability. (Sec. 39, NIL)
   o Where an indorsement is conditional, a party required to pay the instrument may disregard the condition, and make payment to the indorsee or his transferee, whether condition has been fulfilled or not.

b. unconditional

5. other classifications:

a. Absolute – One by which the indorser binds himself to pay, upon no other condition than the failure of prior parties to do so, and of due notice to him of such failure

b. Joint - Where instrument payable to the order of two or more payees or indorsees not partners, all must indorse, unless the one indorsing has authority to endorse for the others (Sec. 41, NIL)

c. Irregular - Where a person, not otherwise a party to the instrument, places thereon his signature in blank before delivery, he is liable as indorser

3.2. Other Rules on Indorsement

1. Indorsement by Collecting Bank - holder deposits check with a bank other than the drawee, would in effect be negotiating the check to such bank, since he would have to indorse the check before the bank will accept it for deposit. In most cases, the bank is acting as a mere collecting agent.

2. Negotiation by Joint or Alternative Payees or Indorsee – all must indorse, unless the one indorsing has authority to endorse for the others

3. Unindorsed instruments – Sec 49, NIL Where holder of instrument transfers for value without indorsing, transfer vests in transferee:

a. such title as transferor had therein, subject to defenses and equities available to prior parties
   o ex: transferee can sue the transferor, though he does not thereby automatically become a HDC (Furbee v. Furbee, 1936)

b. right to have indorsement of transferor, after which, he becomes a holder or possibly a HDC
   o For purposes of determining whether or not the transferee becomes a HDC after securing the transferor’s indorsement, note that Sec. 52 must be met at the time of the negotiation, i.e., when indorsement is actually made.

BPI vs CA (2007)

The transaction [in Sec. 49, NIL] is an equitable assignment and the transferee acquires the instrument subject to defenses and equities available among prior parties. Thus, if the transferor had legal title, the transferee acquires such title and, in addition, the right to have the indorsement of the transferor and also the right, as holder of the legal title, to maintain legal action against the maker or acceptor or other party liable to the transferor. The underlying premise of this
provision, however, is that a valid transfer of ownership of the negotiable instrument in question has taken place. 

Transferees in this situation do not enjoy the presumption of ownership in favor of holders since they are neither payees nor indorsees of such instruments. Thus, something more than mere possession by persons who are not payees or indorsers of the instrument is necessary to authorize payment to them in the absence of any other facts from which the authority to receive payment may be inferred.

4. Cancellation of Indorsements - Holder may strike out indorsements not necessary to his title. The endorser whose indorsement was struck out, and all endorsers subsequent to him, are relieved from liability on the instrument (Sec. 48, NIL).

5. Indorsement by Agent - agent should make it plain that he is signing in behalf of a principal otherwise he may be made personally liable (Sec 20, NIL)

- The Negotiable Instruments Law provides that where any person is under obligation to indorse in a representative capacity, he may indorse in such terms as to negative personal liability. An agent, when so signing, should indicate that he is merely signing in behalf of the principal and must disclose the name of his principal; otherwise he shall be held personally liable. (FRANCISCO v CA, 1990)

6. Presumption as to Indorsement

- Time (Sec.45, NIL) - Every negotiation deemed prima facie effected before instrument was overdue, except where indorsement bears date after maturity of the instrument.
- Place (Sec.46, NIL) - Every indorsement is presumed prima facie made at place where instrument is dated.
- Where instrument drawn or indorsed to person as cashier (Sec.42, NIL) - deemed prima facie to be payable to the bank or corporation of which he is such officer; may be negotiated by either the indorser (1) of the bank or corporation or (2) of the officer.

7. Continuation of Negotiable Character - An NI, although overdue, retains its negotiability unless it has been paid or restrictively indorsed to prevent further negotiation (Sec. 47, NIL)

8. Indorsement of bearer inst.

- Where an instrument payable to bearer is indorsed specially, it may nevertheless be further negotiated by delivery.
- Person indorsing specially liable as indorser to only such holders as make title through his indorsement.

Chapter IV.

HOLDER IN DUE COURSE

1. Holder (Sec. 191)

- Definition: Payee or indorsee of a bill or note who is in possession of it, or the bearer thereof.
- RIGHTS OF HOLDER (Sec. 51, NIL)
  1. sue thereon in his own name
  2. payment to him in due course

2. Three Kinds of DUE COURSE Holding

a. HDC under Sec 52
b. HDC under Sec 58: A holder who derives title to the instrument through a HDC has all the rights of the latter even though he himself satisfies none of the requirements of due course holding (Campos & Campos)
c. HDC under Sec 59 (presumption): every holder is deemed prima facie to be a holder in due course

3. Requisites to become a holder in due course (Sec.52)

SALAS v. CA (1990)

The indorsee was a HDC, having taken the instrument under the following conditions: (1) it is complete and regular upon its face; (2) it became the holder thereof before it was overdue; (3) it took the same in good faith and for value; and (4) when it was negotiated to the indorsee, the latter had no notice of any infirmity in the instrument or defect in the title of the previous indorser.

HDC is one who has taken the instrument under the following conditions:

3.1. That it is complete and regular upon its face

1. COMPLETE
   - An instrument is complete if it contains all the requisites for making it a negotiable one, even if it may have blanks as to non-essentials.
   - It is incomplete when it is wanting in any material particular or particular proper to be inserted in a NI without w/c the same will not be complete.

2. Material Particulars
   - What are material particulars? A change in the ff. is considered a material alteration (Sec. 125, NIL): i. The date;

6 suggested mnemonics: GROIN: Good faith and value, complete and Regular, not Overdue, no notice of Infirinity at time of Negotiation; or GROCI: Good faith and value, Regular, not Overdue, Complete, no Infirnity,
ii. The sum payable, either for principal or interest;
iii. The time or place of payment;
iv. The number or the relations of the parties;
v. The medium or currency in which payment is to be made;
vi. Or which adds a place of payment where no place of payment is specified,
3. Rights of HDC of instrument that has been materially altered
   - enforce payment thereof according to its original tenor if not a party to the alteration. *(Sec. 124, NIL)*

3.2. That he became the holder of it before it was overdue and without notice that it had been previously dishonored, if such was the fact

1. "OVERDUE"
   a. The ff. cannot be HDCs: *(Sec. 53, NIL)*
      i. A holder who became such after the date of maturity of the instrument (instrument is overdue);
      ii. In case of demand instruments, a holder who negotiates it after an unreasonable length of time after its issue
   b. Instruments with fixed maturity but subject to acceleration: ultimate date of maturity is the date of maturity for the purpose of determining whether a purchaser is a HDC
   c. Undated instruments: Prima facie presumption that it was negotiated before it was overdue *(Sec 45)*
   d. NOTE: An overdue instrument is still negotiable, but it is subject to the defense existing at the time of the transfer.

2. DISHONOR
   a. Non-acceptance
      i. Occurs when drawee refuses to accept the order of the drawer as stated in the bill
      ii. Applicable only to bills of exchange
      iii. May occur before the date of maturity of the bill
   b. Non-payment
      i. Occurs when the party primarily liable fails to pay at the date of maturity
      ii. Date of Maturity
         1) "payable after sight"—date of presentment
         2) Payable on the occurrence of a specified event—date is fixed by happening of event
   c. An instrument is not invalid for the reason only that it is ANTE-DATED OR POST-DATED provided not done for an illegal or fraudulent purpose. The person to whom an instrument so dated is delivered acquires the title thereto as of the date of delivery. *(Sec.12, NIL)*

3.3. That he took it in good faith AND for value:

1. HOLDER FOR VALUE - (a) Where value has at any time been given for the instrument, the holder is deemed a HFV in respect to all parties who become such prior to that time *(Sec.26, NIL)* and (b) Where the holder has a lien on the instrument, he is deemed a HFV to the extent of his lien *(Sec.27, NIL)*
   a. PRESCRIPTION – Every NI is deemed prima facie issued for valuable consideration; and every person whose signature appears thereon to have become a party thereto for value *(Sec. 24, NIL)*
      i. In actions based upon a negotiable instrument, it is unnecessary to aver or prove consideration, for consideration is imported and presumed from the fact that it is a negotiable instrument. The presumption exists whether the words "value received" appear on the instrument or not *(Ong v People, 2000)*

BAYANI VS. PEOPLE (2004)

Under Section 28 of the Negotiable Instruments Law (NIL), absence or failure of consideration is a matter of defense only as against any person not a holder in due course.

Moreover, Section 24 of the NIL provides the presumption of consideration. Such presumption cannot be overcome by the petitioner’s bare denial of receipt of the [consideration].

1) Only evidence of the clearest and most convincing kind will suffice for that purpose. *(Travel-On Inc v CA, 1992)*

b. VALUE - any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value, whether the instrument is payable on demand or at a future time. *(Sec.25, NIL)*

MERCHANTS’ NATIONAL BANK OF ST. PAUL v. STA. MARIA SUGAR CO. (1914)

The mere discounting of the note and placing the amount of said discount to the credit of the HFV would not then have constituted a transfer for value. But if the sum had subsequently been checked out, then value would have passed. The general rule as to the application of payments, there being no special facts to interfere, is that the first payments apply to the oldest debts. The first debits are to be charged against the first credits. It follows therefore, upon the facts as found, that the bank was a bona fide HFV without notice, and, in accordance with the stipulation, judgment should be entered for the plaintiff upon the note. Judgment reversed.

==
Bank credit as value - When the holder of a check deposits it with his bank (assuming it is not the drawee bank) and the bank credits it to his account, is the bank at this stage a HFV?

- Majority View → first money in is presumed to be the first money paid in
- Minority View → as long as the balance in the depositor’s account equals or exceeds the amount of the instrument deposited, the latter cannot be considered as withdrawn for the purpose of treating the bank as a HFV.
- (So far, there has been no decision by the SC on this issue.)

2. GOOD FAITH

a. Holder must have taken the instrument in good faith and 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.

b. NOT a Holder in GOOD FAITH
   i. Holder acted in bad faith
   ii. Holder had NOTICE OF DEFECT

1) ACTUAL KNOWLEDGE
   - SEC 56. WHAT CONSTITUTES NOTICE OF DEFECT—To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.

- It is therefore sufficient that the buyer of a note had notice or knowledge that the note was in some way tainted with fraud. It is not necessary that he should know the particulars of the fraud.

2) SUSPICIOUS CIRCUMSTANCES
   a. BAD FAITH - does not require actual knowledge of the exact fraud that was practiced; knowledge that there was something wrong about the assignor’s acquisition of title is sufficient.
   b. The burden is upon the defendant to show that notwithstanding the SUSPICIOUS CIRCUMSTANCES, it acquired the check in actual good faith. (De Ocampo & Co. v. Gatchalian)

In order to show that the defendant had knowledge of such facts that his action in taking the instrument amounted to bad faith, it is not necessary to prove that the defendant knew the exact fraud that was practiced upon the plaintiff by the defendant’s assignor, it being sufficient to show that the defendant had notice that there was something wrong about the assignor’s acquisition of title, although he did not have notice of the particular wrong that was committed.

...The fact is that it acquired possession of the instrument under circumstances that should have put it to inquiry as to the title of the holder who negotiated the check to it. The burden was, therefore, placed upon the defendant to show that notwithstanding the suspicious circumstances, it acquired the check in actual good faith.

One line of cases had adopted the test of the reasonably prudent man and the other that of actual good faith. It would seem that it was the intent of the Negotiable Instruments Act to harmonize this disagreement by adopting the latter test. Negligence on the part of the plaintiff, or suspicious circumstances sufficient to put a prudent man on inquiry, will not of themselves prevent a recovery, but are to be considered merely as evidence bearing on the question of bad faith.

STATE INVESTMENT HOUSE v. IAC (1989)

A check with 2 parallel lines in the upper left hand corner means that it could only be deposited and may not be converted to cash. Consequently, such circumstance should put the payee on inquiry and upon him devolves the duty to ascertain the holders’ title to the check or the nature of his possession. Failing in this respect, the payee is declared guilty of gross negligence amounting to legal absence of good faith and as such the consensus of authority is to the effect that the holder of the check is not a holder in good faith.

YANG v. CA (2003)

Where Mr. A obtained by fraud from Mr. B crossed checks payable to Mr. C, which Mr. C innocently receives from Mr. A for value, Mr. C is still a holder in good faith despite the fact that the checks were crossed. The crossing of a check does not impair the negotiability of an instrument nor necessarily preclude its holder from being a holder in due course. The crossing of a check only means that it could only be deposited and may not be converted.
into cash. Thus, such should put the holder on inquiry and upon him devolves the duty to ascertain the holder’s title to the check or nature of his possession.

The effects are that:
1. The check may not be encashed but only deposited in the bank.
2. The check may be negotiated only once – to one who has an account with a bank.
3. The act of crossing serves as a warning to the holder that the check was issued for a definite purpose so that he must inquire if he has received the check pursuant to that purpose. Otherwise, he would not be a holder in due course.

Where the holder Mr. C, as in this case, did not have knowledge of Mr. A’s fraudulent actions on Mr. B, and the fact that he was the payee in said check, he was legally warranted to deposit the instrument in his account with the drawee bank. Mr. C was a holder in good faith.

iii. FINANCING COMPANY

In installment sales, the buyer usually issues a note payable to the seller to cover the purchase price.

Many times, pursuant to a previous arrangement with the seller, a finance company pays the full price of the property sold and the note is indorsed to it by the seller, subrogating it to the right to collect the price from the buyer.

RULE → In such cases, the tendency of the courts is to protect the buyer against the finance company in the event that the goods sold turn out to be defective. The finance company will be subject to the defense of failure of consideration and cannot recover the purchase price from the buyer.

CONSOLIDATED PLYWOOD v. IFC (1987)

A FINANCING COMPANY that is the indorsee of a note issued by a buyer payable to the seller of goods is NOT a holder in good faith as to the buyer. In case the goods sold turn out to be defective, it cannot recover the purchase price of the goods from the buyer. The TEST OF PROXIMITY to the transaction was applied in this case. Where the financing company was privy to the initial transaction, it was bound with notice of the warranties attaching to the transaction. It ACTIVELY PARTICIPATED in the transaction, thus it cannot be a holder in good faith. This is the “protective doctrine” – favoring the interests of individual dealers over those of financing companies.

NOTE: The instrument in this case was non-negotiable, so the “active participation” discussion was merely obiter.

SALAS v. Court of Appeals (1990)

Salas defaulted in payments for motor vehicle, the purchase of which was financed by Filinvest. On demand, his defense was that the purchase was invested with fraud on the seller’s part. Filinvest (the financing company) was held to be a holder in good faith, despite privity to the allegedly fraudulent sale. Salas’ defenses were good only against the seller-indorser, and where the note was negotiable and validly negotiated to Filinvest, the latter was a holder in good faith, and may recover from Salas.

Note: This is the “less protective” doctrine – not so much favorable to dealers but as compared to Consolidated, the rule here was actually in the ratio decidendi and not mere obiter.

3.4. That at time it was negotiated to him, he had no notice of:
   - any infirmity in instrument
   - any defect in title of person negotiating;

1. title DEFECTIVE when (Sec. 55, NIL):
   a. instrument / signature obtained by fraud, duress, force or fear or other unlawful means OR for an illegal consideration; or
   b. instrument is negotiated in breach of faith, or fraudulent circumstances

2. NOTICE of infirmity or defect –
   a. actual knowledge of the infirmity or defect OR knowledge of such facts that his action in taking the instrument amounted to bad faith (Sec.56, NIL)
   b. Notice to an AGENT is chargeable against the principal.
   c. INSUFFICIENT NOTICE
      i. CONSTRUCTIVE NOTICE (ex. notice of defenses disclosed by public records, doctrine of lis pendens) is insufficient to charge a purchaser of a NI with notice.
        * Just as a purchaser of a negotiable instrument is not put on inquiry, neither is he charged with notice of defenses or equities disclosed by public records, nor is he affected by the doctrine of lis pendens. However, notice to an agent is chargeable against the principal.
      ii. Notice of an ACCOMMODATION PARTY is not notice of a defect.
        * Thus, an accommodation party (one who has signed the instrument as maker, drawer, acceptor or endorser, without receiving value therefor, and for the purpose of lending his name to some other person) is liable on the instrument, notwithstanding the fact that the holder knew him to be an accommodation party.
d. RIGHT of a transferee who receives NOTICE of any infirmity or defect BEFORE he has PAID THE FULL amount for the instrument
   i. He will be deemed a HDC only to the extent of the amount therefore paid by him (Sec.54, NIL)

4. Effect of Qualified, Conditional and Restrictive Indorsements

A. The status of a holder as a HDC is not affected by his taking under a qualified indorsement.
B. A conditional indorsement does not deprive the conditional indorsee or subsequent holder of the rights of a HDC. If he fulfills all the requisites in Sec. 52 then he is immune from all the personal defense.
C. A restrictive indorsement which prohibits further negotiation will not prevent the indorsee from being a HDC. BUT, if he further indorses the instrument, then the subsequent indorsee will not be a due course holder.

5. Who is Deemed HDC (burden of proof) (Sec.59)

A. General Rule: Prima facie presumption in favor of holder
B. Exception: Burden is reversed (burden on holder to prove that he or some person under whom he claims acquired title as HDC) when it is shown that the title of any person who has negotiated instrument was defective
C. Exception to exception: There will be no reversal if the party being made liable became bound prior to the acquisition of such defective title (i.e., where defense is not his own) – presumption in favor of holder

6. Rights of Holder in Due Course

6.1. Under the NIL
   1. to sue on the instrument in his own name (Sec. 51, NIL)
   2. to receive payment on the instrument – discharges the instrument (Sec. 51, NIL)
   3. holds instrument free of any defect of title of prior parties (Sec. 57, NIL)
   4. free from defenses available to prior parties among themselves (Sec.57, NIL)
   5. may enforce payment of instrument for full amount, against all parties liable (Sec.57, NIL)

6.2. JUR: BPI v. ALFRED BERWIN & CO.
   Only a HDC may enforce payment on the PN. In CAB, it is not clear whether A (the payee) is still the HDC since D (the maker) believed that A may have negotiated it. Thus, to compel D to pay would expose him to pay a second time to the HDC (in case A was no longer one). In short, the drawer may be compelled to pay only to a HOLDER of the instrument.

6.3. DISADVANTAGE of being a NON HDC:
   o The Negotiable Instruments Law does not provide that a holder not in due course can not recover on the instrument. The disadvantage of ... not being a holder in due course is that the negotiable instrument is subject to defenses as if it were non-negotiable. One such defense is absence or failure of consideration. (Atrium Mgt v de Leon, 2001)

7. Rights of Purchaser from Holder in Due Course (Sec.58)

7.1. General Rule: In the hands of any holder other than a HDC, NI is subject to same defenses as if it were non-negotiable.

7.2. Exception: A holder who derives title through a HDC and who is NOT himself A PARTY TO ANY FRAUD or illegality has all rights of such former holder in respect to all parties prior to the latter EVEN though he himself does not satisfy Sec.52

8. Presumption in Favor of Due Course Holding

A. Every holder is deemed prima facie to be a holder in due course;
   1. BURDEN SHIFTS when it is shown that the title of any person who has negotiated the instrument was defective. Holder MUST PROVE that he or some person under whom he claims acquired title as a holder in due course.
   2. But the last mentioned rule does not apply in favor of a party who became bound on the instrument prior to the acquisition of such defective title. (Sec.59, NIL)
B. However, this presumption arises only in favor of a person who is a holder as defined in Section 191 of the Negotiable Instruments Law, meaning a “payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof.” (Yang v CA, 2003)

7 Suggested Mnemonics: REFS: Receive and Enforce payment, Free from any defect of title and defenses. Sue
Chapter V.
DEFENSES & EQUITIES

1. Defenses in General

1.1. REAL defense – attaches to instrument on the principle that there was no contract at all; available against ALL holders including holders in due course. They are those which attach to the instrument itself and generally, disclose an absence of one of the essential elements of a contract.

1.2. PERSONAL defense – grows out of the agreement or conduct of a particular person in regard to the instrument which renders it inequitable FOR HIM, though holding the legal title, to enforce it against the party sought to be made liable; not available against a HDC. can be raised only against holders not on due course. Here, the true contract appears, but for some reason, the defendant is excused from the obligation to perform.

1.3. Equities or Claims of Ownership are of 2 Kinds

1. Legal – one who has legal title to the instrument may recover possession thereof even from holder in due course
2. Equitable – may only recover from a holder not in due course

2. Real Defenses

2.1. Incapacity: REAL defense but available only to the incapacitated party (ex. minor or corporation); the indorsement or assignment of the instrument by a corp. or by an infant passes the property therein, notwithstanding that from want of capacity, the corp. or infant may incur no liability thereon. (Sec.22, NIL)

2.2. Incomplete, Undelivered Instrument

1. Instrument 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. (Sec. 15, NIL)
2. Who may be estopped from raising the real defense under Sec 15? A drawee bank whose negligent custody of the checks, after partial execution, contributed to its escape

3. Personal Defenses

3.1. Complete, Undelivered Instrument

a. CONCLUSIVE presumption of a valid delivery – where the instrument is in the hands of a HDC

b. PRIMA FACIE presumption of a valid delivery – where the instrument is no longer in the possession of a party whose sig appears thereon (Sec. 16, NIL)

3.2. Incomplete, Delivered (sec.14)

1. This is a personal defense only because provision states that if any instrument so completed is negotiated to a holder in due course, it is valid and effectual for all purposes
2. 2 Kinds of Writings:
   i. Where instrument is wanting in any material particular: person in possession has prima facie authority to complete it by filling up blanks therein
   ii. Signature on blank paper delivered by person making the signature IN ORDER that the paper may be CONVERTED into a NI → operates as prima facie authority to fill up as such for any amount

3. The authority to fill up is limited by the following:
   a. When completed, it may be enforced upon the parties thereto only if it was filled strictly in accordance with the authority given
   b. The filling up must be within a reasonable time

NOTE: If the signature on a paper is given only for autograph purposes and the same is converted into a NI, this will amount to forgery, constituting thus a valid defense even against a HDC

4. This provision contemplates delivered instruments, so the person in possession cannot be a thief or a finder but a person in lawful possession- one to whom the instrument has been delivered.

5. In order that any such instrument, when completed, may be enforced against any person who became a party thereto prior to its completion:
   a. must be filled up strictly in accordance w/ AUTHORITY given
   b. within a REASONABLE TIME – in determining what is reasonable time, regard is to be had to the (1) nature of the instrument, (2) usage of trade or business (if any) with respect to such instruments, and 3) the facts of the particular case

6. BUT if negotiated to HDC, may enforce it as if it had been filled up properly

7. What details may be filled up?
   a. Amount, as to a signed blank paper
   b. Date (Sec 13 “… The insertion of a wrong date does not void the instrument in the hands of a subsequent holder in due course…”)
   c. Place of payment
   d. Name of payee

3.3. Lack of Consideration(Sec. 28)

1. ABSENCE or failure of consideration is a matter of defense as against any person not a HDC.
2. PARTIAL FAILURE of consideration is a defense pro tanto whether the failure is an ascertained and liquidated amount or otherwise.
3.4. Illegality

1. In general, a PERSONAL defense even if CC1409 provides that a contract with an illegal cause is void.

2. REAL when the law expressly provides for illegality as a real defense (Statutory declaration of illegality)

**RODRIGUEZ v MARTINEZ (1905)**

Maker cannot be relieved from the obligation of paying the holder the amount of the note alleged to have been executed for an unlawful consideration. (Illegality is personal, so defense only against a holder not in due course)

The holder paid the value of the note to its former holder. He did so without being aware of the fact that the note had an unlawful origin. He accepted note in good faith, believing the note was valid and absolutely good. The maker even assured the holder before the purchase that the note was good and that he would pay it at a discount.

3.5. Duress

1. In general, PERSONAL defense.

2. REAL if duress so serious as to give rise to a real defense for lack of contractual intent

3. CAMPOS: There may be cases where the duress employed is so serious that it will give rise to a real defense because of the lack of contractual intent. Although the signer may know what he is signing, there may be wanting the intent or willingness to be bound. Then it becomes a real defense.

4. Sometimes Real, Sometimes Personal

4.1. Forgery (Sec. 23): made without authority of person whose signature it purports to be

1. In general, a REAL defense: ...

   Effect

   a. signature is wholly inoperative
   b. no right to retain instrument, or give discharge, or enforce payment against any party thereto, can be acquired through or under such signature (unless forged signature unnecessary to holder’s title)
   c. No subsequent party can acquire the right against any party thereto (prior to the forgery) to:
      i. Retain the instrument
      ii. Give a discharge there for
      iii. Enforce payment thereof

2. PERSONAL if the party against whom it is sought to enforce such right is

   PRECLUDED from setting up forgery/want of authority;

   a. Who are PRECLUDED?
      i. parties who make certain warranties, like a general indorser or acceptor after forgery (Sec. 62, NIL)
      ii. estopped / negligent parties
      iii. parties who ratify (BUT there are conflicting views whether “precluded” includes ratification)

   b. One view holds that a forged signature cannot be ratified because ratification involves the relation of agency and a forger does not assume to act for another.

3. ACCEPTANCE AND PAYMENT of a forged instrument

   When there is acceptance and payment of a forged instrument, the rights and liabilities of the parties depend on whether the forgery pertains to the drawer/maker’s signature or merely of an indorsement.

   a. Drawer/Maker’s signature
      i. PRICE v NEAL, The drawee who had paid an accepted bill as well as a non-accepted bill, each of which was forged, could NOT recover the money paid out on the bill. The neglect was on the part of the drawee.

   **PNB v QIMPO (1988)**

   A bank is bound to know the signatures of its depositors. If bank pays a forged check it must be considered as making the payment out of its own funds and cannot charge the account of the depositor whose signature was forged.

   **SAMSUNG CONSTRUCTION CO., INC. VS. FAR EAST BANK AND TRUST CO. AND CA (2004)**

   Consequently, if a bank pays a forged check, it must be considered as paying out of its funds and cannot charge the amount so paid to the account of the depositor. A bank is liable, irrespective of its good faith, in paying a forged check.

   ii. Extensions Of The Price v Neal Doctrine: The bar to recovery (Price v Neal doctrine) is extended to overdrafts and stop payment orders

      1) **Overdraft** occurs when a check is issued for an amount more than what the drawer has in deposit with the drawee bank. **RULE:** The drawee who pays the holder of the bill cannot recover from the holder what he paid under mistake

      2) **Stop Payment Order** is one issued by the drawer of
a check countermanding his first order to the drawee bank to pay the check.  
**RULE:** The drawee bank is bound to follow the order, provided it is received prior to its certification or payment of the check.

3) **SOME EXCEPTIONS:**
   - If the payment to holder is a legitimate debt of the drawer which the holder in due course could have recovered from the drawer anyway.
   - If the stop order comes after the bank has certified or accepted the check, the bank is under the legal duty to pay the holder and will not be liable to the drawer for doing so.

### ii. Effect Of Negligence Of Depositor - If proximate cause of loss, the bank (drawee) is not liable

1) It is the duty of the depositor/drawer to carefully examine bank's statements, cancelled checks, his check stubs, and other pertinent records within a reasonable time and to report any errors without unreasonable delay.

2) If a drawer/depositor's negligence and delay should cause a bank to honor a forged check, drawer cannot later complain should bank refuse to recredit his account.

### ILUSORIO vs CA (2002)

True, it is a rule that when a signature is forged or made without the authority of the person whose signature it purports to be, the check is wholly inoperative.

However, the rule does provide for an exception, namely: "unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority." In the instant case, it is the exception that applies. Petitioner is precluded from setting up the forgery, assuming there is forgery, due to his own negligence in entrusting to his secretary his credit cards and checkbook including the verification of his statements of account.

### SAMSUNG CONSTRUCTION CO., INC. VS. FAR EAST BANK AND TRUST CO. AND CA (2004)

The **general rule** remains that the drawer who has paid upon the forged signature bears the loss. The **exception to this rule** arises only when negligence can be traced on the part of the drawer whose signature was forged, and the need arises to weigh the comparative negligence between the drawer and the drawee to determine who should bear the burden of loss.

Still, even if the bank performed with utmost diligence, the drawer whose signature was forged may still recover from the bank as long as he or she is not precluded from setting up the defense of forgery. After all, Section 23 of the Negotiable Instruments Law plainly states that no right to enforce the payment of a check can arise out of a forged signature. Since the drawer, Samsung Construction, is not precluded by negligence from setting up the forgery, the general rule should apply.

### b. Indorsement:

i. When it is the **signature of the indorser** that is forged, the drawee and drawer CAN recover vs holder
   1) The drawee can recover the amount paid by him in cases where only an indorsement has been forged. This is because drawee makes no warranty as to the genuineness of any indorsement.
   2) Generally, the drawee may only recover from the holder. Should he fail to do so (for instance due to insolvency) he cannot recoup his loss by charging it to the drawer's account.
   3) Although a depositor/drawer owes a duty to his drawee bank to examine his cancelled checks, he has no similar duty as to forged indorsements.
   4) The drawer, as soon as he comes to know of the forged indorsement should promptly notify the drawee bank.

### REPUBLIC v EBRADA

Drawee can recover. It is not supposed to be the duty of the drawee to ascertain whether the signatures of the payee or indorsers are genuine or not.

ii. **When drawee may recover from DRAWER**

1) Where the instrument is originally a bearer instrument, because the indorsement can be disregarded as being unnecessary to the holder's title.
2) Indorsement forged by an employee or agent of the drawer.
3) If due to the drawer's negligence/delay, the forgery is not discovered
NEGOTIABLE INSTRUMENTS LAW

While there is no duty resting on the drawer to look for forged indorsements on his cancelled checks, a depositor is under a duty to set up an accounting system and business procedure as are reasonably calculated to prevent or render the forgery of indorsements difficult, particularly by the depositor’s own employees. As a rule the drawee bank who has paid the check with forged indorsement, cannot charge the drawer’s account for the amount of the said check. An exception to this rule is where the drawer is guilty of such negligence which causes the bank to honor the check.

iii. When drawee may not recover from holder

1) Where the instrument is originally a bearer instrument, because the indorsement can be disregarded as being unnecessary to the holder’s title
2) If drawee fails to act promptly, if he delays in informing the holder whom he paid

iv. Between Drawee Bank and Collecting Bank

1) Collecting bank only liable for forged indorsements and not forgeries of the drawer or maker’s signature. (PNB v CA, 1968)
2) The collecting bank or last indorser generally suffers the loss because it has the duty to ascertain the genuineness of all prior indorsements considering that the act of presenting the check for payment to the drawee is an assertion that the party making the presentment had done its duty to ascertain the genuineness of the indorsements. (BPI v CA, 1992)
3) In presenting the checks for clearing the collecting agent, made an express guarantee on the validity of “all the prior endorsements”. (BDO v Equitable bank)
4) The drawee bank is not similarly situated as the collecting bank because the former makes no warranty as to the genuineness of any indorsement. The drawee bank’s duty is but to verify the genuineness of the drawer’s signature and not of the indorsement because the drawer is its client.
5) Where the negligence of the drawee bank is the proximate cause of the collecting bank’s payment of a check with a forged indorsement, the drawee bank may be held liable to the collecting bank.
6) When both are guilty of negligence, the degree of negligence of each will be weighed in considering the amount of loss which each should bear. (refer to BPI v CA, 1992)

GREAT EASTERN LIFE v HONGKONG & SHANGHAI BANK (1922)

“Where a check is drawn payable to the order of one person and is presented to a bank by another and purports upon its face to have been duly indorsed by the payee of the check, it is the duty of the bank to know that the check was duly indorsed by the original payee and where the bank pays the amount of the check to a 3rd person, who has forged the signature of the payee, the loss falls upon the bank who cashed the check, and its remedy is against the person to whom it paid the money.”

BPI v CA (1992)

Section 23 of the NIL has 2 parts. The first part states the general rule that a forged signature is wholly inoperative and payment made through or under such signature is ineffectual. The second part admits of exception. In this jurisdiction, the negligence of the party invoking the forgery is an exception to the general rule.

Both drawee and collecting bank were negligent in the selection and supervision of their employees resulting in the encashment of the checks by the impostor. Both banks were not able to overcome the presumption of negligence in the selection and supervision of their employees.
Considering the comparative negligence of the parties, the demands of substantive justice are satisfied by allocating the loss and the costs on a 60-40 ratio.

ASSOCIATED BANK v CA (1996)

By reason of the statutory warranty of a general indorser in Section 66 of the Negotiable Instruments Law, a collecting bank which indorses a check bearing a forged indorsement and presents it to the drawee bank guarantees all prior indorsements, including the forged indorsement. It warrants that the instrument is genuine, and that it is valid and subsisting at the time of his indorsement. Because the indorsement is a forgery, the collecting bank commits a breach of this warranty and will be accountable to the drawee bank. This liability scheme operates without regard to fault on the part of the collecting/presenting bank. Even if the latter bank was not negligent, it
would still be liable to the drawee bank because of its indorsement.

PCIB v. CA (2001)

... A bank which cashes a check drawn upon another bank, without requiring proof as to the identity of persons presenting it, or making inquiries with regard to them, cannot hold the proceeds against the drawee when the proceeds of the checks were afterwards diverted to the hands of a third party. In such cases the drawee bank has a right to believe that the cashing bank (or the collecting bank) had, by the usual proper investigation, satisfied itself of the authenticity of the negotiation of the checks. Thus, one who encashed a check which had been forged or diverted and in turn received payment thereon from the drawee, is guilty of negligence which proximately contributed to the success of the fraud practiced on the drawee bank.

4.2. Material Alteration (Sec.124)

1. As a DEFENSE:
   a. PERSONAL defense when used to deny liability according to the tenor of the instrument
   b. REAL defense when relied on to deny liability according to the altered terms.

2. What constitutes material alteration?
   a. Statutory: Review Sec.125, NIL
      i. change date
      ii. sum payable, either for principal or interest
      iii. time or place of payment
      iv. number/relations of parties
      v. medium/currency of payment,
      vi. adds place of payment where none specified,
      vii. other change/addition altering effect of
      viii. instrument in any respect
   b. Jurisprudence
      i. An alteration is said to be material if it changes the effect of the instrument. It means that an unauthorized change in an instrument that purports to modify in any respect the obligation of a party or an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party. (PNB v CA, 1996)
      ii. A material alteration is one which changes the items which are required to be stated under Section 1 of the Negotiable Instruments Law. (Metrobank v Cabilzo, 2006)

3. IMMATERIAL ALTERATION
   a. Campos: Any other alteration would be non-material and would not affect the liability of any prior party. Note that #7 is a catch-all provision such that sec 125 may still have broad applicability.
   b. Alterations of the serial numbers do not constitute material alterations on the checks... [It] is not an essential requisite for negotiability under Section 1 of the Negotiable Instruments Law. The aforementioned alteration did not change the relations between the parties. The name of the drawer and the drawee were not altered. The intended payee was the same. The sum of money due to the payee remained the same. (PNB v CA, 1996; Int’l Corporate Bank v CA, 2006)
   c. EFFECT: an innocent alteration (generally, changes on items other than those required to be stated under Sec. 1 of N. I. L.) and spoliation (alterations done by a stranger) will not avoid the instrument, but the holder may enforce it only according to its original tenor. (PNB v CA, citing J. Vitug)

4. EFFECT OF MATERIAL ALTERATION
   a. General Rule: Where NI materially altered w/o the assent of all parties liable thereon it is AVOIDED, except as against:
      i. party who has himself made, authorized or assented to alteration
      ii. subsequent indorser because by indorsement he warrants that the instrument is in all respects what it purports to be and that it was valid and subsisting at the time of his indorsement (Secs. 65 and 66, NIL)
   b. As to a HOLDER in DUE COURSE
      i. When an instrument that has been materially altered is in the hands of a HDC not a party to the alteration, HDC may enforce payment thereof according to orig. tenor.
      ii. Alteration must NOT be apparent on the face of the instrument for the holder then would not be a holder in due course
      iii. Where the interest rate is altered, the holder in due course can recover the principal sum with the original rate of interest
   c. When alteration is of the amount or the interest rate is altered, the holder can recover the ORIGINAL AMOUNT/interest rate.

5. DRAWER’S NEGLIGENCE
   a. The general rule is that the drawee cannot charge against the drawer’s account the amount of an altered check.
   b. BUT, the drawer’s negligence, before or after the alteration, may
estop him from setting up alteration as a defense.

c. However, the drawer is not bound to so prepare the check that nobody else can successfully tamper with it (ex: a drawer cannot be expected to foresee that his clerk will use acid to alter his checks, *Critten v. Chemical Nat'l Bank*).

d. Where the negligence of the drawer consists in failing to discover alterations previously made which he could have discovered by a comparison of the cancelled checks and check stubs or by diligent observation of his records and could thus have prevented the drawee bank from subsequently cashing other altered checks, the drawee can charge the subsequent check against the negligent drawer’s account.

6. EFFECT OF DRAWEE’S ACCEPTANCE OF ALTERED CHECKS

a. Where the interest rate is altered, the HDC can recover the principal sum with the original rate of interest.

i. EXCEPT: A subsequent indorser, because by the indorsement he warrants that the instrument is in all respects what it purports to be and that it was valid and subsisting at the time of his indorsement (Sec 65 and 66).

b. RECOVERY after acceptance or payment by the drawee bank

i. FROM HOLDER

1) Prevailing view - Yes, bec. of (1) payment under mistake, (2) Sec. 124 and (3) Sec.62 in relation to Sec. 132.

2) Minority view – No, bec. of (1) estoppel, (2) stability of transactions and (3) bank is in a better position to shoulder the loss.

3) SC:

a. adopted the minority view but on a different basis—the Central Bank Circular regulating clearing of checks and limiting the period within which a drawee bank may return a spurious check.

b. but if holder is guilty of negligence which proximately contributed to the erroneous payment by drawee, holder liable (PCIB v CA, 2001).

MONTINOLA v PNB (1951)

The insertion of the words “Agent Philippine National Bank” converted the bank from a mere drawee to a drawer and therefore changes its liability, constitutes material alteration of the instrument without consent of the parties liable thereon, and so discharges the instrument. Drawee bank is not liable.

HONGKONG & SHANGHAI BANK v PEOPLES BANK (1970)*

The failure of the drawee bank to call the attention of the collecting bank as to such alteration until after the lapse of 27 days would negate whatever right it might have had. The remedy of the drawee bank is against the party responsible for the forgery or alteration.

REPUBLIC BANK v CA (1991)

The collecting bank is protected by the 24-hour clearing house rule from the liability to refund the amount paid by the drawee bank. [Note: A much recent Circular changed the point of reckoning for the return of the altered check from within 24 hours from the clearing to within 24 hours from the discovery of the alteration]

ASSOCIATED BANK v CA (1996)

The rule mandates that the checks be returned within twenty-four hours after discovery of the forgery but in no event beyond the period fixed by law for filing a legal action. The rationale of the rule is to give the collecting bank (which indorsed the check) adequate opportunity to proceed against the forger. If prompt notice is not given, the collecting bank maybe prejudiced and lose the opportunity to go after its depositor.

ii. FROM DRAWER: drawee has no right to seek reimbursement from drawer for its erroneous payment.

METROBANK v CABILZO (2006)

In addition, the bank on which the check is drawn, known as the drawee bank, is under strict liability to pay to the order of the payee in accordance with the drawer’s instructions as reflected on the face and by the terms of the check. Payment made under materially altered instrument is not payment done in accordance with the instruction of the drawer. When the drawee bank pays a materially altered check, it violates the terms of the check, as well as its duty to charge its client’s account only for bona fide disbursements he had made. Since the drawee bank, in the instant case, did not pay according to the original tenor of the instrument, as directed by the drawer, then it has no right to claim reimbursement from the drawer, much less, the right to deduct the erroneous payment it made from the drawer’s account which it was expected to treat with utmost fidelity.

BPI v BUENAVENTURA (2005)

* Affirmed the minority view that drawee cannot recover
It should be able to detect alterations, erasures, superimpositions or intercalations thereon, for these instruments are prepared, printed and issued by itself, it has control of the drawer's account, and it is supposed to be familiar with the drawer's signature. It should possess appropriate detecting devices for uncovering forgeries and/or alterations on these instruments...

There is nothing inequitable in such a rule for if in the regular course of business the check comes to the drawee bank which, having the opportunity to ascertain its character, pronounces it to be valid and pays it, as in this case, it is not only a question of payment under mistake, but payment in neglect of duty which the commercial law places upon it, and the result of its negligence must rest upon it.

c. REMEDY: Unless a forgery or alteration is attributable to the fault or negligence of the drawer himself, the remedy of the drawee bank that negligently clears a forged and/or altered check for payment is against the party responsible for the forgery or alteration, otherwise, it bears the loss. (BPI v Buenaventura, 2005)

4.3 Fraud

1. REAL DEFENSE
   a. fraud in execution / fraud in factum: did not know that paper was a NI when it was signed
   b. not liable to ANY holder

2. PERSONAL DEFENSE
   a. Fraud in inducement: knows it is NI but deceived as to value/terms
      i. Available as a defense against non-HDC
   b. Fraud in factum accompanied by NEGLIGENCE of maker or signer
      i. Where the signor does not know the nature of the instrument he signs, but where, by the exercise of ordinary care, he could have discovered it.
      ii. Three factors are typically used in determining the existence of negligence:
         1) legal character of the instrument which the signer thinks he is signing
         2) the physical condition of the signer and his ability to read
         3) whether the signer had the opportunity at the time of signing, to ascertain the legal nature of the paper he is executing

Chapter VI.
LIABILITY OF PARTIES

1. In General

1.1. Parties primarily liable:
   1. person who by the terms of the instrument is absolutely required to pay the same.
      a. Maker of promissory note
      b. Acceptee of bill of exchange
   2. unconditionally liable; duty bound to pay the holder at date of maturity, WON holder demands payment from him, and he is not relieved from liability even if the instrument should become overdue due to failure of holder to make such demand.

1.2. Parties secondarily liable:
   1. SECONDARY PARTIES:
      a. Indorsers, both note and bill
      b. Drawer of bill
   2. Conditionally liable; not bound to pay unless the following has been fulfilled
      a. Due presentment or demand from primary party for payment or acceptance;
      b. Dishonor by such party; and
      c. Taking of proceedings required by law after dishonor.

2. Primary Parties

2.1. PAYMENT: Presentment and Tender
   1. Presentment for payment not necessary to charge primary party
   2. if the instrument is, by its terms, payable at a special place, and he is able and willing to pay it there at maturity, such ability and willingness are equivalent to a tender of payment upon his part. (Sec. 70, NIL)

2.2. Liability of MAKER
   1. Promises to pay it according to its tenor
   2. Admits existence of payee and his then capacity to indorse.
      a. Therefore, PRECLUDED from setting up the following defenses:
      i. the payee is a fictitious person
      ii. the payee was insane, a minor, or a corporation acting ultra vires

2.3. DRAWEES and ACCEPTORS
   1. Drawee
      a. A person on whom a bill of exchange or check is drawn who is ordered to pay it
   2. Holder
      1) Not liable on the instrument until he accepts it and even a holder in due course cannot sue him on the instrument before his acceptance
      2) A bill/check of itself does not operate as an assignment of the funds in the hands of the drawee/bank (Sec 189, NIL), and the drawee/bank is NOT
LIABLE on the bill unless and UNTIL he/it ACCEPTS (or certifies) the same. (Sec. 127, NIL)

3. Drawer
   1) Payment despite Stop Payment Order
      a) Before payment or certification by the bank, the drawer may countermand the order, and payment thereafter to the payee by the bank is wrongful.
   b) Since a check is not an assignment of the drawer’s fund, the bank is liable for paying it in disregard of the countermand.
   c) Moreover, drawee can no longer recover what it voluntarily paid to the holder of the uncertified and unaccepted instrument.

2) Refusal to Accept
   a) Under some circumstances, the drawee who refuses to accept may be made liable for breach of contract or for damages based on a tort either to the drawer (refer to Araneta v. Bank of America) or to the holder (refer to HSBC v. Catalan).

ARANETA V. BANK OF AMERICA (1971)

This was an action by a depositor against a bank for damages resulting from the wrongful dishonor of the depositor’s checks. HELD: Araneta’s claim for temperate damages is legally justified because of the adverse reflection on the financial credit of a businessman, a prized and valuable asset, w/c constitutes material loss.

HSBC VS. CATALAN (2004)

HSBC is not being sued on the value of the check itself but for how it acted in relation to Catalan’s claim for payment despite the repeated directives of the drawer Thomson to recognize the check the latter issued.

Her allegations in the complaint that the gross inaction of HSBC on Thomson’s instructions, as well as its evident failure to inform Catalan of the reason for its continued inaction and non-payment of the checks, smack of insouciance on its part, are sufficient statements of clear abuse of right for which it may be held liable under Article 19 of the Civil Code for any damages she incurred resulting therefrom.

HSBANK’s actions, or lack thereof, prevented Catalan from seeking further redress with Thomson for the recovery of her claim while the latter was alive.

3. Acceptor: Liability

   a. (Sec.62, NIL) Drawee is not liable unless he accepts the bill and in doing so, he engages to pay the bill according to the tenor of his acceptance, and admits the following:
      i. existence of drawer
      ii. genuineness of his signature
      iii. his capacity and authority to draw the instrument
      iv. existence of payee and his then capacity to endorse

   b. Meaning of “according to the tenor of his acceptance”
      i. Majority and prevailing view:
         Where alteration consists in raising the amount payable, acceptor liable to HDC only as to its original amount; if the alteration of payee’s name, paying banks cannot charge drawer’s account with the amount of the check because its duty is to pay only “according to the order of the drawer.”
      ii. Common law rule: Acceptor of altered check not liable to innocent holder except for the original amount

2.4. Acceptance

1. IN GENERAL:
   a. Definition:
      i. “Acceptance” means an acceptance completed by delivery or notification (Sec. 19, NIL)
      ii. The signification by the drawee of his assent to the order of the drawer (Sec 132, NIL)

   b. REQUIREMENTS for a valid acceptance (Sec 132, NIL)
      i. It must be in writing and signed by the drawee;
         1) Thus there is no valid or implied acceptance except as provided by Sec. 137 relating to constructive acceptance
      ii. It must not express that the drawee will perform his promise by any other means than the payment of money
      iii. does not change the implied promise of acceptor to pay only in money

   c. MANNER of acceptance
      i. Campos: Usually made by writing the word “accepted” and signing immediately below
         1) BUT, drawee’s signature alone is sufficient (Campos citing Lawless v. Temple)
      ii. Sec 133, NIL: The holder of a bill presenting the same for acceptance may require that the acceptance be written on the bill and if such request is denied, may treat the bill as dishonored
         1) Effect: holder may go against the party’s secondarily liable— the drawer and the indorsers
      iii. Acceptance of an INCOMPLETE bill (Sec 138, NIL)
         1) A bill may be accepted:
            a) before it has been signed by the drawer, or
b) while otherwise incomplete, or
c) when it is overdue, or
d) after it has been dishonored by a previous refusal to accept, or by non payment

2) But when a bill payable after sight is dishonored by non-acceptance and drawee subsequently accepts it, the holder, in the absence of different agreement, is entitled to have bill accepted as of date of the 1st presentment.

a) Sec. 138, NIL allows acceptance to be made while the bill is incomplete.

b) The bill may be accepted even after it is overdue or dishonored, since an instrument DOES NOT LOSE ITS NEGOTIABILITY by the mere fact that its maturity date has passed or the drawee’s refusal to accept or pay it.

d. PERIOD within which to accept
i. The drawee is allowed 24 hours after presentment to decide whether he will accept the bill; the acceptance, if given, dates as of the day of presentation. (Sec. 136, NIL)

ii. Effect of non-acceptance within the prescribed period
1) Where bill is duly presented and is not accepted within the prescribed time, the person presenting it must treat the bill as dishonored by non-acceptance or he loses right of recourse against the drawer and indorsers. (Sec. 150, NIL)

2. CONSTRUCTIVE ACCEPTANCE: occurs in the following circumstances

a. SEC 137, NIL: Where the drawee
   i. destroys the bill, or
   ii. refuses within 24hrs or such other period as the holder may allow, to return the bill accepted or non-accepted to the holder

b. Under the clearing house rules, the drawee bank’s failure to return within the prescribed time will be deemed payment or acceptance of the check.

c. If there is no demand for the return of the bill and the drawee keeps it until after the expiration of said period without expressly accepting or refusing it; two views:
   i. Constitutes constructive notice
   ii. Constitutes dishonor because Sec.137, NIL uses the word “refuses”

d. Acceptance, if given, will retroact to date of presentation.

SUMCAD v. PROVINCE OF SAMAR (1956)

There was implied acceptance in view of the circumstances of the case (furnishing of photostatic copies, presentment for certification) by voluntary assuming the obligation of holding so much deposit as would be sufficient to cover the amount of the check.

3. ACCEPTANCE ON A SEPARATE INSTRUMENT

   a. Extrinsic acceptance - acceptance is written on a paper other than the bill itself; doesn’t bind the acceptor except in favor of a person to whom it is shown and who, on the faith thereof, receives the bill for value. (Sec. 134, NIL): acceptance of an existing bill

   b. Virtual acceptance - unconditional promise in writing to accept a bill before it is drawn; deemed an actual acceptance in favor of every person who, upon the faith thereof, receives the bill for value. (Sec. 135, NIL): acceptance of future bill

   c. In both cases, the acceptance must clearly and unequivocally identify the bill to which the acceptance refers.

3. KINOS OF ACCEPTANCE: An acceptance is either (1) general or (2) qualified.

a. GENERAL - assents without qualification to the order of the drawer. (Sec.139, NIL): includes acceptance to pay at a particular place; unless expressly stated that bill is to be paid there only and not elsewhere. (Sec. 140, NIL)

b. QUALIFIED - in express terms varies the effect of the bill as drawn. (Sec. 139, NIL)
   i. Conditional; payment by the acceptor dependent on the fulfillment of a condition therein stated;
   ii. Partial; to pay part only of the amount for which the bill is drawn;
   iii. Local; to pay only at a particular place;
   iv. Qualified as to time;
   v. The acceptance of some, one or more of the drawees but not of all. (Sec. 141, NIL)

   1) The holder may refuse to take a qualified acceptance; may treat the bill as dishonored by non-acceptance.

   2) Where a qualified acceptance is taken, the drawer and indorsers are discharged from liability on the bill unless they have authorized the holder to take a qualified acceptance, or subsequently assent thereto.

   3) When the drawer or an indorser receives notice of a qualified acceptance, he must, within a reasonable time, express his dissent to the holder or he will be deemed to have assented thereto. (Sec. 142, NIL)
2.5. CHECKS: acceptance and certification

1. Definition: A check is an instrument in the form and nature of a BE, but an unlike an ordinary bill, always payable on demand and always drawn on a bank.

2. Kinds:
   a. Cashier’s or manager’s - drawn by a bank on itself and its issuance has the effect of acceptance; since the drawer and drawee are the same, the holder may treat it is either a BE or PN.
   b. Memorandum check - where the word "memorandum" or "memo" is written across its face, signifying that the drawer will pay the holder absolutely, without need of presentment.
   c. Traveler’s check - upon which the holder’s signature must appear twice -- first when it is issued, and again when it is cashed.
   d. Crossed – when the name of a particular banker or a company is written between the parallel lines drawn.

STATE INVESTMENT HOUSE V. IAC

Crossed check should put the payee on inquiry to ascertain the holders’ title to the check or the nature of his possession. Failing this, the payee is declared guilty of gross negligence to the effect that the holder of the check is not a holder in good faith. Effects of a crossed check:

(a) the check may not be encashed but only deposited in the bank;
(b) the check may be negotiated only once – to one who has an account with the bank; and
(c) the act serves as a warning to the holder that the check has been issued for a definite purpose so that he must inquire if he has received the check pursuant to that purpose, otherwise, he is not a HDC.

BATAAN CIGAR & CIGARETTE FACTORY, INC. V. CA

The negotiability of a check is not affected by its being crossed, whether specially or generally. It may legally be negotiated as long as the one who encashes the check with the drawee bank is another bank, or if it is especially crossed, by the bank mentioned between the parallel lines.

RP V. PNB (1961)

Demand drafts have not been presented either for acceptance or for payment, thus the bank never had any chance of accepting or rejecting them; as such, these cannot be subject of escheat.

Cashier’s check is the substantial equivalent of a certified check and is thus subject to escheat.

Telegraphic transfers are likewise subject to escheat because upon making payment complete the transaction insofar as he is concerned, though insofar as the remitting bank is concerned, the contract is executory until the credit is established.

PAL V. CA (1990)

A check, whether a manager’s check or ordinary check, and an offer of a check in payment of a debt is not a valid tender of payment and may be refused receipt by the obligee or creditor.

The issuance of the check to a person authorized to receive it operates to release the judgment debtor from any further obligations on the judgment.

INTERNATIONAL CORPORATE BANK V. GUECO (2001)

A manager’s check is one drawn by the bank’s manager upon the bank itself. It is similar to a cashier’s check both as to effect and use. A cashier’s check is a check of the bank’s cashier on his own or another check. In effect, it is a bill of exchange drawn by the cashier of a bank upon the bank itself, and accepted in advance by the act of its issuance. It is really the bank’s own check and may be treated as a promissory note with the bank as a maker. The check becomes the primary obligation of the bank which issues it and constitutes its written promise to pay upon demand. The mere issuance of it is considered an acceptance thereof. If treated as promissory note, the drawer would be the maker and in which case the holder need not prove presentment for payment or present the bill to the drawee for acceptance.

EPCIB v ONG (2006)

A manager’s check is an order of the bank to pay, drawn upon itself, committing in effect its total resources, integrity and honor behind its issuance. By its peculiar character and general use in commerce, a manager’s check is regarded substantially to be as good as the money it represents.

3. Clearing

a. Clearing - check collection process
b. Clearing house - where representatives of different banks meet every afternoon of every business day to receive the envelopes containing checks drawn against the bank he represents for examination and clearance.

4. Certification

a. Definition
i. an agreement by which a bank promises to pay the check at any time it is presented for payment
ii. When check certified by bank on which it is drawn, equivalent to acceptance

b. Requisites for a Valid Certification
i. Must be in writing
ii. Made on the check or another instrument
iii. Check must be payable
1) Checks cannot be certified before payable

c. Liability
i. Bank which certifies
1) Becomes liable as an acceptor
2) REFUSAL to certify a check doesn’t constitute dishonor; the holder at that stage cannot exercise his right of recourse against the drawer and the indorsers
ii. If procurement by:
1) Holder
a) The bank becomes the solidary debtor, and
b) The drawer and all indorsers discharged from all liability (versus ordinary bill of exchange - not discharged)
2) Drawer
a) secondary parties not released

ROMAN CATHOLIC BISHOP V. IAC (1990)

A certified personal check is not legal tender nor is it the currency stipulated, and therefore cannot constitute valid tender of payment.

NEW PACIFIC TIMBER v. SENERIS (1980)
(as cited in EPCIB v. Ong, Sept. 2006)

[S]ince the said check had been certified by the drawee bank, by the certification, the funds represented by the check are transferred from the credit of the maker to that of the payee or holder, and for all intents and purposes, the latter becomes the depositor of the drawee bank, with rights and duties of one in such situation. Where a check is certified by the bank on which it is drawn, the certification is equivalent to acceptance. Said certification “implies that the check is drawn upon sufficient funds in the hands of the drawee, that they have been set apart for its satisfaction, and that they shall be so applied whenever the check is presented for payment. It is an understanding that the check is good then, and shall continue good, and this agreement is as binding on the bank as its notes circulation, a certificate of deposit payable to the order of depositor, or any other obligation it can assume. The object of certifying a check, as regards both parties, is to enable the holder to use it as money.” When the holder procures the check to be certified, “the check operates as an assignment of a part of the funds to the creditors.” Hence, the exception to the rule enunciated under Section 63 of the Central Bank Act to the effect “that a check which has been cleared and credited to the account of the creditor shall be equivalent to a delivery to the creditor in cash in an amount equal to the amount credited to his account” shall apply in this case x x x.

5. Surrender of Check
a. The surrender of the check by the holder to the drawee bank upon its payment is not negotiation. By paying the check, the drawee bank extinguishes it as a negotiable instrument and converts it into a mere voucher.
b. Distinction between surrender of check upon payment thereof and negotiation
i. The delivery of the check by the holder to the drawee bank upon its payment is not negotiation. By paying the check, the drawee bank extinguishes it as a negotiable instrument and converts it into a mere voucher.
   ii. In the case of a deposit of a check by the holder thereof in a bank other than the drawee bank, the signature at the back of the check would constitute an indorsement, unless otherwise indicated. The holder in negotiating the check to the depositary bank, which in turn will collect on the check from the drawee bank, through the clearinghouse.

BPI vs CA (2000)

In depositing the check in his name, private respondent did not become the outright owner of the amount stated therein. He was merely designating petitioner as the collecting bank. This is in consonance with the rule that a negotiable instrument, such as a check, whether a manager’s check or ordinary check, is not legal tender. As such, after receiving the deposit, under its own rules, petitioner shall credit the amount in private respondent’s account or infuse value thereon only after the drawee bank shall have paid the amount of the check or the check has been cleared for deposit.

Again, this is in accordance with ordinary banking practices and with this Court’s pronouncement that “the collecting bank or last endorser generally suffers the loss because it has the duty to ascertain the genuineness of all prior endorsements considering the act of presenting the check for payment to the drawee is an assertion that the party making the presentment has done its duty to ascertain the genuineness of the endorsements.” The rule finds more meaning in this case where the check involved is drawn on a foreign bank and therefore collection is more difficult than when the drawee bank is a local one even though the check in question is a manager’s check

3. Secondary Parties

3.1. Liability of DRAWER
1. Sec. 61, NIL
a. Admits existence of payee and his then capacity to endorse
b. Engages that on due presentment instrument will be accepted, or paid, or both, according to its tenor

c. That if it be dishonored + necessary proceedings on dishonor duly taken, will pay the amount thereof to the holder or to a subsequent indorser who may be compelled to pay it

2. Limiting Liability: drawer may insert in the instrument an express stipulation negativating / limiting his own liability to holder

PNB v. PICORNELL (1922)

Picornell obtained money from PNB Cebu to purchase tobacco to be shipped to Manila. Picornell then drew a bill of exchange drawn against his principal, Hyndman, Tavera & Ventura (HTV), in favor of PNB or his order. Upon presentation of the bill, HTV accepted it. However, HTV subsequently refused to pay the bill because some of the tobacco shipped were damaged.

HELD:

A. Liability of Acceptor (HTV)
- PNB is a holder in due course and the partial want of consideration does not exist with respect to the bank who paid full value for the bill of exchange.
- The want of consideration between the acceptor and drawer does not affect the rights of the payee who is a remote party. The payee or holder gives value to the drawer, and if he is ignorant of the equities between the drawer and acceptor, his is in the position of a bona fide indorsee.

B. Liability of Drawer (Picornell)
- As drawer of the bill, he warranted that it would be accepted upon proper presentment & paid in due course. As it was not paid, he became liable to the payment of its value to PNB.
- The fact that Picornell was an agent of HTV in the purchase of the tobacco does not necessarily make him an agent of HTV in drawing the bill of exchange. These are 2 different contracts. He cannot claim exemption from liability by invoking the existence of agency.
- Drawer received notice of protest in fulfillment of the condition set by law for the time the check was issued to him. Such knowledge negates the element of deceit and was done when the offender had no funds in the bank, or his funds deposited therein were not sufficient to cover the amount of the check;
- 3. Deceit or damage to the payee thereof.

PEOPLE v REYES (2005)

There is no estafa through bouncing checks when it is shown that private complainant knew that the drawer did not have enough funds in the bank at the time the check was issued to him. Such knowledge negates the element of deceit and constitutes a defense in estafa through bouncing checks.

3.2. Liability of INDOMERS:

1. Indorser

a. Sec. 63, NIL: A person placing his signature upon an instrument other than as a maker, drawer, or acceptor unless he indicates by appropriate words his intention to be bound in some other capacity

i. SAPIERA vs CA (1999). It is undisputed that the four (4) checks issued by de Guzman were signed by petitioner at the back without any indication as to how she should be bound thereby and, therefore, she is deemed to be an indorser thereof.

b. Sec. 67, NIL: A person, who places his signature on an instrument negotiable by delivery, incurs all the liabilities of an indorser.

c. Sec 64, NIL: Irregular Indorser

i. When a person not otherwise a party to an instrument, places thereon his signature in blank before delivery, he is liable as an indorser, in accordance w/ these rules:
1) Instrument payable to order of 3rd person: liable to payee and to all subsequent parties
2) Instrument payable to the order of maker/drawer, or payable to bearer: liable to all parties subsequent to maker/drawer
3) Signs for accommodation of payee, liable to all parties subsequent to payee

2. WARRANTIES:
   a. Every person negotiating an instrument by delivery or by a qualified indorsement warrants: (**Sec. 65, NIL**)
      ii. Instrument genuine, in all respects what it purports to be
      iii. He has good title to it
      iv. All prior parties had capacity to contract
      v. He has no knowledge of any fact w/c would impair validity of instrument or render it valueless
   vi. in case of negotiation by delivery only, warranty only extends in favor of immediate transferee

b. **General or Unqualified Indorser:**
   Every person who indorses without qualification, warrants to all subsequent HDCs: (**Sec. 66, NIL**)
   i. instrument genuine, good title, capacity of prior parties
   ii. instrument is at time of indorsement valid and subsisting
   iii. eon due presentment, it shall be accepted or paid, or both, according to tenor
   iv. if it is dishonored, and necessary proceedings on dishonor be duly taken, he will pay the amt. To holder, or to any subsequent indorser who may be compelled to pay it

3. Order of Liability among Indorsers (**Sec. 68, NIL**):
   a. among themselves: liable prima facie in the order they indorse, but proof of another agreement admissible
   b. but holder may sue any of the indorsers, regardless of order of indorsement
   c. joint payees/indorsees deemed to indorse jointly and severally

**TUAZON v RAMOS (2005)**

After an instrument is dishonored by nonpayment, indorsers cease to be merely secondarily liable; they become principal debtors whose liability becomes identical to that of the original obligor. The holder of a negotiable instrument need not even proceed against the maker before suing the indorser.

**3.3. Accommodation Party**

1. Accommodation Party: one who signed instrument as maker/drawer/acceptor/indorser w/o receiving value thereof, for the purpose of lending his name to some other person
2. Liability: Liable on the instrument to HFV even if holder knew he was only an AP

**MAULINI v. SERRANO (1914)**

In accommodation indorsement, the indorser makes the indorsement for the accommodation of the maker. Such an indorsement is generally for the purpose of better securing the payment of the note, i.e. he lends his name to the maker not to the holder. An accommodation note is one which the accommodation party has put his name, without consideration, for the purpose of accommodation some other party who is to use it and is expected to pay it. 

*Note: Campos disagrees with this ruling, referring to the case of Goodman v Gaul where an accommodation indorsement may be made for the accommodation of the payee or holder.*

**ANG TIONG v. TING (1968)**

It is not a valid defense that the accommodation party did not receive any valuable consideration when he executed the instrument. Nor is it correct to say that the holder for value is not a holder in due course merely because at the time he acquired the instrument, he knew that the indorser was only an accommodation party.

The fact that the accommodation party stands only as a surety in relation to the maker is a matter of concern exclusively between accommodation indorser & accommodated party. It is immaterial to the claim of a holder for value. The liability of the accommodation party remains primary & unconditional.

**SADAYA v. SEVILLA (1967)**

The solidary accommodation maker who made payment has the right of contribution from his co-accommodation maker. This right springs from an implied promise between the accommodation makers to share equally the burdens that may ensue from their having consented to stamp their signatures on the promissory note. The following are the rules on reimbursement:

1. A solidary accommodation maker of a note may demand from the principal debtor reimbursement for the amount he paid to the payee; and
2. A solidary accommodation maker who pays on the note may directly demand reimbursement from his co-accommodation maker without first directing his action against the principal debtor provided that:
   (a) he made the payment by virtue of a judicial demand or
   (b) the principal debtor is insolvent.

**TRAVEL-ON, INC. v. CA**

Travel-On was entitled to the benefit of the statutory presumption that it was a HDC, that the checks were supported by valuable consideration. The only evidence private respondent offered was his own testimony that he had issued the checks to Travel-On as payee to “accommodate” its General Manager; this claim was in fact a claim that the
checks were merely simulated, that private respondent did not intend to bind himself thereon. Only evidence of the clearest and most convincing kind will suffice for that purpose.

**CRISOLOGO-JOSE v. CA.**

Section 29 of the NIL does not apply to corporations which are accommodation parties because the issue or indorsement of negotiable paper by a corporation without consideration is ultra vires. Hence, one who has taken the instrument with knowledge of the accommodation cannot recover against a corporation - accommodation party EXCEPT if the officer or agent of the corp. was specifically authorized to execute or indorse the paper for the accommodation of a third person.

Corporate officers, such as the president and vice-president, have no power to execute for mere accommodation a NI of the corporation for their individual debts or transactions in which the corporation has no legitimate concern. It is the signatories thereof that shall be personally liable therefor.

**AGRO CONGLOMERATES v CA (2000)**

An accommodation party is a person who has signed the instrument as maker, acceptor, or indorser, without receiving value therefor, and for the purpose of lending his name to some other person and is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew (the signatory) to be an accommodation party. He has the right, after paying the holder, to obtain reimbursement from the party accommodated, since the relation between them has in effect become one of principal and surety, the accommodation party being the surety.

**3.4. Liability of an AGENT**

1. **AGENCY:**
   a. Signature of any party may be made by duly authorized agent, established as in ordinary agency
   b. Signature per procuration operates as notice that the agent has limited authority to sign, and the principal is bound only in case the agent in so signing acted within the actual limits of his authority

2. **LIABILITY**
   a. **GEN RULE:** Where person adds to his signature words indicating that he signs on behalf of a principal, not liable if he was duly authorized
   b. **WHEN LIABLE:**
      i. mere addition of words describing him as an agent without disclosing his principal
      ii. Where a broker or agent negotiates an instrument without indorsement, he incurs all liabilities in Sec. 65, unless he discloses name of principal and fact that he's only acting as agent. (Sec. 69, NIL)

**INSULAR DRUG v. PNB**

The right of an agent to indorse commercial paper will not be lightly inferred. A salesman with authority to collect money does not have the implied authority to indorse checks received in payment. Any person taking checks made payable to a corporation does so at his peril & must abide by the consequences if the agent who indorses the same is without authority.

**PBC v ARUEGO (1981)**

Aruego obtained a credit accommodation from PBC. For every printing of the publication, the printer collected the cost of printing by drawing a draft against PBC, which will later be sent to Aruego for acceptance. PBC seeks recovery on these drafts. Aruego invokes the defense that he signed the document in his capacity as President of the Phil. Education Foundation & only as an accommodation party. 

HELD: Aruego is personally liable because nowhere in the draft did he disclose that he was signing as a representative of the Phil Education Foundation. Neither did he disclose his principal. As an accommodation party, Aruego is liable on the instrument to a holder for value, notwithstanding such holder, at the time of the taking of the instrument knew him to be only an accommodation party. Aruego signed as a drawee/acceptor. As drawee, he is primarily liable for the drafts.

**4. Presentment**

4.1. **Definition:**
1. the production of a BE to the drawee for his ACCEPTANCE, or to the drawer or acceptor for PAYMENT; or
2. the production of a PN to the party liable for payment

4.2. **Presentment for Acceptance**
1. When necessary (Sec. 143, NIL)
   a. bill payable after sight, or in other cases where presentment for acceptance necessary to fix maturity
   b. where bill expressly stipulates that it shall be presented for acceptance
   c. where bill is drawn payable elsewhere than at residence / place of business of drawee
   d. In no other case is presentment for acceptance necessary in order to render any party to the bill liable

2. Effect of non-presentment [w/in reasonable time] (Sec. 144, NIL) - discharges the drawer and all indorsers.
   a. Reasonable Time: considerations
      i. nature of instrument
      ii. usage of trade or business with respect to instrument
      iii. facts of each case

3. **How made** (Sec. 145, NIL)
   a. BY or ON BEHALF of the holder
b. AT a reasonable hour,
c. ON a business day and before the bill is overdue,
d. TO the drawee or some person authorized to accept or refuse acceptance on his behalf; and
i. bill addressed to drawees not partners, MUST be made to them all unless one has authority to accept or refuse acceptance for all;
ii. drawee is dead, MAY be made to his personal representative;
iii. drawee has been adjudged a bankrupt or an insolvent or has made an assignment for the benefit of creditors, MAY be made:
1) to him or
2) to his trustee or assignee.

i. bill addressed to drawees not partners, MUST be made to them all unless one has authority to accept or refuse acceptance for all;

4. When made (Sec. 146, NIL) on any day on which NIs may be presented for payment under:
   a. Sec. 72, NIL – at a reasonable hour on a business day
      i. Instruments falling due or becoming payable on Saturday - next succeeding business day
      ii. EXCEPT instruments payable on demand [at the option of the holder] – before twelve o’clock noon on Saturday WHEN that entire day is not a holiday.
   b. Sec. 85, NIL –
      i. at the time fixed therein without grace.
   c. Where the holder has no time, with the exercise of reasonable diligence, to present the bill for acceptance before presenting it for payment, delay is excused and doesn’t discharge the drawers and indorsers. (Sec. 147, NIL)

5. When Excused (Sec. 148, NIL) Bill may be treated as dishonored by non-acceptance:
   a. Where the drawee is (1) dead, (2) absconded, (3) fictitious, (4) does not have capacity to contract by bill.
   b. Where, after the exercise of reasonable diligence, presentment can not be made.
   c. Where, although presentment has been irregular, acceptance has been refused on some other ground.

6. Dishonor and Effects
   a. Dishonor by nonacceptance:
      i. When duly presented for acceptance – acceptance is refused or can not be obtained; or
      ii. When presentment for acceptance is excused – bill is not accepted. (Sec. 149, NIL)
   b. NON ACCEPTANCE of the bill
      i. Duty of holder: must treat the bill as dishonored by nonacceptance or he loses the right of recourse against the drawer and indorsers. (Sec. 150, NIL)
      ii. Right of holder: immediate right of recourse against the drawer and indorsers and no presentment for payment is necessary. (Sec. 151, NIL)

   c. NOTICE OF DISHONOR
      i. Recipient: (Sec.89, NIL) Except as herein otherwise provided, 1) to the drawer and
      ii. Effect of omission to give notice of non-acceptance
         1) any drawer or indorser to whom such notice is not given is discharged
         2) does not prejudice the rights of a HDC subsequent to the omission. (Sec. 117, NIL)

4.3. Presentment for Payment

1. IN GENERAL
   a. NECESSARY in order to charge the drawer and indorsers (Sec. 70, NIL)
   b. NOT necessary
      i. to charge the person primarily liable on the instrument (Sec. 70, NIL)
      ii. to charge the drawer where he has no right to expect or require that the drawee or acceptor will pay the instrument. (Sec. 79, NIL)
      iii. to charge an indorser where the instrument was made or accepted for his accommodation and he has no reason to expect that the instrument will be paid if presented. (Sec. 80, NIL)
      iv. Excused:
         1) Where, after the exercise of reasonable diligence, presentment cannot be made;
         2) Where the drawee is a fictitious person;
         3) By waiver of presentment, express or implied.
   v. when a bill is dishonored by nonacceptance – immediate right to recourse accrues to holder (Sec. 151, NIL)
   vi. in case of waiver of protest, whether in the case of a foreign bill of exchange or other NI – deemed to be a waiver not only of a formal protest but also of presentment and notice of dishonor. (Sec. 111, NIL)

2. Date and time of presentment
   a. bearing fixed maturity / not payable on demand – on the day it falls due
   iii. if day of maturity falls on Sunday or a holiday, the instruments falling due or becoming payable on Saturday are to be presented for payment on the next succeeding business day (Sec.85, NIL)
   b. payable on demand – within a reasonable time after its issue,
iv. at the option of the holder, may be presented for payment before twelve o'clock noon on Saturday when that entire day is not a holiday. (Sec. 85, NIL)

c. demand bill of exchange - within a reasonable time after the last negotiation. (Sec. 71, NIL) (NOTE: though reasonable time from last negotiation, it may be unreasonable time from issuance thus holder may not be HDC under sec. 71)

d. Check - must be presented for payment within reasonable time after its issue or drawer will be discharged from liability thereon to extent of loss caused by delay

i. How time computed. — When payable at a (1) fixed period after date, (2) after sight, or (3) after that happening of a specified event, exclude day from which the time is to begin to run, include date of payment. (Sec. 86, NIL)

ii. Where the day, or the last day for payment falls on a Sunday or a holiday - may be done on the next succeeding secular or business day. (Sec. 194, NIL)

PNB v. SEETO (1952)

On 13 March, Seeto indorsed to PNB-Surigao a bearer check dated 10 March drawn against PBC-Cebu. PNB-Surigao mailed the check to its Cebu branch on 20 March & was presented to the drawee bank on 09 April. The check was dishonored for insufficient funds because the delay in presentment cause the exhaustion of the drawer's funds. Indorser Seeto asked that the suit be deferred while he made inquiries. He assured PNB that he would refund the value in case of dishonor.

HELD: The indorser is discharged from liability by reason of the delay in the presentment for payment, under §84.

Drawee had enough funds when he issued the check because his subsequent checks drawn against the same bank had been encashed. The assurances of refund by the indorser are the ordinary obligation of an indorser which are discharged by the unreasonable delay in presentation of the check.

NOTE: Campos notes that the discharge of the indorser should have been based on §§ 66 & 71 on presentment as a condition to the indorser's liability & presentment for payment of a demand bill made within a reasonable time from its last negotiation.


Granting that petitioner had never encashed the check, his failure to do so for more than ten (10) years undoubtedly resulted in the impairment of the check through his unreasonable and unexplained delay.

While it is true that the delivery of a check produces the effect of payment only when it is cashed, the rule is otherwise if the debtor is prejudiced by the creditor's unreasonable delay in presentment. The acceptance of a check implies an undertaking of due diligence in presenting it for payment, and if he from whom it is received sustains loss by want of such diligence, it will be held to operate as actual payment of the debt or obligation for which it was given.

It has, likewise, been held that if no presentment is made at all, the drawer cannot be held liable irrespective of loss or injury unless presentment is otherwise excused. This is in harmony with Article 1249 of the Civil Code under which payment by way of check or other negotiable instrument is conditioned on its being cashed, except when through the fault of the creditor, the instrument is impaired. The payee of a check would be a creditor under this provision and if its non-payment is caused by his negligence, payment will be deemed effected and the obligation for which the check was given as conditional payment will be discharged.

3. Where DELAY excused - when the delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct, or negligence; when the cause of delay ceases to operate, presentment must be made with reasonable diligence (Sec. 81, NIL)

4. Manner of Presentment

a. The instrument must be exhibited; when paid, must be delivered up to the party paying it. (Sec. 74, NIL)

b. What constitutes a sufficient presentment. (Sec. 72, NIL)

i. BY WHOM: the holder, or by some person authorized to receive payment on his behalf;

CHAN WAN v. TAN KIM (1960)

Tan Kim drew specially crossed checks payable to bearer. Chan Wan presented the checks for payment to the drawee bank but they were dishonored due to insufficient funds. Chan Wan seeks recovery on these checks.

HELD: Checks crossed specially to China Banking should have been presented for payment by that bank, not by Chan Wan. Inasmuch as Chan Wan presented them for payment himself, there was no proper presentment & the liability did not attach to the drawer.

But there was due presentment as clearance endorsements by China Bank can be found at the back of the checks. However, some of the checks were stamped account closed. As Chan Wan failed to indicate how the checks reached his hands, the court held him not to be a holder in due course who can still recover on the checks but subject to personal defenses, such as lack of consideration.

NOTE: Campos notes that despite the addition of the words "non-negotiable" on the specially crossed checks, the Court considered the checks as negotiable instruments. A check on its face normally has all the requisites of negotiability, and the addition of the above words should not change its character as a negotiable instrument.

ASSOCIATED BANK v. CA & REYES (1992)

Different department stores issued crossed checks bearing "for payee's account only" payable to
Melissa’s RTW. Sayson, acting without authority, deposited & encashed the checks with Associated Bank.
Held: Citing State Invt House v IAC, the effects of crossing a check are:
1. check may not be encashed but only deposited in the bank;
2. check may be negotiated only one -- to one who has an account with a bank; and
3. the act of crossing the check serves as a warning to the holder that the check has been issued for a definite purpose so that he must inquire if he has received the check pursuant to that purpose.
The effects of crossing a check relate to the mode of presentment for payment.
The law imposes a duty of diligence on the collecting bank to scrutinize checks deposited with it, for the purpose of determining their genuineness & regularity.

ii. TIME: reasonable hour on a business day;
1) where instrument payable at bank. — must be made during banking hours, UNLESS the person to make payment has no funds there to meet it at any time during the day, in which case presentment at any hour before the bank is closed on that day is sufficient (Sec. 75, NIL)

iii. PLACE: proper place as herein defined: (Sec. 73, NIL)
1) place of payment specified – at place of payment;
2) no place of payment specified but address of the person to make payment is given in the instrument – at the address given;
3) no place of payment and no address is given – at the usual place of business or residence of the person to make payment;
1) in any other case - wherever person to make payment can be (1) found, or if presented (2) at his last known place of business or residence
2) where principal debtor is dead and no place of payment is specified – to his personal representative, IF any AND IF he can be found with the exercise of reasonable diligence (Sec. 76, NIL)
3) where persons primarily liable are partners and no place of payment is specified - to any one of them, even though there has been a dissolution of the firm. (Sec. 77, NIL)
4) joint debtors and no place of payment is specified - to them all (Sec. 78, NIL)

iv. TO WHOM: (1) person primarily liable on the instrument, or if he is absent or inaccessible, (2) to any person found at the place where the presentment is made.

5. Dishonor by Nonpayment
a. Sec 83, NIL The instrument when:
i. duly presented for payment and payment refused or cannot be obtained; or
ii. presentment is excused and the instrument is overdue and unpaid.
b. Effect: [subject to NIL provs] an immediate right of recourse to all parties secondarily liable accrues to the holder. (Sec. 84, NIL)
i. Dishonor is a condition precedent to the enforcement of the liability of secondary parties.
ii. This is conditioned upon the giving of due notice of dishonor
iii. An indorser whose liability has become fixed by demand and notice is, as to holder, a principal debtor.

5. Notice of Dishonor

5.1. Definition
1. To bring either verbally or by writing, to the knowledge of the drawer or indorser of an instrument, the fact that a specified NI, upon proper proceedings taken, has not been accepted or has not been paid, and that the party notified is expected to pay it
2. Parties entitled to notice:
   a. Drawer
   b. Indorser
   c. Accomodation Indorsers
   i. Joint maker excluded if not an indorser
3. Acceleration Clause
   a. If clause is optional on holder:
      i. The bringing of an action against the maker and indorsers constitutes a valid exercise of option and a valid notice of dishonor
   b. Clause is automatic:
      i. Notice of dishonor must be given at once
      ii. Not sufficient to give it upon commencement of action

GULLAS v. PNB (1935)
A notice of dishonor is necessary to charge an indorser & that the right of action against him does not accrue until the notice is given.

As a general rule, a bank has a right of set off of the deposits in its hands for the payment of any indebtedness to it on the part of a depositor. However, prior to the mailing of notice of dishonor & without awaiting any action by Gullas, the bank made use of the money standing in his account to make good for the treasury warrant. Gullas was merely an indorser & notice should actually have been given to him in order that he might protect his interests.

5.3. Form and Contents (Sec 96)

1. Form of Notice:
   a. may either be in writing, or oral
   b. Campos: must be in a language that will inform the addressed party that the instrument has been duly presented

2. Contents – must contain any terms which sufficiently
   a. identify the instrument, and
   b. indicate that it has been dishonored by non-acceptance or non-payment;

3. Mode of delivery
   a. Personal service
      i. There must be actual personal service, or
      ii. An ordinary intelligent and diligent effort to make personal service
   b. Through the mails
   c. Campos: Through the telephone
      i. Party to be notified must be fully identified as the party at the receiving end of the line

4. The ff. notice still sufficient: (Sec. 95, NIL)
   a. a written notice, not signed
   b. insufficient written notice, supplemented and validated by verbal communication
   c. instrument suffering from misdescription UNLESS the party to whom the notice is given is in fact misled thereby.

5.4. Time and Place

1. Notice may be given as soon as the instrument is dishonored and **within the time fixed by NIL**, unless delay excused (Sec. 102, NIL)

2. NOTICE to SUBSEQUENT PARTY: Each party who receives a notice is given the same period of time within which to notify prior indorsers that the last holder had. (Sec. 107)

3. TIME FIXED BY THE NIL:
   a. Where parties reside in same place (Sec. 103, NIL): Must be given w/in the ff. times:
      i. If given at the place of business of the person to receive notice - before the close of business hours on the day following
      ii. If given at his residence - before the usual hours of rest on the day following
      iii. If sent by mail - deposited in the post office in time to reach him in usual course on the day following.

b. Where parties reside in different places (Sec. 104, NIL):
   i. If sent by mail - deposited in the post office in time to go by mail the day following the day of dishonor, or if there be no mail at a convenient hour on last day, by the next mail thereafter
   ii. Convenient hour: depends on the usual hours of opening of business houses and the post-office
   iii. If given otherwise - within the time that notice would have been received in due course of mail, if it had been deposited in the post office within the time specified above

c. Delay (Sec. 113, NIL)
   i. Excused: when the delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct, or negligence
   ii. But, when the cause of delay ceases to operate, notice must be given with reasonable diligence.

4. Sender **deemed** to have given due notice (Sec. 105, NIL)
   a. Where notice of dishonor is duly addressed and deposited in the post office,
      i. "deposit in post office" — when deposited in any branch post office or in any letter box under the control of the post-office department. (Sec. 106, NIL)
   b. notwithstanding any miscarriage in the mails

4. Place where notice must be sent (Sec. 108, NIL)
   a. to the address, if any, added by the party to his signature; if address not given:
      i. to the post-office nearest to his place of residence or where he is accustomed to receive his letters; or
      ii. If he lives in one place and has his place of business in another, to either place; or
      iii. If he is sojourning in another place, to the place where he is so sojourning.
   b. Notice sent to place not in accord with NIL, still **SUFFICIENT**
5.5. By Whom Given
1. Sec. 90, NIL
   a. By or on behalf of the holder or
   b. any party to the instrument who may be compelled to pay it to the holder, and who, upon taking it up, would have a right to reimbursement from the party to whom the notice is given

2. Agent
   a. Notice of dishonor may be given by an agent either in his own name or in the name of any party entitled to give notice, whether that party be his principal or not (Sec. 91, NIL)
   b. Where instrument has been dishonored in hands of agent, he may either himself give notice to the parties liable thereon, or he may give notice to his principal (within the same time as if agent were holder) (Sec. 94, NIL)

5.6. To whom notice MAY be given
1. If given by an agent
   a. to his principal, in case of an instrument dishonored in the hands of an agent (Sec. 94, NIL), or
   b. to the parties liable thereon
   c. ex: collecting bank
2. IN GENERAL (Sec. 97)
   a. Party himself
   b. Or his agent in that behalf
3. If party is dead and death known to the party giving notice (Sec. 98, NIL)
   a. MUST be given to a personal representative, if there be one, and if with reasonable diligence, he can be found;
   b. If no personal representative – MAY be sent to the last residence or last place of business of the deceased.
4. To partners : to any one partner, even though there has been a dissolution. (Sec. 99, NIL)
5. To joint parties(Sec. 100, NIL)
   a. to each of the party
   b. unless one of them has authority to receive such notice for the others.
6. to bankrupt (Sec. 101, NIL)
   a. to the party himself or
   b. to his trustee or assignee

5.7. In whose favor notice operates
1. when given by/on behalf of holder: inures to benefit of (Sec. 92, NIL)
   a. all subsequent holders and
   b. all prior parties who have a right of recourse vs. the party to whom it's given
2. where notice given by/on behalf of a party entitled to give notice: inures for benefit (Sec. 93, NIL)
   a. holder
   b. all parties subsequent to party to whom notice given

5.8. When rule requiring notice not applied
1. In general
   a. Sec 112: notice of dishonor is dispensed with when after the exercise of reasonable diligence, it cannot be given to or does not reach the parties sought to be charged
   b. Reasonable diligence depends upon the circumstance of the case
2. When notice of non-acceptance is already given
   a. Sec 116: Where due notice of dishonor by non-acceptance has been given, notice of a subsequent debtor by non-payment is not necessary, unless in the meantime the instrument has been accepted
   b. Ratio for the rule: dishonor by non-acceptance confers upon the holder an immediate right against all secondary parties

3. Waiver
   a. Waiver of notice may be made either:
      i before the time of giving notice has arrived or
      ii after the omission to give due notice; may be expressed or implied. (Sec. 109, NIL)
   b. Parties affected by waiver
      i. Dependent upon where the waiver is written
      ii. Where the waiver is embodied in the instrument itself - binding upon all parties;
      iii. where written above the signature of an indorser - binds him only. (Sec. 110, NIL)

5.9. When Notice Not Necessary
1. When not necessary to charge drawer (Sec. 114, NIL)
   a. drawer/drawee same person
   b. drawee fictitious, incapacitated
   c. drawer is person to whom instrument is presented for payment
   d. drawer has no right to expect/require that drawee/acceptor will honor instrument
   e. drawer countermanded payment

STATE INVESTMENT HOUSE v CA (1993)
Moulic issued 2 checks to Victoriano as security for pieces of jewelry to be sold on commission. Victoriano negotiated these checks to State Investment. As Moulic failed to sell the jewelry, she returned them to Victoriano. However, she failed to retrieve her checks. Moulic withdrew her funds from the drawee bank. Upon presentment, the checks were dishonored.
HELD: State Investment is a holder in due course & is not subject to the personal defense of lack of consideration. 
There is no need to serve the drawer a notice of dishonor because she was responsible for the dishonor of her checks. After withdrawing her funds, she could not have expected her checks to be honored.

2. Where not necessary to charge indorser (Sec. 115, NIL)
   a. drawee fictitious, incapacitated, and indorser aware of the fact at time of indorsement
   b. indorser is person to whom instrument presented for payment
   c. instrument made/accepted for his accommodation

7. Protest

A. Definition: testimony of some proper person that the regular legal steps to fix the liability of drawer and indorsers have been taken

B. When necessary:
   1. In case of a FOREIGN BILL appearing on its face to be such;
   2. protest for non-acceptance if dishonored by nonacceptance &
   3. protest for nonpayment if not previously dishonored by nonpayment.
   4. The cause or reason for protesting the bill;

C. Form
   1. annexed to the bill or must contain a copy thereof, and
   2. must be under the hand and seal of the notary making it;

D. Contents
   1. The time and place of presentment;
   2. The fact that presentment was made and the manner thereof;
   3. The cause or reason for protesting the bill;
   4. The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found. (Sec. 152, NIL)

E. By whom
   1. A notary public; or
   2. any respectable resident of the place where the bill is dishonored, in the presence of two or more credible witnesses. (Sec. 154, NIL)

F. Time
   1. on the day of its dishonor unless delay is excused;
   2. when duly noted, the protest may be subsequently extended as of the date of the noting. (Sec. 155, NIL)

G. Place
   1. at the place where it is dishonored, or
   2. EXCEPT bill drawn payable at the place of business or residence of person other than the drawee has been dishonored by nonacceptance, a. it must be protested for non-payment at the place where it is expressed to be payable, and
   b. no further presentment for payment to, or demand on, the drawer is necessary. (Sec. 156, NIL)

H. Protest for better security against the drawer and indorsers — where the acceptor has been adjudged a bankrupt or an insolvent or has made an assignment for the benefit of creditors before the bill matures (Sec. 158, NIL)

I. Delay excused
   1. Requisites:
      a. when caused by circumstances beyond the control of the holder, and
      b. not imputable to his default, misconduct, or negligence.
   2. When the cause of delay ceases to operate, the bill must be noted or protested with reasonable diligence.

J. When protest dispensed with - by any circumstances which would dispense with notice of dishonor. (Sec. 159, NIL)

K. Waiver of protest: deemed to be a waiver not only of a formal protest but also of presentment and notice of dishonor. (Sec. 111, NIL)

TAN LEONCO v GO INQUI(1907)

In exchange for the abaca from Tan Leonco’s plantations, Go Inqui drew a bill of exchange against Lim Uyco. Upon presentment of the draft, it was refused payment due to a stop order from the drawer. The bill was not protested. HELD: The action is not brought upon the bill of exchange which was used only as evidence of the indebtedness. Under these conditions, protest & notice of nonpayment are unnecessary in order to render the drawer liable.

NOTE: The ruling of the Court on protest is merely obiter dictum.

8. Acceptance or Payment for Honor

A. Acceptance
   1. Practice of accepting for honor is obsolete
   2. When bill may be accepted for honor — When a BE has been (1) protested for dishonor by non-acceptance or protested for better security and (2) is not overdue → any person not being a party already liable may, with the CONSENT of the holder, intervene and accept the bill supra protest for the honor of any party liable thereon or for the honor of the person for whose account the bill is drawn.
   3. The acceptance for honor may be for part only of the sum for which the bill is drawn;
   4. where there has been an acceptance for honor for one party, there may be a further acceptance by a different person for the honor of another party. (Sec. 161, NIL)
   5. Referee in case of need — person whose name is inserted by the drawer of a bill and any indorser to whom the holder may resort in case bill is dishonored by non-acceptance or non-payment; option of the holder to resort to the referee (Sec. 131, NIL)

B. PAYMENT FOR HONOR - any person may intervene and pay bill protested for non-payment supra protest (Sec. 171, NIL)
6.3 INSTRUMENTS PAYABLE AT BANK

Sec 87: Where the instrument is made payable at a bank, it is equivalent to an order to the bank to pay the same for the account of the principal debtor therein

BINGHAMPTON PHARMACY v FIRST NATIONAL BANK (1915)
There is a distinction between the drawer of a check & the maker of a note payable at a bank:

<table>
<thead>
<tr>
<th>Note payable at bank</th>
<th>Check</th>
</tr>
</thead>
<tbody>
<tr>
<td>maker of a note</td>
<td>drawer of a check</td>
</tr>
<tr>
<td>is primarily liable</td>
<td>is only liable after dishonor</td>
</tr>
<tr>
<td>on the instrument</td>
<td>Law excuses</td>
</tr>
<tr>
<td>presentsment of the instrument</td>
<td>requires presentment within a reasonable time at the peril of discharging the drawer</td>
</tr>
</tbody>
</table>

Breach of the duty of the holder of a check to present for payment at the place where it is payable at a reasonable time discharges the drawer from liability to the extent he is damaged by the breach.

Chapter VII
DISCHARGE

1. Definition: Discharge

The release of all parties, whether primary or secondary, from the obligation on the instrument; renders the instrument non-negotiable

2. Discharge of the INSTRUMENT

2.1. How discharged: (Sec 119)\(^\text{10}\)

1. By Payment in due course
   a. Sec. 88: Payment is made in due course when it is made:
      i. at or after the maturity of the payment
      o. if payment is made before maturity and the note is negotiated to a HDC, the latter may recover on the instrument.
      ii. to the holder thereof
         o. payment to one of several payees or indorsees in the alternative discharges the instrument,
         o. but payment to one of several joint payees or joint indorsees is not a discharge. The party receiving payment must have been authorized by others to receive payment.
      iii. in good faith and without notice that his title is defective
   b. By whom made:
      i. payment in due course by or on behalf of principal debtor
      ii. payment in due course by party accommodated where party is made/ accepted for accommodation
   c. When check deemed paid by drawee bank
      i. Once the holder receives the cash
      ii. If the bank credits the amount of the check to the depositor's account
      iii. Where the drawee bank charges the check to the account, indicating intention to honor the check

2. Intentional cancellation by holder
   a. if unintentional or under mistake or without authority of holder, inoperative;
   b. where instrument or signature appears to have been cancelled, burden of proof on party which alleges it was unintentional, etc. (Sec. 123, NIL)

3. any other act which discharges a simple contract for payment of money

\(^{10}\)Suggested Mnemonics: PICK ROAD: Payment in due course, Intentional Cancellation, Renunciation, any Other Act: Debtor becomes holder.
a. issuance of a renewal note—novation
b. Refer to Art 1231 of the Civil Code

4. principal debtor becomes holder of instrument at or after maturity in his own right

5. renunciation of holder: (Sec. 122, NIL)
   a. holder may expressly renounce his rights vs. any party to the instrument, before or after its maturity
   b. absolute and unconditional renunciation of his rights against PRINCIPAL DEBTOR made at or after maturity discharges the instrument
   c. renunciation does not affect rights of HDC w/o notice.
   d. Renunciation must be in writing unless instrument delivered up to person primarily liable thereon

material alteration – review Sec. 125, NIL: what constitutes material alteration (Sec. 124, NIL: material alteration w/o assent of all parties liable avoids instrument except as against party to alteration and subsequent indorsers)

3. OF SECONDARY PARTIES (Sec. 120, NIL)\(^{11}\)

<table>
<thead>
<tr>
<th>A.</th>
<th>by discharge of instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>B.</td>
<td>intentional cancellation of signature by holder</td>
</tr>
<tr>
<td>C.</td>
<td>discharge of prior party</td>
</tr>
<tr>
<td>D.</td>
<td>valid tender of payment by prior party</td>
</tr>
<tr>
<td>E.</td>
<td>release of principal debtor, unless holder’s right of recourse vs. 2ndary party reserved</td>
</tr>
<tr>
<td>F.</td>
<td>any agreement binding upon holder to extend time of payment, or to postpone holder’s right to enforce instrument, UNLESS</td>
</tr>
<tr>
<td></td>
<td>1. made with assent of party secondarily liable, or</td>
</tr>
<tr>
<td></td>
<td>2. right of recourse reserved.</td>
</tr>
<tr>
<td>G.</td>
<td>Failure to make due presentment (Secs. 70, 144, NIL)</td>
</tr>
<tr>
<td>H.</td>
<td>failure to give notice of dishonor</td>
</tr>
<tr>
<td>I.</td>
<td>certification of check at instance of holder</td>
</tr>
<tr>
<td>J.</td>
<td>reacquisition by prior party</td>
</tr>
<tr>
<td></td>
<td>1. where instrument negotiated back to a prior party, such party may reissue and further negotiate, but not entitled to enforce payment vs. any intervening party to whom he was personally liable</td>
</tr>
<tr>
<td></td>
<td>2. where instrument is paid by party secondarily liable, it’s not discharged, but</td>
</tr>
<tr>
<td></td>
<td>a. the party so paying it is remitted to his former rights as regard to all prior parties</td>
</tr>
<tr>
<td></td>
<td>b. and he may strike out his own and all subsequent indorsements, and again negotiate instrument, except</td>
</tr>
<tr>
<td></td>
<td>i. where it’s payable to order of 3rd party and has been paid by drawer</td>
</tr>
<tr>
<td></td>
<td>ii. where it’s made/accepted for accommodation and has been paid by party accommodated</td>
</tr>
</tbody>
</table>

---

\(^{11}\) Suggested Mnemonics: CuPID CRRAFFT: intentional Cancellation, Prior Party and Instrument Discharge, Certification, Release, Reacquisition, any Agreement, Failure to make due presentment, Failure to give notice of dishonor, valid Tender of payment.

Chapter VIII
OTHER FORMS OF COMMERCIAL PAPER

1. In General

1.1. Commercial papers –
1. also Negotiable instruments;
2. merely special forms of either PNs or BEs;
3. also governed by the NIL

1.2. Quasi-negotiable includes commercial paper which though not governed by the NIL, have certain attributes of negotiability.

2. Bonds and Debentures

2.1. Bonds

1. evidences of indebtedness, in the nature of a PNs
2. usually accompanied by a mortgage of the property of the issuer
3. issued by the government (municipal & other public corporations) & private corporations:
   a. though not to mature for a long time, assure some regular income to bondholders in the form of interest*, usually payable annually
   b. bonds and interest coupons (evidences interest obligations)*
      ▪ may be negotiable in form, therefore governed by NIL (Sec 65);
      ▪ both are actually promissory notes
   c. they run for long periods of time, and are often sold to the public in general
   d. funds generated by such bonds are used to finance corporate projects and public works;
   e. there is no warranty on the part of such indorser or negotiator that prior parties had capacity to contract. The qualified indorser & negotiator by delivery of a bond do not warrant therefore that the corporation which issued the bonds has any judicial capacity to act. A general indorser thereof however would be liable for such want of capacity.

2.2. Debentures

1. similar to bonds except that they are usually for a shorter term and may or may not be accompanied by a mortgage.
2. they are often issued on the general credit of the issuer corporation

3. Drafts and Letters of Credit

3.1. Drafts and Letters of Credit - The draft and the letter of credit are generally used together to effect payment in international transactions.

3.2. Draft a form of BE generally used to facilitate the transactions between persons physically remote from each other.

3.3. Letters of Credit

1. one person requests some other person to advance money or give credit to a third
person, and promises that he will repay the same to the person making the advancement, or accept bills drawn upon himself for the like amount.

2. must be issued in favor of a definite person, and not to order.

3. under our law, a letter of credit cannot be a negotiable instrument because (a) it may not contain the words of negotiability; (b) may be issued for an undetermined amount. See Art 568 Code of Commerce.

4. "INDEPENDENCE PRINCIPLE": Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit. Consequently, the undertaking of a bank to pay, accept and pay drafts, or negotiate and/or fulfill any other obligation under the credit is not subject to claims or defenses by the applicant resulting from his relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant and the issuing bank.

a. Thus, the engagement of the issuing bank is to pay the seller or beneficiary of the credit once the draft and the required documents are presented to it. This principle assures the seller or the beneficiary of prompt payment independent of any breach of the main contract and precludes the issuing bank from determining whether the main contract is actually accomplished or not. Under this principle, banks assume no liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any documents, or for the good faith or acts and/or omissions, solvency, performance or standing of the consignor, the carriers, or the insurers of the goods, or any other person whomsoever.

b. The independent nature of the letter of credit may be: (a) independence in toto where the credit is independent from the justification aspect and is a separate obligation from the underlying agreement like for instance a typical standby; or (b) independence may be only as to the justification aspect like in a commercial letter of credit or repayment standby, which is identical with the same obligations under the underlying agreement. In both cases the payment may be enjoined if in the light of the purpose of the credit the payment of the credit would constitute fraudulent abuse of the credit. (Transfield vs. Luzon Hydro).

5. Pertinent Code of Commerce provisions:

a. Art 567. Letters of credit - issued by one merchant to another for the purpose of attending to a commercial transaction.

b. Art 568. The essential conditions of letters of credit shall be:

i. issued in favor of a definite person, and not to order.

ii. limited to a fixed and specified amount, or to one or more undetermined amount, but all within a maximum the limit of sales or other contract(s) or the maximum fixed therein. Note: Those which do not have any of these last circumstances shall be considered as mere letters of recommendation.

c. Art 569. The drawer of a letter of credit shall be liable to the person on whom it was issued, for the amount paid by virtue thereof, within the maximum fixed therein.

Letters of credit may not be protested even if not be paid; bearer cannot acquire any right of action by reason of non-payment against the person who issued the letter. The person paying has right to demand the proof of the identity of the person in whose favor the letter of credit was issued.

d. Art 570. The drawer of a letter of credit may annul it, informing the bearer and the person to whom it is issued, provided such objection is made within 12 months anywhere outside thereof.

e. Art 571. The bearer of a letter or credit shall pay the amount received to the drawer without delay. Should he not do so, an action involving execution may be brought to recover it, with legal interest and the current exchange in the place where it is paid.

f. Art 572. If the bearer of a letter of credit does not make use thereof within the (1) period agreed upon with the drawer, or in default of a period fixed, (2) within 6 months, counted from its date, in any point in the Philippines, and within 12 months anywhere outside thereof, it shall be void in fact and in law.

BPI v. DE RENY FABRIC (1970)

The company and its officers cannot shift the burden of loss to the bank because of the terms of their Commercial Letter of Credit Agreement, which states that the bank provides that latter shall not be responsible for any difference in character or condition of the property. Furthermore, the bank was able to prove the existence of a custom in international banking and financing circles negating any duty of the bank to verify whether what has been described in letters of credits or drafts or shipping documents actually tally with what was loaded aboard ship. Banks, in providing financing in international business transactions do not deal with the property to be exported or shipped to the importer, but deal only with documents.

LEE v CA (2002)
Modern letters of credit are usually not made between natural persons. They involve bank to bank transactions. Historically, the letter of credit was developed to facilitate the sale of goods between, distant and unfamiliar buyers and sellers. It was an arrangement under which a bank, whose credit was acceptable to the seller, would at the instance of the buyer agree to pay drafts drawn on it by the seller, provided that certain documents are presented such as bills of lading accompanied the corresponding drafts. Expansion in the use of letters of credit was a natural development in commercial banking. Parties to a commercial letter of credit include the:

(a) the buyer or the importer,
(b) the seller, also referred to as beneficiary,
(c) the opening bank which is usually the buyer's bank which actually issues the letter of credit,
(d) the notifying bank which is the correspondent bank of the opening bank through which it advises the beneficiary of the letter of credit,
(e) negotiating bank which is usually any bank in the city of the beneficiary. The services of the notifying bank must always be utilized if the letter of credit is to be amended or transferred to the beneficiary through cable,
(f) the paying bank which buys or discounts the drafts contemplated by the letter of credit, if such draft is to be drawn on the opening bank or on another designated bank not in the city of the beneficiary. As a rule, whenever the facilities of the opening bank are not used, the beneficiary is supposed to present his drafts to the notifying bank for negotiation and
(g) the confirming bank which, upon the request of the beneficiary, confirms the letter of credit issued by the opening bank.

**TRANSFIELD VS. LUZON HYDRO (2004)**

Can the beneficiary invoke the independence principle? Yes. To say that the independence principle may only be invoked by the issuing banks would render nugatory the purpose for which the letters of credit are used in commercial transactions. As it is, the independence doctrine works to the benefit of both the issuing bank and the beneficiary.

**Certificate of Stock**

A. or **share certificate** is the customary and convenient evidence of the holder's interest in the corporation which issues it.
B. not a NL, but is included in the term “securities” because it does not contain any promise or order to pay money;
C. described as **Quasi-Negotiable** bec oftentimes, by application of the principles of estoppel, and to effectuate the ends of justice and the intention of the parties, the courts decree a transfer or title to the transferee than actually existed in his transferor, and is the same as would be reached if the certificate were negotiable.
D. When the shareholder signs the back of certificates of stock without filling in the blanks (for the name of the transferee and attorney-in-fact) and the certificate is delivered to another, the latter appears to be the owner thereof. A bona fide purchaser of value without notice, will be protected in his acquisition, although such third person has diverted the certificate from the purpose for which he was entrusted therewith. (Principle of Estoppel)
E. The same rule is applicable if the certificate is bearer form.
F. The rule is applicable where the certificate is lost or stolen while signed in blank. Even a purchaser in good faith cannot acquire title as against the true owner. (?)
G. At common law, stock certificates are given the attributes of negotiability only where the owner thereof has entrusted the wrongdoer with the possession of such certificate and clothed him with apparent ownership thereof.

**SANTAMARIA v HONGKONG & SHANGHAI BANK (1951)**

Plaintiff, in failing to take the necessary precaution upon delivering the certificate of stock to her broker, was chargeable with negligence in the transaction which resulted to her own prejudice, and as such, she is estopped from asserting title to it as against the defendant bank.

A certificate of stock, indorsed in blank, is deemed quasi-negotiable, and as such the transferee thereof is justified in believing that it belongs to the holder and transferor.

**DE LOS SANTOS, McGrath (1955)**

Although a stock certificate is sometimes regarded as quasi-negotiable, in the sense that it may be transferred by endorsement, coupled with delivery it is well settled that the instrument is non-negotiable, because the holder thereof takes it without prejudice to such rights or defense as the registered owner or credit may have under the law, except in so far as such rights or defenses are subject to the limitations imposed by the principles governing estoppel.

**CAPCO v. MACASAET (1990)**

Certificates of stocks are considered as quasi-negotiable instruments. When the owner or shareholder signs the printed form of sale or assignment at the back of every stock certificates without filling in the blanks provided for the name of the transferee as well as for the name of the attorney-in-fact, the said owner or shareholder, in effect, confers on another all the indicia of ownership of the said stock certificates.

4. **Negotiable Documents of Title**

5.1. **In General**

1. as distinguished from negotiable instruments, refer to goods and not to money; the sale of goods covered is effected by the transfer of said document
2. not governed by the NIL but by the Civil Code
3. includes any bill of lading, dock warrant, “quedan”, or warehouse receipt or order for the delivery of goods, or any other document used in the ordinary course of business in the sale or transfer of goods, as proof of the possession or control of the goods, or authorizing or purporting to authorize the possessor of the document to
5.2. Kinds

1. **Warehouse receipts** an agreement by a warehouseman to store goods and deliver them to a named person or his order or to bearer;
2. **Bill of Lading** a similar contract by a carrier to ship goods and deliver them to the person named therein or his order or to bearer; negotiable bill of lading is useful not only as evidence of the receipt of the goods by the carrier but as evidencing title to goods covered by it. It also facilitates the purchase of goods by one person from another who is physically remote and probably unknown to him.

a. “straight” bill where the goods are to be delivered to a specified person, it is not negotiable and is called a “straight” bill. Otherwise, it is referred to as an “order” bill.

3. Certificate of Deposits receipt of a bank for a certain sum of money received upon deposit; generally framed in such FORM as to constitute a promissory note, payable to the depositor, or to the depositor or order, or to bearer:

a. it is taken when depositor does not need his money for some extended period of time and wants it to earn interest; more of an investment paper than a commercial paper because it is not attendant to a commercial transaction in the way a check or a promissory note is.

b. it is negotiable if it meets all the requirements of Sec 1 NIL

5.3. Negotiation - same as those used in NIs; to order = delivery + indorsement, to bearer = delivery
1. The means of negotiating a document of title are the same as those used in negotiable instruments.
2. If by the terms of the document, the goods are deliverable to the order of a specified person, then it should be indorsed by such person, either specially or in blank.
3. If the goods are deliverable to bearer, or the document has been indorsed in blank, then negotiation may be by mere delivery.

5.4. Rights of a Holder
1. When free from personal defense
   a. Under **Art 1518 Civil Code**, a holder of a negotiable document of title in good faith, for value and without notice is placed on the same level as a HDC of a negotiable instrument - i.e., personal defenses enumerated in said article are not available against him. Personal defenses include: negotiation was a breach of duty on the part of the person making the negotiation, owner of the document was deprived of the possession of the same by loss, theft, fraud, accident, mistake, duress or conversion.
   b. Note Art 1518’s conflict with Art 1512. (see p 915)
2. **What title acquired** (NOTE: see Arts 1513, 1514 and 1519 Civil Code)
   a. A person to whom a negotiable document of title has been duly negotiated acquires the title of the person NEGOTIATING it as well as the title of the ORIGINAL BAILOR or depositor of the goods.
   b. The person to whom the holder of the goods, even if in good faith and for value, does not acquire any right to the goods. The holder’s remedy if any, is against his transferor and/or the guilty party.
   i. Thus, if the original bailor or depositor of the goods was not the owner thereof or had no authority from such owner to deposit the goods, then the holder of the negotiable document, even if the negotiation to him was valid, cannot acquire title to the goods; AND even if the original bailor had authority, if the negotiation to the present holder’s transferor was not valid, such holder, even if in good faith and for value, does not acquire any right to the goods.
   ii. On the other hand, even if the original bailor or depositor was the owner or had authority from the owner, if the negotiation to the present holder’s transferor was not valid, such holder, even if in good faith and for value, does not acquire any right to the goods.
   iii. In both cases, the holder’s remedy if any, is against his transferor and/or the guilty party.
   b. The person to whom the document has been negotiated acquires the obligation of the bailee to make delivery to him, as if they had contracted directly with each other.
   i. By issuing a negotiable document of title, such bailie had given in advance his consent to hold the goods for any person to whom such document is negotiated.
   ii. If document non-negotiable, notice of any transfer should be given to the bailee otherwise bailee or any other person better than the transferee.
   iii. Thus, the transferee’s rights may be defeated by a levy of attachment on the goods or by a notification to the bailee of a sale of the goods to another purchaser.
   iv. A sale of the goods without the document on the same level as a HDC of a negotiable instrument will not prejudice a subsequent purchaser who takes the document in good faith and for value.
   v. The bailee’s delivery to the legal holder of the document would relieve him of any further responsibility for the goods.
5.5. Liability of Indorser

1. The indorsement of a negotiable document of title carries with it certain implied warranties by the indorser.

2. As to the document, his warranty covers its genuineness, his legal right to negotiate it and his lack of knowledge of any fact which would impair its validity.

3. As to the goods, he warrants that he has the right to transfer title thereto and that they are merchantable.

4. However, unlike the indorser of a NI who is liable if the primary party fails to pay, the indorser of a negotiable document of title is not liable for the failure of the bailee to fulfill his obligation to deliver the goods.

ROMAN v ASIA BANKING CORP. (1922)

A warehouse receipt must be interpreted according to its evident intent and it is obvious that the deposit evidenced by the receipt in this case was intended to be made subject to the order of the depositor and therefore negotiable. The indorsement in blank of the receipt with its delivery which took place on the date of the issuance of the receipt demonstrate the intent to make the receipt negotiable. Furthermore, the receipt was not marked “non-negotiable.”

SIY CONG BIENG v. HSBC

If the owner of the goods permits another to have the possession or custody of negotiable warehouse receipts running to the order of the latter, or to bearer, it is a representation of title upon which bona fide purchasers for value are entitled to reply, despite breaches of trust or violations of agreement on the part of the apparent owner.
Insurance Code (PD 1460)

Chapter I. INTRODUCTION

1. Laws on Insurance

1.1. Sources of Insurance Law in the Philippines

- During the Spanish period, all the provisions concerning insurance in the Philippines were found in Title 7 of Book 2 and Section 3 of Title 3 of Book 3 of the Code of Commerce, and in Chapters 2 and 4 of Title 12 of Book 4 of the old Civil Code of 1889.
- When Act #2427, enacted on December 11, 1914, otherwise known as the Insurance Act, took effect on July 1, 1915 during the American Regime, the provisions of the Code of Commerce on insurance were expressly repealed.

Ang Giok vs. Springfields

Facts: Ang Giok insured the contents of his warehouse with three insurance companies for 60K. The warehouse and its contents were destroyed by fire while the policies were in force. The plaintiff instituted action in the CFI of Manila against one of the insurers to recover a proportional part of the loss coming to P8,170. The Four special defenses interposed by the insurer, one being planted on a violation of warranty F, is contained in the policy itself and thus embodied in the policy. The word "contained," according to the dictionaries, means "to "another instrument" as here used could not mean a mere slip of paper like a rider, but something akin to the policy itself. The word instrument has a well defined definition in California, and as used in the Codes invariably means some written paper or instrument signed and delivered by one person to another, transferring the title to, or giving a lien, on property, or giving a right to debt or duty. The rider, warranty F, is contained in the policy itself, because by the contract agreed to by the parties is made to form part of the same, but is not another instrument signed by the insured and referred to in the policy as forming a part of it. The rider is therefore valid and binding.

Gercio vs. Sunlife

Facts: On January 1910, the Sun Life assurance Co., of Canada issued a 20-year endowment policy on the life of Hilario Gercio. The insurance company agreed to insure the life of Gercio for P2,000, to be paid to him on February 1, 1930, or if the insured should die before said date, then to his wife, should she survive him; otherwise, to the executors, administrators, or assigns of the insured. The policy did not contain any provision for the reserving to the insured the right too change the beneficiary. When the policy was issued, Andrea Zialcita was the lawful wife of Hilario. In 1919, she was convicted of adultery. In 1920, a decree of divorce was issued in a civil case completely dissolving the bonds of matrimony between Gercio and Zialcita. Fercio formally notified Sun Life that he had revoked his donation in favor of Zialcita, and that he had designated in her stead his present wife, Adela Garcia de Gercio, as the beneficiary of the policy. Gercio requested Sun Life to eliminate Zialcita as beneficiary. This the insurance company has refuse to do and still refuses to do.

Held: The Code of Commerce, the Civil Code or the Insurance Act does not contain any provision either permitting or prohibiting the insured to change the beneficiary. We must perforce conclude that whether the case be considered in the light of the Code of Commerce, the Civil Code, or the Insurance Act, the deficiencies in the law will have to be supplemented by the general principles prevailing on the subject. To that end, we have gathered the rules which follow from the modern Law of Insurance as found in the United States. The beneficiary has an absolute vested interest in the policy from the date of its issuance and delivery. So when a policy of life insurance is taken out by the husband in which the wife is named the beneficiary, she has a subsisting interest in the policy.

- When RA 386, otherwise known as the Civil Code of the Philippines, took effect on August 30, 1950, those provisions of the old Civil Code on insurance were also expressly repealed.
- Presidential Decree #612, as amended, which ordained and instituted the Insurance Code of the Philippines, was promulgated on December 18, 1974, reenacting the provisions of the pre-1974 law. It repealed Act #2427, as amended. Before Presidential Decree 612, amendments to the Act were made by PDs # 63, 123, 317.
- Presidential Decree #1460, consolidated all insurance laws into a single code known as the Insurance Code of 1978. Basically, it reenacted Presidential Decree #612, as amended. It has been amended by Presidential Decree #1814 and Batas Pambansa Blg. 874.
Chapter II
THE CONTRACT OF INSURANCE

1. Definitions

1.1. Section 2, Insurance Code

Sec. 2. Whenever used in this Code, the following terms shall have the respective meanings hereinafter set forth or indicated, unless the context otherwise requires:

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

A contract of suretyship shall be deemed to be an insurance contract, within the meaning of this Code, only if made by a surety who or which, as such, is doing an insurance business as hereinafter provided.

(2) The term "doing an insurance business" or "transacting an insurance business", within the meaning of this Code, shall include (a) making or proposing to make, as insurer, any insurance contract; (b) making or proposing to make, as surety, any contract of suretyship as a vocation and not as merely incidental to any other legitimate business or activity of the surety; (c) doing any kind of business, including a reinsurance business, specifically recognized as constituting the doing of an insurance business within the meaning of this Code; (d) doing or proposing to do any business in substance equivalent to any of the foregoing in a manner designed to evade the provisions of this Code.

In the application of the provisions of this Code the fact that no profit is derived from the making of insurance contracts, agreements or transactions or that no separate or direct consideration is received therefore, shall not be deemed conclusive to show that the making thereof does not constitute the doing or transacting of an insurance business.

(3) As used in this code, the term "Commissioner" means the "Insurance Commissioner".

1.2. "Contract of Insurance"

- An agreement by which one party (insurer) for a consideration (premium) paid by the other party (insured), promises to pay money or its equivalent or to do some act valuable to the latter (or his nominee), upon the happening of a loss, damage, liability, or disability arising from an unknown or contingent event.

White Gold Marine Services vs. Pioneer (2005)

An insurance contract is a contract is a contract of indemnity wherein one undertakes for a consideration to indemnify another against loss, damage, or liability arising from an unknown or contingent event. Regulation by the state through a license or certification of authority is necessary since a contract of insurance involves public interest.
1.3. “Doing an Insurance Business”

**General Rule:** An insurance business consists of undertaking, for a consideration, to indemnify another against loss, damage or liability arising from an unknown or contingent event.

**Supplementary Rule:** The fact that an establishment is not formally designated as one of insurance does not preclude its being deemed to be engaged in an insurance business if it undertakes any of the following (even if not for profit or for any independent consideration):

- Making or proposing to make, as insurer, any insurance contract
- Making or proposing to make, as surety, any contract of suretyship as a vocation
- Doing any kind of business, including a reinsurance business, specifically recognized as constituting the doing of an insurance business with the meaning of this Code
- Doing or proposing to do any business in substance equivalent to any of the foregoing in a manner designed to evade the provisions of the Insurance Code

2. Elements

2.1. Insurable interest
- The insured has an insurable interest in the thing or the life of the insured

2.2. Risk of Loss or Damage / Designated Peril as Cause
- The happening of the designated events, either unknown or contingent, past or future, will subject such interest to some loss, whether in the form of injury, damage, or liability

2.3. Consideration: Premium
- The insurer undertakes to assume the risk of such a loss for a consideration called the premium to be paid by the insured

2.4. Risk Distributing Scheme
- This assumption of risk is part of a general scheme to distribute the loss among a large number of persons exposed to similar risks

3. Characteristics/Nature of Insurance Contracts

3.1. Consensual
- Perfected by the meeting of the minds of the parties
- If an application for insurance has not been either accepted or rejected, there is no contract as yet

3.2. Voluntary
- It is not compulsory and the parties may incorporate such terms and conditions as they may deem convenient which will be binding provided they do not contravene any provision of law and are not opposed to public policy

3.4. Executory (insurer) and executed (insured)
- Executory on the part of the insurer in the sense that it is not executed until payment for a loss
- It is executed as to the insured after payment of the premium
- It is a unilateral contract imposing legal duties only on the insurer who promises to indemnify in case of loss

3.5. Conditional
- It is subject to conditions the principal one of which is the happening of the event insured against
- The contract usually includes many other conditions, such as payment of premium or performance of some other act, which must be complied with as precedent to the right of the insured to claim benefit under it

3.3. Aleatory

Art. 2010. By an aleatory contract, one of the parties or both reciprocally bind themselves to give or to do something in consideration of what the other shall give or do upon the happening of an event which is uncertain, or which is to occur at an indeterminate time.

- It depends upon some contingent event
- Not a contract of chance although the event against the occurrence of which it is intended to provide may never occur
- It means one of the parties or both reciprocally bind themselves to give or to do something in consideration of what the other shall give or do upon the happening of the event which is uncertain, or which is to occur at an indefinite time
- Each party must take a risk
  - Insurer - being compelled upon the happening of the contingency, to pay the entire sum agreed upon
  - Insured – parting with the amount required as premium without receiving anything in case the contingency does not happen except what is ordinarily termed “protection” which is itself is a valuable consideration
3.6. A contract of indemnity (except life and accident insurance where the result is death)
- The promise of the insurer is to make good only the loss of the insured
- Any contract that contemplates a possible gain to the insured by the happening of any event upon which the liability of the insurer becomes fixed is contrary to the nature of insurance
- No person may secure insurance upon property in which he has no interest.
- If the insured has no insurable interest, the contract is void and unenforceable as being contrary to public policy because it affords a temptation to the insured to wish or bring about the happening of the loss.

3.7. An investment (life insurance)
- Measure of economic security for the insured during life, and beneficiary after death
- Financial assistance during financial crisis
- Liability of insurer is face value of the policy and not the earning capacity of the insured at the time of death.

3.8. A personal contract
- Each party having in view the credit, character and conduct of another
- As a rule, the insured cannot assign, before the happening of the loss, his rights under a property policy without the consent of the insurer. The obligation of the insurer to pay does not attach or run with the property whether it be real property or personal.
  » If a person whose property is insured sells it to another, the buyer cannot be his successor in the contract of insurance unless, of course, the sale is with the consent of the insurer or unless by express stipulation of the parties, the contract is made to run with the property of the transferee.
  » Where the insurance is "on account of the owner" or "for whom it may concern" or where "the loss is payable to bearer," the subsequent transferees or owners become by the terms of the contract, the real parties to the contract of insurance.
- All insurance contracts share a common trait of "personal-ness"
  » Personal insurance (includes life, health, accident, and disability insurance) - applies only to a particular individual, and it is not possible, for example, for the insured unilaterally declaring that his health insurance policy shall now be deemed to cover the health of someone else.
  » Liability insurance - each person purchases coverage for his own (or a group of related persons) potential liability to others. The insurer prices the coverage depending on the characteristics and traits of the particular insured.
  » Property insurance - the insurance is on the insured’s interest in the property, not on the property itself. It is the damage to the personal interest not the property that is being reimbursed.

3.9. A contract of adhesion
- Policy is presented to the insured already in its printed form.
- "Take it or leave it"

3.10. Of highest degree of good faith
- Each party is enjoined by law to deal with each other in good faith.
- Disclosure or the duty to disclose.
- Violation of the duty gives the other party the right to rescind the contract.

3.11. It is property in legal contemplation.

4. Requisites of a valid contract of insurance
- A subject matter in which the insurer has an insurable interest.
- Event or peril insured against which may be any (future) contingent or unknown event, past or future (Sec. 3), and a duration for the risk thereof.
- A promise to pay or indemnify in a fixed or ascertainable amount.
- A consideration for the promise known as a "premium".
- A meeting of the minds of the parties upon all of the foregoing essentials.
- The parties must be competent to enter into the contract.
- Under Sec. 226, "no policy of insurance shall be issued or delivered within the Philippines unless in the form previously approved by the Insurance Commissioner."
- The purpose must not be contrary to law or public policy.
5. Contracts for Contingent Services; Pre-need Plans and Similar Arrangements

5.1. Contracts for Contingent Personal Services
- It does not necessarily follow that a contract containing the abovementioned elements would be an insurance contract.
- The primary purpose of the parties making the contract may negate the existence of an insurance contract.
  » A law firm which enters into contracts with clients in consideration of periodical payments, where it promises to represent such clients in all suits for or against them, is not engaged in an insurance business. Its contracts are simply for the purpose of rendering personal services.
  » A contract by which a consideration of a stipulated amount, agrees at its own expense to defend a physician against all suits for damages for malpractice is one of insurance, and the corporation will be deemed as engaged in the business of insurance.
- Unlike the lawyer's retainer contract, the essential purpose of such a contract is not to render personal services, but to indemnify against loss or damage resulting from the defense of actions for malpractice.
- A corporation which enters into contracts with car owners and agrees to engage and pay for the services of a lawyer to handle any defense cases arising from collision of their cars, is engaged in the insurance business and must therefore comply with the laws relative to the transaction of insurance business and should be licensed as such before it can lawfully transact such business.
- Such contracts do not provide for the payment of any sum directly to the contractee, but it does provide for the relief of the contractee from the expenses of employing an attorney.
- It would be immaterial that the contract states on its face that it is not a contract of insurance, for the nature of the contract cannot be changed by a declaration.

5.2. Contracts with Contingent Incidental Benefit
In the case of Attorney General ex rel Monk vs. C.E. Osgood Co., the defendant company was engaged in the business of selling household furniture on the installment plan. Under the contracts with its customers, although delivery would be made at the time of the contract, title to the furniture would not pass until all payments have been completed. Said contracts also provided that should the buyer die before full payment of the agreed price, the unpaid balance would be remitted to the extent of $500.

The Insurance Commissioner, through the Atty. Gen., claiming that this last provision made it an insurance contract brought suit to restrain the defendant from pursuing its business without first securing the proper license. The Court upheld the Attorney General's contention and issued an injunction holding that the contract had all the elements of an insurance contract. Whether this clause in the contract is ancillary to defendant's chief business or is mainly for advertising ends was held irrelevant in view of the prohibition against the making of insurance contracts by companies not authorized by law.

It would seem, however, that the purpose of the stipulation, taken with its effects in case of the death of the buyer, did not warrant a holding that the furniture company should first secure a license to engage in the insurance business. Although all the elements of an insurance contract may seem to be present, yet the furniture buyer and/or his heirs did not, under the circumstances, need the protection which the law aims to give the insuring public by the requirement of a prior license.

First of all, when the buyer purchased the furniture, he must have seen and examined it and must have believed that it was worth the amount he agreed to pay for it. Secondly, the furniture was delivered to him at the time of the contract and used by him thereafter. Upon his death, his heirs continued enjoying the use of the furniture. Therefore, the buyer and/or his heirs stood to lose nothing by the questioned stipulation, and if at all, stood to gain by it.

5.3. Pre-need Plans

Philamcare Health Systems vs. CA

Ratio: Section 3 of the Insurance Code states that any contingent or unknown event, whether past or future, which may damnify a person having an insurable interest against him, may be insured against. Every person has an insurable interest in the life and health of himself. Section 10 provides: Every person has an insurable interest in the life and health (1) for himself, of his spouse and of his children; (2) of any person on whom he depends wholly or in part for education or support, or in whom he has a pecuniary interest; (3) of any person under a legal obligation to him for the payment of the money, respecting property or service, of which death or illness might delay or prevent the performance; and (4) of any person upon whose life any estate or interest vested in him depends. In the case at bar, the insurable interest of respondent’s husband in obtaining the health care agreement was on his own health. The health care agreement was in the nature of non-life insurance, which is primarily a contract of indemnity. Once the member incurs hospital, medical or any other expense arising from sickness, injury or other stipulated contingent, the health care provider must pay for the same to the extent agreed upon under the contracts.

6. Classification under the Code
6.1. Life - defined as a mutual agreement by which a party agrees to pay a given sum on the happening of a particular event contingent on the duration of human life, in consideration of the
payment of a smaller sum immediately, or in periodical payments by the other party

a) Individual life

Sec. 179. Life insurance is insurance on human lives and insurance appertaining thereto or connected therewith.

Sec. 180. An insurance upon life may be made payable on the death of the person, or on his surviving a specified period, or otherwise contingently on the continuance or cessation of life. Every contract or pledge for the payment of endowments or annuities shall be considered a life insurance contract for purpose of this Code. In the absence of a judicial guardian, the father, or in the latter's absence or incapacity, the mother, or any minor, who is an insured or a beneficiary under a contract of life, health or accident insurance, may exercise, in behalf of said minor, any right under the policy, without necessity of court authority or the giving of a bond, where the interest of the minor in the particular act involved does not exceed twenty thousand pesos. Such right may include, but shall not be limited to, obtaining a policy loan, surrendering the policy, receiving the proceeds of the policy, and giving the minor's consent to any transaction on the policy.

Sec. 180-A. The insurer in a life insurance contract shall be liable in case of suicides only when it is committed after the policy has been in force for a period of two years from the date of its issue or of its last reinstatement, unless the policy provides a shorter period. Provided, however, That suicide committed in the state of insanity shall be compensable regardless of the date of commission. (As amended by Batasang Pambansa Blg. 874)

Sec. 181. A policy of insurance upon life or health may pass by transfer, will or succession to any person, whether he has an insurable interest or not, and such person may recover upon it whatever the insured might have recovered.

Sec. 182. Notice to an insurer of a transfer or bequest thereof is not necessary to preserve the validity of a policy of insurance upon life or health, unless thereby expressly required.

Sec. 183. Unless the interest of a person insured is susceptible of exact pecuniary measurement, the measure of indemnity under a policy of insurance upon life or health is the sum fixed in the policy.

- Insurance on human lives and insurance appertaining thereto or connected therewith.
- Made payable on the death of a person, or on his surviving a specified period, or otherwise contingently on the continuance or cessation of life
- one insures one's life or that of another against death or sickness
- Effect of suicide of insured Liability of insurer in case of suicide

» When liable:
  - The suicide is committed after the policy has been in force for a period of 2 years from date of its issue or of its reinstatement;
  - The suicide is committed after a shorter period provided in the policy although within the 2-year period;
  - The suicide is committed in the state of insanity regardless of the date of commission, unless suicide is an excepted risk.

*Note that the policy cannot provide a period longer than 2 years. So, if the policy provides for a 3-year period and suicide is committed within the period but after 2 years, insurer is liable.

» When not liable:
  - Suicide is not by reason of insanity and is committed within the 2-year period.
  - Suicide is by reason of insanity but is not among the risks assumed by the insurer regardless of the date of commission.
  - Insurer can show that the policy was obtained with the intention to commit suicide even in the absence of any suicide exclusion in the policy.

b) Group life

Sec. 50. The policy shall be in printed form which may contain blank spaces; and any word, phrase, clause, mark, sign, symbol, signature, number, or word necessary to complete the contract of insurance shall be written on the blank spaces provided therein.

Any rider, clause, warranty or endorsement purporting to be part of the contract of insurance and which is pasted or attached to said policy is not binding on the insurer, unless the descriptive title or name of the rider, clause, warranty or endorsement is also mentioned and written on the blank spaces provided in the policy.

Unless applied for by the insured or owner, any rider, clause, warranty or endorsement issued after the original policy shall be countersigned by the insured or owner, which countersignature shall be taken as his agreement to the contents of such rider, clause, warranty or endorsement.

Group insurance and group annuity policies, however, may be typewritten and need not be in printed form.

- May be typewritten and need not be in printed form
- Members usually a cohesive group
  - Pay a uniform premium
  - Usually no medical examination
  - Normally requires a specified number of persons insured before policy is issued
### a) Marine

**Sec. 99.** Marine Insurance includes:

1. Insurance against loss of or damage to:
   a. Vessels, craft, aircraft, vehicles, goods, freights, cargoes, merchandise, effects, disbursements, profits, moneys, securities, choses in action, evidences of debts, valuable papers, bottomry, and respondenda interests and all other kinds of property and interests therein, in respect to, appertaining to or in connection with any and all risks or perils of navigation, transit or transportation, or while being assembled, packed, crated, baled, compressed or similarly prepared for shipment or while awaiting shipment, or during any delays, storage, transhipment, or reshipment incident thereto, including war risks, marine builder's risks, and all personal property floater risks;
   b. Person or property in connection with or appertaining to a marine, inland marine, transit or transportation insurance, including liability for loss of or damage arising out of or in connection with the construction, repair, operation, maintenance or use of the subject matter of such insurance (but not including life insurance or surety bonds nor insurance against loss by reason of bodily injury to any person arising out of ownership, maintenance, or use of automobiles);
   c. Precious stones, jewels, jewelry, precious metals, whether in course of transportation or otherwise;
   d. Bridges, tunnels and other instrumentalities of transportation and communication (excluding buildings, their furniture and furnishings, fixed contents and supplies held in storage); piers, wharves, docks and slips, and other aids to navigation and transportation, including dry docks and marine railways, dams and appurtenant facilities for the control of waterways.

2. "Marine protection and indemnity insurance," meaning insurance against, or against legal liability of the insured for loss, damage, or expense incident to ownership, operation, chartering, maintenance, use, repair, or construction of any vessel, craft, aircraft, construction or instrumentality in use of ocean or inland waterways, including liability of the insured for personal injury, illness or death or for loss of or damage to the property of another person.

### b) Non-life

- **Sec. 229.** The term "industrial life insurance" as used in this Code shall mean that form of life insurance under which the premiums are payable either monthly or oftener, if the face amount of insurance provided in any policy is not more than five hundred times that of the current statutory minimum daily wage in the City of Manila, and if the words "industrial policy" are printed upon the policy as part of the descriptive matter.

An industrial life policy shall not lapse for non-payment of premium if such non-payment was due to the failure of the company to send its representative or agent to the insured at the residence of the insured or at some other place indicated by him for the purpose of collecting such premium; Provided, That the provisions of this paragraph shall not apply when the premium on the policy remains unpaid for a period of three months or twelve weeks after the grace period has expired.

#### 6.2. Non-life

- Form of life insurance under which the premiums are payable either monthly or oftener.
- Face amount of insurance provided in any policy is not more than five hundred times that of the current statutory minimum daily wage in the City of Manila.
- Shall not lapse for non-payment of premium if such non-payment was due to the failure of the company to send its representative or agent to the insured at the residence of the insured or at some other place indicated by him for the purpose of collecting such premium.

This shall not apply when the premium on the policy remains unpaid for a period of three months or twelve weeks after the grace period has expired.
b) Fire

Sec. 167. As used in this Code, the term "fire insurance" shall include insurance against loss by fire, lightning, windstorm, tornado or earthquake and other allied risks, when such risks are covered by extension to fire insurance policies or under separate policies.

c) Casualty or Liability Insurance

Sec. 174. Casualty insurance is insurance covering loss or liability arising from accident or mishap, excluding certain types of loss which by law or custom are considered as falling exclusively within the scope of other types of insurance such as fire or marine. It includes, but is not limited to, employer's liability insurance, motor vehicle liability insurance, plate glass insurance, burglary and theft insurance, personal accident and health insurance as written by non-life insurance companies, and other substantially similar kinds of insurance.

d) Suretyship

Sec. 175. A contract of suretyship is an agreement whereby a party called the surety guarantees the performance by another party called the principal or obligor of an obligation or undertaking in favor of a third party called the obligee. It includes official recognizances, stipulations, bonds or undertakings issued by any company by virtue of and under the provisions of Act No. 536, as amended by Act No. 2206.

Sec. 176. The liability of the surety or sureties shall be joint and several with the obligor and shall be limited to the amount of the bond. It is determined strictly by the terms of the contract of suretyship in relation to the principal contract between the obligor and the obligee. (As amended by Presidential Decree No. 1455)

Sec. 178. Pertinent provisions of the Civil Code of the Philippines shall be applied in a suppletory character whenever necessary in interpreting the provisions of a contract of suretyship.

- A contract of suretyship shall be deemed to be an insurance contract, only if made by a surety who or which is doing an insurance business.

- When the specified number of premium payments have been made, the insurance is fully paid for.

- It is like whole life policies in that it is payable only at the death of the insured.

- If the insured should die within the specified period, his beneficiary is entitled to all the proceeds of the policy without any liability for the unpaid premiums.

- Because of the limited number of payments to be made by the insured, the premiums are proportionately higher.

- One which provides coverage only of the insured dies during a limited period.

- It is an insurance for a fixed or a specific term, such as two, five, or ten years.

- If the insured dies within the period specified, the policy is paid to the beneficiary.

- If he survives the period, the contract terminates.

- The premium paid is levied during the specified terms and increases with each renewal term or the amount of the coverage declines, and this is because as a person ages, the risk of death increases.

- The premium is lower than in the case of whole life policies because of the possibility that the insurer may not be obliged to pay anything in proceeds whatsoever if the insured survives the term.

- Insured pays premium for a specified period and should he survive the period, the insurance company pays him the face value of the policy.

- If he should die within the period the insurance company is released from any liability and unless provided in the contract, need not reimburse any part of the premiums paid.

- The terms of which the insurer binds himself to pay a fixed sum to the insured if he survives for a specified period (maturity date stated in the policy), or if he dies within such period, to some other person indicated.

- The premium is higher because the cash value of the policy grow more rapidly.

- This kind of policy differs from the limited payment life policy in that in the case of the latter, the policy is paid only upon the death of the insured.

- The insured stands a chance of being paid the proceeds of the policy while still alive.

- The proceeds on maturity can be paid either in a lump sum or as an annuity.

6.3. Variations in Life Insurance Contracts

a) Whole life plan

- The terms of which the insured is required to pay a certain fixed premium annually or at more frequent intervals throughout life and the beneficiary is entitled to receive payment under the policy only after the death of the insured.

- The ultimate payment of the insurance proceeds is as certain as death itself.

b) Limited payment plan

- The terms of which the premiums are payable only during a limited period of years, usually ten, fifteen, or twenty years.

- It is like whole life policies in that it is payable only at the death of the insured.

- If the insured should die within the specified period, his beneficiary is entitled to all the proceeds of the policy without any liability for the unpaid premiums.

- Because of the limited number of payments to be made by the insured, the premiums are proportionately higher.

- One which provides coverage only of the insured dies during a limited period.

- It is an insurance for a fixed or a specific term, such as two, five, or ten years.

- If the insured dies within the period specified, the policy is paid to the beneficiary.

- If he survives the period, the contract terminates.

- The premium paid is levied during the specified terms and increases with each renewal term or the amount of the coverage declines, and this is because as a person ages, the risk of death increases.

- The premium is lower than in the case of whole life policies because of the possibility that the insurer may not be obliged to pay anything in proceeds whatsoever if the insured survives the term.

- Insured pays premium for a specified period and should he survive the period, the insurance company pays him the face value of the policy.

- If he should die within the period the insurance company is released from any liability and unless provided in the contract, need not reimburse any part of the premiums paid.

- The terms of which the insurer binds himself to pay a fixed sum to the insured if he survives for a specified period (maturity date stated in the policy), or if he dies within such period, to some other person indicated.

- The premium is higher because the cash value of the policy grow more rapidly.

- This kind of policy differs from the limited payment life policy in that in the case of the latter, the policy is paid only upon the death of the insured.

- The insured stands a chance of being paid the proceeds of the policy while still alive.

- The proceeds on maturity can be paid either in a lump sum or as an annuity.

7. Construction / Interpretation of Insurance Contracts

7.1. Where there is Ambiguity or Doubt

- As a general rule, contracts of insurance are to be construed liberally in favor of the insured and strictly against the insurer, resolving all ambiguities against the latter, so as to effect its dominant purpose of indemnity or payment to the insured, especially were a forfeiture is involved.

- An insurance contract should be so interpreted as to carry out the purpose for which the parties entered into the contract.
which is to insure against risk of loss, damage or liability on the part of the insured
- The insurer is under the duty to make its meaning clear if it desires to limit or restrict the
terms of insurance as agreed upon by the parties.
- A policy of insurance which contains exceptions or conditions tending to work a
forfeiture of the policy shall be interpreted most favorably toward those against whom
they are intended to operate and most strictly against the insurance company or the
party for whose benefit they are inserted.
- Where restrictive provisions are open to
two interpretations, that which is most
favorable to the insured is adopted.
- Limitations of liability must be construed in
such a way as to preclude the insurer from
non compliance with its obligations.

7.2. Where Terms are Clear
- The cardinal principle of insurance law of
interpreting insurance contracts favorably
to the insured is applicable only in cases of
doubt, not when the intention of the policy
is clear or the language is sufficiently clear
to convey the meaning of the parties.
- The court is bound to adhere to the
insurance contract as the authentic
expression of the intention of the parties,
and it must be construed and enforced
according to the sense and meaning of the
terms which the parties themselves have
used.
- If such terms are clear and certain, they
must be taken in their plain and ordinary
sense.
- Obligations arising from contracts have the
force of law between the contracting
parties and should be complied with in
good faith.

7.3. Literal or Strict Interpretation

First Quezon City Insurance vs. CA

Facts: Del Rosario fell off a De Dios Marikina
Transportation Co. Inc. bus. Del Rosario was
brought to the hospital and stayed there for 40
days. The cost for the hospitalization amounted
to ₱69,444 while unearned salary due to
confine ment amounted to ₱7,500. Del Rosario
filed a complaint against DMTC and its
insurance company, First Quezon City Insurance Company.

Held: The insurance company’s liability should be
limited to ₱12,000 only. The insurance policy
clearly set forth the maximum limit of First Quezon
City’s liability for damages arising from death or
bodily at ₱12,000 per passenger and its
maximum liability per accident at ₱50,000. This
means that the insurer’s maximum liability for
any single accident will not exceed ₱50K
regardless of the number of the passengers killed
or injured.

Ty vs. First National

Facts: Ty was a mechanic foreman in the
Broadway Cotton Factory. A fire broke out which
totally destroyed the factory. As Ty was fighting
his way out of the factory, he injured his left
hand, causing temporary total disability due to
fractures of his index, middle, and fourth fingers.
He filed a notice of accident and claim to recover
indemnity from First National Surety Co. Inc., pursuant to his insurance policy which
provides: “…the loss of a hand shall mean the
loss by amputation through the bones of the
wrist…” The insurance company rejected Ty’s
claim saying that since there was no severance
by amputation of the hand, the disability suffered
by him was not covered under the policy.

Held: The insurance company is not liable to
indemnify Ty. We cannot go beyond the clear
and express conditions of the insurance policies,
all of which define partial disability as loss of
either hand by “amputation through the bones of
the wrist” There was no amputation in this case.
The agreement contained in the insurance policies is the law between the parties. An
interpretation that would include the mere
fracture of the forearm temporary disability not covered by the policies would certainly be
unwarranted.

Misamis Lumber vs. Capital Inc.

Facts: Misamis Lumber Corporation, insured its
motor car for the amount of ₱14,000. The
insured car, passed over a water whole which the
driver did not see because an oncoming car
did not dim its lights. The car was later towed
and repaired by Morosi Motors at a total cost of
₱302.27. Capital Insurance refused to pay for
the total cost of towage and repairs.

Held: The insurance company is not liable for
the payment of the repairs in excess of ₱150. The
insurance policy stipulated that, if the insured
authorizes the repair, the liability of the
insurer is limited to ₱150. The literal meaning of this stipulation must control, it
being the actual contract, expressly and plainly
provided for in the policy. The policy is also drew
out not only the limits of the insurer’s liability but
also the mechanical that the insured had to follow
to be entitled to full indemnity of repairs. The
option to undertake the repairs is accorded to
the insurance company per paragraph 2. The said
company was deprived of the option because the
insured took it upon itself to have the repairs
made, and only notified the insurer when the
repairs were done. As a consequence, paragraph
4, which limits the company’s liability to ₱150
applies.

Sun Insurance vs. CA

Facts: Tan took from Sun Insurance a property
insurance worth ₱300K to insure his interest in the
electrical supply store of his brother housed in a
building in Iloilo City. Four days after, the
building was burned down including the insured
store. When Tan filed a claim with the insurance
company, the same was denied, after which he
filed a notice of accident and claim to recover
from the insurance company as the insurer of the
damage or liability on the part of the
insured. He filed a notice of accident and claim to recover
indemnity from First National Surety Co. Inc., pursuant to his insurance policy which
provides: “…the loss of a hand shall mean the
loss by amputation through the bones of the
wrist…” The insurance company rejected Ty’s
claim saying that since there was no severance
by amputation of the hand, the disability suffered
by him was not covered under the policy.

Held: The insurance company is not liable to
indemnify Ty. We cannot go beyond the clear
and express conditions of the insurance policies,
all of which define partial disability as loss of
either hand by “amputation through the bones of
the wrist” There was no amputation in this case.
The agreement contained in the insurance policies is the law between the parties. An
interpretation that would include the mere
fracture of the forearm temporary disability not covered by the policies would certainly be
unwarranted.
reconsideration. The words of the provisions in the insurance policy is clear and free from any doubt or ambiguity whatsoever and thus must be taken and understood in its plain, ordinary and popular sense.

Fortune Insurance vs. CA

Facts: An armored car of Producers Bank, while in the process of transferring cash in the sum of 725K, was robbed of the said cash. After an investigation by police authorities, the driver and the guard were charged with Violation of PD 532, the Anti-Highway Robbery Law. Demands were made by the bank upon the insurance company to pay the amount of 725K, but the latter refused to pay as the loss is excluded from the coverage of the insurance policy which reads: “The company shall not be liable under this policy in respect of...any loss caused by any dishonest, fraudulent or criminal acts of persons granted or having unrestricted access to the bank’s money or payroll. When it used the term “employee,” it must have in mind any person who qualifies as such as generally and equivocally understood, or jurisprudentially established in light of the determination of the EA for purposes. It is the effect of the policy constitute the measure of the insurer’s liability. In the absence of statutory prohibition to the contrary, insurance companies have the same rights as individuals to limit their liability and to impose whatever conditions they deem best upon their obligations not inconsistent with public policy.

7.4. Liberal Interpretation: Reasonable Expectations

Fieldman’s Inc. vs. Vda. De Songco

Facts: Songco owned a private jeepney. He was induced by an agent of Fieldmen’s Insurance to apply for a Common Carrier’s Insurance Policy, which is applicable to public utility vehicles. The policy provides: “the company will...subject to the limits of liability and under terms of this policy, indemnify the insured in the event of accident caused by or arising out of the use of motor vehicle against all sums which will become liable to pay in respect of death or bodily injury to any fare-paying passenger.” During the effectivity of the policy, the insured vehicle collided with another car killing Songco’s son and wounding his wife.

Held: Doctrine of estoppel applies. After leading Songco to believe that he could qualify under the common carrier policy and to enter into the contract of insurance paying the premiums due, Fieldmen’s cannot be permitted to change its stand. Also, except for the fact that the victims were not fare-paying passengers, their status as beneficiaries under the policy is recognized. Even assuming there was an ambiguity, ambiguities or obscurities must be strictly interpreted against the party that caused them. This rigid application of the rule of ambiguities has become necessary in view of current business practices.

Malayan Ins. vs. CA

Facts: TKC Marketing Corp. was the owner/consignee of some 3,189.171 metric tons of soya bean meal which was loaded on board the ship MV Al Kaziemah. Said cargo was insured against the risk of loss by Malayan Insurance Corporation. While the vessel was docked in South Africa on September 1989 enroute to Manila, the cargo was arrested and detained it because of a lawsuit on a question of ownership and possession. TKC notified the insurance company of the arrest of the vessel and made a formal claim for the amount of US$916,886.66. Malayan replied that the arrest of the vessel by civil authority was not a peril covered by the policies.

Held: Malayan insurance should be held liable for the payment of the insurance claim. Since what was also excluded in the deleted F.C. & S. Clause was "arrest" occasioned by ordinary judicial process, logically, such "arrest" would now become a covered risk under subsection 1.1 of Section 1 of the Institute War Clauses, regardless of whether or not said "arrest" by civil authorities occurred in a state of war. It has been held that a strained interpretation which is unnatural and forced, as to lead to an absurd conclusion or to render the policy nonsensical, should, by all means, be avoided. Likewise, it must be borne in mind that such contracts are invariably Western Guaranty companies and must be accepted by the insured in the form in which they are written. Exceptions to the general coverage are construed most strongly against the company. Even an express exception in a policy is to be construed against the underwriters by whom the policy is framed, and for whose benefit the exception is introduced.

Western Guaranty vs. CA

Facts: De Dios Transportation Inc. Figured in an accident when it struck Rodriguez who was crossing the pedestrian lane on Airport Road. The driver ignored the stop signal given by a traffic enforcer. Rodriguez was thrown to the ground and hit her head and resulted to her face getting permanently disfigured. De Dios Transportation filed a complaint against Western Guaranty since they were insured by Western under a Master Policy which provided protection against third party liability.

Held: Western Guaranty is liable to pay for the damage caused to the victim including loss of earnings, moral damages and attorney’s fees. The Schedule of Indemnities does not purport to limit or exhaustively enumerate the species of bodily injury to the list found in the Schedule of Indemnities since an accident may result to an injury to internal organs not necessarily to a loss of limb (amputation of the leg, arm, finger, hand) but such injuries are certainly covered by the Master Plan since they constituted bodily injuries. Also, the Schedule of Indemnities also does not purport to restrict the kind of damages that may be paid by the insurer once liability has arisen, under the Liability to Third Party clause, and does not say that the limit is subject to the list indicated in the Schedule of Indemnities. All
other types of damages may be awarded against the insurer once liability is shown to have arisen. A contract of insurance is a contract of adhesion and must be construed strictly against the party which prepared the contract.

Qua Chee Gan vs. Law Union

Facts: This case involved a claim on a fire insurance policy which contained a provision as to the installation of fire hydrants the number of which depended on the height of the external wall perimeter of the bodega that was insured. When it was determined that the bodega should have eleven fire hydrants in the compound as required by the terms of the policy, instead of only two that it had, the claim under the policy was resisted on that ground.

Held: The said deviation from the terms of the policy did not prevent the claim under the same. We are in agreement with the trial Court that the appellant is barred by waiver (or rather estoppel) to claim violation of the so called fire hydrants warranty, for the reason that knowing fully that the number of hydrants demanded therein never existed from the very beginning, the appellant nevertheless issued the policies in question subject to such warranty, and received the corresponding premiums. It would be perilously close to conniving at fraud upon the insured to allow the appellant to claim now as void ab initio the policies that it had issued to the plaintiff without warning of their fatal defect, of which it was informed, and after it had misled the defendant Tri into believing that the policies were effective. When the policy contains a condition which renders it voidable at its inception, and this result is known to the insurer, it will be presumed to have intended to waive the conditions and to execute a binding contract, rather than to have deceived the insured into thinking he is insured when he is not, and to have taken his money without consideration. The insurance company is liable on the insurance contract.

Del Rosario vs. Equitable Insurance

Facts: The insurer has bound itself under the policy to pay P1,000-3,000 as indemnity for the death of the insured for bodily injury, the policy containing specific amounts that may be recovered. The policy, however, does not positively state any definitive amount that may be recoverable in case of death by drowning, although it is a ground for recovery apart from death for bodily injury.

Held: The ambiguity in this respect in the policy, which ambiguity must be interpreted in favor of the insured and strictly against the insurer to allow a greater indemnity, that is, P3,000.

Geagonia vs. CA

Facts: Geagonia is the owner of Norman’s Mart located in the public market of San Francisco, Agusan del Sur. He obtained from the private respondent, Country Bankers Insurance Corporation. The policy contained the following condition: “…3. The insured shall give notice to the Company of any insurance or insurances already effected, or which may subsequently be effected, covering any of the property or properties consisting of stocks in trade...” Fire of accidental origin broke out at the public market of San Francisco, Agusan del Sur. Geagonia’s insured stocks-in-trade were completely destroyed prompting him to file with CBIC a claim under the policy. The company denied the claim and the basis of which was the insurer’s alleged violation of Condition 3 of the policy.

Held: Geagonia is not precluded from recovering from Country Bankers. Condition 3 of the policy is a condition which is not proscribed by law. Its incorporation in the policy is allowed by Section 75 of the Insurance Code which provides that “[a] policy may declare that a violation of specified provisions thereof shall avoid it, otherwise the breach of an immaterial provision does not avoid the policy.” Its violation would thus avoid the policy. However, in order to constitute a violation, the other insurance must be upon the same subject matter, the same interest therein, and the same risk. As to a mortgaged property, the mortgagor and the mortgagee have each an independent insurable interest therein and both interests may be covered by one policy, or each may take out a separate policy covering his interest, either at the same or at separate times. It is a cardinal principle of law that forfeitures are not favored and that any construction which would avoid the forfeiture of the policy benefits for the person claiming, will be avoided, if it is possible to construe the policy in a manner which would permit recovery, as, for example, by finding a waiver for such forfeiture. Provisions, conditions or exceptions in policies which tend to work a forfeiture of policies which would construe most strictly against those for whose benefits they are inserted, and most favorably toward those against whom they are intended to operate.

Sun Insurance vs. CA

Facts: Sun Insurance issued a Personal Accident Policy to Lim with a face value of 200K. Two months later he was dead with a bullet wound on his head. Lim’s death was caused when he was playing with his handgun which accidentally fired. His wife sought payment on the policy but her claim was rejected. The contention of Sun Insurance was that Lim willfully exposed himself to needless peril and thus removed himself from the coverage of the insurance policy. Under the exceptions clause of the policy, the insurance company shall not be liable when the insured person attempting to commit suicide or willfully exposing himself to needless peril except in an attempt to save human life.

Held: The cause of Lim’s death was an accident within the limits set forth in the policy and therefore not exempt from the liability of the insurer. The definition of an accident is “an event which happens without any human agency or, if happening through human agency, an event which under the circumstances, is unusual to and not expected by the person to whom it happens...” Contrary to the contention of Sun Insurance, Lim did not intentionally expose himself to danger, as testified by his secretary, he removed the magazine of the gun to ensure that it would not fire and pointed it to his temple in the belief that it is safe to do so.
Rizal Surety vs. CA

Facts: Rizal Surety issued a fire insurance policy for Transworld Knitting Mills. A fire broke out in the compound of Transworld, razing the middle portion of the four-span building and partly gutting the left and right sections. It also destroyed the two-storey annex building where fun and amusement machines and spare parts were stored. Transworld filed insurance claim with Rizal but to no avail. Rizal’s contention is that the policy covered only the contents of the four-span building which was only partly burned and not the damage caused to the two-storey annex building.

Held: The annex building and the contents are covered under the policy. The so called “annex” formed an integral and inseparable part of the four-span building. It was a [permanent structure which] adjoined the 4-storey building described in the policy and consequently, the things stored therein were covered by the insurer. Considering that the annex was already existing when the insurance policy was contracted, Rizal should have specifically excluded it from the coverage of the fire insurance if it wanted to but it did not. Doubt should be resolved against Rizal who drafted the insurance contract. This is because the insured usually has no voice in the selection or arrangement of the words employed and that the language of the contract is selected with great care and deliberation by experts and legal advisers employed by, and acting exclusively in the interest of the insurance companies.

Gulf Resorts vs Philippine Charter Insurance Corporation (2005)

Intention of parties is shown by provisions of contracts and the amount of premium paid since premium is the consideration paid for the risk undertaken by the insurer. What then, is an apparent change of the wording of an insurance contract but no corresponding change in the amount of premium paid, it will be interpreted to mean that there was no intended change at all. An assumption of additional risk is presumed to cause a commensurate additional premium because the premium, not the mere wording of the policy, is a more accurate indication of such an assumption of additional risk.

8. Perfection of the Contract of Insurance

8.1. Offer and Acceptance; consensualy

- Applicant usually makes the offer to the insurer.
- Submission of application, even w/o payment is a mere offer on the part of the applicant, it does not bind the insurer.
- Approval of the application by the insurer is necessary to perfect contract. If made:
  - w/ payment of premium – policy becomes effective
  - w/o payment – effective upon payment of premium

i. Delay in Acceptance; Tort Theory

- Situation where applicant submits application for insurance, but due to negligence of company, w/c takes an unreasonably long time before processing the application, the applicant dies before the application is processed, thus, the contract is not perfected.

- REMEDY: Insurer liable for damages (Tort Theory) in the amount of the face value of the policy, w/c is given to the estate of the deceased applicant. (not to beneficiary because contract not perfected. Also, no contractual liability also bec. no contact)

- Why Tort Theory - because Insurance business is affected w/ public interest. It is thus, the duty of insurer, w/o denials its authority to act as soon as the State (when it applies to get license to be in the insurance business), to act w/ reasonable promptness in either rejecting or accepting the application. In case of unreasonable delay and applicant dies, applicant would have been denied of opportunity to secure insurance from another source.

ii. Delivery of the Policy

- Delivery – the act of putting the insurance policy – the physical document – into the possession of the insured.

- Individual life insurance contracts usually stipulate that:
  » Premium be paid and
  » Policy be delivered to the insured while he is alive and in good health. Concurrence of both is necessary. (see Perez v CA case)

- Actual delivery of the policy is not essential unless the parties have so agreed in clear language. Constructive delivery may be sufficient. (See Vda. De Sindayen case)

- Won Policy was delivered after its issuance depends not upon manual possession by the insured but rather upon the intention of the parties as manifested in their acts or agreements.

- Won Delivery to agent is delivery to insured is a question over w/c there has been many conflicting opinions.

- Effect of Delivery:
  » Where delivery is conditional – Non-performance of Condition precedent prevents contract from taking effect
  » Where delivery is unconditional – if corresponding terms of application, ordinarily consummates the contract and policy as delivered becomes final contract between the parties. Where parties so intend, insurance becomes effective at the same time as delivery
  » Where premium still unpaid after unconditional delivery - Policy will lapse if premium unpaid at time and manner specified in the policy, in the absence of any clear agreement that insurer will extend credit. Insurer cannot be presumed to have extended credit from the mere fact of unconditional delivery of the policy w/o prepayment of premium, and even if such presumption may be inferred, there must be a clear and express
acceptance by insured of the insurer’s offer to extend credit.

Perez v CA

Facts: Perez, already previously insured with BF Lifeman Insurance Co. applied for additional coverage. He paid premium and was issued a receipt by the agent of BF Lifeman. However, he died before his application papers were transmitted to the head office of BF Lifeman.

Issue: WON the insurance policy was perfected
Held: No. There was no acceptance of the offer. The perfection of the contract was conditional upon compliance with the provision in the application form w/c stated that perfection only lies when the applicant pays the premium and receives and accepts the policy while still in good health. Thus, the assent of BF Life was not given when it merely received the application form of Perez in its provincial office. Also, delivery to Perez would be impossible as he is already dead. So long as an application for insurance has not been accepted or rejected by the insurer, it is merely an offer or proposal to make a contract. The contract to be binding from date of application must have been a completed contract that leaves nothing to be done, passed upon or determined, before it shall take effect...


FACTS Dec. 1932 Arturo Sindayen had partially paid his agent the first premium for a life insurance policy. Agent and Sindayen agreed that policy, when and if issued, would be paid to Sindayen’s aunt who will complete the payment of the first annual premium. Jan. 16, 1933 – agent received approved policy and delivered it to Sindayen’s aunt on Jan. 18. However, before the policy was given to Arturo himself, he died on Jan. 19.

ISSUE: WON Insular Life assumed the risk covered by Sindayen’s policy
HELD: YES. Delivery to the insured in person is not necessary, and may be made by mail or duly constituted agent (in this case, Sindayen’s aunt). Insurance company is bound by the acts of its agent. In this case, the agent is not a mere automaton and is vested w/ some discretion in deciding whether or not an application is accepted. This assumption is inconsistent w/ the next sentence w/c says that no policy can be binding w/o premium payment.

Enriquez v Sun Life Assurance Co.

Facts: Herrer applied for insurance and paid the premium, however, he died before he received the notice of acceptance (of his application) sent by Sun Life from its Montreal head office.

Issue: WON the insurance contract was perfected w/o the notice of acceptance coming to the knowledge of the applicant
Held: NO. Under the CC, Consent is shown by the concurrence of offer and acceptance. An acceptance shall not bind the person making the offer except from the time it came to his knowledge.

8.2. Premium Payment
Sec. 77 &78; 64

- Premium – the agreed price for assuming and carrying the risk, that is, the consideration paid an insurer for undertaking to indemnify the insured against the specified peril.
- if only one premium is paid for several things not separately valued or separately insured, the contract is indivisible or entire, not divisible or severable, as to items insured.
- SIR: WORST SECTION of the Insurance Code. This is the cash-and-carry provision (see below for explanation why)
- Why it raises several questions (Campos): -- Is it intended to apply to all classes of insurance, or does the word “thing” limit it to property insurance? As to exception, it only applies to non-life policies w/in the grace period w/c does not support the theory that it applies only to property insurance.
- As to grace period, grace period in life insurance applies only to premiums subsequent to the first, therefore, how can this be an exception to the rule?
- With respect to non-life insurance, the first sentence gives the insurer the right to demand the payment of the premium as soon as the “thing insured is exposed to peril insured against” This assumes the contract is binding even before the payment of the premium meaning the contract is perfected when the applicant’s offer is accepted by the insurer. This assumption is inconsistent w/ the next sentence w/c says that no policy can be binding w/o premium payment.
- Also, Sec. 77 and 78 seem contradictory.
- However, Sir says above does not apply to life insurance because Life Insurance lapses upon non-payment.
- Present provision came from Sec 72 of the old Insurance Code. However, Sec. 77 has omitted the portion of Sec. 72 w/c permitted credit extension of the premium due (meaning, extension of period to pay the premium). Apparently, the intention is to put the contract of insurance on a “cash-and-carry basis” meaning the premium must be paid in cash as a condition precedent for a non-life insurance policy to be valid and binding, and an agreement to grant the insured credit extension of the premium is void. However, Makati Tuscan v CA and the second UCPB case says otherwise. Hence, credit extension agreements may be valid.

- EXCEPTIONS to Sec. 77:

12 This was asked 2006, 1978, and 1977. Note the effects of non-payment of premiums.
In the case of a life or an industrial policy whenever the grace period provision applies (Sec. 77)
- Article 78 (see below)
- Agreement to grant the insured credit extension for the payment of the premium
- When there is an agreement allowing the insured to pay premium in installment and partial payment has been made at the time of the loss (See Makati Tuscany v CA)

BPI vs. Posadas, 56 Phil. 215
If the premiums are paid out of the conjugal funds, the proceeds are considered conjugal. If the beneficiary is other than the insured’s estate, the source of premiums would not be relevant.

Philippine Pryce Assurance Corp. vs. CA, 230 SCRA 164 (1994)
Generally, premium is also necessary in order for the contract of suretyship or bond to be binding. However, where the obligor has accepted the bond, it is binding even if the premium has not been paid subject to the right of the insurer to recover the premium from its principal.

Sec. 78 An acknowledgment in a policy or contract of insurance of receipt of premium is conclusive evidence of its payment, so far as to make the policy binding, notwithstanding any stipulation therein that it shall not be binding until the premium is actually paid.

- Effect of acknowledgment of receipt of premium in property – Insurer cannot deny the truth of the receipt of the premium even if it is unpaid.
- Law established a legal fiction of payment (prima facie evidence of payment). Thus insurer presumed to have waived the condition of prepayment.
- SC has decided that above is an exception to Sec. 77

Sec. 64 No policy of insurance other than life shall be cancelled by the insurer except upon prior notice thereof to the insured, and no notice of cancellation shall be effective unless it is based on the occurrence, after the effective date of the policy, of one or more of the following:
- (a) non-payment of premium;
- (b) conviction of a crime arising out of acts increasing the hazard insured against;
- (c) discovery of fraud or material misrepresentation
- (d) discovery of willful or reckless acts or omissions increasing the hazard insured against;
- (e) physical changes in the property insured which result in the property becoming uninsurable; or
- (f) a determination by the Commissioner that the continuation of the policy would violate or would place the insurer in violation of this Code

- Cancellation – right to rescind, abandon or cancel a contract of insurance, termination of policy before its expiration.
- Premium referred to in 64(a) refers to payment “after effective date of the policy” because Sec. 77 ordains that insurance policy is valid and binding unless and until premium has been paid.
- Conditions under w/c above exercised:
  - Prior notice of cancellation to insured
  - Notice must be based on the occurrence, after the effective date of the policy, of one or more of the grounds mentioned
  - It must be in writing, mailed or delivered to the named insured at the address shown in the policy. In this regard, proof of actual receipt of the notice is necessary for it to take effect; mere proof that the insurer mailed the notice is not sufficient to effect the cancellation.
  - It must state w/c of the ground set forth is relied upon
  - It is the duty of the insurer upon written request of the insured to furnish the facts in which the cancellation is based.

- If there was no premium paid at all, the action appropriate would be a declaration of nullity, based on Section 77 which provides that “no policy or contract of insurance issued by an insurance company is valid and binding unless and until the premium thereof has been paid”.

Tibay v CA

Facts: Fortune Life issued a fire insurance policy in favor of Tibay on a bldg in Makati, together w/ all their personal effects therein. Tibay paid part of the total premium. 2 mos. Afer, a fire completely destroyed the bldg. 2 days after the fire, Tibay paid the balance of the premium. Fortune denied Tibay’s claim for violation of Sec 77 of Insurance Code.

Issue: WON a fire insurance policy is already valid, binding and enforceable upon mere partial payment of premium

Held: NO Sec. 77 applies. Since acceptance of partial payment is not mentioned among the exceptions provided in Sec 77 and 78 of the Insurance Code, no policy of insurance can ever pretend to be efficacious until premium has been fully paid.

Dissent: (IMPT) The insurance coverage should become effective from the day that the partial payment is accepted by the insurer, any stipulation in the policy to the contrary notwithstanding. Partial payment is enough to establish the juridical relation between the two parties. The law does not require a specific amount of premium payment in order to create the juridical tie.

- If the contract is automatically cancelled upon the non-payment in full by the insured, then the efficacy of the contract will be fully dependent on his will. This violates the principle of mutuality of contracts.
Makati Tuscany v CA

Facts: American Home Assurance (AHAC) issued in favor or Makati Tuscany an insurance policy on the latter’s bldgs for 1 year. It was renewed over the course of 3 years. In 1982, the total premiums were paid in 4 installments but in 1983, Tuscany paid only 2 installments and refused to pay the remaining balance. Reason for discontinuation: policy contained a reservation wherein “Acceptance of payment by AHAC will not waive any of the company rights to deny liability on any claim under the policy arising before such payments or after the expiration of the credit clause of the policy, and Subject to no loss prior to premium payment. If there be any loss, such is not covered.” AHAC filed a suit to recover the remaining balance. Makati Tuscany filed counterclaim for the total amount of premiums it had paid during the previous years.

Issue: Will payment by installment of premiums due on an insurance policy invalidates the contract of insurance

Held: NO The policies are valid even if the premiums paid in installments because the records clearly show that the two parties intended the policies to be binding and effective notwithstanding the staggered payment of the premium payments over the period of 3 years speak loudly of intention of insurer to honor the policies it issued to Makati Tuscany.

- Sec 77 merely prohibits the parties from stipulating that the policy is valid even if premiums were not paid, but it does not expressly prohibit an agreement granting credit extensions. Sec. 78 also allows the insurer to waive the condition of full payment by acknowledging in the policy that there has been receipt of premium despite the fact that premium is actually unpaid. If the Code allows a waiver when no actual payment has been made, then a waiver should be allowed in this case where the insurer has already acknowledged receipt of partial payment.

NOTE: Difference with Tibay case: In Tibay, there was an express stipulation w/c said that payment shall be made in full. In this case, the policy was binding because of the prior agreement to allow installment payments, hence full payment under Sec.77 deemed waived.

UCPB Gen. Ins. v Masagana Telemart

Facts: Masagan Telemart obtained insurance policies on its properties from UCPB. The policies had the effectivity term of May 1991 - May 1992. On June 1992, Masagan’s properties were razed by a fire. On the same day, Masagana tendered, and UCPB accepted renewal premium payments. The next day, Masagana filed a claim for the burned insured bldgs. UCPB rejected the claims on the ground that the policies expired on May 1992 and were not renewed for another term and that the fire took place before the tender of premium payment under the renewed policy.

(Note: This is a motion for reconsideration from previous SC decision declaring that there was no renewal of the policy and that UCPB not liable)

Issue: WON Sec 77 of the Insurance Code must be strictly applied despite its practice of granting a 60-90 day credit term for payment of premium

Held: NO There are exceptions to Sec 77:

a.) The first is provided by Sec. 77 itself and that is, in case of a life or industrial life policy whenever the grace period applies

b.) Sec 78: An acknowledgment in a policy or contract of insurance of the receipt of premium is conclusive evidence of its payment, so far as to make the policy binding, notwithstanding any stipulation therein that it shall not be binding until premium is actually paid.

c.) Sec. 77 may not apply if the parties have agreed to the payment in installments of the premium and partial payment has been made at the time of the loss.

d.) The insurer may grant credit extension for the payment of the premium

e.) It would be unjust and inequitable if recovery on the policy would not be permitted against UCPB, w/c consistently granted the 60-90 day credit term for the payment of the premiums despite its full awareness of Sec. 77. Estoppel bars it from taking refuge under the action, since Masagana relied on good faith on such a practice

Dissent (Vitug):

- Estoppel cannot create a contract of insurance neither can it be invoked to create a PRIMARY LIABILITY. So essential is the premium payment to the creation of the vinculum juris that it would be doubtful to have that payment validly excused even for a fortuitous event

Dissent (Pardo):

- Masagana tried to pay the overdue premiums before giving written notice that a fire has razed the property. This shows the fraudulent character of the claim. Failure to give notice is was a material misrepresentation affecting the risk insured against.

- Estoppel cannot give validity to an act that is prohibited by law or against public policy. Actual payment of premiums is a condition precedent to the validity of an insurance contract other than the insurance policy. Any agreement to the contrary is VOID as against the law and public policy.
8.3. Premium default in life insurance (Sec 227, h & j): options; lapsed policy

Sec. 227 In the case of individual life or endowment insurance, the policy shall contain in substance the following conditions: x x x

(h) A table showing in figures cash surrender values and paid-up options available under the policy each year upon default in premium payments, during at least twenty years of the policy beginning with the year in which the values and options first become available, together with a provision that in the event of the failure of the policy-holder to elect one of the said options within the time specified in the policy, one of the said options shall automatically take effect and no policyholder shall ever forfeit his right to same by reason of his failure to so elect.

x x x x x x x x x x x x x x x

(j) A provision that the policy shall be entitled to have the policy reinstated at any time within 3 years from the date of default of premium payment unless the cash surrender value has been duly paid, or the extension period has expired, upon production of evidence of insurability satisfactory to the company and upon payment of all overdue premiums and any indebtedness to the company upon said policy, with interest rate not exceeding that which would have been applicable to said premiums and indebtedness in the policy years prior to reinstatement x x x

NON-LIFE

• (Refer to Sec.77) Seems to say that policy is in effect as soon as the thing is exposed to risk even if the premium has not been paid yet.
• Where contract covers a period of 1 year, there would normally be only one premium payment for the period.
• If parties agreed to pay in installments, and there is a failure to pay any installment when it falls due insurer may:
  - cancel policy after due notice
  - compel the payment of installments

LIFE

• Intended to be in force for a period longer than a year; involves several periodical premium payments (annual, semi-annual, etc)
• Contract not binding until first periodical premium payment. After first payment, insured under no legal obligation to pay subsequent premium.
• Insurance Code grants grace period within which to pay subsequent premiums. If policy becomes a claim during the grace period but before overdue premium is paid, overdue may be deducted from proceeds of policy.
• Failure to pay w/in grace period = automatic lapse
• Exception: Insured has paid three full annual premiums. Entitled to the following Options upon default:
  » Cash Surrender Value
    - The amount the insured, in case of default, after the payment of at least 3 full annual premiums, is entitled to receive if he surrenders the policy and releases his claims upon it. It is the portion of reserve on a life policy.
    - Nature of CSV: Premium is uniform throughout lifetime of policy, so during the earlier years of the policy, the premium charges will be more than the actual cost of the protection against the risk in order to meet the higher cost of risk during the latter years of the policy when the insured is older. Reserve Value = Surrender Charge = Cash Surrender Value
  - The more premiums he has paid, the greater will be the CSV but the value is always a lesser sum than the total amt of premiums paid.
  - CSV is the amount company holds in trust for insured deliverable upon demand. So long as the policy remains in force, the company has practically no beneficial interest in it except as its custodian; this is the practical, though not the legal, relation of the company to this fund.
  • EFFECT: Surrender policy; terminates contract of insurance
    » Extended Insurance
      • EFFECT: Policy continues in force from date of default, for a period either stated or equal to the amount of the cash surrender value, taken as a single premium, will purchase; the insured is given the right, upon default, after the payment of at least three full annual premiums to have the policy continued in force from the date of default for a time either stated or equal to the amount as the net value of the policy taken as a single premium, will purchase Also called “term insurance”, “temporary insurance” or “paid-up extended insurance”
      - Depends on availability of CSV.
      - During extended period: If insured dies, beneficiary can recover face amount of policy. Insured can also reinstate the policy w/in this period.
      - Beyond extended period: If he survives No benefits. He cannot even reinstate the policy by paying past premiums; has to purchase new policy
      • Better option if insured not in good health or geriatric
  » Paid-up Insurance
    • Amount of Insurance that the CSV, applied as a single premium, can purchase.
    • EFFECT: Policy continues in force from date of default for the whole period and under the same conditions of the original contract w/o further payment of premiums. However, in case of death of insured, he may recover only the “paid-up” value of the policy w/c is much less than the original amount agreed upon. (In other words, na-reduce yung original insurance contract to one with a lower value)
    • Better option if insured is still young and in good health because unlike extended insurance, he may later reinstate policy if he wishes.
    » Automatic Premium Loan
      • Upon default, insurer lends/advances to the insured without any need of application on his part, amount necessary to pay overdue premium, but not to exceed the CSV of the policy.
Only applies if requested in writing by the insured either in the application or at any time before the expiration of the grace period.

**EFFECT:** Insurance continues in force for period covered by the payment. After period, if insured still does not resume paying his premiums, policy lapses, unless there remains CSV. 

- If there is still CSV, auto premium loan continues until it is exhausted.
- Advantageous to the insured because it helps to continue the contract and all its features in full force and effect.
- Insured under no legal obligation to repay “loan”

**Reinstatement (Sec j)**

- **EFFECT:** Does not create a new contract, merely REVIVES the old policy. Thus, insurer cannot require higher premium than amount stipulated in the contract.
- Required by Insurance Code for every individual and industrial life policy
- Not required that 3 annual premiums have been paid
- **REQUISITES:**
  - exercised **w/in 3 years** from default
  - insured must present evidence of insurability satisfactory to the company
  - pay all back premiums and all his indebtedness to the insurance company
  - CSV has not been duly paid nor the extension period expired

**Insurability –** does not mean that insured is in good health. Other factors affect insurability like nature of work, age, etc.

Application for reinstatement must be filed during the insured’s lifetime.

**Other Effect:**

- **Forfeiture –** Absolute forfeiture of all insured rights. Generally not favored. Due to liberal spirit in the conduct of life insurance, insurers instead, give the insured the benefit of the reserve value of the policy.

### 8.4. Form and contents of policy

**Sec. 49** The written instrument in which a contract of insurance is set forth is called a policy insurance.

**Sec. 50** The policy shall be in printed form which may contain blank spaces; and any word, phrase, clause, mark, sign, symbol, signature, number, or word necessary to complete the contract of insurance shall be written on the blank spaces provided therein.

Any rider, clause, warranty, or endorsement purporting to be part of the contract of insurance and which is pasted or attached to said policy is not binding on the insured, unless the descriptive title or name of the rider, clause, warranty, or endorsement is also mentioned and written on the blank spaces provided in the policy.

Unless applied for by the insured or owner, any rider, clause, warranty or endorsement issued after the original policy shall be countersigned by the insured or owner, which countersignature shall be taken as his agreement to the contents of such rider, clause, warranty, or endorsement.

Group insurance and group annuity policies, however, may be typewritten and need not be in printed form.

### Sec 51. A policy of insurance must specify:

(a) The **parties** between whom the contract is made;
(b) The **amount** to be insured except in the cases of open or running policies;
(c) The **premium**, or if the insurance is of a character where the exact premium is only determinable upon the termination of the contract, a statement of the basis and rates upon which the final premium is to be determined;
(d) The **property or life insured**;
(e) The **interest** of the insured in property insured, if he is not he absolute owner thereof;
(f) The **risks** insured against; and
(g) The **period** during which the insurance is to continue.

- The Insurance Code does not require a particular form for the validity of the contract. However, the policy must contain the enumeration in Art. 51 (see above)
- The policy is different from the contract itself.
- **Policy –** written instrument embodying the terms and stipulations of a contract of insurance. Not essential to the validity of the contract as long as all the essential elements for the existence of contract are present. (Consent, object, consideration, competent parties)
- Other stipulations not required by law may be included as long as they are not prohibited or inconsistent with the law.
- Missing provisions required does not void policy. Missing provisions will be read into the policy and will substitute those w/c are in conflict w/ the law.
- Stipulations not in the exact terms of the statute, if more favorable to the insured, will be enforced.
- SIR (on oral contracts): In some jurisdictions of the US, oral contract is valid, provided that all the terms are agreed upon. In our Insurance Code, although written form not required for validity, some provisions say that a PRINTED POLICY is best evidence of contract. SC has not ruled categorically on this matter.
- The following are required to appear in insurance policies:
  - The **policy**, which must be in printed form (except group insurance policies which may be typewritten), may contain blank spaces; any word, phrase, clause, mark, sign, symbol, signature, number, or word necessary to complete the contract of insurance shall be written on the blank spaces provided.
  - Any rider, clause, warranty, or endorsement may only be deemed part of the insurance policy if, after having been attached to the policy itself, its descriptive title or name is also
mentioned and written in the blank spaces in the policy.

- Required clauses in the policy:
  - The parties between whom the contract is made;
  - The amount to be insured except in the cases of open or running policies;
  - The premium, or if the insurance is of a character where the exact premium is only determinable upon the termination of the contract, a statement of the basis and rates upon which the final premium is to be determined;
  - The property or life insured;
  - The interest of the insured in property insured, if he is not the absolute owner thereof;
  - The risks insured against; and
  - The period during which the insurance is to continue.

- Express warranties must also be contained in the policy, or in another instrument signed by the insured and referred to in the policy as making a part of it.

i. Riders, clauses, endorsements

- If parties wish to include special stipulations, may attach riders, endorsements, warranties.
- **Rider** – a printed or typed stipulation contained on a slip of paper attached to the policy and forming an integral part of the policy.

  - **To be binding:**
    - Must be attached/pasted to the policy
    - Descriptive title or name of the rider, clause, warranty, or endorsement is mentioned and written on the blank spaces provided in the policy.
    - Countersignature by insured

  - **Rule:** Not necessary if rider attached to the policy when issued.

  - **Exception:** Necessary when added AFTER policy is issued. REASON: To prevent an insurer from adding or inserting provisions w/o the consent of the insured.

- In case of conflict between rider and printed stipulation, the rider prevails as being a more deliberate expression of the agreement of the contracting parties.

- **Warranty** – inserted or attached to a policy to eliminate specific potential increases of hazard during the policy term owing to: 1) actions of the insured or 2) condition of the property.

- **Clause** – an agreement between the insurer and the insured on certain matters relating to the liability of the insurer in case of loss.

- **Endorsement** – any provision added to an insurance contract altering its scope or application. Ex. Endorsements extending the perils covered. Most times, they are merely typewritten additions to the contract, changing its amount, rate, or term.

ii. Cover Notes or binding receipts

Sec 52. Cover notes may be issued to bind insurance temporarily pending the issuance of the policy. Within sixty days after issue of a cover note, a policy shall be issued in lieu thereof, including within its terms the identical insurance bound under the cover note and the premium therefor.

Cover notes may be extended or renewed beyond such sixty days with the written approval of the Commissioner if he determines that such extension is not contrary to and is not for the purpose of violating any provisions of this Code. The Commissioner may promulgate rules and regulations governing such violation and may be such rules and regulations dispense with the requirement of written approval by him in the case of extension in compliance with such rules and regulations (n)

- Cover notes/Binders – a written memorandum of the most important items of a preliminary contract intended to give temporary protection (to insured) pending the investigation of the risk by the insurer, or until the issue of the formal policy, provided it is later determined that the applicant was insurable at the time it was given.

- It is a binding contract and has full force and effect during its duration.

- Insurer not obliged to give cover notes but many do so in order to gain goodwill.

- Usually contain only the bare essentials of an insurance contract: i.e. the name of the parties, risks insured against, amount of insurance, premium, property/life insured.

- Issuance of cover notes is ordinarily a conclusive evidence of making a contract.

- The issuance and effectivity of cover notes are governed by the following rules:
  1) **May be issued temporarily, pending issuance of policy**
  2) **Deemed a contract of insurance within meaning of §(1)**
  3) **No cover note may be issued or renewed unless in the Code’s previously prescribed form**

  - **4) Cover notes are valid and binding for a period not over 60 days from date of issuance.** Whether or not premium therefor has been paid, but it may only be cancelled by either party upon least 7 days notice to other party

  - **5) If it is not cancelled, policy shall, within 60 days after issuance of cover note, be issued in lieu thereof.** Policy will include, within its terms the identical insurance bond under the cover note and the premium therefor

  - **6) Cover note may be extended or renewed beyond the 60-day period with the written approval of the Insurance Commission, provided that the written approval may be dispensed with upon the certificate of the Pres, VP, or general manager of the company that the risks involved, the values of such risks and/or premiums therefor have not as yet been determined or established and that such extension or renewal is not contrary to and is not for the purpose of violating any provisions of the Insurance Code, or of any of the rulings, instructions, circulars,
orders or decisions of the Insurance Commissioner
7) Companies may impose on cover notes a deposit premium equivalent to at least 25% of the estimated premium of the intended insurance coverage but never less than 500 pesos.

iii. Open and Valued Policies (non-life)

**Sec 59.** A policy is either open, valued or running.

**Sec 60.** An open policy is one in which the value of the thing insured is not agreed upon, but is left to be ascertained in case of loss.

**Sec 61.** A valued policy is one which expresses on its face an agreement that the thing insured shall be valued at a specified sum.

**Sec. 62.** A running policy is one which contemplates successive insurances, and which provides that the object of the policy may be from time to time defined, especially as to the subjects of insurance, by additional statements or indorsements.

8.5. Kinds of insurance policies:

- **Open or Unvalued Policy**
  - One in which a certain agree sum is written on the face of the policy not as the value of the property insured, but as the maximum limit of the insurer’s liability (i.e. face value) in case of destruction by the peril insured against.
  - Insurer only pays the actual cash value of the property as determined at the time of loss.

- **Valued Policy**
  - One in which the parties expressly agree on the value of the subject matter of the insurance.
  - Two values:
    1) Face value of the policy w/c is the max amt insurer pays in case of loss
    2) Value of the thing insured
  - In the absence of fraud or mistake, the agreed value of the thing insured will be paid in case of total loss of the property, unless the insurance is for a lower amount.
  - In case of loss, parties may claim that value of insured property is more or less than agreed upon.
  - The liability of the insurer in a life policy is measured by the face value of the policy (because the value of a human life cannot be measured in actual monetary terms).

- **Running Policy**
  - Intended to provide indemnity for property w/c cannot well be covered by a valued policy because of its frequent change of location and quantity, or for property of such a nature as not to admit of a gross valuation. Also denotes insurance over a class of property rather than any particular thing. Ex. Insurance over constantly changing stock of goods.
  - In reality, these are open policies.
  - Contemplates successive insurances.
  - Advantages of a running policy
    1) *Neither underinsured nor overinsured* at any time, premium being based on monthly values reported.
    2) Avoids cancellations otherwise necessary to keep insurance adjusted to the thing’s value at each location and for which cancellations the insured would be charged the expensive short rate;
    3) Saves trouble of watching the insurance and danger of being underinsured in spite of care, through oversight or mistake;
    4) Rate is adjusted to 100% insurance, whereas valued policies requiring insurance only up to, say 80% of value, give either a small, if any, reduction for amounts of insurance above this figure.

9. Parties

Essential Requisites for a person to be a party in an insurance contract:
- Must be COMPETENT to enter (has capacity)
- Must possess INSURABLE INTEREST
- Must NOT be a PUBLIC ENEMY

9.1. Insurer

**Sec 6.** Every person, partnership, association, or corporation duly authorized to transact insurance business as elsewhere provided in this Code, may be an insurer. (a)

**Sec 184** For purposes of this Code, the term "insurer" or "insurance company" shall include all individuals, partnerships, associations, or corporations, including government-owned or controlled corporations or entities, engaged as principals in the insurance business, excepting mutual benefit associations. Unless the context otherwise requires, the term shall also include professional reinsurers, defined in Section 280. "Domestic company" shall include companies formed, organized or existing under the laws of the Philippines. "Foreign company" when used without limitation shall include companies formed, organized, or existing under any laws other than those in the Philippines.

**Sec 185** Corporations formed or organized to save any person or persons or other corporations harmless from loss, damage, or liability arising from any unknown or future or contingent event, or to indemnify or to compensate any person or persons or other corporations for any such loss, damage, or liability, or to guarantee the performance of or compliance with contractual obligations or the payment of debts or others shall be known as “insurance corporations”.

The provisions of the Corporation Law (BP Blg 68) shall apply to all insurance corporations now or hereafter engaged in business in the Philippines insofar as they do not conflict with the provisions of this Chapter.

- **Insurer** – party who assumes or accepts the risk of loss and undertakes for a consideration to indemnify the insured or to pay him a certain sum on the happening of a specified contingency or event; This can be an

13 Who is a public enemy and the prohibition was asked in 2002.
individual, a corporation, an association, even the State, as long as it is authorized to engage in a business of insurance.

- Summary of 184 and 185:
  184: What term "insurer" includes
  185: What “Insurance Corporations” are regulated by the State: To engage in the business of insurance, required to get certificate of authority from the Insurance Commissioner, and must possess sufficient capital assets. (Will not include other requirements, medyo technical. We only need to know defn of insurer and insurance corporations): Banking institutions are not allowed to engage in insurance business (General Banking Act 173)

9.2. Insured

**Sec. 7** Anyone except a public enemy must be insured

**Sec. 56** When the description of the insured in a policy is so general that it may comprehend any person or any class of persons, only he who can show that it was intended to include him can claim the benefit under the policy.

RA 6809 - Lowered the age of EMANCIPATION AND AGE OF MAJORITY

Art. 234. Emancipation takes place by the attainment of majority. Unless otherwise provided, majority commences at the age of eighteen years. (as amended by RA 6809)

Art. 236. Emancipation for any cause shall terminate parental authority over the person and property of the child who shall then be qualified and responsible for all acts of civil life, save the exceptions established by existing laws in special cases. x x x (as amended by RA 6809)

**Art. 110 (Family Code)** The spouses retain the ownership, possession, administration and enjoyment of their exclusive properties.

Either spouse may, during the marriage, transfer the administration of his or her exclusive property to the other by means of a public instrument, which shall be recorded in the registry of property of the place the property is located. (137a, 168a, 169a)

**Art. 111 (Family Code)** A spouse of age may mortgage, encumber, alienate or otherwise dispose of his or her exclusive property, without the consent of the other spouse, and appear alone in court to litigate with regard to the same. (n)

**Art. 1390 (Civil Code).** The following contracts are voidable or annulable, even though there may have been no damage to the contracting parties:

1. Those where one of the parties is incapable of giving consent to a contract;
2. Those where the consent is vitiated by mistake, violence, intimidation, undue influence or fraud.

These contracts are binding, unless they are annulled by a proper action in court. They are susceptible of ratification.

- **Insured** – the party in whose favor the contract is operative and who is indemnified against, or is to receive a certain sum upon the happening of a specified contingency or event. He is the person whose loss is the occasion for the payment of the proceeds by the insurer; But the proceeds need not go to him but the designated beneficiary or someone the insured assigns the proceeds to.
- As in all other contracts, only persons who have the capacity to enter into a contract may be insured.
- Policy must specify the parties between whom the contract is made. (Sec. 51)
- **Public enemy** – citizen or subject of a nation at war with the Philippines. Does not include robbers, thieves, criminals.
  - a private corporation may be deemed an enemy corporation if controlled by enemy aliens.

9.3. Beneficiaries

**Sec. 11** The insured shall have the right to change the beneficiary he designated in the policy, unless he has expressly waived this right in said policy.

- Refers to the person who designated in a contract, upon the death of the insured.
- *Must be a risk acceptable to the insurer*
- **Kinds of beneficiaries** – either insured himself or his personal representatives or someone other than the insured. If others are recipients, their relations to the insured may be:
  - Insured himself – one who bought the policy and paid the premiums. Such is an immediate party to the contract and is usually called the assured (creditor insures debtor’s life).
  - Third person who paid a consideration – as when insured took up the policy for the benefit of the creditor or to secure some other obligation; or
  - Third person through mere bounty of insured – no consideration paid but made beneficiary (may be the insured’s estate or a third party).
In the 2nd and 3rd cases, beneficiary is not a party to the contract. In all 3 cases, proceeds of a life insurance policy become the exclusive property of the beneficiary upon insured's death. So if insured was judicially insolvent before he died, proceeds to go to the beneficiary and not to the assignee in insolvency.

- **Rules governing beneficiaries**
  - **Selection of the beneficiary must be in good faith and without intent to make the transaction a cover for a forbidden wagering contract.**

  **General Rule:** The insured may change the designated beneficiary without the consent of the latter and retain the right to receive the cash value of the policy, to take out loans against the cash value, to assign the policy to or surrender it without the beneficiary's consent. However, this right belongs only personally to the insured and cannot be exercised by his representatives or assignees upon his death.

  **Exception:** If there has been an express waiver of the right to change the beneficiary without the latter's consent, the beneficiary acquires an absolute vested interest to all benefits under the policy. A new beneficiary cannot be added to the original one/s because such would amount to the diminution of the original benefits. The insured also loses the power to destroy the policy because the beneficiary can pay the premiums himself to ensure the continued effectivity of the contract.

- **DE LEON** is inclined to believe that, in case the beneficiary dies before the insured, the proceeds shall go to the estate of the insured, rather than to the estate of the beneficiary. He believes that the purpose of the insured in taking out the policy is to provide a fund for the benefit of those he is accustomed to supporting. He would not have intended to extend such provision of funds to the heirs/assignees of the beneficiary.

- **In designating the beneficiaries, words used will not be given their technical significance but will be broadly construed so that the benefit shall be received by those intended by the insured as the object of his bounty.**

- **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 this case, the nearest relative of the insured shall receive the proceeds of said insurance if not otherwise disqualified.**

- **The right to receive the proceeds of life insurance policies shall follow the order of intestate succession in the Civil Code in default of any specific designation in the policy:**
  - a. Legitimate children;
  - b. Father and mother, if living;
  - c. Grandfather and grandmother; or ascendants nearest in degree, if living;
  - d. Illegitimate children;
  - e. Surviving spouse; and
  - f. Collateral relatives, to wit:
    - f.a. brothers and sisters of the full blood;
    - f.b. brothers and sisters of the half-blood; and
    - f.c. nephews and nieces
  - g. In default of above, State is entitled to receive the proceeds

  **General Rule:** The person designated in the policy as the insured or the beneficiary shall be the only one entitled to recover the proceeds of the policy.

  **Exception:** A third person may recover from the policy as against the insured if there has been a prior contract of express or implied trust between the insured and the third person. A third person may recover from the policy as against the insurer only if such person has been specifically given the right of recovery in the insurance policy.

- **Statutory Limitations on life insurance**

  **Art. 2012 (Civil Code)** Any person who is forbidden from receiving any donation under Article 739 cannot be named beneficiary of a life insurance policy by the person who cannot make any donation to him, according to said article. (n)

  - (1) Those made between persons who were guilty of adultery or concubinage at the time of the donation;
  - (2) Those made between persons found guilty of the same criminal offense, in consideration thereof;
  - (3) Those made to a public officer or his wife, descendants and ascendants, by reason of his office.

  In the case referred to in No. 1, the action for declaration of nullity may be brought by the spouse of the donor or donee; and the guilt of the donor and donee may be proved by preponderance of evidence in the same action. (n)

  - In the first case (adultery/ concubinage), no need of criminal conviction to void policy. Enough if there is a preponderance of evidence.
  - In the second case however, the CC uses the words "found guilty" hence criminal conviction necessary.
  - Public Enemies also disqualified from being beneficiary.

  **Insular Life Assurance Co v Ebrado**

  FACTS Ebrado took out a life insurance policy and named his common-law partner, Carponia, his beneficiary. Upon his death, his lawful wife also filed a claim w/ Insular Life as the widow. RTC disqualified Carponia from claiming benefits under the policy.
ISSUE: WON Carponia disqualified from claiming insurance proceeds because of her illicit relation with the insured.
HELD: YES. (SC applied CC) Since the Insurance Code does not contain any specific provision on rules respecting who may be named beneficiary, the CC will apply. Art 2012 states that “any person forbidden from receiving donations under Art 739 cannot be named beneficiary of a life insurance policy” Art. 739 declares void donations made between persons who are guilty of adultery or concubinage at the time of the donation. Hence, Carponia is disqualified from being named a beneficiary.

Vda. de Consuegra v GSIS

FACTS: Jose Consuegra contracted two marriages, to Diaz and Berdin. After his death, the proceeds of his life insurance w/ the GSIS went to Berdin. However, he was also entitled to retirement benefits to which he did not designate any beneficiary.
ISSUE: WON Berdin should be considered the sole beneficiary of the retirement benefits being the beneficiary of the life insurance policy
HELD: NO. Life Insurance and retirement insurance are separate and distinct funds. Life Insurance is paid to whoever is named the beneficiary and may not necessarily be the heir of the insured. Retirement benefits on the other hand, are primarily intended for the benefit of the insured person, to provide for his old age, incapacity, etc. If the beneficiary reaches the age of retirement, he gets the retirement benefits, not the proceeds of the life insurance policy if the ee dies before retirement. If there is no beneficiary designated in the policy, benefits will accrue to the estate, hence Diaz is also entitled to the retirement benefits.

Del Val v Del Val

FACTS: Plaintiff and Defendant are siblings. Prior to their father’s death, he took out a life insurance policy and made the Def the sole beneficiary.
ISSUE: WON the insurance proceeds belong exclusively to the DEF who was the sole beneficiary
HELD: YES The proceeds of an insurance policy are separate and distinct funds. Life Insurance is paid to whoever is named the beneficiary. The beneficiary of the insurance policy can only claim the proceeds of the insurance policy if the ee dies before retirement. If there is no beneficiary designated in the policy, benefits will accrue to the estate, hence Diaz is also entitled to the retirement benefits.

9.4. Other parties to an insurance contract

● Assignee of the thing insured ----- General Rule: If the thing insured is assigned to another, the policy is not deemed transferred with the thing. The policy is instead deemed suspended until the assignee also becomes the owner of the policy. The assignor, on the other hand, cannot recover on the policy after the transfer since he has already lost insurable interest over the thing.

Exceptions: The general rule on suspension of policy is not applicable in the following cases:

a. In life, health and accident insurance

b. A change of interest in the thing insured after an injury occurs resulting in a loss ($21);

c. A change of interest in one or more of several things, separately insured by one policy ($22);

d. A change of interest by will or succession on the death of the insured ($23);

e. A transfer of interest by one of several persons, joint owners or owners in common, jointly insured, to the others ($24);

f. When a policy will inure to the benefit of the one who may become the new owner of the interest insured during the continuance of the risk ($57);

● Agent or trustee ----- If an agent or trustee takes out an insurance policy for the benefit of his principal or beneficiary, he shall state that the latter is the real party in interest by designating himself as an agent or trustee in the insurance policy itself. He can also signify his designation by some other general words in the policy.

Valenzuela vs CA (1990)
The general rule that the principal reserves the right to terminate the agent-principal relationship at its will admits of an exception: when the agency has been given not only for the interests of the principal but of 3rd persons or for the mutual interest of agent and principal. Also, an insurance agent can’t be held liable for all uncollected premiums under his account because the remedy for non-payment of premiums is the termination of any insurance policy.

● Partner or co-owner ----- Insurable interest in the property of a partnership exists in both the partnership and the partners and a partner has an insurable interest in the firm property which will support the policy taken out thereon for his own benefit. But a partner who takes out the policy in own name limits the coverage to his individual share unless the terms clearly show the policy was meant to cover all the shares.

● Mortgagor/ mortgagee ----- General Rule: When a mortgagor takes out an insurance policy on his own name but stipulates that the proceeds shall be payable to the mortgagee, or assigns the said policy to the mortgagee, the insurance shall be deemed to be upon the insurable interest of the mortgagor. Consequently, three rules apply: (1) any act of the mortgagor prior to the loss, which would otherwise avoid the insurance, shall have the same effect even if the property insured is in the hands of the mortgagee (2) any act which would have to be performed by the mortgagor may be performed by the mortgagee, with the same effect as if it were performed by the former (3) if an insurer assents to the transfer of an insurance from a mortgagor to a mortgagee, and, at the time of his assent, imposes further obligation on the assignee, making
a new contract with him, the act of the mortgagor cannot affect the rights of said assignee.

**SUPPLEMENTARY RULES:**

On the insurable interest of mortgagor and mortgagee:

a. Separate insurable interests – each has his own insurable interest in the mortgaged property which is kept separate from each other. The benefits of such belongs to the insured alone and if the two insure the same property or take out a policy covering their respective interests, this is not double insurance.

b. Extent of insurable interest of mortgagor – the owner-mortgagor has an interest to the extent of the property’s value even if the mortgage debt equals it since the loss or destruction of the insured property will not extinguish his debt.

c. Extent of insurable interest of mortgagee – he or his assignee has an interest to the extent of the debt secured, the property used as security. His interest is prima facie the value mortgaged, only as to the amount owed, not exceeding the value of the property.

d. Extent of amount of recovery – Mortgagor: only up to full amount of loss; Mortgagee: up to the amount of credit at the time of the loss or the value of the property.

**Insurance by mortgagee of his own interest**

a. Right in case of loss – the mortgagee is entitled to proceeds if loss happens before payment of mortgage.

b. Subrogation of insurer to the right of the mortgagee – mortgagee’s claim passes by subrogation to the insurer to the extent of the insurance money paid.

c. Change of creditor – payment of the insurance to the mortgagee due to loss does not extinguish the principal obligation but only changes the creditor. The mortgagee can’t claim both the insurance and the debt.

**Insurance taken out by mortgagor**

a. For his own benefit, as owner – proceeds won’t go to the mortgagee who has no greater right than unsecured creditors.

b. For the mortgagee’s benefit – loss is payable to the mortgagee (usual practice), to the extent of the credit. Upon payment of the proceeds to the extent of the credit, the debt is extinguished. The mortgagee can be made the beneficial payee by:

1. Becoming the assignee of the policy with insurer’s consent;
2. Becoming the mere pledge without such consent;
3. A rider (§50), making the policy payable to the Mortgagee “as his interest may appear”, may be attached;
4. A “standard mortgage clause” containing a collateral independent contract between the two parties may be attached; or
5. The policy, though by its terms payable to the mortgagor, may have been procured by a mortgagor under a contract duty to insure for the mortgagee’s benefit, where the latter acquires an equitable line upon the proceeds.
Chapter III

INSURABLE INTEREST

1. Definition and Purpose

**Sec 21** A change on interest in a thing insured, after the occurrence of an injury which results in a loss does not affect the right of the insured to indemnity for the loss.

**Sec 25** Every stipulation in a policy of insurances for the payment of loss whether the person insured has or has not any interest in the property insured, or that the policy shall be received as proof of such interest, and every policy executed by way of gaining or wagering, is void.

**Insurable interest** – interest which the law requires policy owner to have in the person or thing insured.
- 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 and will suffer pecuniary loss or damage from its destruction, termination, or injury by the happening of the event insured against.
  - Essential element of an insurance contract.
  - Not legally possible to waive requirement
  - Rationale for requiring insurable interest:
    - As deterrence to the insured – public policy holds wager policies invalid for being against public interest and demoralizing in that:
      - The insured has an interest in the destruction rather than the preservation of a subject matter.
      - It tempts or induces the insured, with nothing to lose and everything to gain, to bring about the event upon the happening of which the policy becomes payable.
    - As a measure of limit of recovery – in contracts to pay indemnity, the insurable interest will be the measure of the upper limit of his provable loss under the contract. The policy should not provide the insured with the means of making a net profit from the happening of the event insured against.
  - Difference between life and non-life insurance (pertaining to interest):
    - **LIFE** - basically a contract of INVESTMENT; can only recover face amount of the policy
    - **NON-LIFE** – based on principle of INDEMNITY for exact pecuniary value; can only recover on the policy the value of the actual loss

**2. Insurable Interest in life/health**

**Sec 10** Every person has an insurable interest in the life and health:

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

- Person may take out insurance on own life or someone else's life provided insurable interest exists.
- **Cestui que vie** must consent.
- **Sec. 10** provides the test of presence of insurable interest. Said section does not require the consent of the person being insured for the policy to be effective. The policy is valid as long as the presence of insurable interest can be adequately shown.

2.1. In one’s own life/health

**Sec 11** The insured shall have the right to change the beneficiary he designated in the policy, unless he has expressly waived this right in said policy.

**Sec 12** 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.

**Insured is the cestui que vie**
- As a rule, each has unlimited insurable interest in his own life, whether the insurance is for the benefit of himself or another
- In insuring one's own life for another's benefit, insurable interest is only needed as evidence of good faith of the parties; it is contrary to human experience that a person will insure his own life for the benefit of another for the purpose of speculation, to take his own life to secure payment to another, or designate as a beneficiary, a person interested in the destruction, not the continuance of the insured's life.
- The nearest relative of the insured shall receive the proceeds of said insurance if not otherwise disqualified
- **GENERAL RULE:** Beneficiary is the choice of the insured regardless of WoN beneficiary has an insurable interest in insured's life
- **Assumption:** Insured would not designate as his beneficiary a person whom he would not trust with his own life
- **EXCEPTIONS**
  - Waiver

---

» Irrevocable beneficiary (right to proceed vests)

2.2. In the life/health of others

Art 195 (Family Code). Subject to the provisions of the succeeding articles, the following are obliged to support each other to the whole extent set forth in the preceding article:
1. The spouses;
2. Legitimate ascendants and descendants;
3. Parents and their legitimate children and the legitimate and illegitimate children of the latter;
4. Parents and their illegitimate children and the legitimate and illegitimate children of the latter; and
5. Legitimate brothers and sisters, whether of full or half-blood (291a)

Insured is not the cestui que vie but is the beneficiary
- When person names himself the beneficiary in a policy taken out on the life of another, he must have insurable interest in the life of the other person (his interest must show some pecuniary interest and it exists whenever the relation between the assured and the insured, whether by blood, marriage or commercial intercourse)
- Mere love and affection NOT insurable interest

CESTUI QUE VIE: person upon whose life insurance is taken out on
- Must agree to the taking out of insurance
- No law saying you don't need his consent
- Public policy demands consent be obtained
- Exception: Parent taking policy out on minor child
- No amount of consent can make up for lack on surable interest
- When the owner of the policy insures the life of another—the cestui que vie—and designates a third party as beneficiary, both the owner and beneficiary must have an insurable interest in the life of the cestui que vie. If the insurable interest requirement is satisfied, a life policy is assignable regardless of whether the assignee has an insurable interest in the life of the cestui que vie. In our law, insurable interest in another’s life must be one of those mentioned in §10. Being engaged with one another is not such interest.

CLOSE RELATIVES
- Spouse and children (minor or not, married or unmarried dependent or not)
  - Law presumes natural affection existing between spouses, parents and children. Thus, Law recognizes a parent’s insurable interest in child’s life but is silent as to whether or not a child has insurable interest in the parent’s life.
  - Child entitled to support required by law, whether or not he/she is financially independent sufficient to constitute pecuniary interest.
- Other close relatives (brothers and sisters) not expressly covered by law (but look at Art 195, FC)

* Blood relationship or relationship by affinity is IMMATERIAL when relative is source of support (where no legal obligation exists)
  - There is insurable interest both ways

OTHER RELATIVES and STRANGERS
- Must prove that he has some pecuniary interest in the life of the cestui que vie otherwise policy is void
- Mere relationship will not suffice
- The requirements of insurable interest cannot be circumvented by an agreement between the insured (cestui que vie) and a 3rd person who has no interest, whereby the latter, having induced the insured to take out a policy, promises to pay of premiums if the policy is assigned to him.
  » The intention to take out policy is clearly not to insure life but rather to circumvent the requirement
  » Is different from taking a policy out on self and then later assigning it to someone who has no insurable interest, because law allows policy to transfer whether or not there is insurable interest

Sec 181 A policy of insurance upon life or health may pass by transfer, will or succession to any person, whether he has an insurable interest or not, and such person may recover upon it whatever the insured might have recovered.

Sec 182 Notice to an insurer of a transfer or bequest thereof is not necessary to preserve the validity of a policy of insurance upon life or health, unless thereby expressly required.

- Insurable interest of assignee in life insurance not required - since it is not a contract of indemnity. Life insurance is one of the best recognized forms of investment and holds its own as a reliable savings. So far as reasonable safety permits, it is desirable to give life policies the ordinary characteristics of property. To require insurable interest in assignee is to diminish the investment value of the contract to the owner.
- No insurable interest is required where policy is procured by the person whose life is insured on his own initiative. Since anyone can be named beneficiary, an assignment would not be invalidated by the lack of insurable interest of the assignee.
- Assignment is distinguished from a change in the designated beneficiary.

COMMERCIAL or CONTRACT RELATIONS
- Creditor may take out insurance on life of his debtor
  » The extent of the creditor’s interest is only as to the amount of debt and cost of carrying the insurance on debtor’s life. The total value must not make the policy a wagering or speculative one. This kind of policy is not taken out for the benefit of the debtor. The debtor cannot claim the proceeds because the creditor does not act as an agent of the former.
**Sec 13** Every interest in property, whether real or personal, or any relation thereto, or liability in respect thereof, of such nature that a contemplated peril might directly damnify the insured, is an insurable interest.

Contract of indemnity - measure of insurable interest in property is the extent to which the insured might be indemnified by loss or injury.

**Sec 14** An insurable interest in property may consist in:
- a) an existing interest;
- b) An inchoate interest founded on an existing interest; or
- c) An expectancy, coupled with an existing interest in that out of which the expectancy arises

**Sec 15** An interest in property must exist
- upon the death of property owner
- upon the death of an officer of the corporation
- upon a person who has a beneficial interest in the property

**Sec 16** A mere contingent or expectant interest in anything, not founded on an actual right to the thing, nor upon any valid contract for it, is not insurable.

- Insurable interest deemed to exist as long as such interest, relation or liability is of such nature that a contemplated part might directly damnify the insured
- Even without legal or equitable title as long as it can be shown that the insured will be benefited by property’s continued existence or will suffer pecuniary loss by its destruction.
- **FORMS OR INSURABLE INTEREST**
  - a) INTEREST in the property itself, whether such property be real or personal
  - ex. Ownership of or a lien on property
  - any RELATION to such property
  - ex. interest of a commission agent on goods he is selling
  - b) LIABILITY in respect thereof
  - ex. interest of carrier on cargo which he ought to carry safely to destination
- **NATURE OF INSURABLE INTEREST**
  - an existing interest
  - may arise from legal title (ex. mortgagor of the property mortgaged; lessor of the property leased; assignee of property for the benefit of creditors, etc.); clearly definably based on some legal title
  - may also be from equitable title (ex. Purchaser of property before delivery; builders in the building under construction or upon completion of building)
  - An inchoate interest founded on an existing interest

**Sec 183** Unless the interest of a person insured is susceptible of exact pecuniary measurement, the measure of indemnity under a policy of insurance upon life or health is the sum fixed in the policy.

**3. Insurable Interest In property**

**3.1. Definition**

- Relationship slightly different because no exact pecuniary value can be given. BUT same principle holds that the cannot recover.

**EMPLOYER/BUSINESS ASSOCIATE**

- Debtor may insure self and name creditor as beneficiary
  - Creditor is entitled to full proceeds of policy just as any other beneficiary when debtor dies even if his credit is much less.
- Debtor assigns policy to creditor as collateral security
  - Creditor can only recover amount of his credit
  - Balance will go to designated beneficiary
- Firm may take out policy on officers/employees
  - Services are valuable to the business
  - Proceeds of policy not taxable income because it serves as indemnity to the employee for the loss the business suffers upon the death of the valued officer of employee.

**2.3. Time when it should exist**

- **General Rule:** insurable interest must exist only at inception
  - Policy not indemnifying loss but rather giving financial security to insured or to beneficiaries
  - Law gives insured the right to convert policy into cash by selling it to a third person who doesn’t have any insurable interest in his life.
  - Policy is an investment
- **Exceptions:** (cases where interest of the insured is capable of exact pecuniary benefit)
  - Creditor who takes insurance out on life of debtor to secure debt
    - Once debt has been paid insurable interest disappears
    - No liability to pay proceeds because there is no longer anything to indemnify
    - If debt already been paid should be denied recovery on the policy
    - Debtor should have the right to take over the policy from creditor after the termination of relationship prevent the premium paid from going to waste.
  - Company takes out insurance on life of employee
    - Employee leaves company
    - Policy is to indemnify employee for losses upon death of employee not resigning
    - Company cannot recover on life of employee who has already left/resigned – there is nothing to indemnify
must be founded on an existing contract but not yet clearly defined or identified (Ex. A stockholder has an inchoate interest in the property of the corporation w/c is founded on an existing interest arising from his ownership shares)  
A partner has an insurable interest in the firm’s property which will support a separate policy for his benefit  
An expectancy, coupled with an existing interest in that out of which the expectancy arises  
such must be coupled with an existing interest in that out of which such expectancy arises. (Ex. Farmer insuring future crops if it be grown on land owned by him at the time of the issuance of the policy)

3.3. Measure of interest in property

Sec 15 A carrier or depository of any kind has an insurable interest in a thing held by him as such, to the extent of his liability but not to exceed the value thereof.

Sec 17 A mere contingent or expectant interest in anything, not founded on an actual right to the thing, not upon any valid contract for it, is not insurable.

Other Interests
- STOCKHOLDER/PARTNER to FIRM  
  - Has sufficient interest in property of corporation  
  - Interest does not rise to the dignity of a title yet he stands in such a relation to such corporate property to vest him with an inchoate right to dividends in case of profits and to share in the assets upon liquidation  
  - Interest not measured by value of what is destroyed  
  - Interest is to share in the distribution of the proceeds only after payment of corporation’s debts  
  - Must prove actual injury, otherwise cannot recover more than nominal damages
- GENERAL CREDITOR  
  - No insurable interest in the property of the debtor  
  - No right to posses, no lien, no relation that would cause him direct damage  
  - Cannot take out policy on debtor’s property  
  - Cannot recover as appointee or beneficiary on policy taken out by debtor
- JUDGEMENT CREDITOR  
  - Sufficient interest in debtor’s property because given right to levy (general lien)  
  - In order to recover must show debtor has no other property with which to satisfy debt  
  - May insure debtor’s property due to pecuniary interest
- MORTGAGE CREDITOR  
  - Has insurable interest (general lien)  
  - Direct prejudice if there is loss  
  - Recognized by insurance Code (SEC8)

3.4. When it should exist

Sec 19 An interest in property insured must exist when the insurance takes effect, and when the loss occurs, but need not exist in the meantime; and interest in the life or health of a person insured must exist when the insurance takes effect, but need not exist thereafter or when the loss occurs.

General Rule: Interest must exist at inception and at time of loss, but not in the meantime  
- PROPERTY must exist when the insurance takes effect and when the loss occurs but not exist in the meantime.  
- Nature of contract as indemnity  
- Mere transfer of thing does not carry transfer of policy  
  - Doesn’t own it anymore cannot recover  
  - New owner not a party to contract cannot recover  
  - Can recover if valid assignment to buyer made, notation of contract  
  - Transfer suspends the contract until same person owns thing and policy

Exception:  
- (21) A CHANGE IN INTEREST IN A THING INSURED. After occurrence of an injury which results in a loss does not affect the right of the insured to indemnify for the loss  
  - insured of the policy, after fire may sell remains of property without prejudicing his right to recovery
- (22) A change of interest IN ONE OR MORE SEVERAL DISTINCT THINGS, SEPARATELY INSURED by one policy does not avoid the insurance as to the others.  
  - Single fire policy covers several pieces of furniture and appliances, insurance value of each as indicated, sale of one item will not prevent insured from recovering on items he did not sell
- (23) A change on interest by WILL or SUCESSION on the death of the insured, does not avoid an insurance and his interest in the insurance passes to the person taking his interest in the thing insured  
  - Fire insurance on building owned by father, father dies, son inherits building and the fire insurance
- (24) A transfer of interest by one of SEVERAL PARTNERS, JOINT OWNERS, or OWNERS IN COMMON WHO ARE JOINTLY INSURED to the others, does not avoid an insurance even though it has been agreed that the insurance shall cease upon an alienation of the thing insured  
  - Acquiring co-owner has the same interest, interest merely increases upon acquiring other co-owners interest
  - Although there may be a stipulation that insurance ceases upon alienation  
  - Law allows policy to be framed in such a way that it will inure to the benefit of whomever during the continuance of the risk may become owner of the interest insured.  
  - Sale of property will not suspend the policy or render it ineffective.
3.5. Special Provisions on mortgagor and mortgagee

Sec 8 Unless the policy otherwise provides, where a mortgagor of property effects insurance in his own name providing that the loss shall be payable to the mortgagee, or assigns a policy of insurance to a mortgagee, the insurance is deemed to be upon the interest of the mortgagor, who does not cease to be a party to the original contract, and any of his, prior to the loss which would otherwise avoid the insurance, will have the same effect, although the property is in the hands of the mortgagee, but any act which, under the contract of insurance, is to be performed by the mortgagor, may be performed by the mortgagee therein named, with the same effect as it had been performed by the mortgagor.

Sec 9 If an insurer assents to the transfer of an insurance from a mortgagor to a mortgagee, and at the time of this assent imposes further obligations on the assignee, making a new contract with him, the acts of the mortgagor cannot affect the rights of said assignee.

- See part IV-C
- "Open mortgage clause" and "union mortgage"
  a) Open Mortgage (Sec 8) – mortgage that can be paid-off to maturity w/o penalty; mortgagee is the beneficiary for insurance taken by mortgagor
  - Lenders generally do not like open mortgages because the early pay-off reduces the interest they earn
  - Acts of mortgagor invalidates the insurance
  b) Union Mortgage – standard mortgage clause
  - Mortgagee may perform the acts of mortgagor
  - Clause included wherein the insurance interest of mortgagee shall not be invalidated by any act of the mortgagor or owner of property at the time.
  - Protects mortgagee’s interest from invalidation due to mortgagor’s acts

3.6. Change of interest; instances of automatic transfer of interest

Sec 21 A change in interest in a thing insured, after the occurrence of an injury which results in a loss does not affect the right of the insured to indemnity for the loss.

Sec 22 A change of interest in one or more of several distinct things, separately insured by one policy, does not affect the right of the insured to indemnity for the loss.

Sec 23 A change of interest, by will or succession, on the death of the insured, does not avoid an insurance; and his interest in the insurance passes to the person taking his interest in the thing insured.

Sec 24 A transfer of interest by one of several partners, joint owners, or owners in common, who are jointly insured, to the others, does not avoid an insurance even though it has been agreed that the insurance shall cease upon an alienation of the thing insured.

Sec 53 The insurance proceeds shall be applied to the benefit of whomever, during the continuance of the risk, may become the owner of the interest insured.

- General Rule: If the thing insured is assigned to another, the policy is not deemed transferred with the thing. The policy is instead deemed suspended until the assignee also becomes the owner of the policy. The assignor, on the other hand, cannot recover on the policy after the transfer since he has already lost insurable interest over the thing. When there has been a change of interest in a property insured collectively with others in one policy and paid for with a gross premium, the policy is suspended. If, however, the change of interest affects only one property insured together with others under a divisible contract of insurance, the suspension takes effect only with regard to the property affected.

Exceptions: The general rule on suspension of policy is not applicable in the following cases: Secs. 20 to 24, 57, Art 1306, §24, Civil Code

3.7. Several interests; double insurance (cf. over insurance)

Sec 93 A double insurance exists where the same person is insured by several insurers separately in respect in the same subject and interest.

- Prohibition against additional insurance – When a policy contains a prohibition against additional insurance on the property insured without the insurer's consent, such provision being valid and reasonable, a violation thereof by the insured avoids the policy. (Sta. Ana vs. Commercial Union Assurance Co. 55 Phil 329).

Sec 94 Where this insured is over insured by double insurance:

(a) 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;

(b) Where the policy under which the insured claims is a valued policy, the insured must give credit as against, the valuation for any sum received by him under any other policy without regard to the actual value of the subject matter insured.
(c) Where the policy under which the insured claims is an unvalued policy he must give credit, as against the full insurable value, for any sum received by him under any other policy.

(d) Where the insured receives any sum in excess of the valuation in the case of valued policies, and the insurable value in the case of unvalued policies, and the insurable value in the case of unvalued policies, he must hold such sum in trust for the insurers, according to their right of contribution among themselves.

(e) 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 the contract.

<table>
<thead>
<tr>
<th>Double insurance</th>
<th>Over-insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of the insurance is beyond the value of the insured's insurable interest</td>
<td>There may be no over-insurance as when the sum total of the amounts of the policies issued does not exceed the insurable interest of the insured.</td>
</tr>
<tr>
<td>There may be only one insurer involved</td>
<td>There are always several insurers</td>
</tr>
</tbody>
</table>

- **DOUBLE INSURANCE** – when one gets several policies to cover against the same danger/peril
  - exists where the same person is insured by several insurers separately in respect to the same subject and interest - may recover from insurer, insurer who pays may collect from other insurers
  - a co-insurance by two or more insurers.
  "Double insurance," "additional insurance" and "other insurance" are sometimes used interchangeably, although there is a technical difference in their meaning.
  - Requisites of double insurance
    1. Same person insured
    2. Two or more insurers insuring separately
    3. Same subject matter
    4. Same interest insured
    5. Same Risk or peril insured

- **OVER INSURANCE** – when amount insured is over the value of the property the insured is over insured by double insurance
  - The insured 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.
  - Valued policy – the insured must give credit as against the valuation for any sum received by him under any other policy without regard to the actual value of the subject matter insured.
  - Unvalued policy – he must give credit, as against the full insurable value, for any sum received by him under any policy
  - Insured receives any sum in excess – he must hold such sum in trust for the insurers, according to their right of contribution among themselves.
  - 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 the contract.
  - Cannot get above value of property minus that of proceeds from other policies
  - Cannot be more than loss because that would be wagering
Chapter IV
CONCEALMENT, MISREPRESENTATION & BREACH OF WARRANTIES

A contract of insurance is: UBERRIMAE FIDAE - A contract of utmost good faith

1. PRIMARY CONCERNS OF PARTIES TO AN INSURANCE CONTRACT

The following are affected by an act of concealment:
1. Correct estimation of the risk which enables the insurer to decide whether he is willing to assume it, and if so at what rate of premium
2. The precise delimitation of the risk which determines the extent of the contingent duty to pay undertaken by the insurer
3. Control of the risk after it is assumed as will enable the insurer to guard against the increase of the risk because of change in conditions
4. Determining whether a loss occurred and if so, the amount of such loss.

2. DEVICES FOR ASCERTAINING AND CONTROLLING RISK AND LOSS

2.1. CONCEALMENT & REPRESENTATION

Developed for the purpose of enabling the insurer to secure the same information with respect to the risk that was possessed by the applicant for insurance so that he may be equally capable of forming a just estimate of its quality.

2.2. AFFIRMATIVE WARRANTIES & CONDITIONS

Deals with conditions existing at the inception of the contract, and operates to make more definite and certain the general words used to describe the risk the insurer undertook to bear.

It involves facts the existence of which shows the risk to be greater than that intended to be assumed and operates to create in the insurer the power to extinguish, if he so desires, the legal relations already created.

Ex. Where an insured is required to warrant something and when found guilty of concealment or misrepresentation, operates to void the contract.

2.3. EXCEPTIONS

Makes more definite the coverage indicated by the general description of the risk by excluding certain specified risks that otherwise could have been included under the general language describing the risk assumed.

2.4. EXECUTORY WARRANTIES & CONDITIONS


Are used to enable the insurer to rescind the contract in case subsequent events increased the risk to such an extent that he is no longer willing to bear. That is, undertakings that certain conditions should or should not exist in the future.

2.5. CONDITIONS PRECEDENT

Used by the insurer to protect himself against fraudulent claims of loss; these are conditions requiring immediate notice of loss or injury and detailed proofs of loss within a limited period.

3. CONCEALMENT

3.1. Definition

Sec. 26. A neglect to communicate that which a party knows and ought to communicate, is called a concealment.

3.2. Requisites of concealment:

1. A party knows the fact which he neglects to communicate or disclose to the other
2. The fact concealed is material to the risk
3. Such party is duty bound to disclose such fact to the other
4. The other party has not the means of ascertaining the fact concealed
5. Such party makes no warranty of the fact concealed. (If a warranty is made of the fact concealed, the non-disclosure of such fact is not concealment but constitutes a violation of the warranty)

Sec. 27. A concealment whether intentional or unintentional, entitles the injured party to rescind a contract of insurance. (As amended by BP Blg. 874)

- The effect of concealment on the part of the insured makes the contract VOIDABLE at the insurer’s option
- Insurer NEED NOT PROVE FRAUD in order to rescind a contract on the grounds of concealment.
- The duty of communication is independent of the intention and is violated by the mere fact of concealment even when there is no design to deceive.
- Section 27 must be read in relation to Section 29.

Sec. 28. Each party to a contract of insurance must communicate to the other, in good faith, all facts within his knowledge which are material to the contract, and which the other has not the means of ascertaining, and as to which he makes no warranty

3.3. Matters that Must Be Communicated Even in the Absence of Inquiry:

1. Matters material to the contract
2. Matters which the other has not the means of ascertaining the said facts
3. Matters as to which the party with the duty to communicate makes no warranty.
3.4. Fraudulent Intent

Sec. 29. An intentional and fraudulent omission, on the part of one insured, to communicate information of matters proving or tending to prove the falsity of a warranty, entitles the insured to rescind.

When Fraudulent Intent Necessary:

- Under section 29, concealment relates to the falsity of a warranty.
- For the section to operate it is necessary that the nondisclosure be intentional and fraudulent before the contract may be rescinded.
- The concealment refers to matters proving or tending to prove the falsity of the warranty.

3.5. MATTERS WHICH NEED NOT BE DISCLOSED

Sec. 30. Neither party to a contract of insurance is bound to communicate information of the matters following, except in answer to the inquiries of the others:

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

Sec. 32. Each party to a contract of insurance is bound to know all the general causes which are open to his inquiry, equally with that of the other, and which may affect the political or material perils contemplated; and all general usages of trade.

Sec. 33. The right to information of material facts may be waived, either by the terms of insurance or by neglect to make inquiries as to such facts where they are distinctly implied in other facts of which information is communicated.

Sec. 34. Information of the nature or amount of the interest of one insured need not be communicated unless in answer to an inquiry, except as prescribed by section 51.

3.6. MATERIALITY

Sec. 31. Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the fact upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries.

Test of Materiality: The effect which the knowledge of the fact in question would have on the making of the contract. To be material, a fact need not increase the risk or contribute to any loss or damage suffered. IT IS SUFFICIENT IF THE KNOWLEDGE OF IT WOULD INFLUENCE THE PARTY IN MAKING THE CONTRACT.

- Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries. HOWEVER, matters that may be deemed immaterial in other respects will be deemed material if made the subject of an inquiry.
- The DUTY TO COMMUNICATE is to the extent that, in good faith, all facts within the knowledge of either party which are material to the contract and as to which he makes no warranty, and which the other
4. MISREPRESENTATION

4.1. Definition

Sec. 36. A representation may be oral or written

4.2. Representation vs. Misrepresentation

Representation:
- factual statements made by the insured at the time of, or prior to, the issuance of the policy to give information to the insurer and otherwise induce him to enter into the insurance contract. They may also be made by the insured but cases nearly always refer to representations made by the insured.

Misrepresentation:
- a statement (a) as a fact of something which is untrue; (b) which the insured stated with knowledge that it is untrue and with an intent to deceive, or which he states positively as true without knowing it to be true and which has a tendency to mislead; (c) where such fact in either case is material to the risk.

4.3. Distinguished from Concealment

- In concealment, the insured maintains silence when he ought to speak, while in misrepresentation, the insurer makes a statement of fact which is not true – active form of concealment.

Sec. 37. A representation may be made at the time of, or before, issuance of the policy (a)

Sec. 38. The language of a representation is to be interpreted by the same rules as the language of contracts in general.

4.4. Construction of Representations:

- Construed liberally in favor of the insured and are required to be only substantially true.

Sec. 39. A representation as to the future is to be deemed a promise, unless it appears that I was merely a statement of belief or expectation.

4.5. Kinds of Representation:

1. Oral or Written (Sec. 36)
2. Made at the time of issuing the policy or before (Sec. 37)
3. Affirmative or promissory (Sec. 39 & 42)

Affirmative Representation:
- Is any allegation as to the existence or non-existence of a fact when the contract begins.

Promissory Representation:
- Is any promise to be fulfilled after the contract has come into existence or any statement concerning what is to happen during the existence of the insurance. A promise representation is substantially a condition or warranty.

4.6. When Representation Deemed a Mere Expression of Opinion:

General Rule: a representation of the expectation, belief, opinion, or judgment of the insured, although false, will not avoid the policy, even if such was material to the risk.

Exception: Such representation will avoid the policy if there is a concurrence of materiality and fraudulence or intent to deceive. However, if the representation is one of fact, the insurer need only prove the materiality of the representation, because in such cases the intent to deceive is presumed.

ILLUSTRATION: The statement “I am an intelligent student” will produce the following effects:

a. Even if intelligence is material, if there was no intent to deceive and the insured was merely relying on his own assessment of his abilities, the policy will not be avoided.

b. If intelligence is material and it was proven that there was intent on the part of the insured to mislead the insurer as to his intelligence, the policy will be avoided.
c. If the statement was actually a statement of fact and not mere judgment, the policy will be avoided, as when the insured was not even a student to begin with (“student” is a fact, “intelligence” is an opinion”). Fraudulent intent in this case is presumed.

Sec. 40. A representation cannot qualify an express provision in a contract of insurance; but it may qualify an implied warranty

- A representation cannot qualify an express provision or an express warranty in a contract of insurance because a representation is not a part of the contract but only a collateral inducement to it. It may however qualify an implied warranty.

Sec. 41. A representation may be altered or withdrawn before the insurance is effected, but not afterwards.

- A representation, not being a part of the contract of insurance, may be altered or withdrawn before the contract actually takes effect but not afterwards since the insurer has already been led by the representation in assuming the risk contemplated.

Sec. 42. A representation must be presumed to refer to the date on which the contract goes in effect.

NO FALSE REPRESENTATION IF:

• If it is true at the time the contract takes effect although false at the time

<table>
<thead>
<tr>
<th>CONCEALMENT</th>
<th>MISREPRESENTATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insured withholds information of material facts from the insurer</td>
<td>Insured makes erroneous statements of facts with the intent of inducing the insurer to enter into the insurance contract</td>
</tr>
<tr>
<td>Determined by the same rules as to materiality</td>
<td></td>
</tr>
<tr>
<td>Same effects on the part of the insured; insurer has right to rescind</td>
<td></td>
</tr>
<tr>
<td>Injured party is entitled to rescind a contract of insurance on ground of concealment or false representation, whether intentional or not</td>
<td></td>
</tr>
<tr>
<td>Rules on concealment and representation apply likewise to the insurer as insurance contract is one of utmost good faith</td>
<td></td>
</tr>
</tbody>
</table>

THERE IS FALSE REPRESENTATION IF:

• If it is true at the time it was made/represented but false at the time the contract takes effect.

Sec. 43. When a person insured has no personal knowledge of a fact, he may submit the information, in its whole extent, to the insurer; and in neither case is he responsible for its truth, unless it proceeds from an agent of the insured, whose duty is to give the information.

Art. 44. A representation is to be deemed false when the facts fail to correspond with its assertions or stipulations.

- Sec. 44 defines misrepresentation
- Representations are not required to be literally true (unlike warranties); they need only be SUBSTANTIALLY TRUE

Sec. 45. If a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to rescind the contract from the time when the representation becomes false. The right to rescind granted by this Code to the insurer is waived by the acceptance of premium payments despite knowledge of the grounds for rescission. (As amended by BP Blg. 474)

General Rule: Any misrepresentation on a material point entitles the injured party to rescind the contract from the time the representation becomes false.

Exceptions: The right to rescind on the ground of misrepresentation is deemed waived when the insurer accepts premium payments despite knowledge of the misrepresentation. However, a person cannot be held liable for any misrepresentation that he may apparently have committed if (1) he has no personal knowledge of the matter in question, (2) he relies on the information of others and (3) he believes such information to be true based on such external source, or if he submits the information from an external source in its entirety to the insurer. The EXCEPTION to this rule is when the information relied upon proceeds from an agent of the insured, whose duty it is to give the information.

- Fraud or intent to misrepresent facts not essential to entitle the injured party to rescind a contract of insurance on the ground of false representation.
- To be deemed false, it is sufficient if the representation fails to correspond with the facts in a material point.

Sec. 46. The materiality of a representation is determined by the same rules as the materiality of a concealment.

4.7 CONCEALMENT vs. MISREPRESENTATION

Sec. 47. The provisions of this chapter apply as well to a modification of a contract of insurance as to its original formation.

Ng v Asian Crusaders

Facts: The insured applied for a 20-year endowment insurance on his life and named his wife as beneficiary. Upon application he gave information regarding a previous operation (that
a tumor was taken out). Insured died of liver cancer. The insurer denied the claim of the beneficiary claiming misrepresentation since the operation which the insured undertook was for "peptic ulcer" and not removal of a tumor.

**Ratio:** Concealment exist where the insured had knowledge of a fact material to the risk, and honesty, good faith and fair dealing requires that he should communicate it to the insurer, but he intentionally withheld the same. The insured informed the medical examiner that the tumor he was operated on was associated with ulcer of the stomach. In the absence of evidence that the insured had sufficient medical knowledge as to enable him to distinguish between "peptic ulcer" and tumor" his statement was an expression made in good faith of his belief as to the nature of his ailment and operation. If the operation and ailment of the insured had such an important bearing on the assumption of risk by the insurer, it should have made further inquiries on the matter or required copies of the hospital records before approving the application. As provided by Section 32 where the right to material information may be waived "by neglect to make inquiries as to such facts where they are distinctly implied in other facts of which information is communicated”

**Canilang vs. CA, 223 SCRA 443 (1993)**

**Facts:** The insured failed to disclose to the insurer that he was diagnosed to be suffering from “sinus tachycardia” and that he had consulted with a doctor. He died of congestive heart failure. His wife as the beneficiary filed a claim with the insurer who denied the same.

**Ratio:** The information the insured failed to disclose was material to the ability of the insurer to estimate the probable risk he presented as a subject of life insurance, had he disclosed it, it may be reasonably assumed that the insurer would have made further inquiries on the matter or required copies of the hospital records before approving the application. As provided by Section 32 where the right to material information may be waived "...by neglect to make inquiries as to such facts where they are distinctly implied in other facts of which information is communicated”

**Yu v CA**

**Facts:** The insured applied for a life insurance with private respondent insurance company. He concealed a material fact in his application form when he failed to disclose that he had consulted a doctor prior to his application and that he was suffering from certain symptoms. Insured died and his brother, the petitioner in the case filed a claim which was denied by the insurer.

**Ratio:** The insured is guilty of concealment as the fact which he failed to disclose to the insurance company deprived the respondent of the opportunity to make the necessary inquiry as to the nature of his past illness so that it may form its estimate relative to the approval of his application. "A neglect to communicate that which a party knows and ought to communicate, is called concealment" and "Whether intentional or unintentional, the concealment entitles the insurer to rescind the contract of insurance”. Insurer is relieved from liability.

**Pacific Banking v CA**

**Facts:** The insured, Paramount is in the business of shirt manufacturing, it took out a fire insurance policy with Oriental Insurance for 61K. Because of it’s indebtedness to Pacific Banking Corp., the policy was endorsed to Pacific as mortgagee/trustor. The property insured was gutted by fire. Pacific made a claim on the insurance policy which was denied by Oriental because it is incorrect that Paramount failed to disclose co-insurance with 3 other insurance companies (only declared 3 others) in violation of Policy Condition # 3.

**Ratio:** By reason of the unrevealed co-insurances, the insured had been guilty of a false declaration; a clear misrepresentation and a vital one because where the insured had been asked to reveal but did not, that was deception. Had the insurer known that there were many co-insurers, it could have hesitated or plainly desisted from entering into such contract. Hence, the insured was guilty of clear fraud. The insurance policy against fire expressly required that notice should be given by the insured of other insurance upon the same property, the total absence of such notices nullifies the policy.

**Eguaras v Great Eastern**

**Facts:** The insured applied for a life insurance policy with defendant and named beneficiary his mother-in-law. Petitioner filed a claim which was denied by the insurer.

**Ratio:** Insured falsely answered questions on the application form regarding his health and medical history. Also, when he the insurance company’s physician conducted a physical examination, another person pretending to be the insured was presented. Insured died of intestinal occlusion.

**Great Pacific Life v CA (1999)**

**Facts:** A group life insurance was executed between GrePaLife and DBP for mortgagors of DBP to the amount of debt to DBP. The insured in this case was one such mortgagor to DBP. GrePaLife granted insurance and a couple of months later, insured died of "massive cerebral hemorrhage". Upon DBP’s claim GrePaLife denied claiming non-disclosure of insured that he was suffering from hypertension at the time of application. For the insurance based on the testimony of a doctor who declared that the cause of death was “possible hypertension several years ago”

**Ratio:** GrePaLife failed to establish that the insured concealed a material fact as the medical findings were not conclusive since the doctor who gave the testimony did not conduct an autopsy on the insured nor had he any knowledge of
Edillon v Manila Bankers Life

Facts: The insured applied for a 90-day insurance coverage against accident and injuries. She clearly indicated in the application form that her date of birth was July 11, 1904 (which made her almost 65 at the time of application). The insurer accepted her premium payment and issued her a certificate of insurance. Under the insurance policy, there contained a provision which excludes the company from any liability to pay claims when the insured is under 16 or over 60. Insured died of a vehicular accident during the effectivity of the insurance coverage.

Ratio: The insurer is deemed estopped from claiming that the insured is disqualified. She did not conceal nor misrepresent her age and the insurance corporation has been given sufficient information to know that the insured is over 60 years of age, yet they continued to accept the premium payment and issued her the policy.

New Life Enterprise v Court of Appeals

Facts: The insured contracted 3 insurance policies from 3 different insurance companies for the stocks-in-trade of New Life Enterprises. It was undisputed that the plaintiff failed to indicate any co-insurance in any of the three policies. When the building occupied by the insured enterprise was gutted and the stocks-in-trade insured against were burned, the plaintiff filed claims with the 3 insurers which were all denied. The reason was that the insured violated the terms of policy in relation to co-insurance.

Ratio: The terms of the contract are clear and unambiguous. The insured is specifically required to disclose to the insurer any other insurance and its particulars which he may have effected on the same subject. The excuse of the plaintiff that the agent of the insurance company was aware of the other insurers or that he failed to read the terms of the policies cannot be accepted when the words and language of the documents are clear and plain or readily understandable by an ordinary reader. There is absolute no room for interpretation or construction and the courts are not allowed to make contracts for the parties. The parties must abide by the terms of the contract because such terms constitute the measure of the insurer’s liability and compliance therewith is a condition precedent to the insured’s right to recovery from the insurer.

American Home v CA

Facts: The insured took out a fire insurance policy to cover the stocks-in-trade of his business from the plaintiff insurer. When a fire gutted the business, he filed a claim against plaintiff insurer and several other insurance companies for which he also had a policy for the same stocks-in-trade. The plaintiff insurer refused payment claiming that the insured violated the policy in several instances – for our purposes the violation was the failure of the insured to disclose co-insurance. However, during trial, the trial court found that although the insured failed to disclose co-insurance, the loss adjuster of the insurance company had previous knowledge of the co-insurance prior to the claim.

Ratio: The insurer is estopped from claiming exemption from liability due to the violation of the policy or non-disclosure. It cannot be said that petitioner was deceived by respondent by the latter’s non-disclosure of the other insurance contracts when petitioner actually had prior knowledge as petitioner’s loss adjuster had known all along of the other existing insurance contracts. The loss adjuster being an employee of petitioner is deemed a representative of the latter whose awareness of the other insurance contracts binds the petitioner and thus there was no violation of the “other insurance” clause by the respondent and petitioner is liable to pay its share of the loss.

- Life insurance policy wording that provides a time limit on the insurer’s right to dispute a policy’s validity based on material misstatements in the application.
- Incontestability means that after the requisites are shown to exist, the insurer shall be estopped from contesting the policy or setting up any defense, except as is allowed, on the ground of public policy.

Sec. 48. Whenever a right to rescind a contract of insurance is given to the insurer by any provision of this chapter, such right must be exercised previous to the commencement of an action on the contract.

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

5. RESCISSION

5.1. Grounds
1. Concealment
2. False representation – misrepresentation
3. Breach of Warranty

5.2. When Insurer Must Exercise Right to Rescind:

Non-Life Policy
- Must be exercised prior to the commencement of an action on the contract. The insurer is no longer entitled to rescind a contract of insurance after the insured has filed an action to collect the amount of the insurance.
- **However, it has been held that where any of the material representations is false, the insurer’s tender of the premiums and notice that the policy is cancelled before
commencement of the suite, operates to rescind a contract of insurance.

Life Policy
- The defense is available only during the first two years of a life insurance policy. Or upon the first two years after reinstatement.

5.3. Incontestability clauses
- The principle of incontestability states that, after the requisites are shown to exist, the insurer shall be estopped from contesting the policy or setting up any defense, except as is allowed, on the grounds of public policy. In life insurance policies, the incontestability begins after two years from the time the policy took effect. After this period, the insurer is no longer allowed to declare the policy void or file an action for rescission on the grounds of concealment of misrepresentation of the insured. It has the following requisites:
  1. The policy is a life insurance policy.
  2. It is payable on the death of the insured.
  3. It has been in force during the lifetime of the insured for a period of at least two years from the date of issue or its last reinstatement. This two-year period may be shortened but it cannot be extended by stipulation.
- The period of two years for contesting a life insurance policy by the insurer may be shortened but it cannot be extended by stipulation.

Sec. 227 In the case of individual life or endowment insurance, the policy shall contain in substance the following conditions:

(b) A provision that the policy shall be incontestable after it shall have been in force during the lifetime of the insured for a period of at least two years from the date of issue or its last reinstatement. This two-year period may be shortened but it cannot be extended by stipulation.

Defenses Not Barred by Incontestable Clause:
1. That the person taking the insurance lacked insurability interest as required by law.
2. That the cause of the death of the insured is an excepted risk.
3. That the premiums have not been paid.
4. That the conditions of the policy relating to military or naval service have been violated.
5. That the fraud is of a particularly vicious type, as where the policy was taken out in furtherance of a scheme to murder the insured, or where the insured substitutes another person for the medical examination, or where the beneficiary feloniously kills the insured.
6. That the beneficiary failed to furnish proof of death or to comply with any conditions imposed by the policy after the loss has happened.
7. That the action was not brought within the time specified.

Argente v West Coast Life Ins. Co.

Facts: The insured spouses signed an application for joint insurance which was accepted by the insurer. The wife died of cerebral apoplexy a couple of months after the effectivity of the policy. When the husband filed a claim, the insurer denied the claim due to fraud and misrepresentation of the insured. It appeared that the answers the spouses gave in their medical examinations with regard to their health and previous illnesses and medical attendance were untrue.

Ratio: The spouses were guilty of concealment. As to the issue of the application of section 47 (now sec. 48) on the time the insurer must exercise the right to rescind, the court held that a failure to exercise the right of rescission cannot prejudice any defense to the action which the concealment may furnish. Where any of the material representations are false, the insurer’s tender of the premium and notice that the policy is cancelled, before the commencement of suit thereon, operate to rescind the contract of insurance, and are a sufficient compliance with the law.

6. WARRANTIES

6.1. Definition

Is a statement or promise set forth in the policy itself or incorporated in it by proper reference, the untruth or non-fulfillment of which in any respect and without reference to whether the insurer was in fact prejudiced by such untruth or non-fulfillment, renders the policy voidable by the insurer. A warranty may also be made by an insurer.

Sec. 67. A warranty is either expressed or implied.

6.2. Kinds of Warranties:

1. Express Warranty (Sec 67 & 71) is an agreement contained in the policy or clearly incorporated whereby the insured stipulates that certain facts relating to the risk are or shall be true or certain acts relating to the same subject have been or shall be done.
2. Implied Warranty (marine insurance only) is a warranty which from the very nature of the contract or from the general tenor of the words, although no express warranty is mentioned, is necessarily embodied in the policy as a part thereof and which binds the insured as though expressed in the contract. (There is an implied warranty that the ship is seaworthy when the policy attaches)
3. Affirmative Warranty (Sec. 68) is one which asserts the existence of a fact or condition at the time it is made.
4. Promissory warranty or Executory Warranty (Sec. 72 & 73) is one where

the insured stipulates that certain facts or conditions pertaining to the risk shall exist or that certain things with reference thereto shall be done or omitted. It is in the nature of a condition subsequent.

**Warranties are either affirmative or promissory and expressed or implied – so it comes in pairs you can have an implied affirmative warranty or an expressed affirmative warranty.**

**A warranty is presumed to be affirmative unless the contrary intention appears**

| Sec. 68. | A warranty may relate to the past, the present, the future, or to any or all of these. |
| Sec. 69. | No particular form of words is necessary to create a warranty. |

### 6.3. Warranties v Representation

<table>
<thead>
<tr>
<th>WARRANTY</th>
<th>REPRESENTATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Considered part of the contract</td>
<td>Collateral inducement to the contract</td>
</tr>
<tr>
<td>Always written on the face of the policy, actually or by reference</td>
<td>May be written in a totally disconnected paper or may be oral</td>
</tr>
<tr>
<td>Must be strictly complied with</td>
<td>Only substantial truth is required.</td>
</tr>
<tr>
<td>Falsity or non-fulfillment of a warranty operates as a breach of contract</td>
<td>Falsity of a representation renders the policy void on the ground of fraud.</td>
</tr>
<tr>
<td>Presumed material</td>
<td>Insurer must show the materiality of a representation in order to defeat an action on the policy.</td>
</tr>
</tbody>
</table>

**Risk, as a fact, is an express warranty thereof.**

<table>
<thead>
<tr>
<th>Sec. 72.</th>
<th>A statement in a policy, which imports that it is intended to do or not to do a thing which materially affects the risk, is a warranty that such act or omission shall take place.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Section 72 refers to promissory warranty.</td>
<td>• Breach of promises or agreements as to future acts will not avoid a policy unless the promises are material to the risk.</td>
</tr>
<tr>
<td>• Express warranties regarding the person, thing, or risk must refer to a statement of fact. If it is a mere belief, it will not constitute a warranty as far as the policy is concerned, but merely a warranty that the statement is his honest opinion or judgment.</td>
<td></td>
</tr>
</tbody>
</table>

### 6.4. When Breach of Warranty does not avoid policy:

1. When **loss occurs before** time for performance
2. When **performance becomes unlawful**
3. When **performance becomes impossible** (legal & physical impossibility)
4. When **insurer waives the warranty**, impliedly or expressly.

### 6.5. Materiality and Fraud in Warranty

| Sec. 73. | When, before the time arrives for the performance of a warranty relating to the future, a loss insured against happens, or performance becomes unlawful at the place of the contract, or impossible, the omission to fulfill the warranty does not avoid the policy. |
| Sec. 74. | The violation of a material warranty, or other material provision of a policy, on the part of either party thereto, entitles the other to rescind. |
| Sec. 75. | A policy may declare that a violation of specified provision thereof shall avoid it, otherwise the breach of an immaterial provision does not avoid the policy. |
| Sec. 76. | A breach of warranty without fraud, merely exonerates an insurer from the time that it occurs, or where it is broken in its inception, prevents the policy from attaching to the risk. |

- In order that a stipulation may be considered a warranty, it must not only be clearly shown that the parties intended it as such but it must also form a part of the contract itself or if contained in another instrument, it must be signed by the insured and referred to in the policy as making a part of it. Mere reference alone is not sufficient to give this effect.
- The designation or non-designation of a clause as a warranty is not controlling. What is essential is the intent of the contracting parties to create a warranty, regardless of the form of words used.

| Sec. 71. | A statement in a policy, of a matter relating to the person or thing insured, or to the |
If the breach of the warranty was WITH FRAUD – policy is void ab initio and the insured is not entitled to the return of the premium paid.

### 6.6. Warranties in Fire Insurance

**Sec. 167.** As used in this Code, the term “fire insurance” shall include insurance against loss by fire, lightning, windstorm, tornado or earthquake and other allied risks, when such risks are covered by extension to fire insurance policies or under separate policies. (a)

- A fire insurance is a contract of indemnity by which the insurer, for consideration, agrees to indemnify the insured against loss of, or damage to, property by fire.

**Sec. 168.** 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 risk, entitles an insurer to rescind a contract of fire insurance.

**Sec. 169.** An alteration in the use or condition of a thing insured from that to which it is limited by the policy, which does not increase the risk, does not affect a contract of fire insurance.

**Requisites Alteration to Entitle Insurer to Rescind:**

1. The **use or condition of the thing is specifically limited or stipulated in the policy.**
2. Such use or condition as limited by the policy is altered.
3. The alteration is made without the consent of the insurer.
4. The alteration is made by means within the control of the insured.
5. The alteration increases the risk.

**Increase of Risk or Hazard in General**

- Increase of hazard takes place whenever the insured property is put to some new use, and the new use increases the chance of loss.

Premise: Every insurance policy is made in reference to the conditions surrounding the subject matter of the risk and the premium is fixed with reference thereto. There is thus an implied promise or undertaking on the part of the insured that he will not change the premises or the character of the business carried there, or to be carried on there, so as to increase the risk of loss by fire.

**General Rule:** Insurer is not liable if there was an increase in the risk or hazard. There is increase in hazard when the new use increases the chance of loss. The increase of the risk of loss must in all cases be of a substantial character.

**Exceptions:** (Alterations which will not warrant the avoidance of the policy):

1. The use of the property is changed but it did not in any way increased the risk of loss
2. The use of materials prohibited from being used as per the policy if such materials are necessary or ordinarily used in the insured’s business.
3. Increase in risks brought about by the undertaking of necessary repairs in the premises
4. Increase in risks due to negligent acts temporarily endangering the property, or temporary acts or conditions which have ceased prior to the occurrence of the loss.
5. Alteration made by accident or without the knowledge of the insured.

Qualifier: However, the acts of the insured’s tenants which cause alterations are deemed presumptively known to the insured.

**Exception to the exception:** Under Section 75, the breach of an immaterial provision will not avoid the policy, but the insurer is given the right to insert terms, if violated, which would avoid it. The increase in risk brought by an alteration is therefore irrelevant if there is already a provision in the policy which stipulates that ANY alteration, of whatever nature and effect, shall avoid the policy.

- **For sec. 168 to operate, entitling the insurer the right to rescind, there must be an actual increase of risk and while it is not necessary that the increased risk should have cause or contributed to the loss, it is necessary that the increase be of a substantial character.**

**Sec. 170.** A contract of fire insurance is not affected by any act of the insured subsequent to the execution of the policy, which does not violate its provisions, even though it increases the risk and is the cause of a loss.

- If the policy does not contain any prohibition limiting the use or condition of the thing insured, an alteration in said use or condition does not constitute a violation of the policy. The contract is not affected by such alteration even though it increases the risk and is the cause of the loss.

**Sec. 171.** If there is no valuation in the policy, the measure of indemnity in an insurance against fire is the expense it would be to the insured at the time of the commencement of the fire to replace the thing lost of injured in the condition in which it was at the time of the injury; but if there is a valuation in a policy of fire insurance, the effect shall be the same as in a policy of marine insurance.

**Sec. 172.** Whenever the insured desires to have a valuation named in his policy, insuring any building or structure against fire, he may require such building or structure to be examined by an independent appraiser and the value of the insured’s interest therein may then be fixed as between the insurer and the insured. The cost of such examination shall be paid for by the insured. A clause shall be inserted in such policy stating substantially that the value of the insured’s interest in such building or structure has been thus fixed. In the absence of any change increasing the risk without the consent of the insurer or of fraud on the part of the insured, then in case of a total loss under such policy, the whole amount so insured upon the insured’s interest in such building or structure, as stated in the policy...
Effect of Pledge of Fire Insurance Policy

- After a loss has occurred, the insured MAY pledge, hypothecate or transfer a fire insurance policy or rights thereunder.
- What is being transferred is not the policy itself but the right to claim against the insurer.
- This right however is subject to the prohibition of Section 173.

Pioneer v Yap

**Facts:** The insured was the owner of a store selling bags and footwear, she took out a fire insurance from petitioner insurance company covering her stocks, office furniture, fixtures and fittings of every kind and description. A condition was set which required the insured to disclose to the insurer of any insurance or insurances "already effected, or which may be subsequently effected". It further stipulated that "…unless such notice be given and the particulars of such insurance or insurances be stated in or endorsed on this Policy by or on behalf of the Company before the occurrence of any loss or damage, all benefits under this Policy shall be forfeited". The insured failed to inform the insurer of another co-insurance. Fire broke out, gutted the store of insured. Upon filing of claim, petitioner insurance company denied the claim for violation of condition in the policy.

**Ratio:** By the plain terms of the policy, other insurance without the consent of petitioner would ipso facto avoid the contract. It required not affirmative act of election on the part of the company to make operative the clause avoiding the contract, wherever the specified conditions occur. In the absence of obligations unless being informed of the fact, it consented to the additional insurance. Furthermore, the court quoting Justice Bengson (Gen Insurance & Surety Corp v Ng Hua) said that “…and considering the terms of the policy which required the insured to declare other insurances, the statement in question must be deemed to be a statement (WARRANTY) binding on both insurer and insured, that there were no other insurance on the property....the annotation then, must be deemed to be a warranty that the property was not insured by any other policy. Violation thereof entitled the insured to rescind.”

Young v Midland Textile Insurance

**Facts:** The insured, an owner of a candy and fruit store took out a fire insurance policy from the defendant insurance company to insure his residence and his bodega. Under the policy, a condition was set as "warranty B" which stipulates that no hazardous goods be kept for sale and no hazardous trade or process shall be carried in the building. During the
enforcement of the insurance policy, the insured kept 3 boxes of fire crackers. Sometime later a fire broke out which partially destroyed the building but it appeared that the fire crackers were not the cause of the fire as they were found in an area not burned. Upon claim insurer denied payment.

Ratio: The terms of the contract constitute the measure of the insurer's liability. If the contract has been terminated by a violation of its terms on the part of the insured, there can be no recovery. Compliance with the terms of the contract is a condition precedent to the right of recovery. A violation of terms of a contract of insurance, by either party, will constitute the basis for a termination of the contractual relations, at the election of the other (in this case the insurer). The right to terminate the contractual relations exist even though the violation was not the direct cause of the loss, since the deposit of the "hazardous goods" in building insured was a violation of the terms of the contract. The insurer is relieved from its liability since the deposit of the hazardous materials created a new risk not included in the terms of the contract. The insurer had neither been paid, nor had he entered into a contract to cover the increased risk.

EXCEPTIONS/& EXCLUSION

- Intends to limit the liability of the insurer under certain circumstances.

**Musngi v West Coast Insurance Co. Inc.**

**Facts:** The insured took out two life insurance policies with defendant insurer designating as his beneficiaries the plaintiffs in the case. In his application the insured untruthfully answered questions regarding his health particularly about having consulted any physician regarding an ailment or his ailment. In his application for insurance, the insured had been treated for a number of ailments including peptic ulcer, TB etc. The insured died, and upon his death his beneficiaries filed a claim with defendant insurance company who denied the claim.

**Ratio:** The insured is guilty of concealment and thus relieves the insurer from paying the claim. The insured knew that he had suffered from a number of ailment before subscribing the application, yet he concealed them and omitted the hospital where he was confined as well as the name of his physician who treated him. The concealment and false statement constituted fraud, since it caused the defendant insurer to accept the risk when it would have otherwise refused. Such concealment of the insured rendered the policy null and void (as held also in Argente v West Coast).

**Filipinas Cia de Seguros v Nava**

**Facts:** On February 1939, plaintiff Nava and defendant Filipinas Life Assurance entered into 17 separate contracts of life insurance for which the insured issued 17 life insurance policies for which the insurer issued 17 life insurance policies, one of said policies having a face value of P10,000 while the rest a face value of P5,000 each, or a total of P90K. Each and every policy contains a policy loan clause. On April 1948, plaintiff applied for a loan of P5,000 in line with the loan clause but defendants refused citing certain regulations issued by the Insurance Commissioner on May 1946.

**Held:** Defendant's refusal to give the loan applied for by the plaintiff violated the loan clause embodied in each of the life insurance policies. This violation of the loan clause in the policy entitled plaintiff to rescind all policies under Section 69 of the Insurance Act, which provides: "the violation of a material warranty, or other material provision of a policy, on the part of either party thereto, entitles the other to rescind." Our Insurance Law does not contain an express provision as to what the court should do in cases of rescission of an insurance policy under Section 69, the provision that should apply is that embodied in Art. 1295 of the old civil code, as postulated in Art. 16 of the same Code, which provides that on matters which are not governed by special laws the provision of said Code shall supplement its deficiency. The CA was correct in ordering defendant to refund to plaintiff all premiums paid by him up to the filing of the action amounting to P34,644.60.

**Grounds and Exercise of Right of Rescission**

Sec. 48. Whenever a right to rescind a contract of insurance is given to the insurer by any provision of this chapter, such right must be exercised previous to the commencement of an action on the contract. After a policy of life insurance made payable on the death of the insured shall have been in force during the lifetime of the insured for a period of two years from the date of its issue or of its last reinstatement, the insurer cannot prove that the policy is void ab initio or is rescindable by reason of the fraudulent concealment or misrepresentation of the insured or his agent.

Sec. 63. A condition, stipulation, or agreement, in any policy of insurance, limiting the time for commencing an action thereunder to a period of less than one year from the time when the cause of action accrues is void.

**When Cause of Action Accrues**

- The right of the insured to the payment of his loss accrues from the happening of the loss.
- The cause of action in an insurance contract does not accrue UNTIL THE INSURED'S CLAIM IS FINALLY REJECTED BY THE INSURER, because before such final rejection, there is no real necessity for bringing suit.
- The period is to be computed not from the time the loss actually occurs but from the time when the insured has a right to bring an action against the insurer.

**Cause of Action** – requires as essential elements not only a legal right of the plaintiff and a correlative obligation of the defendant but also "AN ACT OR OMISSION OF THE DEFENDANT IN VIOLATION OF SAID LEGAL RIGHT", the cause of action in favor of the insured does not accrue until the insurer refuses expressly or impliedly to comply with his duty to pay the amount of the loss.
General Rule: a clause in the policy to the effect that an action upon the policy must be brought within a certain period is valid and will prevail over the general law on limitations of actions as prescribed by the Civil Code, if not contrary to Sec. 63, IC.

Exceptions: In industrial life insurance policies, the period cannot be less than 6 years after the cause of action accrues.


Under 384 of the Insurance Code, notice of claim must be filed within six months from the date of accident, otherwise the claim shall be deemed waived. Action or suit must be brought to proper cases, with the Commission of the court within one year from the denial of claim, otherwise, the claimant’s right of action shall prescribe.

Sec. 64. No policy of insurance other than life shall be cancelled by the insurer except upon prior notice thereof to the insured and no notice of cancellation shall be effective unless it is based on the occurrence, after the effective date of the policy, of one or more of the following:

(a) non payment of premium;
(b) conviction of a crime arising out of acts increasing the hazard insured against;
(c) discovery of fraud or material misrepresentation;
(d) discovery of willful or reckless acts or omissions increasing the hazard insured against;
(e) physical changes in the property insured which results in the property becoming uninsurable; or
(f) a determination by the Commissioner that the continuation of the policy would violate or would place the insurer in violation of this Code.

Sec. 65. All notices of cancellation mentioned in the preceding section shall be in writing, mailed or delivered to the named insured at the address shown in the policy and shall state:

(a) which of the grounds set forth in section 64 is relied upon; and
(b) that, upon written request of the named insured, the insurer will furnish the facts on which the cancellation is based.

Form and Sufficiency of Notice of Cancellation

1. There must be prior notice of cancellation to the insured.
2. The notice must be based on the occurrence, after the effective of the policy, of one or more of the grounds mentioned in section 64.
3. It must be in writing, mailed or delivered to the named insured at the address shown in the policy.
4. It must state which of the grounds set forth is relied upon.
5. It is the duty of the insurer upon written request of the insured to furnish the facts in which the cancellation is based. The premium referred to in Section 64 must be a premium subsequent to the first, because it speaks of non-payment “after the effective date of the policy”. If there was no premium paid at all, the action appropriate would be a declaration of nullity, based on Section 77 which provides that “no policy or contract of insurance issued by an insurance company is valid and binding unless and until the premium thereof has been paid”

Sec. 170. A contract of fire insurance is not affected by any act of the insured subsequent to the execution of the policy, which does not violate its provisions, even though it increases the risk and is the cause of a loss.

Sec. 227 In the case of individual life or endowment insurance, the policy shall contain in substance the following conditions:

(b) A provision that the policy shall be incontestable after it shall have been in force during the lifetime of the insured for a period of two years from its date of issue as shown in the policy, or date of approval of last reinstatement, except for non-payment of premium and except for violation of the conditions of the policy relating to military or naval service in time of war.

Sec. 380. No cancellation of the policy shall be valid unless written notice thereof is given to the land transportation operator or owner of the vehicle and to the Land Transportation Commission at least fifteen days prior to the intended effective date thereof. Upon receipt of such notice, the Land Transportation Commission, unless it receives evidence of a new valid insurance or guaranty in cash or surety bond as prescribed in this Chapter, or an endorsement of revival of the cancelled one, shall order the immediate confiscation of the plates of the motor vehicle covered by such cancelled policy. The same may be reissued only upon presentation of a new insurance policy or that a guaranty in cash or surety bond has been made or posted with the Commissioner and which meets the requirements of this chapter, or an endorsement or revival of the cancelled one. (As amended by PD No. 1455)
Chapter V: MARINE INSURANCE

1. DEFINITION

Sec. 99. Marine Insurance includes:
(1) Insurance against loss of or damage to:
(a) Vessels, craft, aircraft, vehicles, goods, freights, cargoes, merchandise, effects, disbursements, profits, moneys, securities, choses in action, evidences of debts, valuable papers, bottomry, and respondentia interests and all other kinds of property and interests therein, in respect to, appertaining to or in connection with any and all risks or perils of navigation, transit or transportation, or while being assembled, packed, crated, baled, compressed or similarly prepared for shipment or while awaiting shipment, or during any delays, storage, transhipment, or reshipment incident thereto, including war risks, marine builder's risks, and all personal property floated risks;
(b) Person or property in connection with or appertaining to a marine, inland marine, transit or transportation insurance, including liability for loss of or damage arising out of or in connection with the construction, repair, operation, maintenance or use of the subject matter of such insurance (but not including life insurance or surety bonds nor insurance against loss by reason of bodily injury to any person arising out of ownership, maintenance, or use of automobiles);
(c) Precious stones, jewels, jewelry, precious metals, whether in course of transportation or otherwise;
(d) Bridges, tunnels and other instrumentalities of transportation and communication (excluding buildings, their furniture and furnishings, fixed contents and supplies held in storage); piers, wharves, docks and slips, and other aids to navigation and transportation, including dry docks and marine railways, dams and appurtenant facilities for the control of waterways.
(2) "Marine protection and indemnity insurance," meaning insurance against, or against legal liability of the insured for loss, damage, or expense incident to ownership, operation, chartering, maintenance, use, repair, or construction of any vessel, craft or instrumentality in use of ocean or inland waterways, including liability of the insured for personal injury, illness or death or for loss of or damage to the property of another person.

1.1. “Navigational Exposure” – basic concept in definition.

- Dean says that since the IC (Insurance Code) does not really define what marine insurance is, most important is to just point out that NAVIGATIONAL EXPOSURE is the common thread that runs through the enumeration in Sec. 99
- Related to Navigation of the ship

17 This was asked in 2005, 2002, 1992, and 1982. Note the definition of constructive total loss, total loss, and notice of abandonment. Also know implied warranties and instances when vessel may proceed to a port other than its port of destination.

Definition of marine insurance under the IC and under the Insurance Act (Law w/c IC amended)

- Campos: the IC gives the terms of marine insurance a very wide coverage including property exposed to risks not connected with navigation.
- The simple clear definition in the IA was better: Marine insurance is an insurance against risks connected with navigation to which a ship, cargo, freightage, profits, or other insurable interest in movable property may be exposed during a certain voyage or a fixed period of time.

<table>
<thead>
<tr>
<th>Insurance Act (old definition)</th>
<th>Insurance Code (present def’n)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marine insurance covers all kinds of movable property, but it operated only if such property is exposed to risks connected with navigation.</td>
<td>Covers property exposed to risks of navigation and even those exposed to risks not connected with navigation, like risks connected with all other means of transportation, including overland and perhaps even air transportation.</td>
</tr>
</tbody>
</table>

- Criticism of IC def’n: It’s confusing impractical and unrealistic to apply provision intended specifically and only for risks of navigation (w/c came down to us from the usages and customs of merchants) to risks connected with land and air transportation.
- IC definition also didn’t serve any legal purpose by widening the scope of the definition since most of the special provisions in the IC relating to marine insurance can properly apply only to ships or other property exposed to navigational risks.
- Everything covered by the new definition would anyway be necessarily governed by the general provisions of the IC, even if the old definition had just been retained.
- Transportation insurance is concerned with the perils of property in transit as opposed to perils at a generally fixed location.

Major divisions of transportation (marine) insurance

1) OCEAN MARINE INSURANCE. An insurance against risk connected with navigation, to which a ship, cargo, freightage, profits or other insurable interest in movable property may be exposed during a certain voyage or a fixed period of time.
    - Scope of ocean marine insurance: it provide protection for: (a) ships or hulls, (b) goods or cargoes; (c) earnings such as freight, commissions, or profits; (d) liability incurred by the owner or any party interested in or responsible for the insured property by reason of maritime perils.
    - All risks or losses may be insured against, except such as are repugnant to public policy or
positively prohibited. A general marine insurance policy which does not state the risks assured is valid and covers the usual marine risks; and in a marine policy, the general enumeration of "all other perils etc." extends only to marine damage of like kind to those enumerated. To sustain recovery on a marine policy, the loss must have been proximately caused by the risk or peril insured against.

2) INLAND MARINE INSURANCE. Covers primarily the land or over the land transportation perils of property shipped by railroads, motor trucks, airplanes, and other means of transportation. It also covers risks of lake, river, or other inland waterway transportation and waterborne perils outside of some marine peril. The property covered by inland marine insurance is movable type of goods which is often at different locations.

- Divisions of inland marine insurance:
  1. Property in transit - the insurance provides protection to property frequently exposed to loss while it is in transportation from one location to another
  2. Bailee liability - the insurance provides protection to persons who have temporary custody of the goods or personal property of others, such as carriers, laundymen, warehousemen, garagekeepers
  3. Fixed transportation property - the insurance covers bridges, tunnels, and other instrumentalities of transportation and communication, although as a matter of fact they are fixed property. They are insured because they are essential to the transportation system. Marine policies must exclude buildings, their furniture, fixtures, fixed contents, and supplies held in storage. They invariably extend to cover more perils than those included in the usual fire policy. In order for a risk to qualify for a marine contract, there must be included some additional marine peril such as collapse, collision, flood, etc.
  4. Floater - in inland marine insurance, the term is used in the sense that it provides insurance to follow the insured property wherever it may be located, subject always to territorial limits of the contract. Although the basis for eligibility is the fact that transportation or movement of property is often present, the condition need not necessarily occur. Floaters have been issued covering property that is seldom moved.

Property covered by marine policy:
- A marine policy may cover any property or interest therein which may be subjected to the risks of navigation. Definition in policy may be modified or enlarged by riders, warranties, or indorsements attached to the policy.

- Term "goods and merchandise" usually found in a marine policy includes all articles which are on board the ship for COMMERCIAL purposes. (Does not incl. Clothing of crew, food, etc). Expected profits from the sale of such goods may also be protected.

- Freight or Freightage - all benefits derived by the owner, either from chartering (borrowing the entire ship) of the ship or its employment for the carriage of his own goods or those of others. This is not covered unless expressly stated in the policy.

- Freight Insurance doesn't cover passage money payable by passenger at the completion of the voyage unless expressly provided.

Risks which may be insured against:
- Insurer is liable for all losses PROXIMATELY caused by the perils covered by the marine policy
- Usually enumerated

1.2. "Perils of the Sea" and "Perils of the Ship"
- Peril of the Sea
  - includes only casualties arising from the violent action of the elements and does not cover ordinary wear and tear, like the silent, natural and gradual action of the elements on the vessel itself, or other damage usually incident to the voyage.
  - It also does not include (1) an injury due to the violence of some marine force if such violence was not unusual or unexpected; (2) loss of a sail during a tempest, for neither events are unusual (but carrying away of a mast or loss of an anchor will be covered, for in such cases the storm’s violence is definitely unusual and not to be expected as incident to navigation)
  - Fortuitous and unusual
  - Must be connected with maritime navigation
  - It is a relative term and the meaning may vary with the circumstances.

- It embraces all kinds of marine casualty such as (1) shipwreck, foundering, stranding, collision, and damages done to the ship or goods at sea by violent action of wind and waves; (2) losses occasioned by the jettisoning of cargo if it is made for the purpose of saving a vessel rendered unworthy during the voyage, not through the fault of the captain; (3) barratry, or any willful misconduct on the part of the master or crew in pursuance of some unlawful or fraudulent purpose without the consent of the owners, and to the prejudice of the owner’s interest. Barratry requires a willful and intentional act in its commission. No honest error of judgment or mere negligence, unless criminally gross, can be barratry.
The meaning of "perils of the sea" varies with circumstances. FOR EXAMPLE, a vessel designed for inland waters was insured. It was towed in the Gulf of Mexico. The insurer was aware of the hazardous nature of the journey and charged an extra premium. If any loss occurs, it will be held to be due to perils of the sea although a sea-going vessel would not have been damaged by the moderate waves encountered.

- **Peril of the Ship**
  - Loss which in the ordinary course of events results from (a) the **Natural and inevitable action of the sea**; (b) **ordinary Wear and Tear** of the ship; (c) the **negligent failure of the ship’s owner** to provide the vessel with proper equipment to convey the cargo under ordinary conditions
  - The insurer does not undertake to insure against perils of the ship.

Note: Everything that happens thru the inherent vice of the thing, or by the act of the owner, master or shipper shall not be reputed a peril if not otherwise borne in the policy.

- **Barratry** - willful and intentional act on the part of the master or crew, in pursuance of some unlawful or fraudulent purpose, without the consent of the owner, and to the prejudice of his interest; Neither honest error or judgment nor mere negligence. May be covered by policy

- **Taking at sea, arrests, restraints, and detainments of all kings, princes and people** - extraordinary acts by a sovereign authority in time of war, or under other unusual international conditions like blockades and embargoes. Acts done in the course of regular proceedings not included (i.e. vessel libeled and detained for non-payment of debt) since there is nothing fortuitous about the situation.
  - Includes not only “arrests” caused by political acts of a seizing state but also by ordinary legal processes such as a lawsuit on ownership and possession of goods. (see Malayan Insurance Corp v CA case)

- **All other perils, losses and misfortunes** - covers risks which are of like kind with the particular risks which are enumerated in the preceding part of the same clause of the contract

**La Razon Social “Go Tiaoco y Hermanos” v Union Insurance Society of Canton Ltd.**

**Facts**: A drain pipe passing through the hold where the insured rice was stored had become corroded in course of time, w/c created a hole in the pipe. An attempt was made to cement the hole and cover it with a strip of iron but due to the loading of the ship, this part of the pipe was submerged in water during the trip and was washed out. Water flowed into the hold and damaged the rice.

**Issue**: WON the insurer was liable

**Held**: NO. A loss which in the ordinary course of events, results from the natural and inevitable action of the sea, from the ordinary wear and tear of the ship, or from the negligent failure of the ship’s owner to provide the vessel with proper equipment to convey the cargo under ordinary conditions, is not a peril of the sea, but rather a “peril of the ship.” In such a case, the remedy of the insured shipper or consignee is not against the insurer but against the shipowner.

**Cathay Insurance v CA**

**Facts**: Remington Industrial Sales filed for the recovery of losses incurred due to the rusting of steel pipes it imported from Japan while it was in transit. Cathay Insurance refused payment claiming that the rusting was not due to a peril of the sea since it was not a casualty which could not be foreseen.

**Held**: NO question that rusting of steel pipes in the course of voyage is a “peril of the sea” in view of the toll on the cargo by wind, water and salt conditions. We would fail to observe a cardinal rule in the interpretation of contracts, namely, that any ambiguity therein should be construed against the issuer/drafter, namely, the insurer.

**Malayan Insurance Corp v CA (1997)**

**Facts**: TKC Marketing was the owner/consignee of soya bean meal shipped from Brazil to Manila. It was insured by Malayan Insurance. While the vessel was in South Africa it was arrested and detained due to a lawsuit questioning its ownership and possession. As a result, TKC Marketing filed a claim with Malayan for the non-delivery of the cargo.

**Issue**: WoN the arrest of the vessel by the civil authority was a peril of the sea

**Held**: The “arrest” caused by ordinary judicial process is deemed included among the covered risks. (Decision detailed the history of the “Free from Capture and Seizure” clause) Although the Free from Capture and Seizure clause was originally inserted in marine policies to protect against risks of war, its interpretation in recent years to include seizure or detention by civil authorities seems consistent with the general purposes of the clause.

**Filipino Merchants Insurance Co v CA**

**Facts**: A shipment of fishmeal insured by Filipino Merchants Co. was found to be damaged upon its unloading in the Port of Manila. The owner/consignee filed action to recover the amount represented by the damages based on the “all risks” clause of the policy but fil.Merchants refused claiming that there must be some casualty or accidental cause to which the loss is attributable.

**Held**: An “all risks” policy should be read literally (not technically) as meaning all risks whatsoever and covering all losses by an accidental cause of any kind. It has evolved to grant a greater protection than that afforded by the “perils” clause in order to assure that no loss can happen through the incident of a cause neither insured against nor creating liability in the ship. The insured under an all risks policy has the initial burden of proving that the cargo was damaged
when unloaded from the vessel, thereafter, the burden then shifts to the insurer to show the exception to the coverage. Under this policy it is sufficient to show that there was damage occasioned by some accidental cause of any kind and there is no necessity to point to any particular cause.

2. INSURABLE INTEREST

Sec. 100. The owner of a ship has in all cases an insurable interest in it, even when it has been chartered by one who covenants to pay him its value in case of loss: Provided, That in this case the insurer shall be liable for only that part of the loss which the insured cannot recover from the charterer.

- Owner of Vessel has insurable interest in the vessel even if he has mortgaged it. However, if ship is chartered and charterer agrees to pay him its value in case of loss, it is only liable for that part of the loss which the insured cannot recover from the charterer.
- Insurable interest of insured in marine insurance
  - General Rule: there can be no valid marine insurance unless supported by an insurable interest in the thing insured.
  - Exception: in certain cases of marine insurance, the insurer will still be held liable if he agreed to insure a ship or cargo “lost or not lost”, that is, he agreed to be bound in any case, even if it would later on be proved that the insured had nothing to insure when the contract was made.

Sec. 101. The insurable interest of the owner of the ship hypothecated by bottomry is only the excess of its value over the amount secured by bottomry.

Sec. 102. Freightage, in the sense of a policy of marine insurance, signifies all the benefits derived by the owner, either from the chartering of the ship or its employment for the carriage of his own goods or those of others.

Sec. 103. The owner of a ship has an insurable interest in expected freightage which according to the ordinary and probable course of things he would have earned but for the intervention of a peril insured against or other peril incident to the voyage.

Sec. 104. The interest mentioned in the last section exists, in case of a charter party, when the ship has broken ground on the chartered voyage. If a price is to be paid for the carriage of goods it exists when they are actually on board, or there is some contract for putting them on board, and both ship and goods are ready for the specified voyage.

Sec. 105. One who has an interest in the thing from which profits are expected to proceed has an insurable interest in the profits.

Sec. 106. The charterer of a ship has an insurable interest in it, to the extent that he is liable to be damnedified by its loss.

In Ship
- **Bottomry Loan** – one given on the security of the ship, on condition that the loan be repaid only if the ship arrives safely at the port of destination; money given in advance; if ship sinks, bottomry loan extinguished and owner doesn’t have to pay it.
- Bottomry loans and marine insurance can share protection and coverage of same risks; but cannot coextend with each other.
- Where a vessel is hypothecated by way of bottomry, the owner has an insurable interest only in the excess of the vessel’s value over the amount of the bottomry loan. This is so because when the vessel bottomed is lost, the owner need not pay the loan and is therefore benefited to the extent of the amount of the load obtained and the loss he actually suffers is only the difference between the actual value of the vessel and the bottomry.
- The lender in bottomry is entitled to receive a high rate of interest to compensate him for the risk of losing his loan.
3. CONCEALMENT

Sec. 107. In marine insurance each party is bound to communicate, in addition to what is required by section twenty-eight, all the information which he possesses, material to the risk, except such as is mentioned in Section thirty, and to state the exact and whole truth in relation to all matters that he represents, or upon inquiry discloses or assumes to disclose.

Sec. 108. In marine insurance, information of the belief or expectation of a third person, in reference to a material fact, is material.

Sec. 109. A person insured by a contract of marine insurance is presumed to have knowledge, at the time of insuring, of a prior loss, if the information might possibly have reached him in the usual mode of transmission and at the usual rate of communication.

Sec. 110. A concealment in a marine insurance, in respect to any of the following matters, does not vitiate the entire contract, but merely exonerates the insurer from a loss resulting from the risk concealed:

(a) The national character of the insured;
(b) The liability of the thing insured to capture and detention;
(c) The liability to seizure from breach of foreign laws of trade;
(d) The want of necessary documents;
(e) The use of false and simulated papers.

- Concealment in marine insurance is the failure to disclose any material fact or circumstance which in fact or law is within, or which ought to be, within the knowledge of one party and of which the other has no actual or presumptive knowledge.
- The rules are stricter than in the case of fire insurance because, in the latter, the insurer can easily obtain information regarding the property insured. In marine insurance, the vessels insured are often absent or afloat. Under Section 107, it is sufficient that the insured is in possession of the material fact concealed although he may not be aware of it.
- Opinions or expectations of third persons:
  - General Rule in insurance: the insured is not bound to communicate information of his own judgment and what he learns from a third person.
  - In marine insurance: the insured is bound to communicate the beliefs/opinions of third persons, as long as the information is in reference to a material fact.
- Presumptive knowledge by insured of prior loss: Sec. 109 establishes a rebuttable presumption of knowledge of prior loss on the part of the insured, on the recognition of the fact that communications technology nowadays makes it possible for the insured to be apprised of the loss of his vessel immediately after it occurs. The insured is not bound, however, to use all accessible means of information at the very last instant of time to ascertain the condition of the property insured.
- When concealment does not vitiate entire contract
  - General Rule in insurance: concealment of a material fact entitles the injured party to rescind.
  - In marine insurance: if loss happens under any of the conditions in Section 110 and such was concealed, the insurer is
merely exonerated from liability. The insurer, however, remains liable to pay for damage or loss brought by other perils of the sea.

**REPRESENTATION**

**Sec. 111.** If a representation by a person insured by a contract of marine insurance, is intentionally false in any material respect, or in respect of any fact on which the character and nature of the risk depends, the insurer may rescind the entire contract.

**Sec. 112.** The eventual falsity of a representation as to expectation does not, in the absence of fraud, avoid a contract of marine insurance. (Note: Will be void if there is fraud)

- Applicability of rules on representation to marine insurance:
  - The rules on representation are applicable to marine insurance, like the rules on distinction between representations and warranties, construction of representations, and avoidance of the policy based on a substantial misrepresentation of any material fact or circumstance. The test of materiality of representations also applies in marine insurance.
  - Anything which concerns the state of the vessel at any particular period of her voyage are material. Statements of the nature and amount of cargo, or whether the vessel was overloaded, or where the insurer did not rely thereon, have been held to be immaterial.
  - Effect of falsity of representation as to expectation:
    - Representations of expectations are statements of future facts or events which are in their nature contingent and which the insurer is bound to know that the insured could not have intended to state as known facts, but as mere expectations or intentions. Unless made with fraudulent intent, failure of the fulfillment of a representation of expectation is not a ground for rescission. They must be carefully distinguished from promissory warranties.

**Special Rule in Marine Insurance**

- Substantial truth of any material statement is NOT sufficient
- Law requires the insured to state the exact and whole truth in relation to all matters that he represents, or upon inquiry, discloses or assumes to disclose.
- Due to nature of contract

**Rules on Concealment and Misrepresentation**

- All information he possesses which are material to risk, except as is mentioned in Sec. 30 (cf with Sec. 28 which only require communication of facts which are material to the contract as to which he makes no warranty)
- Beliefs and expectations of 3rd persons in reference to a material fact.

**Sec. 28.** Each party to a contract of insurance must communicated to the other, in good faith, all facts within his knowledge which are material to the contract and as to which he makes no warranty, and which the other has not the means of ascertaining.

**Sec. 30.** Neither party to a contract of insurance is bound to communicate information of the matters following, except in answer to the inquiries of the other:

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

**TEST of Materiality:** Whether the concealed fact caused the loss and not its probable influence on the other party in deciding whether or not to enter the contract.

**Representations:** Insured must state the exact and whole truth in relation to all matters that he represents of upon inquiry discloses or assumes to disclose.

**False representations:**

1. Any misrepresentation of a material fact made with fraudulent intent
2. The character and nature of the risk depends on the fact misrepresented

**Effect:** Insurer may RESCIND the contract

**Exception:** Eventual falsity of a representation as to expectation, in the absence of fraud, does not avoid the contract.

**Coastwise v CA**

**Facts:** Pag-Asa Sales had molasses transported from Negros to Manila using Coastwise Lighterage Corp’s open barges. However, one of the barges sank when it hit an unknown sunken object while approaching Manila Bay Port. Because of this, Pag-Asa rejected the shipment as a total loss and Phil. General Insurance Company paid for the loss. PhilGen then filed an action against Coastwise Lighterage seeking to recover the amount it paid Pag-asa. Coastwise claims that it was unaware of the hidden danger in its path, thus it became impossible for Coastwise to avoid it, even with the exercise of extraordinary diligence.

**Held:** Coastwise’s assertion is belied by the evidence. The patron of the vessel which sank admitted that he was not licensed thus, it cannot safely claim to have exercised extraordinary
diligence by placing a person whose navigational skills are questionable at the helm of the vessel w/c met the accident. Logically, a person w/o a license to navigate lacks not just the skill to do so, but also the familiarity with the usual and safe routes taken by seasoned and legally authorized persons.

4. IMPLIED WARRANTIES

Sec. 113. In every marine insurance upon a ship or freight, or freightage, or upon any thing which is the subject of marine insurance, a warranty is implied that the ship is seaworthy.

Sec. 114. A ship is seaworthy when reasonably fit to perform the service and to encounter the ordinary perils of the voyage contemplated by the parties to the policy.

Sec. 115. An implied warranty of seaworthiness is complied with if the ship be seaworthy at the time of commencement of the voyage, except in the following cases:
(a) When the insurance is made for a specified length of time, the implied warranty is not complied with unless the ship be seaworthy at the commencement of each voyage it undertakes during that time;
(b) When the insurance is upon the cargo which, by the terms of the policy, description of the voyage, or established custom of the trade, is to be transhipped at an intermediate port, the implied warranty is not complied with unless each vessel upon which the cargo is shipped, or transhipped, be seaworthy at the commencement of each particular voyage.

Sec. 116. A warranty of seaworthiness extends not only to the condition of the structure of the ship itself, but requires that it be properly laden, and provided with a competent master, a sufficient number of competent officers and seamen, and the requisite appurtenances and equipment, such as ballasts, cables and anchors, cordage, sails, food, water, fuel, and lights, and other necessary or proper stores and implements for the voyage.

Sec. 117. Where different portions of the voyage contemplated by a policy differ in respect to the things requisite to make the ship seaworthy therefor, a warranty of seaworthiness is complied with if, at the commencement of each portion, the ship is seaworthy with reference to that portion.

Sec. 118. When the ship becomes unseaworthy during the voyage to which an insurance relates, an unreasonable delay in repairing the defect exonerates the insurer on ship or shipowner’s interest from liability from any loss arising therefrom.

Sec. 119. A ship which is seaworthy for the purpose of an insurance upon the ship may, nevertheless, by reason of being unfitted to receive the cargo, be unseaworthy for the purpose of the insurance upon the cargo.

Sec. 120. Where the nationality or neutrality of a ship or cargo is expressly warranted, it is implied that the ship will carry the requisite documents to show such nationality or neutrality and that it will not carry any documents which cast reasonable suspicion thereon.

- Warranty, in marine insurance, has been defined as a stipulation, either expressed or implied, forming part of the policy as to some fact, condition or circumstance relating to the risk.
- Implied Warranties - conditions upon the underwriter’s liability for the risks assumed in every insurance upon any marine venture whether of vessel, cargo, or freight.

4.1. Implied warranties in marine insurance

a) Seaworthiness
b) Deviation
c) Other Implied Warranties:
   - Carry the requisite documents to show nationality or neutrality
   - Not engage in any illegal venture
d) it is also impliedly warranted that the insured has an insurable interest in the subject matter insured

- General provisions on warranties also apply to marine insurance
- ONLY marine insurance has IMPLIED WARRANTIES provided by law

a) Seaworthiness:

   Meaning

   - Ship is seaworthy when reasonably fit to perform the services and to encounter the ordinary perils of the voyage contemplated by the parties to the policy.
   - NOT absolute guarantee that vessel will safely meet all possible perils
   - CIRCUMSTANCES determine WON vessel is reasonably seaworthy
   - Seaworthiness extends not only to condition of ship’s structure, but requires
     - ship to be properly laden
     - competent master
     - sufficient number of competent officers and crew
     - requisite appurtenances and equipment (ballasts, cables, anchors, cordage, sails, food, water, fuel, lights, necessary/proper stores and implements for the voyage)
   - In a fit state as to repair, equipment, crew, and in all other respects to perform the voyage insured and to encounter the ordinary perils of navigation
   - Must also be in a suitable condition to carry the cargo put on board or intended to be put on board

- Such warranty can be excluded only by clear provisions of the policy
- Where seaworthiness admitted by insurer:
  a. Admission is stipulated in the contract: the issue of seaworthiness cannot be raised by the insurer without showing concealment or misrepresentation by the insured.
  b. The admission may mean:
(1) that the warranty of seaworthiness is to be taken as fulfilled; or
(2) that the risk of unseaworthiness is assumed by the insurer.

c. Insertion of waiver clauses in cargo policies is in recognition of the realistic fact that cargo owners cannot control the state of the vessel.

- Where unseaworthiness unknown to owner of cargo insured:
  a. SUBJECT MATTER IS CARGO: the implied warranty of seaworthiness attaches to whoever is insuring the cargo, WON he is the shipowner.
  b. Lack of knowledge by the insured is immaterial in ordinary marine insurance and is not a defense in order to recover on the policy.
  c. Since the law provides for an implied warranty, it becomes the obligation of a cargo owner to look for a reliable common carrier which keeps its vessels in seaworthy condition. Shipper may have no control over the vessel but he has full control in the choice of the common carrier that will transport his goods.
  d. Cargo owner may also enter into a contract of insurance which specifically provides that the insurer answers not only for the perils of the sea but also provides for coverage of perils of the ship.
  e. A charterer of a vessel has no obligation before transporting its cargo to ensure that the vessel complied with all the legal requirements. The duty rests upon the common carrier simply for being engaged in "public services."
  f. Because of the implied warranty of seaworthiness, shippers are not expected, when transacting with common carriers, to inquire into the vessel's seaworthiness, genuineness of its licenses and compliance with all maritime laws.

- Seaworthiness is a relative term depending upon the nature of ship (must be in a fit state as to repair, equipment, crew and in all other respects to perform the voyage insured and encounter the ordinary perils; suitable condition to carry cargo), nature of voyage (determines WON vessel is well-fitted), nature of service (nature of cargo should be determined; the vessel should be reasonable capable of safely carrying the cargo), and purpose of voyage.

- Failure of a common carrier to maintain in seaworthy condition the vessel is a clear breach of its duty prescribed in Article 1755, CC.

- It is not necessary that the cargo itself shall be seaworthy.

When warranty deemed complied with; exceptions

- Implied warranty of seaworthiness is deemed complied with if ship is seaworthy AT THE TIME OF THE COMMENCEMENT OF THE RISK; What matters is that at the start of the voyage insured, ship is seaworthy. Assured makes no warranty that vessel will continue to be seaworthy, or that the crew won't be negligent.

- Principle Behind this: If vessel, crew, and equipment be originally sufficient, the assured has done all that he contracted to do (not anymore responsible for future deficiencies).

- Exceptions: Secs. 115a, 115b, 117
  - (115a) In case of TIME policy – insurance made for a specified length of time, ship must be seaworthy at the commencement of every voyage she may undertake.
  - (115b) In case of Cargo policy – Insurance is upon the cargo which by the terms of the policy, description of the voyage, or established custom of the trade, is to be transshipped at an intermediate port; each vessel upon which the cargo is shipped must be seaworthy at the commencement of each particular voyage.
  - (117) In case of Voyage policy contemplating a voyage in different stages – ship must be seaworthy at the commencement of each portion; stages must be separate and distinct in order to have a different degree of seaworthiness for particular parts.

Scope of Seaworthiness of vessel

1. INSURANCE ON CARGO: it must be properly loaded, stowed, dunnaged, and secured so as not to imperil the navigation of the vessel to cause injury to the vessel or cargo.

2. INSURANCE ON VESSEL: ship is not seaworthy because of some defect in loading or stowage which is easily curable by those on board, and was cured before the loss.

3. DECK CARGO: carrying it raises a presumption of unseaworthiness which can be overcome only by showing affirmatively that the deck cargo was not likely to interfere with the due management of the vessel.

Where ship becomes unseaworthy during voyage

General Rule: There is no implied warranty that the vessel will remain in a seaworthy condition throughout the life of the policy.

1. When the vessel becomes unseaworthy during the voyage, it is the duty of the master, as the shipowner’s representative, to exercise due diligence to make it seaworthy again, and if loss should occur because of his negligence in repairing the defect, the insurer is relieved of liability but the contract of insurance is not affected as to any other risk or loss covered and not caused or increased by such particular defect.

18 Transshipment - the act of taking cargo out of one ship and loading it in another or the transfer of goods from the vessel stipulated in the contract of affreightment to another vessel before the place of destination named in the contract has been reached or the transfer for further transportation from one ship or conveyance to another. Fact of transshipment is not dependent upon the ownership of the transporting conveyances but rather on the fact of actual physical transfer or cargoes from one vessel to another. Transshipment of freight without legal excuse, however competent and safe the vessel into which the transfer is made, is an infringement on the right of the shipper and subjects the carrier to liability if the freight is lost even by a cause otherwise excepted.
2. Benefit of exoneration is given only to an "insurer on ship or shipowner's interest."

Due diligence not a defense
- Warranty precludes any defense that insured had exercised due diligence to make the ship seaworthy.
- SHIP MUST ACTUALLY BE SEAWORTHY

Seaworthiness as to cargo
- Ship may be seaworthy for purpose of insurance on the ship, but may still be unseaworthy for purpose of insurance of the cargo.
- One ship may be seaworthy but the cargo it carries may not be.
- SHIP MUST ACTUALLY BE SEAWORTHY

Delsan for any liability under its contractual obligation as a common carrier. The fact of payment grants the private respondent subrogatory right w/c enables it to exercise legal remedies that would otherwise be available to Caltex as owner of the lost cargo.

b) Voyage and Deviation

Sec. 121. When the voyage contemplated by a marine insurance policy is described by the places of beginning and ending, the voyage insured in one which conforms to the course of sailing fixed by mercantile usage between those places.

Sec. 122. If the course of sailing is not fixed by mercantile usage, the voyage insured by a marine insurance policy is that way between the places specified, which to a master of ordinary skill and discretion, would mean the most natural, direct and advantageous.

Sec. 123. Deviation is a departure from the course of the voyage insured, mentioned in the last two sections, or an unreasonable delay in pursuing the voyage or the commencement of an entirely different voyage.

Sec. 124. A deviation is proper:
(a) When caused by circumstances over which neither the master nor the owner of the ship has any control;
(b) When necessary to comply with a warranty, or to avoid a peril, whether or not the peril is insured against;
(c) When made in good faith, and upon reasonable grounds of belief in its necessity to avoid a peril; or
(d) When made in good faith, for the purpose of saving human life or relieving another vessel in distress.

Sec. 125. Every deviation not specified in the last section is improper.

Sec. 126. An insurer is not liable for any loss happening to the thing insured subsequent to an improper deviation.

What Voyage Insured

<table>
<thead>
<tr>
<th>Policy</th>
<th>What ship must do</th>
</tr>
</thead>
<tbody>
<tr>
<td>Names:</td>
<td>Vessel insured MUST follow course SPECIFIED</td>
</tr>
<tr>
<td>Names:</td>
<td>1. Voyage insured is the one which conforms to course of sailing fixed by mercantile usage between ports (Sec. 121)</td>
</tr>
<tr>
<td></td>
<td>2. if not fixed by mercantile usage, course between ports specified which to a master of ordinary skill and discretion would be</td>
</tr>
</tbody>
</table>

Facts: Manila Bay Lighterage Corp., a common carrier, entered into a contract w/ Roque whereby Manila Bay Lighterage would carry on board its barge Roque’s logs from Palawan to Manila. The logs were insured by Pioneer Insurance. However, the barge sank. It was found that the barge was not seaworthy (one of the hatches was left open, there was a leak in the barge). Pioneer refused to pay damages because of the breach of the implied warranty on seaworthiness. Roque’s defense is that as a mere shipper of cargo, they have no control of the ship therefore seaworthiness has nothing to do with the matter of insurance over the logs.

Issue: WON the implied warranty of seaworthiness also applies to marine insurance on cargo.

Held: YES For every contract of insurance which is a subject of marine insurance, a warranty is implied that the ship will be seaworthy. Since the law provides for an implied warranty of seaworthiness in every contract of marine insurance, it becomes the obligation of a cargo owner to look for a reliable common carrier which keeps its vessels in seaworthy condition. The shipper of the cargo may have no control over the vessel but he has full control in the choice of the common carrier that will transport his goods.

Delsan Transport v CA

Facts: Caltex entered into a contract of affreightment with Delsan Transport Lines to transport Caltex’s fuel oil from its refinery to different parts of the country. However, the ship to Zamboanga which was insured by American Home Corp. sank. American Home paid Caltex representing the insured value of the lost cargo. American Home, exercising its right of subrogation, demanded of Delsan the same amount paid to Caltex but Delsan refused. It was found that the chief mate of the vessel was not qualified under the Phil. Merchant Marine Rules.

Issue: WON the payment made by American Home to Caltex amounted to admission that the vessel was seaworthy

Held: NO. The payment made by American Home operates as a waiver of its right to enforce the term of the implied warranty against Caltex under the insurance policy. However, the same cannot be validly interpreted as an automatic admission of the vessel’s seaworthiness by American home as to foreclose recourse against Delsan for any liability under its contractual obligation as a common carrier. The fact of payment grants the private respondent subrogatory right w/c enables it to exercise legal remedies that would otherwise be available to Caltex as owner of the lost cargo.

Name: | Vessel insured MUST follow course SPECIFIED |
| Names: | 1. Voyage insured is the one which conforms to course of sailing fixed by mercantile usage between ports (Sec. 121) |
|        | 2. if not fixed by mercantile usage, course between ports specified which to a master of ordinary skill and discretion would be |
Deviation (Sec. 123)
- Is any unexcused departure from the regular course or route of the insured voyage or any other act which substantially alters the risk constitutes a deviation
- Departure from course of ship
- Unreasonable delay in pursuing voyage
- Commencement of entirely different voyage

Proper and Improper Deviation
- PROPER deviation – those allowed by law (Sec. 124)
- IMPROPER deviation – all other deviation not mentioned in Sec. 124; any loss suffered by thing insured subsequent to improper deviation exonerates insurer from liability, regardless of whether deviation increased risk or not
- WHY does improper deviation exonerate? Because insured novated contract without consent of insurer!
- TEST: WON deviation was proper or not (NOT WON risk was increased or diminished)

General Rule: when the voyage covered by the policy is described by the places of beginning and ending, the voyage insured is the one which conforms to the course of sailing fixed by mercantile usage between the places, or in absence of the latter, the way between the places that to a master of ordinary skill and discretion would mean the most natural, direct and advantageous route. The insurer is not liable for a loss after an improper deviation.

When deviation is proper
- No vitiation of the policy if the deviation is justified or caused by actual necessity which is equal in importance to such deviation.
- Such compulsory deviations are risks impliedly assumed by the underwriter. While deviation to save property is not justified, unless it is to save another vessel in distress, a deviation for the purpose of saving life does not constitute a breach of warranty. Justification rests on ground of humanity.

Deviations to repair damaged ship
- If during voyage, vessel becomes so damaged as to render it unsafe without undergoing repairs, insurer is not relieved by deviation from the ship’s course in order to make the nearest port for such repairs (can fall under “avoid peril”)
- Master must consider distance, facilities of port, quickness new material can be procured, etc. (not necessarily nearest port, but must be most proper port for repair).
- Once repair is made, ship must pursue new course without deviation in shortest and most expeditious manner (otherwise, this is deviation and will absolve insurer)

Waiver of warranty against improper deviation
- Done by expressly permitting waiver in policy “at a PREMIUM to be hereafter arranged,” provided DUE NOTICE be given by insured upon receipt of advice of such deviation.
- Requirement: EXPRESSED in policy.
- PREMIUM paid, NOTICE given

OTHER IMPLIED WARRANTIES
- Nationality or Neutrality of ship or cargo is expressly warranted, it’s implied ship will carry requisite documents showing nationality or neutrality and will not carry documents that will cause reasonable suspicion
- Nationality - doesn’t mean that the ship was built in such country, but that the property belongs to a subject thereof
- Neutrality – property insured belongs to neutrals; a warranty of neutrality imports that the property insured is neutral in fact, and in appearance and conduct, that the property shall belong to neutrals, that no act of insured or his agent shall be done which can legally compromise its neutrality; warranty extends to insured’s interest in all the property intended to be covered by the policy, but not to the interest of a third person not covered by the policy.
- A warranty of national character may be gathered from the language of the policy although an exception has been made where the fact recited could have no relation to the risk.
- Implied that ship will not engage in any venture which is illegal under the laws of the country where contract is made or before whose courts question may come; CANNOT be waived since rule of public policy.
- Implied warranty to carry requisite documents:
  1) Warranty of nationality also requires that the vessel be conducted and documented as of such nation, a breach of warranty in either particular will avoid the policy.
  2) Warranty is a continuing one, change of nationality is a breach of the warranty, but warranty is not broken by a contract for sale and transfer to an alien at a future date.
  3) Proper papers must be produced when necessary to prove ownership. Production not excused because the papers were lost by the fault of the master.

5. LOSS

5.1. KINDS COVERED, ACTUAL AND CONSTRUCTIVE LOSS
A loss may be either total or partial.

Every loss which is not total is partial.

A total loss may be either actual or constructive.

An actual total loss is caused by:
(a) A total destruction of the thing insured;
(b) The irretrievable loss of the thing by sinking, or by being broken up;
(c) Any damage to the thing which renders it valueless to the owner for the purpose for which he held it; or
(d) Any other event which effectively deprives the owner of the possession, at the port of destination, of the thing insured.

A constructive total loss is one which gives to a person insured a right to abandon, under Section one hundred thirty-nine.

An actual loss may be presumed from the continued absence of a ship without being heard of. The length of time which is sufficient to raise this presumption depends on the circumstances of the case.

When a ship is prevented, at an intermediate port, from completing the voyage, by the peril insured against, the liability of a marine insurer on the cargo continues after they are thus reshipped.

Nothing in this section shall prevent an insurer from requiring an additional premium if the hazard be increased by this extension of liability.

In addition to the liability mentioned in the last section, a marine insurer is bound for damages, expenses of discharging, storage, reshipment, extra freightage, and all other expenses incurred in saving cargo reshipped pursuant to the last section, up to the amount insured.

Nothing in this or in the preceding section shall render a marine insurer liable for any amount in excess of the insured value or, if there be none, of the insurable value.

Upon an actual total loss, a person insured is entitled to payment without notice of abandonment.

Where it has been agreed that an insurance upon a particular thing, or class of things, shall be free from particular average, a marine insurer is not liable for any particular average loss not depriving the insured of the possession, at the port of destination, of the whole of such thing, or class of things, even though it becomes entirely worthless; but such insurer is liable for his proportion of all general average loss assessed upon the thing insured.

An insurance confined in terms to an actual loss does not cover a constructive total loss, but covers any loss, which necessarily results in depriving the insured of the possession, at the port of destination, of the entire thing insured.

1) Total – underwriter is liable for the whole of the amount insured
   - may be actual or absolute OR constructive or technical

2) Partial (refer to gen. and part average)
   TOTAL LOSS (any loss not total is partial)

a. Actual Total Loss
1. Total destruction thing insured
2. Irretrievable loss of thing by sinking or by being broken up
3. Any damage to thing which renders it valueless to owner for the purpose for which the owner held it
   - Loss by sinking may not be irretrievable, but there’s still actual total loss if thing becomes valueless to owner for purpose for which he held it
   - TOTAL LOSS is cost of RETRIEVAL equal to or more than original value
4. Any other event which effectively deprives owner of possession, at the port of destination of thing insured.

5. Under Section 130, the complete physical destruction of the subject matter as in the case of fire is not essential to constitute an actual total loss ([b], [c], [d]). Such loss may exist where the form and specie of the thing is destroyed although the materials of which it consisted still exist (Pan Malayan v. CA [91]). For example, when repairs would be more expensive than the original cost of the vessel and effective deprivation of use and possession of property.
   - Presumed from continued absence of ship without being heard of (for length of time sufficient to raise such presumption)

General Rule: if a vessel is not heard of at all within a reasonable time after sailing or for a reasonable time after she was last seen, she will be presumed to have been lost from a peril insured against.

How presumption is established:
Plaintiff must prove that vessel left the port of outfit for the voyage insured. Then, he must show that the vessel was not heard of at port of departure after sailing, without calling witnesses from port of destination to show she never arrived there. No rule as to the time after which missing vessel is presumed lost—depends on the circumstances of the case.

- Insured has ABSOLUTE right to claim whole amount of insurance even without notice of abandonment. Once he receives amount, it takes the place of the vessel and must be used to pay for any damage for which it be held liable.
b. Constructive (or Technical) total loss; Abandonment (refer to the next few sections)
- Loss, although not actually loss, is of character that the insured is entitled, if he thinks fit, to treat it as total by abandonment.
- Gives the insured the right to abandon the thing insured by relinquishing to the insurer his interest in such a thing, entitling him to recover for a total loss thereof.
- Right to abandon granted by law if the peril insured against causes a loss of more than 1/3 the value of the thing insured.
- Insurer acquires all rights over the thing insured.
- If abandonment is not proper or properly made, the insured would still be liable as upon the Actual total loss, deducting from the amount any proceeds from the thing insured which may have come to the hands of the insurer.
- Why differentiate between the 2 types of total loss: the kind of loss is the basis for the application of the doctrine of abandonment (Section 138, 139). In actual total loss, no abandonment necessary; but if loss merely constructively total, an abandonment becomes necessary to recover as for a total loss.
- Stipulation of “actual total loss” only strictly construed: an insurance against “total loss only” covers any total loss, actual or constructive, although there is authority to the contrary. If against “absolute” or “actual total loss, insurer not liable for constructive loss.

Liability of insurer in case of partial loss of ship or its equipment
- There is a deduction from the cost of repairs of “one third new for old”, on the theory that the new materials render the vessel much more valuable than it was before the loss. When repairs are made, one-third of the cost of the repair is laid upon the insured as his burden, and the implied agreement under the policy is that in case of damage to the ship by a peril within the policy, the loss shall be estimated at two-thirds of the cost of repairs fairly executed or one-third new for old, as is commonly expressed.

IF VOYAGE CAN’T BE COMPLETED (See Sec. 133)
- In Insurance Act (Sec.126), if ship is prevented from leaving an intermediate port by perils insured against, the master must make every exertion to procure, in the same or contiguous port, another ship for the purpose of conveying the cargo to its destination and the liability of a marine insurer thereon continues after they are thus reshipped. However, such an obligation was deleted from the Insurance Code. Campos says that this may be either an unintentional omission/error or intentional. In any case, in case of reshipment, the insurer is liable:
  1. For any loss which may take place on goods until they are reshipped if voyage cannot be completed in any insurance upon cargo – insurer may required additional premium if the hazard be increased by the extension of liability (Sec. 133)
  2. Insurer also liable for expenses necessary to complete the transportation of cargo reshipped; damages, expenses of discharging, storage, reshipment, extra freightage, and all other expenses incurred in saving cargo reshipped – such liability, however, cannot exceed the amount of insurance (Sec 134)

General Rule: if the original ship be disabled, and the master, acting with a wise discretion, as the agent of the merchant and the shipowner, forwards the cargo in another ship, such reshipment is authorized. In case of ship, cargo or both will not discharge the underwriter on the goods from liability for any loss which may take place on goods after such reshipment.
- Exception: the general rule is not obligatory if the crew had to procure a vessel from distant places and there are serious impediments in the way of putting the cargo on board.
- Subsidiary Rule: additional premium may be required if the hazard is increased by extension of liability.

LIABILITY OF INSURER IN CASE OF AVERAGE Average – any extraordinary or accidental expenses incurred during the voyage for the preservation of the vessel, cargo or both and all damages to the vessel and cargo from the time it is loaded and the voyage commenced until it ends and the cargo unloaded

Two kind of Averages (Under Admiralty Law):
- a. Particular Average – partial loss caused by the peril insured against which is not a general average loss out of the ordinary use of the thing
  - Not everyone benefits.
  - Not intentionally caused to prevent a common danger
  - Insurer liable for the particular average unless policy excludes it.
  - Liability is limited to the proportion of the contribution attaching to his policy value where this is less than the contributing value of the thing insured.
  - Liability for particular insurance
- b. General Average – common benefit (to everyone), INTENTIONAL damage to save the majority thing (something is sacrificed).
  - Applies only when it is SUCCESSFUL
  - Includes all damages and expenses which are deliberately caused in order to save the vessel, its cargo or both at the same time, from a real and known risk
  - Therefore, when everyone benefits, everyone has to spend for it, so the person whose cargo was sacrificed cannot recover
everything because part of that will go to the pro-rata damage to save the majority

- "General average" contribution is a device for a limited distribution of loss. Loss is pro tanto made up by proportionate or "general average" contributions from owners of interests benefited by the sacrifice.
- A principle of customary law, independent of contract
- Ex. Entering another port for repairs, rehandling of cargo, and jettisoning of goods to lighten vessel in case of danger of shipwreck.
- Gives rise to right of owner to contribution form those benefited thereby or from insurer.
- Formalities in Art. 813 and 814 of the Code of Commerce must be complied with to incur expenses and cause damages corresponding to gross average.
- Liability of Insurer: If owner is insured, he has the alternative of seeking from his insurer, subrogating the latter to his said right of contribution. He loses this alternative, however, if he neglects or waives his right to such contribution.
- Exception: There can be no recovery for general average loss against the insurer:
  1. After the separation of the interests liable to the contribution
  2. When the insured has neglected or waived his right to contribution.
- Requisites for Gen. Ave to exist
  1. There must be common danger to ship and cargo
  2. For common safety, part of the vessel or cargo is sacrificed deliberately
  3. From the expenses or damages caused follows the saving of the vessel and cargo
  4. That the expenses or damages were incurred or inflicted after taking the proper legal steps.
  5. Made by the master or upon his authority.
  6. Not caused by any fault of party asking for contribution
  7. Necessary
- Liability of insurer for general average

\[
\text{Limit as to liability of insurer for general average loss}
\]

It is limited to the proportion of contribution attaching to his policy value where this is less than the contributing value of the thing insured. In other words, the liability of the insurer shall be less than the proportion of the general average loss assessed upon the thing insured where its contributing value is more than the amount of the insurance. In such a case, the insured is liable to contribute ratably with the insurer to the indemnity of the general average:

\[
\text{Amount of insurance} \times \frac{\text{Proportion of general}}{\text{average loss assessed}} = \text{Limit of liability of insurer}
\]

**Facts:** The insured vessel owned by Phil. Manufacturing Co. sand due to a typhoon. Despite the offer of Phil Man. To abandon the vessel as an absolute total loss, the insurer, Ins. Society of Canton refused it and required that the ship be salvaged. After several futile attempts, the ship was finally raised about two months later and was repaired. The cost of salvage and repair was substantially equal to the original cost of the vessel.

**Issue:** WON Insurance Society can be held for total loss of the vessel even after its recovery

**Held:** YES. Insurer liable for total loss because while the ship was in the bottom of the sea, it was of no value to the owner. To render it valueless to the insured, it is no necessary that there be an actual or total loss or destruction of all the different parts of the entire vessel.

**Choa v CA**

**Facts:** Choa imported some lactose crystals from Holland. The goods were insured with Filipino Merchants against all risks. Upon arrival in Manila, it was found that out of the 600 bags, 403 were in bad order. Choa filed a claim for the loss but Fil. Mer rejected.

**Issue:** WON an “all risks” coverage covers only losses occasioned by fortuitous events

**Held:** NO. An all risk insurance policy insures against all cause of conceivable loss or damage except as otherwise excluded in the policy or due to fraud. The terms of the policy are clear and require no interpretation. An “all risks” provision creates a special type of insurance w/c extends coverage to risks not usually contemplated and avoids putting upon the insured the burden of establishing that insurer can avoid coverage upon demonstrating that a specific provision expressly excludes the loss from coverage.

**Aboitiz Shipping v PHILAMGEN**

**Facts:** Marinduque Mining Industrial Crop had shipped from the US a shipment of one skid carton parts for valves. When cargo arrived in Manila, it was deposited in the office of Aboitiz Shipping Corp for transshipment to Nonoc Island. However, before it was transshipped, said cargo was pilfered. Marinduque filed a claim against Aboitiz in the amount of the pilfered cargo. It also filed for the same amount against Philippine
American General Insurance Co (Phil-Am), its insurer. 

**Issue:** WON Aboitiz should be held liable for the pilfered cargo. 

**Held:** YES. The questioned shipment is covered by a continuing open insurance coverage from the time it was loaded in the US to the time it was delivered to the possession of Aboitiz in its Manila office. Aboitiz’s contention is that it could not be held liable for the pilferage as it was stolen even before it was loaded on the vessel. This is untenable as the logs were in its possession before it was pilfered.

**Oriental Assurance v CA**

**Facts:** Panama Sawmill Co had logs shipped from Palawan aboard the barges of Transpacific Towage Inc. It was insured with Oriental Assurance Corp and loaded on 2 barges. However, during the voyage, 497 pieces of the 598 pieces loaded on one of the barges was lost. 

**Issue:** WON Panama can demand payment for constructive loss of the logs on one of the barges 

**Held:** NO. The logs involved, although placed in two barges, were not separately valued by the policy, nor separately insured. Resultantly, the logs lost in the barge in relation to the total number of logs loaded on the same barge can not be made the basis for determining constructive total loss. The logs having been insured as one inseparable unit, the correct basis for determining the existence of constructive total loss is the totality of the shipment of logs. (OF the 1,208 logs, only 497 pieces were lost or 41% therefore it cannot fall under constructive total loss) 

**Pan Malayan Insurance v CA**

**Facts:** The barge carrying a shipment of certified rice seeds to Kampuchea sank. The owner of the rice seeds, the Food and Agricultural Organization of the U.N. (FAO) filed its claim under a marine insurance policy with Pan Malayan. Later, it was informed by Luzon Stevedoring Corporation, the carrier, that the shipment was recovered, hence FAO filed a claim w/ Luzon Stevedoring for compensation for damages of its cargo. 

**Issue:** WON FAO can recover for total loss even if some of the rice seeds was recovered.

**Held:** YES. The complete physical destruction of the subject matter is not essential to constitute an actual total loss. Such a loss may exist where the form and specie of the thing is destroyed although the materials which it consisted still exist. Of the 34,122 bags of rice seeds shipped, 27,922 bags were determined to be lost/damaged (78% of cargo damaged).

6. ABANDONMENT

6.1. Requisites and Conditions

**Sec. 139.** A person insured by a contract of marine insurance may abandon the thing insured, or any particular portion thereof separately valued by the policy, or otherwise separately insured, and recover for a total loss thereof, when the cause of the loss is a peril insured against: 

(a) If more than three-fourths thereof in value is actually lost, or would have to be expended to recover it from the peril; 

(b) If it is insured to such an extent as to reduce its value more than three-fourths; 

(c) If the thing insured is a ship, and the contemplated voyage cannot be lawfully performed without incurring either an expense to the insured of more than three-fourths the value of the thing abandoned or a risk which a prudent man would not take under the circumstances; or 

(d) If the thing insured, being cargo or freightage, and the voyage cannot be performed, nor another ship procured by the master, within a reasonable time and with reasonable diligence, to forward the cargo, without incurring the like expense or risk mentioned in the preceding sub-paragraph. But freightage cannot in any case be abandoned unless the ship is also abandoned.

**Sec. 140.** An abandonment must be neither partial nor conditional. 

**Sec. 141.** An abandonment must be made within a reasonable time after receipt of reliable information of the loss, but where the information is of a doubtful character, the insured is entitled to a reasonable time to make inquiry. 

**Sec. 142.** Where the information upon which an abandonment has been made proves incorrect, or the thing insured was so far restored when the abandonment was made that there was then in fact no total loss, the abandonment becomes ineffectual.

**Sec. 143.** Abandonment is made by giving notice thereof to the insurer, which may be done orally, or in writing; Provided, That if the notice be done orally, a written notice of such abandonment shall be submitted within seven days from such oral notice.

**Sec. 144.** A notice of abandonment must be explicit, and must specify the particular cause of the abandonment, but need state only enough to show that there is probable cause therefor, and need not be accompanied with proof of interest or of loss.

**Sec. 145.** An abandonment can be sustained only upon the cause specified in the notice thereof. 

**Sec. 146.** An abandonment is equivalent to a transfer by the insured of his interest to the insurer, with all the chances of recovery and indemnity.
Sec. 147. If a marine insurer pays for a loss as if it were an actual total loss, he is entitled to whatever may remain of the thing insured, or its proceeds or salvage, as if there had been a formal abandonment.

Sec. 148. Upon an abandonment, acts done in good faith by those who were agents of the insured in respect to the thing insured, subsequent to the loss, are at the risk of the insurer and for his benefit.

Sec. 149. Where notice of abandonment is properly given, the rights of the insured are not prejudiced by the fact that the insurer refuses to accept the abandonment.

Sec. 150. The acceptance of an abandonment may be either express or implied from the conduct of the insurer. The mere silence of the insurer for an unreasonable length of time after notice shall be construed as an acceptance.

Sec. 151. The acceptance of an abandonment, whether express or implied, is conclusive upon the parties, and admits the loss and the sufficiency of the abandonment.

Sec. 152. An abandonment once made and accepted is irrevocable, unless the ground upon which it was made proves to be unfounded.

Sec. 153. On an accepted abandonment of a ship, freightage earned previous to the loss belongs to the insurer of said freightage; but freightage subsequently earned belongs to the insurer of the ship.

Sec. 154. If an insurer refuses to accept a valid abandonment, he is liable as upon actual total loss, deducting from the amount any proceeds of the thing insured which may have come to the hands of the insured.

Sec. 155. If a person insured omits to abandon, he may nevertheless recover his actual loss.

When Constructive TOTAL loss exists: ¾ Rule (Sec. 139)

1. If more than ¾ thereof in value is actually lost, or would have to be expended to recover from peril
2. If it is injured to such an extent as to reduce its value more than ¾
3. If the thing insured is a ship, and the contemplated voyage can't be lawfully performed w/o incurring either an expense to the insured or more than ¾ the value of the thing abandoned or a risk which a prudent man would not take under the circumstances
4. If the thing insured, being cargo or freightage, and the voyage can't be performed, nor another ship procured by the master, within a reasonable time and with reasonable diligence, to forwword the cargo, without incurring the like expense or risk mentioned in the preceding subparagraph. But freightage cannot in any case be abandoned unless the ship is also abandoned.

Requirements:
1. There must be actual relinquishment by the person insured of his interest in the thing insured (138)
2. There must be constructive total loss (139). Any particular portion of the thing insured separately valued by the policy may be separately abandoned as it is deemed separately insured
3. It must be total and absolute (140)
4. It must be within a reasonable time after the receipt of reliable information of the loss (141)
5. It must be factual (142)
6. It must be made by giving notice thereof to the insurer which may be done orally or in writing (143)
7. Notice must be explicit and must specify the particular cause of the abandonment (144)

ABANDONMENT

- Abandonment, in marine insurance, is the act of the insured by which, after a constructive total loss, he declares the relinquishment to the insurer of his interest in the thing insured. The insured chooses to take the proceeds in place of the remaining parts of the thing, which is ceded to the insurer.
- Right to abandon is granted by law to the insured if peril insured against causes a loss of more than ¾ the thing insured, or where its value is reduced by more than ¾
- **Remember:** 75% loss = Constructive Loss which entitles recovery of the full amount in the policy. Does not mean that recovery is only up to 75%.
**Ineffective abandonment**

- Abandonment can be sustained only upon cause specified.
- If cause is unfounded and info upon which it was made proves incorrect.
- Thing insured was so far restored when the abandonment was made that there was in fact no total loss.

<table>
<thead>
<tr>
<th>ACCEPTANCE</th>
<th>NO ABANDONMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Express or implied from conduct of insurer</td>
<td>Insured still entitled to recover actual loss</td>
</tr>
<tr>
<td>Mere silence for unreasonable length of time may be deemed acceptance</td>
<td>Same rule applies where abandonment wasn’t proper or where it wasn’t properly made</td>
</tr>
</tbody>
</table>

**Necessity for abandonment**

- TECHNICAL TOTAL LOSS: insured can’t claim the whole insurance without showing some regard to the interest the underwriter may take in the abandoned property. If underwriter can save some parts, he is entitled to timely notice of abandonment and can’t be liable for a total loss without it. But there is no obligation to abandon—insured’s choice. He still recovers actual loss even if he doesn’t abandon (§155).

**International Rule:**

- right of abandonment of vessels, as a legal limitation of a ship owner’s liability, does not apply where injury or average was caused by ship owner’s own fault. Art.587 (Code of Commerce) refers only to cases of captain’s fault or negligence. If owner is also at fault, Civil Code provisions on Common Carriers apply.

**When there is constructive total loss**

- Philippine rule - insured many not abandon unless loss/damage is more than ¾ of value as indicated in §139.

**Abandonment where insurance divisible and where indivisible**

- Things separately valued by the policy may be separately abandoned because they are separately insured (Section 139). This is a question of intention to be determined by the language used.

**Criterion as to extent of loss**

**General Rule:** The extent of injury to the vessel is considered with reference to the general market value immediately before the disaster. The rule is said to apply even though the policy is valued but some think otherwise. If the policy is expressly provides that the valuation will be used, it should be followed. The expenses incurred or to be incurred by the insured recovering the thing insured are also considered (ex. cost for refloating the ship).

**Abandonment must be absolute**

**General Rule:** To cover the whole interest insured, abandonment must be unconditional.

**Exception:** if only part of the thing is covered by the insurance, the insurer need only abandon that part.

**Abandonment must be made within a reasonable time**

- Once the insured received the notice of loss, he must choose within a reasonable time to abandon or claim for partial loss. If he chooses to do so, he must give notice so that the insurer may not be prejudiced by the delay and may take immediate steps for the preservation of the property.

- Reasonable time - depending on the facts and circumstances in each case. If the first notice is not clearly made, the insured must have sufficient time to ascertain the facts. He cannot wait an undue length of time to see if it will be more profitable to abandon or claim for partial loss.

**Abandonment must be factual**

1. Existence of loss at time of abandonment - the right of the insured to choose between abandonment or recovery for total loss depends on the facts at the time of the offer to abandon and not upon the state disclosed by the information received or state of loss before the time of offer.

2. Effect of subsequent events - none. Once the abandonment is made good the rights of the parties become fixed. The same is true when the abandonment is not made good. Subsequent events will not affect it as to retroactively impart validity.

   a. Insured cannot abandon when the thing is safe or when he knew at the time he made the offer that the vessel had been repaired and is continuing voyage.

   b. If after abandonment, the thing is recovered, insured may not withdraw.
3. Instances justifying abandonment - insured may abandon for a total loss in case of capture, seizure, or detention of the ship or cargo; restraint by blockade or embargo; funds for repair cannot be raised w/o fault of owner; where voyage absolutely lost; where sale made by master of the vessel because of urgent necessity.

Information need not be direct or positive
- Direct or positive information not necessary (ex. newspaper report, letter from an agent)
- The information must be of such facts and circumstances as to render it highly probable that a constructive total loss has occurred, and facts sufficient to constitute a total loss must exist. But the facts and information need not be the same.

Form of notice of abandonment
**General Rule:** no particular form of giving notice of abandonment is required by law. It may be made orally unless the policy requires that it be made in writing. Notice by telegraph may be sufficient.

**Subsidiary Rule:** if notice is done orally, the insurer must submit to the insurer a written notice w/in 7 days from the oral notice.

Notice of abandonment must be explicit
- Notice cannot just be inferred from some equivocal acts. There must be an intention to abandon, apparent from the communication.
- The use of the word “abandon” is not necessary.
- There is no abandonment although the insurer has given notice of an intention to abandon if he continues to claim and use the property as his own.

Notice of abandonment must specify particular cause thereof
- The grounds must be stated with such particularity as to enable the insurer to determine WON he is bound to accept the offer.
- Probable cause of abandonment contained in the notice is sufficient.
- Proof of interest or of loss is not necessary in the notice.

Proof of other causes not admissible
- Sufficient grounds for abandonment must be stated to make the abandonment valid. He cannot avail himself of any ground other than those he stated.

Form of acceptance of abandonment
- Need not be express. It may be implied by conduct, as from an act of the insurer in consequence of an abandonment, which can only be justified under a right derived from the abandonment (ex. when the insurer took possession of the ship and made repairs already followed by retention for an unreasonable amount of time)
- Silence, if not for an unreasonable amount of time will not operate as an acceptance.

Right of the insurer to freightage

**General Rule:** a validly made abandonment passes to the insurer the interest that the insured has over the thing

**Subsidiary Rule, as to a ship:** the insurer, after abandonment, becomes the owner thereof and his title becomes vested as of the time of the loss.

**Subsidiary Rule, as to freightage:** depends upon when such freightage was earned. If subsequent to the loss, it belongs to the insurer of the ship. If previously earned, to the insurer of the freightage who is subrogated to the rights of the insured up to the time of the loss.

Effects of acceptance of abandonment
1. Upon receiving notice of abandonment, the insurer may accept or reject abandonment.
2. Insurer becomes liable for whole amount of insurance and becomes entitled to all the rights which the insured has over the thing.
3. The parties’ rights become fixed.
4. The insurer may no longer rely on any insufficiency in the form, time or right of abandonment. WON the insured has a right to abandon is immaterial where offer is already accepted and there is no fraud.
5. EXCEPTION to the general effects of acceptance: when the ground upon which it was made proves to be unfounded.
6. Abandonment can be sustained only upon the ground specified in the notice.

Effect of refusal to accept a valid abandonment on insurer’s liability
**General Rule:** the insured’s right to abandon is absolute when it is justified by circumstances. Acceptance is not necessary to validate it.

7. MEASURE OF INDEMNITY

7.1. Open and Valued Policy

Sec. 156. A valuation in a policy of marine insurance in conclusive between the parties thereto in the adjustment of either a partial or total loss, if the insured has some interest at risk, and there is no fraud on his part; except that when a thing has been hypothecated by bottomry or respondentia, before its insurance, and without the knowledge of the person actually procuring the insurance, he may show the real value. But a valuation fraudulent in fact, entitles the insurer to rescind the contract.
whole interest of the insured in the property insured.

Sec. 158. Where profits are separately insured in a contract of marine insurance, the insured is entitled to recover, in case of loss, a proportion of such profits equivalent to the proportion which the value of the property lost bears to the value of the whole.

Sec. 159. In case of a valued policy of marine insurance on freightage or cargo, if a part only of the subject is exposed to the risk, the evaluation applies only in proportion to such part.

Sec. 160. When profits are valued and insured by a contract of marine insurance, a loss of them is conclusively presumed from a loss of the property out of which they are expected to arise, and the valuation fixes their amount.

Sec. 161. In estimating a loss under an open policy of marine insurance the following rules are to be observed:

(a) The value of a ship is its value at the beginning of the risk, including all articles or charges which add to its permanent value or which are necessary to prepare it for the voyage insured;

(b) The value of the cargo is its actual cost to the insured, when laden on board, or where the cost cannot be ascertained, its market value at the time and place of lading, adding the change incurred in purchasing and placing it on board, but without reference to any loss incurred in raising the same from the bottom, or to any drawback on its exportation, or to the fluctuation of the market at the port of destination, or to expenses incurred on the way or on arrival;

(c) The cost of freightage is the gross freightage, exclusive of primage, without reference to the cost of earning it; and

(d) The cost of insurance is in each case to be added to the value thus estimated.

Sec. 162. If cargo insured against partial loss arrives at the port of destination in a damaged condition, the loss of the insured is deemed to be the same proportion of the value which the market price at that port, of the thing so damaged, bears to the market price it would have brought if sound.

Sec. 163. A marine insurer is liable for all the expenses attendant upon a loss which forces the ship into port to be repaired; and where it is stipulated in the policy that the insured shall labor for the recovery of the property, the insurer is liable for the expense incurred thereby, such expense, in either case, being in addition to a total loss, if that afterwards occurs.

Sec. 164. A marine insurer is liable for a loss falling upon the insured, through a contribution in respect to the thing insured, required to be made by him towards a general average loss called for by a peril insured against; provided, that the liability of the insurer shall be limited to the proportion of contribution attaching to his policy value where this is less than the contributing value of the thing insured.

Sec. 165. When a person insured by a contract of marine insurance has a demand against others for contribution, he may claim the whole loss from the insurer, subrogating him to his own right to contribution. But no such claim can be made upon the insurer after the separation of the interests liable to the contribution, nor when the insured, having the right and opportunity to enforce the contribution from others, has neglected or waived the exercise of that right.

Sec. 166. In the case of a partial loss of ship or its equipment, the old materials are to be applied towards payment for the new. Unless otherwise stipulated in the policy, a marine insurer is liable for only two-thirds of the remaining cost of repairs after such deduction, except that anchors must be paid in full.

A. Valued Policy

- Valuation fixes in advance the value of the property and thus avoids the necessity of proving its actual value in case of loss.
- Valuation is conclusive between the parties in the adjustment of either a total or partial loss.
- Exception: If there is FRAUD on the part of the insured, insurer would have the right to RESCISSION.
- The change in a vessel’s value after a long period of voyage cannot bind the parties, as the insured value stated in the policy is conclusive upon them.
- Neither party can give evidence of the real value of the thing insured. But when the thing has been hypothecated by bottomry or respondentia before its insurance and without the knowledge of the person who actually procured the insurance, the insurer may show the real value but he is not entitled to rescind the contract unless he can prove that the valuation was in fact fraudulent.
- When insured a co-insurer in marine insurance

- In marine insurance, the insured is expected to cover by insurance the full value of the property insured. If the value of his interest exceeds the amount of the insurance, he is considered the co-insurer for an amount determined by the difference between the insurance taken out and the value of the property:

\[
\text{Amount of Recovery} = \frac{(\text{partial}) \text{ Loss}}{\text{Amount of Profits}} \times \text{value of thing insured}
\]

- Section 157 applies only if (1) the loss is partial and (2) the amount of insurance is less than the insured entire insurable interest in the property insured.
- Loss of profits separately insured
  - If the profits to be realized are separately insured from the vessel or
cargo, the insured is entitled to recover, in case of loss, such proportion of the profits as the value of the property lost bears to the value of the whole property:

- If policy is valued, loss of such profits is conclusively presumed from a loss of the property out of which they are expected to arise, and the valuation fixes their amount.

Where only part of a cargo or freightage insured exposed to risk:
- The valuation will be reduced proportionately. The insurer is bound to return such portion of the premium as corresponds with the portion of the cargo which had been exposed to the risk.

Presumption of loss of profits:
- Where profits are separately insured from the property out of which they are expected to arise, the insurer, in case of partial loss of the property, is entitled merely to partial indemnity for the profits lost.
- If the property is totally lost, pro tanto the total profits are also lost. Such loss of the profits is conclusively presumed from the loss of the property and the valuation agreed upon in the policy fixes the amount of recovery.

B. Open Policy
- Loss is estimated in accordance with certain rules laid down in the code (refer to table below)
- Cost of insurance must be added to the value of ship, cargo, or freightage as the case may be
- However, maximum recovery may only be up to the face value of the policy

<table>
<thead>
<tr>
<th>WHAT</th>
<th>VALUE in OPEN POLICY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ship</td>
<td>Value at beginning of risk (incl all articles which add to its permanent value or which are necessary to prepare if for the voyage insured), not the value at time she was built</td>
</tr>
<tr>
<td>Cargo</td>
<td>Actual cost when laden on board. IF actual cost can’t be determined, market value at time and place of lading, PLUS expenses incurred in purchasing and placing them on board. Expected profits are not considered since they can be separately insured.</td>
</tr>
<tr>
<td>Freightage</td>
<td>Gross freightage without reference to cost of earning it</td>
</tr>
</tbody>
</table>

- The cost of insurance is added in calculating the value of the ship, cargo, or freightage of other subject matter in an open policy.
- Where cargo insured against partial loss is damaged:
  - Section 162 is applicable if the cargo is insured against a partial loss and it suffers damage as a result of which its market value at the port of destination is reduced:

<table>
<thead>
<tr>
<th>Market price in sound state</th>
<th>Less: Market price in damaged state</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduced in value X amount of = amount</td>
<td></td>
</tr>
<tr>
<td>Market price in insurance of sound state</td>
<td>recovery</td>
</tr>
</tbody>
</table>

C. Total Loss
In case of open policy:
- Value of total loss will be computed in rules stated above
- Insurer liable for total loss, but it can’t exceed face amount of policy

In case of valued policy:
- Insurer must pay valuation fixed in the policy without any right to argue against its correctness except on basis of fraud
- Liability can’t exceed amount in policy

D. Partial Loss; Co-Insurance
- In both open and valued policies, in case of partial loss, the insured is deemed by law as co-insurer if the value of the insurance is less than the value of the property or interest insured, even in the absence of any agreement to that effect.
- However, law does not prevent parties from stipulating otherwise
- Difference with Fire Insurance: Policy should expressly provide for co-insurance otherwise, insurer is liable for the full amount of the partial loss. In marine insurance, co-insurance is mandated by law.
- Example of Co-Insurance:
  - Ship: $100 M
  - Insurance: $80M
  - Loss: $50M
  - What does insured get? $40M
    - only gets proportion

E. Other Expenses Chargeable to Insurer
- If ship has to make port for repairs, marine insurer must bear the attendant expenses
- Insurer also liable for expenses for recovery of the property if policy imposed upon the insured the duty of such recovery, such expenses being additional to total loss

F. Franchise Clause
- Franchise = Designated Percentage
- Sometimes, policy on cargo may provide that unless damage reaches a designated percentage of the value of such cargo, no amount will be paid by insurer.
- If loss reaches such percentage, insured will be entitled to full amount of loss
Chapter VI
CLAIMS, SETTLEMENT & SUBROGATION

1. NOTICE AND PROOF OF LOSS

Title 10 – Notice and Proof of Loss

Sec. 88. In case of loss upon an insurance against fire, an insurer is exonerated, if notice thereof be not given to him by an insured, or some person entitled to the benefit of the insurance, without unnecessary delay.

Sec. 89. When a preliminary proof of loss is required by a policy, the insured is not bound to give such proofs as would be necessary in a court of justice; but it is sufficient for him to give the best evidence which he has in his power at the time.

Notice of Loss – the formal notice given the insurer by the insured or claimant under a policy of the occurrence of the loss insured against.

- The purpose is to apprise the insurance company so that it may make proper investigation and take such action as may be necessary to protect its interest.
- It is necessary as the insurer cannot be liable to pay a claim unless he receives notice of that claim.
- Under Sec. 88 insurer is exonerated if notice of loss is not given to the insurer by the insured or by the person entitled to the benefit without unnecessary delay.
- It has been held however that formal notice of loss is not necessary if insurer has actual notice of loss already.

Proof of Loss – is the formal evidence given the insurance company by the insured or claimant under a policy of the occurrence of the loss, the particulars and the data necessary to enable the company to determine its liability and the amount. Is not tantamount to proof or evidence under the law on evidence.

- Proof of loss is distinct from notice of loss and intended to:
  1. give the insurer information by which he may determine the extent of his liability
  2. afford him a means of detecting any fraud that may have been practiced upon him.

- The law does not stipulate any requirement as to the form in which notice or proof of loss must be given. However according to De Leon, it is advisable to give the notice in writing for the protection of the insured or his beneficiary. Notice may be an informal or provisional claim containing a minimum of information as distinguished from a formal claim which contains full details of the loss, computations of the amounts claimed, and supporting evidence, together with a demand or request for payment.

Nature of notice and proof of loss

- Although they are in the form of conditions precedent, they are in the nature of conditions subsequent the breach of which affects a right that has already accrued (before the loss, insurer's liability is contingent but with the happening of the loss, his liability becomes properly fixed).
- These conditions are intended merely for evidentiary purposes and do not form any part of the conditions of liability and are construed with much less strictness than those conditions that operate prior to loss.

Sec. 90. All defects in a notice of loss; or in preliminary proof thereof, which the insured might remedy, and which the insurer omits to specify to him, without unnecessary delay, as grounds of objection, are waived.

Sec. 91. Delay in the presentation to an insurer of notice or proof of loss is waived if caused by any act of him, or if he omits to take objection promptly and specifically upon that ground.

- Delay in the presentation of notice and proof of loss is deemed waived when due to an act of the insurer, by failure to take objection promptly and specifically upon that ground.
- If the insured attempted to comply and the company made objections, the insured will be allowed a reasonable time after he is apprised within which to remedy the defects regardless of the time prescribed by the policy for furnishing proofs. Delay as a ground for resisting a claim places the insurer on duty to inquire when the loss took place, so that it could determine whether delay would be a valid ground to object to a claim.

Sec. 92. If the policy requires, by way of preliminary proof of loss, the certificate or testimony of a person other than the insured, it is sufficient for the insured to use reasonable diligence to procure it, and in case of the refusal of such person to give it, then to furnish reasonable evidence to the insurer that such refusal was not induced by any just grounds of disbelief in the facts necessary to be certified or testified.

Certificate or Testimony of Person other than Insured as Preliminary Proof

- May be required by the policy
- Sufficient that he insured use reasonable diligence to procure it
- If person refuses to give it, it is sufficient to furnish reasonable evidence to the insurer that such refusal was not induced by any grounds of DISBELIEF in the facts necessary to be certified.

General Rule: Insured must give, by way of preliminary proof of loss, the certificate or testimony of a person other than the insured when required by the policy.

Supplementary Rules: It is sufficient for the insured to use reasonable diligence to procure it. In case of the refusal of such person to give it,
insured must furnish reasonable evidence to the insurer that such refusal was not induced by any just grounds of disbelief in the facts necessary to be certified or testified, but because of other grounds. This requirement must be liberally construed in favor of the insured.

Phil. Am. Life v CA & Pulido

**Facts:** The insured Florence Pulido took out a non-medical life insurance policy from Philamlife in the amount of 100K and the policy was issued on Feb. 11, 1989. She died on Sept. 10, 1991 and her beneficiary, her sister Eliza Pulido filed a claim which was denied by Philamlife on the ground of fraud claiming that at the time the insured applied for the policy, she was already actually dead.

**Ratio:** There was no fraud, the death certificates and notes by the municipal health officer prepared in the regular performance of duties are prima facie evidence of facts. A duly-registered death certificate is considered a public document and the entries found therein are presumed correct, unless the party who contests its accuracy can produce positive evidence to establish otherwise which in the case at bar Philamlife failed to do.

### 2. GUIDELINES ON CLAIMS SETTLEMENT

**Title 11 – Claims Settlement**

**Sec. 241.** (1) No insurance company doing business in the Philippines shall refuse, without just cause, to pay or settle claims arising under coverages provided by its policies, nor shall any such company engage unfair claim settlement practices. Any of the following acts by an insurance company, if committed without just cause and performed with such frequency as to indicate a general business practice, shall constitute unfair claim settlement practice:

(a) knowingly misrepresenting to claimants pertinent facts or policy provisions relating to coverages at issue;

(b) failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies;

(c) failing to adopt and implement reasonable standards for the prompt investigation of claims arising under its policies;

(d) not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear; or

(e) compelling policyholders to institute suits to recover amounts due under its policies by offering without justifiable reason substantially less than the amounts ultimately recovered in suits brought by them.

(2) Evidence as to the numbers and types of valid and justifiable complaints to the Commissioner against an insurance company, and the Commissioner’s complaint experience with other insurance companies writing similar lines of insurance shall be admissible in evidence in an administrative or judicial proceeding brought under this section.

(3) If it is found, after notice and an opportunity to be heard, that an insurance company has violated this section, each instance of non compliance with paragraph (1) may be treated as a separate violation of this section and shall be considered sufficient cause for the suspension or revocation of the company’s certificate of authority.

**Sec. 242.** The proceeds of a life insurance policy shall be paid immediately upon maturity of the policy, unless such proceeds are made payable in installments or as an annuity, in which case the installments, or annuities shall be paid as they become due: Provided, however, That in the case of a policy maturing by the death of the insured, the proceeds thereof shall be paid within sixty days after presentation of the claim and filing of the proof of the death of the insured. Refusal or failure to pay the claim within the time prescribed herein will entitle the beneficiary to collect interest on the proceeds of the policy for the duration of the delay at the rate of twice the ceiling prescribed by the Monetary Board, unless such failure or refusal to pay is based on the ground that the claim is fraudulent.

The proceeds of the policy maturing by the death of the insured payable to the beneficiary shall include the discounted value of all premiums paid in advance of their due dates, but are not due and payable at maturity.

**Sec. 243.** The amount of any loss or damage for which an insurer may be liable, under any policy other than life insurance policy, shall be paid within thirty days after proof of loss is received by the insurer and ascertainment of the loss or damage is made either by agreement between the insured and the insurer or by arbitration; but if such ascertainment is not had or made within sixty days after such receipt by the insurer of the proof of loss, then the loss or damage shall be paid within ninety days after such receipt. Refusal or failure to pay the loss or damage within the time prescribed herein will entitle the assured to collect interest on the proceeds of the policy for the duration of the delay at the rate of twice the ceiling prescribed by the Monetary Board, unless such failure or refusal to pay is based on the ground that the claim is fraudulent.
Sec. 244. In case of any litigation for the enforcement of any policy or contact of insurance, it shall be the duty of the Commissioner or the Court, as the case may be, to make a finding as to whether the payment of the claim of the insured has unreasonably denied or withheld; and in the affirmative case, the insurance company shall be adjudged to pay damages which shall consist of attorney's fees and other expenses incurred by the insured person by reasons of such unreasonable denial or withholding of payment plus interest of twice the ceiling prescribed by the Monetary Board of the amount of the claim due the insured, from the date following the time prescribed in Section two hundred forty-two or in Section two hundred forty-three, as the case may be, until the claim is fully satisfied; Provided, That the failure to pay any such claim within the time prescribed in said section shall be considered prima facie evidence of unreasonable delay in payment.

2.1. Unfair Claims Settlement

Sec. 241 (1) provides instances of unfair claims settlement done by an insurance company:

(a) knowingly misrepresenting to claimants pertinent facts or policy provisions relating to coverages at issue;
(b) failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies;
(c) failing to adopt and implement reasonable standards for the prompt investigation of claims arising under its policies;
(d) not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear; or
(e) compelling policyholders to institute suits to recover amounts due under its policies by offering without justifiable reason substantially less than the amounts ultimately recovered in suits brought by them.

2.2. Civil Code Rules on Presumption of Death

Art. 390. After an absence of seven years, it being unknown whether or not the absentee still lives, he shall be presumed dead for all purposes except for those of succession. The absentee shall not be presumed dead for the purpose of opening his succession till after an absence of ten years. If he disappeared after the age of seventy-five years, an absence of five years shall be sufficient in order that his succession may be opened. (n)

Art. 391. The following shall be presumed dead for all purposes, including the division of the estate among the heirs:

1. A person on board a vessel lost during a sea voyage, or an aeroplane which is missing, who has not been heard of for four years since the loss of the vessel or aeroplane;
2. A person in the armed forces who has taken part in war, and has been missing for four years;
3. A person who has been in danger of death under other circumstances and his existence has not been known for four years. (n)

Londres v National Life Insurance Co.

Facts: National Life issued a life insurance policy on the life of Jose C. Londres in the amount of PhP3,000.00 on April 14, 1943 (during the war period). He died on Feb. 7, 1945. His beneficiary filed a claim which National denied claiming that there was a lack of proof of death and a slew of other special defenses, including the payment should be made based on the Ballantyne scales.

Ratio: National must pay the beneficiary of the insured the amount of the policy (3,000.00) as the agreement was that the obligation will be made in the currency prevailing at the end of the stipulated period which in this case is the Philippine currency. The proof of death was substantially made by the claimant and was not properly disproved by National.

Fernandez v National Life Insurance Co.

Facts: National insured the life of Juan Fernandez for the period of July 15, 194 to July 14, 1945. Juan died on Nov. 2, 1944. His Beneficiaries filed their claim 7 years after his death or on Aug. 1, 1952. The dispute is WON the Ballantyne scale applicable in computing the amount which should be paid to the beneficiaries. The CFI rendered judgment that National should pay the proceed of PhP 500.00 Ballantyne scale applicable.

Ratio: CFI correct. Ballantyne scale is applicable since in life insurance, the policy matures upon the expiration of the term set forth therein – in this case upon the death of Juan. The obligation of National arose as of that date and not at the time of the claim. Since the National could have paid his obligation at any time during the Japanese occupation. Payment after liberation must be adjusted in accordance with the Ballantyne schedule.

Tio Khe Chio v CA & Eastern Assurance

Facts: Tio Khe Chio imported fishmeal. These were insured with Eastern Assurance. The vessel used to ship the fishmeal was Far Eastern Shipping Co. When the goods reached Manila, they found to be damaged – and therefore useless. The issue is WON the interest to be paid by Eastern Assurance is 12% or 6%?
Ratio: 6% only, as Sec. 243 and 244 of the Insurance Code is not applicable to the case as these provisions apply only when the court finds an unreasonable delay or refusal in the payment of the claims. The applicable law according to SC is Art. 2209 of the Civil Code which stipulates that in the absence of stipulation the legal interest applicable is 6%.

Cathay v CA

Facts: Lugay insured against fire with the 6 insurance companies named as petitioner in this case for the total sum of 4 million her printing press which was razed by fire on December 15, 1982. She filed a claim submitting all the required proof of loss. After nearly 10 months of waiting for her claim to be paid she filed a suit to collect her claim. After the trial on the merits, the TC rendered judgment in favor of Lugay and directed the 6 insurance companies to pay their share in the insurance and further made them pay plaintiff interest at the rate of 2x the ceiling being prescribed by the Monetary board from the time when the case was filed. Upon appeal to the CA, the CA affirmed the decision of the TC.

Ratio: The award made by the TC of double interest is justified under Sections 243 and 244 of the Insurance Code which provides that “Sec. 243. ...Refusal or failure to pay the loss or damage within the time prescribed herein will entitle the assured to collect interest on the proceeds of the policy for the duration of the delay at the rate of twice the ceiling prescribed by the Monetary Board...” and “Sec. 244. In case of any litigation for the enforcement of any policy or contract of insurance, it shall be the duty of the Commissioner or the Court, as the case may be to make a finding as to whether the payment of the claim of the insured has been unreasonably denied or withheld; and in the affirmative case, the insurance company shall be adjusted to pay damages which shall consist of attorney’s fees and other expenses incurred by the insured person by reason of such unreasonable denial or withholding of payment plus interest of twice the ceiling prescribed by the Monetary Board of the amount of claim due the insured...”.

Noda v Cruz-Arnaldo

Facts: Noda obtained from Zenith 2 fire insurance policies for 2 of his properties. Both was destroyed by fire. When Noda filed a claim, it was denied by Zenith due to premiums not paid and the other one was settled only for 15K++. IC denied Noda to claim full amount due to insufficient proof of the value of his losses.

Ratio: Noda was able to prove sufficient losses, since the document offered by Noda were offered by Zenith itself to proof the amount of it’s liability being 1/6th of the total loss only. Thus could very well be considered as an admission of its liability up to the amount recommended.

Finman General v CA

Facts: USIPHIL obtained a fire insurance policy from FINMAN. The property insured was lost due to fire and USIPHIL filed a claim. H.H. Bayne was appointed by FINMAN to undertake evaluation. USIPHIL submitted all the required proof of losses substantially. Despite all these, FINMAN refused to pay USIPHIL’S claim due to failure to comply with Condition 13 of the policy. TC and CA ruled in favor of USIPHIL and ordered FINMAN to pay + double the interest (24%).

Ratio: Substantial compliance, not strict compliance with the requirements will be deemed sufficient. The double interest of 24% is authorized by Sections 243 and 244 of the Insurance Code.

Delsan Transport v CA (supra)

<table>
<thead>
<tr>
<th>CLAIMS</th>
<th>LIFE INSURANCE</th>
<th>NON-LIFE INSURANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maturity</td>
<td>1. Upon death of the person insured;</td>
<td>Upon happening of event insured against</td>
</tr>
<tr>
<td></td>
<td>2. Upon his surviving a specific period</td>
<td>Event must occur within the period specified in policy, otherwise insurer has no liability</td>
</tr>
<tr>
<td></td>
<td>3. Otherwise contingently on the continuance or cessation of life (Sec. 180)</td>
<td></td>
</tr>
<tr>
<td>Delivery of Proceeds</td>
<td>GENERAL RULE:</td>
<td>Within 30 days after</td>
</tr>
<tr>
<td></td>
<td>Immediately upon maturity of policy.</td>
<td>(1) Proof of loss is received by insurer; and</td>
</tr>
<tr>
<td></td>
<td>EXCEPTION:</td>
<td>(2) Ascertainment of loss or damage is made either by agreement between the insured and insurer or by arbitration</td>
</tr>
<tr>
<td></td>
<td>If payable in INSTALLMENTS or as an ANNUITY, when such installments or annuities become due</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IF MATURITY IS UPON DEATH:</td>
<td>If ascertainment not made within 60 days after such receipt by insurer of proof of loss, loss or damage shall be paid within 90 days after such receipt.</td>
</tr>
<tr>
<td></td>
<td>Within 60 days after presentation of claim and filing of proof of death of insured.</td>
<td></td>
</tr>
</tbody>
</table>
Effect of Refusal or Failure to pay claim within time prescribed:

- In case of litigation, it is the duty of the Commissioner or the Court to determine WON claim has been unreasonably denied of withheld.
- Failure to pay any such claim within the time prescribed shall be considered prima facie evidence of unreasonable delay in payment.
- Entities beneficiary to collect interest on the proceeds of policy for the duration of the delay at rate of twice ceiling prescribed by the monetary board (unless refusal to pay is based on ground that claim in fraudulent)
- In case damages awarded, this includes attorney’s fees and other expenses incurred due to delay (plus the interest)
- Entities beneficiary to collect interest on the proceeds of policy for the duration of the delay at rate of twice ceiling prescribed by the monetary board (unless refusal to pay is based on ground that claim in fraudulent)
- In case damages awarded, this includes attorney’s fees and other expenses incurred due to delay (plus the interest)

3. PRESCRIPTION OF ACTION

3.1. Title 6 – The Policy

Sec. 63. A condition, stipulation, or agreement in any policy of insurance, limiting the time for commencing an action thereunder to a period of less than one year from the time when the cause of action accrues, is void.

- A clause in an insurance policy to the effect that an action upon the policy by the insured must be brought within a certain period is VALID and will prevail over the general law on limitations of actions.
- HOWEVER, if the period fixed is less than one year from the time the cause of action accrues, it is VOID.
- Nature of condition limiting period for filing claim: It is not merely a procedural requirement. It is essential for the prompt settlement of claims as it demands for suits to be brought while the evidence as to the origin and cause of the loss or destruction has not yet disappeared. It is a condition precedent to the insurer’s liability or a resolutory cause in case the action is not filed by the insured within the stipulated period.
- Insurance Commissioner to adjudicate disputes relating to an insurance company’s liability to an insured under a policy. A complaint or claim filed with such official is considered an “action” or “suit” the filing of which would have the effect of tolling the suspending the running of the prescriptive period.

Cause of Action – The violation of a legal right committed knowingly; An act or omission of one party in violation of the legal right/s of the other.

3.2. Requisites/Essential Elements:

1. A legal right of the plaintiff
2. A correlative obligation of the defendant
3. An act or omission of the defendant in violation of the legal right of plaintiff.

- The cause of action in an insurance policy therefore does not accrue until the insurer refuses expressly or impliedly to comply with his duty to pay the amount of the loss.

3.3. Compulsory Motor Vehicle Liability Insurance

Sec. 384. Any person having any claim upon the policy issued pursuant to this chapter shall, without any unnecessary delay, present to the insurance company concerned a written notice of claim setting forth the nature, extent and duration of the injuries sustained as certified by a duly licensed physician. Notice of claim must be filed within six months from date of the accident, otherwise, the claim shall be deemed waived. Action or suit for recovery of damage due to loss or injury must be brought, in proper cases, with the Commissioner or the Courts within one year from the denial of the claim, otherwise the claimant’s right of action shall prescribe (As amended by PD No. 1814 and BP Blg. 874.)

Compulsory Motor Vehicle Liability Insurance (CPTL) – The Insurance Code makes it unlawful for any land transportation operator or owner of motor vehicle to operate the same in public highways unless there is an insurance or guaranty to indemnify the death or bodily injury of a third party or passenger arising from the use thereof.

Rules of CPTL

1. Registration of any vehicle will not be made or renewed without complying with the requirement.
2. The protection may be complied with using any of the following:
   - Insurance policy
   - Surety bond
   - Cash bond

First Integrated Bonding and Ins. Co., Inc. vs. Hernando, 199 SCRA 746

The purpose of CPTL is to give immediate financial assistance to victims of motor vehicle accidents and/or their dependents, especially if they are poor regardless of the financial capability of motor vehicle owners or operators responsible for the accident.

3.4. Civil Code – Prescription
Art. 1144. The following action must be brought within ten years from the time the right of action accrues:
(1) Upon a written contract;
(2) Upon an obligation created by law;
(3) Upon a judgment. (n)

General Rules on Prescription:
- 10 Years (CC)

Exceptions to the General Rule:
- Stipulation in the contract (Sec. 63) – a clause in an insurance policy limiting the period for which an action upon the policy may be brought is valid provided it be not less than one year.
- Motor Vehicle Insurance – One (1) year only

4. THE INSURANCE COMMISSIONER
ADMINISTRATIVE AND ADJUDICATORY POWERS

Sec. 416. The Commissioner shall have the power to adjudicate claims and complaints involving any loss, damage or liability for which in insurer may be answerable under any kind of policy or contract of insurance, or for which such insurer may be liable under a contract of suretyship, or for which a reinsurer may be sued under any contract of reinsurance it may have entered into; or for which a mutual benefit association may be held liable under the membership certificates it has issued to its members, where the amount of any such loss, damage or liability, excluding interest, cost and attorney's fees, being claimed or sued upon any kind of insurance, bond, reinsurance contract, or membership certificate does not exceed in any single claim one hundred thousand pesos.

The insurer or surety may, in the same action file a counterclaim against the insured or the obligee. The insurer or surety may also file a cross-claim against a party for any claim arising out of the transaction or occurrence that is the subject matter of the original action or of a counterclaim therein.

With leave of the Commissioner, an insurer or surety may file a third-party complaint against its reinsurers for indemnification, contribution, subrogation or any other relief, in respect of the transaction that is the subject matter of the original action filed with the Commissioner.

The party filing an action pursuant to the provisions of this section thereby submits his person to the jurisdiction of the Commissioner. The Commissioner shall acquire jurisdiction over the person of the impleaded party or parties in accordance with and pursuant to the provisions of the Rules of Court.

The authority to adjudicate granted to the Commissioner under this section shall be concurrent with that of the civil courts, but the filing of a complaint with the Commissioner shall preclude the civil courts from taking cognizance of a suit involving the same subject matter.

Any decision, order or ruling rendered by the Commissioner after a hearing shall have the force and effect of a judgment. Any party may appeal from a final order, ruling or decision of the Commissioner by filing with the Commissioner within thirty days from receipt of copy of such order, ruling or decision a notice of appeal to the Intermediate Appellate Court in the manner provided for in the Rules of Court for appeals from the Regional Trial Court to the Intermediate Appellate Court. (As amended by Batas Pambansa Blg. 874.)

As soon as a decision, order or ruling has become final and executory, the Commissioner shall motu proprio or on motion of the interested party, issue a writ of execution requiring the sheriff or the proper officer to whom it is directed to execute said decision, order or award, pursuant to Rule thirty-nine of the Rules of Court.

For the purpose of any proceeding under this section, the Commissioner, or any officer thereof designated by him, empowered to administer oaths and affirmation, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, documents, or contracts or other records which are relevant or material to the inquiry. In case of contumacy by, or refusal to obey a subpoena issued to any person, the Commissioner may invoke the aid of any court of first instance within the jurisdiction of which such proceeding is carried on, where such person resides or carries on his own business, in requiring the attendance and testimony of witnesses and the production of books, papers, documents, contracts or other records. And such court may order requiring such person to appear before the Commissioner, or officer designated by the Commissioner, there to produce records, if so ordered or to give testimony touching the matter in question. Any failure to obey such order of the court may be published by such court as a contempt thereof.

A full and complete record shall be kept of all proceedings had before the commissioner, or the officers thereof designated by him, and all testimony shall be taken down and transcribed by a stenographer appointed by the Commissioner.

A transcribed copy of the evidence and proceeding, or any specific part thereof, of any hearing taken by a stenographer appointed by the Commissioner, being certified by such stenographer to be a true and correct transcript of the testimony on such hearing of a particular witness, or of a specific proof thereof, carefully compared by him from his original notes, and to be a correct statement of evidence and proceeding had in such hearing so purporting to be taken and subscribed, may be received as
evidence by the Commissioner and by any court with the same effect as if such stenographer were present and testified to the facts so certified. (As amended by Presidential Decree No. 1455).

4.1. Jurisdiction of Insurance Commission
Includes the following as long as any SINGLE CLAIM does NOT EXCEED 100,000.00:
(1) Claims and complaints involving liability of insurer under any kind of policy or contract
(2) Suretyship
(3) Reinsurance
(4) Mutual Benefit membership certificates

2. Relation to RTC
The RTC and IC have concurrent jurisdiction. HOWEVER, filling a complaint with the IC PRECLUDES civil courts from taking cognizance of suit involving the same subject.

Lopez v Filipinas

Facts: Lopez insured with FCS his Biederman truck tractor and Winter Weils trailer from loss or damages. It appeared that Lopez concealed some material fact with regard to questions asked by FCS. The vehicles figured in an accident. Lopez filed a claim which FCS denied. Lopez filed a complaint with IC less than 2 months after the denial and a complaint with the Court 17 months after the denial when FCS told the IC that it refused to subject itself to arbitration. FCS claimed prescription.

Ratio: The right of action has prescribed. There is nothing in the Insurance Law, nor in any of its allied Legislations which empower the IC to adjudicate on disputes relating to an insurance company’s liability to an insured under a policy issued by the insurer to an insured. The validity of an insured’s claim under a specific policy, its amount, and all such other matters as might involve the interpretation and construction of the insurance policy, are issues which only a regular Court of justice may resolve and thus the complaint filed by Lopez with the IC could not have been an action or suit. The prescription period started to run on August 28, 1960 when FCS rejected the claim of Lopez and the commencement of an action was filed only on September 19, 1961 with the CFI of Manila, nearly 17 months after the claim was rejected. Thus the action has already prescribed.

Finman v Inocencio

Facts: Pan Pacific obtained a surety bond from Finman in compliance with POEA rules. Inocencio et.al filed complaint against Pan Pacific. POEA ordered Pan Pacific and Finman jointly and severally to pay the claim of Inocencio et.al.

Ratio: POEA has jurisdiction over the surety bonds as it is a well settled doctrine that the conditions of a bond specified in the statute providing for the submission of a bond are built into all bonds tendered under that statute even through not printed therein. Finman may be held liable, if it is solidarily liable with Pan Pacific under the terms of the bond, it must follow that it is also liable to both Inocencio et.al and POEA. 

Eagle Star v Chin Yu

Facts: Chin Yu consigned 14 bales of underwear. Insured with Eagle Star. Upon arrival to Manila, 4 bales were lost and 3 were damages. Chin Yu filed claim for the lost and damages bales against he carrier and then with the insurer. Both denied liability.

Ratio: Action has not prescribed under Sec. 61-A, the period of prescription starts to run when the cause of action accrues and the cause of action accrues only upon the rejection of the insurer of the claim and not upon the filing of the claim.

ACCFA v Alpha Ins

Facts: FACOMA took out a fidelity bond of Php5,000.00 to insure its funds from Alpha Insurance which it later assigned to ACCFA. The funds were misappropriated upon which ACCFA immediately notified Alpha of the loss and presented proof of loss within the period fixed, but despite repeated demands, the surety company refused and failed to pay. It filed a suit against Alpha. Alpha moved to dismiss claiming that ACCFA’s right of action has prescribed since it filed an action one year after it filed its notice of loss -- claiming that ACCFA’s right of action accrued upon submission of notice of loss as stipulated under Condition 8 of the contract.

Ratio: The action does not accrue until the party obligated refuses, expressly or implied to comply with its duty (in this case refusal of Alpha to pay the amount of the bond). The year for instituting the action in court must be reckoned from the time of Alpha refused to comply with its bond and not from the creditor’s filing of the claim of loss (since the creditor does not know yet upon filing that the claim would be denied or refused). Therefore, condition #8 which required action to be filed within one year from the filing of the claim for loss contradicts the public policy expressed in Sec. 61-A of the Philippine Insurance Act and is thus null and void

Ang v Fulton

Facts: Ang insured his property against fire for 1 year with Fulton through its agent Paramount.

Ang v Fulton

Facts: Ang insured his property against fire for 1 year with Fulton through its agent Paramount.

12.27.1973 -- Store was destroyed through fire (3 days later, Ang filed claim)
1.13.1955 – Ang charred with arson, acquitted
4.6.1956 -- Fulton denied Ang’s claim
4.19.1956 – Ang received Fulton denial
5.1956 – Ang instituted claim against Paramount which was dismissed w/o prejudice on 9.1957
5.5.1958 – Ang instituted present action against Fulton. According to CFI, action not yet prescribed

Ratio: Action already prescribed. The action of Ang against Paramount does not have any legal
effect except that of notifying the agent and serves no other purpose. It did not stop the prescription from running. The filing of a claim within one year after rejection is a condition precedent to the liability of the insurer – a resolutory cause, the purpose of which is to terminate all liabilities in case action is not filed within the said period.

Travellers Insurance v CA

**Facts:** A 78 year old woman was hit by a taxi cab, died. Her son (Vicente) filed a claim against the owner of the Lady Love taxi cab, the driver and Travellers as the compulsory insurer.

**Ratio:** Travellers cannot be held jointly and severally liable with the owner and driver of the Lady Love taxi cab as Vicente failed to attach a copy of the insurance contract to his complaint, there could be no basis to apprise the real nature and pecuniary limits of Travellers liability. Further, he also failed to file a written notice of claim with Traveller, which is an indispensable requirement thus his cause of action did not accrue.

Sun Insurance v CA (supra)

### 5. SUBROGATION


**Obligations & Contracts – Extinguishment of Obligations**

*Art. 1236.* The creditor is not bound to accept payment or performance by a third person who has no interest in the fulfillment of the obligation, unless there is a stipulation to the contrary.

Whoever pays for another may demand from the debtor what he has paid, except that if he paid without the knowledge or against the will of the debtor, he can recover only insofar as the payment has been beneficial to the debtor (1158a)

**Damages**

*Art. 2207.* If the plaintiff’s property has been insured, and he has received indemnity from the insurance company for the injury or loss arising out of the wrong or breach of contract complained of, the insurance company shall be subrogated to the rights of the insured against the wrongdoer or the person who has violated the contract. If the amount paid by the insurance company does not fully cover the injury or loss, the aggrieved party shall be entitled to recover the deficiency from the person causing the loss or injury.

According to sir – there is only subrogation in property insurance.

#### 5.2. Concept:

- Process of legal substitution (insurer steps into shoes of insured)
- Reason: EQUITY – to prevent the insured from receiving more than his actual loss,

**Loss Due to Wrongful Act or Breach of Contract by Third Person, NOT APPLICABLE TO LIFE INSURANCE.**

- Options available to insured when through wrongful act or breach of contract committed by 3rd person, insured property suffers loss:
  1. Collect from insurer – if insurer pays, insurer subrogates insured under Civil Code
    - Right of subrogation exist even if no express agreement recognizing it since it’s under the CC
  2. Demand payment from wrongdoer
    - Since Life Insurance is not contract of INDEMNITY, subrogation obviously cannot apply.

**When May Liability to Subrogee be Limited:**

- Bill of Lading (St. Paul v Macondray)
- Contributory Negligence (Tabacalera v NFS)

**Effect of Voluntary Payment**

- Right of Subrogation does not exist in favor of mere volunteer
- If insurer has right to rescind, but still pays insured, there is still subrogation – the 3rd party has no privity.
- Where the insurer pays the insured for a loss or liability which is not a risk covered by the policy, it will be considered as a volunteer with no right of subrogation. HOWEVER, insurer may still recover under Art. 1236 of the Civil Code – to the extent that the debtor had been benefited.
- If insured gets amount of policy not as payment but as a LOAN, repayable to the extent of any recovery from the 3rd party responsible, there can be no subrogation.

**In Case of General Averages:**

1. Demand contributions directly from different persons liable.
2. Clam whole loss from the insurer – insurer subrogates right of contribution.

---

**Cebu Shipyard v Willaim Lines**

**Facts:** William Lines, Inc contracted the services of CSEW for its ships annual dry-docking and repairs. The vessel was insured with Prudential for 45 million for hull and machinery. The coverage included an “Additional Perils” clause covering loss of or damage to the vessel through the negligence of ship repairman. The vessel caught fire and sank resulting to its eventual total loss. Prudential paid William Lines the total amount of the insurance policy and sued CSEW, as subrogee to the rights of William Lines.

**Ratio:** Since it has already been resolved that the cause of the fire which gutted MV Manila City was...
the negligence act of CSEW, the proof of payment made by Prudential to William Lines, Inc operated to properly subrogate Prudential to the rights of William Lines under Art. 2207 of the Civil Code

**Pioneer Insurance v CA**

**Facts:** Jacob Lim purchased 2 aircrafts from JDA using funds from Bormaheco, the Cervantes and Maglana. Insured it with Pioneer as surety. Lim failed to pay, Pioneer paid (Pioneer reissued the surety with an unnamed reinsurer) and collected from the reinsurer. Also foreclosed aircraft, sold it and collected proceeds.

**Ratio:** Pioneer no longer has any claim since it has already collected the proceeds of the reinsurance on its bond. Under the principle of Art. 2207 of the CC, the reinsurer, on payment of a loss acquires the same rights by subrogation as are acquired in similar cases where the original insurer pays a loss.

**Manila Mahogany v CA**

**Facts:** Manila Mahogany insured its Mercedez Benz with Zenith. Car was bumped and damaged by SMC truck. Zenith paid Mahogany in amicable settlement. Zenith then demanded reimbursement from SMC, but it appeared that SMC already paid Mahogany evidenced by a Release of Claim.

**Ratio:** By the act of Manila Mahogany issuing a release claim to SMC, the right of Zenith against SMC is nullified since the insurer can be subrogated to only such rights as the insured may have, should the insured, after receiving payment from the insurer, release the wrongdoer who causes the loss, the insurer loses his rights against him. But in such a case the insurer will be entitled to recover from the insured whatever it has paid, unless it was made with the consent of the insurer.

**Pan Malayan v CA & Fabie**

**Facts:** The driver of Erlinda Fabie hit the insured Mitsubishi Colt Lancer owned by the Canlubang Automotive Resources Corporation. The vehicle was insured with PANMALAY who paid the amount insured under the “own damage” coverage of the insurance policy. PANMALAY then demanded from Fabie the payment of whatever amount it paid claiming that they were subrogated to the rights of Canlubang.

**Ratio:** Art. 2207 of the Civil Code apply in the case at bar, under the principle of subrogation. If the insured property is destroyed or damaged through the fault or negligence of a party other than the assured, then the insurer, upon payment to the assured will be subrogated to the rights of the assured to recover from the wrongdoer to the extent that the insurer has been obligated to pay. Payment by the insurer to the assured operates as an equitable assignment to the former of all remedies which the latter may have against the third party whose negligence or wrongful act caused the loss. The right of subrogation is not dependent upon, nor does it grow out of, any privity of contract or upon written assignment of claim. It accrues simply upon payment of the insurance claim.

**Fireman’s Fund v Jamila & Co.**

**Facts:** Firestone lose some properties due to the acts of its employees and the security guards provided by the security agency of Jamila & Co. Fireman’s Fund, the insurer of Firestone paid the loss and proceeded against Jamila and Jamila’s insurer First Quezon City Ins. Co. Both denied liability, TC dismissed complaint due to no cause of action.

**Ratio:** Firestone no longer has cause of action since it has already been paid by Fireman’s Fund. Fireman’s Fund however has a cause of action as this falls under Art. 2207 under the doctrine of subrogation.

**Tabacalera v North Front Shipping**

**Facts:** Sacks of corn grain valued at over 3M were consigned to RFM under a bill of lading and insured with Tabacalera et al. The vessel was owned by North Front. Prior to leaving port, the vessel was inspected and was deemed fit to carry merchandise. When it arrived, it advised RFM who did not immediately commence unloading without any apparent reason. When unloaded, there was shortage and the rest were moldy, rancid and unfit for its purpose. RFM rejected cargo and demanded from North Front payment for damages which was denied. Tabacalera et.al paid, then sued North Front. TC and CA dismissed case.

**Ratio:** North Point is liable since it is a common carrier and as such is required to observe extraordinary diligence in its vigilance over the goods it transports. When goods placed in its care are lost or damaged, the carrier is presumed to have been at fault or to have acted negligently. North Front has burden of proving it observed extraordinary diligence in order to avoid responsibility which it failed to do. However since RFM was guilty of contributory negligence, they should share at least 40% of the loss. North Point ordered to pay Tabacalera et al 60% of the total amount it paid to RFM.

**Philamgen v CA**

**Facts:** Coca-Cola Bottlers Philippines, Inc. (CCBPI) loaded on board “MV Asilda” 7,500 cases of 1-liter Coke to be transported from Zamboanga City to Cebu City. The vessel was owned and operated by FELMAN. The shipment was insured with PHILAMGEN. The vessel sank. CCBPI filed a claim with FELMAN for recovery of damages which was denied and thus CCBPI filed an insurance claim with PHILAMGEN which paid its claim for PhP755,250.00. Claiming its right of subrogation, PHILAMGEN sought recourse against FELMAN who disclaimed any liability from the lost.

**Ratio:** Clearly falls under Art. 2207 of the Civil Code. The payment by the assured to the assured operates as an equitable assignment to the assurer of all the remedies which the assured may have against the third party whose negligence or wrongful act caused the loss. The right of subrogation is not dependent upon, nor does it grow out of any privity of contract. It accrues simply upon payment by the insurance company of the insurance claim.
St Paul v Macondray

**Facts:** Winthrop Products consigned to Winthrop Stearns drugs and medicines (from NY to Mla) through Macondray & Co. Insured with St. Paul Fire. Arrastre services provided by Mla. Port Services. Upon arrival to Manila one drum and several cartons arrived in bad condition. Winthrop Stearns filed a claim for damages. St. Paul paid claim. St. Paul then proceeded against the Arrastre Service who resisted action which claimed it delivered goods in same condition it received from the carrier (Macondray). Macondray denied liability claiming liability ceased upon discharge of goods from ship’s tackle. Note: there is a bill of lading which stipulated that the amount of the liability should only be Php1k++, but St. Paul paid amount US$1k++. Ratio: St. Paul should receive the amount according to the bill of lading. The purpose of the bill of lading is to provide for the rights and liabilities of the parties. The stipulation in the bill of lading limiting the common carrier’s liability to the value of the goods appearing in the bill is valid and binding. St. Paul after paying the claim of the insured for damages under the policy is subrogated merely to the rights of the assured as subrogee, it can recover only the amount that is recoverable by the latter. Since the right of Winthrop in case of loss or damage to the goods is limited or restricted by the provision in the bill of lading, a suit by St. Paul as subrogee is necessarily subject to like limitations and restrictions.

Chapter VII

**REINSURANCE**

**Title 12 – Reinsurance**

Sec. 95. A contract of reinsurance is one by which an insurer procures a third person to insure him against loss or liability by reason of such original insurance.

1. **DEFINITION OF REINSURANCE**

   - It is a contract whereby one party, the reinsurer, agrees to indemnify another, the reinsured, either in whole or in part, against loss or liability which the latter may sustain or incur during a separate and original contract of insurance with a third party, the original insured.
   - A contract of reinsurance is an insurance of an insurance or when insurance business is transferred from one insurance company to another. Sometimes called “treaties.”

2. **RATIONALE OF REINSURANCE**

   - It is one type of liability insurance.
   - It represents a further extension of the fundamental idea of insurance, that is, distribution among many of the risks resting upon one.
   - Where an insurer desires to entirely relieve himself of liability under contracts made and reinsures all his risks.

Contracts/treaties of reinsurance are plainly beneficial to the public inasmuch as they promote both efficiency and stability in the conduct of the insurance business.

3. **BENEFITS OF REINSURANCE TO THE INSURER**

   1. Insurers are able to issue policies in excess of such retention limits or the maximum claim it wishes to pay out of its own resources.
   2. Pooling the resources of many companies also extends greater coverage of insurance protection, extended even among APPLICANTS requiring large amounts and those not eligible for insurance at standard rates.
   3. UNDERWRITERS benefit through the placing of additional insurance in an expanded market.
   4. The insurance INDUSTRY benefits by reducing the waste arising out of policies which are applied for but not issued.
   5. The REINSURER benefits through the acquisition of business which is expected to prove profitable in the long run.

4. **BENEFITS OF REINSURANCE TO THE INSURED**

   1. It gives insurance companies greater financial stability and thus makes the insured’s individual policy more reliable.
   2. If a large amount of insurance is needed, the insured may obtain it without negotiating with numerous companies.
   3. It enables the insured to obtain protection promptly, without the delay that would be required to divide and distribute the amount among many companies.
   4. All the insurance can be written under identical contract provisions, whereas otherwise these might vary with the different companies among whom the insurance is divided.
   5. Small companies are encouraged to divide large exposures for safety and enabled to accept a wide variety of applicants.

5. **NATURE OF CONTRACT OF REINSURANCE**

   The subject of the contract of reinsurance is the primary insurer’s risk and not the property insured under the original policy.

   1. CONTRACT OF INDEMNITY AGAINST LIABILITY. The reinsurer agrees to indemnify the insured, not against actual payment made but against liabilities incurred. It is not necessary that the insurer first pay the loss accruing to demand payment from reinsurer.
   2. CONTRACT SEPARATE FROM ORIGINAL INSURANCE POLICY. Contracts of insurance and reinsurance are independent from each other. The practice is for the reinsurer to pay the insurer even before the latter has indemnified the original insured.
   3. CONTRACT BASED ON ORIGINAL POLICY. The reinsurance policy is necessarily based on the original contract, and the rights of the parties in the reinsurance are greatly
affected by the latter’s terms and conditions. The reinsured risk must be the same as that covered by the original policy.

4. INSURABLE INTEREST REQUIREMENT APPLICABLE. The doctrine of insurable interest used in the original policy is also applicable to reinsurance. Hence, the primary insurer is not entitled to contract for reinsurance exceeding the limits of the policy ceded to the reinsurer.

5. RULE ON SUBROGATION AVAILABLE. In general, a reinsurer, on payment of a loss, acquires the same rights by subrogation as are acquired in similar cases where the original insurer pays a loss.

6. REINSURANCE VS DOUBLE INSURANCE DISTINGUISHED

<table>
<thead>
<tr>
<th>Reinsurance</th>
<th>Double Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurer becomes the insured, insofar as the reinsurer is concerned</td>
<td>Insurer remains as the insurer of the original insured</td>
</tr>
<tr>
<td>The subject of the insurance is the original insurer’s risk</td>
<td>The subject of the insurance is the property being insured</td>
</tr>
<tr>
<td>Insurance of a different interest</td>
<td>Insurance of the same interest</td>
</tr>
<tr>
<td>Original insured has no interest in the contract of reinsurance which is independent of the original contract of insurance</td>
<td>Insured is the party in interest in all the contracts</td>
</tr>
<tr>
<td>Consent of the original insured is not necessary</td>
<td>The insured has to give his consent</td>
</tr>
</tbody>
</table>

Sec. 96. Where an insurer obtains reinsurance, except under automatic reinsurance treaties, he must communicate all the representations of the original insured, and also all the knowledge and information he possesses, whether previously or subsequently acquired, which are material to the risk.

The reinsured has the duty to disclose all material facts to the reinsurer (since the risk insured against in a contract of reinsurance is the probability that the original insurer may be compelled to indemnify form the loss under the policy issued by him), the duty imposed is similar to persons seeking an original insurance – that of the strictest good faith.

When called TREATIES – where the insurer insures all or a substantial portion of its risk with one insurer

7. REINSURANCE TREATIES VS REINSURANCE POLICIES

This was asked in 2005. Note when double insurance occurs and the nature of the liabilities of the various insurers.

<table>
<thead>
<tr>
<th>Reinsurance Treaty</th>
<th>Reinsurance Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merely an agreement between two insurance companies where one agrees to cede and the other to accept reinsurance business pursuant to provisions specified in the treaty</td>
<td>Contract for indemnity one insurer makes with another to protect the first insurer from risk it has already assumed</td>
</tr>
</tbody>
</table>

Automatic Reinsurance Treaties – the ceding company (reinsured) is bound to cede and the reinsurer is obligated to accept a fixed share of the risk which has to be reinsured under the contract.

Facultative Reinsurance Treaties – there is no obligation either to cede or to accept participation in the risk insured, each party having a free choice.

Advantage to the insurer - The advantage of the automatic method is avoidance of delay in issuing the insurer’s policy. The advantage of the facultative method is that it receives the reinsurer’s underwriting opinion before the policy is issued.

Protection to the reinsurer - By agreeing to accept business automatically, the reinsurer is relying on the underwriting judgment of the insurer and is bound to accept a case even though it may not agree with the underwriting decision. The insurer is protected by the requirement that the original insurer retains its full retention limit, which assures a measure of self-interest

History: In the 1950’s, domestic insurer’s ceded risks to foreign reinsurers because there was no reinsurance company in the Philippines. Although, today even when there are domestic reinsurance companies operating in the country, domestic risks are still ceded to foreign reinsurance companies since the Philippines is a CALAMITY PRONE country.

Limitation

Code limits risk which a non-life insurer may retain on any one subject of insurance to 20% of its net worth.

Any reinsurance ceded by it is deducted in determining the risk retained.

Sec. 97. A reinsurance is presumed to be a contract of indemnity against liability, and not merely against damage.

Sec. 98. The original insured has no interest in a contract of reinsurance.

8. RELATIONSHIP OF INSURED TO REINSURER

General Rule

Original insured has NO INTEREST in the reinsurance contract

Whatever the reinsurer pays the insurer upon the happening of the loss becomes part of the insurer’s assets, and all its creditors share equal rights with the
insured to demand payment from such funds.

Exceptions:

- Contract may expressly bind the reinsurer to pay directly to the original owner any loss for which the original insurer may be liable.
  - Insured may choose to sue either insurer, reinsurer or BOTH. However, total recovery cannot be more than the actual loss.
  - Liability of reinsurer to original insured would not be affected by any defense which the reinsurer may have against the original insurer.
  - No novation which discharges original policy — original policy remains in full force and original insured has right to demand that all its terms and conditions be complied with.

- If insured agreed with insurer and reinsurer that he will look only to reinsurer for indemnity in case of loss
  - Novation discharged original insurer
  - Technically not a reinsurance.

9. LIABILITY OF REINSURER TO REINSURED

Reinsurer is entitled to avail himself of every defense which the reinsured might urge in an action by the person originally insured. Thus, the reinsurer is not liable to the reinsured for a loss under an original policy if the latter is not liable to the original insured or for an amount more than the sum actually paid to the insured.

Philam v Auditor

Facts: Philamlife had a reinsurance treaty with AIRCO with an agreement to pay reinsurance premiums on an annual basis. The Central Bank collected foreign exchange margin on the remittances of Philamlife to AIRCO. Philamlife filed for refund contending that the reinsurance premiums remitted were paid pursuant to the reinsurance treaty and therefore were pre-existing obligations expressly exempt from the margin fee.

Ratio: Philamlife is not entitled to refund. Reinsurance treaties and reinsurance policies are not one and the same. Reinsurance treaties are contracts FOR insurance while reinsurance policies are contracts OF insurance. Philamlife’s obligation to remit reinsurance premiums becomes fixed and definite only upon the execution of the reinsurance policy, because it is only after a reinsurance policy is made that payment of reinsurance premiums may be exacted as it is only after Philamlife seeks to remit the reinsurance premiums that the obligation to pay the margin fee arises.

Fieldman’s v Asian Surety

Facts: Fieldman’s and Asian entered into a reinsurance treaty wherein Asian will cede to Fieldman’s a specified portion of the amount of insurance underwritten by ASIAN. The contract stipulates that if either party wishes to terminate or cancel the agreement, they must give at least 3 months notice by registered mail to the other party and the cancellation was to take effect as of the 31st of December of the year in which the notice was given. Sometime in September 1961 Fieldman’s gave notice to Asian which Asian did not reply to, Fieldman’s gave 2 other notices. During this time, one of the reinsurance contracts – GSIS property was razed by fire. Asian filed a claim with Fieldman’s who denied liability pointing out that they have already terminated the reinsurance treaty.

Ratio: The basis of the obligation of the reinsurance treaty is that of the Fieldman’s under current cessions shall continue in full force and effect until their natural expiry.

Fieldman’s v Asian Surety

Facts: Fieldman’s issued to Manila Yellow Taxicab a common carrier accident insurance policy which will “incurmify the insured in the event of accident caused by or arising out of the use of Motor Vehicle against all sums which the insured will become legally liable to pay in respect of: death or bodily injury to any fare-paying passenger including the driver, conductor and/or inspector…” While policy was in force, Carlito Coquia driving the insured vehicle met an accident and died. His heirs filed claim against Fieldman’s.

Ratio: Heirs of Coquia have cause of action against Fieldman’s under Art. 1311 of the Civil Code (contracts pour autrui). This rule is the exception to the general rule that only parties to a contract may bring an action. Under this exception, third parties may demand the enforcement of the contract which was made for benefit.
Insurance Company (Philamlife). One such client died one year and eight months after Eternal had submitted his application to Philamlife, which did not act on the application. Philamlife, however, denied Eternal's insurance claim. Eternal filed the case before the Makati RTC, which had ordered Philamlife to pay the proceeds of the policy. On appeal, the CA reversed the RTC, dismissing the case.

**Held:** The Court noted that the group life policy was ambiguous as to whether the insurance coverage of Eternal's clients became effective upon contracting a loan with Eternal or upon Philamlife's approval. Emphasizing that an insurance contract is an adhesion contract which must be construed liberally in favor of the insured and strictly against the insurer, which was the party which prepared and had exclusive control over the terms and phraseology of the insurance contract, the Supreme Court interpreted the ambiguity to mean that upon a party's purchase of a memorial lot on installment from Eternal, an insurance contract covering the lot purchaser is created and the same is effective until terminated by Philamlife's disapproval of the application. The Court likewise found that Philamlife's receipt of a letter, the contents of which state that attached thereto are insurance forms for a list of burial lot owners including the disputed application, is an admission of Philamlife against its own interest, as well as an acknowledgement of the receipt of the letter together with the attachments. Such receipt, the Court said, shifted the burden of evidence to Philamlife to prove that the letter did not contain the disputed application. Having failed to do so, Philamlife is deemed to have received the insurance application. The Court thus held the case before the Makati RTC, which had ordered Philamlife to pay the proceeds of the policy. On appeal, the CA reversed the RTC, dismissing the case.

**Facts:** The deceased in this case had 2 common-law wives and that deceased had a legal wife, Gina. Gina, however, filed the same claim with the SSS. Petitioner, Editha, had refused until a certification could be issued that her stroke was not due to pre-existing conditions. Dr. Saniel, her physician, however, was not able to issue such a certification, stating that because the patient invoked the doctor-patient confidentiality, such information could not be given to the petitioner.

**Yolanda Signey v. Social Security System**

January 28, 2008

**Facts:** The deceased in this case had 2 common-law wives, petitioner and Gina, and one legal wife, Editha. Petitioner had filed a claim with the SSS alleging that she was the legal wife and that her husband had a common-law wife, Gina. Gina, however, filed the same claim with the SSS, alleging that both she and petitioner were common-law wives and that deceased had a legal wife. The SSS had denied petitioner's claim stating that the marriage between her and the deceased was not valid as it was executed during a prior existing marriage of the deceased against Editha, that deceased’s only legitimate child had predeceased him, that deceased’s 4 children with petitioner and deceased’s 2 children with Gina as primary beneficiaries.

**Held:** Whoever claims entitlement to the benefits provided by law should establish his or her right thereto by substantial evidence. Since petitioner is disqualified to be a beneficiary and because the deceased has no legitimate child, it follows that the dependent illegitimate minor children of the deceased shall be entitled to the death benefits as primary beneficiaries. The SSS Law is clear that for a minor child to qualify as a “dependent,” the only requirements are that he/she must be below 21 years of age, not married nor gainfully employed. In this case, the minor illegitimate children Ginalyn and Rodelyn were born on 13 April 1996 and 20 April 2000, respectively. Had the legitimate child of the deceased and Editha survived and qualified as a dependent under the SSS Law, Ginalyn and Rodelyn would have been entitled to a share equivalent to only 50% of the share of the said legitimate child. Since the legitimate child of the deceased predeceased him, Ginalyn and Rodelyn, as the only qualified primary beneficiaries of the deceased, are entitled to 100% of the benefits.

**Filipinas Life Assurance Company v. Clemente N. Pedroso, et al.**

February 4, 2008

**Facts:** The respondents were duped by an agent (Valle) of the petitioner into investing in a “promotional investment” program offering 8% prepaid interest a month for certain deposits made on a monthly basis. Basically, the issue is whether or not the insurance company should be held solidarily liable, or whether it should hold only the agent solely liable to the respondents.

**Held:** Filipinas Life, as the principal, is liable for obligations contracted by its agent Valle. By the contract of agency, a person has the authority to render some service or to do something in representation or on behalf of another, with the consent or authority of the latter. The general rule is that the principal is responsible for the acts of its agent done within the scope of its authority, and should bear the damage caused to third persons. When the agent exceeds his authority, the agent becomes personally liable for the damage. But even when the agent exceeds his authority, the principal is still solidarily liable together with the agent if the principal allowed the agent to act as though the agent had full powers. In other words, the acts of an agent beyond the scope of his authority do not bind the principal, unless the principal ratified them, expressly or impliedly. Filipinas Life cannot profess ignorance of Valle’s acts. Even if Valle’s representations were beyond his authority as a debit/insurance agent, Filipinas Life expressly and knowingly ratified Valle’s acts. It cannot even be denied that Filipinas Life benefited from the investments deposited by Valle in the account of Filipinas Life. In our considered view, Filipinas Life had clothed Valle with apparent authority; hence, it is now estopped to deny said authority. Innocent third persons should not be prejudiced if the principal failed to adopt the needed measures to prevent misrepresentation, much more so if the principal ratified his agent’s acts beyond the latter’s authority.

**Blue Cross Health Care v. Neomi and Danilo Olivares**

February 12, 2008

**Facts:** Neomi suffered a stroke and applied for reimbursement of her medical bills from petitioner, her health care provider. Petitioner refused until a certification could be issued that her stroke was not due to pre-existing conditions. Dr. Saniel, her physician, however, was not able to issue such a certification, stating that because the patient invoked the doctor-patient confidentiality, such information could not be given to the petitioner.
The issue is whether petitioner was able to prove that Neomi’s stroke was caused by pre-existing conditions and was therefore outside the coverage of her plan.

**Held:** It is an established rule in insurance contracts that when their terms contain limitations on liability, they should be construed strictly against the insurer. These are contracts of adhesion the terms of which must be interpreted and enforced stringently against the insurer which prepared the contract. This doctrine is equally applicable to health care agreements. Petitioner never presented any evidence to prove that respondent Neomi had a pre-existing condition. It merely speculated that Dr. Saniel’s report would be adverse to Neomi, based on her invocation of the doctor-patient privilege. This was a disputable presumption at best. Suffice it to say that this presumption does not apply if the suppression is an exercise of a privilege. Here, respondents’ refusal to present or allow the presentation of Dr. Saniel’s report was justified. It was privileged communication between physician and patient. Furthermore, limitations of liability on the part of the insurer or health care provider must be construed in such a way as to preclude it from evading its obligations. Accordingly, they should be scrutinized by the courts with “extreme jealousy” and “care” and with a “jaundiced eye.” Since the petitioner had the burden of proving exception to liability, it should have made its own assessment of whether respondent Neomi had a pre-existing condition when it failed to obtain the attending physician’s report. It could not just passively wait for Dr. Saniel’s report to bail it out. The mere reliance on a disputable presumption does not meet the strict standard required under our jurisprudence.

**Philippine Deposit Insurance Corporation v. COA**

**February 22, 2008**

**Facts:** The former Finance Secretary, Mr. Roberto de Ocampo, in his capacity as ex-officio Chairman of the Philippine Deposit Insurance Corporation (PDIC) Board for the years 1994-1996 received a total amount of ₱440,068.62 representing Business Policy Development and Enforcement Expenses (BPDEE) and Christmas gift checks. The Auditor thereat issued Notice of Disallowance disallowing in audit the payment of said expenses on the ground that it partook of the nature of additional compensation or remuneration in violation of the rule on multiple positions proscribed under Section 13, Article VII of the Philippine Constitution and Section 2(9), Republic Act No. 3591, as amended. PDIC sought reconsideration of the subject disallowance but the same was denied by COA. The SC affirmed with finality said COA decision and resolution. The Final Order of Adjudication (FOA) was issued to PDIC for enforcement of the decision. However, instead of complying with the Order, PDIC conditioned the amount of ₱413,866.62 invoking its power to condone under Section 8, paragraph 12 of its charter.

**Held:** It is a fundamental rule that when a judgment becomes final and executory it becomes immutable and unalterable, the prevailing party can have it executed as a matter of right, and the issuance of a writ of execution becomes a ministerial duty of the court. The writ of execution must conform to the judgment to be executed and adhere strictly to the very essential particulars. Following this rule, PDIC should have reasonably expected that a final order directing payment of the refund of the disallowed amount was forthcoming in accordance with the COA Rules as, in fact, a Final Order of Adjudication was issued. Whatever may have been the reason for the dismissal of PDIC’s petition, the fact remains that the decision upholding the audit disallowance had become final and executory. Hence, of plead, the decision is now unalterable and immutable. It is no longer subject to any revision, modification or appeal.

In dismissing the petition and affirming the audit disallowance, this Court effectively declared that the payment of the BPDEE to Secretary De Ocampo is prohibited as it violates the rule against double compensation. This declaration necessarily also means that condonation of the same payment in favor of the same person is likewise prohibited. To settle the matter once and for all, the audit disallowance is not subject to condonation following the principle that what is prohibited directly is also prohibited indirectly. The audit disallowance cannot be condoned excepted, and legitimized by resorting to condonation. The authority of PDIC to condone applies only to ordinary receivables, penalties and surcharges and must be submitted to the Commission before it is implemented. This procedure would enable the Commission to inquire into the propriety of the condonation and to determine whether the same would be in the interest of the government consistent with COA’s constitutional mandate to examine, audit and settle all accounts of the government, its subdivisions, agencies and instrumentalities, including government-owned and controlled corporations. Furthermore, PDIC’s authority to condone under its charter is circumscribed by the phrase “to protect the interest of the Corporation.” This authority does not include the power to condone a liability that arises from a violation of law. With greater reason, the condonation of a liability that arises from a violation of no less than the Constitution, as in this case, is not encompassed by PDIC’s charter. It is not in the interest of PDIC to forego audit disallowances, as it is neither its mandate nor its task to perpetuate breaches of law.

**Gloria Sondayon v. P.J. Lhullier, Inc and Ricardo Diago**

**February 27, 2008**

**Facts:** Petitioner had pledged her P250K watch to respondent pawnshop. The pawnshop was robbed, and among the items seized was petitioner’s watch. Petitioner tried to recover the watch but respondent argued that the robbery was a fortuitous event, hence, they were not liable.

**Held:** Had respondent company insured the articles pledged against burglary, petitioner would have been reimbursed for its loss from the burglary. Respondent company’s failure to insure the article is, therefore, a contributory cause to petitioner’s loss. Considering, however, that petitioner agreed to a valuation of ₱15,000 for the article pledged in case of a loss, the replacement value for failure to insure is likewise limited to ₱15,000. Nevertheless, this Court, taking into account all the circumstances of this case, deems it
fair and just to award exemplary damages against respondent company for its failure to comply with the rule and regulation requiring it to insure the articles pledged against fire and burglary, in the amount of Twenty Five Thousand (P25,000) Pesos. This is without prejudice to appropriate proceedings to recover any excess value of the article pledged from amounts that may be or have been awarded payable by third parties answerable for the loss arising from the robbery.

**Philippine Deposit Insurance Corporation Act**  
**(RA 3591 as amended by RAs 6037, 7400, 8791 and 9302 and PDs 120, 1094, 1451 and 1935)**

1. **Basic Policy**
   - To insure the deposits of all banks which are entitled to the benefits of insurance under this Act
   - To promote and safeguard the interests of the depositing public by way of providing permanent and continuing insurance coverage on all insured deposits.

2. **PDIC Functions**
   - Can lend money to banks before closure
   - Insurer of deposits against bank closures
   - Acts as receiver for banks
   - The PDIC Act is not applicable to Offshore Banking Units
   - Nature of insurance function: compulsory insurance on all bank deposits

**Administrative Functions:**

2.1. **Authority to Examine Banks**
   The PDIC has the power to conduct examination of banks with prior approval of the Monetary Board:

   Provided, No examination can be conducted within 12 months from the last examination date.

2.2. **Authority to Underwrite and Advance Legal Fees and Litigation Expenses**

**Who are covered?**
The Corporation shall underwrite or advance litigation costs and expenses, or provide legal assistance to its directors, officers, employees or agents in connection with any civil, criminal, administrative or any other action or proceeding, to which such director, officer, employee or agent is made a party by reason of the exercise of authority or performance of functions and duties under this Act.

Directors, officers, employees or agents who shall resign, retire, transfer to another agency or be separated from the service, shall continue to be provided with such legal protection in connection with any act done or omitted to be done by them in good faith during their tenure or employment.

This shall not apply to any civil, criminal, administrative or any action or proceeding initiated by the Corporation against such director, officer, employee or agent.

**What fees / expenses are covered?**
- Litigation costs and expenses, including legal fees and other expenses of external counsel, or providing legal assistance
- Legal assistance shall include the grant or advance of reasonable legal fees to enable the employee to engage counsel of his choice.
- In the event of a settlement or compromise, indemnification shall be provided only when the Corporation is advised by counsel that the persons to be indemnified did not commit any negligence or misconduct.
- The costs and expenses incurred may be paid by the Corporation in advance of the final disposition upon receipt of an undertaking by the employee to repay the amount advanced should it ultimately be determined by the Board of Directors that he is not entitled to be indemnified.

2.3. **Authority to Provide Financial Assistance**

**What entities are covered?**
- **Insured banks in danger of closing**
  When the Corporation has determined that:
  - an insured bank is in danger of closing
  - the continued operation of such bank is essential to provide adequate banking service in the community maintain financial stability in the economy.

- **Insured banks that have already closed**
  The authority to extend financial assistance may also be exercised in the case of a closed insured bank if the Corporation finds that:
  - the resumption of operations of such bank is vital to the interests of the community, or
  - a severe financial climate exists which threatens the stability of a number of banks possessing significant resources

- **Entities acquiring /merging with closed / closing insured banks**
  The Corporation may provide any corporation:
  - acquiring control of
  - merging with
  - consolidating with
  - acquiring the assets of an insured bank in danger of closing in order to prevent such.

- **Closure of entities that may produce systemic consequences**
  When the Monetary Board has determined that there are systemic consequences of a probable closure of an insured bank, the Corporation may grant financial assistance in such amount as may be necessary to prevent its failure or closure and/or restore the insured bank to viable operations.

A **systemic risk** refers to the possibility that failure of one bank to settle net transactions with other banks will trigger a chain reaction, depriving other banks of funds leading to a general shutdown...
of normal clearing and settlement activity. It also means the likelihood of a sudden, unexpected collapse of confidence in a significant portion of the banking or financial system with potentially large real economic effects.

What are PDIC’s powers with regard to financial assistance?

It is authorized to

- make loans
- purchase the assets
- assume liabilities
- make deposits
- Provide financial assistance which may take the form of equity or quasi-equity of the insured bank Provided That the Corporation shall dispose of such equity as soon as practicable.

The Corporation, prior to the exercise of its powers, shall determine that actual payoff and liquidation will be more expensive than the exercise of this power.

The Corporation may not use its authority to purchase the voting or common stock of an insured bank but it can enter into and enforce agreements that it determines to be necessary to protect its financial interests.

3. Concept of Insured Deposits

The term "insured deposit" means the amount due to any depositor for deposits in an insured bank net of any obligation of the depositor to the insured bank as of the date of closure, but not to exceed P250,000.00.

In determining such amount due to any depositor, there shall be added together all deposits in the bank maintained in the same right and capacity for his benefit either in his own name or in the name of others.

A joint account regardless of whether the conjunction “and,” “or,” “and/or” is used, shall be insured separately from any individually-owned deposit account:

Provided, That

a. If the account is held jointly by two or more natural persons, or by two or more juridical persons or entities, the maximum insured deposit shall be divided into as many equal shares as there are individuals, juridical persons or entities, unless a different sharing is stipulated in the document of deposit and

b. If the account is held by a juridical person or entity jointly with one or more natural persons, the maximum insured deposit shall be presumed to belong entirely to such juridical person or entity

c. The aggregate of the interests of each co-owner over several joint accounts, whether owned by the same or different combinations of individuals, juridical persons or entities, shall likewise be subject to the maximum insured deposit of P250,000.00

No owner/holder of any negotiable certificate of deposit shall be recognized as a depositor entitled to the rights provided in this Act unless his name is registered as owner/holder thereof in the books of the issuing bank.

4. Liability to Depositors

4.1. Commencement of Liability

Liability commences when an insured bank is closed by the Monetary Board pursuant to Sec 30 of R.A. 7653.

4.2. Extent of Liability

Liability covers the amount due to any depositor for deposits in an insured bank net of any obligation of the depositor to the insured bank as of the date of closure, but not to exceed P250,000.00.

4.3. Determination of Insured Deposits

The Corporation shall commence the determination of insured deposits upon its actual takeover of the closed bank.

In order that a claim for deposit insurance with the PDIC may prosper, the law requires that a corresponding deposit be placed in the insured bank. A deposit as defined in Section 3(f), may be constituted only if money or the equivalent of money is received by a bank:

(f) 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 passbook, check and/or certificate of deposit (PDIC vs CA, 1997)

The Corporation shall publish the notice once a week for at least 3 consecutive weeks in a newspaper of general circulation or, when appropriate, in a newspaper circulated in the community or communities where the closed bank or its branches are located.

4.4. Calculation of Liability

(See Part III)

Special Provisions for Joint Accounts (PDIC Bulletin 2004-04)

1. A joint account regardless of whether the conjunction “and”, “or” or “and/or” is used, shall be insured separately from an individually-owned deposit account.

2. If the account is held jointly by two or more natural persons, or by two or more juridical persons or entities, the maximum insured deposit shall be divided into as many equal shares as there are individuals, juridical persons or entities, unless a different sharing is stipulated in the document of deposit.

Document of deposit referred to in the preceding paragraph pertains to joint account agreements, account ledgers, certificate of time deposits, passbooks or other evidence of deposits, specimen signature cards, corporate resolutions, contracts or similar instruments, copies of which must be in the custody or possession of the bank upon takeover by PDIC.
3. If the account is held by a juridical person or entity jointly with one or more natural persons, the maximum insured deposit shall be presumed to belong entirely to the juridical person or entity.

4. The aggregate of the interests or total share of each co-owner over several joint accounts, whether owned by the same or different combinations of individuals, juridical persons or entities, shall likewise be subject to the maximum insured deposit of ₱250,000.00.

5. The amount of insurance due to any depositor for deposits in an insured bank shall be net of any matured or unmatured obligation of the depositor to the insured bank as of date of closure. In case of joint deposit accounts where only one of the co-depositors has an obligation to the closed bank, the following shall apply:

a. Where the deposit is a joint “and/or” or “or” account which is covered by a hold-out agreement, the obligation secured by the hold-out agreement shall be deducted from the balance of the joint account, regardless of the fact that only one of the co-depositors in the joint account is indebted to the closed bank.

b. When the deposit is a joint “and” account which is covered by a hold-out agreement, the obligation secured by the hold-out agreement shall be deducted only from the share in the joint account of the depositor who is indebted to the closed bank, unless his co-depositor is himself a co-signatory to the hold-out agreement.

c. Where the deposit is either a joint “and”, “or” or “and/or” account which is not covered by a hold-out agreement, the obligation of the depositor who is indebted to the closed bank shall be deducted only from his share in the balance of the joint deposit account.

4.5. Mode of Payment
Payment of the insured deposits shall be made by the Corporation as soon as possible either

» by cash or
» by making available to each depositor a transferred deposit in another insured bank.

The term "transfer deposit" means a deposit in an insured bank made available to a depositor by the Corporation as payment of insured deposit of such depositor in a closed bank and assumed by another insured bank.

4.6. Conditions that may be imposed prior to payment

» The Corporation, in its discretion, may require proof of claims to be filed before paying the insured deposits
» Where the Corporation is not satisfied as to the viability of a claim for an insured deposit, it may require final determination of a court of competent jurisdiction before paying such claim

4.7. Effect of Payment of Insured Deposit

» PDIC is discharged from obligations
• Payment of an insured deposit to any person by the Corporation shall discharge the Corporation
• Payment of a transferred deposit by the new bank or by an insured bank in which a transferred deposit has been made available shall discharge the Corporation and such new bank or other insured bank
» PDIC is subrogated to depositor’s rights
• The Corporation, upon payment of any deposit shall be subrogated to all rights of the depositor against the closed bank. But the depositor shall retain his claim for any uninsured portion of his deposit.
• All payments by the Corporation of insured deposits in closed banks partake of the nature of public funds, and must be considered a preferred credit similar to taxes due to the National Government.

4.8. Failure to settle claim of insured depositor
Failure to settle the claim, within 6 months from the date of filing of claim for insured deposit, where such failure was due to grave abuse of discretion, gross negligence, bad faith, or malice, shall subject the directors, officers or employees responsible to imprisonment from 6 months to 1 year.

The period shall not apply if the validity of the claim requires the resolution of issues of facts and law by another office, body or agency.

4.9. Failure of Depositor to Claim Insured Deposit

Unless otherwise waived by the Corporation, if the depositor in the closed bank shall fail to claim his insured deposits with the Corporation

» within 2 years from actual takeover of the closed bank by the receiver, or
» within 2 years after the two-year period to file a claim,
all rights of the depositor against the Corporation shall be barred.

However, all rights of the depositor against the closed bank and its shareholders or the receivership estate to which the Corporation may have become subrogated, shall revert to the depositor.

5. Restriction on Payment of Dividends by Insured Bank

5.1. General Rule:
No insured bank shall pay any dividend on its capital stock or interest on its capital notes or debentures (if such interest is required to be paid only out of net profits) or distribute any of its capital assets while it remains in default in the payment of any assessment due to the Corporation.

5.2. Exception:
• If such default is due to a dispute between the insured bank and the Corporation over the amount of such assessment and Bank deposits
security satisfactory to the Corporation for payment upon final determination

6. Prohibition against Splitting of Deposits

The penalty of prision mayor or a fine of not less than P50,000 but not more than P2,000,000 or both shall be imposed upon any director, officer, employee or agent of a bank for:

5) splitting of deposits or creation of fictitious loans or deposit accounts.

7. Prohibition against Issuance of TROs

- No court, except the CA, shall issue any TRO, preliminary injunction or preliminary mandatory injunction against the Corporation.
- This prohibition shall apply in all cases, disputes or controversies instituted by a private party, the insured bank, or any shareholder.
- The Supreme Court may issue a restraining order or injunction when
  - the matter is of extreme urgency involving a constitutional issue
  - grave injustice and irreparable injury will arise
  - The party applying shall file a bond in an amount to be fixed by the Supreme Court

Effects of issuing TRO:
- Any restraining order or injunction issued in violation of this Section is void and of no force and effect
- Any judge who has issued the same shall suffer the penalty of suspension of at least 60 days without pay
TRANSPORTATION LAW

I. General Considerations

A. Public Utilities

1987 Constitution, Article XII

Section 11

No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines, at least sixty per centum of whose capital is owned by such citizens; nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than fifty years. Neither shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the common good so requires. The State shall encourage equity participation in public utilities by the general public. The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital, and all the executive and managing officers of such corporation or association must be citizens of the Philippines.

Section 17

In times of national emergency, when the public interest so requires, the State may, during the emergency and under reasonable terms prescribed by it, temporarily take over or direct the operation of any privately-owned public utility or business affected with public interest.

Agan, Jr. vs. PIATCO, 402 SCRA 612 (2003)

The Constitution envisions a situation wherein the exigencies of the times necessitated the government to “temporarily take over or direct the operation of any privately owned public utility or business affected with public interest”. Since the State, in this case, is merely exercising its police power, such exercise must not be unreasonably hampered nor can it be a source of obligation, in the absence of damage due to arbitrariness. Also, requiring, the government pay reasonable compensation for the reasonable use of the property pursuant to the operation of the business contravene the Constitution.

Section 18

The State may, in the interest of national welfare or defense, establish and operate vital industries and, upon payment of just compensation, transfer to public ownership utilities and other private enterprises to be operated by the Government.

Section 19

The State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed.
WHEN IS A BUSINESS A PUBLIC UTILITY?
When it involves a commodity or service of public consequence.

2 CONCEPTS OF PUBLIC UTILITY UNDER THE 1987 CONSTITUTION:
1. A public utility is a partly nationalized business endeavor.
2. It is a business affected with the public interest. ("national emergency"; "general welfare"; "common good")

2 TESTS FOR DETERMINING PUBLIC UTILITY:
1. Is it engaged in regularly supplying the public with some commodity or service (per definition in Albano v. Reyes below)?
2. If #1 is uncertain, is it a public service as defined in the Public Service Law under CA 146 Sec 13(b)? If it falls under any one of the examples given under CA 146 Sec 13(b), then it is a public utility.

WHAT DOES "REGULARLY SUPPLYING THE PUBLIC..." MEAN?
The utility must hold itself out to the public as a public utility by demand and as a matter of right, and not by permission. To determine what constitutes regularity, look at it from the perspective of the public, and not the operator. It is a service or a readiness to serve an indefinite portion of the population subject only to the limitations of the service as given by the grant such that [the utility] incurs a liability as a violation of its duty if it refuses, that is, the absence of the service has become, through time, a matter of right and not of mere privilege. (also in US v. Tan Pica)

ARE ALL PUBLIC UTILITIES COMMODITIES OR SERVICE OF PUBLIC CONSEQUENCE?
Yes. All public utilities have a public consequence. But not all businesses bearing public consequence are public utilities. This is because almost all types of business have some form of regulation from the State.

TO WHOM DOES "PUBLIC" REFER TO? IS THE WORD "PUBLIC" IN "PUBLIC UTILITY" THE SAME IN "PUBLIC SERVICE"?
There are three senses of the word "public" in Transportation Law: a) public utility; b) public service; and c) definition of a common carrier under Art. 1732 of the Civil Code. To determine a public utility, the two tests above & the definition under Albano v. Reyes apply.

WHAT IS A PUBLIC SERVICE?
In determining public need, the presumption of need for a service shall be deemed in favor of the applicant. The burden of proving that there is no need for a proposed service shall be with the oppositor(s).

Public convenience and necessity exists when the proposed facility or service meets a reasonable want of the public and supply a need which the existing facilities do not adequately supply. The existence or nonexistence of public convenience and necessity is therefore a question of fact that must be established by evidence, real and/or testimonial; empirical data; statistics and such other means necessary, in a public hearing conducted for that purpose. The object and purpose of such procedure, among other things, is to look out for, and protect, the interests of both the public and the existing transport operators.

Albano v. Reyes (1989)
Franchises issued by Congress are not required before each and every public utility may operate.

A public utility is a business or service engaged in regularly supplying the public with some commodity or service of public consequence, such as electricity, gas, water, transportation, telephone or Telegraph services. Apart from statutes which define public utilities that are within the purview of such statutes, it would be difficult to construct a definition of a public utility which would fit every conceivable case. As its name indicates, however, the term public utility implies a public use and service to the public.

Tatad v Garcia
What constitutes a public utility is not their ownership but their use to serve the public.

PAL v. Civil Aeronautics Board (1997)
WON "certificates of Public Convenience and Necessity" (franchise required) as used in RA 776 to authorize the Board is different from "Certificates of Public Convenience" (no franchise required)? No
There is no authoritative basis in distinguishing a Certificate of Public Convenience and Necessity (franchise required) and a Certificate of Public Convenience (no franchise required) based only on the use of the words convenience and necessity. The use of the words "necessity" in conjunction with "public convenience" in a certificate of authorization to a public service entity to operate, does not in any way modify the nature of such certification, or the requirements for the issuance of the same. It is the law which determines the requisites for the issuance of such certification, and not the title indicating the certificate.

WHAT IS THE DIFFERENCE BETWEEN A PUBLIC UTILITY AND A PUBLIC SERVICE?
For all intents and purposes, they are the same and are used interchangeably. However, public utility is a broader concept that embraces public service. A public service is necessarily a public utility, but not all public utilities are public services.

WHEN IS A PUBLIC UTILITY NOT A PUBLIC SERVICE?
If it is not included in the enumeration in the Public Service Act (CA 146 Sec. 13(b)) and Albano v. Reyes.

HOW DO THEY DIFFER IN CONSTITUTIONAL RESTRICTIONS AND REQUIREMENTS?
If a business is a public utility, then it is subject to the limitations and restrictions provided for in the 1987 Constitution (Art 12 Secs. 11,17,18,19) Since a public service is necessarily a public utility, therefore public services are subject to the same Constitutional limitations and restrictions.
If a public utility is not a public service, it is still subject to the same Constitutional limitations and restrictions.

Therefore, public utility = Constitution + public service = Constitution + Public Service Act

B. Transportation

DEFINITION

The movement of goods or persons from one place to another, by a carrier. (Black's Law Dictionary)

A contract of transportation is one whereby a certain person or association of persons obligate themselves to transport persons, things, news from one place to another for a fixed price. It is the removal of goods or persons from one place to another.

NOTE:

Art. 1766 In all matters not regulated by this Code, the rights and obligations of common carriers shall be governed by the Code of Commerce and by special laws.

PUBLIC NATURE

It is for public use, which means that the use is not confined to privileged individuals, but is instead open to an indefinite public. It is this indefinite or unrestricted quality that gives it its public character. The true criterion by which to judge the character of the use is whether the public may enjoy it by right or by permission. There must be, in general, a right under the law which compels the owner to give the service for the general public.

PUBLIC SERVICE ACT

THE PUBLIC SERVICE LAW (CA 146)

(As amended, and as modified particularly by PD No. 1, Integrated Reorganization Plan and EO 546)

CHAPTER I

ORGANIZATION

SECTION 1

This Act shall be known as the "Public Service Act."

SECTION 2

There is created under the Department of Justice a commission which shall be designated and known as the Public Service Commission, composed of one Public Service Commissioner and five Associate Commissioners, and which shall be vested with the powers and duties hereafter specified. Whenever the word "Commission" is used in this Act, it shall be held to mean the Public Service Commission, and whenever the word "Commissioner" is used in this Act it shall be held to mean the Public Service Commissioner or anyone of the Associate Commissioners. The Public Service Commissioner and the Associate Public Service Commissioners shall be natural born citizens and residents of the Philippines, not under thirty years of age; members of the Bar of the Philippines, with at least five years of law practice or five years of employment in the government service requiring a lawyer's diploma; and shall be appointed by the President of the Philippines, with the consent of the Commission on Appointments of the Congress of the Philippines: Provided, however, That the present Commissioner and the personnel of the Commission shall continue in office without the necessity of re-appointment. The Commissioners shall have the rank and privilege of retirement of Judges of the Courts of First Instance. (As amended by Republic Act Nos. 178 and 2677)

SECTION 3

The Commissioner and Associate Commissioners shall hold office until they reach the age of seventy years, or until removed in accordance with the procedures prescribed in section one hundred and seventy-three of Act Numbered Twenty-seven hundred and eleven, known as the Revised Administrative Code: Provided, however, That upon retirement any Commissioner of Associate Commissioner shall be entitled to all retirement benefits and privileges for Judges of the Courts of First Instance or under the retirement law to which he may be entitled on the date of his retirement. In case of the absence, for any reason, of the Public Service Commissioner, the Associate Commissioner with seniority of appointment shall act as Commissioner. If on account of absence, illness, or incapacity of any of three Commissioners, or whenever by reason of temporary disability of any Commissioner or of a vacancy occurring therein, the requisite number of Commissioners necessary to render a decision or issue an order in any case is not present, or in the event of a tie vote among the Commissioners, the Secretary of Justice may designate such number of Judges of the Courts of First Instance, or such number of attorneys of the legal division of the Commission, as may be necessary to sit temporarily as Commissioners in the Public Service Commission.

The Public Service Commission shall sit individually or as a body en banc or in two divisions of three Commissioners each. The Public Service Commissioner shall preside when the Commission sits en banc and in one division. In the other division, the Associate Commissioner with seniority of appointment in that division shall preside. Five Commissioners shall constitute a quorum for sessions en banc and two Commissioners shall constitute a quorum for the sessions of a division. In the absence of a quorum, the session shall be adjourned until the requisite number is present.

All the powers herein vested upon the Commission shall be considered vested upon any of the Commissioners, acting either individually or jointly as hereinafter provided. The Commissioners shall equitably divide among themselves all pending cases and those that may hereafter be submitted to the Commissioner, in such manner and form as they may determine, and shall proceed to hear and determine the case assigned to each or to their respective divisions, or to the Commission en banc as follows: uncontested cases, except those pertaining to the fixing of rates, shall be decided by one Commissioner; contested cases and all cases involving the fixing of rates shall be decided by the Commission in division and the concurrence of at least two Commissioners in the division shall be necessary for the promulgation of a decision or non-interlocutory order in these cases: Provided,
however, That any motion for reconsideration of a
decision or non-interlocutory order of any
Commissioner or division shall be heard directly by
the Commission en banc and the concurrence of at
least four Commissioners shall be necessary for the
promulgation of a final decision or order resolving
such motion for reconsideration. (As amended by
Republic Act Nos. 723 and 2677)

SECTION 4

The Public Service Commissioner shall receive an
annual compensation of thirteen thousand pesos;
and each of the Associate Commissioners an annual
compensation of twelve thousand pesos. The
Commissioners shall be assisted by one chief
attorney, one finance and rate regulation officer,
one chief utilities regulation engineer, one chief
accountant, one transportation regulation chief,
one secretary of the Public Service Commission,
and three public utilities advisers who shall receive
an annual compensation of not less than ten
thousand eight hundred pesos each; five assistant
chiefs of division who shall receive an annual
compensation of not less than nine thousand six
hundred pesos each; twelve attorneys who shall
receive an annual compensation of not less than
nine thousand pesos each; and a technical and
confidential staff to be composed of two certified
public accounts, two electrical engineers, two
mechanical or communication engineers, and two
special assistants who shall receive an annual
compensation of not less than seven thousand two
hundred pesos each. (As amended by Republic Act Nos. 723, 2677 and 3792)

SECTION 5

The Public Service Commissioner, the Associate
Public Service Commissioners, and all other officers
and employees of the Public Service Commission
shall enjoy the same privileges and rights as the
officer and employees of the classified civil service
of the Government of the Philippines. They shall
also be entitled to receive from the Government of
the Philippines their necessary travelling expenses
while travelling on the business of the Commission,
which shall be paid on proper voucher therefor,
approved by the Secretary of Justice, out of funds
appropriated for the contingent expenses of the
Commission.

When the exigency of the service so requires and
with the approval of the Secretary of Justice, and
subject to the provisions of Commonwealth Act
Numbered Two hundred forty-six, as amended,
funds may be set aside from the appropriations
provided for the Commission and/or from the fees
collected under Section forty of this Act to defray
the expenses to be incurred by the Public Service
Commissioner or any of the Associate
Commissioners, officers or employees of the
Commission to be designated by the Commissioner,
with the approval of the Secretary of Justice, in the
study of modern trends in supervision and
regulation of public services. (As amended by
Republic Act No. 3792)

SECTION 6

The Secretary of Justice, upon recommendation of
the Public Service Commissioner, shall appoint all
subordinate officers and employees of the
Commission as may be provided in the
Appropriation Act. The Public Service Commissioner
shall have general executive control, direction, and
supervision over the work of the Commission and
of its members, body and personnel, and over all
administrative business. (As amended by Republic
Act Nos. 178 and 3792)

SECTION 7

The Secretary of the Commission, under the
direction of the Commissioner, shall have charge of
the administrative business of the Commission and
shall perform such other duties as may be required
of him. He shall be the recorder and official
reporter of the proceedings of the Commission and
shall have authority to administer oaths in all
matters coming under the jurisdiction of the
Commission. He shall be the custodian of the
records, maps, profiles, tariffs, itineraries, reports,
and any other documents and papers filed with the
Commission or entrusted to his care and shall be
responsible therefor to the Commission. He shall
have authority to designate from time to time any
of his delegates to perform the duties of Deputy
Secretary with any of the Commissioners.

SECTION 8

The Commission shall furnish the Secretary such of
its findings and decisions as in its judgment may be
of general public interest; the Secretary shall
compile the same for the purpose of publication in
a series of volumes to be designated "Reports of
the Public Service Commission of the Philippines,"
which shall be published in such form and manner
as may be best adapted for public information and
use, and such authorized publications shall be
competent evidence of the reports and decisions of
the Commission therein contained without any
further proof or authentication thereof.

SECTION 9

No member or employee of the Commission shall
have any official or professional relation with any
public service as herein defined, or hold any office
of profit or trust with the Government of the
Philippines.

SECTION 10

The Commission shall have its office in the City of
Manila or at such other place as may be
designated, and may hold hearings on any
proceedings at such times and places, within the
Philippines, as it may provide by order in writing:
Provided, That during the months of April and May
of each year, at least three Commissioners shall be
on vacation in such manner that once every two
years at least three of them shall be on duty during
April and May: Provided, however, That in the
interest of public service, the Secretary of Justice
may require any or all the Commissioners not on
duty to render services and perform their duties
during the vacation months. (As amended by Republic Act Nos. 176 and 3792)

SECTION 11
The Commission shall have the power to make needful rules for its Government and other proceedings not inconsistent with this Act and shall adopt a common seal, and judicial notice shall be taken for such seal. True copies of said rules and other amendments shall be promptly furnished to the Bureau of Printing and shall be forthwith published in the Official Gazette.

SECTION 13
(a) The Commission shall have jurisdiction, supervision, and control over all public services and their franchises, equipment, and other properties, and in the exercise of its authority, it shall have the necessary powers and the aid of the public force: Provided, That public services owned or operated by government entities or government-owned or controlled corporations shall be regulated by the Commission in the same way as privately-owned public services, but certificates of public convenience or certificates of public convenience and necessity shall not be required of such entities or corporations: And provided, further, That it shall have no authority to require steamboats, motor ships and steamship lines, whether privately-owned, or owned or operated by any Government controlled corporation or instrumentality to obtain certificate of public convenience or to prescribe their definite routes or lines of service.

(b) The term "public service" includes every person that now or hereafter may own, operate, manage, or control in the Philippines, for hire or compensation, with general or limited clientele, whether permanent, occasional or accidental, and done for general business purposes, any common carrier, railroad, street railway, traction railway, sub-way motor vehicle, either for freight or passenger, or both with or without fixed route and whether may be its classification, freight or carrier service of any class, express service, steamboat or steamship line, pontines, ferries, and water craft, engaged in the transportation of passengers or freight or both, shipyard, marine railways, marine repair shop, [warehouse] wharf or dock, ice plant, ice-refrigeration plant, canal, irrigation system, gas, electric light, heat and power water supply and power, petroleum, sewerage system, wire or wireless communications system, wire or wireless broadcasting stations and other similar public services: Provided, however, That a person engaged in agriculture, not otherwise a public service, who owns a motor vehicle and uses it personally and/or enters into a special contract thereby said motor vehicle is offered for hire or compensation to a third party or third parties engaged in agriculture, not itself or themselves a public service, for operation by the latter for a limited time and for a specific purpose directly connected with the cultivation of his or their farm, the transportation, processing, and marketing of agricultural products of such third party or third parties shall not be considered as operating a public service for the purposes of this Act.

(c) The word "person" includes every individual, co-partnership, joint-stock company or corporation, whether domestic or foreign, their lessees, trustees, or receivers, as well as any municipality, province, city, government-owned or controlled corporation, or agency of the Government of the Philippines, and whatever other persons or entities that may own or possess or operate public services. (As amended by Com. Act 454 and RA No. 2677)

SECTION 14
The following are exempted from the provisions of the preceding section:

(a) Warehouses;

(b) Vessels engaged in the transporation of goods or passengers by oar or sail, and tugboats and lighters;

(c) Airships within the Philippines except as regards the fixing of their maximum rates on freight and passengers;

(d) Radio companies except with respect to the fixing of rates;

(e) Public services owned or operated by any instrumentality of the National Government or by any government-owned or controlled corporation, except with respect to the fixing of rates. (As amended by Com. Act 454, RA No. 2031, and RA No. 2677)

SECTION 15
With the exception of those enumerated in the preceding section, no public service shall operate in the Philippines without possessing a valid and subsisting certificate from the Public Service Commission known as "certificate of public convenience," or "certificate of public convenience and necessity," as the case may be, to the effect that the operation of said service and the authorization to do business will promote the public interests in a proper and suitable manner.

The Commission may prescribe as a condition for the issuance of the certificate provided in the preceding paragraph that the service can be acquired by the Republic of the Philippines or any instrumentality thereof upon payment of the cost price of its useful equipment, less reasonable depreciation; and likewise, that the certificate shall be valid only for a definite period of time; and that the violation of any of these conditions shall produce the immediate cancellation of the certificate without the necessity of any express action on the part of the Commission.

In estimating the depreciation, the effect of the use of the equipment, its actual condition, the age of the model, or other circumstances affecting its value in the market shall be taken into consideration.

The foregoing is likewise applicable to any extension or amendment of certificates actually in force and to those which may hereafter be issued, to permit to modify itineraries and time schedules.
of public services, and to authorizations to renew and increase equipment and properties.

SECTION 16

Proceedings of the Commission, upon notice and hearing. - The Commission shall have power, upon proper notice and hearing in accordance with the rules and provisions of this Act, subject to the limitations and exceptions mentioned and saving provisions to the contrary:

(a) To issue certificates which shall be known as certificates of public convenience, authorizing the operation of public service within the Philippines whenever the Commission finds 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. Provided, That thereafter, certificates of public convenience and certificates of public convenience and necessity will be granted only to citizens of the Philippines or of the United States or to corporations, co-partnerships, associations or joint-stock companies constituted and organized under the laws of the Philippines; Provided, That sixty per centum of the stock or paid-up capital of any such corporations, co-partnership, association or joint-stock company must belong entirely to citizens of the Philippines or of the United States: Provided, further, That no such certificates shall be issued for a period of more than fifty years.

(b) To approve, subject to constitutional limitations any franchise or privilege granted under the provisions of Act No. Six Hundred and Sixty-seven, as amended by Act No. One Thousand and twenty-two, by any political subdivision of the Philippines, when, in the judgment of the Commission, such franchise or privilege will properly conserve the public interests, and the Commission shall in so approving impose such conditions as to construction, equipment, maintenance, service, or operation as the public interests and convenience may reasonably require, and to issue certificates of public convenience and necessity when such is required or provided by any law or franchise.

(c) To fix and determine individual or joint rates, tolls, charges, classifications, or schedules thereof, as well as commutation, mileage, kilometrage, and other special rates which shall be imposed observed and followed thereafter by any public service: Provided, That the Commission may, in its discretion, approve rates proposed by public services provisionally and without necessity of any hearing; but it shall call a hearing thereon within thirty days, thereafter, upon publication and notice to the concerns operating in the territory affected: Provided, further, That in case the public service equipment of an operator is used principally or secondarily for the promotion of a private business, the net profits of said private business shall be considered in relation with the public service of such operator for the purpose of fixing the rates.

(d) To fix just and reasonable standards, classifications, regulations, practices, measurement, or service to be furnished, imposed, observed, and followed thereafter by any public service.

(e) To ascertain and fix adequate and serviceable standards for the measurement of quantity, quality, pressure, initial voltage, or other condition pertaining to the supply of the product or service rendered by any public service, and to prescribe reasonable regulations for the examination and test of such product or service and for the measurement thereof.

(f) To establish reasonable rules, regulations, instructions, specifications, and standards, to secure the accuracy of all meters and appliances for measurements.

(g) To compel any public service to furnish safe, adequate, and proper service as regards the manner of furnishing the same as well as the maintenance of the necessary material and equipment.

(h) To require any public service to establish, construct, maintain, and operate any reasonable extension of its existing facilities, where in the judgment of said Commission, such extension is reasonable and practicable and will furnish sufficient business to justify the construction and maintenance of the same and when the financial condition of the said public service reasonably warrants the original expenditure required in making and operating such extension.

(i) To direct any railroad, street railway or traction company to establish and maintain at any junction or point of connection or intersection with any other line of said road or track, or with any other line of any other railroad, street railway or traction to promote, such just and reasonable construction and maintenance of the same and when the financial condition of the said public service reasonably warrants the original expenditure required in making and operating such extension.

(j) To authorize, in its discretion, any railroad, street railway or traction company to lay its tracks across the tracks of any other railroad, street railway or traction company or across any public highway.

(k) To direct any railroad or street railway company to install such safety devices or about such other reasonable measures as may in the judgment of the Commission be necessary for the protection of the public are passing grade crossing of (1) public highways and railroads, (2) public highways and streets railway, or (3) railways and street railways.

(l) To fix and determine proper and adequate rates of depreciation of the property of any public service which will be observed in a proper and adequate
depreciation account to be carried for the protection of stockholders, bondholders or creditors in accordance with such rules, regulations, and form of account as the Commission may prescribe. Said rates shall be sufficient to provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry. Each public service shall conform its depreciation accounts to the rates so determined and fixed, and shall set aside the moneys so provided for out of its earnings and carry the same in a depreciation fund. The income from investments of money in such fund shall likewise be carried in such fund. This fund shall not be expended otherwise than for depreciation, improvements, new construction, extensions or conditions to the property of such public service.

(m) To amend, modify or revoke at any time certificate issued under the provisions of this Act, whenever the facts and circumstances on the strength of which said certificate was issued have been misrepresented or materially changed.

(n) To suspend or revoke any certificate issued under the provisions of this Act whenever the holder thereof has violated or willfully and contumaciously refused to comply with any order rule or regulation of the Commission or any provision of this Act: Provided, That the Commission, for good cause, may prior to the hearing suspend for a period not to exceed thirty days any certificate or the exercise of any right or authority issued or granted under this Act by order of the Commission, whenever such step shall in the judgment of the Commission be necessary to avoid serious and irreparable damage or inconvenience to the public or to private interests.

(o) To fix, determine, and regulate, as the convenience of the state may require, a special type for auto-busses, trucks, and motor trucks to be hereafter constructed, purchased, and operated by operators after the approval of this Act; to fix and determine a special registration fee for auto-buses, trucks, and motor trucks so constructed, purchased and operated: Provided, That said fees shall be smaller than none those charged for auto-buses, trucks, and motor trucks of types not made and determined a special type for auto-busses, trucks, and motor trucks to

SECTION 18

It shall be unlawful for any individual, co-partnership, association, corporation or joint-stock company, their lessees, trustees or receivers appointed by any court whatsoever, or any municipality, province, or other department of the Government of the Philippines to engage in any public service business without having first secured from the Commission a certificate of public convenience or certificate of public convenience and necessity as provided for in this Act, except grantees of legislative franchises expressly exempting such grantees from the requirement of securing a certificate of the Commission as well as concerns at present existing expressly exempted from the jurisdiction of the Commission, either totally or in part, by the provisions of section thirteen of this Act.

SECTION 19

Unlawful Acts. - It shall be unlawful for any public service:

(a) To provide or maintain any service that is unsafe, improper, or inadequate or withhold or refuse any service which can reasonably be demanded and furnished, as found and determined by the Commission in a final order which shall be conclusive and shall take effect in accordance with this Act, upon appeal of otherwise.

(b) To make or give, directly or indirectly, by itself or through its agents, attorneys or brokers, or any of them, discounts or rebates on authorized rates, or grant credit for the payment of freight charges, or any undue or unreasonable preference or advantage to any person of corporation or to any locality or to any particular description of traffic service, or subject any particular person or corporation or locality to any particular description of traffic to any prejudice or disadvantage in any respect whatsoever; to adopt, maintain, or enforce any regulation, practice or measurement which shall be found or determined by the Commission to be unjust, unreasonable, unduly preferential or unjustly discriminatory in a final order which shall be conclusive and shall take effect in accordance with the provisions of this Act, upon repeal or otherwise.

(g) To sell, alienate, mortgage, encumber or lease its property, franchises, certificates, privileges, or rights or any part thereof; or merge or consolidate its property, franchises privileges or rights, or any part thereof, with those of any other public service. The approval herein required shall be given, after notice to the public and hearing the persons interested at a public hearing, if it be shown that there are just and reasonable grounds for making the mortgaged or encumbrance, for liabilities of more than one year maturity, or the sale, alienation, lease, merger, or consolidation to be approved, and that the same are not detrimental to the public interest, and in case of a sale, the date on which the same is to be consummated shall be fixed in the order of approval: Provided, however, that nothing herein contained shall be construed to prevent the transaction from being negotiated or completed before its approval or to prevent the sale, alienation, or lease by any public service of any of its property in the ordinary course of its business.

(h) To sell or register in its books the transfer or sale of shares of its capital stock, if the result of that sale in itself or in connection with another previous sale, shall be to vest in the transferee more than forty per centum of the subscribed capital of said public service. Any transfer made in violation of this provision shall be void and of no effect and shall not be registered in the books of the public service corporation. Nothing herein contained shall be construed to prevent the holding of shares lawfully acquired. (As amended by Com. Act No. 454.)

(i) To sell, alienate or in any manner transfer shares of its capital stock to any alien if the result of that sale, alienation, or transfer in itself or in connection with another previous sale shall be the
reduction to less than sixty per centum of the capital stock belonging to Philippine citizens. Such sale, alienation or transfer shall be void and of no effect and shall be sufficient cause for ordering the cancellation of the certificate.

Y Transit v. NLRC

The sale, alienation or other encumbrance of a public service operator’s properties requires the previous approval and authorization of the Commission.

NOTE: The Public Service Commission does not exist anymore. It is now the Department of Transportation and Communications.

THE CERTIFICATE OF PUBLIC CONVENIENCE (CPC); THE CERTIFICATE OF PUBLIC CONVENIENCE & NECESSITY (CPCN) AND THE PRIOR OPERATOR RULE

Does the sale of a CPC, CPCN or other properties of the public utility have to be approved before it is sold to a third person?

No. The approval of the sale of CPCs, CPCNs or other properties does not affect the validity (perfection) of the sale between the parties as long as all the elements of a contract are met. This only affects the relation of the parties to the DOTC or to 3rd parties. If there is no approval, then the sale does not bind the DOTC or 3rd parties. The controlling factor therefore is the registration.

If a stockholder of a public utility transfers his stock to the 3rd person, is there a need to obtain the approval of the DOTC?

It depends. If the transfer results in the transferee owning more than 40% of the stock of the public utility, then the approval of the DOTC is needed.

When must the approval of the DOTC be secured?

Before or after the execution of the contract.

What if the transferree is an alien?

VOID. An alien cannot own more than 40% of the stock of a public utility.

What is a Certificate of Public Convenience? (CPC)

The Public Service Law, Sec. 15

With the exception of those enumerated in the preceding section, no public service shall operate in the Philippines without possessing a valid and subsisting certificate from the Public Service Commission known as “certificate of public convenience,” or “certificate of public convenience and necessity,” as the case may be, to the effect that the operation of said service and the authorization to do business will promote the public interests in a proper and suitable manner.

The Commission may prescribe as a condition for the issuance of the certificate provided in the preceding paragraph that the service can be acquired by the Republic of the Philippines or any instrumentality thereof upon payment of the cost price of its useful equipment, less reasonable depreciation; and likewise, that the certificate shall be valid only for a definite period of time; and that the violation of any of these conditions shall produce the immediate cancellation of the certificate without the necessity of any express action on the part of the Commission.

A CPC is any authorization to operate a public service issued by the PSC (now DOTC).

It is an authorization issued by the Commission for the operation of public services for which no franchise, either municipal or legislative, is required by law) e.g. motor vehicles

It constitutes neither a franchise nor a contract, it does not confer property rights, and is a mere license or privilege. (Pantenco v. PSC) Such privilege is forfeited when the grantee fails to comply with his commitments to serve the public and public necessity. However, these certificates represent property rights to the extent that if the rights which any public utility is exercising pursuant to the lawful orders of the PSC (now DOTC) has been invaded by another public utility, in appropriate cases, actions may be maintained by the complainant public utility.

Which public utilities are exempted from getting a CPC?

The Public Service Law, Sec. 14

The following are exempted from the provisions of the preceding section:

(a) Warehouses;

(b) Vehicles drawn by animals and bancas moved by oar or sail, and tugboats and lighters;

(c) Airships within the Philippines except as regards the fixing of their maximum rates on freight and passengers;

(d) Radio companies except with respect to the fixing of rates;

(e) Public services owned or operated by any instrumentality of the National Government or by any government-owned or controlled corporation, except with respect to the fixing of rates. (As amended by Com. Act 454, RA No. 2031, and RA No. 2677)

What is a Certificate of Public Convenience & Necessity? (CPCN)

It is a certificate issued by the PSC to a public service to which any political subdivision has granted a franchise under RA 667 after the PSC has approved the same under Sec. 16(b). It is an authorization issued by the PSC for the operation of public services for which a franchise is required by law. (e.g. electric, telephone)

What is the difference between a CPC & a CPCN?

A CPCN requires a franchise from Congress. The public utility cannot be issued a CPCN and cannot operate, therefore, without a franchise from Congress.
A CPC does not.

What is a franchise?

It is a legislative grant from Congress or a local legislative body. If it is of nationwide application (e.g. Philippine Air Lines), then it must take the form of a Republic Act.

How does one get a franchise?

It is the same procedure for any law (file a bill, 3 readings in Congress, etc) The applicant must a) prove that he or she is a Filipino citizen; b) demonstrate financial capacity, and c) must show that he or she is applying for a business of public convenience, that the public shall benefit from the grant of the franchise.

Is a franchise enough in order to operate?

No. All public utilities require either a CPC or CPCN to operate. Those public utilities for which franchises have been granted still require a CPCN in order to operate. Those public utilities that did not require a franchise for there creation still require a CPC in order to operate.

Raymundo v. Luneta Motor Corporation (1933)

The Public Service Law, Act No. 3108, as amended, authorizes certificates of public convenience to be secured by public service operators from the PSC. A CPC granted to the owner or operator of public service motor vehicles grants a right in the nature of a limited franchise.

The Code of Civil Procedure establishes the general rule that “property, both real and personal, or any interest therein of the judgment debtor, not exempt by law, and all property and rights of property seized and held under attachment in the action, shall be liable to execution.” The statutory exemptions do not include franchises or certificates; of public convenience. The word “property” as used in section 450 of the Code of Civil Procedure comprehends every species of title, inchoate or complete, legal or equitable. The TEST to determine whether or not property can be attached and sold upon execution is whether the judgment debtor has such a beneficial interest therein that he can sell or otherwise dispose of it for value.

Now the Public Service Law permits the PSC to approve the sale, alienation, mortgaging, encumbering, or leasing of property, franchises, privileges, or rights or any part thereof (sec. 16 [h]), and in practice the purchase and sale of certificates of public convenience has been permitted by the PSC. If the holder of a CPC can sell it voluntarily, there is no valid reason why the same certificate cannot be taken and sold involuntarily pursuant to court process.

CPCs secured by public service operators are liable to execution, and the Public Service Commission is authorized to approve the transfer of the certificates of public convenience to the execution creditor.

What is the prior operator rule?

The prior operator rule works to protect the prior operator if it maintains an adequate service and is able to meet the demands of the public. His or her investment is protected by not allowing a subsequent operator to be granted a license for the same route. The rationale for this rule is for the preservation of public convenience and to prevent ruinous competition.

What are some of the instances where the prior operator rule does NOT apply?

The prior operator rule does not apply when the CPC or CPCN granted to the applicant is a maiden franchise that covers a new route, even if it overlaps with the route of the prior operator.

The prior operator rule is inapplicable where the corporate existence of the prior operator has expired.

Regular operators are preferred over irregular operators.

The Commission cannot grant a CPC or CPCN that comprises a larger territory than that applied for.

How do you know whether there is ruinous competition enough for the prior operator rule to take effect?

Ruinous competition means that there is actual ruin of the business of the operator; that the existing operator will not gain enough profits if another person is allowed to enter the business; that which will result in the deprivation of sufficient gain in respect of reasonable return of investment, therefore the oppositor, alleging this, must show that he will be deprived of a reasonable return on his investment.

The mere possibility of reduction in the earnings of the business or the deterioration in the income of his business is not sufficient to prove ruinous competition. It must be shown that the business would not have sufficient gains to pay a fair rate of interest on his capital investments.

Does the prior operator rule create a monopoly?

Legally speaking, there cannot be a monopoly where a property is operated as a public utility. The prior operator rule does not encourage a monopoly because the theory is that one operator keeps the prices low.

Batangas Transportation Co. v. Cayetano Orlanes (1928)

So long as the 1st licensee keeps and performs the terms and conditions of its license and complies with the reasonable rules and regulations of the Commission and meets the demands of the public, it should have more or less of a bested and preferential right over a person who seeks to acquire another and a later license over same route. Otherwise, the first licensee would not have protection on his investment and would be subject
to ruinous competition and this defeat the very purpose and intent for the PSC was created.

**San Pablo v. Pantranco (1987)**

Before private respondent may be issued a franchise or CPC for the operation of the said service as a common carrier, it must comply with the usual requirements of filing an application, payment of the fees, publication, adducing evidence at a hearing and affording the oppositors the opportunity to be heard, among others, as provided by law. Considering the environmental circumstances of the case, the conveyance of passengers, trucks and cargo from Matnog to Allen is certainly not a ferry boat service but a coastwise or interisland shipping service. Under no circumstance can the sea between Matnog and Allen be considered a continuation of the highway, Matnog and Allen are separated by an *open sea*. Its CPC as a bus transportation cannot be merely amended to include this water service under the guise that it is a mere private ferry service.

What is an example of the “kabit system”?  

A, a grantee of a CPC from the LTFRB, is given the authority to operate 10 units of taxis. B, a non-grantee, wishes to operate as a common carrier and “kabits” with the CPC of A who will obtain approval from the LTFRB to operate another taxi. The taxi will be registered in the name of A, who will be paid by B. Assume that A executed a deed of sale in favor of B in case B decides not to go on with the arrangement, in order to safeguard the rights of B. However, in case of injury to a passenger of the taxi actually operated by B (and previously sold to B as well) it is still A who will be liable. The illegal contract of sale between A & B cannot be put up as a defense. A does not have a cause of action against B either. They are *in pari delicto*.

**Teja Marketing v. IAC (1987)**

Parties operated under an arrangement, commonly known as the “kabit system” whereby a person who has been granted a certificate of public convenience allows another person who owns motor vehicles to operate under such franchise for a fee. A certificate of public convenience is a special privilege conferred by the government. Although not outrightly penalized as a criminal offense, the kabit system is invariably recognized as being contrary to public policy and, therefore, void and in existent under Article 1409 of the Civil Code.

**PRIVATE NATURE; RIGHTS AND OBLIGATIONS OF PARTIES ARISING FROM TRANSACTIONS RELATING TO TRANSPORTATION**

**ABSENT A TRANSPORTATION CONTRACT**

**Lara v. Valencia (1958)**

The owner and driver of a vehicle owes to accommodation passengers or invited guests merely the duty to exercise reasonable care so that they may be transported safely to their destination.

Thus, “The rule is established by the weight of authority that the owner or operator of an automobile owes the duty to an *invited guest* to exercise reasonable care in its operation, and not unreasonably to expose him to danger and injury by increasing the hazard of travel. Valencia therefore is only required to observe ordinary care, and is not in duty bound to exercise extraordinary diligence as required of a common carrier by our law (Art. 1755 & 1756, new CC)

**ARISING FROM A TRANSPORTATION CONTRACT**

**Contract of transportation, defined:**

A contract of transportation is one whereby a certain person or association of persons obligate themselves to transport persons, things, or news from one to another for a fixed price.

**Contract of transportation, elements:**

Parties to the contract:  
*Shipper* - one who gives rise to the contract of transportation by agreeing to deliver the things or news to be transported, or to present his own person or those of other or others in the case of transportation of passengers  
*Carrier or conductor* - one who binds himself to transport person, things, or news, as the case may be, or one employed in or engaged in the business of carrying good for others for hire  
*Consignee* - the party to whom the carrier is to deliver the things being transported; to whom the carrier may lawfully make delivery in accordance with its contract of carriage. The shipper and the consignee may be the same person.

---

21 This was asked in 2005. Know the definition of the Kabit System and the liability of the party.
III. Code of Commerce Provisions on Overland Transportation

(Unless otherwise indicated, reference is to Code of Commerce)

What does the Code of Commerce cover?
It governs overland transportation and maritime admiralty. It governs only commercial contracts.

Commercial contracts involving common carriers refer first to the Civil Code, then to the Code of Commerce.

Private carriers involved in commercial contracts refer first to the Code of Commerce, then to the Civil Code, but excluding the Civil Code provisions on common carriers.

A. Scope of Overland Transportation

What is overland transport?
Overland transport applies to transport on land and on small bodies of water, waterways, both natural and artificial, including transport on rivers which are not very large. (If it is transport at sea, then it is admiralty).

B. Nature of Contract

ARTICLE 349
A contract for all kinds of transportation over land or river shall be considered commercial:
1. When it involves merchandise or any commercial goods.
2. When, no matter what its object may be, the carrier is a merchant or is customarily engaged in making transportation for the public.

C. Effect of Civil Code

Art 1766
In all matters not regulated by this Code, the rights and obligations of common carriers shall be governed by the Code of Commerce and by special laws.

Art. 2270
The following laws and regulations are hereby repealed:
(1) Those parts and provisions of the Civil Code of 1889 which are in force on the date when this new Civil Code becomes effective;
(2) The provisions of the Code of Commerce governing sales, partnership, agency, loan, deposit and guaranty;
(3) The provisions of the Code of Civil Procedure on prescription as far as inconsistent with this Code; and
(4) All laws, Acts, parts of Acts, rules of court, executive orders, and administrative regulations which are inconsistent with this Code.

D. Contract of Carriage

1. BILL OF LADING

DEFINITION, SUBJECT MATTER

ARTICLE 352
Bills of lading or tickets in the case of transportation of passengers may be different, one for persons and another for baggage, but all of them shall contain the name of the carrier, the date of shipment, the points of departure and arrival, the price, and with regard to baggage, the number and weight of the packages, with any other indications which may be considered necessary in order to easily identify them.

What is a bill of lading?
It may be defined as a written acknowledgment of the receipt of goods and an agreement to transport and to deliver them at a specified place to a person named or on his order. It comprehends all methods of transportation.

Each bill of lading is a contract in itself and the parties are bound by its terms. A bill of lading is also a receipt, and it is likewise a symbol of the goods covered by it. It is also a document of title.

Who are the parties to a bill of lading?

1. shipper
2. consignee
3. carrier

FORM, CONTENT

ARTICLE 350
The shipper as well as the carrier of merchandise and goods may mutually demand of each other the issue of a bill of lading in which there shall be stated:
1. The name, surname, and domicile of the shipper.
2. The name, surname, and domicile of the carrier.
3. The name, surname and domicile of the person to whom or to whose order the goods are addressed, or whether they are to be delivered to the bearer of the said bill.
4. A description of the goods, stating their generic character, their weight, and the external marks or signs of the packages containing the same.
5. The cost of the transportation.
6. The date on which the shipment is made.
7. The place of the delivery to the carrier.
8. The place and time at which the delivery is to be made to the consignee.
9. The damages to be paid by the carrier in case of delay, if any agreement is made on this point.

ARTICLE 351
In shipments made over railroads or by other enterprises which are subject to schedules or the time fixed by regulations, it shall be sufficient that the bills of lading or declarations of shipment furnished by the shipper refer, with regard to the rate, terms, and special conditions of the
transportation, to the schedules and regulations, the application of which is requested; and should no schedule be determined the carrier must apply the rate of the merchandise paying the lowest, with the condition inherent thereto, always including such statement or reference in the bill of lading delivered to the shipper.

Is the form material?

No. As long as it contains an acknowledgment by the carrier of the receipt of goods for transportation, it is in legal effect, a bill of lading.

FUNCTION

ARTICLE 353
The legal basis of the contract between the shipper and the carrier shall be the bills of lading, by the contents of which all disputes which may arise with regard to their execution and fulfillment shall be decided without admission of other exceptions than forgery or material errors in the drafting thereof. After the contract has been complied with the bill of lading issued by the carrier shall be returned to him, and by virtue of the exchange of this certificate for the article transported, the respective obligations and actions shall be considered as canceled, unless in the same act the claims which the contracting parties desired to reserve are reduced to writing, exception being made of the provisions of Article 366.

If in case of loss or for any other reason whatsoever, the consignee can not return upon receiving the merchandise the bill of lading subscribed by the carrier, he shall give said carrier a receipt for the goods delivered, this receipt producing the same effects as the return of the bill of lading.

2. REFUSAL TO TRANSPORT

ARTICLE 356
Carrier may refuse to accept packages which appear unfit for transportation; and if said transportation is to be made by railway and the shipment is insisted on, the company shall carry them, being exempt from all liability if its objections are so stated in the bill of lading.

3. DOUBTFUL DECLARATION OF CONTENTS

ARTICLE 357
If the carrier by reason of well-founded suspicions as to the correctness of the declaration of the contents of a package should determine to examine it, he shall do so before witnesses, in the presence of the shipper or of the consignee. Should the shipper or consignee to be cited not appear, the examination shall be made before a notary, who shall draft a certificate of the result of the examination, for the proper purposes.

If the declaration of the shipper should be correct, the expenses caused by the examination and those of carefully repacking the packages shall be defrayed by the carrier, and in a contrary case by the shipper.

4. NO BILL OF LADING

ARTICLE 354
In the absence of a bill of lading the respective claims of the parties shall be decided by the legal proofs that each one may submit in support of his claims, in accordance with the general provisions established in this Code for commercial contracts.

ARTICLE 351
In transportation made by railroads or other enterprises which are subject to schedules or the time fixed by regulations, it shall be sufficient that the bills of lading or the declarations of shipment furnished by the shipper refer, with respect to the rate, terms, and special conditions of the transportation, to the schedules and regulations, the application of which he requests, and should no schedule by determined, the carrier must apply the rate of the merchandise paying the lowest, with the conditions inherent therein, always including such statement or reference to them in the bill of lading which he delivers to the shipper.

Is a bill of lading essential to a contract of transportation?

No. While under Art. 350 the shipper and the common carrier may mutually demand that a bill of lading be made, it is not obligatory. The fact that a bill of lading is not issued does not preclude the existence of a contract of transportation. Where no bill of lading is issued, the disputes between the parties shall be decided according to the rules laid down in Art. 354.

E. Responsibility of the carrier

1. WHEN IT COMMENCES

ARTICLE 355
The liability of the carrier shall begin from the moment he receives the merchandise, in person or through a person intrusted thereto in the place indicated for their reception.

2. ROUTE

ARTICLE 359
If there should be an agreement between the shipper and the carrier with regard to the road over which the transportation is to be made, the carrier can not change the route, unless obliged to do so by force majeure; and should he do so without being forced to, he shall be liable for any damage which may be suffered by the goods transported for any other cause whatsoever, besides being required to pay the amount which may have been stipulated for such a case.

When on account of the said force majeure the carrier is obliged to take another route, causing an increase in the transportation charges, he shall be reimbursed for said increase after presenting the formal proof thereof.

3. CARE OF GOODS

ARTICLE 361
Merchandise shall be transported at the risk and venture of the shipper, if the contrary was not expressly stipulated. Therefore, all damages and impairment suffered by the goods during the transportation, by reason of accident, force majeure, or by virtue of the nature or defect of the articles, shall be for the account and risk of the shipper. cdta

The proof of these accidents is incumbent on the carrier.
ARTICLE 362
The carrier, however, shall be liable for the losses and damages arising from the causes mentioned in the foregoing article if it is proved that they occurred on account of his negligence or because he did not take the precautions usually adopted by careful persons, unless the shipper committed fraud in the bill of lading, making him believe that the goods were of a class or quality different from what they really were.

If, notwithstanding the precaution referred to in this article, the goods transported run the risk of being lost on account of the nature or by reason of an unavoidable accident, without there being time for the owners of the same to dispose thereof, the carrier shall proceed to their sale, placing them for this purpose at the disposal, of the judicial authority or the officials determined by special provisions.

Art 1734
Common carriers are responsible for the loss, destruction, or deterioration of the goods, unless the same is due to any of the following causes only:
1. Flood, storm, earthquake, lightning, or other natural disaster or calamity;
2. Act of the public enemy in war, whether international or civil;
3. Act of omission of the shipper or owner of the goods;
4. The character of the goods or defects in the packing or in the containers;
5. Order or act of competent public authority.

Art. 1735. In all cases other than those mentioned in Nos. 1, 2, 3, 4, and 5 of the preceding article, if the goods are lost, destroyed or deteriorated, common carriers are presumed to have been at fault or to have acted negligently, unless they prove that they observed extraordinary diligence as required in Article 1733.

4. DELIVERY

CONDITION OF GOODS

ARTICLE 363
With the exception of the cases prescribed in the second paragraph of Article 361, the carrier shall be obliged to deliver the goods transported in the same condition in which, according to the bill of lading, they were at the time of their receipt, without any detriment or impairment, and should he not do so, he shall be obliged to pay the value of the goods not delivered at the point where they should have been and at the time the delivery should have taken place.

If part of the goods transported should be delivered the consignee may refuse to receive them, when he proves that he can not make use thereof without the others.

ARTICLE 364
If the effect of the damage referred to in Article 361 should be only a reduction in the value of the goods, the obligation of the carrier shall be reduced to the payment of the amount of said reduction in value, after appraisal by experts.

ARTICLE 365
If, on account of the damage, the goods are rendered useless for purposes of sale or consumption in the use for which they are properly destined the consignee shall not be bound to receive them, and may leave them on the hands of the carrier, demanding payment therefor at current market prices.

If among the goods damaged there should be some in good condition and without any defect whatsoever, the foregoing provision shall be applicable with regard to the damaged ones, and the consignee shall receive those which are sound, this separation being made by distinct and separate articles, no object being divided for the purpose, unless the consignee proves the impossibility of conveniently making use thereof in this form. The same provision shall be applied to merchandise in bales or packages, with distinction of the packages which appear sound.

ARTICLE 366
Within the twenty-four hours following the receipt of the merchandise a claim may be brought against the carrier on account of damage or average found therein on opening the packages, provided that the indications of the damage or average giving rise to the claim can not be ascertained from the exterior of said packages, in which case said claim would only be admitted on the receipt of the packages.

After the periods mentioned have elapsed, or after the transportation charges have been paid, no claim whatsoever shall be admitted against the carrier with regard to the condition in which the goods transported were delivered.

ARTICLE 367
If there should occur doubts and disputes between the consignee and the carrier with regard to the condition of goods transported at the time of their delivery to the former, the said goods shall be examined by experts appointed by the parties, and a third one, in case of disagreement, appointed by the judicial authority, the result of the examination being reduced to writing; and if the persons interested should not agree to the report of the experts and could not settle their disputes, said judicial authority shall order the deposits of the merchandise in a safe warehouse, and the parties interested shall make use of their rights in the proper manner.

To whom delivery made

ARTICLE 368
The carrier must deliver to the consignee without any delay or difficulty the merchandise received by him, by reason of the mere fact of being designated in the bill of lading to receive it; and should said carrier not do so he shall be liable for the damages which may arise therefrom.

JUDICIAL DEPOSIT

ARTICLE 369
Should the consignee be not found at the domicile indicated in the bill of lading, or should refuse to pay the transportation charges and expenses, or to receive the goods, the deposit of said goods shall be ordered by the municipal judge, where there is no judge of first instance, to be placed at the disposal of the shipper or sender, without prejudice
to a person having a better right, this deposit having all the effects of a delivery.

**Art. 1752**

Even when there is an agreement limiting the liability of the common carrier in the vigilance over the goods, the common carrier is disputably presumed to have been negligent in case of their loss, destruction or deterioration.

**WHEN TO BE MADE**

**ARTICLE 370**

If a period has been fixed for the delivery of the goods, it must be made within the same, and otherwise the carrier shall pay the indemnity agreed upon in the bill of lading, neither the shipper nor consignee being entitled to anything else. Should no indemnity have been agreed upon and the delay exceeds the time fixed in the bill of lading, the carrier shall be liable for the damages which may have been caused by the delay.

**ARTICLE 358**

Should no period within which goods are to be delivered be previously fixed, the carrier shall be under the obligation to forward them in the first shipment of the same or similar merchandise which he may make to the point of delivery; and should he not do so, the damages occasioned by the delay shall be suffered by him.

**TWO OR MORE CARRIERS**

**ARTICLE 373**

A carrier who delivers merchandise to a consignee by virtue of agreements or combined services with other carriers shall assume the obligations of the carriers who preceded him, reserving his right to proceed against the latter if he should not be directly responsible for the fault which gives rise to the claim of the shipper or of the consignee. The carrier making the delivery shall also assume all the actions and rights of those who may have preceded him in the transportation. The sender and the consignee shall have an immediate right of action against the carrier who executed the transportation contract, or against the other carriers who received the goods transported without reserve. The reservations made by the latter shall not exempt them, however, from the liabilities they may have incurred by reason of their own acts.

**OBLIGATION TO KEEP REGISTRY**

**ARTICLE 378**

Transportation agents shall be obliged to keep a special registry, with the formalities required by Article 36, in which there shall be entered, in progressive order of numbers and dates, all the goods the transportation of which is undertaken, stating the circumstances required by Articles 390 et seq. for the responsive bills of lading.

**COMPLIANCE WITH ADMINISTRATIVE REGULATIONS**

**ARTICLE 377**

The carrier shall be liable for all the consequences arising from noncompliance on his part with the formalities prescribed by the laws and regulations of the public administration during the entire course of the trip and on the arrival at the point of destination, except when his omission arises from his having been induced into error by false statements of the shipper in the declaration of the merchandise. If the carrier has acted in accordance with a formal order received from the shipper or consignee of the merchandise both shall incur liability.

**F. Rights and Obligations of Shipper and/or Consignee**

**1. RIGHTS TO DAMAGES**

**CONDITION IMPOSED ON RIGHT**

**ARTICLE 366**

Within the twenty-four hours following the receipt of the merchandise a claim may be brought against the carrier on account of damage or average found therein on opening the packages, provided that the indications of the damage or average giving rise to the claim can not be ascertained from the exterior of said packages, in which case said claim would only be admitted on the receipt of the packages. After the periods mentioned have elapsed, or after the transportation charges have been paid, no claim whatsoever shall be admitted against the carrier with regard to the condition in which the goods transported were delivered.

**ARTICLE 357**

If the carrier by reason of well-founded suspicions as to the correctness of the declaration of the contents of a package should determine to examine it, he shall do so before witnesses, in the presence of the shipper or of the consignee. Should the shipper or consignee to be cited not appear, the examination shall be made before a notary, who shall draft a certificate of the result of the examination, for the proper purposes. If the declaration of the shipper should be correct, the expenses caused by the examination and those of carefully repacking the packages shall be defrayed by the carrier, and in a contrary case by the shipper.

**ARTICLE 353**

The legal basis of the contract between the shipper and the carrier shall be the bills of lading, by the contents of which all disputes which may arise with regard to their execution and fulfillment shall be decided without admission of other exceptions than forgery or material errors in the drafting thereof. After the contract has been complied with the bill of lading issued by the carrier shall be returned to him, and by virtue of the exchange of this certificate for the article transported, the respective obligations and actions shall be considered as canceled, unless in the same act the claims which the contracting parties desired to reserve are reduced to writing, exception being made of the provisions of Article 366.
If in case of loss or for any other reason whatsoever, the consignee can not return upon receiving the merchandise the bill of lading subscribed by the carrier, he shall give said carrier a receipt for the goods delivered; this receipt producing the same effects as the return of the bill of lading.

**AMOUNT OF DAMAGES FOR LOSS**

**ARTICLE 372**

The appraisement of the goods which the carrier must pay in case of their being lost or mislaid shall be fixed in accordance with what is stated in the bill of lading, no proofs being allowed on the part of the shipper that there were among the goods declared therein articles of greater value, and money.

Horses, vehicles, vessels, equipment, and all the other principal and accessory means of transportation, shall be especially obligated in favor of the shipper, although with relation to railroads said obligation shall be subordinated to the provisions of the laws of concession with regard to property and to those of this Code with regard to the manner and form of making attachments and retentions against the said companies.

**Art. 1744**

A stipulation between the common carrier and the shipper or owner limiting the liability of the former for the loss, destruction, or deterioration of the goods to a degree less than extraordinary diligence shall be valid, provided it be:

1. In writing, signed by the shipper or owner;
2. Supported by a valuable consideration other than the service rendered by the common carrier; and
3. Reasonable, just and not contrary to public policy.

**AMOUNT OF DAMAGES FOR DELAY**

**ARTICLE 371(3).** Should the abandonment not occur the indemnity for loss and damages on account of the delays can not exceed the current price of the goods transported on the day and at the place where the delivery was to have been made. The same provision shall be observed in all cases where this indemnity is due.

**2. RIGHT TO ABANDON**

**ARTICLE 371**

In cases of delay on account of the fault of the carrier, referred to in the foregoing articles, the consignee may leave the goods transported on the hands of the carrier, informing him thereof in writing before the arrival of the same at the point of destination.

When this abandonment occurs, the carrier shall satisfy the total value of the goods, as if they had been lost or mislaid, as aforesaid.

Should the abandonment not occur the indemnity for loss and damages on account of the delays can not exceed the current price of the goods transported on the day and at the place where the delivery was to have been made. The same provision shall be observed in all cases where this indemnity is due.

**ARTICLE 360**

The shipper may, without changing the place where the delivery is to be made, change the consignment of the goods delivered to the carrier, and the latter shall comply with his orders, provided that at the time of making the change of the consignee the bill of lading subscribed by the carrier be returned to him, if one were issued, exchanging it for another containing the novation of the contract.

The expenses arising from the change of consignment shall be defrayed by the shipper.

**ARTICLE 363**

With the exception of the cases prescribed in the second paragraph of Article 361, the carrier shall be obliged to deliver the goods transported in the same condition in which, according to the bill of lading, they were at the time of their receipt, without any detriment or impairment, and should he not do so, he shall be obliged to pay the value of the goods not delivered at the point where they should have been and at the time the delivery should have taken place.

If part of the goods transported should be delivered the consignee may refuse to receive them, when he proves that he can not make use thereof without the others.

**ARTICLE 365**

If, on account of the damage, the goods are rendered useless for purposes of sale or consumption in the use for which they are properly destined the consignee shall not be bound to receive them, and may leave them on the hands of the carrier, demanding payment therefor at current market prices.

If among the goods damaged there should be some in good condition and without any defect whatsoever, the foregoing provision shall be applicable with regard to the damaged ones, and the consignee shall receive those which are sound, this separation being made by distinct and separate articles, no object being divided for the purpose, unless the consignee proves the impossibility of conveniently making use thereof in this form.

The same provision shall be applied to merchandise in bales or packages, with distinction of the packages which appear sound.

3. **RIGHT TO CHANGE CONSIGNMENT**

**ARTICLE 360**

The shipper may, without changing the place where the delivery is to be made, change the consignment of the goods delivered to the carrier, and the latter shall comply with his orders, provided that at the time of making the change of the consignee the bill of lading subscribed by the carrier be returned to him, if one were issued, exchanging it for another containing the novation of the contract.

The expenses arising from the change of consignment shall be defrayed by the shipper.
4. OBLIGATION TO PAY TRANSPORTATION CHARGES

ARTICLE 374
The consignees to whom the remittance may have been made can not defer the payment of the expenses and transportation charges on the goods that they received after twenty-four hours have elapsed from the time of the delivery; and in case of delay in making this payment, the carrier may request the judicial sale of the goods he transported to a sufficient amount to cover the transportation charges and the expenses incurred.

ARTICLE 375
The goods transported shall be specifically obligated to answer for the transportation charges and for the expenses and fees caused by the same during their transportation, or until the time of their delivery. This special right shall be limited to eight days after the delivery has been made, and after said prescription the carrier shall have no further right of action than that corresponding to an ordinary creditor.

ARTICLE 376
The preference of the carrier to the payment of what is due him for the transportation and expenses of the goods delivered to the consignee shall not be affected by the bankruptcy of the latter, provided the action is brought within the eight days mentioned in the foregoing article.

Art. 2241
With reference to specific movable property of the debtor, the following claims or liens shall be preferred:

(9) Credits for transportation, upon the goods carried, for the price of the contract and incidental expenses, until their delivery and for thirty days thereafter;

5. OBLIGATION TO RETURN BILL OF LADING

ARTICLE 353. (2) (3)
After the contract has been complied with the bill of lading issued by the carrier shall be returned to him, and by virtue of the exchange of this certificate for the article transported, the respective obligations and actions shall be considered as canceled, unless in the same act the claims which the contracting parties desired to reserve are reduced to writing, exception being made of the provisions of Article 366. If in case of loss or for any other reason whatsoever, the consignee can not return upon receiving the merchandise the bill of lading subscribed by the carrier, he shall give said carrier a receipt for the goods delivered, this receipt producing the same effects as the return of the bill of lading.

G. Applicability of Provisions

ARTICLE 379
The provisions contained in Articles 349 et seq. shall also be understood as relating to persons who, although they do not personally effect the transportation of commercial goods, contract to do so through others, either as contractors for a special and fixed transaction or as freight and transportation agents. In either case they shall be subrogated to the place of the carriers with regard to the obligations and liability of the latter, as well as with regard to their right.

IV. Admiralty and Maritime Commerce

A. Sources of Maritime/Admiralty Laws in the Philippines

Main source of law: Code of Commerce

If common carrier, apply Civil Code first, then Code of Commerce and special laws.

Maritime law includes coastwise, oceanwise and commercial laws.

B. Concept of Admiralty; jurisdiction over admiralty cases

Admiralty is distinguished from overland transportation on the size of the vessel and size of the body of water over which a vessel traverses. However, it is now the amount of the claim that is relevant, and not whether it is an admiralty or maritime claim.

BP 129 Sec 19

Jurisdiction in civil cases. — Regional Trial Courts shall exercise exclusive original jurisdiction:

(3) In all actions in admiralty and maritime jurisdiction where he demand or claim exceeds One hundred thousand pesos (P100,000.00) or, in Metro Manila, where such demand or claim exceeds Two hundred thousand pesos (200,000.00);

Section 33. Jurisdiction of Metropolitan Trial Courts, Municipal Trial Courts and Municipal Circuit Trial Courts in civil cases. — Metropolitan Trial Courts, Municipal Trial Courts, and Municipal Circuit Trial Courts shall exercising:

(1) Exclusive original jurisdiction over civil actions and probate proceedings, testate and intestate, including the grant of provisional remedies in proper cases, where the value of the personal property, estate, or amount of the demand does not exceed One hundred thousand pesos (P100,000.00) or, in Metro Manila, where such personal property, estate, or amount of the demand does not exceed Two hundred thousand pesos (200,000.00) exclusive of interest damages of whatever kind, attorney's fees, litigation expenses, and costs, the amount of which must be specifically alleged: Provided, That where there are several claims or causes of action between the same or different parties, embodied in the same complaint, the amount of the demand shall be the
totality of the claims in all the causes of action, irrespective of whether the causes of action arose out of the same or different transactions;

C. Vessels

1. MEANING
Vessels are those engaged in navigation, whether coastwide or on the high seas, including floating docks, pontoons, dredges, scows, and any other floating apparatus destined for the services of the industry or maritime commerce.

Vessels engaged in the business of carrying or transporting passengers or goods for compensation, offering their services to the public, are common carriers, and are governed primarily by the Civil Code and suppletorily by the Code of Commerce and special laws.

2. NATURE AND ACQUISITION OF
Lopez v. Duruelo
The word vessel used in the section was not intended to include all ships, craft or floating structures of every kind without limitation, and the provision of that section should not be held to include minor craft engaged only in river or bay traffic. Vessels of a minor nature, such as river boats and those carrying passengers from ship to shore, are governed as to their liability in passengers by the Civil Code.

ARTICLE 573
Merchant vessels constitute property which may be acquired and transferred by any of the means recognized by law. The acquisition of a vessel must be included in a written instrument, which shall not produce any effect with regard to third persons if not recorded in the mercantile registry.

The ownership of a vessel shall also be acquired by the possession thereof in good faith for three years, with a good title duly recorded. In the absence of any of these requisites, uninterrupted possession for ten years shall be necessary in order to acquire ownership.

A captain cannot acquire by prescription the ship of which he is in command.

ARTICLE 574
The builders of vessels may employ the material and with regard to their construction and rigging may follow the system which is most convenient to their interests. Ship agents and seamen shall be subject to the provisions of the laws and regulations of the public administration on navigation, customs, health, safety of the vessels, and other similar provisions.

ARTICLE 585
For all purposes of law not modified or restricted by the provisions of this Code, vessels shall continue to be considered as personal property.

Art. 712
Ownership is acquired by occupation and by intellectual creation.

Ownership and other real rights over property are acquired and transmitted by law, by donation, by estate and intestate succession, and in consequence of certain contracts, by tradition. They may also be acquired by means of prescription.

D. Persons Participating in Maritime Commerce

1. SHIPOWNERS AND SHIPAGENTS

Owners of Vessels and Ship Agents

ARTICLE 586
The owner of a vessel and the agent shall be civilly liable for the acts of the captain and for the obligations contracted by the latter to repair, equip, and provision the vessel, provided the creditor proves that the amount claimed was invested therein.

By agent is understood the person intrusted with the provisioning of a vessel, or who represents her in the port in which she happens to be.

ARTICLE 587
The agent shall also be civilly liable for the indemnities in favor of third persons which arise from the conduct of the captain in the care of the goods which the vessel carried; but he may exempt himself therefrom by abandoning the vessel with all her equipments and the freight he may have earned during the voyage.

ARTICLE 588
Neither the owner of the vessel nor the agent shall be liable for the obligations contracted by the captain if the latter exceeds his powers and privileges which are his by reason of his position or have been conferred upon him by the former.

However, if the amounts claimed were made use of for the benefit of the vessel, the owner or agent shall be liable.

ARTICLE 589
If two or more persons should be part owners of a merchant vessel, an association shall be presumed as established by the part owners. This association shall be governed by the resolutions of a majority of the members. A majority shall be the relative majority of the voting members.

If there should be only two part owners, in case of disagreement the vote of the member having the largest interest shall be decisive. If the interests are equal, it shall be decided by lot.

The representation of the smallest part in the ownership shall have one vote; and proportionately the other part owners as many votes as they have parts equal to the smallest one. aisdad

A vessel can not be detained, attached or levied upon execution in her entirety for the private debts of a part owner, but the proceedings shall be limited to the interest the debtor may have in the vessel, without interfering with her navigation.

ARTICLE 590
The owners of a vessel shall be civilly liable in the proportion of their contribution to the common

22 The liabilities of shipowners and shipagents were asked in 1989, 1984, and 1981.
fund, for the results of the acts of the captain, referred to in Article 587.

Each part owner may exempt himself from this liability by the abandonment before a notary of the part of the vessel belonging to him.

**ARTICLE 591**

All the part owners shall be liable, in proportion to their respective ownership, for the expenses of repairs to the vessel, and for other expenses which are incurred by virtue of a resolution of the majority.

They shall likewise be liable in the same proportion for the expenses of maintenance, equipment, and provisioning of the vessel, necessary for navigation.

**ARTICLE 592**

The resolutions of the majority with regard to the repair, equipment, and provisioning of the vessel in the port of departure shall bind the majority unless the partners in the minority renounce their participation therein, which must be acquired by the other part owners after a judicial appraisement of the value of the portion or portions assigned.

The resolutions of the majority relating to the dissolution of the association and sale of the vessel shall also be binding on the minority.

The sale of the vessel must take place at a public auction, subject to the provisions of the law of civil procedure unless the part owners unanimously agree otherwise, the right of option to purchase and to withdraw mentioned in Article 575 being always reserved in favor of said part owners.

**ARTICLE 593**

The owners of a vessel shall have preference in her charter to other persons, offering equal conditions and price. If two or more of the former should claim said right the one having greater interest shall be preferred, and should they have an equal interest it shall be decided by lot.

**ARTICLE 594**

The part owners shall elect the manager who is to represent them in the capacity of agent.

The appointment of director or agent shall be revocable at the will of the members.

**ARTICLE 595**

The agent, be he at the same time an owner of a vessel or a manager for an owner or for an association of co-owners, must be qualified to trade and must be recorded in the merchant’s registry of the province.

The agent shall represent the ownership of the vessel, and may in his own name and in such capacity take judicial and extrajudicial steps in all that relates to commerce.

**ARTICLE 596**

The agent may discharge the duties of captain of the vessel, subject, in every case, to the provisions contained in Article 609.

If two or more co-owners request the position of captain, the disagreement shall be decided by a vote of the members; and if the vote should result in a tie, the position shall be given to the part owner having the larger interest in the vessel.

If the interest of the petitioners should be the same, and there should be a tie, the matter shall be decided by lot.

**ARTICLE 597**

The agent shall select and come to an agreement with the captain, and shall contract in the name of the owners, who shall be bound in all that refers to repairs, details of equipment, armament, provisions, fuel, and freight of the vessel, and, in general, in all that relates to the requirements of navigation.

**ARTICLE 598**

The agent can not order a new voyage, nor make contracts for a new charter, nor insure the vessel, without the authority of her owner or by virtue of a resolution of the majority of the co-owners, unless these privileges were granted him in the certificate of his appointment.

If he should insure the vessel without authority therefor he shall be secondarily liable for the solvency of the underwriter.

**ARTICLE 599**

The managing agent of an association, shall give his co-owners an account of the results of each voyage of the vessel, without prejudice to always leaving the books and correspondence relating to the vessel and to its voyages at the disposal of the same.

**ARTICLE 600**

After the account of the managing agent has been approved by a relative majority, the co-owners shall satisfy the expenses in proportion to their interest, without prejudice to the civil or criminal actions which the minority may deem fit to institute afterwards.

In order to enforce the payment, the managing agent shall have a right of action to secure execution, which shall be instituted by virtue of a resolution of the majority, and without further proceedings than the acknowledgment of the signatures of the persons who voted the resolution.

**ARTICLE 601**

Should there be any profits, the co-owners may demand of the managing agent the amount due to them, by means of an executory action without further requisites than the acknowledgment of the signatures of the instrument approving the account.

**ARTICLE 602**

The agent shall indemnify the captain for all the expenses he may have incurred from his own funds or from those of other persons, for the benefit of the vessel.

**ARTICLE 603**

Before a vessel goes out to sea the agent shall have at his discretion, a right to discharge the captain and members of the crew whose contract did not state a definite period nor a definite voyage, paying them the salaries earned according to their contracts, and without any indemnity whatsoever, unless there is a special and specific agreement in respect thereto.

**ARTICLE 604**

If the captain or any other member of the crew should be discharged during the voyage, they shall receive their salary until the return to the place
where the contract was made, unless there are good reasons for the discharge, all in accordance with Articles 636 et seq. of this Code.

ARTICLE 605
If the contracts of the captain and members of the crew with the agent should be for a definite period or voyage, they can not be discharged until the fulfillment of their contracts, except for reasons of insubordination in serious matters, robbery, theft, habitual drunkenness, and damage caused to the vessel or to its cargo by malice or manifest or proven negligence.

ARTICLE 606
If the captain should be a part owner in the vessel, he can not be discharged without the agent returning him the amount of his interest therein, which, in the absence of an agreement between the parties, shall be appraised by experts appointed in the manner established in the law of civil procedure.

ARTICLE 607
If the captain who is a part owner should have obtained the command of the vessel by virtue of a special agreement contained in the articles of co-partnership, he can not be deprived thereof except for the reasons mentioned in Article 605.

ARTICLE 608
In case of the voluntary sale of the vessel, all contracts between the agent and captain shall terminate, the right to proper indemnity being reserved in favor of the captain, according to the agreements made with the agent. They vessel sold shall remain subject to the security of the payment of said indemnity if, after the action against the vendor has been instituted, the latter should be insolvent.

ARTICLE 618
The captain shall be civilly liable to the agent, and the latter to the third persons who may have made contracts with the former —
1. For all the damages suffered by the vessel and his cargo by reason of want of skill or negligence on his part. If a misdemeanor or crime has been committed he shall be liable in accordance with the Penal Code. cda
2. For all the thefts committed by the crew, reserving his right of action against the guilty parties.
3. For the losses, fines, and confiscations imposed an account of violation of the laws and regulations of customs, police, health, and navigation.
4. For the losses and damages caused by mutinies on board the vessel, or by reason of faults committed by the crew in the service and defense of the same, if he does not prove that he made full use of his authority to prevent or avoid them.
5. For those arising by reason of an undue use of powers and non-fulfillment of the obligations which are his in accordance with Articles 610 and 612.
6. For those arising by reason of his going out of his course or taking a course which he should not have taken without sufficient cause, in the opinion of the officers of the vessel, at a meeting with the shippers or supercargoes who may be on board.
7. For those arising by reason of his voluntarily entering a port other than his destination, with the exception of the cases or without the formalities referred to in Article 612.
8. For those arising by reason of the non-observance of the provisions contained in the regulations for lights and evolutions for the purpose of preventing collisions.

Standard Oil v. Castelo (1921)
In considering the question now before us it is important to remember that the owner of the ship ordinarily has vastly more capital embarked upon a voyage than has any individual shipper of cargo. Moreover, the owner of the ship, in the person of the captain, has complete and exclusive control of the crew and of the navigation of the ship, as well as of the disposition of the cargo at the end of the voyage. It is therefore proper that any person whose property may have been cast overboard by order of the captain should have a right of action directly against the ship’s owner for the breach of any duty which the law may have imposed on the captain with respect to such cargo. To adopt the interpretation of the law for which the appellant contends would place the shipowner in a position to escape all responsibility for a general average of this character by means of the delinquency of his own captain. This cannot be permitted. The evident intention of the Code, taken in all of its provisions, is to place the primary liability upon the person who has actual control over the conduct of the voyage and who has most capital embarked in the venture, namely, the owner of the ship, leaving him to obtain recourse, as it is very easy to do, from other individuals who have been drawn into the venture as shippers.

Responsibilities and Liabilities

Yu Con v. Ipil (1916)
As to the shipowner: Estasen, makes the following remarks: It is well and good that the shipowner be not held criminally liable for such crimes or quasi crimes; but the cannot be excused from liability for the damage and harm which, in consequence of those acts, may be suffered by the third parties who contracted with the captain, in his double capacity of agent and subordinate of the shipowner himself. In maritime commerce, the shippers and passengers in making contracts with the captain do so through the confidence they have in the shipowner who appointed him; they presume that the owner made a most careful investigation before appointing him, and, above all, they themselves are unable to make such an investigation, and even though they should do so, they could not obtain complete security, inasmuch as the shipowner can, whenever he sees fit, appoint another captain instead.
Doctrine of limited liability and exceptions

ARTICLE 587
The agent shall also be civilly liable for the indemnities in favor of third persons which arise from the conduct of the captain in the care of the goods which the vessel carried; but he may exempt himself therefrom by abandoning the vessel with all her equipments and the freight he may have earned during the voyage.

ARTICLE 590
The owners of a vessel shall be civilly liable in the proportion of their contribution to the common fund, for the results of the acts of the captain, referred to in Article 587. Each part owner may exempt himself from this liability by the abandonment before a notary of the part of the vessel belonging to him.

ARTICLE 837
The civil liability contracted by the shipowners in the cases prescribed in this section, shall be understood as limited to the value of the vessel with all her appurtenances and all the freight earned during the voyage.

Yangco v. Laserna et al (1941)
If the shipowner or agent may in any way be held civilly liable at all for injury to or death of passengers arising from the negligence of the captain in cases of collisions or shipwrecks, his liability is merely co-extensive with his interest in the vessel such that a total loss thereof results in its extinction. In arriving at this conclusion, the fact is not ignored that the ill-fated S. S. Negros, as a vessel engaged in interisland trade, is a common carrier, and that the relationship between the petitioner and the passengers who died in the mishap rests on a contract of carriage. But assuming that petitioner is liable for a breach of contract of carriage, the exclusively “real and hypothecary nature” of maritime law operates to limit such liability to the value of the vessel, or to the insurance thereon, if any. In the instant case it does not appear that the vessel was insured.

Art. 587 of the Code of Commerce appears to deal only with the limited liability of shipowners or agents for damages arising from the misconduct of the captain in the care of the goods which the vessel carries, but this is a mere deficiency of language and in no way indicates the true extent of such liability.

Whether the abandonment of the vessel sought by the petitioner in the instant case was in accordance with law or not is immaterial. The vessel having totally perished, any act of abandonment would be an idle ceremony. Judgment is reversed and petitioner is hereby absolved of all the complaints, without costs.

ABUEG vs. SAN DIEGO (1946)
The real and hypothecary nature of the liability of the shipowner or agent embodied in the provisions of the Maritime Law, Bk III, Code of Commerce, had its origin in the prevailing continues of the maritime trade and sea voyages during the medieval ages, attended by innumerable hazards and perils. To offset against these adverse conditions and encourage shipbuilding and maritime commerce, it was deemed necessary to confine the liability of the owner or agent arising from the operation of a ship to the vessel, equipment, and freight, or insurance, if any, so that if the shipowner or agent abandoned the ship, equipment, and freight, his liability was extinguished.

If an accident is compensable under the Workmen’s Compensation Act, it must be compensated even when the workman’s right is not recognized by or is in conflict with other provisions of the Civil Code or the Code of Commerce. The reason behind this principle is that the Workmen’s Compensation Act was enacted by the Legislature in abrogation of the other existing laws.

Specific rights and prerogatives

ARTICLE 575
Part owners of vessels shall enjoy the right of option of purchase and withdrawal in the sales made to strangers; but they can only exercise it within the nine days following the record of the sale in the registry and by delivering the price at once.

ARTICLE 593
The owners of a vessel shall have preference in her charter to other persons, offering equal conditions and price. If two or more of the former should claim said right the one having greater interest shall be preferred, and should they have an equal interest it shall be decided by lot.

ARTICLE 594
The part owners shall elect the manager who is to represent them in the capacity of agent. The appointment of director or agent shall be revocable at the will of the members.

ARTICLE 596
The agent may discharge the duties of captain of the vessel, subject, in every case, to the provisions contained in Article 609. If two or more co-owners request the position of captain, the disagreement shall be decided by a vote of the members; and if the vote should result in a tie, the position shall be given to the part owner having the larger interest in the vessel.

If the interest of the petitioners should be the same, and there should be a tie, the matter shall be decided by lot.

ARTICLE 601. Should there be any profits, the co-owners may demand of the managing agent the amount due them, by means of an executory action without further requisites than the acknowledgment of the signatures of the instrument approving the account.

2. CAPTAINS AND MASTERS

Qualifications and licensing

ARTICLE 609
Captains and masters of vessels must be Spaniards * having legal capacity to bind themselves in accordance with this Code, and must prove that they have the skill, capacity, and qualifications required to command and direct the vessel, as established by marine laws, ordinances, or regulations, or by those of navigation, and that they are not disqualified according to the same for the discharge of the duties of that position. cdt
If the owner of a vessel desires to be the captain thereof and does not have the legal qualifications therefor, he shall limit himself to the financial administration of the vessel, and shall intrust her navigation to a person possessing the qualifications required by said ordinances and regulations.

POWERS AND DUTIES

ARTICLE 610
The following powers are inherent in the position of captain or master of a vessel:
1. To appoint or make contracts with the crew in the absence of the agent and propose said crew, should said agent be present; but the agent shall not be permitted to employ any member against the captain's express refusal.
2. To command the crew and direct the vessel to the port of its destination, in accordance with the instructions he may have received from the agent.
3. To impose, in accordance with the agreements and the laws and regulations of the merchants marine, on board the vessel, correctional punishment upon those who do not comply with his orders or who conduct themselves against discipline, holding a preliminary investigation on the crimes committed on board the vessel on the high seas, which shall be turned over to the authorities, who are to take cognizance thereof, at the first port touched.
4. To make contracts for the charter of the vessel in the absence of the agent or of her consignee, acting in accordance with the instructions received and protecting the interests of the owner most carefully.
5. To adopt all the measures which may be necessary to keep the vessel well supplied and equipped, purchasing for the purpose all that may be necessary, provided there is no time to request instructions of the agent.
6. To make, in similar urgent cases and on a voyage, the repairs to the hull and engines of the vessel and to her rigging and equipment which are absolutely necessary in order for her to be able to continue and conclude her voyage; but if she should arrive at a point where there is a consignee of the vessel, he shall act in concurrence with the latter.

ARTICLE 611
In order to comply with the obligations mentioned in the foregoing article, the captain, when he has no funds and does not expect to receive any from the agent, shall procure the same in the successive order stated below:
1. By requesting said funds of the consignees or correspondents of a vessel.
2. By applying to the consignees of the cargo or to the persons interested therein.
3. By drawing on the agent.
4. By borrowing the amount required by means of a bottomry bond.
5. By selling a sufficient amount of the cargo to cover the amount absolutely necessary to repair the vessel, and to equip her to pursue the voyage.
In the two latter cases he must apply to the judicial authority of the port, if in Spain * and to the Spanish * consul, if in a foreign country; and where there should be none, to the local authority, proceeding in accordance with the prescriptions of Article 583, and with the provisions of the law of civil procedure.

ARTICLE 622
If while on a voyage the captain should learn of the appearance of privateers or men of war against his flag, he shall be obliged to make the nearest neutral port, inform his agent or shippers, and await an occasion to sail under convoy, or until the danger is over or he has received express orders from the ship agent or the shippers.

ARTICLE 624
A captain whose vessel has gone through a hurricane or who believes that the cargo has suffered damages or averages, shall make a protest thereon before the competent authority at the first port he touches, within 24 hours following his arrival and shall ratify it within the same period when he arrives at his destination, immediately proceeding with the proof of the facts, and he may not open the hatches until after this has been done.

The captain shall proceed in the same manner, if, the vessel having been wrecked; he is saved alone or with part of his crew, in which case he shall appear before the nearest authority, and make a sworn statement of facts.

The authority or the consul shall verify the said facts receiving sworn statements of the members of the crew and passengers who may have been saved; and taking such other steps as may assist in arriving at the facts he shall make a statement of the result of the proceedings in the log book and in that of the sailing mate, and shall deliver to the captain the original records of the proceedings, stamped and folioed, with a memorandum of the folios, which he must rubricate, in order that it may be presented to the judge or court of the port of destination.

The statement of the captain shall be accepted if it is in accordance with those of the crew and passengers; if they disagree, the latter shall be accepted, always saving proof to the contrary.

ARTICLE 625
The captain, under his personal responsibility, as soon as he arrives at the port of destination, should get the necessary permission from the health and customs officers, and perform the other formalities required by the regulations of the administration, delivering the cargo without any defalcation, to the consignee, and in a proper case, the vessel, rigging and freightage to the ship agent.
If by reason of the absence of the consignee or on account of the nonappearance of a legal holder of the bills of lading, the captain should not know to whom he is to legally make the delivery of the cargo, he shall place it at the disposal of the proper judge or court or authority, in order that he may determine what is proper with regards to its deposit, preservation and custody.

**Prohibited acts and transactions**

**ARTICLE 613**
A captain who navigates for freight in common or on shares can not make any transaction for his exclusive account, and should he do so the profit shall belong to the other persons in interest, and the losses shall be for his own exclusive account.

**ARTICLE 614**
A captain who, having made an agreement to make a voyage, fails to perform his undertaking, without being prevented by fortuitous accident or force majeure, shall indemnify for all the losses which he may cause, without prejudice to the criminal penalties which may be proper.

**ARTICLE 615**
Without the consent of the agent, the captain can not have himself substituted by another person; and should he do so, besides being liable for all the acts of the substitute and bound to the indemnities mentioned in the foregoing article, the substitute as well as the captain may be discharged by the agent.

**ARTICLE 617**
The captain can not contract loans on respondentia, and should he do so the contracts shall be void.
Neither can he borrow money on bottomry for his own transactions, except on the portion of the vessel he owns, provided no money has been previously borrowed on the whole vessel, and provided there does not exist any other kind of lien or obligation thereon. When he is permitted to do so, he must necessarily state what interest he has in the vessel.
In case of violation of this article the principal, interest, and costs shall be charged to the private account of the captain, and the agent may furthermore have the right to discharge him.

**ARTICLE 621**
A captain who borrows money on bottomry, or who pledges or sells merchandise or provisions in other cases and without the formalities prescribed in this Code, shall be liable for the principle, interest, and costs, and shall indemnify for the damages he may cause.
The captain who commits fraud in his accounts shall reimburse the amount defrauded, and shall be subject to the provisions contained in the Penal Code.

**ARTICLE 583**
If the ship being on a voyage the captain should find it necessary to contract one or more of the obligations mentioned in Nos. 8 and 9 of Article 580, he shall apply to the judge or court if he is in Spanish * territory, and otherwise to the consul of Spain, * should there be one, and, in his absence to the judge or court or to the proper local authority, presenting the certificate of the registry of the vessel treated of in Article 612, and the instruments proving the obligation contracted.
The judge or court, the consul or the local authority as the case may be, in view of the result of the proceedings instituted, shall make a temporary memorandum in the certificate of their result, in order that it may be recorded in the registry when the vessel returns to the port of her registry, or so that it can be admitted as a legal and preferred obligation in case of sale before the return, by reason of the sale of the vessel by virtue of a declaration of unseaworthiness.
The lack of this formality shall make the captain personally liable to the creditors who may be prejudiced through his fault.

### 3. Other Officers and Crew

**Contracts and formalities**

**ARTICLE 634**
The captain may make up his crew with the number he may consider advisable, and in the absence of Spanish * sailors he may ship foreigners residing in the country, the number thereof not to exceed one-fifth of the total crew. If in foreign ports the captain should not find a sufficient number of Spanish * sailors, he may make up the crew with foreigners, with the consent of the consul or marine authorities.
The agreements which the captain may make with the members of the crew and others who go to make up the complement of the vessels, to which reference is made in Article 612, must be reduced to writing in the account book without the intervention of a notary public or clerk, signed by the parties thereto, and vised by the marine authority if they are executed in Spanish * territory, or by the consuls or consular agents of Spain * if executed abroad, stating therein all the obligations which each one contracts and all the rights they acquire, said authorities taking care that these obligations and rights are recorded in a concise and clear manner, which will not give rise to doubts or claims.

The captain shall take care to read to them the articles of this Code, which concern them, stating that they were read in the said document.
If the book includes the requisites prescribed in Article 612, and there should not appear any signs of alterations in its clauses, it shall be admitted as evidence in questions which may arise between the captain and the crew with regard to the agreements contained therein and the amounts paid on account of the same.
Every member of the crew may request a copy of the captain, signed by the latter, of the agreement and of the liquidation of his wages, as they appear in the book.

### Duties and liabilities

**ARTICLE 635**
A sailor who has been contracted to serve on a vessel can not rescind his contract nor fail to
comply therewith except by reason of a legitimate impediment which may have occurred. Neither can he pass from the service of one vessel to another without obtaining the written consent of the vessel on which he may be.

If, without obtaining said permission, the sailor who has signed for one vessel should sign for another one, the second contract shall be void, and the captain may choose between forcing him to fulfill the service to which he first bound himself or look for a person to substitute him at his expense. Said sailor shall furthermore lose the wages earned on his first contract to the benefit of the vessel for which he may have signed.

A captain who, knowing that a sailor is in the service of another vessel, should have made a new agreement with him, without having requested the permission referred to in the foregoing paragraphs, shall be personally liable to the captain of the vessel to which the sailor first belonged for that part of the indemnity, referred to in the third paragraph of this article, which the sailor could not pay.

**RIGHTS**

**ARTICLE 636**
Should a fixed period for which a sailor has signed not be stated, he can not be discharged until the end of the return voyage to the port where he enrolled.

**ARTICLE 637**
Neither can the captain discharge a sailor during the time of his contract except for sufficient cause, the following being considered as such:
1. The perpetration of a crime which disturbs order on the vessel.
2. Repeated offenses of insubordination, against discipline, or against the fulfillment of the service.
3. Repeated incapacity or negligence in the fulfillment of the service to be rendered.
4. Habitual drunkenness.
5. Any occurrence which incapacitates the sailor to carry out the work under his charge, with the exception of the provisions contained in Article 644.
6. Desertion.

The captain may, however, before setting out on a voyage and without giving any reason whatsoever, refuse to permit a sailor he may have engaged from going on board and may leave him on land, in which case he will be obliged to pay him his wages as if he had rendered services. This indemnity shall be paid from the funds of the vessel if the captain should have acted for reasons of prudence and in the interest of the safety and good service of the former. Should this not be the case, it shall be paid by the captain personally.

After the vessel has sailed, and during the voyage and until the conclusion thereof, the captain can not abandon any member of his crew on land or on the sea, unless, by reason of being guilty of some crime, his imprisonment and delivery to the competent authority is proper in the first port touched, which will be obligatory on the captain.

**ARTICLE 638**
If, the crew having been engaged, the voyage is revoked by the will of the agent or of the charterers before or after the vessel has put to sea or if the vessel is in the same manner given a different destination than that fixed in the agreement with the crew, the latter shall be indemnified because of the rescission of the contract according to the case, viz:
1. If the revocation of the voyage should be decided before the departure of the vessel from the port, each sailor engaged shall be given one month’s salary, besides what may be due him in accordance with his contract for the services rendered to the vessel up to the date of the revocation.
2. If the agreement should have been for a fixed amount for the whole voyage, there shall be graduated what may be due for said month and days, calculating the same in proportion to the estimated duration of the voyage, in the judgment of experts, in the manner established in the law of civil procedure; and if the proposed voyage should be of such short duration that it is calculated at one month more or less, the indemnity shall be fixed for fifteen days, discounting in all cases the sums advanced.
3. If the revocation should take place after the vessel has put to sea, the sailors engaged for a fixed amount for the voyage shall receive the salary which may have been offered them in full as if the voyage had terminated, and those engaged by the month shall receive the amount corresponding to the time they might have been on board and to the time they may require to arrive at the port of destination, the captains being obliged, furthermore, to pay said sailors the passage to the said port or to the port of sailing of the vessel, as may be convenient for them.
4. If the agent or the charterers of the vessel should give said vessel a destination other than that fixed in the agreement, and the members of the crew should not agree thereto, the latter shall be given by way of indemnity half the amount fixed in case No. 1, besides what may be owed them for the part of the monthly wages corresponding to the days which have elapsed from the date of their agreements.

If they accept the change, and the voyage, on account of the greater distance or for other reasons, should give rise to an increase of wages, the latter shall be privately regulated, or through amicable arbitrators in case of disagreement. Even though the voyage may be to a nearer point, this shall not give rise to a reduction in the wages agreed upon.

If the revocation or change of the voyage should originate from the shippers or charterers, the agent shall have a right to demand of them the indemnity which is justly due.

**ARTICLE 639**
If the revocation of the voyage should arise from a just cause independent of the will of the agent or charterers, and the vessel should not have left the port, the members of the crew shall not have any other right than to receive the wages earned up to the day on which the revocation took place.

**ARTICLE 640**
The following shall be just causes for the revocation of the voyage:
ARTICLE 641
If, after a voyage has begun, any of the first three causes mentioned in the foregoing article should occur, the sailors shall be paid at the port the voyage had been made for a fixed sum for the voyage, the full amount of wages or the full part of the profits due him as to the others of his grade. The sailors shall likewise be considered as present in the voyage, the full amount of wages or the full part of the profits due him as to the others of his grade. The sailor shall be considered as living, and his heirs shall be paid, at the end of the voyage, the full amount of wages or the full part of the profits due him as to the others of his grade. The sailor shall likewise be considered as present in the event of his capture when defending the vessel, and the death should have occurred after the departure of the vessel from the port, the heirs shall not be entitled to claim anything.

ARTICLE 642
If the vessel and her freight should be totally lost, by reason of capture or wreck, all rights of the crew to demand any wages whatsoever shall be extinguished, as well as that of the agent for the recovery of the advances made. If a sailor should die during the voyage his heir shall be given the wages earned and not received, according to his engagement and the reason for his death, namely —

ARTICLE 644
A sailor who falls sick shall not lose his right to wages during the voyage, unless the sickness is the result of his own fault. At any rate, the costs of the attendance and cure shall be defrayed from the common funds, in the form of a loan. If the sickness should be caused by an injury received in the service or defense of the vessel the sailor shall be attended and cured from the common funds, there being deducted before anything else from the proceeds of the freight, the cost of the attendance and cure.

If a declaration of war or interdiction of commerce with the power to whose territory the vessel was bound.

2. The blockade of the port of destination or the breaking out of an epidemic after the agreement.

3. The prohibition to receive in said port the goods which make up the cargo of the vessel.

4. The detention or embargo of the same by order of the Government, or for any other reason independent of the will of the agent.

5. The inability of the vessel to navigate.
4. SUPERCARGOES

ARTICLE 649
Supercargoes shall discharge on board the vessel the administrative duties which the agent or shippers may have assigned them; they shall keep an account and record of their transactions in a book which shall have the same conditions and requisites as required for the accounting book of the captain, and shall respect the latter in his duties as chief of the vessel. cda
The powers and liabilities of the captain shall cease, when there is a supercargo, with regard to that part of the administration legitimately conferred upon the latter, but shall continue in force for all acts which are inseparable from his authority and office.

ARTICLE 650
All the provisions contained in the second section of Title III, Book II, with regard to qualifications, manner of making contracts, and liabilities of factors shall be applicable to supercargoes.

ARTICLE 651
Supercargoes can not, without special authorization or agreement, make any transaction for their own account during the voyage, with the exception of the ventures which, in accordance with the custom of the port of destination, they are permitted to do. Neither shall they be permitted to invest in the return trip more than the profits from the ventures, unless there is a special authorization thereeto from the principals.

What is a supercargo?
He or she is an agent of the owner of goods shipped as cargo on a vessel, who has charge of the cargo on board, sells the same to the best advantage in the foreign markets, buys cargo to be brought back on the return voyage of the ship, and comes home with it.

E. Accidents and Damages in Maritime Commerce

1. AVERAGES24

NATURE AND KINDS

ARTICLE 806
For the purposes of this Code the following shall be considered averages:
1. All extraordinary or accidental expenses which may be incurred during the navigation for the preservation of the vessel or cargo, or both.
2. All damages or deterioration the vessel may suffer from the time she puts to sea from the port of departure until she casts anchor in the port of destination, and those suffered by the merchandise from the time it is loaded in the port of shipment until it is unloaded in the port of consignment.

ARTICLE 807
24 General averages, requisites and jettison were asked in 2000, 1983, and 1982.

The petty and ordinary expenses of navigation, such as pilotage of coasts and ports, lightering and towage, anchorage dues, inspection, health, quarantine, lazaretto, and other so-called port expenses, costs of barges, and unloading, until the merchandise is placed on the wharf, and any other expenses common to navigation shall be considered ordinary expenses to be defrayed by the shipowner, unless there is a special agreement to the contrary.

ARTICLE 808
Averages shall be:
1. Simple or particular.
2. General or gross.

i. Simple or Particular

(a) Defined

ARTICLE 809
Simple or particular averages shall be, as a general rule, all the expenses and damages caused to the vessel or to her cargo which have not redounded to the benefit and common profit of all the persons interested in the vessel and her cargo, and especially the following:
1. The damages suffered by the cargo from the time of embarkation until it is unloaded, either on account of the nature of the goods or by reason of an accident at sea or force majeure, and the expenses incurred to avoid and repair the same.
2. The damages suffered by the vessel in her hull, rigging, arms, and equipment, for the same causes and reasons, from the time she puts to sea from the port of departure until she anchored in the port of destination.
3. The damages suffered by the merchandise loaded on deck, except in coastwise navigation, if the marine ordinances allow it.
4. The wages and victuals of the crew when the vessel should be detained or embargoed by a legitimate order or force majeure, if the charter should have been for a fixed sum for the voyage.
5. The necessary expenses on arrival at a port, in order to make repairs or secure provisions.
6. The lowest value of the goods sold by the captain in arrivals under stress for the payment of provisions and in order to save the crew, or to cover any other requirement of the vessel against which the proper amount shall be charged.
7. The victuals and wages of the crew during the time the vessel is in quarantine.
8. The damage suffered by the vessel or cargo by reason of an impact or collision with another, if it were accidental and unavoidable. If the accident should occur through the fault or negligence of the captain, the latter shall be liable for all the damage caused.
9. Any damage suffered by the cargo through the faults, negligence, or barratry of the captain or of the crew, without prejudice to the right of the owner to recover the corresponding indemnity from the captain, the vessel, and the freight.

(b) Effects

ARTICLE 810
The owner of the goods which gave rise to the expense or suffered the damage shall bear the simple or particular averages.

ii. Gross or General
ARTICLE 811
General or gross averages shall be, as a general rule, all the damages and expenses which are deliberately caused in order to save the vessel, her cargo, or both, at the same time, from a real and known risk, and particularly the following:
1. The goods or cash invested in the redemption of the vessel or cargo captured by enemies, privateers, or pirates, and the provisions, wages, and expenses of the vessel detained during the time the arrangement or redemption is taking place.
2. The goods jettisoned to lighten the vessel, whether they belong to the vessel, to the cargo, or to the crew, and the damage suffered through said act by the goods kept.
3. The cables and masts which are cut or rendered useless, the anchors and the chains which are abandoned in order to save the cargo, the vessel, or both.
4. The expenses of removing or transferring a portion of the cargo in order to lighten the vessel and place her in condition to enter a port or roadstead, and the damage resulting therefrom to the goods removed or transferred.
5. The damage suffered by the goods of the cargo through the opening made in the vessel in order to drain her and prevent her sinking.
6. The expenses caused through floating a vessel intentionally stranded for the purpose of saving her.
7. The damage caused to the vessel which it is necessary to break open, scuttle, or smash in order to save the cargo.
8. The expenses of curing and maintaining the members of the crew who may have been wounded or crippled in defending or saving the vessel.
9. The wages of any member of the crew detained as hostage by enemies, privateers, or pirates, and the necessary expenses which he may incur in his imprisonment, until he is returned to the vessel or to his domicile, should he prefer it.
10. The wages and victuals of the vessel chartered by the month during the time it is necessary to save the cargo.
11. The loss suffered in the value of the goods sold at arrivals under stress in order to repair the vessel because of gross average.
12. The expenses of the liquidation of the average.

ARTICLE 817
If in lightening a vessel on account of a storm, in order to facilitate her entry into a port or roadstead, part of her cargo should be transferred to lighters or barges and be lost, the owner of said part shall be entitled to indemnity, as if the loss had originated from a gross average, the amount thereof being distributed between the entire vessel and cargo which caused the same.
If, on the contrary, the merchandise transferred should be saved and the vessel should be lost, no liability can be demanded of the salvage.

ARTICLE 818
If, as a necessary measure to extinguish a fire in a port; roadstead; creek, or bay, it should be decided to sink any vessel, this loss shall be considered gross average, to which the vessels saved shall contribute.

(b) Essential Requisites

ARTICLE 813
In order to incur the expenses and cause the damages corresponding to gross average, a previous resolution of the captain, adopted after deliberation with the sailing mate and other officers of the vessel, and with a hearing of the persons interested in the cargo who may be present, shall be required.
If the latter shall object, and the captain and officers, or a majority, or the captain, if opposed to the majority, should consider certain measures necessary, they may be executed under his liability, without prejudice to the freighters exercising their rights against the captain before the judge or court of competent jurisdiction, if they can prove that he acted with malice, lack of skill, or negligence.
If the persons interested in the cargo, being on the vessel, should not be heard, they shall not contribute to the gross average, which contribution shall be paid by the captain, unless the urgency of the case should be such that the time necessary for previous deliberation was lacking.

ARTICLE 814
The resolution adopted to cause the damages which constitute a general average must necessarily be entered in the log book, stating the motives and reasons therefor, the votes against it, and the reasons for the disagreement should there be any, and the irresistible and urgent causes which moved the captain if he acted of his own accord.
In the first case the minutes shall be signed by all the persons present who could do so before taking action if possible, and if not at the first opportunity; in the second case by the captain and by the officers of the vessel.
In the minutes and after the resolution there shall be stated in detail all the goods cast away, and mention shall be made of the injuries caused to those kept on board. The captain shall be obliged to deliver one copy of these minutes to the maritime judicial authority of the first port he may make within twenty-four hours after his arrival, and to ratify it immediately by an oath.

ARTICLE 860
If, notwithstanding the jettison of the merchandise, breakage of masts, ropes, and equipment, the vessel should be lost running said risk, no contribution whatsoever by reason of gross average shall be proper.
The owners of the goods saved shall not be liable for the indemnity of those jettisoned, lost, or damaged.

MAGSAYSAY INC. vs AGAN (1955)
REQUISITES FOR GENERAL AVERAGE:
1. There must be a common danger. This means, that both the ship and the cargo, after it has been loaded, are subject to the same danger, whether during the voyage, or in the port of loading or unloading; that the danger arises from the accidents of the sea, dispositions of the authority, or faults of men, provided that the circumstances producing the peril should be ascertained and imminent or may rationally be said to be certain and imminent. This last requirement excludes measures undertaken against a distant peril.
2. That for the common safety, part of the vessel or of the cargo or both is sacrificed deliberately.
3. That from the expenses or damages caused follows the successful saving of the vessel and cargo.
4. That the expenses or damages should have been incurred or inflicted after taking proper legal steps and authority.

(c) Effects

ARTICLE 812
In order to satisfy the amount of the gross or general averages, all the persons having an interest in the vessel and cargo therein at the time of the occurrence of the average shall contribute.

(d) Jettison

ARTICLE 815
The captain shall supervise the jettison, and shall order the goods cast overboard in the following order:
1. Those which are on deck, beginning with those which embarrass the handling of the vessel or damage her, preferring, if possible, the heaviest ones and those of least utility and value. cda
2. Those in the hold, always beginning with those of the greatest weight and smallest value, to the amount and number absolutely indispensable.

ARTICLE 816
In order that the goods jettisoned may be included in the gross average and the owners thereof be entitled to indemnity, it shall be necessary in so far as the cargo is concerned that their existence on board be proven by means of the bill of lading; and with regard to those belonging to the vessel, by means of the inventory made up before the departure, in accordance with the first paragraph of Article 612.

(e) Jason Clauses (York - Antwerp Rules, Rule D)

Rights to contribution in general average shall not be affected, though the event which gave rise to the sacrifice or expenditure may have been due to the fault of one of the parties to the adventure; but this shall not prejudice any remedies which may be open against that party for such fault.

What are the York-Antwerp Rules and the Jason Clause?
The York-Antwerp Rules is an international system of rules (they are not law or international treaties, but are just widely in use) for the liquidation and payment of average to avoid the problem of characterization.

The Jason Clause is a standard provision in maritime contracts. It provides for uniform rules on adjustment, proof and liquidation of avergaes in maritime accidents to address various systems of determining the same.

PROOF AND LIQUIDATION OF AVERAGES

i. Modes

ARTICLE 846

The persons interested in the proof and liquidation of averages may mutually agree and bind themselves at any time with regard to the liability, liquidation, and payment thereof. cdt

In the absence of agreements, the following rules shall be observed:
1. The proof of the average shall take place in the port where the repairs are made, should any be necessary, or in the port of unloading.
2. The liquidation shall take place in the port of unloading should it be a Spanish port.
3. Should the average have occurred outside of the waters under the jurisdiction of the Philippines or the cargo should have been sold in a foreign port by reason of an arrival under stress, the liquidations shall be made in the port of arrival.
4. If the average should have occurred near the port of destination, so that said port can be made, the proceedings treated of in Rules 1 and 2 shall be held there.

ARTICLE 847

In case of making the liquidation of the averages privately by virtue of agreement, as well as when a judicial authority takes part therein at the request of any of the parties interested who do not agree thereto, all of them shall be cited and heard, should they not have renounced this right. Should they not be present or not have a legitimate representative, the liquidation shall be made by the consul in a foreign port, and where there is none, by the judge or court of competent jurisdiction, according to the laws of the country, and for the account of the proper person.

When the representative is a person well known in the place where the liquidation takes place, his intervention shall be admitted and produce legal effects, even though he be authorized only by a letter of the shipowner, freighter, or underwriter.

ARTICLE 848

Claims for averages shall not be admitted if they do not exceed 5 per cent of the interest which the claimant may have in the vessel or cargo if it is gross average, and 1 per cent of the goods damaged if particular average, deducting in both cases the expenses of appraisal, unless there is an agreement to the contrary.

ii. Appraisal of general average

ARTICLE 850

If by reason of one or more accidents of the sea particular and gross averages of the vessel or the cargo, or of both, should take place on the same voyage, the expenses and damages corresponding to each one shall be determined separately in the port where the repairs are made or where the cargo is discharged, or sold, or the merchandise is benefited. For this purpose the captains shall be obliged to demand of the expert appraisers and of the contractors making the repairs, as well as of those appraising and taking part in the unloading, repair, sale, or the benefiting of the merchandise, that they separate and detail exactly in their appraisements or estimates and accounts all the expenses and damages belonging to each average, and in those of each average those corresponding to the vessel and to the cargo, stating also separately whether there are or not any damages proceeding from the nature of the goods, and not by reason of a sea accident; and in case there...
should be expenses common to the different averages and to the vessel and her cargo, there must be calculated the amount corresponding to each and stated distinctly.

SECTION II
Liquidation of Gross Averages

ARTICLE 851
At the instance of the captain, the adjustment, liquidation, and distribution of gross averages shall be held privately, with the consent of all the parties in interest.

For this purpose, within forty-eight hours following the unloading of the vessel at the port, the captain shall call all the persons interested, in order that they may decide as to whether the adjustment or liquidation of the gross average is to be made by experts and liquidators appointed by themselves, in which case this shall be done should the persons interested agree.

Should an agreement not be possible, the captain shall apply to the judge or court of competent jurisdiction, who shall be the one of the port where these proceedings are to be held in accordance with the provisions of this Code, or to the consul of Spain, * should there be one, and otherwise to the local authority when they are to be held in a foreign port. cdta

ARTICLE 852
If the captain should not comply with the provisions contained in the foregoing article, the shipowner or agent or the freighters shall demand the liquidation, without prejudice to the action they may bring to demand indemnity from him.

ARTICLE 853
After the experts have been appointed by the persons interested, or by the judge or court, before the acceptance, an examination of the vessel and of the repairs required shall be made, as well as an estimate of their cost, separating these losses and damages from those arising from the natural vice of the thing.

The experts shall also declare whether the repairs can be made immediately, or whether it is necessary to unload the vessel to examine and repair her. With regard to the merchandise, if the average should be visible at a mere glance, the examination thereof must be made before it is delivered. Should it not be visible at the time of unloading, said examination may be held after the delivery provided it is done within forty-eight hours from the unloading and without prejudice to the other proofs which the experts may deem necessary.

ARTICLE 854
The appraisement of the goods which are to contribute to the gross average, and that of those which constitute the average, shall conform to the following rules:

1. The merchandise saved which is to contribute to the payment of the gross average shall be valued at the current price thereof at the port of unloading, deducting the freights, customs duties, and charges for unloading, as may appear from a material inspection of the same, not taking into consideration the bills of lading, unless there is an agreement to the contrary.

2. If the liquidation is to take place in the port of sailing, the value of the merchandise loaded shall be fixed by the purchase price, including the expenses until they are put on board, excluding the insurance premium.

3. If the merchandise should be damaged, it shall be appraised at its true value.

4. If the voyage should be interrupted, the merchandise having been sold in a foreign port and the average cannot be estimated, there shall be taken as the contributing capital the value of the merchandise in the port of arrival, or the net proceeds obtained at the sale thereof.

5. Merchandise lost, which should constitute the gross average, shall be appraised at the value of the merchandise, and its kind and quality appears in the bill of lading; and should this not be the case, the invoices of the purchase issued in the port of shipment shall be taken as a basis, adding to its value the expenses and freights subsequently arising. cd

6. The masts cut down, the sails, cables, and other equipment of the vessel rendered useless for the purpose of saving her, shall be appraised at the current value, deducting one-third by reason of the difference between new and old.

This deduction shall not be made in regard to anchors and chains.

7. The vessel shall be appraised at her real value in her condition at the time.

8. The freights shall represent 50 per cent by way of contributing capital.

ARTICLE 855
The merchandise loaded on the upper deck of the vessel shall contribute to the gross average should it be saved; but there shall be no right to indemnity if it should be lost by reason of being jettisoned for general safety, except when the marine ordinances allow its shipment in this manner in coastwise navigation.

The same shall take place with that which is on board and is not included in the bills of lading or inventories, according to the cases.

In any case the shipowner and the captain shall be liable to freighters for the loss of the jettison, if the storage on the upper deck took place without the consent of the latter.

ARTICLE 857
After the appraisement of the goods saved has been concluded by the experts, as well as that of the goods lost which constitute the gross average, and after the repairs have been made to the vessel, should any have to be made, and in such case after the approval of the accounts of the same by the persons interested or by the judge or court, the entire record shall be turned over to the liquidator appointed, in order that he may proceed with the distribution of the average.

iii. Liquidation of general averages

ARTICLE 858
In order to effect the liquidation the liquidator shall examine the sworn statement of the captain, comparing it, if necessary, with the log book and all the contracts which may have been made between the persons interested in the average, the appraisements, expert examinations, and accounts of repairs made. If, as a result of this examination, he should find any defect in this procedure which might injure the rights of the persons interested or affect the liability of the captain, he shall call attention thereto in order that it be corrected, if
possible, and otherwise he shall include it in the preliminaries of the liquidation.
Immediately thereafter he shall proceed with the distribution of the amount of the average, for which purpose he shall fix:
1. The contributing capital, which he shall determine by the value of the cargo, in accordance with the rules established in Article 854.
2. That of the vessel in her actual condition, according to a statement of experts.
3. The 50 per cent of the amount of the freight, deducting the remaining 50 per cent for wages and maintenance of the crew.

After the amount of the gross average has been determined in accordance with the provisions of this Code, it shall be distributed pro rata among the goods which are to cover the same.

ARTICLE 865
The distribution of the gross average shall not be final until it has been agreed to, or in the absence thereof, until it has been approved by the judge or court after an examination of the liquidation and a hearing of the persons interested who may be present, or of their representatives.

ARTICLE 866
After the liquidation has been approved it shall be the duty of the captain to collect the amount of the distribution, and he shall be liable to the owners of the goods averaged for the losses they suffer through his delay or negligence.

ARTICLE 867
If the contributors should not pay the amount of the assessment within the third day after having been requested to do so, the goods saved shall be attached, at the request of the captain, and shall be sold to cover the payment.

ARTICLE 868
If the persons interested in receiving the goods saved should not give security sufficient to answer for the amount corresponding to the gross average, the captain may defer the delivery thereof until payment has been made.

SECTION III
Liquidation of Ordinary Averages

ARTICLE 869
The experts which the judge or court or the persons interested may appoint, according to the cases, shall proceed with the appraisement and examination of the averages in the manner prescribed in Article 853 and in Article 854, Rules 2 to 7, in so far as they are applicable.

iv. Liquidation of particular average

ARTICLE 869
The experts which the judge or court or the persons interested may appoint, according to the cases, shall proceed with the appraisement and examination of the averages in the manner prescribed in Article 853 and in Article 854, Rules 2 to 7, in so far as they are applicable.

2. ARRIVALS UNDER STRESS

Causes

ARTICLE 819
If the captain during the navigation should believe that the vessel can not continue the voyage to the port of destination on account of the lack of provisions, well founded fear of seizure, privateers or pirates, or by reason of any accident of the sea disabling her to navigate, he shall assemble the officers and shall call the persons interested in the cargo who may be present, and who may attend the meeting without the right to vote; and if, after examining the circumstances of the case, the reasons should be considered well founded, it shall be decided to make the nearest and most convenient port drafting and entering in the log book the proper minutes, which shall be signed by all.

The captain shall have the deciding vote and the persons interested in the cargo may make the objections and protests they may deem proper, which shall be entered in the minutes in order that they may make use thereof in the manner they may consider advisable.

ARTICLE 820
The arrival under stress shall not be considered legal in the following cases:
1. If the lack of provisions should arise from the failure to take the necessary provisions for the voyage, according to usage and custom, or if they should have been rendered useless or lost through bad stowage or negligence in their care.
2. If the risk of enemies, privateers, or pirates should not have been well known, manifest, and based on positive and justifiable facts.
3. If the injury to the vessel shall have been caused by reason of her not being repaired, rigged, equipped, and arranged in a convenient manner for the voyage, or by reason of some erroneous order of the captain.
4. Whenever malice, negligence, want of foresight, or lack of skill on the part of the captain is the reason for the act causing the damage.

FORMALITIES

ARTICLE 819
If the captain during the navigation should believe that the vessel can not continue the voyage to the port of destination on account of the lack of provisions, well founded fear of seizure, privateers or pirates, or by reason of any accident of the sea disabling her to navigate, he shall assemble the officers and shall call the persons interested in the cargo who may be present, and who may attend the meeting without the right to vote; and if, after examining the circumstances of the case, the reasons should be considered well founded, it shall be decided to make the nearest and most convenient port drafting and entering in the log book the proper minutes, which shall be signed by all.

The captain shall have the deciding vote and the persons interested in the cargo may make the objections and protests they may deem proper, which shall be entered in the minutes in order that they may make use thereof in the manner they may consider advisable.

ARTICLE 822
If in order to make repairs to the vessel or because there should be danger of the cargo suffering damage it should be necessary to unload, the captain must request authorization of the judge or court of competent jurisdiction to lighten the vessel, and do so with the knowledge of the person...
interested or representative of the cargo, should there be one. In a foreign port, it shall be the duty of the Spanish consul, where there is one, to give the authorization. In the first case, the expenses shall be defrayed by the ship agent or owner, and in the second, they shall be for the account of the owners of the merchandise, for whose benefit the act took place. If the unloading should take place for both reasons, the expenses shall be defrayed in proportion to the value of the vessel and that of the cargo.

EXPENSES

ARTICLE 821
The expenses caused by the arrival under stress shall always be for the account of the shipowner or agent, but the latter shall not be liable for the damage which may be caused the shippers by reason of the arrival under stress, provided the latter is legitimate. Otherwise, the shipowner or agent and the captain shall be jointly liable.

ARTICLE 822
In order to make repairs to the vessel or because there should be danger of the cargo suffering damage it should be necessary to unload, the captain must request authorization of the judge or court of competent jurisdiction to lighten the vessel, and do so with the knowledge of the person interested or representative of the cargo, should there be one. In a foreign port, it shall be the duty of the Spanish consul, where there is one, to give the authorization. In the first case, the expenses shall be defrayed by the ship agent or owner, and in the second, they shall be for the account of the owners of the merchandise, for whose benefit the act took place. If the unloading should take place for both reasons, the expenses shall be defrayed in proportion to the value of the vessel and that of the cargo.

RESPONSIBILITY OF THE CAPTAIN

ARTICLE 823
The care and preservation of the cargo which has been unloaded shall be in charge of the captain, who shall be responsible for the same, except in cases of force majeure.

ARTICLE 824
If the entire cargo or part thereof should appear to be damaged, or there should be imminent danger of its being damaged, the captain may request of the judge or court of competent jurisdiction or the consul, in a proper case, the sale of all or of part of the former, and the person taking cognizance of the matter shall authorize it after an examination and declaration of experts, advertisements, and other formalities required by the case and an entry in the book, in accordance with the provisions of Article 634. The captain shall, in a proper case, justify the legality of the procedure, under the penalty of answering to the shipper for the price the merchandise would have brought if it should have arrived at the port of its destination in good condition.

ARTICLE 825
The captain shall answer for the damages caused by his delay, if the reason for the arrival under stress having ceased, he should not continue the voyage. If the reason for said arrival should have been the fear of enemies, privateers, or pirates, before sailing, a discussion and resolution of a meeting of the officers of the vessel and persons interested in the cargo who may be present shall take place, in accordance with the provisions contained in Article 819.

3. COLLISIONS

NOTE:
Collision – the impact of two vessels both of which are moving.
Allision – the striking of a moving vessel against one that is stationary.

CLASSES AND EFFECTS

i. Fortuitous

ARTICLE 830
If a vessel should collide with another by reason of an accident or through force majeure, each vessel and her cargo shall be liable for their own damage.

ARTICLE 831
If a vessel should be forced to collide with another one by a third vessel, the owner of the third vessel shall indemnify for the losses and damages caused, the captain thereof being civilly liable to said owner.

ARTICLE 832
If, by reason of a storm or other cause of force majeure, a vessel which is properly anchored and moored should collide with those in her immediate vicinity, causing them damage, the injury occasioned shall be looked upon as particular average to the vessel run into.

ii. Culpable

ARTICLE 826
If a vessel should collide with another through the fault, negligence, or lack of skill of the captain, sailing mate, or any other member of the complement, the owner of the vessel at fault shall indemnify the losses and damages suffered, after an expert appraisal.

ARTICLE 827
If both vessels may be blamed for the collision, each one shall be liable for his own damages, and both shall be jointly responsible for the losses and damages suffered by their cargoes.

ARTICLE 831
If a vessel should be forced to collide with another one by a third vessel, the owner of the third vessel shall indemnify for the losses and damages caused, the captain thereof being civilly liable to said owner.
iii. Inscrutable Fault

ARTICLE 828
The provisions of the foregoing article are applicable to the case in which it can not be decided which of the two vessels was the cause of the collision.

PRESUMPTION OF LOSS BY COLLISION

ARTICLE 833
A vessel shall be presumed as lost thru a collision which, upon being run into, sinks immediately, and also any vessel which is obliged to make a port to repair the damages caused by the collision should be lost during the voyage, or should be obliged to be stranded in order to be saved.

LIABILITIES

i. Shipowner or agent

ARTICLE 837
The civil liability contracted by the shipowners in the cases prescribed in this section, shall be understood as limited to the value of the vessel with all her appurtenances and all the freight earned during the voyage.

ARTICLE 838
When the value of the vessel and her appurtenances should not be sufficient to cover all the liabilities, the indemnity due by reason of the death or injury of persons shall have preference.

ii. Captain, pilot, others

ARTICLE 829
In the cases above mentioned the civil action of the owner against the person liable for the damage is reserved, as well as the criminal liabilities which may be proper.

ARTICLE 834
If the vessels colliding should have pilots on board discharging their duties at the time of the collision, their presence shall not exempt the captains from the liabilities they incur; but the latter shall have the right to be indemnified by the pilots without prejudice to the criminal liability which the latter may incur.

iii. Conditions, protest

Maritime Protest – a written statement under oath, made by the master of a vessel, after the occurrence of an accident or disaster in which the vessel or cargo is lost or injured, with respect to the circumstances attending such occurrence. It is usually intended to show that the loss or damage resulted from a peril of the sea, or from some other cause for which neither the master nor owner was responsible, and concludes with the protestation against any liability of the owner for such loss or damage.

25 See footnote 12. Distinguish inscrutable fault with the doctrine of last clear chance and with the doctrine of limited liabilities.

26 See footnote 15.

27 Take note of the concept of maritime protest, and when and where it should be file. This was asked in 2007, 1988, 1978, and 1977.

ARTICLE 835
The action for the recovery of losses and damages arising from collisions can not be admitted if a protest or declaration is not presented within twenty-four hours to the competent authority of the point where the collision took place, or that of the first port of arrival of the vessel, if in Spain, * and to the consul of Spain * if it should have occurred in a foreign country.

ARTICLE 836
In so far as the damages caused to persons or to the cargo are concerned, the absence of a protest can not prejudice the persons interested who were not on board or were not in a condition to make known their wishes.

ARTICLE 839
If the collision should occur between Spanish * vessels in foreign waters, or if it should take place in open waters, and the vessels should make a foreign port, the Spanish * consul in said port shall hold a summary investigation of the accident, forwarding the proceedings to the captain-general of the nearest department * for continuation and conclusion.

4. SHIPWRECKS

ARTICLE 840
The losses and deteriorations suffered by a vessel and her cargo by reason of shipwreck or stranding shall be individually for the account of the owners, the part of the wreck which may be saved belonging to them in the same proportion.

ARTICLE 841
If the wreck or stranding should arise through the malice, negligence, or lack of skill of the captain, or because the vessel put to sea insufficiently repaired and prepared, the owner or the freighters may demand indemnity of the captain for the damages caused to the vessel or cargo by the accident, in accordance with the provisions contained in Articles 610, 612, 614, and 621.

ARTICLE 842
The goods saved from the wreck shall be specially liable for the payment of the expenses of the respective salvage, and the amount thereof must be paid by the owners of the former before they are delivered to them, and with preference to any other obligation, if the merchandise should be sold.

ARTICLE 843
If several vessels navigate under convoy, and any of them should be wrecked, the cargo saved shall be distributed among the rest in the proportion to the amount each one can receive. If any captain should refuse, without sufficient cause, to receive what may correspond to him, the captain of the wrecked vessel shall enter a protest against him before two sea officials of the losses and damages resulting therefrom, ratifying the complaint within twenty-four hours after arrival at the first port, and including it in the proceedings he must institute in accordance with the provisions contained in Article 612. Should it not be possible to transfer to the other vessels the entire cargo of the one wrecked, the goods of the highest value and smallest volume shall be saved first, the designation thereof being made by the captain, in concurrence with the officers of his vessel.
F. Special Contracts of Maritime Commerce

1. CHARTER PARTIES

**Definition**
A charter party is a contract by virtue of which the owner or agent of a vessel binds himself to transport merchandise or persons for a fixed price. It is a contract by which the owner or agent of the vessel leases for a certain price the whole or portion of a vessel for the transportation of the goods or persons from one port to another. Towage is not a charter party. It is a contract for the hire of services by which a vessel is engaged to tow another vessel from one port to another for consideration.

**Kinds**

As to extent of vessel hired:

- Total
- Partial - charterer as a rule does not acquire the right to fix the date when the vessel should depart, unless such right is expressly granted in the contract

As to time:

- Until a fixed day or for a determined number of days or months
  - For a voyage

As to freightsage:

- For a fixed amount for the whole cargo
- For a fixed rate per ton
- For so much per month

**Coastwise Lighterage Corp vs. CA and Phil. Gen. Insurance Co. (1995)**
The distinction between the two kinds of charter parties (i.e. bareboat or demise and contract of affreightment) is more clearly set out in the case of Puromines, Inc. vs. Court of Appeals:
Under the demise or bareboat charter of the vessel, the charterer will generally be regarded as the owner for the voyage or service stipulated. The charterer mans the vessel with his own people and becomes the owner pro hac vice, subject to liability to others for damages caused by negligence. To create a demise, the owner of a vessel must completely and exclusively relinquish possession, command and navigation thereof to the charterer, anything short of such a complete transfer is a contract of affreightment (time or voyage charter party) or not a charter party at all.

A contract of affreightment is one in which the owner of the vessel leases part or all of its space to haul goods for others. It is a contract for special service to be rendered by the owner of the vessel and under such contract the general owner retains the possession, command and navigation of the ship, the charterer or freighter merely having use of the space in the vessel in return for his payment of the charter hire. Although a charter party may transform a common carrier into a private one, the same however is not true in a contract of affreightment on account of the aforementioned distinctions between the two. Thus, Coastwise, by the contract of affreightment, was not converted into a private carrier, but remained a common carrier and was still liable as such.

**Owner Pro Hac Vice** – demise charter to whom the owner of the vessel has completely and exclusively relinquished possession, command and navigation of the vessel. In this kind of charter, the charterers mans and equips the vessel and assumes all responsibility for navigation, management and operation. He thus acts as the owner of the vessel in all important aspects during the duration of the charter.

**Forms and Effects**

Charter Parties
1. Forms and Effects of Charter Parties

 ARTICLE 652
A charter party must be drawn in duplicate and signed by the contracting parties, and when either does not know how or can not do so, by two witnesses at their request.
The charter party shall include, besides the conditions unrestrictedly stipulated, the following statements:
1. The kind, name, and tonnage of the vessel.
2. Her flag and port of registry.
3. The name, surname, and domicile of the captain.
4. The name, surname, and domicile of the agent, if the latter should make the charter party.
5. The name, surname, and domicile of the charterer, and if he states that he is acting by commission, that of the person for whose account he makes the contract.
6. The port of loading and unloading.
7. The capacity, number of tons or weight, or measure which they respectively bind themselves to load and transport, or whether it is the total cargo.
8. The freightage to be paid, stating whether it is to be a fixed amount for the voyage or so much per month, or for the space to be occupied, or for the weight or measure of the goods of which the cargo consists, or in any other manner whatsoever agreed upon.
9. The amount of primage to be paid to the captain.
10. The days agreed upon for loading and unloading.
11. The lay days and extra lay days to be allowed and the rate of demurrage.

 ARTICLE 653
If the freight should be received without the charter party having been signed, the contract shall be understood as executed in accordance with what appears in the bill of lading, which shall be the only instrument with regard to the freight to determine the rights and obligations of the owner, of the captain, and of the charterer. cdt

 ARTICLE 654

---

The charter parties executed with the intervention of a broker, who certifies to the authenticity of the signatures of the contracting parties made in his presence, shall be full evidence in court; and if said signatures should not agree the ones identical with the signatures the broker must keep in his registry, if kept in accordance to law, shall be invalid.

The contracts shall also be admitted as evidence, even though a broker has not taken part therein, if the contracting parties acknowledge the signatures to be the same as their own.

Should no broker have taken part in the charter party and should the signatures not have been accepted by the broker, doubts shall be decided by what is provided for in the bill of lading, and in the absence thereof by the proofs submitted by the parties.

**ARTICLE 655**
Charter parties executed by the captain in the absence of the agent shall be valid and efficient, even though, in executing them he should have acted in violation of the orders and instructions of the agent or shipowner; but the latter shall have a right of action against the captain to recover damages.

**ARTICLE 656**
If in the charter party the time in which the loading and unloading is to take place is not stated, the customs of the port where these acts take place shall be observed. After the period stipulated or the customary one has passed, and should there not be in the freight contract an express clause fixing the indemnification for the delay, the captain shall be entitled to demand demurrage for the usual and extra lay days which may have elapsed in loading and unloading.

**ARTICLE 657**
If during the voyage the vessel should be rendered unseaworthy the captain shall be obliged to charter another one at his expense, in good condition, to take the cargo to its destination, for which purpose he shall be obliged to look for a vessel not only at the port of arrival but in the other ports within a distance of 150 kilometers.

If the captain should not furnish a vessel to take the cargo to its destination, either through indolence or malice, the freighters, after a demand of the captain to charter a vessel within an unextendible period, may charter one and apply to the judicial authority requesting that the charter party which may have been made be immediately approved.

The same authority shall judicially compel the captain to confirm the charter made by the shippers for his account and under his responsibility.

If the captain, notwithstanding his efforts, should not find a vessel to charter, he shall deposit the cargo at the disposal of the freighters, to whom he shall communicate the facts on the first opportunity presenting itself, the charter being regulated in accordance to law, shall be valid.

If the captain, notwithstanding his efforts, should not find a vessel to charter, he shall deposit the cargo at the disposal of the freighters, to whom he shall communicate the facts on the first opportunity presenting itself, the charter being regulated in accordance to law, shall be valid.

**Is there a valid contract if there was no charter party and bill of lading?**
If we take Art. 653 literally, no. However, if we take into account the fact that delivery of the cargo does not constitute the making of a contract but rather the partial performance thereof, the mere fact of delivery and receipt of such cargo, the good faith and mutual consent with which they have been made, should be a better substitute for the charter party than the bill of lading which is nothing more than proof of such delivery.

**What is primacy?**
It was formerly a small allowance or compensation payable to the master and marines of a ship, to the former for the use of his cables and ropes to discharge the goods of the merchant; to the latter for the lading and unloading in any port of haven. Today, it is no longer a gratuity but is included in the freight rate.

**What is demurrage?**
It is the sum fixed by the contract of carriage, or which is allowed, as remuneration to the owner of a ship for the detention of his vessel beyond the number of days allowed by the charter party for loading and unloading of for sailing. It is an indemnity by ended freight or reward to the vessel in compensation for the earnings she is improperly caused to lose.

**What are lay days?**
Lay days are days allowed to charter parties for loading and unloading the cargo.

**RIGHTS AND OBLIGATIONS OF SHIPOWNERS**

2. Rights and Obligations of Owners

**ARTICLE 669**
The owners or the captain shall observe in charter parties the capacity of the vessel or that expressly designated in the registry of the same, a difference greater than 2 per cent between that stated and her true capacity not being permissible.

If the owners or the captain should contract to carry a greater amount of cargo than the vessel can hold, in view of her tonnage, they shall indemnify the freighters whose contracts they do not fulfill for the losses they may have caused them by reason of their default, according to the cases, viz:

If the vessel has been chartered by one freighter only, and there should appear to be an error or fraud in her capacity, and the charterer should not wish to rescind the contract, when he has a right to do so, the charter should be reduced in proportion to the cargo the vessel can not receive, the person from whom the vessel is chartered being furthermore obliged to indemnify the charterer for the losses he may have caused.

If, on the contrary, there should be several charter parties, and by reason of the want of space all the cargo contracted for can not be received, and none of the charterers desires to rescind the contract, preference shall be given to the person who has already loaded and arranged the freight in the vessel, and the rest shall take the place corresponding to them in the order of the dates of their contracts.

Should there be no priority, the charterers may load, if they wish, pro rata of the amounts of weight or space they may have engaged, and the person from whom the vessel was chartered shall be obliged to indemnify them for the loss and damage.

**ARTICLE 670**
If the person from whom the vessel is chartered, after receiving a part of the freight, should not find sufficient to make up at least three-fifths of the amount which the vessel can hold, at the price he
may have fixed, he may substitute for the transportation another vessel inspected and declared suitable for the same voyage, the expenses of transfer being defrayed by him, as well as the increase, should there be any, in the price of the charter. Should he not be able to make this change, the voyage shall be undertaken at the time agreed upon; and should no time have been fixed, within fifteen days from the time of beginning to load, should nothing to the contrary have been stipulated.

If the owner of the part of the freight already loaded should procure some more at the same price and under similar or proportionate conditions to those accepted for the freight received, the person from whom the vessel is chartered or the captain can not refuse to accept the rest of the cargo; and should he do so, the freighter shall have a right to demand that the vessel put to sea with the cargo she may have on board.

ARTICLE 671
After three-fifths of the vessel is loaded, the person from whom she is chartered can not, without the consent of the charterers or freighters substitute the vessel designated in the charter party by another one, under the penalty of making himself thereby liable for all the losses and damages occurring during the voyage to the cargo of the person who did not consent to the change.

ARTICLE 672
If the vessel has been chartered in whole, the captain can not, without the consent of the person chartering her, accept freight from any other person; and should he do so, said charterer may oblige him to unload it and require him to indemnify him for the losses suffered thereby.

ARTICLE 673
The person from whom the vessel is chartered shall be liable for all the losses caused the charterer by reason of the voluntary delay of the captain in putting to sea, according to the rules prescribed, provided he has been requested to put to sea at the proper time through a notary or judicially.

ARTICLE 674
If the charterer should carry to the vessel more freight than that contracted for, the excess may be admitted in accordance with the price stipulated in the contract, if it can be well stowed without injuring the other freighters, but if in order to stow said freight it should be necessary to stow it in such manner as to throw the vessel out of trim the captain must refuse it or unload it at the expense of its owner.

The captain may likewise, before leaving the port, unload the merchandise placed on board clandestinely, or transport it, if he can do so and keep the vessel in trim, demanding by way of freighitage the highest price which may have been stipulated for said voyage.

ARTICLE 675
If the vessel has been chartered to receive the cargo in another port, the captain shall appear before the consignee designated in the charter party, and, should the latter not deliver the cargo to him, he shall inform the charterer and await his instructions, and in the meantime the lay days agreed upon shall begin to run, or those allowed by custom in the port, unless there is a special agreement to the contrary.

Should the captain not receive an answer within the time necessary therefor, he shall make efforts to find freight; and should he not find any after the lay days and extra lay days have elapsed, he shall make a protest and return to the port where the charter was made.

The charterer shall pay the freighitage in full, discounting that which may have been earned on the merchandise which may have been carried on the voyage out or on the return trip, if carried for the account of third persons. The same shall be done if a vessel, having been chartered for the round trip, should not be given any cargo for her return.

ARTICLE 676
The captain shall lose the freighitage and shall indemnify the charterers if the latter should prove, even against the certificate of inspection, should one have taken place at the port of departure, that the vessel was not in a condition to navigate at the time of receiving the cargo.

ARTICLE 677
The charter party shall be enforced if the captain should not have any instructions from the charterer, and a declaration of war or a blockade should take place during the voyage. In such case the captain shall be obliged to make the nearest safe and neutral port, and request and await orders from the freighter; and the expenses incurred and salaries earned during the detention shall be paid as general average.

If, by orders of the freighter, the cargo should be discharged at the port of arrival, the freight for the voyage out shall be paid in full.

ARTICLE 678
If the time necessary, in the opinion of the judge or court, in which to receive orders from the freighters should have elapsed without the captain having received any instructions, the cargo shall be deposited, and it shall be liable for the payment of the freight and expenses incurred by reason of the delay which shall be paid from the proceeds of the part first sold.

OBLIGATIONS OF CHARTERERS
3. Obligations of Charterers

ARTICLE 679
The charterer of an entire vessel may subcharter the whole or part thereof for the amounts he may consider most convenient, without the captain being allowed to refuse to receive on board the freight delivered by the second charterers, provided the conditions of the first charter are not changed, and that the person to whom the vessel is chartered be paid the full price agreed upon even though the full cargo is not embarked, with the limitation established in the next article. ctdai

ARTICLE 680
A charterer who does not make up the full cargo he bound himself to ship shall pay the freighitage of the amount he fails to ship, if the captain did not take other freight to make up the cargo of the vessel, in which case he shall pay the first charterer the difference should there be any.

ARTICLE 681
If the charterer should ship goods different from those indicated at the time of executing the charter
party, without the knowledge of the person from whom the vessel was chartered or of the captain, and should thereby give rise to losses, by reason of confiscation, embargo, detention, or other causes, to the person from whom the vessel was chartered or to the shippers, the person giving rise thereto shall be liable with the value of his shipment and furthermore with his property, for the full indemnity to all those injured through his fault.

ARTICLE 682
If the merchandise shipped should have been for the purpose of illicit commerce, and was taken on board with the knowledge of the person from whom the vessel was chartered or of the captain, the latter, jointly with the owner of the same, shall be liable for all the losses which may be caused the other shippers, and even though it may have been agreed, they can not demand any indemnity whatsoever of the charterer for the damage caused the vessel.

ARTICLE 683
In case of making a port to repair the hull, machinery, or equipment of the vessel, the freighters must wait until the vessel is repaired, being permitted to unload her at their own expense should they deem it advisable.
If, for any reason, the cargo subject to deterioration, the freighters or the court, or the consul, or the competent authority in a foreign land should order the merchandise to be unloaded, the expenses of loading and unloading shall be for the account of the former.

ARTICLE 684
If the charterer, without the occurrence of any of the cases of force majeure mentioned in the foregoing article, should wish to unload his merchandise before arriving at the port of destination, he shall pay the full freight, the expenses of the stop made at his request, and the losses and damages caused the other freighters, should there be any.

ARTICLE 685
In charters for transportation of general freight any of the freighters may unload the merchandise before the beginning of the voyage, by paying one-half the freight, the expense of stowing and restowing the cargo, and any other damage which may be caused the other shippers.

ARTICLE 686
After the vessel has been unloaded and the cargo placed at the disposal of the consignee, the latter must immediately pay the captain the freight due and the other expenses to which he may be liable for said cargo.
The primage must be paid in the same proportion and at the same time as the freight, all the changes and modifications to which the latter should be subject also governing the former.

ARTICLE 687
The charters and freighters can not abandon merchandise damaged on account of the inherent vice of the goods or by reason of an accidental case, for the payment of the freight and other expenses. If, however, the cargo should consist of liquids and should they have leaked out, there not remaining in the containers more than one-quarter of their contents.

TEXT END
1. A declaration of war or interdiction of commerce with the power to whose ports the vessel was going to sail.
2. A condition of blockade of the port of destination of said vessel, or the breaking out of an epidemic after the contract was executed.
3. The impossibility of the vessel to navigate, by means of a public instrument.
4. An indefinite detention, by reason of an embargo of the vessel by order of the government or for any other reason independent of the will of the agent.
5. The impossibility of the vessel to navigate, without fault of the captain or agent.

The unloading shall be made for the account of the charterer.

ARTICLE 691
If the vessel can not put to sea on account of the closing of the port of departure, or any other temporary cause, the charter shall be in force without any of the contracting parties having a right to claim damages. The subsistence and wages of the crew shall be considered as general average. During the interruption the charterer may, at the proper time and for his own account, unload and load the merchandise, paying demurrage if the reloading should continue after the reason for the detention has ceased.

ARTICLE 692
A charter party shall be partially rescinded, unless there is an agreement to the contrary, and the captain shall only be entitled to the freight for the voyage out, if, by reason of a declaration of war, closing of ports, or interdiction of commercial relations during the voyage, the vessel should make the port designated for such a case in the instructions of the charterer.

2. LOANS ON BOTTOMRY AND RESPONDENTIA

<table>
<thead>
<tr>
<th>Ordinary Loan</th>
<th>Loan on Bottomry or Respondentia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collateral is not required</td>
<td>Collateral required</td>
</tr>
<tr>
<td>Collateral may be any property, real or personal</td>
<td>Collateral must be a vessel or cargo subject to maritime risks</td>
</tr>
<tr>
<td>Absolutely repayable</td>
<td>Depends upon the safe arrival at the port of the collateral of the loan</td>
</tr>
<tr>
<td>Subject to usury law</td>
<td>Not subject to usury law</td>
</tr>
<tr>
<td>Need not be in writing except the interest</td>
<td>Must be in writing</td>
</tr>
<tr>
<td>Need not be registered to be binding on third persons</td>
<td>Must be registered in the registry of vessels of the port of entry of registry of the vessel</td>
</tr>
<tr>
<td>Loss of collateral does not extinguish the same</td>
<td>Loss of collateral extinguishes the same</td>
</tr>
</tbody>
</table>

LOAN ON BOTTOMRY, DEFINED
It is a contract in the nature of a mortgage, by which the owner of the ship borrows money for the use, equipment and repair of the vessel for a definite term, and pledges the ship as a security for its repayment, with maritime or extraordinary interest on account of the maritime risks to be borne by the lender, it being stipulated that if the ship be lost in the course of the specific voyage or during the limited time, by any of the perils enumerated in the contract, the lender shall also lose his money.

LOAN ON RESPONDENTIA, DEFINED
It is a contract made on the goods laden on board the ship, and which are to be sold or exchanged in the course of the voyage, the borrower’s personal responsibility being deemed the principal security for the performance of the contract. The lender must be paid his principal and interest, though the ship perishes, provided that the goods are saved.

CHARACTER OF LOAN, ART. 719

ARTICLE 719
A loan on bottomry or respondentia shall be considered that which the repayment of the sum loaned and the premium stipulated, under any condition whatsoever, depends on the safe arrival in port of the goods on which it is made, or of their value in case of accident.

FORMS AND REQUISITES

ARTICLE 720
Loans on bottomry or respondentia may be executed:
1. By means of a public instrument.
2. By means of a bond signed by the contracting parties and the broker who took part therein, cdt.
3. By means of a private instrument.
Under whichever of these forms the contract is executed, it shall be entered in the certificate of the registry of the vessel and shall be recorded in the commercial registry, without which requisites the credits originating from the same shall not have, with regard to other credits, the preference which, according to their nature, they should have, although the obligation shall be valid between the contracting parties.

The contracts made during a voyage shall be governed by the provisions of Articles 583 and 611, and shall be effective with regard to third persons from the date of their execution, if they should be recorded in the commercial registry of the port of registry of the vessel before eight days have elapsed from the date of her arrival. If said eight days should elapse without the record having been made in the commercial registry, the contracts made during the voyage of a vessel shall not have any effect with regard to third persons, except from the day and date of their entry.

In order that the bonds of the contracts celebrated in accordance with No. 2 may have legal force, they must conform to the registry of the broker who took part therein. In those celebrated in accordance with No. 3 the acknowledgment of the signature must precede.
Contracts which are not reduced to writing shall not be the basis for a judicial action.

ARTICLE 721
In a bottomry or respondentia bond there must be stated:
1. The kind, name, and registry of the vessel.
2. The name, surname, and domicile of the captain.

29 The definitions of loan on bottomry and loan on respondentia were asked in 1980 and 1975.
3. The names, surnames, and domicile of the person giving and of the person receiving the loan.
4. The amount of the loan and the premium stipulated.
5. The time for repayment.
6. The goods pledged to secure repayment.
7. The voyage for which the risk is run.

ARTICLE 722
The bonds may be issued to order, in which case they shall be transferable by indorsement, and the assignee shall acquire all the rights and run all the risks corresponding to the indorser.

ON WHAT CONSTITUTED

ARTICLE 724
The loans may be constituted jointly or separately:
1. On the hull of the vessel.
2. On the rigging.
3. On the equipment, provisions, and fuel.
4. On the engine, if the vessel is a steamer.
5. On the cargo.
If the loan is constituted on the hull of the vessel, there shall be understood as also subject to the liability of the loan, the rigging, equipment and other goods, provisions, fuel, steam engines, and the freight earned during the voyage subject to the loan.
If the loan is made on the cargo, all that constitutes the same shall be subject to the repayment; and if on a particular object of the vessel or of the cargo, the object exclusively and specifically mentioned only shall be liable.

ARTICLE 725
No loans can be made on the salaries of the crew, nor on the profits which it is expected to earn.

AMOUNT

ARTICLE 723
Loans made be made in goods and in merchandise, fixing their value in order to determine the principal of the loan.

ARTICLE 726
If the lender should prove that he loaned a larger amount than the value of the article liable for the bottomry loan, by reason of fraudulent measures employed by the borrower the loan shall only be valid for the amount at which said object is appraised by experts.
The surplus principal shall be returned with legal interest for the whole period of the duration of the disbursement.

ARTICLE 727
If the full amount of the loan contracted to load the vessel should not be made use of for the cargo, the surplus shall be returned before clearing.
The same procedure shall be observed with regard to the goods taken as a loan if they could not all have been loaded.

ARTICLE 728
The loan which the captain takes at the point of residence of the owners of the vessel shall only affect that part of the latter which belongs to the captain, if the other owners or their agents should not have given their express authorization thereto or should not have taken part in the transaction.
If one or more of the owners should be requested to furnish the amount necessary to repair or provision the vessel, and should not do so within twenty-four hours, the interest which the parties in default may have in the vessel shall be liable for the loan in the proper proportion.
Outside of the residence of the owners the captain may contract loans in accordance with the provisions of Articles 583 and 611.

BY WHOM

ARTICLE 611
In order to comply with the obligations mentioned in the foregoing article, the captain, when he has no funds and does not expect to receive any from the agent, shall procure the same in the successive order stated below:
1. By requesting said funds of the consignees or correspondents of a vessel.
2. By applying to the consignees of the cargo or to the persons interested therein.
3. By borrowing the amount required by means of a bottomry bond.
4. By selling a sufficient amount of the cargo to cover the amount absolutely necessary to repair the vessel, and to equip her to pursue the voyage.
In the two latter cases he must apply to the judicial authority of the port, if in Spain * and to the Spanish * consul, if in a foreign country; and where there should be none, to the local authority, proceeding in accordance with the prescriptions of Article 583, and with the provisions of the law of civil procedure.

ARTICLE 617
The captain can not contract loans on respondencia, and should he do so the contracts shall be void.
Neither can he borrow money on bottomry for his own transactions, except on the portion of the vessel he owns, provided no money has been previously borrowed on the whole vessel, and provided there does not exist any other kind of lien or obligation thereon. When he is permitted to do so, he must necessarily state what interest he has in the vessel.
In case of violation of this article the principal, interest, and costs shall be charged to the private account of the captain, and the agent may furthermore have the right to discharge him.

ARTICLE 583
If while on voyage the captain should find it necessary to contract one or more obligations mentioned in subdivisions 8 and 9 of Article 580, he shall apply to the judge or court if he is in Philippine territory, and otherwise to the consul of the Republic of the Philippines, should there be one, and in his absence, to the judge or court or proper local authority, presenting the certificate of the registration sheet treated of in Article 612 and the instruments proving the obligation contracted.
The judge or court, the consul, or the local authority, as the case may be, in view of the result of the proceedings instituted, shall make a temporary memorandum of their result in the certificate, in order that it may be recorded in the registry when the vessel returns to the port of its registry, or so that it can be admitted as a legal and preferred obligation in case of sale before its return, by reason of the sale of the vessel on account of a declaration of unseaworthiness.
EFFECTS OF CONTRACT

ARTICLE 719
A loan on bottomry or respondentia shall be considered that which the repayment of the sum loaned and the premium stipulated, under any condition whatsoever, depends on the safe arrival in port of the goods on which it is made, or of their value in case of accident.

ARTICLE 726
If the lender should prove that he loaned a larger amount than the value of the article liable for the bottomry loan, by reason of fraudulent measurements employed by the borrower the loan shall only be valid for the amount at which said object is appraised by experts.

The surplus principal shall be returned with legal interest for the whole period of the duration of the disbursement.

ARTICLE 727
If the full amount of the loan contracted to load the vessel should not be made use of for the cargo, the surplus shall be returned before clearing.

The same procedure shall be observed with regard to the goods taken as a loan if they could not all have been loaded.

ARTICLE 729
Should the goods on which money is taken not be subjected to any risk, the contract shall be considered an ordinary loan, the borrower being under the obligation to return the principal and interest at the legal rate, if the interest stipulated should not have been lower.

ARTICLE 730
Loans made during the voyage shall have preference over those made before the clearing of the vessel, and they shall be graduated by the inverse order to that of their dates.

The loans for the last voyage shall have preference over prior ones.

Should several loans have been made at a port made under stress and for the same purpose, all of them shall be paid pro rata.

G. Bill of Lading

1. CONTENTS

ARTICLE 706
The captain and the freighter of the vessel are obliged to draft the bill of lading, in which there shall be stated:
1. The name, registry, and tonnage of the vessel.
2. The name of the captain and his domicile.
3. The port of loading and that of unloading.
4. The name of the shipper.
5. The name of the consignee, if the bill of lading is issued to order.
6. The quantity, quality, number of packages, and marks of the merchandise.
7. The freight and the primage stipulated.

The bill of lading may be issued to bearer, to order, or in the name of a specific person, and must be signed within twenty-four hours after the cargo has been received on board, the freighter being able to request the unloading thereof at the expense of the captain should he not sign it, and in every case indemnity for the losses and damages suffered thereby.

ARTICLE 707
Four true copies of the original bill of lading shall be made, all of which shall be signed by the captain and by the freighter. Of these copies the freighter shall keep one and send another to the consignee; the captain shall take two, one for himself and another for the agent.

There may, furthermore, be made as many copies of the bill of lading as may be considered necessary by the persons interested; but when they are issued to order or to the bearer there shall be stated in all the copies, be they either of the first four or of the subsequent ones, the destination of each one, stating whether it is for the agent, for the captain, for the freighter, or for the consignee.

If the copy sent to the latter should be duplicated there must be stated in said duplicate this fact, and that it is not valid except in case of the loss of the first one.

ARTICLE 713
If before delivering the cargo a new bill of lading should be demanded of the captain, it being alleged that the previous ones are not presented on account of their loss or for any other sufficient cause, he shall be obliged to issue it, provided security for the value of the cargo is given to his satisfaction; but without changing the consignment and stating therein the circumstances prescribed in the last paragraph of Article 707, when the bills of lading referred to therein are in question, under the penalty otherwise to be liable for said cargo if not properly delivered through his fault.

ARTICLE 714
If before the vessel puts to sea the captain should die or should discontinue in his position through any accident, the freighters shall have a right to demand of the new captain the ratification of the first bills of lading, and the latter must do so, provided all the copies previously issued be presented or returned to him, and it should appear from an examination of the cargo that they are correct.

The expenses arising from the examination of the cargo shall be defrayed by the agent, without prejudice to the right of action of the latter against the first captain, if he ceased to be such through his own fault. Should said examination not be made, it shall be understood that the new captain accepts the cargo as it appears from the bills of lading issued.

2. PROBATIVE VALUE

ARTICLE 709
A bill of lading drawn up in accordance with the provisions of this title shall be proof as between all those interested in the cargo and between the latter and the underwriters, proof to the contrary being reserved by the latter.

ARTICLE 710
Should the bills of lading not agree, and there should not be observed any correction or erasure in any of them, those possessed by the freighter or consignee signed by the captain shall be proof against the captain or agent in favor of the

---

30 The presentation of the bill of lading and the liability of the ship owner when bill of lading is not presented were asked in 2005. In 1998 it definition and two-fold character was also asked.
consignee or freighter; and those possessed by the captain or agent signed by the freighter shall be proof against the freighter or consignee in favor of the captain or agent.

H. Passengers on Sea Voyage

1. NATURE OF CONTRACT

ARTICLE 695
The right to passage, if issued to a specified person, can not be transferred without the consent of the captain or of the consignee.

2. OBLIGATIONS OF PASSENGERS

ARTICLE 693
Should the passage price not have been agreed upon, the judge or court shall summarily fix it, after a statement of experts.

ARTICLE 699
After the contract has been rescinded, before or after the commencement of the voyage, the captain shall have a right to claim payment for what he may have furnished the passengers.

ARTICLE 704
The captain, in order to collect the price of the passage and expenses of maintenance, may retain the goods belonging to the passenger, and in case of the sale of the same he shall be given preference over the other creditors, acting in the same way as in the collection of freight.

ARTICLE 694
Should the passenger not arrive on board at the time fixed, or should leave the vessel without permission from the captain, when the latter is ready to leave the port, the captain may continue the voyage and demand the full passage price.

ARTICLE 700
In all that relates to the preservation of order and police on board the vessel the passengers shall conform to the orders given by the captain, without any distinction whatsoever.

3. RIGHTS OF PASSENGERS

ARTICLE 697
If before beginning the voyage it should be suspended through the sole fault of the captain or agent, the passengers shall be entitled to have their passage refunded and to recover for losses and damages; but if the suspension was due to an accidental cause, or to force majeure, or to any other cause beyond the control of the captain or agent, the passengers shall only be entitled to the return of the passage money.

ARTICLE 698
In case a voyage already begun should be interrupted the passengers shall be obliged only to pay the passage in proportion to the distance covered, and shall not be entitled to recover for losses and damages if the interruption is due to an accidental cause or to force majeure, but have a right to indemnity if the interruption should have been caused by the captain exclusively. If the interruption should be by reason of the disability of the vessel, and the passenger should agree to await her repair, he can not be required to pay any increased price of passage, but his living expenses during the delay shall be for his own account. In case the departure of the vessel is delayed the passengers have a right to remain on board and to be furnished with food for the account of the vessel, unless the delay is due to an accidental cause or to force majeure. If the delay should exceed ten days, the passengers who request it shall be entitled to the return of the passage; and if it were due exclusively to the captain or agent they may furthermore demand indemnity for losses and damages.

A vessel which is exclusively destined to the transportation of passengers must take them directly to the port or ports of destination, no matter what the number of passengers may be, making all the stops indicated in her itinerary.

4. RESPONSIBILITIES OF CAPTAIN

ARTICLE 701
The convenience or the interest of the passengers shall not obligate nor empower the captain to stand in shore or enter places which may take the vessel out of her course, nor to remain in the ports he must or is under the necessity of touching for a period longer than that required for the business of the navigation.

ARTICLE 702
In the absence of an agreement to the contrary, it shall be understood that the maintenance of the passengers during the voyage is included in the price of the passage; but should said maintenance be for the account of the latter, the captain shall be under the obligation, in case of necessity, to furnish them the victuals at a reasonable price necessary for their maintenance.

ARTICLE 703
A passenger shall be looked upon as a shipper in so far as the goods he carries on board are concerned, and the captain shall not be liable for what said passenger may preserve under his immediate and special custody unless the damage arises from an act of the captain or of the crew.

ARTICLE 705
In case of the death of a passenger during the voyage the captain is authorized, with regard to the body, to take the steps required by the circumstances, and shall carefully take care of the papers and goods there may be on board belonging to the passenger, observing the provisions of Case No. 10 of Article 612 with regard to members of the crew.

ARTICLE 612
The following obligations are inherent in the office of captain:

1. To have on board before starting on a voyage a detailed inventory of the hull, engines, rigging, tackle, stores, and other equipments of the vessel; the navigation certificate; the roll of the persons who make up the crew of the vessel, and the contracts entered into with the crew; the list of passengers; the health certificate; the certificate of the registry proving the ownership of the vessel, and all the obligations which encumber the same up to that date; the charters or authenticated copies thereof; the invoices or manifest of the cargo, and the instrument of the expert visit or inspection, should it have been made at the port of departure.
2. To have a copy of this Code on board.
3. To have three folioed and stamped books, placing at the beginning of each one a note of the number of folios it contains, signed by the maritime official, and in his absence by the competent authority.

In the first book, which shall be called "log book," he shall enter every day the condition of the atmosphere, the prevailing winds, the course sailed, the rigging carried, the horsepower of the engines, the distance covered, the maneuvers executed, and other incidents of navigation. He shall also enter the damage suffered by the vessel in her rigging and engines, if any, and the nature of the repairs made; the name of what is its cause, as well as the imperfections and averages of the cargo, and the effects and consequences of the jettison, should there be any; and in cases of grave resolutions which require the advice or a meeting of the officers of the vessel, or even of the passengers and crew, he shall record the decision of the passengers. For the information indicated he shall make use of the binnacle book, and of the steam or engine book kept by the engineer.

In the second book, called the "accounting book," he shall enter all the amounts collected and paid for the account of the vessel, entering specifically article by article, the sources of the collection, and the amounts invested in provisions, repairs, and all other expenses. He shall furthermore enter therein a list of all the members of the crew, stating their domiciles, their wages and salaries, and the amounts they may have received on account, either directly or by delivery to their families.

In the third book, called "freight book," he shall record the entry and exit of all the goods, stating their marks and packages, names of the shippers and of the consignees, ports of loading and unloading, and the freight earned. In the same book he shall record the names and places of departure of the passengers, and the number of packages of which their baggage consists, and the price of the passage.

4. To make, before receiving the freight, with the officers of the crew, and the two experts, if required by the shippers and passengers, an examination of the vessel, in order to ascertain whether she is watertight, and whether the rigging and engines are in good condition; and if she has the equipment required for good navigation, preserving a certificate of the memorandum of this inspection, signed by all the persons who may have taken part therein, under their liability.

The experts shall be appointed one by the captain of the vessel and the other one by the person responsible for the examination, and in case of disagreement a third shall be appointed by the marine authority of the port.

5. To remain constantly on board the vessel with the crew during the time the freight is taken on board and carefully watch the stowage thereof; not to consent to any merchandise or goods of a dangerous character to be taken on, such as inflammables or explosives, without the precautions which are recommended for their packing, management and isolation; not to permit that any freight be carried on deck which by reason of its disposition, volume, or weight makes the work of the sailors difficult, and which might endanger the safety of the vessel; and if, on account of the nature of the merchandise, the special character of the shipment, and principally the favorable season it takes place, he allows merchandise to be carried on deck, he must hear the opinion of the officers of the vessel, and have the consent of the shippers and of the agent.

6. To demand a pilot at the expense of the vessel whenever required by navigation, and principally when the arrival of a port, canal, roadstead or anchoring place is to be entered with which neither he, the officers nor the crew are acquainted.

7. To be on deck at the time of sighting land and to take command on entering and leaving ports, canals, roadsteads, and rivers, unless there is a pilot on board discharging his duties. He shall not spend the night away from the vessel except for serious causes or by reason of official business.

8. To present himself, when making a port or in distress, to the maritime authority if in Spain * and to the Spanish * consul if in a foreign country.

9. To take the steps necessary before the competent authority in order to enter in the certificate of the Commercial Registry of the vessel the obligations which he may contract in accordance with Article 58.

10. To put in a safe place and keep all the papers and belongings of any members of the crew who might die on the vessel, drawing up a detailed inventory, in the presence of passengers as witnesses, and, in their absence, of members of the crew.

11. To conduct himself according to the rules and precepts contained in the instructions of the agent, being liable for all that he may do in violation thereof.

12. To give an account to the agent from the port where the vessel arrives, of the reason thereof, taking advantage of the semaphore, telegraph, mail, etc., according to the cases; notify him the freight he may have received, stating the name and domicile of the shippers, freight earned, and amounts borrowed on bottomry bond, advise him of his departure, and give him any information and data which may be of interest.

13. To observe the rules on the situation of lights and evolutions to prevent collisions.

14. To remain on board in case of danger to the vessel, until all hope to save her is lost, and before abandoning her to hear the officers of the crew, abiding by the decision of the majority; and if he should have to take a boat he shall take with him, before anything else, the books and papers, and then the articles of most value, being obliged to prove in case of the loss of the books and papers that he did all he could to save them.

15. In case of wreck he shall make the proper protest in due form at the first port reached, before the competent authority or the Spanish * consul, within twenty-four hours, stating therein all the incidents of the wreck, in accordance with case 8 of this article.
16. To comply with the obligations imposed by the laws and rules of navigation, customs, health, and others.

I. Carriage of Goods by Sea Act
(Commonwealth Act No. 65; Public Act No. 65; Public Act 521, 74th US Congress)

CA No. 65 ACT TO DECLARE THAT
PUBLIC ACT NUMBERED FIVE HUNDRED AND
TWENTY-ONE, KNOWN AS "CARRIAGE OF
GOODS BY SEA ACT," ENACTED BY THE
SEVENTY-FOURTH CONGRESS OF THE UNITED
STATES, BE ACCEPTED, AS IT IS HEREBY
ACCEPTED BY THE NATIONAL ASSEMBLY

WHEREAS, the Seventy-fourth Congress of the United States enacted Public Act Numbered Five hundred and twenty-one, entitled:

"Carriage of Goods by Sea";

WHEREAS, the primordial purpose of the said Acts is to bring about uniformity in ocean bills of lading and to give effect to the Brussels Treaty, signed by the United States with other powers;

WHEREAS, the Government of the United States has left it to the Philippine Government to decide whether or not the said Act shall apply to carriage of goods by sea in foreign trade to and from Philippine ports;

WHEREAS, the said Act of Congress contains advanced legislation, which is in consonance with modern maritime rules and the practices of the great shipping countries of the world;

WHEREAS, shipping companies, shippers, and marine insurance companies, and various chambers of commerce, which are directly affected by such legislation, have expressed their desire that said Congressional Act be made applicable and extended to the Philippines; therefore,

Be it enacted by the National Assembly of the Philippines:

Section 1

That the provisions of Public Act Numbered Five hundred and twenty-one of the Seventy-fourth Congress of the United States, approved on April sixteenth, nineteen hundred and thirty-six, be accepted, as it is hereby accepted to be made applicable to all contracts for the carriage of goods by sea to and from Philippine ports in foreign trade: Provided, That nothing in the Act shall be construed as repealing any existing provision of the Code of Commerce which is now in force, or as limiting its application.

Section 2

This Act shall take effect upon its approval.

Approved: October 22, 1936.


Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That every bill of lading or similar document of title which is evidence of a contract for the carriage of goods by sea to or from ports of the United States, in foreign trade, shall have effect subject to the provisions of the Act.

TITLE I

Section 1

When used in this Act —

(a) The term "carrier" includes the owner or the charterer who enters into a contract of carriage with a shipper.

(b) The term "contract of carriage" applies only to contracts of carriage covered by a bill of lading or any similar document of title, insofar as such document relates to the carriage of goods by sea, including any bill of lading or any similar document as aforesaid issued under or pursuant to a charter party from the moment at which such bill of lading or similar document of title regulates the relations between a carrier and a holder of the same.

(c) The term "goods" includes goods, wares, merchandise, and articles of every kind whatsoever, except live animals and cargo which by the contract of carriage is stated as being carried on deck and is so carried.

(d) The term "ship" means any vessel used for the carriage of goods by sea.

(e) The term "carriage of goods" covers the period from the time when the goods are loaded on to the time when they are discharged from the ship.

RISKS

Section 2

Subject to the provisions of section 6, under every contract of carriage of goods by sea, the carrier in relation to the loading handling, stowage, carriage, custody, care, and discharge of such goods, shall be subject to the responsibilities and liabilities and entitled to the rights and immunities hereinafter set forth.

RESPONSIBILITIES AND LIABILITIES

Section 3

1) The carrier shall be bound, before and at the beginning of the voyage, to exercise due diligence to —

(a) Make the ship seaworthy;

(b) Properly man, equip, and supply the ship;
(c) Make the holds, refrigerating and cooling chambers, and all other parts of the ship in which goods are carried, fit and safe for their reception carriage and preservation.

(2) The carrier shall properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried.

(3) After receiving the goods into his charge the carrier, or the master or agent of the carrier, shall, on demand of the shipper, issue to the shipper a bill of lading showing among other things —

(a) The leading marks necessary for identification of the goods as the same are furnished in writing by the shipper before the loading of such goods starts, provided such marks are stamped or otherwise shown clearly upon the goods if uncovered, or on the cases or coverings in which such goods are contained, in such a manner as should ordinarily remain legible until the end of the voyage.

(b) Either the number of packages or pieces, or the quantity or weight, as the case may be, as furnished in writing by the shipper.

(c) The apparent order and condition of the goods: Provided, That no carrier, master, or agent of the carrier, shall be bound to state or show in the bill of lading any marks, number, quantity, or weight which he has reasonable ground for suspecting not accurately to represent the goods actually received, or which he has had no reasonable means of checking.

(4) Such a bill of lading shall be prima facie evidence of the receipt by the carrier of the goods as therein described in accordance with paragraphs (3) (a), (b), and (c) of this section: Provided, That nothing in this Act shall be construed as repealing or limiting the application of any part of the Act, as amended, entitled "An Act relating to bills of lading in interstate and foreign commerce," approved August 29, 1916 (U. S. C. title 49, secs. 81-124), commonly known as the "Pomerene Bills of Lading Act."

(5) The shipper shall be deemed to have guaranteed to the carrier the accuracy at the time of shipment of the marks, number, quantity, and weight, as furnished by him; and the shipper shall indemnify the carrier against all loss damages, and expenses arising or resulting from inaccuracies in such particulars. The right of the carrier to such indemnity shall in no way limit his responsibility and liability under the contract of carriage or to any person other than the shipper.

(6) Unless notice of loss or damage and the general nature of such loss or damage be given in writing to the carrier or his agent at the port of discharge before or at the time of the removal of the goods into the custody of the person entitled to delivery thereof under the contract of carriage, such removal shall be prima facie evidence of the delivery by the carrier of the goods as described in the bill of lading. If the loss or damage is not apparent, the notice must be given within three days of the delivery.

Said notice of loss or damage may be endorsed upon the receipt for the goods given by the person taking delivery thereof.

The notice in writing need not be given if the state of the goods has at the time of their receipt been the subject of joint survey or inspection.

In any event the carrier and the ship shall be discharged from all liability in respect of loss or damage unless suit is brought within one year after delivery of the goods or the date when the goods should have been delivered: Provided, That if a notice of loss or damage, either apparent or concealed, is not given as provided for in this section, that fact shall not affect or prejudice the right of the shipper to bring suit within one year after the delivery of the goods or the date when the goods should have been delivered.

In the case of any actual or apprehended loss or damage the carrier and the receiver shall give all reasonable facilities to each other for inspecting and tallying the goods.

(7) After the goods are loaded the bill of lading to be issued by the carrier, master, or agent of the carrier to the shipper shall, if the shipper so demands, be a "shipped" bill of lading Provided, That if the shipper shall have previously taken up any document of title to such goods, he shall surrender the same as against the issue of the "shipped" bill of lading, but at the option of the carrier such document of title may be noted at the port of shipment by the carrier, master, or agent with name or name the names of the ship or ships upon which the goods have been shipped and the date or dates of shipment, and when so noted the same shall for the purpose of this section be deemed to constitute a "shipped" bill of lading.

(8) Any clause, covenant, or agreement in a contract of carriage relieving the carrier or the ship from liability for loss or damage to or in connection with the goods, arising from negligence, fault, or failure in the duties and obligations provided in this section, or lessening such liability otherwise than as provided in this Act, shall be null and void and of no effect. A benefit of insurance in favor of the carrier, or similar clause, shall be deemed to be a clause relieving the carrier from liability.

RIGHTS AND IMMUNITIES

Section 4

(1) Neither the carrier nor the ship shall be liable for loss or damage arising or resulting from unseaworthiness unless caused by want of due diligence on the part of the carrier to make the ship seaworthy, and to secure that the ship is properly manned, equipped, and supplied, and to make to the holds, refrigerating and cool chambers, and all other parts of the ship in which goods are carried fit and safe for their reception, carriage, and preservation in accordance with the provisions of paragraph (1) of section 3. Whenever loss or damage has resulted from unseaworthiness, the burden of proving the exercise of due diligence...
shall be on the carrier or other persons claiming exemption under the section.

(2) Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from —

(a) Act, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or in the management of the ship;

(b) Fire, unless caused by the actual fault or privity of the carrier;

(c) Perils, dangers, and accidents of the sea or other navigable waters;

(d) Act of God;

(e) Act of war,

(f) Act of public enemies;

(g) Arrest or restraint of princes, rulers, or people, or seizure under legal process;

(h) Quarantine restrictions;

(i) Act or omission of the shipper or owner of the goods, his agent or representative;

(j) Strikes or lockouts or stoppage or restraint of labor from whatever cause, whether partial or general; Provided, That nothing herein contained shall be construed to relieve a carrier from responsibility for the carrier's own acts;

(k) Riots and civil commotions

(l) Saving or attempting to save life or property at sea;

(m) Wastage in bulk or weight or any other loss or damage arising from inherent defect, quality, or vice of the goods;

(n) Insufficiency of packing;

(o) Insufficiency of inadequacy of marks;

(p) Latent defects not discoverable by due diligence; and

(q) Any other cause arising without the actual fault and privity of the carrier and without the fault or neglect of the agents or servants of the carrier, but the burden of proof shall be on the person claiming the benefit of this exception to show that neither the actual fault or privity of the carrier nor the fault or neglect of the agents or servants of the carrier contributed to the loss or damage.

(3) The shipper shall not be responsible for loss or damage sustained by the carrier or the ship arising from any cause without the act, fault, or neglect of the shipper, his agents, or servants.

(4) Any deviation in saving or attempting to save life or property at sea, or any reasonable deviation shall not be deemed to be an infringement or breach of this Act or of the contract of carriage, and the carrier shall not be liable for any loss or damage resulting therefrom: Provided, however, That if the deviation is for the purpose of loading cargo or unloading cargo or passengers it shall, prima facie, be regarded as unreasonable.

(5) Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with the transportation of goods in an amount exceeding $600 per package lawful money of the United States, or in case of goods not shipped in packages, per customary freight unit, or the equivalent of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading. This declaration, if embodied in the bill of lading, shall be prima facie evidence, but shall not be conclusive on the carrier.

By agreement between the carrier, master, or agent of the carrier, and the shipper another maximum amount than that mentioned in this paragraph may be fixed: Provided, That such maximum shall not be less than the figure above named. In no event shall the carrier be liable for more than the amount of damage actually sustained.

Neither the carrier nor the ship shall be responsible in any event for loss or damage to or in connection with the transportation of the goods if the nature or value thereof has been knowingly and fraudulently misstated by the shipper in the bill of lading.

(6) Goods of an inflammable, explosive, or dangerous nature to the shipment whereof the carrier, master or agent of the carrier, has not consented with knowledge of their nature and character, may at any time before discharge be landed at any place or destroyed or rendered innocuous by the carrier without compensation, and the shipper of such goods shall be liable for all damages and expenses directly or indirectly arising out of or resulting from such shipment. If any such goods shipped with such knowledge and consent shall become a danger to the ship or cargo, they may in like manner be landed at any place, or destroyed or rendered innocuous by the carrier without liability on the part of the carrier except to general average, if any.
The provisions of this Act shall not be applicable to charter parties; but if bills of lading are issued in the case of a ship under charter party, they shall comply with the terms of this Act. Nothing in this Act shall be held to prevent the insertion in a bill of lading of any lawful provision regarding general average.

SPECIAL CONDITIONS

Section 6
Notwithstanding the provisions of the preceding sections, a carrier, master or agent of the carrier, and a shipper shall, in regard to any particular goods be at liberty to enter into any agreement in any terms as to the responsibility and liability of the carrier for such goods, and as to the rights and immunities of the carrier in respect of such goods, or his obligation as to seaworthiness (so far as the stipulation regarding seaworthiness is not contrary to public policy), or the care or diligence of his servants or agents in regard to the loading, handling, stowage, cargo, custody, care, and discharge of the goods carried by sea: Provided, That in this case no bill of lading has been or shall be issued and that the terms agreed shall be embodied in a receipt which shall be a non-negotiable document and shall be marked as such.

Any agreement so entered into shall have full legal effect: Provided, That this section shall not apply to ordinary commercial shipments made in the ordinary course of trade but only to other shipments where the character or condition of the property to be carried or the circumstances, terms, and conditions under which the carriage is to be performed are such as reasonably to justify a special agreement.

Section 7
Nothing contained in this Act shall prevent a carrier or a shipper from entering into any agreement, stipulation, condition, reservation, or exemption as to the responsibility and liability of the carrier or the ship for the loss or damage to or in connection with the custody and care and handling of goods prior to the loading on and subsequent to the discharge from the ship on which the goods are carried by sea.

Section 8
The provisions of this Act shall not affect the rights and obligations of the carrier under the provisions of the Shipping Act, 1916, or under the provisions of section 4281 to 4289, inclusive, of the Revised Statutes of the United States, or of any amendments thereto; or under the provisions of any other enactment for the time being in force relating to the limitation of the liability of the owners of seagoing vessels.

TITLE II

Section 9
Nothing contained in this Act shall be construed as permitting a common carrier by water to discriminate between competing shippers similarly placed in time and circumstances, either (a) with respect to the right to demand and receive bills of lading subject to the provisions of this Act; or (b) when issuing such bills of lading, either in the surrender of any of the carrier's rights and immunities or in the increase of any of the carrier's responsibilities and liabilities pursuant to section 6, title I, of this Act or (c) in any other way prohibited by the Shipping Act, 1916, as amended.

Section 10
Section 25 of the Interstate Commerce Act is hereby amended by adding the following proviso at the end of paragraph 4 thereof: "Provided, however, That insofar as any bill of lading authorized hereunder relates to the carriage of goods by sea, such bill of lading shall be subject to the provisions of the Carriage of Goods by Sea Act."

Section 11
Where under the customs of any trade the weight of any bulk cargo inserted in the bill of lading is a weight ascertained or accepted by a third party other than the carrier or the shipper, and the fact that the weight is so ascertained or accepted is stated in the bill of lading, then, notwithstanding any thing in this Act, the bill of lading shall not be deemed to be prima facie evidence against the carrier of the receipt of goods of the weight so inserted in the bill of lading, and the accuracy thereof at the time of shipment shall not be deemed to have been guaranteed by the shipper.

Section 12
Nothing in this Act shall be construed as superseding any part of the Act entitled "An act relating to navigation of vessels, bills of lading, and to certain obligations, duties, and rights in connection with the carriage of property," approved February 13, 1893, or of any other law which would be applicable in the absence of this Act, insofar as they relate to the duties, responsibilities, and liabilities of the ship or carrier prior to the time when the goods are loaded on or after the time they are discharged from the ship.

Section 13
This Act shall apply to all contracts for carriage of goods by sea to or from ports of the United States in foreign trade. As used in this Act the term "United States" includes its districts, territories, and possessions: Provided, however, That the Philippine legislature may by law exclude its application to transportation to or from ports of the Philippine Islands. The term "foreign trade" means the transportation of goods between the ports of the United States and ports of foreign countries. Nothing in this Act shall be held to apply to contracts for carriage of goods by sea between any
port of the United States or its possessions, and any other port of the United States or its possession: Provided, however, That any bill of lading or similar document of title which is evidence of a contract for the carriage of goods by sea between such ports, containing an express statement that it shall be subject to the provisions of this Act, shall be subjected hereto as fully as if subject hereto as fully as if subject hereto by the express provisions of this Act: Provided, further, That every bill of lading or similar document of title which is evidence of a contract for the carriage of goods by sea from ports of the United States, in foreign trade, shall contain a statement that it shall have effect subject to the provisions of this Act.

Section 14

Upon the certification of the Secretary of Commerce that the foreign commerce of the United States in its competition with that of foreign nations is prejudiced the provisions, or any of them, of Title I of this Act, or by the laws of any foreign country or countries relating to the carriage of goods by sea, the President of the United States, may, from time to time, by proclamation, suspend any or all provisions of Title I of this Act for such periods of time or indefinitely as may be designated in the proclamation. The President may at any time rescind such suspension of Title I hereof, and any provisions thereof which may have been suspended shall thereby be reinstated and again apply to contracts thereafter made for the carriage of goods by sea. Any proclamation of suspension or rescission of any such suspension shall take effect on a date named therein, which date shall be not less than ten days from the issue of the proclamation.

Any contract for the carriage of goods by sea, subject to the provisions of this Act, effective during any period when title I hereof, or any part thereof, is suspended, shall be subject to all provisions of law now or hereafter applicable to that part of Title I which may have thus been suspended.

Section 15

This Act shall take effect ninety days after the date of its approval; but nothing in this Act shall apply during a period not to exceed one year following its approval to any contract for the carriage of goods by sea, made before the date on which this Act is approved, nor to any bill of lading or similar document of title issued, whether before or after such date of approval in pursuance of any such contract as aforesaid.

Section 16

This Act may be cited as the "Carriage of Goods by Sea Act."

Approved, April 16, 1936.

PUBLIC ACT 521  CARRIAGE OF GOODS BY SEA ACT

Section 1

That the provisions of Public Act No. 521 of the 7th Congress of the United States, approved on April 16, 1936, be accepted, as it is hereby accepted to be made applicable to all contracts for the carriage of goods by sea to and from Philippine ports in foreign trade: Provided, that nothing in this Act shall be construed as repealing any existing provision of the Code of Commerce which is now in force, or as limiting its application.

Sec. 2

This Act shall take effect upon its approval. (Approved October 22, 1936).

TITLE I

Sec. 1

When used in this Act —

(a) The term "carrier" includes the owner or the charterer who enters into a contract of carriage with a shipper.

(b) The term "contract of carriage" applies only to contracts of carriage by covered by a bill of lading or any similar document of title, insofar as such document relates to the carriage of goods by sea, including any bill of lading or any similar document as aforesaid issued under or pursuant to a character party from the moment at which such bill of lading or similar document of title regulates the relations between a carrier and a holder of the same.

(c) The term "goods" includes goods, wares, merchandise, and articles of every kind whatsoever, except live animals and cargo which by the contract of carriage is stated as being carried on deck and is so carried.

(d) The term "ship" means any vessel used for the carriage of goods by sea.

(e) The term "carriage of goods" covers the period from the time when the goods are loaded to the time when they are discharged from the ship.

RISKS

Sec. 2

Subject to the provisions of Section 6, under every contract of carriage of goods by sea, the carrier in relation to the loading, handling, stowage, carriage, custody, care, and discharge of such goods shall be subject to the responsibilities and liabilities and entitled to the rights and immunities hereinafter set forth.

RESPONSIBILITIES AND LIABILITIES

Sec. 3

(1) The carrier shall be bound before and at the beginning of the voyage to exercise due diligence to —

(a) Make the ship seaworthy;

(b) Properly man, equip, and supply the ship;

(c) Make the holds, refrigerating and cooling chambers, and all other parts of the ship in which goods are carried, fit and safe for their reception, carriage, and preservation.

(2) The carrier shall properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried.

(3) After receiving the goods into his carrier, or the master or agent of the carrier, shall, on demand of the shipper, issue to the shipper a bill of lading showing among other things —.
(a) The loading marks necessary for identification of the goods as the same are furnished in writing by the shipper before the loading of such goods starts, provided such marks are stamped or otherwise shown clearly upon the goods if uncovered, in such a manner as should ordinarily remain legible until the end of the voyage.
(b) Either the number of packages or pieces, or the quantity or weight, as the casemay be, as furnished in writing by the shipper.
(c) The apparent order and conditions of the goods: Provided, that no carrier, master, or agent of the ship be held liable for error in stating in the bill of lading any marks, number, quantity, or weight which he has reasonable ground for suspecting not accurately to represent the goods actually received or which he has had no reasonable means of checking.
(4) Such a bill of lading shall be prima facie evidence of the receipt by the carrier of the goods as therein described in accordance with paragraphs (3) (a), (b), and (c), of this section: (The rest of the provision is not applicable to the Philippines).
(5) The shipper shall be deemed to have guaranteed to the carrier the accuracy at the time of shipment of the marks, number, quantity, and weight, as furnished by him; and the shipper shall indemnify the carrier against loss or damage arising or resulting from inaccuracies in such particulars. The right of the carrier to such indemnity shall in no way limit his responsibility and liability under the contract of carriage to any person other than the shipper.
(6) Unless notice or loss or damage and the general nature of such loss or damage by written notice be given in writing to the carrier or his agent at the port of discharge or at the time of the removal of the goods into the custody of the person entitled to delivery thereof under the contract of carriage, such removal shall be prima facie evidence of the delivery by the carrier of the goods as described in the bill of lading. If the loss or damage is not apparent, the notice must be given within three days of the delivery.
Said notice of loss or damage may be endorsed upon the receipt for the goods given by the person taking delivery thereof.
The notice in writing need not be given if the state of the goods has at the time of their receipt been such as to prevent concealment of loss or damage; provided, that notice of loss or damage unless suit is brought within one year after delivery of the goods or the date when the goods should have been delivered: Provided, that, if a notice of loss or damage, either apparent or concealed, is not given as provided for in this section, that fact shall not affect or prejudice the right of the shipper to bring suit within one year after the delivery of the goods or the date when the goods should have been delivered.
In any event the carrier and the ship shall be discharged from all liability in respect of loss or damage unless suit is brought within one year after delivery of the goods or the date when the goods should have been delivered: Provided, that, if a notice of loss or damage, either apparent or concealed, is not given as provided for in this section, that fact shall not affect or prejudice the right of the shipper to bring suit within one year after the delivery of the goods or the date when the goods should have been delivered.
In the case of any actual or apprehended loss or damage, the carrier and the receiver shall give all reasonable facilities to each other for inspecting and tallying the goods.
(7) After the goods are loaded the bill of lading to be issued by the carrier, master, or agent of the carrier to the shipper shall if the shipper so demands, be a “shipped” bill of lading: Provided, that if the shipper shall have previously taken up any document of title to such goods, he shall surrender the same as against the issue of the “shipped” bill of lading, but at the option of the carrier such document of title may be noted at the port of shipment by the carrier, master, or agent with the name or names of the ship or ships upon which the goods have been shipped and the date or dates of shipment, and when so noted the same shall for the purpose of this section be deemed to constitute a “shipped” bill of lading.

(8) Any clause, covenant, or agreement in a contract of carriage relieving the carrier of the ship from liability for loss or damage to or in connection with the goods, arising from negligence, fault, or failure in the duties and obligations provide in this section or lessening such liability otherwise than as provided in Section 2, shall be void and of no effect. A benefit of insurance in favor of the carrier, or similar clause, shall be deemed to be a clause relieving the carrier from liability.

RIGHTS AND IMMUNITIES
Sec. 4
(1) Neither the carrier nor the ship shall be liable for loss or damage arising or resulting from unseaworthiness unless caused by want of due diligence on the part of the carrier to make the ship seaworthy and to secure that the ship is properly manned, equipped, and supplied, and to make the holds, refrigerating and cooling chambers, and all other parts of the ship in which goods are carried fit and safe for their carriage, reception, carriage, and preservation, in accordance with the provisions of paragraph (1) of Section 3. Whenever loss or damage has resulted from unseaworthiness, the burden of proving the exercise of due diligence shall be on the carrier or other person claiming exemption under this section.
(2) Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from—
(a) Art, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or in the management of the ship;
(b) Fire, unless caused by the actual fault or privity of the carrier;
(c) Perils, dangers, and accidents of the sea or other navigable water;
(d) Act of God;
(e) Act of war;
(f) Act of public enemies;
(g) Arrest or restraint of princes, rulers, or people, or seizure under legal process;
(h) Quarantine restrictions;
(i) Act or omission of the shipper or owner of the goods, his agent or representative;
(j) Strikes or lockouts or stoppage or restraint of labor from whatever cause, whether partial or general: Provided, that nothing herein contained shall be construed to relieve a carrier from responsibility for the carrier’s own acts;
(k) Riots and civil commotions;
(l) Saving or attempting to save life or property at sea;
(m) Wastage in bulk or weight or any other loss or damage arising from inherent defect, quality, or vice of the goods;
(n) Insufficiency or packing;
(o) Insufficiency or inadequacy of marks;
(p) Latent defects not discoverable by due diligence; and.
(q) Any other cause arising without the actual fault and privity of the carrier and without the fault or neglect of the agents or servants of the carrier, but the burden of proof shall be on the person claiming the benefit of this exception to show that neither the actual fault or privity of the carrier nor
the fault or neglect of the agents or servants of the carrier contributed to the loss or damage.

(3) The shipper shall not be responsible for loss or damage sustained by the carrier or the ship arising or resulting from any cause without the act, or neglect of the shipper, his agents, or his servants.

(4) Any deviation in saving or attempting to save life or property at sea, or any reasonable deviation shall not be deemed to be an infringement or breach of this Act or of the contract of carriage, and carrier shall not be liable for any loss or damage resulting therefrom: Provided, however, that refusal to deviate in the purpose of loading or unloading cargo or passengers it shall, prima facie, be regarded as unreasonable.

(5) Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with the transportation of goods in an amount exceeding $500 per package of lawful money of the United States, or in case of goods not shipped in packages, per customary freight unit, or the equivalent of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading. This declaration, if embodied in the bill of lading, shall be prima facie evidence, but shall not be conclusive on the carrier.

By agreement between the carrier, master or agent of the carrier, and the shipper another maximum amount than that mentioned in this paragraph may be fixed: Provided, that such maximum shall not be less than the figure above named. In no event shall the carrier be liable for more than the amount of damage actually sustained..

The provisions of this Act shall not be applicable to any particular goods be at liberty to enter into any agreement in any terms as to the responsibility and liability of the carrier for such goods, and as to the rights and immunities of the carrier in respect to such goods, or his obligation to seaworthiness, (so far as the stipulation regarding seaworthiness is contrary to public policy), or the care or diligence of his servants or agents in regard to the loading, handling, stowage, carriage, custody, care and discharge of the goods carried by sea; provided, that in this case no bill of lading has been or shall be issued and that the terms agreed shall be a non-negotiable document and shall be marked as such.

Any agreement so entered into shall have full legal effect: Provided, that this section shall not apply to ordinary commercial shipments made in the ordinary course of trade but only to other shipments where the character or condition of the property to be carried or the circumstances, terms and conditions under which the carriage is to be performed are such as reasonably to justify a special agreement.

Sec. 7 Nothing contained in this Act shall prevent a carrier or a shipper from entering into any agreement, stipulation, condition, reservation, or exemption as to the responsibility and liability of the carrier for the ship for the loss or damage to or in connection with the custody and care and handling of goods prior to the loading on and subsequent to the discharge from the ship on which the goods are carried by sea.

Sec. 8 The provisions of this Act shall not affect the rights and obligations of the carrier under the provisions of the Shipping Act, 1916, or under the provisions of Sections 4281 to 4292, inclusive, of the Revised Statutes of the United States, or of any amendments thereto, or under the provisions of any other enactment for the time being in force relating to the limitation of the liability of the owners of seagoing vessels.

TITLE II
Sec. 9 Nothing contained in this Act shall be construed as permitting a common carrier by water to discriminate between competing shippers similarly placed in time and circumstances, either (a) with respect to their right to demand and receive bills of lading subject to the provisions of this Act; or (b) when issuing such bills of lading either in the surrender of any of the carrier’s rights and immunities or in the increase of any of the carrier’s responsibilities and liabilities pursuant to Section 5, Title 1, of this Act; (c) in any other way prohibited by the Shipping Act, 1916, as amended.

Sec. 10 (Not applicable to the Philippines.).

Sec. 11 When under the custom of any trade the weight of any bulk cargo inserted in the bill of lading is a
weight ascertained or accepted by a third party other than the carrier or the shipper and the fact that the weight as ascertained or accepted is stated in the bill of lading, then notwithstanding anything in this Act, the bill of lading shall not be deemed to be prima facie evidence against the carrier of the weight of goods the weight so inserted in the bills of lading, and the accuracy thereof at the time of shipment shall not be deemed to have been guaranteed by the shipper.

Sec. 12
(Not applicable to the Philippines).

Sec. 13
This Act shall apply to all contracts for carriage of goods by sea to or from ports of the United States in foreign trade. As used in this Act the term "United States" includes its districts, territories, and possessions: Provided, however, that the Philippine Legislature may by law exclude its application to transportation to or from ports of the Philippine Islands. The term "foreign trade" means the transportation of goods between the ports of the United States and ports of foreign countries. Nothing in this Act shall be held to apply to contracts for carriage of goods by sea between any port of the United States or its possessions and any other port of the United States or its possessions: Provided, however, that any bill of lading or similar document of the title which is evidence of a contract for the carriage of goods by sea between such ports, containing an express statement that it shall be subject to the provisions of this Act; shall be subjected hereto as fully as if subject hereto by the express provisions of this Act: Provided, further, that every bill of lading or similar document of title which is evidence of a contract for the carriage of goods by sea from ports of the United States in foreign trade, shall contain a statement that it shall have effect subject to the provisions of this Act.

Sec. 14
Upon the certification of the Secretary of Commerce that the foreign commerce of the United States in its competition with that of foreign nations is prejudiced by the provisions, or any of them, of the Title I of this Act, or by the laws of any foreign country or countries relating to the carriage of goods by sea, the President of the United States may, from time to time by proclamation, suspend any or all provisions of Title I of this Act for such periods of time or indefinitely as may be designated in the proclamation. The President may at any time rescind such suspension of Title I hereof, and any provisions thereof which may have been suspended shall thereby be reinstated and again apply to contracts thereafter made for carriage of goods by sea. Any proclamation of suspension or rescission of any such suspension shall take effect on the date named therein, which date shall be not less than ten days from the issue of the proclamation. Any contract for the carriage of goods by sea, subject to the provisions of this Act, effective during any period when Title I hereof, or any part thereof, is suspended, shall be subject to all provisions of law now or hereafter applicable to that part of Title I which may have thus been suspended.

Sec. 15
This Act shall take effect ninety days after the date of its approval; but nothing in this Act shall apply during a period not to exceed one year following its approval to any contract for the carriage of goods by sea, made before the date on which this Act is approved nor to any bill of lading or similar document of title issued, whether before or after such date of approval in pursuance of any such contract as aforesaid.

Sec. 16
This Act may be cited as the "Carriage of Goods by Sea Act."

1. CONTRACTS COVERED UNDER COGSA

COGSA is a special law that governs in all contracts of carriage of:

- goods by sea
- between or to and from Philippine ports
- vessels involved in foreign trade

Application of laws:
- If the common carrier is coming to the Philippines:
  - First: Civil Code
  - Second: COGSA (in foreign trade)
  - Third: Code of Commerce
- If the private carrier is coming to the Philippines:
  - First: COGSA
  - Second: Code of Commerce
  - Third: Civil Code (excluding rules on common carriers)

If the private or common carrier is from the Philippines to a foreign country:
- Apply the law of the foreign country (per Art. 1753, CC) UNLESS the parties make COGSA applicable

Hierarchy of laws:
1) Art. 1766, CC (COGSA as only in matters not regulated by this Code) This is notwithstanding that COGSA is a special law. Goods in a foreign country shipped to the Philippines are governed by the Civil Code

2) Art. 1753, CC (Conflict of Laws provision)

2. LIMIT OF LIABILITY PER PACKAGE

BELGIAN OVERSEAS vs. PHILIPPINE FIRST INSURANCE CO., INC. (2002)

The Civil Code does not limit the liability of the common carrier to a fixed amount per package. In all matters not regulated by the Civil Code, the right and the obligations of common carriers shall be governed by the Code of Commerce and special laws. Thus, the COGSA, which is suppletory to the provisions of the Civil Code, supplements the latter by establishing a statutory provision limiting the carrier’s liability in the absence of a shipper’s declaration of a higher value in the bill of lading. In the case before us, there was no stipulation in the Bill of Lading limiting the carrier’s liability. Neither did the shipper declare a higher valuation of the goods to be shipped. Petitioners’ liability should be computed based on US$500 per package
and not on the per metric ton price declared in the Letter of Credit.

On Notice of Claim/On Prescription of Action:
First, the provision of COGSA provides that the notice of claim need not be given if the state of the goods, at the time of their receipt, has been the subject of a joint inspection or survey. Prior to unloading the cargo, an Inspection Report as to the condition of the goods was prepared and signed by representatives of both parties. Second, as stated in the same provision, a failure to file a notice of claim within three days will not bar recovery if it is nonetheless filed within one year. This one-year prescriptive period also applies to the shipper, the consignee, the insurer of the goods or any legal holder of the bill of lading. "Inasmuch as the neither the Civil Code nor the Code of Commerce states a specific prescriptive period on the matter, the Carriage of Goods by Sea Act (COGSA)–which provides for a one-year period of limitation on claims for loss of, or damage to, cargoes sustained during transit–may be applied suppletorily to the case at bar." In the present case, the cargo was discharged on July 31, 1990, while the Complaint was filed by respondent on July 25, 1991, within the one-year prescriptive period.

3. NOTICE OF LOSS OF CLAIM
4. PRESCRIPTION OF ACTION

Filipino Merchants Insurance, Inc. v. Alejandro (1986)
Clearly, the coverage of the Act includes the insurer of the goods. Otherwise, what the Act intends to prohibit after the lapse of the one-year prescriptive period can be done indirectly by the shipper or owner of the goods by simply filing a claim against the insurer even after the lapse of one year.

Maritime Agencies & Services, Inc. v. CA
The period for filing the claim is one year, in accordance with the Carriage of Goods by Sea Act. This was adopted and embodied by our legislature in Com. Act No. 65 which, as a specific prescriptive period, can be applied suppletorily to the case at bar. In the present case, the cargo was discharged on July 31, 1990, while the Complaint was filed by respondent on July 25, 1991, within the one-year prescriptive period.

5. WAIVER UNDER COGSA

V. INTERNATIONAL AIR TRANSPORT

A. The Warsaw Convention

Chapter III - Liability of the Carrier

Article 17
The carrier is liable for damage sustained in the event of the death or wounding of a passenger or any other bodily injury suffered by a passenger, if the accident which caused the damage so sustained took place on board the aircraft or in the course of any of the operations of embarking or disembarking.

Article 18
1. The carrier is liable for damage sustained in the event of the destruction or loss of, or of damage to, any registered luggage or any goods, if the occurrence which caused the damage so sustained took place during the carriage by air.
2. The carriage by air within the meaning of the preceding paragraph comprises the period during which the luggage or goods are in charge of the carrier, whether in an aerodrome or on board an aircraft, or, in the case of a landing outside an aerodrome, in any place whatsoever.
3. The period of the carriage by air does not extend to any carriage by land, by sea or by river performed outside an aerodrome. If, however, such a carriage takes place in the performance of a contract for carriage by air, for the purpose of loading, delivery or transshipment, any damage is presumed, subject to proof to the contrary, to have been the result of an event which took place during the carriage by air.

Article 19
The carrier is liable for damage occasioned by delay in the carriage by air of passengers, luggage or goods.

Article 20
1. The carrier is not liable if he proves that he and his agents have taken all necessary measures to avoid the damage or that it was impossible for him or them to take such measures.
2. In the carriage of goods and luggage the carrier is not liable if he proves that the damage was occasioned by negligent pilotage or negligence in the handling of the aircraft or in navigation and that, in all other respects, he and his agents have taken all necessary measures to avoid the damage.

Article 21
If the carrier proves that the damage was caused by or contributed to by the negligence of the injured person the Court may, in accordance with the provisions of its own law, exonerate the carrier wholly or partly from his liability.

Article 22
1. In the carriage of passengers the liability of the carrier for each passenger is limited to the sum of 125,000 francs. Where, in accordance with the law of the Court seised of the case, damages may be awarded in the form of periodical payments, the equivalent capital value of the said payments shall not exceed 125,000 francs. Nevertheless, by special contract, the carrier and the passenger may agree to a higher limit of liability.
2. In the carriage of registered luggage and of
goods, the liability of the carrier is limited to a sum of 250 francs per kilogram, unless the consignor has made, at the time when the package was handed over to the carrier, a special declaration of the value at delivery and has paid a supplementary sum if the case so requires. In that case the carrier will be liable to pay a sum not exceeding the declared sum, unless he proves that that sum is greater than the actual value to the consignor at delivery.

3. As regards objects of which the passenger takes charge himself the liability of the carrier is limited to 5,000 francs per passenger.

4. The sums mentioned above shall be deemed to refer to the French franc consisting of 65 milligrams gold of millesimal fineness 900. These sums may be converted into any national currency in round figures.

Article 23
Any provision tending to relieve the carrier of liability or to fix a lower limit than that which is laid down in this Convention shall be null and void, but the nullity of any such provision does not involve the nullity of the whole contract, which shall remain subject to the provisions of this Convention.

Article 24
1. In the cases covered by Articles 18 and 19 any action for damages, however founded, can only be brought subject to the conditions and limits set out in this Convention.
2. In the cases covered by Article 17 the provisions of the preceding paragraph also apply, without prejudice to the questions as to who are the persons who have the right to bring suit and what are their respective rights.

Article 25
1. The carrier shall not be entitled to avail himself of the provisions of this Convention which exclude or limit his liability, if the damage is caused by his wilful misconduct or by such default on his part as, in accordance with the law of the Court seised of the case, is considered to be equivalent to wilful misconduct.
2. Similarly the carrier shall not be entitled to avail himself of the said provisions, if the damage is caused as aforesaid by any agent of the carrier acting within the scope of his employment.

Article 26
1. Receipt by the person entitled to delivery of luggage or goods without complaint is prima facie evidence that the same have been delivered in good condition and in accordance with the document of carriage.
2. In the case of damage, the person entitled to delivery must complain to the carrier forthwith after the discovery of the damage, and, at the latest, within three days from the date of receipt in the case of luggage and seven days from the date of receipt in the case of goods. In the case of delay the complaint must be made at the latest within fourteen days from the date on which the luggage or goods have been placed at his disposal.
3. Every complaint must be made in writing upon the document of carriage or by separate notice in writing despatched within the times aforesaid.
4. Failing complaint within the times aforesaid, no action shall lie against the carrier, save in the case of fraud on his part.

Article 27
In the case of the death of the person liable, an action for damages lies in accordance with the terms of this Convention against those legally representing his estate.

Article 28
1. An action for damages must be brought, at the option of the plaintiff, in the territory of one of the High Contracting Parties, either before the Court having jurisdiction where the carrier is ordinarily resident, or has his principal place of business, or has an establishment by which the contract has been made or before the Court having jurisdiction at the place of destination.
2. Questions of procedure shall be governed by the law of the Court seised of the case.

Article 29
1. The right to damages shall be extinguished if an action is not brought within two years, reckoned from the date of arrival at the destination, or from the date on which the aircraft ought to have arrived, or from the date on which the carriage stopped.
2. The method of calculating the period of limitation shall be determined by the law of the Court seised of the case.

Article 30
1. In the case of carriage to be performed by various successive carriers and falling within the definition set out in the third paragraph of Article 1, each carrier who accepts passengers, luggage or goods is subjected to the rules set out in this Convention, and is deemed to be one of the contracting parties to the contract of carriage in so far as the contract deals with that part of the carriage which is performed under his supervision.
2. In the case of carriage of this nature, the passenger or his representative can take action only against the carrier who performed the carriage during which the accident or the delay occurred, save in the case where, by express agreement, the first carrier has assumed liability for the whole journey.
3. As regards luggage or goods, the passenger or consignor will have a right of action against the first carrier, and the passenger or consignee who is entitled to delivery will have a right of action against the last carrier, and further, each may take action against the carrier who performed the carriage during which the destruction, loss, damage or delay took place. These carriers will be jointly and severally liable to the passenger or to the consignor or consignee.

B. Applicability; meaning of international transportation

International air transportation is transportation by air between points of contact of two high contracting parties, or those countries that have acceded to the Convention.

C. Liabilities under the Convention

The enumeration of causes of action in the Warsaw Convention is not an exclusive list. You can have a cause of action even if it is not: a) death or wounding of the passenger; b) damage or loss or destruction of checked baggage, or c) delay in the transportation of passengers, luggage and goods.
Note however, that the limitations of liability in the Convention favor the carrier.

**NORTHWEST AIRLINES, INC., vs. CUENCA (1965)**

The Articles merely declare the carrier liable for damages in the enumerated cases, if the conditions therein specified are present. Neither said provisions nor others in the aforementioned Convention regulate or exclude liability for other breaches of contract by the carrier. Under petitioner's theory, an air carrier would be exempt from any liability for damages in the event of its absolute refusal, in bad faith, to comply with a contract of carriage, which is absurd.

**ALITALIA vs IAC (1990)**

Under the Warsaw Convention, an air carrier is made liable for damages for:

1. the death, wounding or other bodily injury of a passenger if the accident causing it took place on board the aircraft or in the course of its operations of embarking/dismounting
2. the destruction or loss of, or damage to, any registered baggage or goods, if the occurrence causing it took place during the carriage by air
3. delay in the transportation by air of passengers, baggage, or goods.

In these cases, the Convention provides that the "acts or damages, however founded, can only be brought subject to the conditions and limits set out therein."

The Warsaw Convention however denies to the carrier availment "of the provisions w/c exclude or limit his liability, if the damage is caused by his willful misconduct or by such default on his part as, in accordance w/ the law of the court seized of the case, is considered to be equivalent to willful misconduct, or if the damage is similarly caused by any agent of the carrier acting w/n the scope of his employment."

The Convention does not operate as an exclusive enumeration of the instances of an airline's liability, or as an absolute limit of the extent of that liability.

Moreover, it should be deemed a limit of liability only in those cases where the cause of the death or injury to person, or destruction, loss or damage to property or delay in its transport is not attributable to or attended by any willful misconduct, bad faith, recklessness, or otherwise improper conduct on the part of any official or employee for which the carrier is responsible, and there is otherwise no special or extraordinary form of resulting injury.

The Convention has invariably been held inapplicable, or as not restrictive of the carrier's liability, where there was satisfactory evidence of malice or bad faith attributable to its officers and employees.

Note: Liability of carrier in case of loss of luggage is limited to a sum of $USD 20 per kilo or $USD 9.07 per pound unless a higher value is declared in advance and additional charges are paid.

**D. Limitations on Liability**

**PAL INC. v CA and JESUS SAMSON (1981)**

Ration: The limitation of their liability under 1711 of NCC: If the mishap was due to the employee's own notorious negligence, or voluntary act, or drunkenness, the employer shall not be liable for compensation. When the employee's lack of due care contributed to his death or injury, the compensation shall be equitably reduced. AND under 1712 If a fellow worker's intentional malicious act is the only cause of the death or injury, the employer shall not be answerable...

**PAL vs. CA, DR. JOSEFINO MIRANDA and LUISA MIRANDA (1996)**

The appelatees do not seek payment for loss of any baggage. They are claiming damages arising from the discriminatory off-loading of their baggage. That cannot be limited by the printed conditions in the tickets and baggage checks. Neither can the Warsaw Convention exclude nor regulate the liability for other breaches of contract by air carriers. A recognition of the Warsaw Convention does not preclude the operation of our Civil Code and related laws in determining the extent of liability of common carriers in breach of contract of carriage, particularly for willful misconduct of their employees. Said convention does not operate as an exclusive enumeration of the instances for declaring a carrier liable for breach of contract of carriage or as an absolute limit of the extent of that liability. The Warsaw Convention declares the carrier liable in the enumerated cases and under certain limitations. However, it must not be construed to preclude the operation of the Civil Code and pertinent laws. It does not preclude, much less exempt, the carrier from liability for damages for violating the rights of its passengers under the contract of carriage, especially if willful misconduct on the part of the carrier's employees is found or established, which is the case before Us.

**E. When Limitations Unavailable**

**TWA v. CA and Vinluan (1988)**

The petitioner's contention that it is not liable is devoid of merit. Private respondent had a first class ticket for Flight No. 41 of petitioner from New York to San Francisco on April 20, 1979. It was twice confirmed and yet respondent unceremoniously told him that there was no first class seat available for him and that he had to be downgraded to the economy class. As he protested, he was arrogantly threatened by one Mr. Braam. Worst still, while he was waiting for the flight, he saw that several Caucasians who arrived much later were accommodated in first class seats when the other passengers did not show up. The discrimination is obvious and the humiliation to which private respondent was subjected is undeniable. Consequently, the award of moral and exemplary damages by the respondent court is in order.

At the time of this unfortunate incident, the private respondent was a practicing lawyer, a senior partner of a big law firm in Manila. He was a director of several civic and social organizations in the Philippines. Considering the circumstances of this case and the social standing of private respondent in the community, he is entitled to the award of moral and exemplary damages. However, the moral damages should be reduced to P300,000.00, and the exemplary damages should be reduced to P200,000.00. This award should be reasonably sufficient to indemnify private respondent for the
humiliation and embarrassment that he suffered and to serve as an example to discourage the repetition of similar oppressive and discriminatory acts.

F. Conditions on Liability

**Luna v. Estrada (1992)**

**HELD:**

The Warsaw Convention was a treaty commitment voluntarily assumed by the Philippine government; consequently, it has the force and effect of law in this country. But, in the same token, jurisprudence shows that the Warsaw Convention does not operate as an exclusive enumeration of the instances for declaring an airline liable for breach of contract of carriage or as an absolute limit of the extent of that liability.

The failure of private respondent to deliver their luggage at the designated time and place does not *ipso facto* amount to willful misconduct. For willful misconduct to exist, there must be a showing that the acts complained of were impelled by an intention to violate the law, or were in persistent disregard of one's rights. It must be evidenced by a flagrantly or shamefully wrong or improper conduct.

G. Venue of Court Actions

**SANTOS vs NORTHWEST ORIENT AIRLINES**

(1992)

(Petitioner claims that Art 28(1) is a rule merely of venue and was waived by NOA when it did not move to dismiss on the ground of improper venue.)

SC: A number of reasons tend to support the characterization of Art 28(1) as a jurisdiction and not a venue provision.

1. the wording of Art. 32, w/c indicates the places where the action for damages "must" be brought, underscores the mandatory nature of Art 28(1).

2. this characterization is consistent w/ one of the objectives of the Convention, w/c is to regulate in a uniform manner the conditions of int'l transportation by air.

3. the Convention doesn't contain any provision prescribing rules of jurisdiction other than Art 28(1), w/c means that the phrase "rules as to jurisdiction" used in Art 32 must refer only to Art 28(1). In fact, the last sentence of Art 32 specifically deals w/ the exclusive enumeration in Art 28(1) as "jurisdictions", w/c as such, cannot be left to the will of the parties regardless of the time when the damage occurred.

Where the matter is governed by the Warsaw Convention, jurisdiction takes on a dual concept. Jurisdiction in the international sense must be established in accordance w/ Art 28(1) of the Warsaw Convention, following w/c the jurisdiction of a particular court must be established pursuant to the applicable domestic law. Only after the question of which court has jurisdiction is determined will the issue of venue be taken up. This second question shall be governed by the law of the court to w/c the case is submitted.
CODE OF COMMERCE

a. Merchants and Commercial Transactions (Articles 1-63)

1. Definition of Merchants

Merchant – is the middleman between the consumer and manufacturer; a merchant must do business in his own name

1.1. Natural persons
- Those, who having legal capacity to engage in commerce, habitually devote themselves thereto (Art 1)
  - Legal capacity to engage in commerce: having completed the age of 18 years
  - Having free disposition of their property (Art 4)
- Legal presumption of habitually engaging in commerce exists from the moment the person who intends to engage therein announces through circulars, newspapers, handbills, posters exhibited to the public, or in any manner whatsoever, an establishment which has for its object some commercial operation. (Art 3)
- A merchant need not devote his full time to commerce

1.2. Foreign entities
- Foreigners and companies created abroad may engage in commerce subject to the laws of their country with respect to their capacity to contract,
- Foreign corporations and partnerships can engage business here, provided they get a license from the SEC. For insurance companies, they need a certificate of authority from the Insurance Commission. Banks need a license from the Monetary Board.
- Code of Commerce governs:
  - regards the creation of their establishments in Philippine territory,
  - their mercantile operations, and
  - the jurisdiction of the courts of the Philippines.
- But if there’s a special treaty, the treaty governs.

2. Applicable Laws

(whether or not executed by merchants)

a. Code of Commerce
b. If no provision, commercial customs
c. In the absence of these two, Civil Code

- Customs take precedence over civil law because of the progressive character of commerce. For centuries, negotiable instruments are governed mostly by customs rather than law. But civil law can also supplement the Code of Commerce – the Code does not contain provisions on extinguishments of obligations or damages.

3. Absolute Disqualification from Trade

The following cannot engage in commerce nor hold office or have any direct, administrative, or financial intervention in commercial or industrial companies:

a. Persons sentenced to the penalty of civil interdiction, while they have not served their sentence or have not been amnestied or pardoned
b. Persons who have been declared bankrupt, while they have not obtained their discharge, or been authorized by virtue of an agreement accepted at a general meeting of creditors and approved by judicial authority, to continue at the head of their establishments; the discharge being considered in such cases is limited to that expressed in the agreement
c. Persons who, on account of laws or special provisions, may not engage in commerce

4. Relative Disqualification from Trade

The following cannot engage in the commerce, either in person or by proxy, nor can they hold any office or have any direct, administrative or financial intervention in commercial or industrial companies, within the limits of the districts, provinces or towns in which they discharge their duties:

a. Judges of the Supreme Court, judges and officials of the department of public prosecutors in active service. This provision shall not be applicable to the municipal mayors, judges or prosecuting attorneys, nor to those who by chance are temporarily discharging the functions of judges or prosecuting attorneys.
b. Administrative, economic or military heads of districts, provinces or posts
c. Employees engaged in the collection and administration of funds of the State, appointed by the Government. Persons who by contract administer and collect temporarily or their representatives are exempted.
d. Stock and commercial brokers of whatever class they may be.
e. Those who by virtue of laws or special provisions, may not engage in commerce in a determinate territory.
f. Members of Congress (‘87 Consti)
g. President, Vice President, Cabinet members and their deputies or assistants (‘87 Consti)
h. Members of Constitutional Commission (‘87 Consti)
i. President, Vice President, Members of the Cabinet, Congress, Supreme Court and the Constitutional Commission, Ombudsmen with respect to any loan, guaranty, or other form of financial accommodation for any business purpose by any government-owned or controlled bank to them (Art XI, Sec. 16, ‘87 Consti)

31 The Code of Commerce sets it at 21 years, but RA 6809 lowered the majority age to 18 years

32 Judges are no longer disqualified, as per Macario vs. Asuncion (114 SCRA 77, 1982). Since the relative disqualification of judges is political in nature, this was deemed abrogated by change in sovereignty from Spain to the United States.
Debtor is in delay when:

- The Code of Commerce does not attempt to define what commercial transactions are. It only specifies 2 general classes.
- An act need not be performed by a merchant in order that it may be considered an act of commerce (Cia Agricola de Ultramar vs. Reyes, 4 Phil 2)

5. Acts of Commerce (Commercial Transactions)

a. Those acts contained in the Code of Commerce
b. all others of analogous character

- The Code of Commerce does not attempt anywhere to define what commercial transactions are.
- An act need not be performed by a merchant in order that it may be considered an act of commerce.

6. Commercial Contracts

6.1. Enforceability of Contracts

i. Commercial contracts shall be valid, whatever the form and language, provided their existence is shown by any means established by the civil law. EXCEPT when the contract exceeds P300 (the equivalent of 1,500 pesetas), it cannot be proved by the testimony of a witness alone. There must be some other evidence.

6.2. Efficacy of Contracts

i. General Rule: Commercial contracts are consensual, so a written instrument is not necessary. Exception: in the ff cases in Art 52
- Contracts stated in the Code or in special laws which must be reduced to writing or require forms or formalities necessary for their efficacy
- Contracts executed in a foreign country in which the law requires certain instruments, forms or formalities for their validity, although Philippine law does not require them.

ii. If these contracts do not satisfy the circumstances respectively required, it shall not give rise to obligations or causes of action

6.3. Perfection of Contracts

i. Contracts entered into by correspondence shall be perfected from the moment an answer is made accepting the offer or the conditions by which the latter may be modified. (Art 54)

ii. Note that receipt of the acceptance by the offeror is immaterial,

- Theory of manifestation: in commercial transactions, since time is of the essence the contract is perfected from the moment the acceptance is sent, even if it has not yet been received by the offeror. The offeror can no longer withdraw the offer or change the terms of his offer.
- Theory of cognition: in civil law, when a contract is entered into by correspondence, it will be perfected only upon receipt by the offeror of the unconditional acceptance of the offeree.

iii. Compare with Art 1319, Civil Code: Perfection is only from the time the offeror has actual knowledge of acceptance.

iv. But a different rule when a broker or agent intervenes: perfection is when the contracting parties shall have accepted his offer. (Art 55)

6.4. Indemnification

i. If the penalty for indemnification is fixed, the injured party may demand through legal means the fulfillment of the contract or the penalty stipulated. Recourse to one extinguishes the other unless the contrary is stipulated. (Art 56)

6.5. Interpretation

i. Interpretation and compliance in good faith and full enforceability of their provisions in their plain, usual and proper meanings (Art 57)

ii. In case of conflicts between copies of the contract, and an agent intervened in the negotiation, that which appears in the agent’s book shall prevail (Art 58)

iii. In case of doubt, and the rules cannot resolve the conflict, issues shall be decided in favor of the debtor (Art 59)

6.6. Miscellaneous provisions

i. Days of grace, courtesy or others which under any name whatsoever defer the fulfillment of commercial obligations, shall not be recognized, except those in which the parties may have previously fixed in contract or which are based on a definite provision of law. (Art 61).

Ratio: Time is of the essence in commercial contracts, so days of grace are prohibited.

Exception: 30-day grace period in the Insurance Code to pay premiums

ii. Debtor is in delay when:

- If day of performance is fixed by the parties or by law, debtor is in default on the day following the day fixed (art 63)

- If no period is fixed, 10 days from execution of contract and on 11th day, debtor in delay without need of demand (Art 62)

- Potestative period (“when debtor desires”), debtor is in delay from demand

iii. Art. 50. Commercial contracts. They are governed by:

<table>
<thead>
<tr>
<th>Absolute Incapacity</th>
<th>Relative Incapacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extends throughout the Philippines</td>
<td>Extends only to the territory where the officer is exercising his functions</td>
</tr>
<tr>
<td>Effect of act is null and void</td>
<td>Effect is to subject the violator to disciplinary action or punishment</td>
</tr>
</tbody>
</table>

33 The Code requires specific forms for charter parties and loans on bottomry and respondentia (Arts 267, 578, 652 and 720).

34 Negotiable Instruments Law requires negotiable instruments to be in writing. Insurance Code requires payment of premium for a fire insurance contract to exist.
1.00% UP LAW

7. Commercial Registry

a. A book where entries are made of merchants and of documents affecting their commercial transactions.
b. An office established for the purpose of copying and recording verbatim certain classes of documents of commercial nature.

7.1. Nature of registration:
- by individual merchants – optional
- by corporation – compulsory, as it is the fact of registration which creates the corporation
- partnerships with a capital of P3000 or more or where the contributions consists of real estate properties – compulsory, per Art. 1772, Civil Code
- Philippine vessels
  - with more than 3 tons gross – compulsory

7.2. Effect of failure to register:
- an individual merchant who fails to register cannot request the inscription of any document in the mercantile registry, nor take advantage of its effects (Art. 18, Code of Commerce)
- failure to register the articles of incorporation will not create the corporation
- failure to register the partnership does not affect the existence of juridical personality, whether or not it has P3000 or more or real estate properties in contributions by the partners (Bar Review Materials in Commercial Law – J. Miravite, 2005 ed.)

7.3. Bookkeeping of Commerce:
- National Internal Revenue Code: a taxpayer must keep a journal and a ledger. But if his gross quarterly receipts do not exceed P5000, he can keep a simplified set of books. In the case of corporations and partnerships, if their gross income exceed P25,000 quarterly, their books must be audited by an independent CPA.
- NIRC also requires that the books must be kept for 3 years. In case of corporations, the Corporation Code requires them to keep record of all business transactions, minutes of meeting of BOD and stockholder, and stock and transfer book.
- Art. 48 lays down certain evidentiary rules regarding keeping of books:
  - This is an admission against interest. The entries in the books of merchants may be used as evidence against them.
  - If the books of 2 merchants conflict where 1 book is kept in accordance with law while the other is not, the former will prevail.

8. Cuentas en Participacion

- A partnership the existence of which was only known to those who had an interest in the same, being no mutual agreements between the partners and without a corporate name indicating to the public in some way that there were other people besides the one who ostensibly managed and conducted the business, is exactly the accidental partnership of cuentas en participacion defined in article 239 of the Code of Commerce.
- Those who contract with the person under whose name the business of such partnership of cuentas en participacion is conducted, shall have only a right of action against such person and not against the other persons interested, and the latter, on the other hand, shall have no right of action against the third person who contracted with the manager unless such manager formally transfers his right to them. (Art 242 of the code Of Commerce.) (Bourne vs Carman, 1906)

<table>
<thead>
<tr>
<th></th>
<th>Joint Account</th>
<th>Partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td>No firm name</td>
<td>Has a firm name</td>
<td></td>
</tr>
<tr>
<td>No common fund</td>
<td>Has common fund</td>
<td></td>
</tr>
<tr>
<td>No juridical personality</td>
<td>Has juridical personality</td>
<td></td>
</tr>
<tr>
<td>Only ostensible partner liable to 3rd persons</td>
<td>All general partners liable to 3rd persons</td>
<td></td>
</tr>
<tr>
<td>Only ostensible partner manages</td>
<td>All general partners manage</td>
<td></td>
</tr>
<tr>
<td>Liquidation done by ostensible partner</td>
<td>Liquidation entrusted to any partner/s</td>
<td></td>
</tr>
</tbody>
</table>
b. Letters of Credit (Articles 567-572)

1. Definition

- An engagement by a bank or other person made at the request of a customer that the issuer (bank) will honor a draft or other demands for payment or other complaints with the conditions specified in the credit. (Prudential Bank vs. IAC, 1992).
- An instrument issued by a bank in behalf of a customer authorizing a beneficiary to draw a draft or drafts which will be honored on presentation to the bank if drawn in accordance with the terms and conditions specified in the letter of credit.
- Art. 567, Code of Commerce: those issued by one merchant to another or for the purpose of attending to a commercial transaction.

2. Purpose

- To satisfy the seemingly irreconcilable interests of a 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. (Bank of America vs. CA, 1993)
- The primary purpose of the LoC is to substitute for and support the agreement of the buyer/importer to pay money under a contract or other arrangement. It creates in the seller/exporter a secure expectation of payment.

3. Nature

- The buyer may be required to contract a bank to issue a letter of credit in favor of the seller so that 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 seller gets paid only if he delivers the documents of title over the goods, while the buyer gets the goods only after reimbursing the bank.
- Basic principle: bank deals with documents only. As such, they are not qualified to deal with goods. They will act on the basis of documents only.
- 3 distinct and separate contracts in the LoC:
  - One links the party applying for the LoC (buyer) and the party for whose benefit the LoC is issued (seller).
  - Between the account party (buyer) and the issuing bank. Under this contract, (sometimes called the “Application and Agreement” or the “Reimbursement Agreement”), the account party applies to the issuing bank for a specified LoC and agrees to reimburse the bank for amounts paid by that bank
  - Between the issuing bank and the beneficiary (seller), in order to support the contract. It is the LoC proper in which the bank promises to pay the seller pursuant to the terms and conditions stated therein
- Independent contracts involved in a LoC:
  - contract of sale between buyer and seller
  - contract of the issuing bank
  - LoC

4. How it works:

Buyer procures LoC and obliges himself to reimburse the issuing bank upon receipt of the documents of title

Issuing bank issues LoC in favor of seller

Issuing bank opens a LoC with a correspondent bank abroad (bank-to-bank transaction)

Seller ships goods to the buyer and delivers documents of title and draft to the issuing (or negotiating) bank to recover payment

5. Perfection of the LoC

- From the time the correspondent bank makes payment to persons in whose favor the LoC has been opened (Belman Inc. vs. Central Bank, 1958)
- Take note: The opening of a LoC is only a mode of payment, which is not an essential requisite of a contract (Johannes Schuback & Sons vs. CA, 1993). A contract can still be perfected, even without the perfection of a LoC.

6. Rules on LoC

Bank of America vs. CA (1993)

- If there is no provision in the Code of Commerce, follow Uniform Customs and Practice or generally observed usages and customs
- Rule of Strict Conformity/Compliance: Documents tendered must strictly conform to the terms of the LoC. The tender of documents by the beneficiary (seller) must include all documents required by the letter. A correspondent bank which departs from what has been stipulated under the letter of credit, as when it accepts a faulty tender, acts on its own risks and it may not thereafter be able to recover from the buyer or the issuing bank, as the case may be, the money thus paid to the beneficiary

Feati Bank vs CA (1991)

- An advising or notifying bank does not incur any obligation by the notification. Its only obligation is to check the apparent authenticity of the LoC
- Negotiating bank has a right of recourse against the issuer bank. Until the negotiating
bank is reimbursed, drawer of the draft is still contingently liable.

- Relationship between the seller and the negotiating bank is like that between drawer and purchaser of drafts, i.e. the involved bank deals only with documents and not on the goods described in the documents.

7. Obligations of Parties in Letter of Credit

- Independence Principle: Negotiating bank has no duty to verify if what is described in the LoC or shipping documents actually tallies with that loaded aboard a ship. Banks do not deal with the property to be exported or shipped to the importer, but deal only with documents. International custom negates any duty on the part of a bank to verify whether what has been described in letters of credits or drafts or shipping documents actually tallies with what was loaded aboard ship

BPI vs De Reny Fabrics (1970)

- LoC is a primary obligation of the bank. It is separate from the underlying contract it may support, and is not merely an accessory contract.

8. Parties

8.1. Buyer
- procures the LoC and obliges himself to reimburse the issuing bank upon receipt of the document’s title

8.2. Issuing bank
- undertakes to pay the seller upon receipt of the draft and proper documents of titles and to surrender the documents to the buyer upon reimbursement

8.3. Seller
- 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.

8.4. Other parties may include:
- Advising (notifying) bank
  - may be utilized to convey to the seller the existence of the credit
- Confirming bank
  - will lend credence to the LoC issued by a lesser known issuing bank. The confirming bank is directly liable to pay the seller-beneficiary
- Paying bank
  - undertakes to encash the drafts drawn by the exporter/seller
- Instead of going to the place of the issuing bank to claim payment, the buyer may approach another bank (termed the negotiating bank) to have the draft discounted (Charles Lee vs CA, 2002)

9. Letter of Credit-Trust Receipt Transaction

- Bank extends loan to borrower. Loan is covered by a LoC, and the security for the loan is a trust receipt.

10. Kinds of LoC

10.1. Commercial LoC

10.2. Traveller’s LoC

Note: No protest is required in case of dishonor. LoCs are issued to definite persons and not to order, thus non-negotiable.

10.3. Other kinds: (Sundiang Reviewer)
- Confirmed LoC - whenever the beneficiary stipulates that the obligation of the opening bank shall also be made the obligation of another bank to himself
- Irrevocable LoC- a definite undertaking on the part of the issuing bank and constitutes the engagement of that bank to the beneficiary and bona fide holders of drafts drawn and/or documents presented thereunder, that the provisions for payment, acceptance or negotiation contained in the credit will be duly fulfilled, provided that all terms and conditions of the credit are complied with.
  - Issuing bank cannot revoke without consent of beneficiary and applicant (Without such consent, it cannot be cancelled even by a court order)
- Revolving LoC - one that provides for renewed credit to become available as soon as the opening bank has advised that the negotiating or paying that the drafts already drawn by the beneficiary have been reimburse to the opening bank by the buyer
- Back-to-Back LoC - a credit with identical documentary requirements and covering the same merchandise as another LoC, except for a difference in the price of the merchandise as shown by the invoice and the draft. The second letter can be negotiated only after the first is negotiated.
- Standby LoC - a security arrangement for the performance of certain obligations. It can be drawn against only if another business transaction is not performed. It may be issued in lieu of a performance bond.
  - an absolute undertaking to pay the money advanced or the amount for which credit is given on the faith of the instrument. They are primary obligations and not accessory contracts. But while they are a security arrangement, they are not converted thereby into contracts of guaranty. (IBAA vs IAC, 1988)
11. Sight Drafts

- No presentment required before acceptance.

12. Margin Fee

- Tax on sale of foreign exchange. Since the contract of sale is consensual, it falls due as soon as the local bank opens the LoC (Pacific Oxygen Company vs. Central Bank, 1968).

1. Bulk Sales Law

(Act 3952, as amended)

1. Purpose

- To regulate the sale, transfer, mortgage or assignment of goods, wares, merchandise, provisions or materials in bulk, and prescribing penalties for the violation of the provisions thereof.

- To prevent the defrauding of creditors by the secret sale or disposal or mortgage in bulk of all or substantially all of a merchant’s stock of goods bulk until the creditor of the seller shall have been paid in full.

- The law is penal in nature. Thus, its provisions must be strictly construed against the government and liberally in favor of the accused.

- The general scheme of the law is to declare such bulk sales fraudulent and void as to creditors of the vendor, or presumptively so, unless specified formalities are observed, such as the demanding and the giving of a list of creditors, the giving of actual or constructive notice to such creditors, by the record or otherwise, and the making of an inventory. (Comments and Cases on Sales – De Leon, 2005 ed.)

- Justification: police power of the state (Liwanag vs Mengra)

2. Types of Sales in Bulk

- Not in the ordinary course of trade or business Any sale, transfer, mortgage or assignment of a stock of goods, wares, merchandise, provisions, or materials (Sec 2)

- In the course of trade or business Sale, transfer, mortgage or assignment of all, or substantially all, of the business or trade conducted or of all, or substantially all, of the fixtures and equipment used in and about the business (Sec 2)

- Exempt Transactions:
  - Sale or mortgage is made in the ordinary course of business
  - When accompanied with a written waiver by all the seller/mortgagor’s creditors (Sec. 2)
  - Sale by virtue of a judicial order (Sec. 8)
  - Sale by assignee in insolvency or those beyond the reach of creditors
  - Sale of properties exempt from attachment or execution (Rule 39, Sec. 13, Rules of Court)

- Creditors contemplated:
  - Creditor at the time of the sale/mortgage
  - Need not be judgment creditors
  - Claim need not be due

- Fraudulent conveyance under the Bulk Sales Law as against transfer in fraud of creditors under the CC:
  - The former is null and void while the latter (under Arts. 1381-1389) is rescissible and is valid until set aside by a competent court
  - When the law is duly complied with, the creditors may not object to the transaction, but it may be rescinded if it is shown that it was, in fact, made in fraud of creditors (Pandect of Commercial Law and Jurisprudence - Justice Vitug, 1997 ed.)

- The law covers all transactions, whether done in good faith or not, or whether the seller is in a state of insolvency or not, as long as the transaction falls within the description of what is a “bulk sale”. Neither the motive nor the intention of the seller, nor the resulting consequence thereof to his estate, constitutes an element of what is a bulk sale; nor is the proof thereof relevant in determining whether the said transaction falls within the coverage of the law.

Albercht vs Cudikee (79 Pac. 628)
The common use of the term stock when applied to goods in a mercantile house refers to that which are kept for sale.

Boise Credit Men’s Assoc. vs Ellis (133 Pac. 6)
Merchandise must be construed to mean such things as are usually bought and sold in trade by merchants. (People’s Savings Bank vs Ben Alsliburg, 131 N.W. 101) It means something that is sold everyday, and is constantly going out of the store and being replaced by other goods.

Brown vs Quigley (130 N.W. 690)
The term (fixtures) refers to such articles of merchandise usually possessed and annexed to the premises occupied by merchants to enable them better to store, handle, and display their wares although removable without material injury to the premises at or before the end of tenancy.

Comments ad Cases on Sales – De Leon, 2000 ed.

Lands and buildings are not "goods, merchandise and fixtures" therefore not covered by the BSL.


- The qualification “in the normal course of business” applies only to the first type of bulk sale defined by law.
- Fraud and insolvency is not an element of what constitutes “Bulk Sales”.
- The law covers all transactions, whether done in good faith or bad faith.

3. Duties of Persons Selling in Bulk

3.1. Statement of Creditors

Vendor must, before receiving from the vendee, mortgagee, or agent any part of the purchase price, or any promissory note, memorandum, or other evidence therefore deliver a written statement of creditors with the following information:

i. names and addresses of all creditors to whom said vendor or mortgagor may be indebted
   ii. amount of indebtedness due or owing, or to become due or owing to each of said creditors (Sec 3)

The sworn statement shall be registered in the Bureau of Commerce. For the registration of each such sworn statement a fee of five pesos shall be charged. (Sec 9)

If the vendor/mortgagor receives any part of the purchase price, or any promissory note, or other evidence of indebtedness without having first delivered the sworn statement and without applying the purchase or mortgage money of the said property to the pro rata payment of the bona fide claims of the creditors of the vendor or mortgagor, he shall be deemed to have violated this Act, and any such sale, transfer or mortgage shall be fraudulent and void. (Sec 4)

3.2. Inventory and Notification

Vendor / mortgagor must, at least ten days before the sale, transfer or execution of a mortgage

i. make a full detailed inventory
   ii. preserve the same showing the quantity and, so far as is possible with the exercise of reasonable diligence, the cost price to the vendor, transferor, mortgagor or assignor of each article to be included in the sale, transfer or mortgage
   iii. notify every creditor whose name and address is set forth in the verified statement personally or by registered mail, of the price, terms conditions of the sale, transfer, mortgage, or assignment.

3.3. Transfer for Consideration

It shall be unlawful for vendor to transfer title without consideration or for a nominal consideration only. (Sec 7)

4. Consequences of Non-compliance

Any person violating any provision of this Act shall, be punished by imprisonment not less than six months, nor more than five years, or fined in sum not exceeding five thousand pesos, or both. (Sec 11)

4.1. Incomplete or false or untrue sworn written statement is a violation

4.2. Effects of false statements in the schedule of creditors

- Without knowledge of the buyer: if the statement is fair upon its face he will be protected
- With knowledge or imputed knowledge of buyer: the vendee accepts it at his peril. The sale is valid between the vendor and the vendee but void as against the creditors
- With names of certain creditors without notice: the sale is void as to such creditors, whether that omission was fraudulent or not
- With respect to an innocent purchaser for value from the original purchaser: purchaser shall be protected

4.3. Effects of violation of law on transfer

- As between the parties: valid contract
- As between persons other than the creditors: valid
- As to affected creditors of the seller/mortgagor: void
- Criminal liability, if expressly provided

1.11
Warehouse Receipts Law
(Act 2137)

1. Purpose and Coverage

- To regulate the status, rights and liabilities of the parties in a warehousing contract
- To protect those who, in good faith and for value, acquire negotiable warehouse receipts by negotiation
- To render the title to, and the right of possession of, property stored in warehouses more easily convertible
- To facilitate the use of warehouse receipts as documents of title
In order to accomplish these, to place a much greater responsibility on the warehouseman.

Covers negotiable warehouse receipts, which can only be issued by a warehouseman in the business of receiving commodities on deposit for storage. In all other cases where receipts are not issued by a warehouseman, Art. 1507-1520 of the Civil Code applies.

For public and private warehouses.

Bills of lading and quedans are governed by Art 1507-1520 and 1636 of the Civil Code (Ratio: Sugar centrals that issue quedans are not warehousemen).

But note: a warehouse receipt is also cited in Art 1636 as a document of title.

All other negotiable receipts are covered by the law on negotiable instruments.

Where a warehouse receipt or quedan is transferred or endorsed to a creditor only to secure the payment of a loan or debt, the transferee or endorsee does not automatically become the owner of the goods covered by the warehouse receipt or quedan but he merely retains the right to keep, and with the consent of the owner to sell, them so as to satisfy the obligation from the proceeds of the sale, this for the simple reason that the transaction involved is not a sale but only a mortgage or pledge, and if the property covered by the quedans or warehouse receipts is lost later without the fault or negligence of the mortgagee or pledgee or the transferee or endorsee of the warehouse receipt or quedan, then said goods are to be regarded as lost on account of the real owner, mortgagor or pledgor.

2. Definitions

2.1. Warehouseman

- Person lawfully engaged in the business of storing goods for profit (Sec. 58a).
- Duly authorized officer/agent of a warehouseman may validly issue a warehouse receipt (National Bank vs Producer’s Warehouse Association, 42 Phil 609).

2.2. Warehouse

- Building or place where goods are deposited and stored for profit.

2.3. Warehouse receipt

- Written acknowledgment by a warehouseman that he has received and holds certain goods therein described in store for the person to whom it is issued.
- Simple written contract between the owner of the goods and the warehouseman to pay the compensation for that service.
- Bilateral contract; imports that goods are in the house of the warehouseman and is a symbolical representation of the property itself.
- Not a negotiable instrument although it is negotiable as provided by the act.


3.1. Function of Warehouse Receipt

Negotiation carries with it transfer of title over the commodity covered by the receipt (thus, it has the same function as a negotiable bill of lading).

Except: Where a negotiable warehouse receipt is indorsed and delivered to a creditor as a collateral for a loan.

If commodity covered by receipt is lost through a fortuitous event, the debtor will bear loss.

Martinez vs PNB (1953)

3.2. Form of Warehouse Receipt

Sec 2. Warehouse receipts need not be in any particular form but every such receipt must embody within its written or printed terms:

i. The location of the warehouse where the goods are stored.
ii. The date of the issue of the receipt.
iii. The consecutive number of the receipt.
iv. A statement whether the goods received will be delivered to the bearer, to a specified person, or to a specified person in his order.
v. The rate of storage charges.
vi. A description of the goods or of the packages containing them.
vii. The signature of the warehouseman or his authorized agent.
viii. If the receipt is issued for goods of which the warehouseman is owner, either solely or in common with others, the fact of such ownership, and.
ix. A statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien. If the precise amount of such advances made or of such liabilities incurred is, at the time of the issue of, unknown to the warehouseman or to his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof is sufficient.

- The date of issue appearing in the receipt indicates prima facie the date when the contract of deposit is perfected and when the storage charges shall begin to run against the depositor.

- The mere fact that the goods deposited are incorrectly described does not make ineffective the receipt when the identity of the goods is fully established by evidence. Thus, its endorsement and delivery shall constitute a sufficient transfer of the title of the goods (American Foreign Banking Corp. vs Herridge, 49 Phil 975).
3.3. Effect of Non-compliance:

- Sec. 2. A warehouseman shall be liable to any person injured thereby for all damages caused by the omission from a negotiable receipt of any of the terms herein required.
- If any of these requisites in Sec. 2 are absent, it becomes a deposit only.

3.4. Effect of omission of any of the essential terms:

- Validity of receipt is not affected
- Warehouseman is liable for damages
- Negotiability of receipt is not affected
- The issuance of a warehouse receipt in the form provided by the law is merely permissive and directory and not mandatory in the sense that if the requirements are not observed, then the goods delivered for storage become ordinary deposits.

3.5. Terms that cannot be included

- Those contrary to the provisions of the Warehouse Receipts Law
- Those which may impair his obligation to exercise that degree of care in the safekeeping of the goods entrusted to him which a reasonably careful man would exercise in regard to similar goods of his own
- Those contrary to law, morals, public customs, public order or public policy
- Those exempting the warehouseman from liability for misdelivery
- Those exempting the warehouseman from liability for negligence

3.6. Kinds of Warehouse Receipts

i. Non-negotiable

- Sec. 4. A receipt in which it is stated that the goods received will be delivered to the depositor or to any other specified person.

- Sec. 7. A non-negotiable receipt shall have plainly placed upon its face by the warehouseman issuing it “non-negotiable” or “not negotiable.” In case of the warehouseman’s failure so to do, a holder of the receipt who purchased it for value supposing it to be negotiable, may, at his option, treat such receipt as imposing upon the warehouseman the same liabilities he would have incurred had the receipt been negotiable.

This section shall not apply to letters, memoranda, or written acknowledgement of an informal character.

- It is transferred by its delivery to the transferee accompanied by a deed of assignment, donation or other form of transfer.
- Effect of failure to mark “negotiable”: does not render it non-negotiable if it contains words of negotiability.

ii. Negotiable

- Sec. 5. A receipt in which it is stated that the goods received will be delivered to the bearer or to the order of any person named in such receipt.
- No provision shall be inserted in a negotiable receipt that it is non-negotiable. Such provision shall be void.

- It is negotiated either by delivery or indorsement.
- When negotiable receipt not required to be surrendered.

**Estrada vs CAR (1961)**

(No surrender needed if ordered by court) The SC ordered the manager of Moncada Bonded Warehouse to release shares in palay without the necessity of producing and surrendering the original of the warehouse receipts issued. The SC stated “our order must be carried out in the meantime that this cases have not been finally decided in order to ameliorate the precarious situation in which said petitioners find themselves.”

### Duplicate Receipts

**Sec. 6.** When more than one negotiable receipt is issued for the same goods, the word “duplicate” shall be plainly placed upon the face of every such receipt, except the first one issued. A warehouseman shall be liable for all damages caused by his failure to do so to any one who purchased the subsequent receipt for value supposing it to be an original, even though the purchase be after the delivery of the goods by the warehouseman to the holder of the original receipt.

- Negotiable vs Non-negotiable receipts

<table>
<thead>
<tr>
<th>Non-Negotiable</th>
<th>Negotiable</th>
</tr>
</thead>
<tbody>
<tr>
<td>If goods are sold by assignment, assignee must advise warehouseman. Until he does, his rights may be defeated by a subsequent attaching creditor, or a subsequent levy on execution, or a vendor’s lien or stoppage in transit that could be enforced against the assignor.</td>
<td>Rights of the transferee: 1. Title of the goods, as against the transferor (merely steps into the shoes). 2. Right to notify the warehouseman of the transfer and acquire the direct obligation of the warehouseman to hold the goods for him.</td>
</tr>
<tr>
<td>Rights of the person to whom it is negotiated (holder): 1. Title to the goods of the person negotiating the receipt and title of the person to whose order the goods were to be delivered. 2. Direct obligation of the warehouseman to hold possession of the goods for him, as if the warehouseman directly contracted.</td>
<td>As long as the goods covered by a negotiable warehouse receipt, these goods may not be attached etc.</td>
</tr>
</tbody>
</table>

---

### 38. Non-Negotiable

<table>
<thead>
<tr>
<th>Non-Negotiable</th>
<th>Negotiable with him</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiation defeats the lien of the seller of the goods (sec. 9)</td>
<td></td>
</tr>
</tbody>
</table>

**Goods represented can be subject to attachment or levy by execution (Sec. 42)**

**Goods represented cannot be subject to attachment or levy by execution, unless in proper circumstances (Sec. 25)**

- Deliver to X – this is non-negotiable. To sell the goods, the warehouse receipt must be assigned.
- Deliver to X or order - this is negotiable. The goods can be sold by special endorsement and delivery.
- Deliver to X or bearer- this is negotiable because it is deliverable to bearer. The goods can be sold by delivery.

### Lost/destroyed receipts

**Sec. 14. Lost / destroyed receipts**

Where a negotiable receipt has been lost / destroyed, a court may order the delivery of the goods upon

- satisfactorily proof of loss/ destruction
- giving of a bond with sufficient sureties to be approved by the court to protect the warehouseman from any liability or expense, which he or any person injured by such delivery may incur by reason of the original receipt remaining outstanding

A court may also order payment of warehouseman’s reasonable costs and counsel fees.

The delivery of goods shall not relieve the warehouseman from liability to a person to whom the negotiable receipt has been/shall be negotiated for value without notice of the proceedings/delivery of goods.

### 4. Assignment and Negotiation

**Sec 41.** A person to whom a negotiable receipt has been duly negotiated acquires thereby:

- 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, and also such title to the goods as the depositor or person to whose order the goods were to be delivered by the terms of the receipt had or had ability to convey to a purchaser in good faith for value, and
- 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 the warehouseman and contracted directly with him.

**Note:** Negotiable Warehouse Receipt is different from a Negotiable Instrument

**Note:** Negotiation takes effect as of the time when the indorsement is actually made.

<table>
<thead>
<tr>
<th>Negotiable Instruments</th>
<th>Negotiable Warehouse Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allow negotiation</td>
<td></td>
</tr>
<tr>
<td>If deliberately altered, it becomes null and void</td>
<td>If altered, it is still valid, but can be enforced only accdg to its original tenor</td>
</tr>
<tr>
<td>Subject is money</td>
<td>Subject is merchandise</td>
</tr>
<tr>
<td>Object of value is the instrument itself</td>
<td>Object of value is the goods deposited</td>
</tr>
<tr>
<td>Liability of intermediate parties is secondary (NIL)</td>
<td>Liability of intermediate parties is none (for failure to deliver goods)</td>
</tr>
<tr>
<td>If originally payable to bearer, it will always remain so even if it is endorsed specially or in blank</td>
<td>If originally payable to bearer but is endorsed specially, it will become deliverable to order and can only be negotiated by indorsement and delivery</td>
</tr>
<tr>
<td>Holder in due course may obtain a title better than that which the party negotiating to him had</td>
<td>Endorsee, even if a holder in due course, obtains only such title as the person negotiating had over the goods</td>
</tr>
</tbody>
</table>

- Who may negotiate a warehouse receipt:
  - its owner
  - any person to whom the possession or custody of the receipt has been entrusted by the owner, if, by the terms of the receipt, the goods are deliverable to the person to whom the possession or custody of receipt has been entrusted or in such a form that it may be negotiated by delivery (Sec. 40)

- Warranties:
  - that receipt is genuine
  - legal right to negotiate
  - no knowledge of defects that may impair receipt
  - right of transfer to title over goods and that the goods are merchantable

The indorser does not guarantee that the warehouseman will comply with his duties (Sec. 45)

- Creditor receiving the warehouse receipt which is given as a collateral makes no warranty (Sec. 46)

### 5. Rights and Duties of a Warehouseman

**5.1. Rights**

- Degree of Care

---

38 Sec. 25 was asked in 1999 and 1981.

Sec 3. A warehouseman may insert in a receipt issued by him any other terms and conditions provided that such terms and conditions shall not:

a) in any wise impair his obligation to exercise that degree of care which a reasonably careful man would exercise in regard to similar goods of his own

General Rule: Warehouseman is required to exercise such degree of care which a reasonable careful owner would exercise over similar goods of his own. He shall be liable for any loss or injury to the goods caused by his failure to exercise such care.

Exception: He shall not be liable for any loss or injury which could not have been avoided by the exercise of such care.

Exception to the exception: He may limit his liability to an agreed value of the property received in case of loss. He cannot stipulate that he will not be responsible for any loss caused by his negligence.

» To be paid

» In case of non-payment, to exercise his lien on the goods deposited

» To refuse delivery in proper legal circumstances

5.2. Duties

» Issue a warehouse receipt in the required form for goods received

» Obligation to Deliver Goods

Sec 8. A warehouseman, in the absence of some lawful excuse provided by this Act, is bound to deliver the goods upon a demand made either by the holder of a receipt for the goods or by the depositor; if such demand is accompanied with:

1. an offer to satisfy the warehouseman’s lien
2. an offer to surrender the receipt, if negotiable, with such indorsements as would be necessary for the negotiation of the receipt; and
3. a readiness and willingness to sign, when the goods are delivered, an acknowledgement that they have been delivered, if such signature is requested by the warehouseman.

The burden shall be upon the warehouseman to establish the existence of a lawful excuse for such refusal.

General Rule: a demand should be made on the warehouseman in order that the duty to deliver the goods will arise

Exception: when the warehouseman has rendered it beyond his power to deliver the goods, demand may be dispensed with [Art. 1169(3), Civil Code]

Sec 9. A warehouseman is justified in delivering the goods to one who is:

1. the person lawfully entitled to the possession of the goods, or his agent;
2. a person who is either himself entitled to delivery by the terms of a non-negotiable receipt issued for the goods, or who has written authority from the person to whom the goods are deliverable to him or order, or to bearer, or which has been indorsed to him or in blank by the person to whom delivery was promised by the terms of the receipt or by his mediate or immediate indorser.

Sec 10. When a warehouseman delivers the goods to one who is not in fact lawfully entitled to the possession of them, the warehouseman shall be liable as for conversion to all having a right of property or possession in the goods if he delivered the goods otherwise than as authorized by (b) and (c) of Sec 9

Though he delivered the goods as authorized by said subdivisions he shall be so liable, if prior to such delivery he had either:

1. been requested, by or on behalf of the person lawfully entitled, not to make such delivery or
2. had information that the delivery about to be made was to one not lawfully entitled

Conversion - an unauthorized assumption and exercise of the right of ownership over goods belonging to another through the alteration of their condition or the exclusion of the owner’s right (Bouvier’s Law Dictionary)

Sec 17. If more than one person claims the title/possession of the goods, the warehouseman may, either as a defense to an action or as an original suit, require all known claimants to interplead.

Sec 18. If:

1. someone other than the depositor or person claiming under him has a claim to the title or possession of goods AND
2. the warehouseman has information of such claim

the warehouseman shall be excused from liability for refusing to deliver the goods until he has had:

2. reasonable time to ascertain the validity of the adverse claim OR
3. bring legal proceedings to compel claimants to interplead

- Sec. 18 not applicable to cases where the warehouseman himself makes a claim to the goods (67 C.J. 536)

- In case there are adverse claimants, the warehouseman can refuse to deliver the goods to anyone of them until he has had

40 This topic on adverse claimants was asked in 2005 and 1975.
reasonable time to ascertain the validity of the various claims; he is not excused from liability in case he makes a mistake (Comments and Cases on Credit Transactions – De Leon, 2002 ed.)

- Original action or counterclaim for interpleader, whichever is appropriate. In such case, the warehouseman will be relieved from liability in delivering the goods to the person found by the court to have a better right (Comments and Cases on Credit Transactions – De Leon, 2002 ed.)

- Other instances when the warehouseman may refuse to deliver:
  - when the holder of the receipt does not satisfy the conditions prescribed in Sec. 8
  - when the warehouseman has legal title in himself on the goods, such title or right being derived directly or indirectly from the transfer made by the depositor at the time or subsequent to the deposit for storage, or from the warehouseman’s lien (Sec. 16)

**General rule:** The warehouseman cannot refuse to deliver on the ground that he owns the goods (bailee cannot assert title to the goods entrusted to him).

**Exceptions:** In the 2 cases mentioned above

- Where the goods have already been lawfully sold to third persons to satisfy the warehouseman’s lien or disposed of because of their perishable nature (Sec. 36)
- In the valid exercise of the warehouseman’s lien (Sec. 31)

> The warehouseman will not be required to deliver the goods if such had been lost. But this is without prejudice to liabilities which may be incurred by him due to such loss.

> **On commingling of Goods**

**General Rule :**

Sec. 22 A warehouseman shall keep the goods so far separate from

1. the goods of other depositors and
2. from other goods of the same depositor for which a separate receipt has been issued

as to permit at all times the identification and redelivery of the goods deposited.

**Exception:**

Sec. 23.

1. If authorized by agreement or custom and
2. Goods are fungible

the warehouseman may mingle with other goods of the same kind and grade.

The various depositors shall own the entire mass and each shall be entitled to such portion as the amount deposited by him bears to the whole.

- The warehouseman shall be severally liable to each depositor for the care and redelivery of his share of such mass to the same extent and under the same circumstances as if the goods had been kept separate.

> To **insure the goods** in proper circumstances

- Where the law provides
- Where it was an inducement for the depositor to enter into the contract
- Established practice
- Where the warehouse receipt contains a representation to that effect

> To **mark a non-negotiable warehouse receipt** as such

> To **mark as such the duplicates of a negotiable warehouse receipt**

> To **give the proper notice in case of sale** of the goods as provided in the law

> To **take up and cancel the warehouse receipt** when the goods are delivered

**Other Duties**

- If warehouseman fails to cancel receipt when he delivers goods, he is liable if receipt should turn up again (Sec 11)
- Warehouseman should record partial delivery on receipt, or else he is liable on entire receipt (Sec 12)
- If alteration is authorized, warehouseman is liable as altered. If not authorized, warehouseman is liable as originally issued (Sec 13)

- Effects of alteration:

| Alteration immaterial (tenor of receipt not changed) (WON fraudulent; WON authorized) | Warehouseman is liable on the altered receipt accdg to its original tenor |
| Material alteration but authorized | Warehouseman is liable accdg to its terms as altered |
| Material alteration innocently made | Liable accdg to its original tenor |
| Material alteration fraudulently made | Liable accdg to the original tenor to a purchaser of receipt for value without notice and even to the alterer and subsequent purchasers with notice (except that liability is limited only to delivery as he is excused from any liability) |

- A fraudulent alteration cannot divest the title of the owner of the stored goods and the warehouseman is liable to return them to the owner
- A bona fide holder acquires no right to the goods under a lost or stolen negotiable receipt or to which the indorsement of the depositor has been forged
Warehouseman is liable for issuing receipt for non-existing goods or misdescribed goods (Sec. 20)

Effect of misdescription of goods:
- Warehouseman is under the obligation to deliver the identical property stored with him and if he fails to do so, he is liable directly to the owner.
- As against a bona fide purchaser of a warehouse receipt, the warehouseman is estopped from denying that he has received the goods described in the receipt.
- If the description consists merely of marks or label upon the goods or upon the packages containing them, the warehouseman is not liable even if the goods are not of the kind as indicated in the marks or labels.

- Warehouseman is estopped to set up title in himself (Sec 16)
- Non-delivery or goods do not correspond to description => warehouseman is liable

6. Warehouseman’s Lien

Sec. 27. A warehouseman shall have a lien on the goods deposited or on the proceeds thereof for:
1. All lawful charges for storage and preservation of goods
2. All lawful claims for money advanced, interest, insurance, transportation, labor, weighing, co-operating, and other charges in relation to such goods
3. All reasonable charges for notice and advertisements of sale
4. Sale of goods where default has been made in satisfying the warehouseman’s lien

- In case of a negotiable receipt, the charges that are present at the time of the issuance of the receipt must be so stated in the receipt with the amounts thereof specified. If the existing charges are not stated, the warehouseman shall have no lien thereon, except only for charges for storage of those goods subsequent to the date of the receipt.

Sec. 28. A warehouseman’s lien may be enforced:
1. Against all goods belonging to the person who is liable as debtor for the claims
2. Against all goods belonging to others which have been deposited at any time by the person who is liable as debtor for the claims

If such person had been so entrusted with the possession of goods such that a pledge by him at the time of the deposit to one who took the goods in good faith for value would have been valid.

Sec. 29. A warehouseman loses his lien:
1. By surrendering possession of the goods
2. By refusing to deliver the goods when a demand is made with which he is bound to comply

Sec. 31. A warehouseman having a valid lien against the person demanding the goods may refuse to deliver the goods until the lien is satisfied.

- The warehouseman’s lien is possessory in nature (PNB vs Judge Se)
- Involuntary parting with possession of goods ordinarily does not result in loss of his lien by a warehouseman (93 C.J.S. 59)
- A warehouseman who has released his lien by the surrender of the goods may not thereafter claim a lien on other goods of the same depositor for unpaid charges on the goods if the goods were delivered to him under different bailments
- The loss of the warehouseman’s lien does not necessarily mean the extinguishments of the depositor’s obligation to pay the warehousing fees and charges which subsists to be a personal liability
- Remedies discussed in PNB vs. Sajo, 292 SCRA 202 (1998)
  - To refuse to deliver the goods until his lien is satisfied (Sec 31)
  - To sell the goods by public auction and apply the proceeds to the value of the lien (Sec 33 and 34)

Effects:
- The warehouseman is not liable for non-delivery even if the receipt given for the goods were negotiated (Sec. 36)
- Where the sale was made without the publication required and before the time provided by law, such sale is void and the purchaser of the goods acquires no title in them (Eastern Paper Mills Co., Inc. vs Republic Warehousing Corp, 170 SCRA 595)
  - By other means allowed by law to a creditor against his debtor, to collect from the depositor all charges and advances which the depositor expressly or impliedly contracted with the warehouseman to pay (Sec 32)
  - Other remedies allowed by law to enforce a lien against personal property (Sec 35)

- The warehouseman may refuse to deliver goods to any holder of the receipt when the storage fee stipulated in the receipt has not yet been paid

PNB vs. Se (1996)

While the PNB is entitled to the stocks of sugar as the endorsee of the quedans, delivery to it shall be effected only upon payment of the storage fees. Imperative is the right of the warehouseman to demand payment of his lien at this juncture, because in accordance with Section 29 of the Warehouse Receipts Law, the warehouseman loses his lien upon goods by surrendering possession thereof. In other words, the lien may be lost where the warehouseman surrenders the possession of the goods without requiring payment of his lien, because a warehouseman’s lien is possessory in nature.
But the warehouseman cannot refuse to deliver the goods because of an adverse claim of ownership [PNB vs. Sayo, 292 SCRA 202 (1998)]

Rules on attachment/execution of goods deposited:
» In case of negotiable receipt, the goods cannot be attached or levied in execution unless:
  ▫ receipt is first surrendered
  ▫ its negotiation is enjoined
  ▫ receipt is impounded by the court (Sec. 25)
Creditor’s remedies: seek for the attachment of the receipt or seek aid from courts to compel the debtor to satisfy claims by means allowed by law in regard to property which cannot readily be attached or levied upon by ordinary process (Sec. 26)

Not applicable:
  ▫ If the depositor is not the owner of the goods (thief) or one who has no right to convey title to the goods binding upon the owner
  ▫ Actions for recovery or manual delivery of goods by the real owner
  ▫ Where attachment is made prior to the issuance of receipt

Rights acquired by attaching creditors cannot be defeated by the issuance of a negotiable receipt of title thereafter (International Breeding Co. vs Terminal Warehouse Co., 126 Atl. 902)

» In case of a non-negotiable receipt, the goods can be attached, provided it is done prior to the notification of the warehouseman of the transfer (Sec. 42); reason: absent such notice, both the warehouseman and the sheriff have a right to assume that the goods are still owned by the person whose name appears in the receipt

7. Liabilities

<table>
<thead>
<tr>
<th>Civil liabilities</th>
<th>Criminal liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warehouseman or his agent</td>
<td>For damages suffered for failure to comply with legal duties</td>
</tr>
<tr>
<td>1. issuance of receipts for goods not received (Sec. 50)</td>
<td>1. issuance of negotiable warehouse receipt for goods of which he is an owner without stating such fact of ownership (Sec. 51)</td>
</tr>
<tr>
<td>2. issuance of receipt containing false statement (Sec. 51)</td>
<td>5. delivery of goods without obtaining negotiable warehouse receipt (Sec. 54)</td>
</tr>
<tr>
<td>3. issuance of duplicate negotiable warehouse receipt not marked as such (Sec. 52)</td>
<td>3rd persons</td>
</tr>
<tr>
<td>4. issuance of</td>
<td>Negotiation of warehouse receipt issued for mortgaged goods with intent to deceive</td>
</tr>
</tbody>
</table>

General Bonded Warehouse Act
(Act 3893 as amended by RA 247)

1. Purpose

- An act to regulate the business of receiving commodities for storage, giving the director of Commerce and Industry the duty to enforce if, providing penalties for violation of the provisions, exempting cooperative marketing associations of commodity producers from application thereof.
- To protect depositors by giving them a direct recourse against the bond filed by the warehouseman in case of the latter’s insolvency
- To encourage the establishment of more warehouses

2. Definition of Terms

2.1. Warehouse
Every building, structure, or other protected enclosure in which commodities are kept for storage.

2.2. Warehouseman
A person engaged in the business receiving commodities for storage

2.3. Receipt
Any receipt issued by a warehouseman for commodities delivered to him.

Gonzales vs Go Tiong (1958)
The kind or nature of the receipts issued by him for the deposits is not very material, much less decisive. Though it is desirable that receipts issued by a bonded warehouseman should conform to the provisions of the
Warehouseman Receipts Law, said provisions are not mandatory. Under Section 1 of the Warehouse Receipts Act, the issuance of a warehouse receipt in the form provided by it is merely permissive and directory and not obligatory.

- **Commodities**
  - Any farm, agricultural or horticultural product;
  - animal and animal husbandry or livestock, dairy or poultry product;
  - water, marine or fish product;
  - mineral, chemical, drug or medicinal product;
  - forestry product; and any raw, processed, manufactured or finished product or by-product
  - good, article, or merchandise, either of domestic or of foreign production or origin, which may be traded or dealt in openly and legally.

3. Business of Receiving Commodities for Storage

The business of receiving commodities for storage shall include any contract or transaction wherein

1. the warehouseman is obligated to return the very same commodities delivered to him or pay its value;
2. the commodities delivered is to be milled for and on account of the owner thereof;
3. the commodities delivered is commingled with the commodities delivered by or belonging to other persons and the warehouseman is obligated to return the commodities of the same kind or pay its value.

- The kinds of commodity to be deposited must be those, which may be traded or dealt in openly and legally. Thus, illegal and prohibited goods may not be validly received (Sec. 2)
- The warehouseman is not covered by law if the owner merely rents space to a certain group of persons because the law covers warehouse that accepts goods: (a) storage, (b) milling and commingling with the obligation to return the same quantity or to pay their value.

**Limjoco vs Director of Commerce (1965)**

Any contract or transaction wherein the palay delivered is to be milled for and on account of the owner shall be deemed included in the business of receiving rice for storage. In other words, it is enough that the palay is delivered, even if only to have it milled.

In this case it is a fact that palay is delivered to appellant and sometimes piled inside her "camalig" in appreciable quantities, to wait for its turn in the milling process. This is precisely the situation covered by the statute. The main intention of the law-maker is to give protection to the owner of the commodity against possible abuses (and we might add negligence) of the person to whom the physical control of his properties is delivered.

4. Requirement of License

No person shall engage in the business of receiving commodities for storage without first securing a license therefore from the Director of the Bureau of Commerce and Industry. Said license shall be annual and shall expire on the thirty-first day of December.

Any person applying for a license shall set forth in the application

- the place or places where the business and warehouse are to be established or located and
- the maximum quantity of commodities to be received.

There shall be imposed an annual license fee of:

- P50 for the first 1000 square meters of protected enclosure or 1000 cubic meters of storage space, or any fraction of such enclosure or space, and
- 2 ½ centavos for each additional square meter or cubic meter.

5. Requirement of Bond

The application shall be accompanied by a cash bond or a bond secured by real estate or signed by a duly authorized bonding company at not less than 33 1/3% of the market value of the maximum quantity or commodities to be received.

Said bond shall be so conditioned as to respond for the market value of the commodities actually delivered and received at any time the warehouseman is unable to return the commodities or to pay its value.

The bond shall be approved by the Director of the Bureau of Commerce and Industry before issuing a license under this Act.

Whenever the Director shall determine that a bond approved by him has become insufficient, he may require an additional bond or bonds to be given by the warehouseman concerned.

Any person injured by the breach of any obligation to secure which a bond is given, shall be entitled to sue on the bond in his own name in any court of competent jurisdiction to recover the damages he may have sustained by such breach.

Nothing contained herein shall except any property of assets of any warehouseman from being sued on in case the bond given is not sufficient to respond for the full market value of the commodities received by such warehouseman.

6. Requirement of Insurance

Every person licensed to engage in the business of receiving commodities for storage shall insure the commodities so received and stored against fire.

- For palay and corn license, a bond with the National Grains Authority is required; also an insurance cover is required

7. Duties of Bonded Warehouseman

7.1. Storage of Commodities

Every warehouseman shall receive for storage, so far as his license and the capacity of his warehouse permit, any commodities, of the kind customarily stored therein by him, which
may be tendered to him in a suitable condition for warehousing, in the usual manner and in the ordinary and usual course of business, without making any discrimination between persons desiring to avail themselves of warehouse facilities.

7.2. Give the necessary bond

7.3. Insure against fire the commodity received (Sec. 6)

7.4. Record-Keeping and Reporting Requirements

Every warehouser shall keep a complete record of:
- the commodities received by him,
- the receipts issued therefor of the withdrawals,
- the liquidations and all receipts returned to and cancelled by him.

He shall make reports to the Director of Bureau of Commerce and Industry concerning his warehouse and the conditions, contents, operations, and business.

7.5. Observe rules and regulations of the Bureau of Domestic Trade (Sec. 9)

- A person injured by the breach of the warehouser may sue on the bond put up by the warehouser to recover damages he may have sustained on account of such breach. In case the bond is insufficient to cover full market value of the commodity stored, he may sue on any property or assets of the warehouser not exempt by law from attachment and execution (Sec. 7)

8. Warehouse Receipts Law vs. General Bonded Warehouse Act

<table>
<thead>
<tr>
<th>Warehouse Receipts Law</th>
<th>General Bonded Warehouse Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prescribes the mutual duties and rights of a warehouser who issues warehouse receipts, and his depositor, and covers all warehouses whether bonded or not</td>
<td>Regulates and supervises warehouses which put up a bond</td>
</tr>
</tbody>
</table>


9. Liabilities

a. civil: breach of obligations secured by the bond
b. criminal:
   i. engaging in business covered by the Act in violation of the license requirement (Sec. 11)
   ii. receiving a quantity of commodity greater than its capacity or that specified in the license, if the goods deposited are lost or destroyed (Sec. 12)
   iii. connivance with a warehouser for the purpose of evading the license requirement (Sec. 13)

1. Definition of Trust Receipt

- As a document, it is a written or printed document signed by the entrustee in favor of the entruster whereby the latter releases the goods to the possession of the former upon the entrustee's promise to hold said goods in trust for the entruster, to sell or dispose of the goods, and to return the proceeds thereof to the extent of what is owing to the entruster; OR to return the goods, if unsold or not otherwise dispose of (Sec. 4)
- Trust Receipt transaction – a separate and independent security transaction intended to aid in financing importers and retail dealers who do not have sufficient funds to finance the importation/purchases and who may not be able to acquire credit except through utilization, as collateral, of the merchandise imported/purchased (Nacu vs. CA; South City Home vs. BA Finance)
- Goods are owned by the bank, and are only released to the importer in trust after the grant of the loan. The bank acquires a security interest in the goods as holder of a security title for the advances it made to the entrustee.
- Entrustee must deliver money or return unsold goods to entruster
- Bank is preferred over other creditors.
- Bank is also not liable to buyer of goods as vendor
- Purchaser from entrustee gets good title.
- No particular form is required for trust receipt, but it must substantially contain:
  » Description of the goods, documents or instruments subject of the TR
  » Total invoice value of the goods and the amount of the draft to be paid by the entrustee
  » Undertaking or a commitment of the entrustee
  » to hold in trust for the entruster the goods, documents or instruments therein described
  » to dispose of them in the manner provided for in the trust receipt
  » to turn over the proceeds of the sale of the goods, documents or instruments to the entruster to the extent of the amount owing to the entruster or as appears in the trust receipt or to return the goods, documents or instruments in the event of their non-sale within the period specified therein (Sec. 5)
  » the trust receipt may contain other terms and conditions agreed upon by the parties in addition to those hereinafore enumerated provided that such terms and conditions shall not be contrary to provisions of this Decree, any existing laws, public policy or morals, public order or good customs (Sec. 5)
  » trust receipts are denominated in Philippine currency or acceptable and eligible foreign currency
2. Purposes of the Law

- To encourage the use of and promote transactions based on trust receipts; regulate the use of trust receipts; encourage and promote the use of trust receipts as an additional and convenient aid to commerce and trade.
- To regulate trust receipt transactions in order to assure the protection of the rights and the enforcement of the obligations of the parties involved.
- To declare the misuse or misappropriation of goods or the proceeds realized from the sale of goods released under trust receipts as an offense punishable under Art. 315, RPC (Sec. 2).
- To punish the dishonesty and abuse of confidence in the handling of money or goods to the prejudice of another regardless of whether or not the latter is the owner (Colinares vs. CA, 2000).

3. Nature of Trust Receipt Transaction

Sec 4. Any transaction by and between an entruster and an entrustee, whereby
- the entrustee, who owns/holds absolute title or security interests over certain specified goods, documents or instruments,
- releases the same to the possession of the entrustee upon the latter’s execution and delivery of a signed document called a “trust receipt” wherein the entrustee binds himself
  » to hold the designated goods, documents or instruments in trust for the entruster and
  » to sell or otherwise dispose of the goods, documents or instruments with the obligation to turn over to the entrustee the proceeds or the goods, documents or instruments themselves if they are unsold or for other purposes substantially equivalent to any of the following:
  - In the case of goods or documents
    - to sell / procure their sale; or
    - to manufacture or process the goods with the purpose of ultimate sale: Provided that the entrustee shall retain title over the goods whether in its original or processed form until the entrustee has complied fully with his obligation under the trust receipt; or
    - to load, unload, ship or tranship or otherwise deal with them in a manner preliminary or necessary to their sale; or
  - In the case of instruments,
    - to sell or procure their sale or exchange; or
    - to deliver them to a principal; or
    - to effect the consummation of some transactions involving delivery to a depository or register; or
- to effect their presentation, collection or renewal.

The sale of goods/documents/instruments by a person in the business of selling such for profit who, at the outset of the transaction, has, as against the buyer, general property rights in such goods/documents/instruments, or who sells the same to the buyer on credit, retaining title or other interest as security for the payment of the purchase price does not constitute a trust receipt transaction and is outside the purview and coverage of this Decree.

Notes:
- This is not a simple loan transaction between a creditor and debtor-importer.
- The law warrants the validity of the entruster’s security interest as against the creditors of the trust receipt agreement.

<table>
<thead>
<tr>
<th>PD 115</th>
<th>Civil Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>Although the entrustee is not the owner of the goods, anyone who buys from him acquires good title over the goods</td>
<td>Buyer acquires only whatever title the seller has at the time the sale is perfected (Art 1505)</td>
</tr>
<tr>
<td>Even if the entrustee is not the owner, he bears risk of loss while the goods are in his possession</td>
<td>Generally, owner bears loss</td>
</tr>
</tbody>
</table>


A trust receipt agreement is merely a collateral agreement, the purpose of which is to serve as security for a loan.

Allied Banking vs Ordonez (1990)
(Capital goods are covered.)

Applies even to goods not destined for sale or manufacture, and would include items obtained to repair and maintain equipment used in business.

4. Trust Receipts as Against Other Transactions


<table>
<thead>
<tr>
<th>Other transactions</th>
<th>Trust Receipt Transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chattel Mortgage</td>
<td>subjects the property to a lien</td>
</tr>
<tr>
<td>Pledge</td>
<td>financer possesses the property</td>
</tr>
<tr>
<td>Conditional Sale</td>
<td>There is a sale of the property from the seller to the buyer</td>
</tr>
<tr>
<td>Consignment</td>
<td>1.Bipartite 2.Consignor retains ownership of the property</td>
</tr>
<tr>
<td></td>
<td>no lien is created over the property</td>
</tr>
<tr>
<td></td>
<td>person financed possesses the property</td>
</tr>
<tr>
<td></td>
<td>There is no sale of the property from the entruster to the entrustee</td>
</tr>
<tr>
<td></td>
<td>1. Tripartite 2. Seller does not retain title to the property</td>
</tr>
</tbody>
</table>
Colinares vs CA (2000)  
(Loan vs trust receipts transaction)

This situation belies what normally obtains in a pure trust receipt transaction where goods are owned by the bank and only released to the importer in trust subsequent to the grant of the loan. The bank acquires a "security interest" in the goods. The ownership of the merchandise continues to be vested in the person who had advanced payment until he has been paid in full, or if the merchandise has already been sold, the proceeds of the sale should be turned over to him. The bank takes full title to the goods and continues to hold that as his indispensable security until the goods are sold and the vendee is called upon to pay for them. Trust receipts partake of the nature of a conditional sale where the importer becomes absolute owner of the imported merchandise as soon as he has paid its price.

Consolidated Bank vs CA (2001)  
(Simple loan vs trust receipt transaction)

The delivery to Corporation of the goods subject of the trust receipt occurred long before the trust receipt itself was executed. This situation is inconsistent with what normally obtains in a pure trust receipt transaction, wherein the goods belong in ownership to the bank and are only released to the importer in trust after the loan is granted.

Robles vs CA (1991)  
(Bipartite transactions are covered).

In deciding WON the delivery trust receipts covered a trial sale transaction or one that fell under the trust receipts law, the SC found that the requisites under Sec 4 were met:

1) Paramount retained ownership of the office equipment covered by the receipts;
2) possession of the goods was subject to a fiduciary obligation to return them within a specified period or to account for the proceeds thereof

6. Rights/Duties of the Entruster

6.1. Rights of Entruster

Sec. 7. The entruster shall be entitled to:
- the proceeds from the sale of the goods, documents or instruments to the extent of the amount owing to the entruster or as appears in the trust receipt, or
- to the return of the goods, documents or instruments in case of non-sale, and
- to the enforcement of all other rights conferred on him in the trust receipt

Extent of security interest
- as against the innocent purchaser for value – not preferred (Sec. 11)
- as against creditors of entrustee – preferred (Sec. 12)

Prudential Bank vs NLRC (1995)  
(Nature of interest of entrustee in goods covered)

The security interest of the entrustee is not merely an empty or idle title. To a certain extent, such interest becomes a "lien" on the goods because the entrustee’s advances will have to be settled first before the entrustee can consolidate his ownership over the goods. The law warrants the validity of petitioner’s security interest as against all creditors of the trust receipt agreement. The only exception is when the properties are in the hands of an innocent purchaser for value and in good faith.

Prudential Bank vs NLRC (1995)  
(The goods covered by trust receipts cannot be levied upon by creditors of the entrustee)

The entruster may cancel the trust and take possession of the goods, documents or instruments subject of the trust or of the proceeds realized therefrom at any time upon default or failure of the entrustee to comply with any of the terms and conditions of the trust receipt or any other agreement between the entrustee and the entrustee.

The entrustee in possession of the goods, documents or instruments may, on or after default, give notice to the entrustee of the intention to sell, and may, not less than five days after serving or sending of such notice, sell the goods, documents or instruments at public or private sale, and the entrustee may, at a public sale, become a purchaser.
The proceeds of any such sale, whether public or private, shall be applied
• to the payment of the expenses thereof;
• to the payment of the expenses of re-taking, keeping and storing the goods, documents or instruments;
• to the satisfaction of the entrustee's indebtedness to the entruster.

The entrustee shall receive any surplus but shall be liable to the entruster for any deficiency.

6.2. Duties of Entruster
» To give possession of the goods to the entrustee
» To give at least 5 days notice to the entrustee of the intention to sell the goods at an intended public sale

State Investment vs CA (2000)
(Entruster not entitled to proceeds of sale of goods not covered by trust receipt)

The evidence for PNB fails to establish that the vehicles sold to the Francos were among those covered by the trust receipts. Neither the trust receipts covering the units imported nor the corresponding bills of lading contain the chassis and engine numbers of the vehicles in question.

7. Rights/Duties of the Entrustee

7.1. Rights of Entrustee
» To receive the surplus from the public sale
» To have possession of the goods as a condition for his liability under the Trust Receipt Law (Ramos vs. CA)

7.2. Duties of Entrustee

Sec. 9.
» hold the goods, documents or instruments in trust for the entruster and shall dispose of them strictly in accordance with the terms and conditions of the trust receipt;
» receive the proceeds in trust for the entruster and turn over the same to the extent of the amount owing to the entrustee or as appears on the trust receipt;
» insure the goods for their total value against loss from fire, theft, pilferage or other casualties;
» keep said goods or proceeds separate and capable of identification;
» return the goods, documents or instruments in the event of non-sale or upon demand;
» observe all other terms and conditions of the trust receipt

Vintola vs IBAA (1987)
(Liability of entrustee not extinguished by return of goods to entrustee)

IBAA did not become the real owner of the goods; it was merely the holder of a security title for the advances it had made to the Vintolas. The goods remain the Vintolas’ own property. The trust receipt arrangement did not convert the IBAA into an investor. The fact that the Vintolas were unable to sell the seashells does not affect IBAA’s right to recover the advances made under the Letter of Credit

7.3. Risk of Loss borne by entrustee

Sec. 10. The risk of loss shall be borne by the entrustee; 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.

7.4. Non-Liability of Entrustee for Sale by Entrustee

Sec. 8. The entrustee holding a security interest shall not, merely by virtue of such interest or having given the entrustee liberty of sale or other disposition of the goods, documents or instruments be responsible as principal or as vendor under any sale or contract to sell made by the entrustee.

8. Purchaser in Good Faith

• Acquisition by purchaser of goods in good faith

Sec 11. Any purchaser of goods from an entrustee with right to sell, or of documents or instruments through their customary form of transfer, who buys such for value and in good faith from the entrustee, acquires said goods, documents or instruments free from the entrustee's security interest.

9. Remedies Available

• Failure to turn over proceeds of the sale of goods or to return unsold goods is a public nuisance to be abated by the imposition of penal sanctions (Tiomico vs. Court of Appeals, 1999).
• The offense is malum prohibitum. There is no need to prove damage to the entrustor. (Metropolitan Bank vs. Tonda, 2000), or intent to defraud (People vs. Cuervo, 1981)
• Offense: estafa under Art 315 of the Revised Penal Code.
• Also, liable for damages under Art. 33, CC (Prudential vs. IAC, PP vs. Cuervo, MBTC vs. Tonda)
• Effect of compliance:
  » before criminal charge – no criminal liability
  » after charge, before conviction – extinguishments of criminal liability
• Liability of entrustee accrues on his failure to comply with his obligation to return. It is not absolutely necessary that the entruster cancels the trust and take possession of the goods to be able to enforce his rights under this law.
• PD 115 allows the bank to take possession of the goods covered by the trust receipts. Thus, even though the bank took possession of the goods covered by the trust receipts, the entrustees remained liable for the entire amount of the loans covered by the trust receipts (Phil. Blooming vs. CA)

Lee vs Rodil (1989)
Acts involving the violation of trust receipt agreements occurring after 29 Jan 1973 would make the accused criminally liable for estafa under par1(b), Art 315 of the RPC, pursuant to the explicit provision in Sec. 13 of P.D. 115.

**Allied vs. Ordoñez**

The penal provisions of PD 115 encompasses any act violative of the obligation covered by the trust receipt. It is not limited to transactions in goods which are to be sold, reshipped or stored, but also applies to goods processed as a component of a product ultimately sold to the general public.

**Sarmiento, Jr. vs. CA (2002)**

The breach of obligation of a trust receipt agreement is separate and distinct from any criminal liability for “misuse and/or misappropriation of goods or proceeds realized from the sale of goods, documents or instruments released under trust receipts”, punishable under Sec. 13 of the Trust Receipts Law (PD 115) in relation to Article 315(1) (b) of the Revised Penal Code. Being based on an obligation ex contractu and not ex delicto, the civil action may proceed independently of the criminal proceedings instituted against petitioners regardless of the result of the latter.

**People vs Nitafan (1992)**

(Violation of PD 115 is an offense against public order, not property)

The Trust Receipts Law punishes the dishonesty and abuse of confidence in the handling of money or goods - it does not seek to enforce payment of the loan. Thus, there can be no violation of a right against imprisonment for non-payment of a debt. P.D. 115, like BP 22, punishes the act "not as an offense against property, but as an offense against public order." Thus the law states that a breach of a trust receipt agreement makes one liable for estafa.

**Philippines Bank vs Ong (2002)**

The Supreme Court ruled that a Memorandum of Agreement entered into between the bank-entruster and entrustee extinguished the obligation under the existing trust receipt because the agreement did not only reschedule the debts of the entrustee but it provided principal conditions which are incompatible with the trust agreement. Hence, the liability for breach of the Memorandum of Agreement would be purely civil in nature and no criminal liability under the Trust Receipt Law can be imposed.

**Prudential Bank vs. NLRC (1995)**

Entrustor can:
- cancel trust and take possession of the goods
- file a 3rd party claim or separate civil action at any time upon default or failure of entrustee to comply with terms and conditions of the trust agreement

Tupaz VI, et. al. vs. CA and BPI, G.R. 145578, Nov. 18, 2005

Here, BPI chose not to file a separate civil action to recover payment under the trust receipts. Instead, respondent bank sought to recover payment in Criminal Case Nos. 8848 and 8849. Although the trial court acquitted petitioner Jose Tupaz, his acquittal did NOT extinguish his civil liability. His liability arose not from the criminal act of which he was acquitted (ex delicto) but from the trust receipt contract (ex contractu) of 30 September 1981. Petitioner Jose Tupaz signed the trust receipt of 30 September 1981 in his personal capacity. Acquittal in a criminal case for estafa does not extinguish civil liability arising from breach of trust receipt contract.
General Banking Law of 2000

(RA 8791)

Section 1 – General Provisions

1.01. LONG TITLE
An act providing for the regulation of and organization and operations of banks, quasi-banks, trust entities and for other purposes.

1.02. LAWS PRIMARILY APPLICABLE TO DIFFERENT BANKS
1. The General Banking Law (GBL) governs
   a. Universal Banks (UB) (esp. Secs. 23-28)
   b. Commercial Banks (KB) (esp. Secs. 29-32)
2. The GBL has suppletory application to
   a. Thrift Banks (primarily governed by RA 7906, the Thrift Banks Act)
   b. Rural Banks (primarily governed by RA 7353, the Rural Banks Act)
   c. Cooperative Banks (primarily governed by RA 6938, the Cooperative Code) (Sec. 71)

Note: Sec 71: [1] For purposes of prescribing the minimum ratio which the net worth of a thrift bank must bear to its total risk assets, the provisions of Section 33 [should be Sec. 34] of the GBL shall govern. [2] Although Sec. 71 provides that “Islamic banks shall be governed by special laws.” It does not include Thrift Banks in the enumeration of Banks to which the GBL has application.

3. The entry of foreign banks in the Phil. through the establishment of branches shall be governed by the provisions of the Foreign Banks Liberalization Act. The conduct of offshore banking business in the Phil. shall be governed by PD 1034, the “Offshore Banking System Decree.” (Sec. 72)

1.03. POLICY OF THE GBL
• The State recognizes
  a. the vital role of banks in providing an environment conducive to the sustained development of the national economy and
  b. the fiduciary nature of banking that requires high standards of integrity and performance.
• The State shall promote and maintain a stable and efficient banking and financial system that is globally competitive, dynamic and responsive to the demands of a developing economy. (Sec. 2)

1.04. BANKS, DEFINED: CORE BANKING
• "Banks" shall refer to entities engaged in
  1. the lending of funds
  2. obtained in the form of deposits. (SubSec. 3.1)
• The "lending of funds obtained in the form of deposits" is classical or core banking function of mobilizing savings (through deposit-taking) and allocating resources (through lending). It was held in the case of RP v Security Credit and Acceptance Corp. (1967) that a bank is "a moneyed institute founded to facilitate the borrowing, lending and safe-keeping of money and to deal, in notes, bills of exchange and credits... Moreover, ...an investment company which loans out the money of its customers, collects the interest and charges a commission to both lender and borrower, is a bank. xxx any person engage in the business carried on by banks of deposit, of discount, or of circulation is doing a banking business, although but one of these functions is exercised." In reality, however, banks do more than deposit-taking and lending. Secs. 29 to 53 of the GBL enumerate these other activities which can all be conducted by a Universal Bank (UB). What is more, both a UB and a Commercial Bank (KB) can have equity interests in allied enterprises. UBs can also be stockholders in non-allied enterprises and can even exercise the powers of an investment house. (Morales)

1.05. QUASI-BANKS, DEFINED
• "Quasi-banks" (QB) refer to entities engaged in the borrowing of funds through the issuance, endorsement or assignment with recourse of deposit substitutes (as defined in Sec. 95 RA 7653, the New Central Bank Act) for purposes of relending or purchasing of receivables and other obligations. (last par of Sec. 4)
• This is an inherent power of UBs and KBs. Thus they do not require separate licensing or authorization for this purpose. Thus, they can take "deposit substitutes" for re-lending. (Morales)

1.06. DEPOSIT SUBSTITUTES
• Deposit substitutes are
  - deposits other than savings, demand/current, time/fixed deposits, but also in the form of cash
  - obtained from the public, i.e. 20 or more lenders at any one time
  - obtained through the issuance, endorsement, or acceptance with recourse or assignment, similar instruments with recourse, and repurchase agreements) obtained for the purpose of relending or purchasing of receivables and other obligations. (Sec. 95 NCBA; Subsec. X234.2.d Manual of Regulations for Banks)
• Deposit substitute taking may be classified as a core-banking operation, especially in the case of UBs and KBs, which are allowed, under Sec. 6 of the GBL, to engage in Quasi-banking activities (more appropriately termed deposit substitute operations, as there is nothing "quasi" about the banks performing these operations themselves). Since a deposit substitute is merely a product of the activity called Quasi-banking (deposit substitute operations), deposit substitute taking may be considered a core banking function in the sense that it mobilizes savings through deposit-substitute taking. It should likewise be noted that the purpose of a deposit-substitute is relending, which is also a core banking function. (Morales)

• The BSP supervises QBs, i.e. entities engaged in obtaining deposit substitutes. This supervision was premised on the finding by the Joint IMF-CBP Banking Survey Commission that "institutions... regularly engaged in the lending of funds obtained from the public through the issuance of their own debt instruments (other than deposit instruments) [and] ...beyond the pale of CB regulatory authority" weakened "to a large extent the effectiveness of CB action in the field of credit regulations." This unregulated segment of the financial system was the "money market" that had developed since the 1960s by what later became known as "investment houses." The said money market involved short-term instruments, and emerged in response to interest rate ceilings imposed by the Usury Law. These ceilings then applied to deposits in banks but not in placements coursed through the investment houses. Naturally, investors flocked to these houses for higher yields. Before long, the deposit generating ability of the banks was seriously undermined by the competition. In 1972, the hitherto unfettered money market was called Quasi-banking and subjected to CB regulation, and funds placed with quasi-banks were labeled as "deposit substitutes." (Morales)

1.07. CLASSIFICATION OF BANKS

1. Universal banks (UB);
2. Commercial banks (KB);
3. Thrift banks, composed of:
   a. Savings and mortgage banks,
   b. Stock savings and loan associations, and
   c. Private development banks;
4. Rural banks;
5. Cooperative banks;
6. Islamic banks (under RA 6848, Charter of Al Amnah Islamic Investment Bank of the Phils.);
7. Other classifications of banks as determined by the MB of the BSP.

1.08. RULE ON BANKING OPERATIONS

• No person or entity shall engage in banking operations or quasi-banking functions without authority from the BSP. Persons or entities found to be performing banking or quasi-banking functions without authority from the BSP shall be subject to appropriate sanctions under the NCBA and other applicable laws. (Sec. 6)

• No person, association, or corporation unless duly authorized to engage in the business of a bank, QB, trust entity, or savings and loan association shall advertise or hold itself out as being engaged in the business of such bank, QB, trust entity, or association, or use in connection with its business title, the word or words "bank", "banking", "banker", "QB ", "quasi-banking", "quasi-banker", "savings and loan association", "trust corporation", "trust company" or words of similar import or transact in any manner the business of any such bank, corporation or association. (Sec. 64)

• An entity authorized by the BSP to perform UB or KB functions shall likewise have the authority to engage in quasi-banking functions. (Sec. 6)

Note: The determination of whether a person or entity is performing banking or quasi-banking functions without Bangko Sentral authority shall be decided by the MB. To resolve such issue, the MB may, through the appropriate supervising and examining department of the BSP, examine, inspect or investigate the books and records of such person or entity. Upon issuance of this authority, such person or entity may commence to engage in banking operations or quasi-banking functions and shall continue to do so unless such authority is sooner surrendered, revoked, suspended or annulled by the BSP in accordance with this Act or other special laws. The department head and the examiners of the appropriate supervising and examining department are hereby authorized to administer oaths to any such person, employee, officer, or director of any such entity and to compel the presentation or production of such books, documents, papers or records that are reasonably necessary to ascertain the facts relative to the true functions and operations of such person or entity. Failure or refusal to comply with the required presentation or production of such books, documents, papers or records within a reasonable time shall subject the persons responsible therefor to the penal sanctions provided under the NCBA. (Sec. 6)

1.09. AUTHORITY OF THE BSP

A. Supervision

The operations and activities of banks shall be subject to supervision of the Bangko Sentral. "Supervision" shall include the following:

1. The issuance of rules of conduct or the establishment of standards of operation for uniform application to all institutions or functions covered;
2. The conduct of examination to determine compliance with laws and regulations;
3. Overseeing to ascertain that laws and regulations are complied with;
4. Regular investigation (not oftener than once a year) to determine whether an institution is conducting its business on a safe or sound basis;
5. Inquiring into the solvency and liquidity of the institution; or
6. Enforcing prompt corrective action. (Sec. 4)
The BSP shall also have supervision over QBs, trust entities and other financial institutions which under special laws are subject to BSP supervision. (Sec. 4)

- The BSP shall, when examining a bank, have the authority to examine an enterprise which is wholly or majority-owned or controlled by the bank. (Sec. 7)

**B. Policy Direction**

The BSP shall provide policy direction in the areas of money, banking and credit. For this purpose, the MB may prescribe ratios, ceilings, limitations, or other forms of regulation on the different types of accounts and practices of banks and QBs which shall, to the extent feasible, conform to internationally accepted standards, including those of the Bank for International Settlements (BIS). The Monetary Board may exempt particular categories of transactions from such ratios, ceilings and limitations, but not limited to exceptional cases or to enable a bank or quasi-bank under rehabilitation or during a merger or consolidation to continue in business with safety to its creditors, depositors and the general public. (Sec. 5)

**C. Authority of BSP over Building and Home Associations**

Within a period of 3 years from the effectivity of the GBL, the BSP shall phase out and transfer its supervising and regulatory powers over building and loan associations to the Home Insurance and Guaranty Corporation which shall assume the same. (Sec. 94)

**Section 2 – Organization, Management and Administration of Banks, Quasi-Banks and Trust Entities**

**2.01. CONDITIONS FOR THE ORGANIZATION OF BANKS AND QBs**

The Monetary Board may authorize the organization of a bank or quasi-bank subject to the following conditions:

1. entity must be a stock corporation and must only issue par value stocks;
2. its funds must be obtained from the public, which shall mean 20 or more persons; and
3. minimum capital requirements prescribed by the MB for each category of banks must be satisfied (Sec. 8).

**2.02. CERTIFICATE OF AUTHORITY TO REGISTER**

The SEC shall not register the articles of incorporation or the by-laws of any bank, or any amendment thereto, unless accompanied by a certificate of authority issued by the MB, under its seal. Such certificate shall not be issued unless the MB is satisfied from the evidence submitted to it that:

1. all requirements of existing laws and regulations to engage in the business for which the applicant is proposed to be incorporated have been complied with;
2. the public interest and economic conditions, both general and local, justify the authorization; and
3. the amount of capital, the financing, organization, direction and administration, as well as the integrity and responsibility of the organizers and administrators reasonably assure the safety of deposits and the public interest. (Sec. 14)

**2.03. PSE-LISTED BANKING CORPORATION SUBJECT TO SEC REPORTORIAL RULES**

A commercial banking corporation listed in the PSE must adhere not only to the banking and other allied special laws, but also to the rules promulgated by the SEC, the government entity tasked not only with the enforcement of the Revised Securities Act, but also the supervision of all corporations, partnerships or associations which are grantees of government-issued primary franchises and/or licenses or permits to operate in the Phils.. That such banking institution is under the supervision of BSP and PSE, does not exempt it from complying with the continuing disclose requirements embodied in the RSA Rules. The bank is primarily subject to the control of BSP; and as a corporation trading its securities in the stock market, it is under the supervision of SEC. There is no over-supervision here; each regulating authority operates within the sphere of its powers; the stringent requirement imposed are understandable, considering the paramount importance given to the interests of the investing public. (*Union Bank of the Phils. v SEC*, 2001)

**2.04. PROHIBITION ON TREASURY STOCKS**

No bank shall purchase or acquire shares of its own capital stock or accept its own shares as a security for a loan, except when authorized by the MB: Provided, That in every case the stock so purchased or acquired shall, within 6 months from the time of its purchase or acquisition, be sold or disposed of at a public or private sale. (Sec. 10)

**2.05. RESTRICTIONS ON FOREIGN STOCKHOLDINGS**

Foreign individuals and non-bank corporations may own or control up to 40% of the voting stock of a domestic bank. This rule shall apply to Filipinos and domestic non-bank corporations. (Sec. 11)
2.06. GRANDFATHER RULE

The percentage of foreign-owned voting stocks in a bank shall be determined by the citizenship of the individual stockholders in that bank. The citizenship of the corporation which is a stockholder in a bank shall follow the citizenship of the controlling stockholders of the corporation, irrespective of the place of incorporation. (Sec. 11)

BSP Circular 256 (2000)
Section 1. Foreign individuals and non-bank corporations may own or control up to 40% of the voting stock of a domestic bank: Provided, That the aggregate ceiling on the ownership by such individuals and corporations in a domestic bank. There shall be no aggregate ceiling on the ownership by such individuals and corporations in a domestic bank.
Section 2. A Filipino individual and a domestic non-bank corporation may each own up to 40% of the voting stock of a domestic bank. There shall be no aggregate ceiling on the ownership by such individuals and corporations in a domestic bank.
Section 3. The citizenship of the corporation which is a stockholder of a bank shall follow the citizenship of the controlling stockholders of the corporation, irrespective of the place of incorporation. The term “controlling stockholders” shall refer to individuals holding more than 50% of the voting stock of the corporate stockholder.
Section 4. The right of Philippine corporations, however, under Sec. 8 of RA 7721 (Act Liberalizing the Entry of Foreign Banks), to wit:
“x x x Any right, privilege or incentive granted to foreign banks or their subsidiaries or affiliates under this Act, shall be equally enjoyed by and extended under the same conditions to Philippine banks. Philippine corporations whose shares of stocks are listed in the PSE or are of long standing for at least 10 years shall have the right to acquire, purchase or own up to 60% of the voting stock of a domestic bank.”
shall continue to be in force and effect.

2.07. DISCLOSURE OF STOCKHOLDINGS OF FAMILY GROUPS OR RELATED INTERESTS

- Stockholdings of individuals related to each other within the fourth degree of consanguinity or affinity, legitimate or common-law, shall be considered family groups or related interests and must be fully disclosed in all transactions by such an individual with the bank. (Sec. 12)
- Two or more corporations owned or controlled by the same family group or same group of persons shall be considered related interests and must be fully disclosed in all transactions by such corporations or related groups of persons with the bank. (Sec. 13)

BSP Circular 332 (2002)
Stockholdings of Family Groups or Related Interests. Individuals related to each other within the 4th degree of consanguinity or affinity, whether legitimate, illegitimate or common-law, shall be considered family groups or related interests but may each own up to 40% of the voting stock of a domestic bank: Provided, That said relationship must be fully disclosed in all transactions by such individual or family group with the bank.

Corporate Stockholdings. 2/more corporations owned or controlled by the same family group or same group of persons shall be considered related interests but may each own up to 40% of the voting stock of a domestic bank: Provided, That said relationship must be fully disclosed in all transactions by such corporations or related groups of persons with the bank.

- A natural person and a corporation or corporations which are wholly-owned, or a majority of the voting stock of which is owned, by him may own only up to a combined 40% of the voting stock of a domestic bank.
- Every natural person acquiring shares cumulatively amounting to at least 2% of the total subscribed capital of a domestic bank must disclose all relevant information on all persons related to him within the 4th degree of consanguinity or affinity as well as corporations, partnerships or associations where he has controlling interests. A corporation acquiring shares amounting to at least 2% of the total subscribed capital of a domestic bank must disclose its controlling stockholder or group of stockholders as well as the corporations, partnerships or associations where such controlling stockholder or group of stockholders have controlling interest.
- Ceilings on stockholdings in a cooperative bank. The equity investment of any cooperative in any Cooperative Bank shall not exceed 40% of the subscribed capital stock of such Cooperative Bank.
- Any arrangement, such as voting trust agreement or proxy, which vests on any person or corporation the right to vote or control voting stocks in banks, if such agreement in itself, or in relation with another previous similar agreement or previous sale or transfer shall result in the acquisition of control, in excess of the prescribed limitations is unlawful and void.

Transfers requiring prior Monetary Board approval.
(a) Any sale or transfer or series of sales or transfers which will result in ownership or control of more than 20% of the voting stock of a bank by any person whether natural or juridical or which will enable such person to elect, or be elected as, a director of such bank; and
(b) Any sale or transfer or series of sales or transfers which will effect a change in the majority ownership or control of the voting stock of the bank from one group of persons to another group: Provided, That in no case shall such sale or transfer be approved unless the bank concerned shall immediately comply with the prescribed minimum capital requirement for new banks
Section 3 – Board of Directors and Officers

3.01. COMPOSITION OF THE BOARD OF DIRECTORS

- The provisions of the Corporation Code to the contrary notwithstanding, there shall be at least 5, and a maximum of 15 members of the board of directors of bank, 2 of whom shall be independent directors. An "independent director" shall mean a person other than an officer or employee of the bank, its subsidiaries or affiliates or related interests. (Sec. 15)
- In the case of a bank merger or consolidation, the number of directors shall not exceed 21. (Sec. 17)
- Non-Filipino citizens may become members of the board of directors of a bank to the extent of the foreign participation in the equity of said bank. (Sec. 15 with Sec. 7, RA 7721)

3.02. QUALIFICATIONS / DISQUALIFICATIONS OF DIRECTORS (BSP CIRCULAR 296 ; 2001)

A director shall have the following minimum qualifications:
- At least 25 years of age at the time of his election or appointment;
- At least a college graduate or have at least 5 years experience in business;
- Must have attended a special seminar for board of directors conducted or accredited by the BSP;
- Must be fit and proper for the position of a director of the bank/quasi-bank/trust entity. In determining whether a person is fit and proper for the position of a director, the following matters must be considered:
  - integrity/probity;
  - competence;
  - education;
  - diligence; and
  - experience/training.

The following are Permanently disqualified from being directors:
- Directors/officers/employees permanently disqualified by the MB;
- Persons who have been convicted by final judgement for offenses involving dishonesty or breach of trust;
- Persons who have been convicted by final judgement for violation of banking laws;
- Persons who have been judicially declared insolvent, spendthrift or incapacitated to contract; or
- Directors, officers or employees of closed banks/quasi-banks/trust entities who were responsible for such institution’s closure.

The following are Temporarily disqualified:
- Directors/officers/employees disqualified by the MB;
- Persons who refuse to fully disclose the extent of their business interest. This disqualification shall be in effect as long as the refusal persists;
- Directors who have been absent or who have not participated for whatever reasons in more than 50% of all meetings, both regular and special, of the board of directors during their incumbency, or any 12 month period during said incumbency. This disqualification applies for purposes of the succeeding election;
- Persons who are delinquent in the payment of their obligations. Delinquency in the payment of obligations means that an obligation of a person with a bank/quasi-bank/trust entity where he/she is a director or officer, or at least two obligations with other banks/financial institution under different credit lines or loan contracts, are past due. This disqualification shall be in effect as long as the delinquency persists.
- Persons convicted for offenses involving dishonesty, breach of trust or violation of banking laws but whose conviction has not yet become final and executory;
- Directors and officers of closed banks/quasi-banks/trust entities pending their clearance by the MB;
- Directors disqualified for failure to observe/discharge their duties and responsibilities prescribed under existing regulations. This disqualification applies until the lapse of the specific period of disqualification or upon approval by the MB; Directors who failed to attend the special seminar for board of directors required;
- Persons dismissed/terminated from employment for cause. This disqualification shall be in effect until they have cleared themselves of involvement in the alleged irregularity;
- Those under preventive suspension; or
- Persons with derogatory records with the NBI, court, police, interpol and monetary authority (central bank) of other countries (for foreign directors and officers) involving violation of any law, rule or regulation of the Government or any of its instrumentalities adversely affecting the integrity and/or ability to discharge the duties of a bank/quasi-bank/trust entity director/officer. This disqualification applies until they have cleared themselves of involvement in the alleged irregularity.

3.03. QUALIFICATIONS/DISQUALIFICATIONS OF OFFICERS (BSP CIRCULAR 296 ; 2001)

An officer shall have the following minimum qualifications:
- At least 21 years of age;
- At least a college graduate, or have at least 5 years experience in banking or trust operations or related activities or in a field related to his position and responsibilities, or have undergone training in banking or trust operations acceptable to the appropriate supervising and examining department of the BSP: Provided, however, That trust officers shall have at least 2 years of actual experience or training in trust operations or fund management or other related fields; and
• Must be fit and proper for the position he is being proposed/appointed to. In determining whether a person is fit and proper for a particular position, the following matters must be considered:
  - integrity/probity;
  - competence;
  - education;
  - diligence; and
  - experience/training.

• The disqualifications for directors mentioned for shall likewise apply to officers, except that stated in Items b.2 (persons who refuse to fully disclose the extent of their business interest ) and b.7 (directors disqualified for failure to observe/discharge their duties and responsibilities).

• Except as may be authorized, the spouse or a relative within the 2nd degree of consanguinity or affinity of any person holding the position of Chairman, President, Executive Vice President or any position of equivalent rank, General Manager, Treasurer, Chief Cashier or Chief Accountant is disqualified from holding or being elected or appointed to any of said positions in the same bank/quasi-bank; and the spouse or relative within the second degree of consanguinity or affinity of any person holding the position of Manager, Cashier, or Accountant of a branch or office of a bank/quasi-bank/trust entity is disqualified from holding or being appointed to any of said positions in the same branch or office.

• In the case of UBs, CBs, and TBs, any appointive or elective officials whether full time or part time, except in cases where such service is incident to financial assistance provided by the government or any government-owned or controlled corporations or in cases allowed under existing law.

• In the case of Cooperative Banks, any officer or employee of the Cooperative Development Authority or any elective public official, except a barangay official.

• Except as may otherwise be allowed under "The Anti-Dummy Law", as amended, foreigners cannot be officers or employees of banks.

3.04. FIT AND PROPER RULE

• To maintain the quality of bank management and afford better protection to depositors and the public in general, the MB shall prescribe, pass upon and review the qualifications and disqualifications of individuals elected or appointed bank directors or officers and disqualify those found unfit. After due notice to the board of directors of the bank, the MB may disqualify, suspend or remove any bank director or officer who commits or omits an act which render him unfit for the position. In determining whether an individual is fit and proper to hold the position of a director or officer of a bank, regard shall be given to his integrity, experience, education, training, and competence. (Sec. 16)

• The suspension of bank officers which is only preventive in nature would require no notice or hearing, and until such time that the officers have proved their innocence, they may be preventively suspended from holding office so as not to influence the conduct of investigation, and to prevent the commission of further irregularities. (Busgeo v CA, 1999)

• As a general rule, a banking corporation is liable for the wrongful or tortuous acts and declarations of its officers or agents within the course and scope of their employment. A bank will be held liable for the negligence of its officers or agents when acting within the course and scope of their employment; it may be liable for the tortuous acts of its officers even as regards that species of tort of which malice is an essential element. A bank holding out its officers and agents as worthy of confidence will not be permitted to profit by the frauds these officers or agents were enabled to perpetrate in the apparent course of their employment; nor will it be permitted to shirk its responsibility for such frauds, even though no benefit may accrue to the bank therefrom. If an officer or official of a bank in his official capacity receives money to satisfy an evidence of indebtedness lodged for his bank collection, the bank is liable for his misappropriation of such sum. (PCI Bank v CA, 2001)

3.05. GOOD GOVERNANCE (BSP CIRCULAR 283; 2001)
The position of a bank/quasi-bank/trust entity director is a position of trust. A director assumes certain responsibilities to different constituencies or stakeholders. These constituencies or stakeholders have the right to expect that the institution is being run in a prudent and sound manner.”

The board of directors is primarily responsible for the corporate governance of the bank/quasi-bank/trust entity. To ensure good governance of the bank/quasi-bank/trust entity, the board of directors should establish strategic objectives, policies and procedures that will guide and direct the activities of the bank/quasi-bank/ trust entity and the means to attain the same as well as the mechanism for monitoring management’s performance.

3.06. REGULATION OF THE COMPENSATION AND OTHER BENEFITS OF DIRECTORS AND OFFICERS

• To protect the funds of depositors and creditors, the MB may regulate the payment by the bank to its directors and officers of compensation, allowance, fees, bonuses, stock options, profit sharing and fringe benefits only in exceptional cases and when the circumstances warrant, such as but not limited to the following instances when a bank is
  1. under comptrollership or conservatorship; or
  2. found by the MB to be conducting business in an unsafe or unsound manner; or
  3. found by the MB to be in an unsatisfactory financial condition. (Sec. 18)

3.07. PROHIBITION AGAINST PUBLIC OFFICIALS
3.08. CONDUCT OF BOARD OF DIRECTORS’ MEETINGS

The meetings of the board of directors may be conducted through modern technologies such as, but not limited to, teleconferencing and video-conferencing. (Sec. 15)

3.09. BANK BRANCHES

Universal or commercial banks may open branches or other offices within or outside the Philippines upon prior approval of the BSP. Branching by all other banks shall be governed by pertinent laws. (Sec. 20)

A bank authorized to establish branches or other offices shall be responsible for all business conducted in such branches and offices to the same extent and in the same manner as though such business had all been conducted in the head office. A bank and its branches and offices shall be treated as one unit. (Sec. 20)

A bank may, subject to prior approval of the Monetary Board, use any or all of its branches as outlets for the presentation and/or sale of the financial products of its allied undertaking or of its investment house units. (Sec. 20)

3.10. BANKING DAYS AND HOURS

Unless otherwise authorized by the BSP in the interest of the banking public, all banks including their branches and offices shall transact business on all working days for at least 6 hours a day. (Sec. 21)

“Working days” shall mean Mondays to Fridays, except if such days are holidays. (Sec. 21)

Banks or any of their branches or offices may open for business on Saturdays, Sundays or holidays for at least 3 hours a day. Banks which opt to open on days other than working days shall report to the BSP the additional days during which they or their branches or offices shall transact business. (Sec. 21)

3.11. STRIKES AND LOCKOUTS

The banking industry is hereby declared as indispensable to the national interest. (Sec. 22)

Notwithstanding the provisions of any law to the contrary, any strike or lockout involving banks, if unsettled after 7 calendar days shall be reported by the BSP to the Secretary of Labor who may assume jurisdiction over the dispute, decide it, or certify the same to the NLRC for compulsory arbitration. However, the President of the Philippines may at any time intervene and assume jurisdiction over such labor dispute in order to settle or terminate the same. (Sec. 22)

4.04. BANKS AS DEBTORS

As per Art. 1980 of the Civil Code, loans from the depositor (creditor) to a bank (debtor) may be in the form of savings deposits, demand/current deposits (“all those liabilities of the BSP and of other banks which are denominated in Phil currency and are subject to payment in legal tender upon demand by the presentation of checks” as per Sec. 58 of NCBA) and time/fixed deposits. For this reason, San Carlos Milling Co., Ltd v. BPI, 1933) declared that “banks are run for gain, and they solicit deposits in order that they can use the money for that very purpose.” For the same reason, it has been held that “a bank has a right of set off of the deposits in its hands for the payment of any indebtedness to it on the part of a depositor.” (Gullas v. PNB, 1935) Conversely, the depositor has every right to apply his deposit in a bank against his loan from such bank. (RP v. CA, 1975) (Morales; Villanueva cites Serrano v. CB, 1980; Ppl v. Ong, 1991)
the true owner of the funds deposited. Thus, it was held in *Fulton Iron Works Co v China Banking Corp* (1930), "The specialized function of a bank is to serve as a place of deposit for money, to keep it safely while on deposit, and to pay it out, upon demand, to the person who effected the deposit or upon his order. A bank is not a guardian of trust funds deposited w/ it in the sense that it must see to their proper application, not is it its business to pry into the uses to which money on deposit in its vault are being put; and so long as it serves its function and pays the money out in good faith to the person who deposited it, or upon his order, w/out knowledge or notice that it is in fact assisting in the misappropriation of the fund, the bank will be protected. As is well said... it would seriously interfere w/ commercial transactions to charge banks w/ the duty of supervising the administration of trust funds, when, in due course of business, they receive checks and drafts in proper form drawn upon such funds in their custody. The law imposes no such duty upon them." Note however that there is a limitation in this regard as per survivorship agreements. (Morales)

4.06. OBLIGATION OF BANKS TO DEPOSITORS

- The bank is under the obligation to treat deposit accounts of it depositors with meticulous care. It must bear the blame for failing to discover the mistake of its employees despite the established procedure requiring bank papers to pass through bank personnel whose duty it is to check and countercheck them for possible errors. (*Metropolitan Bank and Trust Co. v. CA*, 1994 and *Firestone Tire v CA*, 2001)

- As a business affected with public interest and because of the nature of its functions, a bank is under obligation to treat the accounts of its depositors with meticulous care, always having in mind the fiduciary nature of their relationship. (*PCI Bank v. CA*, 1997)

Solidbank Corporation/ Metropolitan Bank and Trust Co. v. Sps. Tan
GR No. 167346
April 2, 2007

10 checks were deposited by representative of Sps. Tan and upon checking their passbook, it was discovered that one check was not posted. The bank proffered the duplicate deposit slip which indicated that the said check was not deposited but it was discovered that it had been cleared in another bank by another person. Sps. Tan filed a collection case against the bank and was able to get favorable judgment from RTC and CA.

HELD: Bank was negligent and so Sps. Tan entitled to damages. Failure to present original deposit slip, which could have proven its claim that it did not receive respondents’ missing check was a suppression of the best evidence that could have bolstered its claim and confirmed its innocence, the presumption now arises that it withheld the same for fraudulent purposes. Citing the case of Canlas v. Asian Savings Bank (2000), the Court held that the degree of diligence required of banks is more than that of a good father of a family in keeping with their responsibility to exercise the necessary care and prudence in handling their clients’ money. It find no compelling reason to disallow the application of the provisions on common carriers to this case if only to emphasize the fact that banking institutions (like petitioner) have the duty to exercise the highest degree of diligence when transacting with the public. By the nature of their business, they are required to observe the highest standards of integrity and performance, and utmost assiduousness as well.

4.07. OPTION TO EXERCISE SET-OFF ON DEPOSIT FOR OUTSTANDING LOAN

A bank is under no duty or obligation to make an application or set-off against the deposit accounts of a borrower. To apply the deposit to the payment of a loan is a privilege, a right of set-off which the bank has the option to exercise, but not the obligation. (*BPI v. CA*, 1994)

4.08. NOTE ON SAFETY DEPOSIT BOXES

In the case of rent of safety deposit box. The contract is a special kind of deposit and cannot be characterized as an ordinary contract of lease because the full and absolute possession and control of the deposit box is not given to the renters. The prevailing rule is that the relation between the bank renting out and the renter is that of bailer and bailee the bailment being for hire and mutual benefit. (*CA Agro-industrial Dev. Corp. v. CA*, 1983; reiterated in *Sia v. CA*, 1993, according to Villanueva). *43*

4.09. MB ORDER OF CLOSURE

In a case a bank or QB notifies the BSP or publicly announces a bank holiday, or in any manner suspends the payment of its deposit liabilities continuously for more than 30 days, the MB may summarily and without need for prior hearing close such banking institution and place it under receivership of the Phil. Deposit Insurance Corp. (PDIC). (Sec. 53)

Section 5 – Loans

5.01. RISK-BASED CAPITAL RATIO

The MB shall prescribe the minimum ratio which the net worth of a bank must bear to its total risk assets which may include contingent accounts [i.e. net worth : total risk assets] (Sec. 33)

5.02. BSP CIRCULAR 280 (2001)

The risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, shall not be less than 10% for both solo basis (head office plus branches) and consolidated basis (parent bank plus subsidiary financial allied undertakings, but excluding insurance companies). The ratio shall be maintained daily.

5.03. POWER OF THE MB IN THIS REGARD

- The MB may - require that such ratio be determined on the basis of the net worth and risk assets of *43* This topic was asked in 2004. Note the liability of back in case of loss.
a bank and its subsidiaries, financial or otherwise;
- prescribe the composition and the manner of determining the net worth and total risk assets of banks and their subsidiaries.

Provided, that:

in the exercise of this authority, the MB shall, to the extent feasible, conform to internationally accepted standards, including those of the Bank for International Settlements (BIS), relating to risk-based capital requirements;
- the MB may alter or suspend compliance with such ratio whenever necessary for a maximum period of 1 year; and,
- such ratio shall be applied uniformly to banks of the same category. (Sec. 33)

5.04. EFFECT OF NON-COMPLIANCE

- The MB may limit or prohibit the distribution of net profits by such bank and may require that part or all of the net profits be used to increase the capital accounts of the bank until the minimum requirement has been met.
- The MB may, furthermore, restrict or prohibit the acquisition of major assets and the making of new investments by the bank, with the exception of purchases of readily marketable evidences of indebtedness of the RP and the BSP and any other evidences of indebtedness or obligations the servicing and repayment of which are fully guaranteed by the RP, until the minimum required capital ratio has been restored. (Sec. 33)

5.05. SINGLE BORROWER’S LIMIT (SBL)

- Except as the MB may otherwise prescribe for reasons of national interest, the total amount of loans, credit accommodations and guarantees as may be defined by the MB that may be extended by a bank to any person, partnership, association, corporation or other entity shall at no time exceed 20% of the net worth of such bank. (Sec. 35.1)
- The basis for determining compliance with SBL is the total credit commitment of the bank to the borrower. (Sec. 35.1)
- Unless the MB prescribes otherwise, the total amount of loans, credit accommodations and guarantees prescribed in the preceding paragraph may be increased by an additional 10% of the net worth of such bank provided the additional liabilities of any borrower are adequately secured by trust receipts, shipping documents, warehouse receipts or other similar documents transferring or securing title covering readily marketable, non-perishable goods which must be fully covered by insurance. (Sec. 35.2)
- **Inclusions.** The above prescribed ceilings shall include:
  a. the direct liability of the maker or acceptor of paper discounted with or sold to such bank and the liability of a general indorser, drawer or guarantor who obtains a loan or other credit accommodation from or discounts paper with or sells papers to such bank;
  b. in the case of an individual who owns or controls a majority interest in a corporation, partnership, association or any other entity, the liabilities of said entities to such bank;
  c. in the case of a corporation, all liabilities to such bank of all subsidiaries in which such corporation owns or controls a majority interest; and
  d. in the case of a partnership, association or other entity, the liabilities of the members thereof to such bank. (35.3)

* Even if a parent corporation, partnership, association, entity or an individual who owns or controls a majority interest in such entities has no liability to the bank, the MB may prescribe the combination of the liabilities of subsidiary corporations or members of the partnership, association, entity or such individual under certain circumstances, including but not limited to any of the following situations:
  a. the parent corporation, partnership, association, entity or individual guarantees the repayment of the liabilities;
  b. the liabilities were incurred for the accommodation of the parent corporation or another subsidiary or of the partnership or association or entity or such individual; or
  c. the subsidiaries through separate entities operate merely as departments or divisions of a single entity. (35.4)

** Certain types of contingent accounts of borrowers may be included among those subject to these prescribed limits as may be determined by the MB. (35.7)

*** Loans and other credit accommodations, deposits maintained with, and usual guaranteed by a bank to any other bank or non-bank entity, whether locally or abroad, shall be subject to the limits as herein prescribed. (35.6)

- **Exclusions.** For purposes of this Section, loans, other credit accommodations and guarantees shall exclude:
  a. loans and other credit accommodations secured by obligations of the BSP or of the Phil. Gov’t;
  b. loans and other credit accommodations fully guaranteed by the gov’t as to the payment of principal and interest;
5.06. Restriction on Bank Exposure to DOSRI

DOSRI = Directors, Officers, Stockholders and their Related Interests;

NOTE: The MB shall define the term "related interests." (Sec. 36 par. 5)

- **GR**: A director or officer of any bank shall neither,
  1. directly or indirectly, for himself or as the representative or agent of others, borrow from such bank; nor
  2. become a guarantor, indorser or surety for loans from such bank to others, or in any manner be an obligor or incur any contractual liability to the bank.

**EXC.** Except with the written approval of the majority of all the directors of the bank, excluding the director concerned. The required approval shall be entered upon the records of the bank and a copy of such entry shall be transmitted forthwith to the appropriate supervising and examining department of the BSP.

* Such written approval shall not be required for loans, credit accommodations and advances granted to officers under a fringe benefit plan approved by the BSP. (Sec. 36 par. 1)

** The limit on loans, credit accommodations and guarantees prescribed herein shall not apply to loans, credit accommodations and guarantees extended by a cooperative bank to its cooperative shareholders. (Sec. 36 par. 6)

---

5.07. Limits on Loans and Other Credit Accommodations on...

- Loans and other credit accommodations against...

<table>
<thead>
<tr>
<th>Real Estate</th>
<th>Security of Chattels and Intangible Properties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shall not exceed 75% of the appraised value of the respective real estate security, plus 60% of the appraised value of the insured improvements, and such loans may be made to the owner of the real estate or to his assignees. (Sec. 37)</td>
<td>Shall not exceed 75% of the appraised value of the security, and such loans and other credit accommodations may be made to the title-holder of the chattels and intangible properties or his assignees. (Sec. 38)</td>
</tr>
</tbody>
</table>

---

5.08. Foreclosure of Real Estate Mortgage

- In the event of foreclosure, whether judicially or extrajudicially, of any mortgage on real estate which is security for any loan or other credit accommodation granted, the mortgagee or debtor whose real property has been sold for the full or partial payment of his obligation shall have the right within one year after the sale of the real estate, to redeem the property by paying the amount due under the mortgage deed, with interest thereon at the rate specified in the mortgage, and all the costs and expenses incurred by the bank or institution.

---

44 This topic was asked in 2006 specifically on requisites before a bank can lend to DOSRI.
from the sale and custody of said property less the income derived therefrom. However, the purchaser at the auction sale concerned whether in a judicial or extrajudicial foreclosure shall have the right to enter upon and take possession of such property immediately after the date of the confirmation of the auction sale and administer the same in accordance with law. Any petition in court to enjoin or restrain the conduct of foreclosure proceedings instituted pursuant to this provision shall be given due course only upon the filing by the petitioner of a bond in an amount fixed by the court conditioned that he will pay all the damages which the bank may suffer by the enjoining or the restraint of the foreclosure proceeding.

- **Juridical Mortgagor.** Notwithstanding Act 3135, juridical persons whose property is being sold pursuant to an extrajudicial foreclosure, shall have the right to redeem the property in accordance with this provision until, but not after, the registration of the certificate of foreclosure sale with the applicable Register of Deeds which in no case shall be more than 3 months after foreclosure, whichever is earlier. Owners of property that has been sold in a foreclosure sale prior to the effectivity of the GBL shall retain their redemption rights until their expiration. (Sec. 47)

### 5.09. OTHER SECURITY REQUIREMENTS OF BANKS

- **Grant and Purpose of Loans and Other Credit Accommodations**
  - A bank shall grant loans and other credit accommodations only in amounts and for the periods of time essential for the effective completion of the operations to be financed. (Sec. 39)
  - Such grant of loans and other credit accommodations shall be consistent with safe and sound banking practices. (Sec. 39)
  - The purpose of all loans and other credit accommodations shall be stated in the application and in the contract between the bank and the borrower. If the bank finds that the proceeds of the loan or other credit accommodation have been employed, without its approval, for purposes other than those agreed upon with the bank, it shall have the right to terminate the loan or other credit accommodation and demand immediate repayment of the obligation. (Sec. 39)

- **Debtor is Capable**
  - Before granting a loan or other credit accommodation, a bank must ascertain that the debtor is capable of fulfilling his commitments to the bank. Toward this end, a bank may demand from its credit applicants a statement of their assets and liabilities and of their income and expenditures and such information as may be prescribed by law or by rules and regulations of MB to enable the bank to properly evaluate the credit application which includes the corresponding financial statements submitted for taxation purposes to the BIR. Should such statements prove to be false or incorrect in any material detail, the bank may terminate any loan or other credit accommodation granted on the basis of said statements and shall have the right to demand immediate repayment or liquidation of the obligation. (Sec. 40)

### 5.10. AMMORTIZATION

- **Amortization on Loans and Other Credit Accommodations.** — The amortization schedule of bank loans and other credit accommodations shall be adapted to the nature of the operations to be financed.
  - In case of loans and other credit accommodations with maturities of more than 5 years, provisions must be made for periodic amortization payments, but such payments must be made at least annually: Provided, however, That when the borrowed funds are to be used for purposes which do not initially produce revenues adequate for regular amortization payments therefrom, the bank may permit the initial amortization payment to be deferred until such time as said revenues are sufficient for such purpose, but in no case shall the amortization date be later than 5 years from the date on which the loan or other credit accommodation is granted.
  - In case of loans and other credit accommodations to microfinance sectors, the schedule of loan amortization shall take into consideration the projected cash flow of the borrower and adopt this into the terms and conditions formulated by banks. (Sec. 44)

### 5.11. PREPAYMENT OF LOANS AND OTHER CREDIT ACCOMMODATIONS

- A borrower may at any time prior to the agreed maturity date prepay, in whole or in part, the unpaid balance of any bank loan and other credit accommodation, subject to such reasonable terms and conditions as may be agreed upon between the bank and its borrower. (Sec. 45)

### 5.12. SOME OF MB’S POWERS RELATED TO LOANS AND CREDIT ACCOMMODATIONS

- The MB is hereby authorized to issue such regulations as it may deem necessary with respect to unsecured loans or other credit accommodations that may be granted by banks. (Sec. 41)

- The MB may, by regulation, prescribe further security requirements to which the various types of bank credits shall be subject, and, in accordance with the authority granted to it in Sec. 106 of the NCBA, the Board may by regulation, reduce the maximum ratios established in Secs. 36 and 37 [should be Secs. 37 and 38] of this Act, or, in special cases, increase the maximum ratios established therein. (Sec. 42)

- The MB may, in accordance with the authority granted to it in Sec. 106 of the NCBA, and...
taking into account the requirements of the economy for the effective utilization of long-
term funds, prescribe the maturities, as well as related terms and conditions for various types of
bank loans and other credit accommodations. Any change by the MB in the maximum maturities shall apply only to loans
and other credit accommodations made after the date of such action. (Sec. 43)

- The Monetary Board shall regulate the interest
imposed on microfinance borrowers by lending
investors and similar lenders, such as, but not limited to, the unconscionable rates of interest
collected on salary loans and similar credit accommodations. (Sec. 43)

- Development Assistance Incentives. The BSP
shall provide incentives to banks which, without
government guarantee, extend loans to finance
educational institutions, cooperatives, hospitals
and other medical services, socialized or low-
cost housing, local government units and other
activities with social content. (Sec. 46)

- Renewal or Extension of Loans and Other Credit
Accommodations. The MB may, by regulation, prescribe the conditions and limitations under
which a bank may grant extensions or renewals of its loans and other credit accommodations. (Sec. 48)

- Provisions for Losses and Write-Offs. The MB
may fix, by regulation or by order in a specific
case, the amount of reserves for bad debts or doubtful accounts or other contingencies.
Writing off of loans, other credit accommodations, advances and other assets shall be subject to regulations issued by the
MB. (Sec. 49)

Section 6 – Other Operations

6.01. MAJOR INVESTMENTS

For the purpose of enhancing bank supervision, the
MB shall establish criteria for reviewing major acquisitions or investments by a bank including corporate affiliations or structures that may expose the bank to undue risks or in any way hinder effective supervision. (Sec. 50)

6.02. ACQUISITION OF REAL ESTATE

- Any bank may acquire real estate as shall be necessary for its own use in the conduct of its business. (Sec. 51)

- The total investment in such real estate and improvements thereof, including bank equipment, shall not exceed 50% of combined capital accounts.
  - Unless otherwise provided by the MB, the equity investment of a bank in another corporation engaged primarily in real estate shall be considered as part of the bank’s total investment in real estate. (Sec. 51)

6.03. BY WAY OF SATISFACTION OF CLAIMS

- Notwithstanding the limitations just mentioned, a bank may acquire, hold or convey real property under the following circumstances:
  1. Such as shall be mortgaged to it in good
     faith by way of security for debts;
  2. Such as shall be conveyed to it in satisfaction of debts previously contracted
     in the course of its dealings; or
  3. Such as it shall purchase at sales under
     judgments, decrees, mortgages, or trust
     deeds held by it and such as it shall
     purchase to secure debts due it. (Sec. 52)

- Any real property acquired or held under these circumstances shall be disposed of by the bank
within a period of 5 years or as may be prescribed by the MB. The bank may, after said
period, continue to hold the property for its own use, subject to the limitation that the total
investment in real estate and improvements thereof, including bank equipment, shall not exceed 50% of combined capital accounts.
(Sec. 52)

6.04. OTHER BANKING SERVICES

1. Receive in custody funds, documents and valuable objects;
2. Act as financial agent and buy and sell, by order of and for the account of their customers, shares, evidences of indebtedness and all types of securities;
3. Make collections and payments for the account of others and perform such other services for their customers as are not incompatible with banking business;
4. Upon prior approval of MB, act as managing agent, adviser, consultant or administrator of investment management/advisory/consultancy accounts; and
5. Rent out safety deposit boxes. (Sec. 53)

- The bank shall perform the services permitted under 1-4 as depositary or as an agent. Accordingly, it shall keep the funds, securities and other effects which it receives duly separate from the bank’s own assets and liabilities. (Sec. 53)

- The MB may regulate all these operations in order to ensure that such operations do not endanger the interests of the depositors and other creditors of the bank. (Sec. 53)

6.05. PROHIBITIONS

A. Against Acting as an Insurer

A bank shall not directly engage in insurance business as the insurer. (Sec. 54)

B. Prohibited Transactions of Directors, Officers, Employees, or Agents of Any Bank*

1. Making false entries in any bank report or statement or participating in any fraudulent transaction, thereby affecting the financial interest of, or causing damage to, the bank or any person;
2. Without order of a court of competent jurisdiction, disclosing to any unauthorized person any information
relative to the funds or properties in the custody of the bank belonging to private individuals, corporations, or any other entity; Provided, That with respect to bank deposits, the provisions of existing laws shall prevail;
3. Accepting gifts, fees or commissions or any other form of remuneration in connection with the approval of a loan or other credit accommodation from said bank;
4. Overvaluing or aiding the overvaluing of any security for the purpose of influencing in any way the actions of the bank or any bank;
5. Outsourcing inherent banking functions. (SubSec. 55.1)

C. BSP Circular 268 (2000)

Section 2.1 Outsourcing of inherent banking functions shall refer to any contract between the bank and a service provider for the latter to supply the manpower to service the deposit transactions of the former.

Section 2.2 Banks cannot outsource management functions except as may be authorized by the Monetary Board when circumstances justify.

Section 3. Outsourcing of Information Technology Systems/Processes. Subject to prior approval of the MB, banks may outsource all information technology systems and processes except for functions excluded in Section 3.1.

Section 3.1 Functions affecting the ability of the bank to ensure the fit of technology services deployed to meet its strategic and business objectives and to comply with all pertinent banking laws and regulations may not be outsourced. Subject to prior approval of the MB, consultants and/or service providers may be engaged to provide assistance/support.

Section 4. Outsourcing of Other Banking Functions.

Section 4.1 Subject to prior approval of the MB, banks may outsource data imaging, storage, retrieval and other related systems; clearing and processing of checks not included in the Philippine Clearing House System; printing of bank deposit statements.

Section 4.2. Banks may outsource credit card services; printing of bank loan statements and other non-deposit records, bank forms and promotional materials; credit investigation and collection; processing of export, import and other trading transactions; transfer agent services for debt and equity securities; property appraisal; property management services; messenger, courier and postal services; security guard services; vehicle service contracts; janitorial services.

Section 5. Service Providers. When allowed by law and under this circular, banks may enter into outsourcing contracts only with service providers with demonstrable technical and financial capability commensurate to the services to be rendered.

- Consistent with the provisions of the Banks Secrecy Law, no bank shall employ casual or nonregular personnel or too lengthy probationary personnel in the conduct of its business involving bank deposits. (Subsec. 55.4)

6.06. PROHIBITED TRANSACTIONS OF BORROWERS OF BANK*

1. Fraudulently overvaluing property offered as security for a loan or other credit accommodation from the bank;
2. Furnishing false or misrepresented or suppressing material facts for the purpose of obtaining, renewing, or increasing a loan or other credit accommodation or extending the period thereof;
3. Attempting to defraud the said bank in the event of a court action to recover a loan or other credit accommodation; or
4. Offering any director, officer, employee or agent of a bank any gift, fee, commission, or any other form of compensation in order to influence such persons into approving a loan or other credit accommodation application. (SubSec. 55.2)

* No examiner, officer or employee of the BSP or of any department, bureau, office, branch or agency of the Gov’t that is assigned to supervise, examine, assist or render technical assistance to any bank shall commit any of the acts enumerated in Subsecs. 55.1 and 55.2 or aid in the commission of the same. The making of false reports or misrepresentation or suppression of material facts by personnel of the BSP shall constitute fraud and shall be subject to the administrative and criminal sanctions provided under the NCBA. (Subsec. 55.3)

6.07. CONDUCTING BUSINESS IN AN UNSAFE OR UNSOUND MANNER

In determining whether a particular act or omission, which is not otherwise prohibited by any law, rule or regulation affecting banks, QBs or trust entities, may be deemed as conducting business in an unsafe or unsound manner, the MB shall consider any of the following circumstances where the act or omission has:

1. resulted or may result in material loss or damage, or abnormal risk or danger to the safety, stability, liquidity or solvency of the institution;
2. resulted or may result in material loss or damage or abnormal risk to the institution’s depositors, creditors, investors, stockholders or to the BSP or to the public in general;
3. has caused any undue injury, or has given any unwarranted benefits, advantage or preference to the bank or any party in the discharge by the director or officer of his duties and responsibilities through manifest partiality, evident bad faith or gross inexcusable negligence; or such involves entering into any contract or transaction manifestly and grossly disadvantageous to
the bank, QB or trust entity, WON the director or officer profited or will profit thereby.

Whenever a bank, QB or trust entity persists in conducting its business in an unsafe or unsound manner, the MB may, without prejudice to the administrative sanctions provided in Sec. 37 of the NCBA, take action under Sec. 30 of the same Act and/or immediately exclude the erring bank from clearing, the provisions of law to the contrary notwithstanding. (Sec. 56)

6.08. ON DIVIDEND DECLARATION

- No bank or QB shall declare dividends greater than its accumulated net profits then on hand, deducting therefrom its losses and bad debts. (Sec. 57)
- No bank nor QB shall declare dividends, if at the time of declaration:
  1. Its clearing account with the BSP is overdrawn; or
  2. It is deficient in the required liquidity floor for gov’t deposits for 5 or more consecutive days; or
  3. It does not comply with the liquidity standards/ratios prescribed by the BSP for purposes of determining funds available for dividend declaration; or
  4. It has committed a major violation as may be determined by the BSP. (Sec. 57)

6.09. INDEPENDENT AUDITOR

- The MB may require a bank, QB or trust entity to engage the services of an independent auditor to be chosen by the bank, QB or trust entity concerned from a list of CPAs acceptable to the MB.
- The term of the engagement shall be as prescribed by the MB which may either be on a continuing basis where the auditor shall act as resident examiner, or on the basis of special engagements, but in any case, the independent auditor shall be responsible to the bank’s, QB’s or trust entity’s board of directors.
- A copy of the report shall be furnished to the MB.
- The MB may also direct the board of directors of a bank, QB, trust entity and/or the individual members thereof, to conduct, either personally or by a committee created by the board, an annual balance sheet audit of the bank, QB or trust entity to review the internal audit and control system of the bank, QB or trust entity and to submit a report of such audit. (Sec. 58)

6.10. FINANCIAL STATEMENTS

- Every bank, QB or trust entity shall submit to the appropriate supervising and examining department of the BSP financial statements in such form and frequency as may be prescribed by the BSP. (Sec. 60)
- Such statements, which shall be as of a specific date designated by the BSP, shall show the actual financial condition of the institution submitting the statement, and of its branches, offices, subsidiaries and affiliates, including the results of its operations, and shall contain such information as may be required in BSP regulations. (Sec. 60)
- In periods of national and/or local emergency or of imminent panic which directly threaten monetary and banking stability, the MB, by a vote of at least 5 of its members, in special cases and upon application of the bank, quasi-bank or trust entity, may allow such bank, QB or trust entity to defer for a stated period of time the publication of the statement of financial condition required herein. (Sec. 61)

6.11. PUBLICATION/POSTING OF FINANCIAL STATEMENTS

- Every bank, QB or trust entity, shall publish a statement of its financial condition, including those of its subsidiaries and affiliates, in such terms understandable to the layman and in such frequency as may be prescribed by the BSP, in English or Filipino, at least once every quarter in a newspaper of general circulation in the city or province where the principal office, in the case of a domestic institution, or the principal branch or office in the case of a foreign bank, is located, but if no newspaper is published in the same province, then in a newspaper published in Metro Manila or in the nearest city or province. The Bangko Sentral may by regulation prescribe the newspaper where the statements prescribed herein shall be published. (Sec. 61)
- The Monetary Board may allow the posting of the financial statements of a bank, QB or trust entity in public places it may determine, in lieu of the publication required in the preceding paragraph, when warranted by the circumstances. (Sec. 61)
- Banks shall also make available to the public in such form and manner as the BSP may prescribe the complete set of its audited financial statements as well as such other relevant information including those on enterprises majority-owned or controlled by the bank, that will inform the public of the true financial condition of a bank as of any given time. (Sec. 61)

6.12. PUBLICATION OF CAPITAL STOCK

- A bank, QB or trust entity incorporated under the laws of the Phils. shall not publish the amount of its authorized or subscribed capital stock without indicating at the same time and with equal prominence, the amount of its capital actually paid up. (Sec. 62)
- No branch of any foreign bank doing business in the Phils. shall in any way announce the amount of the capital and surplus of its head office, or of the bank in its entirety without indicating at the same time and with equal
prominence the amount of the capital, if any, definitely assigned to such branch. In case no capital has been definitely assigned to such branch, such fact shall be stated in, and shall form part of the publication. (Sec. 62)

6.13. ELECTRONIC TRANSACTIONS
- The BSP shall have full authority to regulate the use of electronic devices, such as computers, and processes for recording, storing and transmitting information or data in connection with the operations of a bank, QB or trust entity, including the delivery of services and products to customers by such entity. (Sec. 59)

6.14. OTHER RELATED PROVISIONS OF THE GBL
- The Bangko Sentral may charge equitable rates, commissions or fees, as may be prescribed by the Monetary Board for supervision, examination and other services which it renders under this Act. (Sec. 65)
- Unless otherwise provided, the violation of any of the provisions of this Act shall be subject to Secs. 34, 35, 36 and 37 of the NCBA. If the offender is a director or officer of a bank, quasi-bank or trust entity, the MB may also suspend or remove such director or officer. If the violation is committed by a corporation, such corporation may be dissolved by quo warranto proceedings instituted by the Sol.Gen. (Sec. 66)
- The provisions of any law to the contrary notwithstanding, the BSP shall be consulted by other government agencies or instrumentalities in actions or proceedings initiated by or brought before them involving controversies in banks, QBs or trust entities arising out of and involving relations between and among their directors, officers or stockholders, as well as disputes between any or all of them and the bank, QBs or trust entity of which they are directors, officers or stockholders. (Sec. 63)

Universal Banks | Commercial Banks
---|---
**Powers**
- THE POWERS AUTHORIZED FOR A COMMERCIAL BANK: the powers of an investment house as provided in existing laws; and the power to invest in non-allied enterprises as provided in the GBL. (Sec. 23)
- THE GENERAL POWERS INCIDENT TO CORPORATIONS, ALL SUCH POWERS AS MAY BE NECESSARY TO CARRY ON THE BUSINESS OF COMMERCIAL BANKING, SUCH AS ACCEPTING DRAFTS AND ISSUING LETTERS OF CREDIT; DISCOUNTING AND NEGOTIATING PROMISSORY NOTES, DRAFTS, BILLS OF EXCHANGE, AND OTHER EVIDENCES OF DEBT:
- ACCEPTING OR CREATING DEMAND DEPOSITS;
- RECEIVING OTHER TYPES OF DEPOSITS AND DEPOSIT SUBSTITUTES;
- BUYING AND SELLING FOREIGN EXCHANGE AND GOLD OR SILVER BULLION;
- ACQUIRING MARKETABLE BONDS AND OTHER DEBT SECURITIES; AND
- EXTENDING CREDIT.

**Equity Investments**
- A UB MAY INVEST IN THE EQUITIES OF ALLIED (EITHER FINANCIAL OR NON-FINANCIAL) AND NON-ALLIED ENTERPRISES. (SEC. 24)
- A KB MAY INVEST ONLY IN THE EQUITIES OF ALLIED ENTERPRISES (EITHER FINANCIAL OR NON-FINANCIAL). (SEC. 30)
- EXCEPT AS THE MB MAY OTHERWISE PRESCRIBE:
- THE TOTAL INVESTMENT IN EQUITIES OF ALLIED ENTERPRISES SHALL NOT EXCEED 35% OF THE NET WORTH OF THE BANK: AND
- THE EQUITY INVESTMENT IN ANY ONE ENTERPRISE SHALL NOT EXCEED 25% OF THE NET WORTH OF THE BANK. (SEC. 30)
EXCEED 50% OF THE NET WORTH OF THE BANK; AND

THE EQUITY INVESTMENT IN ANY ONE ENTERPRISE, WHETHER ALLIED OR NON-ALLIED, SHALL NOT EXCEED 25% OF THE NET WORTH OF THE BANK. (SEC. 24)

"NET WORTH" SHALL MEAN THE TOTAL OF THE UNIMPAIRED PAID-IN CAPITAL INCLUDING PAID-IN SURPLUS, RETAINED EARNINGS AND UNDIVIDED PROFIT, NET OF VALUATION RESERVES AND OTHER ADJUSTMENTS AS MAY BE REQUIRED BY THE BSP. (SEC. 24)

THE ACQUISITION OF SUCH EQUITY OR EQUITIES IS SUBJECT TO THE PRIOR APPROVAL OF THE MB WHICH SHALL PROMULGATE APPROPRIATE GUIDELINES TO GOVERN SUCH INVESTMENTS. (SEC. 24 & 30)

Equity Investments in Financial Allied Enterprises

A UB CAN OWN UP TO 100% OF THE EQUITY IN A THRIFT BANK, A RURAL BANK OR A FINANCIAL ALLIED ENTERPRISE. (SEC. 25)

A KB MAY OWN UP TO 100% OF THE EQUITY OF A THRIFT BANK OR A RURAL BANK. (SEC. 31)

WHERE THE EQUITY INVESTMENT OF A KB IS IN OTHER FINANCIAL ALLIED ENTERPRISES, INCLUDING ANOTHER COMMERCIAL BANK, SUCH INVESTMENT SHALL REMAIN A MINORITY HOLDING IN THAT ENTERPRISE. (SEC. 31)

A PUBLICLY-LISTED UB OR KB MAY OWN UP TO ONE HUNDRED PERCENT (100%) OF THE VOTING STOCK OF ONLY ONE OTHER UB OR KB. (SEC. 25)

Equity Investments in Non-Financial Allied Enterprises

A UB OR KB MAY OWN UP TO ONE HUNDRED PERCENT (100%) OF THE EQUITY IN A NON-FINANCIAL ALLIED ENTERPRISE. (SEC. 26 AND 32)

Equity Investments in QBs

TO PROMOTE COMPETITIVE CONDITIONS IN FINANCIAL MARKETS, THE MB MAY FURTHER LIMIT TO 40% EQUITY INVESTMENTS OF UBS AND KBs IN QBs. (SEC. 28)

Equity Investments in Non-Allied Enterprises

THE EQUITY INVESTMENT OF A UB, OR OF ITS WHOLLY OR MAJORITY-OWNED SUBSIDIARIES, IN A SINGLE NON-ALLIED ENTERPRISE SHALL NOT EXCEED 35% OF THE TOTAL EQUITY IN THAT ENTERPRISE NOR SHALL IT EXCEED 35% OF THE VOTING STOCK IN THAT ENTERPRISE. (SEC. 27)

Section 7 – Foreign Banks

7.01. TRANSACTING BUSINESS IN THE PHILS

• The entry of foreign banks in the Phils. through the establishment of branches shall be governed by the provisions of the Foreign Banks Liberalization Act. (Sec. 72)

• In the case of a foreign bank which has more than 1 branch in the Phils., all such branches shall be treated as 1 unit for the purpose of the GBL, and all references to the Phil. branches of foreign banks shall be held to refer to such units. (Sec. 74)

• In all matters not specifically covered by special provisions applicable only to a foreign bank or its branches and other offices in the Phils., any foreign bank licensed to do business in the Phils. shall be bound by the provisions of the GBL and all other laws, rules and regulations applicable to banks organized under the laws of the Phils. of the same class, except those that provide for the creation, formation, organization or dissolution of corporations or for the fixing of the relations, liabilities, responsibilities, or duties of stockholders, members, directors or officers of corporations to each other or to the corporation. (Sec. 77)
The conduct of offshore banking business in the Philippines shall be governed by Offshore Banking System Decree (PD 1034) (Sec. 72)

7.02. ACQUISITION OF VOTING STOCK IN A DOMESTIC BANK

Within 7 years from the effectivity of the GBL and subject to guidelines issued pursuant to the Foreign Banks Liberalization Act, the MB may authorize a foreign bank to acquire up to 100% of the voting stock of only 1 domestic bank.

Within the same period, the MB may authorize any foreign bank, which prior to the effectivity of the GBL availed itself of the privilege to acquire up to 60% of the voting stock of a bank under the Foreign Banks Liberalization Act and the Thrift Banks Act, to further acquire voting shares of such bank to the extent necessary for it to own 100% of the voting stock thereof.

In the exercise of this authority, the MB shall adopt measures as may be necessary to ensure that at all times the control of 70% of the resources or assets of the entire banking system is held by banks which are at least majority-owned by Filipinos.

Any such right, privilege or incentive granted to a foreign bank shall be equally enjoyed by and extended under the same conditions to banks organized under Philippine laws. (Sec. 73)

7.03. HEAD OFFICE GUARANTEE

In order to provide effective protection of the interests of the depositors and other creditors of Phil. branches of a foreign bank, the head office of such branches shall fully guarantee the prompt payment of all liabilities of its Phil. branch.

Residents and citizens of the Phils. who are creditors of a branch in the Phils. of a foreign bank shall have preferential rights to the assets of such branch in accordance with existing laws. (Sec. 75)

7.04. SUMMONS AND LEGAL PROCESS

Upon the Phil. Agent or Head of the Foreign Bank Designated to Accept Service

- Summons and legal process served upon the Phil. agent or head of any foreign bank designated to accept service thereof shall give jurisdiction to the courts over such bank, and service of notices on such agent or head shall be as binding upon the bank which he represents as if made upon the bank itself.

- Should the authority of such agent or head to accept service of summons and legal processes for the bank or notice to it be revoked, or should such agent or head become mentally incompetent or otherwise unable to accept service while exercising such authority, it shall be the duty of the bank to name and designate promptly another agent or head upon whom service of summons and processes in legal proceedings against the bank and of notices affecting the bank may be made, and to file with the SEC a duly authenticated nomination of such agent. (Sec. 76)

Upon the BSP Deputy Governor In-Charge of the Supervising and Examining Departments

- In the absence of the agent or head or should there be no person authorized by the bank upon whom service of summons, processes and all legal notices may be made, service of summons, processes and legal notices may be made upon the BSP Deputy Governor In-Charge of the supervising and examining departments and such service shall be as effective as if made upon the bank or its duly authorized agent or head.

- The said Deputy Governor shall register and transmit by mail to the president or the secretary of the bank at its head or principal office a copy, duly certified by him, of the summons, process, or notice. The sending of such copy of the summons, process, or notice shall be a necessary part of the services and shall complete the service.

- The registry receipt of mailing shall be prima facie evidence of the transmission of the summons, process or notice.

- All costs necessarily incurred by the said Deputy Governor for the making and mailing and sending of a copy of the summons, process, or notice to the president or the secretary of the bank at its head or principal office shall be paid in advance by the party at whose instance the service is made. (Sec. 76)

7.05. REVOCATION OF LICENSE

The MB may revoke the license to transact business in the Phils. of any foreign bank, if it finds that the foreign bank is insolvent or in imminent danger thereof or that its continuance in business will involve probable loss to those transacting business with it.

- After the revocation of its license, it shall be unlawful for any such foreign bank to transact business in the Phils. unless its license is renewed or reissued. The BSP shall take the necessary action to protect the creditors of such foreign bank and the public.

- The provisions of the NCBA on sanctions and penalties shall likewise be applicable. (Sec. 78)
Section 8 – Trust Operations

8.01. AUTHORITY TO ENGAGE IN TRUST BUSINESS

Only a stock corporation or a person duly authorized by the MB to engage in trust business shall act as a trustee or administer any trust or hold property in trust or on deposit for the use, benefit, or behalf of others. For purposes of the GBL, such a corporation is referred to as a trust entity. (Sec. 79)

A trust receipt is a written/printed document and delivered by the entrustee in favor of the entruster, whereby the latter releases the goods, documents or instruments over which he holds absolute title or a security interest in the possession of the former, upon the entrustee’s promise to hold said goods in trust for the entruster, an to sell or otherwise dispose of the goods, etc. with the obligation to turn over the proceeds thereof to the extent of what is owing to the entruster; or to return the goods if UNSOLD, or for other purposes. 45

8.02. BRANCHES OF TRUST ENTITY

• The ordinary business of a trust entity shall be transacted at the place of business specified in its articles of incorporation. Such trust entity may, with prior approval of the MB, establish branches in the Philippines, and the said entity shall be responsible for all business conducted in such branches to the same extent and in the same manner as though such business had all been conducted in the head office. For the purpose of this Act, the trust entity and its branches shall be treated as one unit. (Sec. 93)

8.03. APPLICABILITY OF CIVIL CODE

Art 1442 of the Civil Code: “The principles of the general law of trusts, insofar as they are not in conflict w/ the Civil Code, the Code of Commerce, the Rules of Court and special laws [including the GBL] are hereby adopted.

8.04. HISTORY

“The idea of property held “in trust” is a great legacy from the Wars of the Roses and the messiness of the English Reformation. The purpose of the arrangement is to separate the benefits from the responsibilities of ownership—to permit, for example, land or a business left to a widow or children to be managed by a strong third party committed to act solely in the interest of the “beneficiaries” of the trust. Though beneficiaries have since the 15th century had the right to call trustees to the law courts to account for their stewardship, in fact the guts of the system is the pride of the trustee, for whom the opportunity to employ his powers unselfishly should be an honor and a privilege. “Obviously, the trustee as described in law needs a soul, and comments could be made about the American innovation of 1818 which first chartered a soulless corp to perform trust functions. The “trust company,” so called, performed a number of functions closely analogous to banking: its basic job, after all, was to invest and manage safely the assets left w/ it by others. The question of the standard of care to which such a company could be held was variously resolved xxx. In 1833 the Supreme Judicial Council of Massachusetts ruled that a trustee could manage a trust in any way a “prudent man” would treat his own assets; but other states lagged far behind and will into the 20th century most laws prescribed a “legal list” of investments approved for trusts xxx” (Morales quoting Martin Mayer in The Bankers (1974))

8.05. PRUDENT MAN AND SELF-DEALING RULES

Prudent Man Rule

• A trust entity shall administer the funds or property under its custody with the diligence that a prudent man would exercise in the conduct of an enterprise of a like character and with similar aims. (Sec. 80 par. 1)

• The MB shall promulgate such rules and regulations as may be necessary to prevent circumvention of the prudent man rule and the responsibility therein imposed on a trust entity. (Sec. 80 par. 3)

• This rule is part of the code of conduct required of a trustee and thus set out in the behavioral guidelines of the Manual of Regulation of Banks: “Sec X401 Statement of Principles. The cardinal principle common to all trust and other fiduciary relationships is fidelity. Policies predicated upon this principle are directed towards confidentiality, scrupulous care, safety and prudent management of property including reasonable probability of income w/ proper accounting and appropriate reporting thereon. Practices are designed to promote efficiency in administration and operation; to adhere and conform w/ the terms of the instrument or contract; and to maintain absolute separation of property free from any intrusion of conflict of interest.

“A bank authorized to engage in trust and fiduciary business is under no obligation, either legal or moral, to accept any such business being offered nor has it the right to accept if the same is contrary to law, rules, regulations public order and public policy. It shall advertise its services in a dignified manner and enter such business only when demand for such service is evident, when specially equipped to render such service and upon full appreciation of the responsibilities involved. It shall be ready and willing to give full disclosure of the services being offered and shall conduct its dealing w/ transparency. Harmonious relationship shall likewise be pursued w/ other professions to achieve the common goal of mutual service to the public and protection of its interest.” (Morales noting that there is a similar statement of

45 In 2007, the definition of Trust Receipt was asked.
principles in Sec 4401Q of the Manual of Regulations for Non-Financial Institutions)

Self-Dealing Rule

- **GR:** No trust entity shall, for the account of the trustor or the beneficiary of the trust,
  1. purchase or acquire property from, or sell, transfer, assign or lend money or property to,
  2. purchase debt instruments of
     a. any of the departments, directors, officers, stockholders, or employees of the trust entity
     b. relatives within the 1st degree of consanguinity or affinity, or the related interests, of such directors, officers and stockholders,

**EXC.**

1. the transaction is specifically authorized by the trustor and
2. the relationship of the trustee and the other party involved in the transaction is fully disclosed to the trustor or beneficiary of the trust prior to the transaction. (Sec. 80 par. 2)

- The MB shall promulgate such rules and regulations as may be necessary to prevent circumvention of the self-dealing rule or the evasion of the responsibility therein imposed on a trust entity. (Sec. 80 par. 3)

- Basically, a trustee cannot engage in a self-dealing transaction unless: (1) the transaction is specifically authorized by the trustor and (2) the relationship of the trustee and its counterparty is fully disclosed to the trustor or beneficiary of the trust prior to the transactions (either in a separate instrument of in the trust instrument itself). (Moralese on the basis of Subsec. X409.3 of the Manual of Regulations for Banks and Subsec. 4409Q.3 of the Manual of Regulations for Non-Bank Financial Institutions)

Rationale of the Rules

- "For the protection of the public xxx, there is need for writing into the law provisions intended to ensure that trust managers shall handle trust accounts along the "prudent man" concept of managing funds in trust, since trustors usually entrust their funds xxx in full confidence, secure in the belief that the trustee will manage his funds as a prudent man would.

- "There is need therefore to put in safeguards in the law so as to ensure that the expected prudence in management shall indeed be the norm. Such safeguards or guidelines may take the form of prohibition form purchasing or acquiring property for the trust or for account of the trustor or beneficiary of the trust from the bank proper or any of its dep'ts or directors, officers or employees, unless specifically authorized by the trustor.

- "It has been said that the essence of trusteeship is that the trustee would not be motivated by self-interest, that on no account shall it receive any personal advantage from the trusteeship, that it shall permit no dealings of any character between itself as an individual or corp and itself in its capacity as trustee, and that it shall receive from the trust no profit or financial return, directly or indirectly, other than its rightful compensation for services rendered." (Morales citing Recommendation 70 of Joint IMF-CBP Banking Survey Commission)

8.06. REGISTRATION REQUIREMENT

- The SEC shall not register the articles of incorporation and by-laws or any amendment thereto, of any trust entity, unless accompanied by a certificate of authority issued by the BSP. (Sec. 80)

- Reiterates the requirements under the Corporation Code. (Morales)

Note: Sec 17 par 2 of the Corporation Code: "No articles of incorporation or amendment to the articles of incorporation of banks, banking and Quasi-banking institutions, building and loan associations, trust companies and other financial intermediaries, insurance companies, public utilities, educational institutions, and other corps governed by special laws shall be accepted or approved by the SEC unless accompanied by a favorable recommendation of the appropriate government agency to the effect that such articles or amendment is in accordance with law.” AND Sec 46 par 4: “The SEC shall not accept for filing the by-laws or any amendment thereto of any bank, banking institution, building and loan association, trust company, insurance company, public utility, educational institution or other special corps governed by special laws, unless accompanied by a certificate of the appropriate government agency to the effect that such by-laws or amendments are in accordance with law.

- The certificate of authority need not be issued by the MB itself under its seal. (Morales)

8.07. MINIMUM CAPITALIZATION

- A trust entity, before it can engage in trust or other fiduciary business, shall comply with the minimum paid-in capital requirement which will be determined by the MB. (Sec. 82)

- This means it must have combined capital accounts of P250M. "Combined capital accounts" refers to the the total capital stock, retained earnings and profit and loss summary, net of (1) such unbooked valuation reserves and other capital adjustments as may be required by the BSP and (2) total outstanding unsecured credit accommodations, both direct and indirect, to DOSR1 When applicant is a domestic bank, the combined capital accounts must not be less that the minimum capital prescribed by the MB for such bank but in no case less than P250M; and when applicant is a branch of a foreign bank, it must comply with /
8.08. POWERS OF A TRUST ENTITY

A trust entity, in addition to the general powers incident to corporations, shall have the power to:

1. Act as trustee on any mortgage or bond issued by any municipality, corporation, or any body politic and to accept and execute any trust consistent with law;
2. Act under the order or appointment of any court as guardian, receiver, trustee, or depositary of the estate of any minor or other incompetent person, and as receiver and depositary of any moneys paid into court by parties to any legal proceedings and of property of any kind which may be brought under the jurisdiction of the court;
3. Act as the executor of any will when it is named the executor thereof;
4. Act as administrator of the estate of any deceased person, with the will annexed, or as administrator of the estate of any deceased person when there is no will;
5. Accept and execute any trust for the holding, management, and administration of any estate, real or personal, and the rents, issues and profits thereof; and
6. Establish and manage common trust funds, subject to such rules and regulations as may be prescribed by the MB. (Sec. 83)

8.09. GENERAL GROUPINGS

1. Trust Business

   - any activity resulting from a trustee-trustor relationship (trusteeship) involving the appointment of a trustee by a trustor for the administration, holding management of funds and/or properties of the trustor by the trustee for the use benefit or advantage of the trustor or of others called beneficiaries
   - Trust entity enters into a property relationship, wherein legal title to the property is transferred to it (as trustee) by a trustee for the benefit of one or more beneficiaries, who may or may not include the trustor. There is thus a division of legal and beneficial interests in and to the property entrusted to the trust entity. The trustor is able to shift the burden of management of the property to the trustee and, at the same time, confer the benefits of ownership on the beneficiary.

   Note: Art 1440 Civil Code. A person who establishes a trust is called the trustor; one in whom confidence is reposed as regards property for the benefit of another person is known as the trustee; and the person for whose benefit the trust has been created is referred to as the beneficiary.

2. Other fiduciary business

   - any activity of a trust licensed bank resulting from a contract or agreement whereby the bank binds itself to render services or to act in a representative capacity such as in an agency, guardianship, Administratorship of wills, properties, and estates, executorship, receivership, and other similar services which do not result in a trusteeship.
   - It shall exclude collecting or paying agency arrangements and similar fiduciary services which are inherent in the use of the facilities of the other dept's of said bank. Investment management activities, which are considered as among other fiduciary business, shall be separately defined in the succeeding item to highlights its being a major source of fiduciary business.
   - Does not act as a trustee but renders services to its counterparty in a representative capacity. In particular, the trust entity acts as agent, adviser, consultant or administrator, in respect of an investment management account.
   - Art 1060 Civil Code. A corporation or association authorized to conduct the business of a trust company in the Phils may be appointed as an executor, administrator, guardian of an estate, or trustee, in like manner as an individual; but it shall not be appointed guardian of the person of a ward.

3. Investment management activity

   - Any activity resulting from a contract or agreement primarily for financial return whereby the bank (the investment manager) binds itself to handle or manage investible funds or any investment portfolio in a representative capacity as financial or managing agent, adviser, consultant or administrator of financial or investment management, advisory, consultancy or any similar arrangement which does not create result in a trusteeship. (Morales)

8.10. NECESSARY DEPOSITS

1. Basic Security

   - Before transacting trust business, every trust entity shall deposit with the BSP as security for the faithful performance of its trust duties, cash or securities approved by the MB in an amount equal to not less than P500,000 or such higher amount as may be fixed by the MB.
   - The MB shall require every trust entity to increase the amount of its cash or securities on deposit with the BSP whenever in its judgment such increase is necessary by reason of the trust business of such entity. (Sec. 84)
2. Paid-In Capital and Security

- The paid-in capital and surplus of such entity must be at least equal to the amount required to be deposited with the BSP in accordance with the provisions of this paragraph. (Sec. 84)

3. Reserves

- In addition to basic security, a trust entity is required to maintain reserves against peso-denominated common trust funds as well as certain trust and other fiduciary accounts. (Morales citing Subsec X405.5 Manual of Regulation for banks; Subsec 440SQ.5 Manual of regulation for Non-bank Financial Institutions)

Failure to Maintain such Amounts

- Should the capital and surplus fall below said amount, the MB shall have the same authority as that granted to it under the provisions of the fifth paragraph of Sec. 34 of the GBL.

- A trust entity so long as it shall continue to be solvent and comply with laws or regulations shall have the right to collect the interest earned on such securities deposited with the BSP and, from time to time, with the approval of the BSP, to exchange the securities for others.

- If the trust entity fails to comply with any law or regulation, the BSP shall retain such interest on the securities deposited with it for the benefit of rightful claimants.

- All claims arising out of the trust business of a trust entity shall have priority over all other claims as regards the cash or securities deposited as above provided. The MB may not permit the cash or securities deposited to be reduced below the prescribed minimum amount until the depositing entity shall discontinue its trust business and shall satisfy the MB that it has complied with all its obligations in connection with such business. (Sec. 84)

4. Bond

- Before an executor, administrator, guardian, trustee, receiver or depository appointed by the court enters upon the execution of his duties, he shall, upon order of the court, file a bond in such sum, as the court may direct. (Sec. 85)

- Upon the application of any executor, administrator, guardian, trustee, receiver, depository or any other person in interest, the court may, after notice and hearing, order that the subject matter of the trust or any part thereof be deposited with a trust entity. Upon presentation of proof to the court that the subject matter of the trust has been deposited with a trust entity, the court may order that the bond given by such persons for the faithful performance of their duties be reduced to such sums as it may deem proper: Provided, however, That the reduced bond shall be sufficient to secure adequately the proper administration and care of any property remaining under the control of such persons and the proper accounting for such property. Property so deposited with any trust entity shall be held by such entity under the orders and direction of the court. (Sec.85)

- No bond or other security shall be required by the court from a trust entity for the faithful performance of its duties as court-appointed trustee, executor, administrator, guardian, receiver, or depository. However, the court may, upon proper application with it showing special cause therefor, require the trust entity to post a bond or other security for the protection of funds or property confided to such entity. (Sec. 86)

- That trust entities need not post a bond, unless required by the court, for the faithful performance of Sec 85 GBL duties is based on the presumption that trust entities already have a basic security deposit with the BSP. (Morales)

8.11. SEPARATION OF TRUST BUSINESS AND ASSETS FROM THE OTHER BUSINESSES AND ASSETS OF THE BANK

- The trust business and all funds, properties or securities received by any trust entity as executor, administrator, guardian, trustee, receiver, or depository shall be kept separate and distinct from the general business including all other funds, properties, and assets of such trust entity. The accounts of all such funds, properties, or securities shall likewise be kept separate and distinct from the accounts of the general business of the trust entity. (Sec. 87)

- Trust Business Separation. “Trust and other fiduciary business of a bank shall be carried out through a trust dep’t which shall be organizationally, operationally, administratively and functionally separate and distinct from the other dep’ts and/or business of the institution.” (Morales citing Subsec X406.1.a Manual of Regulations for Banks)

- Trust Assets Separation. “All moneys, properties or securities by a bank in its capacity as trustee, fiduciary or investment manager shall be kept physically separate and distinct from the other assets of its other business and shall be under the joint custody of at least 2 persons, one of whom shall be an officer of the trust or investment management dep’t, designated for that purpose by the board of directors. The investment of each trust, other fiduciary or investment management account shall be kept physically separate from those of other trust, other fiduciary or investment management accounts, and adequately identifies as the assets of property of the relevant account.” (Morales citing Sec X422 Ibid.)
8.12. INVESTMENT LIMITATIONS

- Unless otherwise directed by the instrument creating the trust, the lending and investment of funds and other assets acquired by a trust entity as executor, administrator, guardian, trustee, receiver or depositary of the estate of any minor or other incompetent person shall be limited to loans or investments as may be prescribed by law, the MB or any court of competent jurisdiction. (Sec. 88)

- Historical Note. It used to be that a trust company, particularly in the US could own anything. In fact, many national banks were then subsidiaries of trust companies. When monopolies were being made in the 19th and 20th centuries, the devise used was the trust, as it could hold the stock of all companies w/in the group. Accordingly, then the US Congress was breaking up monopolies, what were passed were “anti-trust” laws. (Morales)

8.13. LOANS OR INVESTMENTS PRESCRIBED BY MB

"Unless otherwise specifically enumerated in the agreement or indenture and directed in writing by the client, court of competent jurisdiction or other competent authority, loans and investments of the [trust or other fiduciary] fund shall be limited to:

1. (a) evidences of indebtedness of the RP and BSP, and
   (b) any other evidences of indebtedness or obligations the servicing and repayment of which are fully guaranteed by the RP or
   (c) loans against such government securities;
2. loans fully guaranteed by the RP as to the payment of principal and interest;
3. loans fully secured by [a] a hold-out on, [b] assignment or [c] pledge of deposits maintained either w/ the bank or other banks, or of deposit substitutes of the bank, or of [d] chattel mortgage bonds issued by the trustee or fiduciary; and
4. loans fully secured by real estate or chattels” (Morales referring to Subsec X409.2 Ibid; similar rule in Subsec 4409Q.2 Manual o Regulations for Non-Bank Financial Institutions)

8.14. REAL ESTATE INVESTMENTS

- Unless otherwise specifically directed by the trustor or the nature of the trust, real estate acquired by a trust entity in whatever manner and for whatever purpose, shall likewise be governed by the relevant provisions of Sec. 52 of the GBL. (Sec. 89)

- The reference to Sec 52 is w/out prejudice to the directives of the trustor or the nature of the trust itself. It is to be understood that the trust entity can take specific directives from the trustor only if the trust is revocable. But if it is irrevocable, then the trustor is out of the picture and the trust entity should take instructions from the beneficiaries themselves in the context of the trust instrument in question. (Morales)
Section 9 – Conservatorship and Cessation of Banking Business

9.01. CONSERVATORSHIP
• The grounds and procedures for placing a bank under conservatorship, as well as, the powers and duties of the conservator appointed for the bank shall be governed by the provisions of Sec. 29 and the last two paragraphs of Sec. 30 of the NCBA: Provided, That this Section shall also apply to conservatorship proceedings of QBs. (Sec. 67, please refer to companion reviewer)

9.02. VOLUNTARY LIQUIDATION
• In case of the voluntary liquidation of any bank organized under the laws of the Phils., or of any branch or office in the Phils. of a foreign bank, written notice of such liquidation shall be sent to the MB before such liquidation is undertaken, and the MB shall have the right to intervene and take such steps as may be necessary to protect the interests of creditors. (Sec. 68)

9.03. RECEIVERSHIP AND INVOLUNTARY LIQUIDATION
• The grounds and procedures for placing a bank under receivership or liquidation, as well as the powers and duties of the receiver or liquidator appointed for the bank shall be governed by the provisions of Secs. 30, 31, 32, and 33 of the NCBA: Provided, That the petitioner or plaintiff files with the clerk or judge of the court in which the action is pending a bond, executed in favor of the BSP, in an amount to be fixed by the court. This shall also apply to the extent possible to the receivership and liquidation proceedings of QBs. (Sec. 69)

9.04. PENALTY FOR TRANSACTIONS AFTER A BANK BECOMES INSOLVENT
• Any director or officer of any bank declared insolvent or placed under receivership by the MB shall be subject to the penal provisions of the NCBA if he
1. refuses to turn over the bank’s records and assets to the designated receivers,
2. tampers with banks records,
3. appropriates for himself or another party or destroys or causes the misappropriation and destruction of the bank’s assets,
4. receives or permits or causes to be received in said bank any deposit, collection of loans and/or receivables,
5. pays out or permits or causes to be paid out any funds of said bank, or
6. transfers or permits or causes to be transferred any securities or property of said bank (Sec. 70)

II. The New Central Bank Act (RA 7653)

A. Creation, Responsibilities and Corporate Powers of the BSP

1. DECLARATION OF POLICY
1. The State shall maintain a central monetary authority that shall function and operate as an independent and accountable body corporate in the discharge of its mandated responsibilities concerning money, banking and credit. (Sec. 1)

2. In line with this policy, and considering its unique functions and responsibilities, the central monetary authority established under the NCBA, while being a gov’t-owned corporation, shall enjoy fiscal and administrative autonomy. (Sec. 1)

NOTE
The NCBA establishes the independent central monetary authority, which is a body corporate known as the BSP. (Sec. 2)

2. PRIMARY OBJECTIVE AND ROLE OF THE BSP
1. To maintain price stability conducive to a balanced and sustainable growth of the economy. (Primary Objective)
2. To promote and maintain monetary stability and the convertibility of the peso.
3. To provide policy directions in the areas of money, banking, and credit.
4. To have supervision over the operations of banks
5. To exercise such regulatory powers (as provided under the NCBA and other pertinent laws) over the operations of finance companies and non-bank financial institutions performing quasi-banking functions and institutions performing similar functions. (Sec. 3)

NOTE
Phase-out of Regulatory Powers Over the Operations of Finance Corporations and Other Institutions Performing Similar Functions. The BSP shall, within a period of 5 years from the effectivity of this Act, phase out its regulatory powers over finance companies without quasi-banking functions and other institutions performing similar functions as provided in existing laws, the same to be assumed by the SEC. (Sec. 130)

3. CAPITAL OF THE BSP
The capital of the BSP shall be P50B, to be fully subscribed by the Gov’t of the RP. (Sec. 2)

4. PLACE OF BUSINESS OF THE BSP
The BSP shall have its principal place of business in Metro Manila, but may maintain branches, agencies and correspondents in such other places as the proper conduct of its business may require. (Sec. 4)
5. CORPORATE POWERS

1. To adopt, alter, and use a corporate seal which shall be judicially noticed;
2. To enter into contracts;
3. To lease or own real and personal property, and to sell or otherwise dispose of the same;
4. To sue and be sued; and
5. To acquire and hold such assets and incur such liabilities in connection with its operations authorized by the provisions of the NCBA, or as are essential to the proper conduct of such operations;
6. To compromise, condone or release, in whole or in part, any claim of or settled liability to the BSP, regardless of the amount involved, under such terms and conditions as may be prescribed by the MB to protect the interests of the BSP;
7. To do and perform any and all things that may be necessary or proper to carry out the purposes of the NCBA (Sec. 5)

NOTE
The powers and functions of the BSP shall be exercised by the BSP MB. (Sec. 6)

6. CREATION: FROM CB TO BSP

1. Transfer of Assets and Liabilities

Upon the effectivity of this Act, 3 members of the MB, which may include the Governor, in representation of the BSP, the Secretary of Finance and the Secretary of Budget and Management in representation of the National Government, and the Chairmen of the Committees on Banks of the Senate and the House of Representatives shall determine the assets and liabilities of the Central Bank (CB) which may be transferred to or assumed by the BSP. (Sec. 132)

2. Mandate to Organize

The BSP shall be organized by the MB by adopting, if it so desires, an entirely new staffing pattern on organizational structure to suit the operations of the BSP. No preferential or priority right shall be given to or enjoyed by any personnel for appointment to any position in the new staffing pattern, nor shall any personnel be considered as having prior or vested rights with respect to retention in the BSP or in any position which may be created in the new staffing pattern, even if he should be the incumbent of a similar position prior to the organization. The formulation of the program of organization shall be completed within 6 months after the effectivity of this Act, and shall be fully implemented within a period of 6 months thereafter. Personnel who may not be retained are deemed separated from the service. (Sec. 133)

3. Separation Benefits

Pursuant to Sec. 15 of this Act, the MB is authorized to provide separation incentives, and all those who shall retire or be separated from the service on account of reorganization under the preceding section shall be entitled to such incentives, which shall be in addition to all gratuities and benefits to which they may be entitled under existing laws. (Sec. 134)

4. Transfer of Powers

All powers, duties and functions vested by law in the Central Bank of the Philippines not inconsistent with the provisions of this Act shall be deemed transferred to the BSP. All references to the Central Bank of the Philippines in any law or special charters shall be deemed to refer to the BSP. (Sec. 136)

5. Implementing Details

The BSP shall be made operational by the performance of the following acts: (a) the President shall constitute the MB by appointing the members thereof within 60 days from the effectivity of this Act; and (b) the transfer of such assets and liabilities from the Central Bank to the BSP as provided in Sec. 132 shall be completed within 90 days from the constitution of the MB.

All incumbent personnel in the Central Bank as of the date of the approval of this Act shall continue to exercise their duties and functions as personnel of the BSP subject to the provisions of Section 133: Provided, That such personnel in the Central Bank as may be necessary for the purpose of implementing Section 132 may be assigned by the BSP MB to the Central Bank. (Sec. 131)

46 "The Committee shall complete its work within 90 days from the constitution of the MB submitting a comprehensive report with all its findings and justification. The following guidelines shall be strictly observed in the determination of which assets and liabilities shall be transferred to the BSP: (a) the MB and the Secretary of Finance shall have primary responsibility for working out creative monetary and financial solutions to retire the Central Bank liabilities and losses at the least cost to the Government; (b) the BSP shall remit 75% of its net profit to a special deposit account (sinking fund) until such time as the net liabilities of the Central Bank shall have been liquidated through generally accepted finance mechanisms such as, but not limited to, write-offs, set-offs, condonation, collections, reappraisal, revaluation and bond issuance by the National Government, or to the National Government as dividends; (c) the assets and liabilities to be transferred shall be limited to an amount that will enable the BSP to perform its responsibilities adequately and operate on a viable basis; Provided, That the assets shall exceed the liabilities as certified by the COA, by an initial amount of P10B; (d) liabilities to be assumed by the BSP shall include liability for notes and coins in circulation as of the effective date of this Act; and (e) any asset or liability of the Central Bank not transferred to the BSP shall be retained and administered, disposed of and liquidated by the Central Bank itself which shall continue to exist as the CB Board of Liquidators only for the purposes provided in this paragraph but not later than twenty-five (25) years or until such time that liabilities have been liquidated: Provided, That the BSP may financially assist the Central Bank of Liquidators in the liquidation of CB liabilities: Provided, finally, That upon disposition of said retained assets and liquidation of said retained liabilities, the Central Bank shall be deemed abolished.

"All actions taken by the BSP MB under this section shall be reported to Congress and the President within 30 days." (Sec. 132)
B. The Monetary Board

1. COMPOSITION
The MB is composed of 7 members appointed by the President for a term of 6 years. No member of the MB may be reappointed more than once.

1. BSP Governor, who shall be the Chairman of the MB — shall be head of a department and his appointment shall be subject to confirmation by the COA. Whenever the Governor is unable to attend a meeting of the Board, he shall designate a Deputy Governor to act as his alternate: Provided, That in such event, the MB shall designate one of its members as acting Chairman;
2. Cabinet Member — designated by the President. Whenever the designated Cabinet Member is unable to attend a meeting of the Board, he shall designate an Undersecretary in his Department to attend as his alternate; and
3. 5 Members from the Private Sector — all of whom shall serve full-time: Provided, however, That three 3 shall have a term of 6 years, and the other 2, 3 years.

2. MEMBERS
1. Qualifications of Members
   1. Must be natural-born citizens of the Philippines,
   2. Must be at least 35 years of age, with the exception of the Governor who should at least be 40 years of age
   3. Must be of good moral character,
   4. Must be of unquestionable integrity,
   5. Must be of known probity and patriotism, and
   6. Must be of recognized competence in social and economic disciplines. (Sec. 8)

2. Disqualifications of Members
   1. The disqualifications imposed by RA 6713 (Code of Conduct and Ethical Standards for Public Officials and Employees), and
   2. A Member may not be a director, officer, employee, consultant, lawyer, agent or stockholder of any bank, QB or any other institution which is subject to supervision or examination by the BSP. In such cases, he shall resign from, and divest himself of any and all interests in such institution before assumption of office as member of the MB.
   3. The members of the MB coming from the private sector shall not hold any other public office or public employment during their tenure.
   4. No person shall be a member of the MB if he has been connected directly with any multilateral banking or financial institution or has a substantial interest in any private bank in the Phils., within 1 year prior to his appointment;
   5. No member of the MB shall be employed in any such institution within 2 years after the expiration of his term except when he serves as an official representative of the Philippine Government to such institution. (Sec. 9)

NOTE
1. In addition to the requirements of RA 6713 (Code of Conduct and Ethical Standards for Public Officials and Employees), any member of the MB with personal or pecuniary interest in any matter in the agenda of the MB shall disclose his interest to the MB and shall retire from the meeting when the matter is taken up. The decision taken on the matter shall be made public. The minutes shall reflect the disclosure made and the retirement of the member concerned from the meeting. (Sec. 14)
2. Outside Interests of the Governor and the Full-time Members of the Board. The Governor of the BSP and the full-time members of the Board shall limit their professional activities to those pertaining directly to their positions with the BSP. Accordingly, they may not accept any other employment, whether public or private, remunerated or ad honorem, with the exception of positions in eleemosynary, civic, cultural or religious organizations or whenever, by designation of the President, the Governor or the full-time member is tasked to represent the interest of the Government or other government agencies in matters connected with or affecting the economy or the financial system of the country. (Sec. 20)

3. Vacancies
Any vacancy in the MB created by the death, resignation, or removal of any member shall be filled by the appointment of a new member to complete the unexpired period of the term of the member concerned. (Sec. 7)

4. Removal
The President may remove any member of the MB for any of the following reasons:
   1. If he no longer possesses the qualifications specified
   2. If he is subsequently disqualified under any of the instances provided for disqualification;
   3. If he is physically or mentally incapacitated that he cannot properly discharge his duties and responsibilities and such incapacity has lasted for more than 6 months; or
   4. If he is guilty of acts or operations which are of fraudulent or illegal character or which are manifestly opposed to the aims and interests of the BSP. (Sec. 10)

5. Salary
The salary of the Governor and the members of the MB from the private sector shall be fixed by the President at a sum commensurate to the importance and responsibility attached to the position. (Sec. 13)
3. EXERCISE OF AUTHORITY

In the exercise of its authority, the MB shall:

1. Issue rules and regulations it considers necessary for the effective discharge of the responsibilities and exercise of the powers vested upon the MB; rules and regulations issued shall be reported to the President and the Congress within 15 days from the date of their issuance;

2. Direct the management, operations, and administration of the BSP, reorganize its personnel and structure such systems and regulations as it may deem necessary or convenient for this purpose. The legal units of the BSP shall be under the exclusive supervision and control of the MB;

3. Establish a human resource management system which shall govern the selection, hiring, appointment, transfer, promotion, or dismissal of all personnel. Such system shall aim to establish professionalism and excellence at all levels of the BSP in accordance with sound principles of management.47

4. Adopt an annual budget for and authorize such expenditures by the BSP as are in the interest of the effective administration and operations of the BSP in accordance with applicable laws and regulations; and

5. Indemnify its members and other officials of the BSP, including personnel of the departments performing supervision and examination functions against all costs and expenses reasonably incurred by such persons in connection with any civil or criminal action, suit or proceedings to which he may be, or is, made a party by reason of the performance of his functions or duties, unless he is finally adjudged in such action or proceeding to be liable for negligence or misconduct.48 (Sec. 15)

4. MEETINGS

NOTES

1. The MB shall meet at least once a week. (Sec. 11)

2. The MB may be called to a meeting by the Governor or by 2 other members of the MB. (Sec. 11)

3. The presence of 4 members shall constitute a quorum: Provided, That in all cases the Governor or his duly designated alternate shall be counted as such an active member of the MB; and

4. Unless otherwise provided in this Act, all decisions of the MB shall require the concurrence of at least 4 members. (Sec. 11)

5. The BSP shall maintain and preserve a complete record of the proceedings and deliberations of the MB, including the tapes and transcripts of the stenographic notes, either in their original form or in microfilm. (Sec. 11)

6. The Deputy Governors may attend the meetings of the MB with the right to be heard. (Sec. 12)

7. In case of emergencies where time is insufficient to call a meeting of the MB, the Governor of the BSP, with the concurrence of 2 other members of the MB, may decide any matter or take any action within the authority of the Board. The Governor shall submit a report to the President and Congress within 72 hours after the action has been taken. At the soonest possible time, the Governor shall call a meeting of the MB to submit his action for ratification. (Sec. 19)

5. SANCTIONS

NOTES

1. Members of the MB, officials, examiners, and employees of the BSP who willfully violate this Act or who are guilty of negligence, abuses or acts of malfeasance or misfeasance or fail to exercise extraordinary diligence in the performance of his duties shall be held liable for any loss or injury suffered by the BSP or other banking institutions as a result of such violation, negligence, abuse, malfeasance, misfeasance or failure to exercise extraordinary diligence. (Sec. 16)

2. Similar responsibility shall apply to members, officers, and employees of the BSP for:

a. the disclosure of any information of a confidential nature, or any information on the discussions or resolutions of the MB, or about the confidential operations of the BSP, unless the disclosure is in connection with the performance of official functions with the BSP, or is with prior authorization of the MB or the Governor; or

b. the use of such information for personal gain or to the detriment of the Government, the BSP or third parties: Provided, however, That any data or information required to be submitted to the President and/or the Congress, or to be published under the provisions of this Act shall not be considered confidential. (Sec. 16)
6. GOVERNOR

1. Powers and Duties

The Governor shall be the chief executive officer of the BSP. (Sec. 17)

1. prepare the agenda for the meetings of the MB and to submit for the consideration of the MB the policies and measures which he believes to be necessary to carry out the purposes and provisions of the NCBA;

2. execute and administer the policies and measures approved by the MB;

3. direct and supervise the operations and internal administration of the BSP. The Governor may delegate certain of his administrative responsibilities to other officers or may assign specific tasks or responsibilities to any full-time member of the MB without additional remuneration or allowance whenever he may deem fit or subject to such rules and regulations as the MB may prescribe;

4. appoint and fix the remunerations and other emoluments of personnel below the rank of a department head in accordance with the position and compensation plans approved by the MB, as well as to impose disciplinary measures upon personnel of the BSP, subject to the provisions of Section 15(c) of this Act: Provided, That removal of personnel shall be with the approval of the MB;

5. render opinions, decisions, or rulings, which shall be final and executory until reversed or modified by the MB, on matters regarding application or enforcement of laws pertaining to institutions supervised by the BSP and laws pertaining to quasi-banks, as well as regulations, policies or instructions issued by the MB, and the implementation thereof; and

6. exercise such other powers as may be vested in him by the MB. (Sec. 17)

2. Representation of the MB and the BSP

The Governor of the BSP shall be the principal representative of the MB and of the BSP and, in such capacity and in accordance with the instructions of the MB, he shall be empowered to:

1. represent the MB and the BSP in all dealings with other offices, agencies and instrumentalities of the Government and all other persons or entities, public or private, whether domestic, foreign or international;

2. sign contracts entered into by the BSP, notes and securities issued by the BSP, all reports, balance sheets, profit and loss statements, correspondence and other documents of the BSP. The signature of the Governor may be in facsimile whenever appropriate;

3. represent the BSP, either personally or through counsel, including private counsel, as may be authorized by the MB, in any legal proceedings, action or specialized legal studies; and

4. delegate his power to represent the BSP, as provided in subsections (a), (b) and (c) of this section, to other officers upon his own responsibility: Provided, however, That in order to preserve the integrity and the prestige of his office, the Governor of the BSP may choose not to participate in preliminary discussions with any multilateral banking or financial institution on any negotiations for the Gov’t within or outside the Phils. During the negotiations, he may instead be represented by a permanent negotiator. (Sec. 18)

3. Deputy Governor(s)

NOTES

1. The Governor of the BSP, with the approval of the MB, shall appoint not more than 3 Deputy Governors who shall perform duties as may be assigned to them by the Governor and the Board.

2. In the absence of the Governor, a Deputy Governor designated by the Governor shall act as chief executive of the BSP and shall exercise the powers and perform the duties of the Governor. Whenever the Government is unable to attend meetings of government boards or councils in which he is an ex officio member pursuant to provisions of special laws, a Deputy Governor as may be designated by the Governor shall be vested with authority to participate and exercise the right to vote in such meetings. (Sec. 21)

C. Operations of the BSP

1. SUPERVISION AND EXAMINATION

The BSP shall have supervision over, and conduct periodic or special examinations of, banking institutions and quasi-banks, including their subsidiaries and affiliates engaged in allied activities. (Sec. 24)

The department heads and the examiners of the supervising and/or examining departments are hereby authorized to administer oaths to any director, officer, or employee of any institution under their respective supervision or subject to their examination and to compel the presentation of all books, documents, papers or records necessary in their judgment to ascertain the facts relative to the true condition of any institution as well as the books and records of persons and entities relative to or in connection with the operations, activities or transactions of the institution under examination, subject to the provision of existing laws protecting or safeguarding the secrecy or confidentiality of bank deposits as well as investments of private persons.

Subsidiary—a corporation more than 50% of the voting stock of which is owned by a bank or QB. Affiliate—a corporation the voting stock of which, to the extent of 50% or less, is owned by a bank or QB or which is related or linked to such institution or intermediary through common stockholders or such other factors as may be determined by the MB. (Sec. 24)
natural or juridical, in debt instruments issued by
the Gov't. (Sec. 24)

1. No Restraining Order

No restraining order or injunction shall be issued by
the court enjoining the BSP from examining any
institution subject to supervision or examination by
the BSP, unless there is convincing proof that the
action of the BSP is plainly arbitrary and made in
bad faith and the petitioner or plaintiff files with the
clerk or judge of the court in which the action is
pending a bond executed in favor of the BSP, in an
amount to be fixed by the court. (Sec. 24)\(^{50}\)

2. Waiver of Secrecy of Deposits in DOSRI
 Accounts

Any director, officer or stockholder who, together
with his related interest (DOSRI), contracts a loan
or any form of financial accommodation from:

1. his bank; or
2. from a bank (a) which is a subsidiary of a
bank holding company of which both his
bank and the lending bank are subsidiaries
or (b) in which a controlling proportion of
the shares is owned by the same interest
that owns a controlling proportion of the
shares of his bank,
in excess of 5% of the capital and surplus of the
bank, or in the maximum amount permitted by
law, whichever is lower, shall be required by the
lending bank to waive the secrecy of his deposits of
whatever nature in all banks in the Philippines.\(^{51}\)
(Sec. 26)

3. Examination and Fees

- The supervising and examining department
head, personally or by deputy, shall examine
the books of every banking institution once in
every 12 months, and at such other times as
the MB finds that a bank or a QB is in
a state of continuing inability or unwillingness to
operate on its own and the co

- The bank concerned shall afford to the head
of the appropriate supervising and examining
departments and to his authorized deputies full
opportunity to examine its books, cash and
available assets and general condition at any
time during banking hours when requested to
do so by the BSP: Provided, That there shall be
an interval of at least twelve 12 months
between annual examinations.

- While the Central Bank law gives vast and far
reaching powers to the conservator of a bank,
such powers must be related to the
preservation of the assets of the bank, the
reorganization of the management and the
restoration of viability. Such powers cannot
extend to the post-facto repudiation of
perfected transactions, otherwise they would
infringe against the non-impairment clause of
the Constitution. The law merely gives the
conservator power to revoke contracts that are
deemed to be defective - i.e., void, voidable,
enforceable or rescissible. The conservator
merely takes the place of a bank’s board of
directors. What the said board cannot do - such
as repudiating a contract validly entered into

- Banking and quasi-banking institutions which
are subject to examination by the BSP shall pay
to the BSP, within the first 30 days of each
year, an annual fee in an amount equal to a
percentage as may be prescribed by the MB of
its average total assets during the preceding
year as shown on its end-of-month balance
sheets, after deducting cash on hand and
amounts due from banks, including the BSP
and banks abroad. (Sec. 28)

2. HANDLING OF BANKS IN DISTRESS

1. Conservatorship

1. Powers of Conservator

Whenever, on the basis of a report submitted by
the appropriate supervising or examining
department, the MB finds that a bank or a QB is in
a state of continuing inability or unwillingness to
maintain a condition of liquidity deemed adequate
to protect the interest of depositors and creditors,
the MB may appoint a conservator with such
powers as the MB shall deem necessary to:

a. take charge of the assets, liabilities,
and the management thereof,
b. reorganize the management,
c. collect all monies and debts due said
institution, and
d. exercise all powers necessary to
restore its viability. (Sec. 29)

2. Period of Conservatorship

The conservatorship shall not exceed 1 year. (Sec.
29) The MB shall terminate the conservatorship
when it is satisfied that the institution can continue
to operate on its own and the conservatorship is no
longer necessary. The conservatorship shall
likewise be terminated should the MB, on the basis
of the report of the conservator or of its own
findings, determine that the continuance in
business of the institution would involve probable
loss to its depositors or creditors, in which case the
provisions of Section 30 shall apply. (Sec. 29)

3. Conservator

The conservator shall report and be responsible to
the MB and shall have the power to overrule or
revoke the actions of the previous management
and board of directors of the bank or quasi-bank.
(Sec. 29)

*\(^{50}\) "The provisions of Rule 58 of the New Rules of Court
insofar as they are applicable and not inconsistent with the
provisions of this section shall govern the issuance and
dissolution of the restraining order or injunction contemplated
in this section." (Sec. 24)

*\(^{51}\) "Any information obtained from an examination of his
deposits shall be held strictly confidential and may be used by
the examiners only in connection with their supervisory and
examination responsibility or by the BSP in an appropriate
legal action it has initiated involving the deposit account."
under the doctrine of implied authority - the conservator cannot do either. Ineluctably, his power is not unilateral and he cannot simply repudiate valid obligations of the Bank. His authority would be only to bring court actions to assail such contracts. (First Philippine International Bank vs CA ; 1996)

- The conservator should be competent and knowledgeable in bank operations and management. (Sec. 29)

- The conservator shall receive remuneration to be fixed by the MB in an amount not to exceed 2/3 of the salary of the president of the institution in 1 year, payable in 12 equal monthly payments: Provided, That, if at any time within one-year period, the conservatorship is terminated on the ground that the institution can operate on its own, the conservator shall not be entitled to such remaining balance. The MB may appoint a conservator connected with the BSP, in which case he shall not be entitled to receive any remuneration or emolument from the BSP during the conservatorship. The expenses attendant to the conservatorship shall be borne by the bank or quasi-bank concerned. (Sec. 29)

2. Closure

1. When closure is ordered

Whenever, upon report of the head of the supervising or examining department, the MB finds that a bank or quasi-bank:

- is unable to pay its liabilities as they become due in the ordinary course of business: Provided, That this shall not include inability to pay caused by extraordinary demands induced by financial panic in the banking community;
- has insufficient realizable assets, as determined by the BSP, to meet its liabilities; or
- cannot continue in business without involving probable losses to its depositors or creditors; or
- has willfully violated a cease and desist order under Sec. 37 that has become final, involving acts or transactions which amount to fraud or a dissipation of the assets of the institution;

in which cases, the MB may summarily and without need for prior hearing forbid the institution from doing business in the Philippines (Sec. 30)


- In case a bank or quasi-bank notifies the BSP or publicly announces a bank holiday, or in any manner suspends the payment of its deposit liabilities continuously for more than 30 days, the MB may summarily and without need for prior hearing close such banking institution and place it under receivership of the Philippine Deposit Insurance Corporation. (Sec 53)

- Whenever a bank, quasi-bank or trust entity persists in conducting its business in an unsafe or unsound manner, the MB may take action under Sec 30. Conducting business in an unsafe or unsound manner means:

  - The act or omission has resulted or may result in material loss or damage, or abnormal risk or danger to safety, stability, liquidity or solvency or
  - to the institution's depositors, creditors, investors, stockholders or to the Bangko Sentral or to the public in general or
  - The act or omission has caused any undue injury, or has given any unwarranted benefits, advantage or preference to the bank or any party in the discharge by the director or officer of his duties and responsibilities through manifest partiality, evident bad faith or gross inexcusable negligence or
  - The act or omission involves entering into any contract or transaction manifestly and grossly disadvantageous to the bank, quasi-bank or trust entity, whether or not the director or officer profited or will profit thereby (Sec. 56)

3. Receivership

1. When Receiver is Designated

Whenever, upon report of the head of the supervising or examining department, the MB finds that a bank or quasi-bank:

- is unable to pay its liabilities as they become due in the ordinary course of business: Provided, That this shall not include inability to pay caused by extraordinary demands induced by financial panic in the banking community;
- has insufficient realizable assets, as determined by the BSP, to meet its liabilities; or
- cannot continue in business without involving probable losses to its depositors or creditors; or
- has willfully violated a cease and desist order under Sec. 37 that has become final, involving acts or transactions which amount to fraud or a dissipation of the assets of the institution;
in which cases, the MB may summarily and without need for prior hearing forbid the institution from doing business in the Philippines and designate the Philippine Deposit Insurance Corporation (PDIC) as receiver of the banking institution. For a quasi-bank, any person of recognized competence in banking or finance may be designated as receiver. (Sec. 30)

- There is no requirement whether express or implied, that a hearing be first conducted before a banking institution may be placed under receivership. The law is explicit as to the conditions prerequisite to the action of the MB to forbid the institution to do business in the Philippines and to appoint a receiver to immediately take charge of the bank’s assets and liabilities. They are: (a) an examination made by the examining department of the CB; (b) report by said department to the MB; and (c) prima facie showing that the bank is in a condition of insolvency or so situated that its continuance in business would involve probable loss to its depositors or creditors. (Rural Bank of Buhi vs CA ; 1988)

2. Functions and Obligations of the Receiver

The receiver shall immediately gather and take charge of all the assets and liabilities of the institution, administer the same for the benefit of its creditors, and exercise the general powers of a receiver under the Revised Rules of Court but shall not, with the exception of administrative expenditures, pay or commit any act that will involve the transfer or disposition of any asset of the institution. Provided, That the receiver may deposit or place the funds of the institution in non-speculative investments.

The receiver shall determine as soon as possible, but not later than 90 days from take over, whether the institution may be rehabilitated or otherwise placed in such a condition so that it may be permitted to resume business with safety to its depositors and creditors and the general public: Provided, That any determination for the resumption of business of the institution shall be subject to prior approval of the MB. (Sec. 30)


The petitioner or plaintiff must file with the clerk or judge of the court in which the action is pending a bond, executed in favor of the BSP, in an amount to be fixed by the court. (Sec 69)

Any director or officer of any bank placed under receivership who refuses to turn over the bank’s records and assets to designated receivers, tampers with records, appropriates or destroys or causes the misappropriation and destruction of the bank’s assets, receives or permits or causes to be received in said bank any deposit, collection of loans and/or receivables, pays out or permits or causes to be transferred any securities or property of said bank shall be subject to the penal provisions of the New Central Bank Act. (Sec 70)

4. Liquidation

If the receiver determines that the institution cannot be rehabilitated or permitted to resume business in accordance with the next preceding paragraph, the MB shall notify in writing the board of directors of its findings and direct the receiver to proceed with the liquidation of the institution.

1. Receiver’s Acts

1. file ex parte with the proper RTC, and without requirement of prior notice or any other action, a petition for assistance in the liquidation of the institution pursuant to a liquidation plan adopted by the Philippine Deposit Insurance Corporation for general application to all closed banks. In case of quasi-banks, the liquidation plan shall be adopted by the MB.

2. upon acquiring jurisdiction, the court shall, upon motion by the receiver after due notice, adjudicate disputed claims against the institution, assist the enforcement of individual liabilities of the stockholders, directors and officers, and decide on other issues as may be material to implement the liquidation plan adopted. The receiver shall pay the cost of the proceedings from the assets of the institution.

- The exclusive jurisdiction of the liquidation court pertains only to the adjudication of claims against the bank. It does not cover the reverse situation where it is the bank which files a claim against another person or legal entity. (Manalo vs CA ; 2001)

3. convert the assets of the institutions to money, dispose of the same to creditors and other parties, for the purpose of paying the debts of such institution in accordance with the rules on concurrence and preference of credit under the Civil Code and

4. he may, in the name of the institution, and with the assistance of counsel as he may retain, institute such actions as may be necessary to collect and recover accounts and assets of, or defend any action against, the institution. (Sec. 30)

5. In case of liquidation of a bank or quasi-bank, after payment of the cost of proceedings, including reasonable expenses and fees of the receiver to be allowed by the court, the receiver shall pay the debts of such institution, under order of the court, in accordance with the rules on concurrence and preference of credit as provided in the Civil Code. (Sec. 31)

6. All revenues and earnings realized by the receiver in winding up the affairs and administering the assets of any bank or quasi-bank within the purview of this Act shall be used to pay the costs, fees and expenses mentioned in no. 5, salaries of such personnel whose employment is rendered necessary in the discharge of the
liquidation together with other additional expenses caused thereby. The balance of revenues and earnings, after the payment of all said expenses, shall form part of the assets available for payment to creditors. (Sec. 32)

- The assets of an institution under receivership or liquidation shall be deemed in custodia legis in the hands of the receiver and shall, from the moment the institution was placed under such receivership or liquidation, be exempt from all orders of garnishment, attachment, or execution. (Sec. 30)

- The BSP may, if public interest so requires, award to an institution, upon such terms and conditions as the MB may approve, the banking franchise of a bank under liquidation to operate in the area where said bank or its branches were previously operating: Provided, That whatever proceeds may be realized from such award shall be subject to the appropriate exclusive disposition of the MB. (Sec. 33)


The petitioner or plaintiff must file with the clerk or judge of the court in which the action is pending a bond, executed in favor of the BSP, in an amount to be fixed by the court. (Sec 69)

3. Provisions common to Conservatorship and Receivership

- The actions of the MB taken under these sections shall be final and executory, and may not be restrained or set aside by the court except on petition for certiorari. (Sec. 30)

- The designation of a conservator or the appointment of a receiver shall be vested exclusively with the MB. Furthermore, the designation of a conservator is not a precondition to the designation of a receiver. (Sec. 30)

5. Other Operations

1. Research, Statistics, Data and Information

- Research and Statistics. The BSP shall prepare data and conduct economic research for the guidance of the MB in the formulation and implementation of its policies. (Sec. 22)

- The BSP shall have the authority to request from government offices and instrumentalities, or GOCCs, any data which it may require for the proper discharge of its functions and responsibilities. The BSP through the Governor or in his absence, a duly authorized representative shall have the power to issue a subpoena for the production of the books and records for the aforesaid purpose. Those who refuse the subpoena without justifiable cause, or who refuse to supply the bank with data requested or required, shall be subject to punishment for contempt in accordance with the provisions of the Rules of Court. (Sec. 23)

- Data on individual firms, other than banks, gathered by the Department of Economic Research and other departments or units of the BSP shall not be made available to any person or entity outside of the BSP whether public or private except under order of the court or under such conditions as may be prescribed by the MB: Provided, however, that the collective data on firms may be released to interested persons or entities: Provided, finally, that in the case of data on banks, the provisions of Sec. 27 of this Act (infra) shall apply. (Sec. 23)

2. Training of Technical Personnel

- The BSP shall promote and sponsor the training of technical personnel in the field of money and banking. (Sec. 23)

3. Operating Departments

- The MB shall, in accordance with its authority under this Act, determine and provide for such operating departments and other offices, including a public information office, of the BSP as it deems convenient for the proper and efficient conduct of the operations and the accomplishment of the objectives of the BSP. The functions and duties of such operating departments and other offices shall be determined by the MB. (Sec. 38)

4. Reports and Publications

- The BSP shall publish a general balance sheet showing the volume and composition of its assets and liabilities as of the last working day of the month within sixty (60) days after the end of each month except for the month of December, which shall be submitted within ninety (90) days after the end thereof. (Sec. 39)

- The MB shall publish and submit the following reports to the President and to the Congress:

  - not later than 90 days after the end of each quarter, an analysis of economic and financial developments, including the condition of net international reserves and monetary aggregates;

  - “Toward this end, the BSP is hereby authorized to defray the costs of study, at home or abroad, of qualified employees of the BSP, of promising university graduates or of any other qualified persons who shall be determined by proper competitive examinations. The MB shall prescribe rules and regulations to govern the training program of the BSP.”

52 “Such data shall include, among others, forecasts of the balance of payments of the Philippines, statistics on the money movement of the monetary aggregates and of prices and other statistical series and economic studies useful for the formulation and analysis of monetary, banking, credit and exchange policies.” (Sec. 22)
• within 90 days after the end of the year, the preceding year's budget and profit and loss statement of the BSP showing in reasonable detail the result of its operations;
• 120 days after the end of each semester, a review of the state of the financial system; and
• as soon as practicable, abnormal movements in monetary aggregates and the general price level, and, not later than 72 hours after they are taken, remedial measures in response to such abnormal movements. (Sec. 39)

5. Annual Report
• Before the end of March of each year, the BSP shall publish and submit to the President and the Congress an annual report on the condition of the BSP, including a review of the policies and measures adopted by the MB during the past year and an analysis of the economic and financial circumstances which gave rise to said policies and measures. The annual report shall also include a statement of the financial condition of the BSP and a statistical appendix. (Sec. 40)
• The BSP shall publish another version of the annual report in terms understandable to the layman. (Sec. 40)

6. Profits, Losses and Special Accounts
• Within the 30 days following the end of each fiscal year, the BSP shall determine its net profits or losses. In the calculation of net profits, the BSP shall make adequate allowance or establish adequate reserves for bad and doubtful accounts. (Sec. 43)
• Within the first 60 days following the end of each fiscal year, the MB shall determine and carry out the distribution of the net profits, in accordance with the following rule: 50% of the net profits shall be carried to surplus and the remaining 50% shall revert back to the National Treasury, except as otherwise provided in the transitory provisions of this Act. (Sec. 44)

• Profits or losses arising from any revaluation of the BSP's net assets or liabilities in gold or foreign currencies with respect to the Philippine peso shall not be included in the computation of the annual profits and losses of the BSP. Any profits or losses arising in this manner shall be determined by any amount which arises as a consequence of such revaluations, are owed by the Philippines to any international or regional intergovernmental financial institution of which the Philippines is a member or are owed by these institutions to the Philippines. Any remaining profit or loss shall be carried in a special frozen account which shall be named "Revaluation of International Reserve" and the net balance of which shall appear either among the liabilities or among the assets of the BSP, depending on whether the revaluations have produced net profits or net losses. The Revaluation of International Reserve account shall be neither credited nor debited for any purposes other than those specifically authorized in this section. (Sec. 45)

7. n.b. Auditor
• The Chairman of the COA shall act as the ex officio auditor of the BSP and, as such, he is empowered and authorized to appoint a representative who shall be the auditor of the BSP and, in accordance with law, fix his salary, and to appoint and fix salaries and number of personnel to assist said representative in his work. The salaries and other emoluments shall be paid by the COA. The auditor of the BSP and personnel under him may be removed only by the Chairman of the COA. (Sec. 47)
• The representative of the Chairman of the COA must be a CPA with at least 10 years experience as such. No relative of any member of the MB or the Chairman of the COA within the 6th degree of consanguinity or affinity shall be appointed such representative. (Sec. 47)

3. PROHIBITIONS ON BSP PERSONNEL

In addition to the prohibitions found in RA 3019 (Anti-Graft and Corrupt Practices Act) and 6713 (Code of Conduct and Ethical Standards for Public Officials and Employees), personnel of the BSP are hereby prohibited from:

1. being an officer, director, lawyer or agent, employee, consultant or stockholder, directly or indirectly, of any institution subject to supervision or examination by the BSP, EBC, or CBA.
   a. non-stock savings and loan associations and provident funds organized exclusively for employees of the BSP, and

54 The statistical appendix "shall present, as a minimum, the following data: (a) the monthly movement of monetary aggregates and their components; (b) the monthly movement of purchases and sales of foreign exchange and of the international reserves of the BSP; (c) the balance of payments of the Philippines; (d) monthly indices of consumer prices and of import and export prices; (e) the monthly movement, in summary form, of exports and imports, by volume and value; (f) the monthly movement of the accounts of the BSP and of other banks; (g) the principal data on government receipts and expenditures and on the status of the public debt, both domestic and foreign; and (h) the texts of the major legal and administrative measures adopted by the Government and the MB during the year which relate to the functions or operations of the BSP or of the financial system." (Sec. 40)

55 "Failure to comply with the reportorial requirements pursuant to this article without justifiable reason as may be determined by the MB shall cause the withholding of the salary of the personnel concerned until the requirements are complied with." (Sec. 40)

56 "The balance sheets and other financial statements of the BSP shall be signed by the officers responsible for their preparation, by the Governor, and by the auditor of the BSP." (Sec. 41)

57 "Sections 43 and 43-A of RA 265, as amended, creating the Monetary Adjustment Account (MAA) and the Exchange Stabilization Adjustment Account (ESAA), respectively, are hereby repealed. Amounts outstanding as of the effective date of this Act based on these accounts shall continue to be for the account of the CB and shall be governed by the transitory provisions of this Act. The Revaluation of International Reserve (RIR) account as of the effective date of this Act of the CB shall continue to be for the account of the same entity and shall be governed by the provisions of Sec. 44 of RA 265, as amended, until otherwise provided for in accordance with the transitory provisions of this Act." (Sec. 46)
b. as otherwise provided in the NCBA in this Act;

2. directly or indirectly requesting or receiving any gift, present or pecuniary or material benefit for himself or another, from any institution subject to supervision or examination by the BSP;

3. revealing in any manner, except under orders of the court, the Congress or any government office or agency authorized by law, or under such conditions as may be prescribed by the MB, information relating to the condition or business of any institution. This prohibition shall not be held to apply to the giving of information to the MB or the Governor of the BSP, or to any person authorized by either of them, in writing, to receive such information; and

4. borrowing from any institution subject to supervision or examination by the BSP shall be prohibited unless said borrowings are adequately secured, fully disclosed to the MB, and shall be subject to such further rules and regulations as the MB may prescribe: Provided, however, That personnel of the supervising and examining departments are prohibited from borrowing from a bank under their supervision or examination. (Sec. 27)

4. SANCTIONS

1. Refusal to Make Reports or Permit Examination

Any officer, owner, agent, manager, director or OIC of any institution subject to the supervision or examination by the BSP within the purview of this Act who, being required in writing by the MB or by the head of the supervising and examining department willfully refuses to file the required report or permit any lawful examination into the affairs of such institution shall be punished by a fine of not less than ₱50,000 nor more than ₱100,000 or by imprisonment of not less than 1 year nor more than 5 years, or both, in the discretion of the court. (Sec. 34)

2. False Statement

The willful making of a false or misleading statement on a material fact to the MB or to the examiners of the BSP shall be punished by a fine of not less than ₱100,000 nor more than ₱200,000, or by imprisonment of not more 5 years, or both, at the discretion of the court. (Sec. 35)

3. Violation of This Act and Other Banking Laws, Rules, Regulations, Orders or Instructions

Whenever a bank or QB, or whenever any person or entity willfully violates this Act or other pertinent banking laws being enforced or implemented by the BSP or any order, instruction, rule or regulation issued by the MB, the person or persons responsible for such violation shall unless otherwise provided in this Act be punished by a fine of not less than ₱50,000 nor more than ₱200,000 or by imprisonment of not less than 2 years nor more than 10 years, or both, at the discretion of the court.

Whenever a bank or QB persists in carrying on its business in an unlawful or unsafe manner, the Board may, without prejudice to the penalties provided in the preceding paragraph of this section and the administrative sanctions provided in Sec. 37, take action under Sec. 30. (Sec. 36)

4. Administrative Sanctions on Banks and QBs

Without prejudice to the criminal sanctions against the culpable persons provided in Secs. 34-36, the MB may, at its discretion, impose upon any bank or QB, their directors and/or officers, for any...

1. willful violation of its charter or by-laws,
2. willful delay in the submission of reports or publications thereof as required by law, rules and regulations;
3. any refusal to permit examination into the affairs of the institution;
4. any willful making of a false or misleading statement to the Board or the appropriate supervising and examining department or its examiners;
5. any willful failure or refusal to comply with, or violation of, any banking law or any order, instruction or regulation issued by the MB, or any order, instruction or ruling by the Governor; or
6. any commission of irregularities, and/or conducting business in an unsafe or unsound manner as may be determined by the MB,

...the following administrative sanctions (which need not be applied in the order of their severity), whenever applicable:

2. fines in amounts as may be determined by the MB to be appropriate, but in no case to exceed P30,000 a day for each violation, taking into consideration the attendant circumstances, such as the nature and gravity of the violation or irregularity and the size of the bank or quasi-bank;
3. suspension of rediscounting privileges or access to BSP credit facilities;
4. suspension of lending or foreign exchange operations or authority to accept new deposits or make new investments;
5. suspension of interbank clearing privileges; and/or
6. revocation of quasi-banking license.

- Resignation or termination from office shall not exempt such director or officer from administrative or criminal sanctions. (Sec. 37)

5. Preventive Suspension

The MB may, whenever warranted by circumstances, preventively suspend any director or officer of a bank or quasi-bank pending an investigation: Provided, That should the case be not finally decided by the BSP within a period of 120 days after the date of suspension, said director or officer shall be reinstated in his position:
Provided, further, That when the delay in the disposition of the case is due to the fault, negligence or petition of the director or officer, the period of delay shall not be counted in computing the period of suspension herein provided. (Sec. 37)

6. Cease and Desist Order

WON there is an administrative proceeding, if the institution and/or the directors and/or officers concerned continue with or otherwise persist in the commission of the indicated practice or violation, the MB may issue an order requiring the institution and/or the directors and/or officers concerned to cease and desist from the indicated practice or violation, and may further order that immediate action be taken to correct the conditions resulting from such practice or violation. The cease and desist order shall be immediately effective upon service on the respondents.

The respondents shall be afforded an opportunity to defend their action in a hearing before the MB or any committee chaired by any MB member created for the purpose, upon request made by the respondents within 5 days from their receipt of the order. If no such hearing is requested within said period, the order shall be final. If a hearing is conducted, all issues shall be determined on the basis of records, after which the MB may either reconsider or make final its order. (Sec. 37)

7. Daily Fines

The Governor is hereby authorized, at his discretion, to impose upon banking institutions, for any failure to comply with the requirements of law, MB regulations and policies, and/or instructions issued by the MB or by the Governor, fines not in excess of P10,000 a day for each violation, the imposition of which shall be final and executory until reversed, modified or lifted by the MB on appeal. (Sec. 37)

D. Peso, Currency, Legal Tender, and Bank Deposit Accounts

1. PESO

The unit of monetary value in the Philippines is the “peso,” which is represented by the sign “P.” The peso is divided into 100 equal parts called “centavos,” which are represented by the sign “c.” (Sec. 48)

2. CURRENCY

- The word “currency” is hereby defined, for purposes of this Act, as meaning all Philippine notes and coins issued or circulating in accordance with the provisions of this Act. (Sec. 49)
- The MB, with the approval of the President of the Philippines, shall prescribe the denominations, dimensions, designs, inscriptions and other characteristics of notes issued by the BSP: Provided, however, That said notes shall state that they are liabilities of the BSP and are fully guaranteed by the BSP and shall replace them by adequate notes and coins of any other denomination requested. If for any reason the BSP is temporarily unable to provide notes or coins of the denominations requested, it shall meet its obligations by delivering notes and coins of the denominations which most nearly approximate those requested. (Sec. 53)
- The BSP shall exchange, on demand and without charge, Philippine currency of any denomination for Philippine notes and coins of any other denomination requested. If for any reason the BSP is temporarily unable to provide notes or coins of the denominations requested, it shall meet its obligations by delivering notes and coins of the denominations which most nearly approximate those requested. (Sec. 54)
- The BSP shall withdraw from circulation and shall demonetize all notes and coins for any reason whatsoever are unfit for circulation and shall replace them by adequate notes and coins: Provided, however, That the BSP shall not replace notes and coins the identification of which is impossible, coins which show signs of filing, clipping or perforation, and notes which have lost more than 2/5 of their surface and all of the signatures inscribed thereon. Notes and coins in such mutilated conditions shall be withdrawn from circulation and demonetized without compensation to the bearer. (Sec. 56)
- The BSP may call in for replacement notes of any series or denomination which are more than 5 years old and coins which are more than 10 years old. Notes and coins called in for replacement in accordance with this provision shall remain legal tender for a period of 1 year from the date of call. After this period, they shall cease to be legal tender but during the following year, or for such longer period as the MB may determine, they may be exchanged at par and without charge in the BSP and by agents duly authorized by the BSP for this purpose. After the expiration of this latter period, the notes and coins which have not been exchanged shall cease to be a liability of the BSP and shall be demonetized. The BSP shall also demonetize all notes and coins which have been called in and replaced. (Sec. 57)

3. EXCLUSIVE ISSUE POWER

- The BSP shall have the sole power and authority to issue currency, within the territory of the Philippines. No other person or entity, public or private, may put into circulation notes, coins or any other object or document which, in the opinion of the MB, might circulate as currency, nor reproduce or imitate the facsimiles of BSP notes without prior authority from the BSP. The MB may issue such regulations as may deem advisable in order to prevent the circulation of foreign currency or of currency substitutes as well as to prevent
the reproduction of facsimiles of BSP notes. The BSP shall have the authority to investigate, make arrests, conduct searches and seizures in accordance with law, for the purpose of maintaining the integrity of the currency.

- Violation of this provision or any regulation issued by the BSP pursuant thereto shall constitute an offense punishable by imprisonment of not less than 5 years but not more than 10 years. In case the RPC provides for a greater penalty, then that penalty shall be imposed. (Sec. 50)

4. LIABILITY FOR NOTES AND COINS

- Notes and coins issued by the BSP shall be liabilities of the BSP and may be issued only against, and in amounts not exceeding, the assets of the BSP. Said notes and coins shall be a first and paramount lien on all assets of the BSP.
- The BSP’s holdings of its own notes and coins shall not be considered as part of its currency issue and, accordingly, shall not form part of the assets or liabilities of the BSP. (Sec. 51)

5. LEGAL TENDER POWER

All notes and coins issued by the BSP shall be fully guaranteed by the Government of the Republic of the Philippines and shall be legal tender in the Philippines for all debts, both public and private: Provided, however, That, unless otherwise fixed by the MB, coins shall be legal tender in amounts not exceeding P50 for denominations of 25 centavos and above, and in amounts not exceeding P20 for denominations of 10 centavos or less. (Sec. 52) 58

6. DEMAND DEPOSITS

- For purposes of this Act, the term "demand deposits" means all those liabilities of the BSP and of other banks which are denominated in Philippine currency and are subject to payment in legal tender upon demand by the presentation of checks. (Sec. 58)
- Only banks duly authorized to do so may accept funds or create liabilities payable in pesos upon demand by the presentation of checks, and such operations shall be subject to the control of the MB in accordance with the powers granted it with respect thereto under this Act. (Sec. 59)
- Checks representing demand deposits do not have legal tender power and their acceptance in the payment of debts, both public and private, is at the option of the creditor: Provided, however, That a check which has been cleared and credited to the account of the creditor shall be equivalent to a delivery to the creditor of cash in an amount equal to the amount credited to his account. (Sec. 60)

E. Monetary Administration by the BSP

1. DOMESTIC MONETARY STABILIZATION

- The MB shall endeavor to control any expansion or contraction in monetary aggregates which is prejudicial to the attainment or maintenance of price stability 59 (Sec. 61)
- Whenever abnormal movements in the monetary aggregates, in credit, or in prices endanger the stability of the Philippine economy or important sectors thereof, the MB shall take such remedial measures as are appropriate and within the powers granted to the MB and the BSP under the provisions of this Act; and submit to the President of the Philippines and the Congress, and make public, a detailed report which shall include, as a minimum, a description and analysis of: (1) the causes of the rise or fall of the monetary aggregates, credit or of prices; (2) the extent to which the changes in the monetary aggregates, in credit, or in prices have been reflected in changes in the level of domestic output, employment, wages and economic activity in general, and the nature and significance of any such changes; and (3) the measures which the MB has taken and the other monetary, fiscal or administrative measures which it recommends to be adopted.
- Whenever the monetary aggregates, or the level of credit, increases or decreases by more than 15%, or the cost of living index increases by more than 10%, in relation to the level existing at the end of the corresponding month of the preceding year, or even though any of these quantitative guidelines have not been reached when in its judgment the circumstances so warrant, the MB shall submit the reports mentioned in this section, and shall state therein whether, in the opinion of the Board, said changes in the monetary aggregates, credit or cost of living represent a threat to the stability of the Philippine economy or of important sectors thereof.
- The MB shall continue to submit periodic reports to the President of the Philippines and to Congress until it considers that the monetary, credit or price disturbances have disappeared or have been adequately controlled. (Sec. 63)

2. INTERNATIONAL MONETARY STABILIZATION

- The BSP shall exercise its powers under this Act to preserve the international value of the peso and to maintain its convertibility into other freely convertible currencies primarily for, although not necessarily limited to, current payments for foreign trade and invisibles. (Sec. 64)

---

58 This topic on Legal Tender was asked in 2000.

59 “For purposes of this article and of this Act, the MB shall formulate definitions of monetary aggregates, credit and prices and shall make public such definitions and any changes thereof.” (Sec. 62)
In order to maintain the international stability and convertibility of the Philippine peso, the BSP shall maintain international reserves adequate to meet any foreseeable net demands on the BSP for foreign currencies. In judging the adequacy of the international reserves, the MB shall be guided by the prospective receipts and payments of foreign exchange by the Philippines. The Board shall give special attention to the volume and maturity of the BSP’s own liabilities in foreign currencies, to the volume and maturity of the foreign exchange assets and liabilities of other banks operating in the Philippines, and, inssofar as they are known or can be estimated, the volume and maturity of the foreign exchange assets and liabilities of all other persons and entities in the Philippines. (Sec. 65)

The international reserves of the BSP may include but shall not be limited to the following assets:
1. gold; and
2. assets in foreign currencies in the form of:
   a. documents and instruments customarily employed for the international transfer of funds;
   b. demand and time deposits in central banks, treasuries and commercial banks abroad; foreign government securities; and foreign notes and coins. (Sec. 66)

The MB shall endeavor to hold the foreign exchange resources of the BSP in freely convertible currencies; moreover, the Board shall give particular consideration to the prospects of continued strength and convertibility of the currencies in which the reserve is maintained, as well as to the anticipated demands for such currencies. The MB shall issue regulations determining the other qualifications which foreign exchange assets must meet in order to be included in the international reserves of the BSP. The BSP shall be free to convert any of the assets in its international reserves into other assets as described in subsections (a) and (b) of Sec. 66. (Sec. 66)

Whenever the international reserve of the BSP falls to a level which the MB considers inadequate to meet prospective net demands on the BSP for foreign currencies, or whenever the international reserve appears to be in imminent danger of falling to such a level, or whenever the international reserve is falling as a result of payments or remittances abroad which, in the opinion of the MB, are contrary to the national welfare, the MB shall:

1. take such remedial measures as are appropriate and within the powers granted to the MB and the BSP under the provisions of this Act; and
2. submit to the President of the Philippines and to Congress a detailed report which shall include, as a minimum, a description and analysis of:
   a. the nature and causes of the existing or imminent decline;
   b. the remedial measures already taken or to be taken by the MB;
   c. the monetary, fiscal or administrative measures further proposed; and
   d. the character and extent of the cooperation required from other government agencies for the successful execution of the policies of the MB.

If the resultant actions fail to check the deterioration of the reserve position of the BSP, or if the deterioration cannot be checked except by chronic restrictions on exchange and trade transactions or by sacrifice of the domestic objectives of a balanced and sustainable growth of the economy, the MB shall propose to the President, with appropriate notice of the Congress, such additional action as it deems necessary to restore equilibrium in the international balance of payments of the Philippines. The MB shall submit periodic reports to the President and to Congress until the threat to the international monetary stability of the Philippines has disappeared. (Sec. 67)

3. INSTRUMENTS OF BSP ACTION

In order to achieve the primary objective of price stability, the MB shall rely on its moral influence and the powers granted to it under this Act for the management of monetary aggregates. (Sec. 68)

1. Purchases in Gold

The BSP may buy and sell gold in any form, subject to such regulations as the MB may issue. The purchases and sales of gold authorized by this section shall be made in the national currency at the prevailing international market price as determined by the MB. (Sec. 69)

2. Purchases in Gold and Foreign Exchange

The BSP may buy and sell foreign notes and coins, and documents and instruments of types customarily employed for the international transfer of funds. The BSP may engage in future exchange operations. The BSP may engage in foreign exchange transactions with the following entities or persons only:

1. banking institutions operating in the Philippines;
2. the Government, its political subdivisions & instrumentalities;
3. foreign or international financial institutions;
4. foreign governments and their instrumentalities; and
5. other entities or persons which the MB is hereby empowered to authorize as foreign exchange dealers, subject to such rules and regulations as the MB shall prescribe. (Sec. 70)

In order to maintain the convertibility of the peso, the BSP may, at the request of any banking institution operating in the Philippines, buy any quantity of foreign exchange offered, and sell any quantity of foreign exchange
demanded, by such institution, provided that the foreign currencies so offered or demanded are freely convertible into gold or United States dollars. This requirement shall not apply to demands for foreign notes and coins. (Sec. 70)

- The BSP shall effect its exchange transactions between foreign currencies and the Philippine peso at the rates determined in accordance with the provisions of Section 74 of this Act.60 (Sec. 70)

- The BSP shall endeavor to maintain at all times a net positive foreign asset position so that its gross foreign exchange assets will always exceed its gross foreign liabilities. In the event that the equivalent amount in pesos of the foreign exchange liabilities of the BSP exceed twice the equivalent amount in pesos of the foreign exchange assets of the bank, the BSP shall, within 60 days from the date the limit is exceeded, submit a report to the Congress stating the origin of these liabilities, and the manner in which they will be paid. (Sec. 71)

- The BSP shall avoid the acquisition and holding of currencies which are not freely convertible, and may acquire such currencies in an amount exceeding the permissible maximum necessary to cover current demands for said currencies only when, and to the extent that, such acquisition is considered by the MB to be in the national interest. The MB shall determine the procedures which shall apply to the acquisition and disposition by the BSP of foreign exchange which is not freely utilizable in the international market. (Sec. 73)

3. Emergency Restrictions on Exchange Operations

- In order to achieve the primary objective of the BSP as set forth in Sec. 3 of this Act, or protect the international reserves of the BSP in the imminence of, or during an exchange crisis, or in time of national emergency and to give the MB and the Government time in which to take constructive measures to forestall, combat, or overcome such a crisis or emergency, the MB, with the concurrence of at least 5 of its members and with the approval of the President of the Philippines, may temporarily suspend or restrict sales of exchange by the BSP, and may subject all transactions in gold and foreign exchange to license by the BSP, and may require that any foreign exchange thereunder obtained by any person residing or entity operating in the Philippines be delivered to the BSP or to any bank or agent designated by the BSP for the purpose, at the effective exchange rate or rates: Provided, however, That foreign currency deposits made under RA 6426 (FCDU Law) shall be exempt from these requirements. (Sec. 72)

4. Operations with Foreign Entities

- The MB may authorize the BSP to grant loans to and receive loans from foreign banks and other foreign or international entities, both public and private, and may engage in such other operations with these entities as are in the national interest and are appropriate to its character as a central bank. The BSP may also act as agent or correspondent for such entities. Upon authority of the MB, the BSP may pledge any gold or other assets which it possesses as security against loans which it receives from foreign or international entities. (Sec. 75)

4. REGULATION OF FOREIGN EXCHANGE OPERATIONS OF THE BANKS

- In order that the BSP may at all times have foreign exchange resources sufficient to enable it to maintain the international stability and convertibility of the peso, or in order to promote the domestic investment of bank resources, the MB may require the banks to sell to the BSP or to other banks all or part of their surplus holdings of foreign exchange. Such transfers may be required for all foreign currencies or for only certain of such currencies, according to the decision of the MB. The transfers shall be made at the rates established under the provisions of Sec. 74 of this Act. (Sec. 76)

- The MB may, whenever warranted, determine the net assets and net liabilities of banks and shall, in making such a determination, take into account the bank’s networth, outstanding liabilities, actual and contingent, or such other financial or performance ratios as may be appropriate under the circumstances. Any such determination of net assets and net liabilities shall be applied in all banks uniformly and without discrimination. (Sec. 76)

- The MB may require the banks to maintain a balanced position between their assets and liabilities in Philippine pesos or in any other currency or currencies in which they operate. The banks shall be granted a reasonable period of time in which to adjust their currency positions to any such requirement. (Sec. 77)61

- In order to restrain the banks from taking speculative positions with respect to future fluctuations in foreign exchange rates, the MB may issue such regulations governing bank purchases and sales of non-spot exchange as it may consider necessary for said purpose. (Sec. 78)

---

60 "Sec. 74. Exchange Rates. — The MB shall determine the exchange rate policy of the country. "The MB shall determine the rates at which the BSP shall buy and sell spot exchange, and shall establish deviation limits from the effective exchange rate or rates as it may deem proper. The BSP shall not collect any additional commissions and charges of any sort, other than actual telegraphic or cable costs incurred by it.

"The MB shall similarly determine the rates for other types of foreign exchange transactions by the BSP, including purchases and sales of foreign notes and coins, but the margins between the effective exchange rates and the rates thus established may not exceed the corresponding margins for spot exchange transactions by more than the additional costs or expenses involved in each type of transactions."

61 "The powers granted under this section shall be exercised only when special circumstances make such action necessary, in the opinion of the MB, and shall be applied to all banks alike and without discrimination." (Sec. 77)
• The banks shall bear the risks of non-compliance with the terms of the foreign exchange documents and instruments which they buy and sell, and shall also bear any other typically commercial or banking risks, including exchange risks not assumed by the BSP under the provisions of the preceding section. (Sec. 79)

• The banks shall report to the BSP the volume and composition of their purchases and sales of gold and foreign exchange each day, and must furnish such additional information as the BSP may request with reference to the movements in their accounts in foreign currencies. The MB may also require other persons and entities to report to it currently all transactions or operations in gold, in any shape or form, and in foreign exchange whether entered into or undertaken by them directly or through agents, or to submit such data as may be required on operations or activities giving rise to or in connection with or relating to a gold or foreign exchange transaction. The MB shall prescribe the forms on which such declarations must be made. The accuracy of the declarations may be verified by the BSP by whatever inspection it may deem necessary. (Sec. 80)

5. LOANS TO BANKING AND OTHER FINANCIAL INSTITUTIONS

• Guiding Principles. The rediscounts, discounts, loans and advances which the BSP is authorized to make to banking institutions under the provisions of the present article of this Act shall be used to influence the volume of credit consistent with the objective of price stability. (Sec. 81)

1. Normal Credit Operations

• Authorized Types of Operations. Subject to the principle stated in the preceding section of this Act, the BSP may normally and regularly carry on the following credit operations with banking institutions operating in the Philippines:

  1. Commercial credits. — The BSP may rediscount, discount, buy and sell bills, acceptances, promissory notes and other credit instruments with maturities of not more than 180 days from the date of their rediscount, discount or acquisition by the BSP and resulting from transactions related to:

  • the importation, exportation, purchase or sale of readily saleable goods and products, or their transportation within the Philippines;
  • the storing of non-perishable goods & products w/c are duly insured & deposited, under conditions assuring their preservation, in authorized bonded warehouses or in other places approved by the MB.

  2. Production credits. — The BSP may rediscount, discount, buy and sell bills, acceptances, promissory notes and other credit instruments having maturities of not more than 360 days from the date of their rediscount, discount or acquisition by the BSP and resulting from transactions related to the production or processing of agricultural, animal, mineral, or industrial products. Documents or instruments acquired in accordance with this subsection shall be secured by a pledge of the respective crops or products: Provided, however, That the crops or products need not be pledged to secure the documents if the original loan granted by the BSP is secured by a lien or mortgage in real estate property 70% of the appraised value of which equals or exceeds the amount of the loan granted.

  3. Other credits. — Special credit instruments not otherwise rediscountable under the immediately preceding subsections (a) and (b) may be eligible for rediscounting in accordance with rules and regulations which the BSP shall prescribe. Whenever necessary, the BSP shall provide funds from non-inflationary sources: Provided, however, That the MB shall prescribe additional safeguards for disbursing these funds.

  4. Advances. — The BSP may grant advances against the following kinds of collaterals for fixed periods which, with the exception of advances against collateral named in clause (4) of the present subsection, shall not exceed 180 days:

  a. gold coins or bullion;
  b. securities representing obligations of the BSP or of other domestic institutions of recognized solvency;
  c. the credit instruments to which reference is made in subsection (a) of this section;
  d. the credit instruments to which reference is made in subsection (b) of this section, for periods which shall not exceed 360 days;
  e. utilized portions of advances in current amount covered by regular overdraft agreements related to operations included under subsections (a) and (b) of this section, and certified as to amount and liquidity by the institution soliciting the advance;
  f. negotiable treasury bills, certificates of indebtedness, notes and other negotiable obligations of the Government
maturing within 3 years from the date of the advance; and

9. negotiable bonds issued by the Government of the Philippines, by Philippine provincial, city or municipal governments, or by recognized instrumentalities, and having maturities of not more than 10 years from the date of advance.

Advances made against the collateral named in clauses (6) and (7) may not exceed 80% of the current market value of the collateral.

The rediscounts, discounts, loans and advances made in accordance with the provisions of this section may, not require redemption unless extraordinary circumstances fully justify such renewal or extension. (Sec. 82)

2. Special Credit Operation

The BSP may extend loans and advances to banking institutions for a period of not more than 7 days without any collateral for the purpose of providing liquidity to the banking system in times of need. (Sec. 83)

3. Emergency Credit Operation

• In periods of national and/or local emergency or of imminent financial panic which directly threaten monetary and banking stability, the MB may, by a vote of at least 5 of its members, authorize the BSP to grant extraordinary loans or advances to banking institutions secured by assets as defined hereunder: Provided, That while such loans or advances are outstanding, the debtor institution shall not, except upon prior authorization by the MB, expand the total volume of its loans or investments.62

The MB may, at its discretion, likewise authorize the BSP to grant emergency loans or advances to banking institutions, even during normal periods, for the purpose of assisting a bank in a precarious financial condition or under serious financial pressures brought about unforeseen circumstances, which, though unforeseeable, could not be prevented by the bank concerned: Provided, however, That the MB has ascertained that the bank is not insolvent and has the assets defined hereunder to secure the advances: Provided, further, That a concurrent vote of at least 5 members of the MB is obtained.

• In connection with the exercise of these powers, the prohibitions in Sec. 128 of this Act shall not apply insofar as it refers to acceptance as collateral of shares and their acquisition as a result of foreclosure proceedings, including the exercise of voting rights pertaining to said shares: Provided, however, That should the BSP acquire any of the shares it has accepted as collateral as a result of foreclosure proceedings, the BSP shall dispose of said shares by public bidding within 1 year from the date of consolidation of title by the BSP. Whenever a financial institution incurs an overdraft in its account with the BSP, the same shall be eliminated within the period prescribed in Sec. 102 of this Act. (Sec. 84)

Credit Terms

• The BSP shall collect interest and other appropriate charges on all loans and advances it extends, the closure, receivership or liquidations of the debtor-institution notwithstanding. This provision shall apply prospectively. (Sec. 85)

• The MB shall fix the interest and rediscount rates to be charged by the BSP on its credit operations in accordance with the character and term of the operation, but after due consideration has been given to the credit needs of the market, the composition of the BSP’s portfolio, and the general requirements of the national monetary policy. Interest and rediscount rates shall be applied to all banks of the same category uniformly and without discrimination. (Sec. 85)

• The documents rediscounted, discounted, bought or accepted as collateral by the BSP in the course of the credit operations authorized in this article shall bear the endorsement of the institution from which they are received. (Sec. 86)

• Documents rediscounted, discounted or accepted as collateral by the BSP must be withdrawn by the borrowing institution on the dates of their maturities, or upon liquidation of the obligations which they represent or to which they relate. Wherever said obligations have been liquidated prior to their dates of maturity, Banks shall have the right at any time to withdraw any documents which they have presented to the BSP as collateral, upon

to supplement, where necessary, the assets tendered by the banking institution to collateralize the subsequent tranche.” (Sec. 84)
payment in full of the corresponding debt to the BSP, including interest charges. (Sec. 87)

- The MB may prescribe, within the general powers granted to it under this Act, additional conditions which borrowing institutions must satisfy in order to have access to the credit of the BSP. These conditions may refer to the rates of interest charged by the banks, to the purposes for which their loans in general are destined, and to any other clearly definable aspect of the credit policy of the bank. (Sec. 88)

- The BSP may make direct provisional advances with or without interest to the National Government to finance expenditures authorized in its annual appropriation: Provided, That said advances shall be repaid before the end of 3 months extendible by another 3 months as the MB may allow following the date the National Government received such provisional advances and shall not, in their aggregate, exceed 20% of the average annual income of the borrower for the last 3 preceding fiscal years. (Sec. 89)

6. OPEN MARKET OPERATIONS

Principles. The open market purchases and sales of securities by the BSP shall be made exclusively in accordance with its primary objective of achieving price stability. (Sec. 90)

1. Purchases and Sales of Government Securities

The BSP may buy and sell in the open market for its own account: (a) evidences of indebtedness issued directly by the Government of the Philippines or by its political subdivisions; and (b) evidences of indebtedness issued by government instrumentalities and fully guaranteed by the Government.

The evidences of indebtedness acquired under the provisions of this section must be freely negotiable and regularly serviced and must be available to the general public through banking institutions and local government treasuries in denominations of a thousand pesos or more. (Sec. 91)

2. Issue and Negotiation of BSP Obligations

In order to provide the BSP with effective instruments for open market operations, the BSP may issue, place, buy and sell freely negotiable evidences of indebtedness of the BSP: Provided, That issuance of such certificates or evidence of indebtedness shall be made only in cases of extraordinary movement in price levels.

Said evidences of indebtedness may be issued directly against the international reserve of the BSP or against the securities which it has acquired or may be issued without relation to specific types of assets of the BSP.

The MB shall determine the interest rates, maturities and other characteristics of said obligations of the BSP, and may, if it deems it advisable, denominate the obligations in gold or foreign currencies.

The evidences of indebtedness of the BSP to which this section refers may be acquired by the BSP before their maturity, either through purchases in the open market or through redemptions at par and by lot if the BSP has reserved the right to make such redemptions. The evidences of indebtedness acquired or redeemed by the BSP shall not be included among its assets, and shall be immediately retired and cancelled. (Sec. 92)

7. BSP PORTFOLIO

VI

BSP PORTFOLIO

- At least once every month the MB shall review the portfolio of the BSP in relation to its future credit policy. In reviewing the BSP's portfolio, the MB shall especially consider whether a sufficiently large part of the portfolio consists of assets with early maturities, in order that a contraction in BSP credit may be effected promptly whenever the national monetary policy so requires. (Sec. 93)

8. BANK RESERVES

1. Reserve Requirements

In order to control the volume of money created by the credit operations of the banking system, all banks operating in the Philippines shall be required to maintain reserves against their deposit liabilities: Provided, That the MB may, at its discretion, also require all banks and/or quasi-banks to maintain reserves against funds held in trust and liabilities for deposit substitutes as defined in this Act.

The required reserves of each bank shall be proportional to the volume of its deposit liabilities and shall ordinarily take the form of a deposit in the BSP. Reserve requirements shall be applied to all banks of the same category uniformly and without discrimination.

Reserves against deposit substitutes, if imposed, shall be determined in the same manner as provided for reserve requirements against regular bank deposits, with respect to the imposition, increase, and computation of reserves.

The MB may exempt from reserve requirements deposits and deposit substitutes with remaining maturities of 2 years or more, as well as interbank borrowings.

Since the requirement to maintain bank reserves is imposed primarily to control the volume of money, the BSP shall not pay interest on the reserves maintained with it unless the MB decides otherwise as warranted by circumstances. (Sec. 94)
2. Deposit Substitutes

The term "deposit substitutes" is defined as an alternative form of obtaining funds from the public, other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the bearer account, 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. The MB shall determine what specific instruments shall be considered as deposit substitutes for the purposes of Section 94 of this Act: Provided, however, That deposit substitutes of commercial, industrial and other non-financial companies for the limited purpose of financing their own needs or the needs of their agents or dealers shall not be covered by the provisions of Sec. 94 of this Act. (Sec. 95)

3. Required Reserves

Against Peso Deposits. The MB may fix and, when it deems necessary, alter the minimum reserve ratios to peso deposits, as well as to deposit substitutes, which each bank and/or quasi-bank may maintain, and such ratio shall be applied uniformly to all banks of the same category as well as to quasi-banks. (Sec. 96)

Against Foreign Currency Deposits. The MB is similarly authorized to prescribe and modify the minimum reserve ratios applicable to deposits denominated in foreign currencies. (Sec. 97)

Against Unused Balances of Overdraft Lines. In order to facilitate BSP control over the volume of bank credit, the MB may establish minimum reserve requirements for unused balances of overdraft lines. The powers of the MB to prescribe and modify reserve requirements against unused balances of overdraft lines shall be the same as its powers with respect to reserve requirements against demand deposits. (Sec. 98)

- Increase in Reserve Requirements. Whenever in the opinion of the MB it becomes necessary to increase reserve requirements against existing liabilities, such increase shall be applied in a gradual manner and shall not exceed four percentage points in any thirty-day period. Banks and other affected financial institutions shall be notified reasonably in advance of the date on which such increase is to become effective. (Sec. 99)

4. Computation on Reserves

The reserve position of each bank or quasi-bank shall be calculated daily on the basis of the amount, at the close of business for the day, of the institution's reserves and the amount of its liability accounts against which reserves are required to be maintained. That with reference to holidays or non-banking days, the reserve position as calculated at the close of the business day immediately preceding such holidays and non-banking days shall apply on such days. For the purpose of computing the reserve position of each bank or quasi-bank, its principal office in the Philippines and all its branches and agencies located therein shall be considered as a single unit. (Sec. 100)

5. Reserve Deficiencies

Whenever the reserve position of any bank or quasi-bank, computed in the manner specified in the preceding section of this Act, is below the required minimum, the bank or quasi-bank shall pay the BSP 1/10 of 1% per day on the amount of the deficiency or the prevailing ninety-one-day treasury bill rate plus three percentage points, whichever is higher: Provided, however, That banks and quasi-banks may voluntarily be permitted to offset any reserve deficiency occurring on one or more days of the week with any excess reserves which they may hold on other days of the same week and shall be required to pay the penalty only on the average daily deficiency during the week. In cases of abuse, the MB may deny any bank or quasi-bank the privilege of offsetting reserve deficiencies in the aforesaid manner. (Sec. 101)

If a bank or quasi-bank chronically has a reserve deficiency, the MB may limit or prohibit the making of new loans or investments by the institution and may require that part or all of the net profits of the institution be assigned to surplus. The MB may modify or set aside reserve deficiency penalties provided in this section, for part or the entire period of a strike or lockout affecting a bank or a quasi-bank as defined in the Labor Code, or of a national emergency affecting operations of banks or quasi-banks. The MB may also modify or set aside reserved deficiency penalties for rehabilitation program of a bank. (Sec. 101)

7. Interbank Settlement

The BSP shall establish facilities for interbank clearing under such rules and regulations as the MB may prescribe, That the BSP may charge administrative and other fees for the maintenance of such facilities. The deposit reserves maintained by the banks in the BSP in accordance with the provisions of Section 94 of this Act shall serve as basis for the clearing of checks and the settlement of interbank balances, subject to such rules and regulations as the MB may issue with respect to such operations: Provided, That any bank which incurs on overdrawing in its deposit account with the BSP shall fully cover said overdraft, including interest thereon at a rate equivalent to 1/10 of 1% per day or the prevailing ninety-one-day treasury bill rate plus three percentage points, whichever is higher, not later than the next clearing day: Provided, further, That settlement of clearing balances shall not be effected for any account which continues to be overdrawn for 5 consecutive banking days until such time as the overdrawing is fully covered or otherwise converted into an emergency loan or advance pursuant to the provisions of Sec. 84 of this Act: Provided, finally, That the appropriate clearing office shall be officially notified of banks with overdrawn balances. Banks with existing overdrafts with the BSP as of the effectivity of this Act shall, within such period as may be prescribed by the MB, either convert the overdraft into an emergency loan or advance with a plan of payment, or settle such overdrafts, and that, upon failure to so comply herewith, the BSP shall take
such action against the bank as may be warranted under this Act. (Sec. 102)

8. Exemption from Attachment and Other Purposes

Deposits maintained by banks with the BSP as part of their reserve requirements shall be exempt from attachment, garnishments, or any other order or process of any court, government agency or any other administrative body issued to satisfy the claim of a party other than the Government, or its political subdivisions or instrumentalities. (Sec. 103)

9. SELECTIVE REGULATION OF BANK OPERATIONS

- Guiding Principle. The MB shall use the powers granted to it to ensure that the supply, availability and cost of money are in accord with the needs of the Philippine economy and that bank credit is not granted for speculative purposes prejudicial to the national interests. Regulations on bank operations shall be applied to all banks of the same category uniformly and without discrimination. (Sec. 104)
- Margin Requirements Against Letters of Credit. The MB may at any time prescribe minimum cash margins for the opening of letters of credit, and may relate the size of the required margin to the nature of the transaction to be financed. (Sec. 105)
- Required Security Against Bank Loans. In order to promote liquidity and solvency of the banking system, the MB may issue such regulations as it may deem necessary with respect to the maximum permissible maturities of the loans and investments which the banks may make, and the kind and amount of security to be required against the various types of credit operations of the banks. (Sec. 106)
- Portfolio Ceilings. Whenever the MB considers it advisable to prevent or check an expansion of bank credit, it may place an upper limit on the amount of loans and investments which the banks may hold, or may place a limit on the rate of increase of such assets within specified periods of time. The MB may apply such limits to the loans and investments of each bank or to specific categories thereof. In no case shall the MB establish limits which are below the value of the loans or investments of the banks on the date on which they are notified of such restrictions. The restrictions shall be applied to all banks uniformly and without discrimination. (Sec. 107)
- Minimum Capital Ratios. The MB may prescribe minimum ratios which the capital and surplus of the banks must bear to the volume of their assets, or to specific categories thereof, and may alter said ratios whenever it deems necessary. (Sec. 108)

RELATED PROVISIONS IN RA 8791 (GENERAL BANKING ACT OF 2000)

- Except as the MB may otherwise prescribe, loans and other credit accommodations against real estate shall not exceed 75% of the appraised value of the respective real estate security, plus 60% of the appraised value of the insured improvements, and such loans may be made to the owner of the real estate or to his assignees. (Sec 37)
- Except as the MB may otherwise prescribe, loans and other credit accommodations on security of chattels and intangible properties such as patents, trademarks, trade names, and copyrights shall not exceed 75% of the appraised value of the security, an such loans and other credit accommodation may be made to the title-holder of the chattels and intangible properties or his assignees.
- The MB may prescribe the maturities, as well as related terms and conditions for various types of bank loans and other credit accommodations. (Sec 43)

10. COORDINATION OF CREDIT POLICIES BY GOVERNMENT INSTITUTIONS

- Coordination of Credit Policies. GOCCs which perform banking or credit functions shall coordinate their general credit policies with those of the MB. Toward this end, the MB may, whenever it deems it expedient, make suggestions or recommendations to such corporations for the more effective coordination of their policies with those of the BSP. (Sec. 109)

F. BSP’S Functions as Banker and Financial Advisor of the Gov’t

1. FUNCTION AS BANKER OF THE GOV’T

A. Representing the Government

With the International Monetary Fund (IMF). The BSP shall represent the Government in all dealings, negotiations and transactions with the IMF and shall carry such accounts as may result from Philippine membership in, or operations with, the IMF. (Sec. 111)

With Other Financial Institutions. — The BSP may be authorized by the Government to represent it in dealings, negotiations or transactions with the International Bank for Reconstruction and Development and with other foreign or international financial institutions or agencies. The President may, however, designate any of his other financial advisors to jointly represent the Government in such dealings, negotiations or transactions. (Sec. 112)
B. Official Depositary

The BSP shall be the official depository of the Government, its political subdivisions and instrumentalities as well as of government-owned or controlled corporations and, as a general policy, their cash balances should be deposited with the BSP, with only minimum working balances to be held by government-owned banks and such other banks incorporated in the Philippines as the BSP may designate, subject to such rules and regulations as the Board may prescribe: Provided, That such banks may hold deposits of the political subdivisions and instrumentalities of the Government beyond their minimum working balances whenever such subdivisions or instrumentalities have outstanding loans with said banks. The BSP may pay interest on deposits of the Government or of its political subdivisions and instrumentalities, as well as on deposits of banks with the BSP. (Sec. 113)

Provided: That the BSP shall not guarantee the placement of said securities, and shall not subscribe to their issue except to replace its maturing holdings of securities with the same type as the maturing securities. (Sec. 117)

Methods of Placing Government Securities. The BSP may place the securities through direct sale to financial institutions and the public. The BSP shall not be a member of any stock exchange or syndicate, but may intervene therein for the sole purpose of regulating their operations in the placing of government securities. (Sec. 118)

The Government, or its political subdivisions or instrumentalities, shall reimburse the BSP for the expenses incurred in the placing of the aforesaid securities. (Sec. 118)

Servicing and Redemption of the Public Debt. The servicing and redemption of the public debt shall also be effected through the BSP. (Sec. 119)

C. Fiscal Operations

The BSP shall open a general cash account for the Treasurer of the Philippines, in which the liquid funds of the Government shall be deposited. Transfers of funds from this account to other accounts shall be made only upon order of the Treasurer of the Philippines. (Sec. 114)

D. Other Banks as Agents of the BSP

In the performance of its functions as fiscal agent, the BSP may engage the services of other government-owned and controlled banks and of other banks for operations in localities at home or abroad in which the BSP does not have offices or agencies adequately equipped to perform said operations: Provided, however, That for fiscal operations in foreign countries, the BSP may engage the services of foreign banking and financial institutions. (Sec. 115)

E. Remuneration for Services

The BSP may charge equitable rates, commissions or fees for services which it renders to the Government, its political subdivisions and instrumentalities. (Sec. 116)

2. BSP Support of the Government Securities Market

The Securities Stabilization Fund. There shall be established a "Securities Stabilization Fund" (SSF) which shall be administered by the BSP for the account of the Government. The operations of the SSF shall consist of purchases and sales, in the open market, of bonds and other evidences of indebtedness issued or fully guaranteed by the Government. The purpose of these operations shall be to increase the liquidity and stabilize the value of said securities in order thereby to promote investment in government obligations. The MB shall use the resources of the SSF to prevent, or moderate, sharp fluctuations in the quotations of said government obligations, but shall not endeavor to alter movements of the market resulting from basic changes in the pattern or level of interest rates. (Sec. 120)\(^\text{63}\)

Phase-out of Fiscal Agency Functions. Unless circumstances warrant otherwise and approved by the Congress Oversight Committee, the BSP shall, within a period of 3 years but in no case longer than 5 years from the approval of this Act, phase out all fiscal agency functions provided for in Secs. 117-120 and 120 as well as in other pertinent provisions of this Act and transfer the same to the Department of Finance. (Sec. 129)

Profits and Losses of the Fund. The SSF shall retain net profits which it may make on its operations, regardless of whether said profits arise from capital gains or from interest earnings. The SSF shall correspondingly bear any net losses which it may incur. (Sec. 122)

3. FUNCTION AS FINANCIAL ADVISOR OF THE GOV'T

\(^\text{63}\) Resources of the SSF. Subject to Sec. 132 of this Act, the resources of the SSF shall come from the balance of the fund as held by the CB under RA 265 as of the effective date of this Act.” (Sec. 121)
Financial Advice on Official Credit Operations. Before undertaking any credit operation abroad, the Government, through the Secretary of Finance, shall request the opinion, in writing, of the MB on the monetary implications of the contemplated action. Such operation shall be based on the sound principles of exchange policy; monetary, credit and fiscal policies of the Government, the BSP's exchange policies, and the balance of payments. (Sec. 123)

Whenever the Government, or any of its political subdivisions or instrumentalities, contemplates borrowing within the Philippines, the prior opinion of the MB shall likewise be requested. The MB may render an opinion on the probable effects of the proposed operation on monetary aggregates, the price level, and the balance of payments. (Sec. 123)

Representation on the National Economic and Development Authority (NEDA). In order to assure effective coordination between the economic, financial and fiscal policies of the Government and the monetary, credit and exchange policies of the BSP, the Deputy Governor designated by the Governor of the BSP shall be an ex officio member of the NEDA Board. (Sec. 124)

4. PRIVILEGES AND PROHIBITIONS

1. Privileges

1. Tax Exemptions. The BSP shall be exempt for a period of 5 years from the approval of this Act: (a) for all taxes, fees, charges, assessments, and duties peculiar to the BSP; (b) for all taxes, fees, charges, assessments, and duties which are analogous to taxes, fees, charges, and assessments payable by persons or other entities doing business with the BSP; (c) for all taxes, fees, charges, and assessments payable by persons or other entities doing business with the BSP; and (d) for all taxes, fees, charges, and assessments payable by persons or other entities doing business with the BSP. (Sec. 125)

2. Exemption from Customs Duties. The BSP shall be exempt from all taxes, fees, charges, and assessments for which the BSP itself would otherwise be liable, and shall not apply to taxes, fees, charges, or assessments payable by persons or other entities doing business with the BSP: Provided, further, That foreign loans and other obligations of the BSP shall be exempt, but not principal and interest, from any and all taxes if the payment of such taxes has been assumed by the BSP. (Sec. 125)

3. Applicability of the Civil Service Law (CSL). Appointments in the BSP, except as to those which are policy-determining, primarily confidential or highly technical in nature, shall be made only according to the CSL and regulations: Provided, That no qualification requirements for positions in the BSP shall be imposed other than those set by the MB: Provided, further, That, the MB or Governor, in accordance with Secs. 15(c) and 17(d) of this Act, respectively, may, without need of obtaining prior approval from any other government agency, appoint personnel in the BSP whose services are deemed necessary in order not to unduly disrupt the operations of the BSP. Officers and employees of the BSP, including all members of the MB, shall not engage in partisan activities or take part in any election except to vote. (Sec. 127)

2. PROHIBITIONS

The BSP shall not acquire shares of any kind or accept them as collateral, and shall not participate in the ownership or management of any enterprise, either directly or indirectly.

The BSP shall not engage in development banking or financing: Provided, however, That outstanding loans obtained or extended for development financing shall not be affected by the prohibition of this section. (Sec. 128)

---

64 “Sec. 15. Exercise of Authority. — In the exercise of its authority, the Monetary Board shall: xxx (c) establish a human resource management system which shall govern the selection, hiring, appointment, transfer, promotion, or dismissal of all personnel.

65 “Sec. 17. Powers and Duties of the Governor. — The Governor shall be the chief executive officer of the Bangko Sentral. His powers and duties shall be to: xxx (d) appoint and fix the remunerations and other emoluments of personnel below the rank of a department head in accordance with the position and compensation plans approved by the Monetary Board, as well as to impose disciplinary actions upon personnel of the Bangko Sentral, subject to the provisions of Sec. 15(c) of this Act: Provided, That removal of personnel shall be with the approval of the Monetary Board; xxx”
III. Law on Secrecy of Bank Deposits (RA 1405)

A. Purpose

1. To give encouragement to the people to deposit their money in banking institutions and to discourage private hoarding (Sec. 1)

2. So that the people's money may be properly utilized by banks in authorized loans to assist in the economic development of the country. (Sec. 1)

B. Coverage

All deposits of whatever nature* with banks or banking institutions in the Phils. are hereby considered as of an absolutely confidential nature and may not be examined. (Sec. 2)

NOTE

This includes investments in bonds issued by the Philippine Government, its political subdivisions and its instrumentalities. (Sec. 2)

C. Prohibited Acts

1. No person, government official, bureau or office may examine, inquire into or look into such deposits; and

2. No official or employee of any banking institution may disclose to any unauthorized person any information concerning said deposits (Sec. 3).

NOTE

RA 1405 does not prohibit attachment or garnishment of bank accounts. (China Banking Corp v. Ortega, 1973, Philippine Commercial and Industrial Bank v. CA, 1991)

D. Exceptions (Under RA 1405)66

1. upon written permission of the depositor, (Sec. 2)

2. in cases of impeachment, (Sec. 2)

3. upon order of a competent court in cases of
   a. bribery,
   b. dereliction of duty of public officials, or
   c. where the money deposited or invested is the subject matter of the litigation. (Sec. 2)

NOTES

1. RA 1405 does not prohibit attachment or garnishment of bank accounts. (China Banking Corp v. Ortega, 1973, Philippine Commercial and Industrial Bank v. CA, 1991)

2. In a collection suit by an insurance company to determine how the defendant has applied the proceeds of a check paid to it, the grant by the trial court of examination of the pertinent records of the bank was allowed without need of notice to the depositor himself, pursuant to Sec. 10, Rule 57 of the Rules of Court covering examination of party who property is attached and persons indebted to him or controlling his property; delivery of property to officer. (Onate v Aborgar, 1994)

3. The exception applies to cases of concealment of illegally acquired property in anti-graft cases. The inquiry into illegally acquired property or property NOT "legitimately acquired" — extends to cases where such property is concealed by being held by or recorded in the name of other persons. This proposition is made clear by R.A. No. 3019 which quite categorically states that the term, "legitimately acquired property of a public officer or employee shall not include .. property unlawfully acquired by the respondent, but its ownership is concealed by its being recorded in the name of, or held by, respondent's spouse, ascendants, descendants, relatives or any other persons." (Banco Filipino vs Purisima ; 1988)

4. It also extends to cases of concealment of illegally acquired property not involving anti-graft cases. In the case of Mellon Bank, N.A. v. Magino, 1990, which involved the erroneous wire transfer and of US$ 1 Million instead of the intended US$ 1,000, and the resulting illegal conversion by the recipients, the Supreme Court held that "an inquiry into the whereabouts of money illegally acquired extends to whatever is concealed or being held or recorded in the name of persons other than the one responsible for the illegal acquisition," inasmuch as the case is aimed at recovering the amount converted.

OTHER EXCEPTIONS

1. upon order of a competent court in cases of unexplained wealth under RA 3019 or the Anti-Graft and Corrupt Practices Act (PNB v. Gancayco, 1965; Banco Filipino v. Purisma, 1988; Marquez v. Desierto, 2001)

   a. Sec. 8 of RA 3019 provides that bank deposits "shall be taken into consideration in the enforcement of this section, notwithstanding any provision of law to the contrary."

   b. Sec. 8 of RA 3019 is intended to amend Sec. 2 of RA 1405 by providing an additional exception to the rule against the disclosure of bank deposits. Cases of unexplained wealth are similar to cases of bribery or dereliction of duty. (PNB v. Gancayco)

   c. In Banco Filipino v. Purisma, 1988, the court went further and stated that the provisions of the Anti-Graft Law warrant examination of bank records not only in the name of the respondent but also those in the name of the respondents' relatives or in the name of other persons.

2. when inquiry is conducted under the authority of the Commissioner of Internal Revenue into the bank accounts of the following:

   a. a decedent in order to determine his gross estate

---

b. any taxpayer who has filed an application for compromise of his tax liability, which application shall include a written waiver of his privilege under RA 1405 or under other general or special laws. (Sec. 6(F) RA 8424 or the National Internal Revenue Code of 1997)

3. in the following cases under the Anti-Money Laundering Act of 2001 (RA 9160):

a. when a banking and other covered institutions are required to report to the Anti-Money Laundering Council (AMLC) any single, series or combination of transactions involving a total amount in excess of P4.0 Million (or an equivalent in foreign currency) within 5 working days from occurrence thereof, unless the Supervising Authority concerned prescribes a longer period not to exceed 19 working days. (Sec. 9(c) RA 9160)

b. when the AMLC inquires into or examines any particular deposit or investment upon order of any competent court, when it has been established that there is probable cause that deposits or investments involved are in any way related to money laundering offense, except that no court order is required in the following cases:

i. unlawful activities under Sections 4, 5, 6, 8, 9, 10, 12, 13, 14, 15, and 16 of the Comprehensive Dangerous Drugs Act of 2002
ii. hijacking and other violations under TA 6235, and
iii. destructive arson and murder including those perpetrated by terrorists against non-combatants and similar targets. (Sec. 11 RA 9160)

c. Bangko Sentral’s inquiry into or examination of deposits or investments with any bank, when the inquiry or examination is made in the course of the Bangko Sentral’s periodic or special examination of such bank (Sec. 11 RA 9160)

4. In the following cases under the NIRC:

a. Inquiry by the Commissioner of Internal Revenue into the deposits of a decedent for the purpose of determining the gross estate of such decedent. (Sec. 6(F), NIRC)

b. In case a taxpayer offers to compromise his tax liabilities on the ground of financial incapacity, he must waive, in writing the secrecy of his bank deposits in favor of the Commissioner of Internal Revenue (Sec. 6(F), NIRC)

5. under Sec. 26 of RA 7653 or the New Central Bank Act of 1993, when the examination is conducted pursuant to the required waiver of the secrecy of deposits (of whatever nature in all banks in the Philippines) made by any DOSRI (Director, Officer or Stockholder who, together with his Related Interest, contracts a loan or any form of financial accommodation from:

a. his bank; or
b. from a bank

i. which is a subsidiary of a bank holding company of which both his bank and the lending bank are subsidiaries or
ii. in which a controlling proportion of the shares is owned by the same interest that owns a controlling proportion of the shares of his bank, in excess of 5% of the capital and surplus of the bank, or in the maximum amount permitted by law, whichever is lower.

Any information obtained from an examination of his deposits shall be held strictly confidential and may be used by the examiners only in connection with their supervisory and examination responsibility or by the Bangko Sentral in an appropriate legal action it has initiated involving the deposit account.

6. Disclosure of certain information about bank deposits which have been dormant for at least ten years, to the Treasurer of the Philippine in a sworn statement, a copy of which is posted in the bank premises. (Sec. 2, Unclaimed Balances Law (Act No. 3926, as amended))

[iii not included in the above enumeration for reasons that shall be soon be provided]

a. In 1981, PD 1792 added the following grounds when the bank can be compelled to reveal the amount of a depositor:

i. “made in the course of a special or general examination of a bank and is specifically 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,” or

ii. “made by an independent auditor hired by the bank to conduct its regular audit provided that the examination is for audit purposes only and the results thereof shall be for the exclusive use of the bank.” However, Sec. 135 of RA 7653 or the New Central Bank Act reverted RA 1405 to its version prior to the promulgation of the decree.

a) Thus Villanueva says that these two instances as excluded from the enumeration of exceptions to the secrecy of bank deposits (Villanueva, Commercial Law Review, 2004).

b) Morales however notes that “With the Amendment of the Anti-Money Laundering Act of 2001, exception (1) has been substantially resurrected. While there is no similar development of exception (2), the exclusion of the Bangko...
Sentral examiners and independent auditors from the coverage of the Secrecy of Bank Deposits Law finds basis in Opinion No. 243 (s. 1975) of then Secretary of Justice Pedro Tuason. (Morales, The Phil. General banking Law Annotated, 2nd ed. 2004)

b. It used to be believed that the RA 1405 did not apply to the Ombudsman, on account of his authority under Sec. 15(8) of RA 6770 or the Ombudsman Act of 1989 to "examine, and have access to bank accounts and records." However, the SC (Marquez v. Desierto, 2001) restricted the Ombudsman’s power as follows: "...before an in camera inspection may be allowed, there must be a pending case before a court of competent jurisdiction. Further, the account holder must be notified to be present during the inspection, and such inspection may cover only the account identified in the pending case.” (Morales, The Phil. General banking Law Annotated, 2nd ed. 2004)

c. "Further, it is interesting to note that the Secretary of Justice in his Opinion No. 13 (s. 1987) concluded that the Presidential Commission on Good Government can conduct a fact finding investigation of the failed coup d’ etat of December 1989, the commission had the power to ask the Monetary board to disclose information on and/or grant authority to examine bank deposits, trust 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 of furtherance of the objectives of the coup d’ etat.” (Morales, The Phil. General banking Law Annotated, 2nd ed. 2004)

d. "Moreover, under Sec. 1(d) of RA 6382 (1990), which created the Davide Commission that conducted a fact finding investigation of the failed coup d’ etat of December 1989, the commission had the power to ask the Monetary board to disclose information on and/or grant authority to examine bank deposits, trust 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 of furtherance of the objectives of the coup d’ etat.” (Morales, The Phil. General banking Law Annotated, 2nd ed. 2004)

E. When May Foreign Currency Deposits Be Examined/Garnished

GENERAL RULE:

Sec. 8. Secrecy of Foreign Currency Deposits.- All foreign currency deposits authorized under this Act, as amended by PD 1035, as well as foreign currency deposits authorized under PD 1034, are declared and considered of an absolutely confidential nature and, except upon the written permission of the depositor, in no instance shall such foreign currency deposits be examined, inquired or looked into by any person, government official bureau or office whether judicial or administrative or legislative or any other entity whether public or private: Provided, however, that said foreign currency deposits shall be exempt from attachment, garnishment, or any other order or process of any court, legislative body, government agency or any administrative body whatsoever

EXCEPTIONS:

1. upon written permission of the depositor (Sec. 8, Foreign Currency Deposit Act ; Intengan vs CA ; 2002)
2. upon order of a competent court in cases of violation of the Anti-Money Laundering Act of 2001 [as in the case of peso deposits, supra]
3. during Bangko Sentral’s periodic or special examinations [as in the case of peso deposits, supra], and
4. disclosure of the Treasurer of the Philippines when the unclaimed balances law applies (Morales, The Phil. General banking Law Annotated, 2nd ed. 2004)
5. In a case where a Filipino child was raped by a foreigner, the SC allowed garnishment of foreign currency deposits stating : We rule that the questioned Section 113 of Central Bank Circular No. 960 which exempts from attachment, garnishment, or any other order or process of any court. Legislative body, government agency or any administrative body whatsoever, is applicable to a foreign transient, injustice would result especially to a citizen aggrieved by a foreign guest. (Salvacion vs CB ; 1997)

F. Penalty For Violations

Any violation of this law will subject offender upon conviction to an imprisonment of not more than 5 years or a fine of not more than P20,000 or both, in the discretion of the court. (Sec. 5)

G. What Else Should I Know About RA 1405?

1. It took effect on April 9, 1955, and is entitled “An act prohibiting disclosure of or inquiry into, deposits with any banking institution and providing the penalty therefore.”
2. Sec. 6 of RA 6426 or The Foreign Currency Deposit Act provides that “the secrecy of deposits under this act shall be governed in accordance with the provisions of” RA 1405.”
3. SubSec. 55.4 of RA 8791 or the General Banking Law of 1991 provides that in line with RA 1405, no bank shall employ casual or non-regular personnel or too lengthy probationary personnel in the conduct of its business involving bank deposits.
ANTI-MONEY LAUNDERING ACT  
(RA 9160 as amended by RA 9194)  

Exception of the Secrecy of Bank Deposits Act  

1. POLICY OF THE LAW  
   • to protect and preserve the integrity and confidentiality of bank accounts  
   • to ensure that the Philippines shall not be used as a money laundering site for the proceeds of any unlawful activity  
   • consistent with its foreign policy, to extend cooperation in transnational investigations and prosecutions of persons involved in money laundering activities whenever committed. (Sec. 2 RA 9160)  

2. POLICY AGAINST POLITICAL HARASSMENT  
This Act shall not be used for political prosecution or harassment or as an instrument to hamper competition in trade and commerce. No case for money laundering may be filed against and no assets shall be frozen, attached or forfeited to the prejudice of a candidate for an electoral office during an election period. (Sec. 16)  

3. COVERED TRANSACTION  
a covered transaction is a transaction in cash or other equivalent monetary instrument involving a total amount in excess of PhP 500,000.00 within one banking day. (Sec. 3(b))  

4. SUSPICIOUS TRANSACTIONS  
Transactions with covered institutions, regardless of the amounts involved, where any of the following circumstances exist:  
1. there is no underlying legal or trade obligation, purpose or economic justification;  
2. the client is not properly identified;  
3. the amount involved is not commensurate with the business or financial capacity of the client;  
4. taking into account all known circumstances, it may be perceived that the client's transaction is structured in order to avoid being the subject of reporting requirements under the Act;  
5. any circumstances relating to the transaction which is observed to deviate from the profile of the client and/or the client's past transactions with the covered institution;  
6. the transactions is in a way related to an unlawful activity or offense under this Act that is about to be, is being or has been committed; or  
7. any transactions that is similar or analogous to any of the foregoing. (Sec. 3(b-1))  

5. COVERED INSTITUTIONS  
1. banks, non-banks, quasi-banks, trust entities, and all other institutions and their subsidiaries and affiliates supervised or regulated by the BSP;  
2. insurance companies and all other institutions supervised or regulated by the Insurance Commission; and  
3. the following entities supervised or regulated by SEC:  
a. securities dealers, brokers, salesmen, investment houses and other similar entities managing securities or rendering services as investment agent, advisor, or consultant,  
b. mutual funds, close and investment companies, common trust funds, pre-need companies and other similar entities,  
c. foreign exchange corporations, money changers, money payment, remittance, and transfer companies and other similar entities, and  
d. other entities administering or otherwise dealing in currency, commodities or financial derivatives based thereon, valuable objects, cash substitutes and other similar monetary instruments or property (Sec. 3(a))  
6. OBLIGATIONS OF COVERED INSTITUTIONS  
1. Customer Identification  
   • establish and record the true identity of its clients based on official documents.  
   • maintain a system of verifying the true identity of their clients  
   • in the case of corporate clients, require a system of verifying their legal existence and organizational structure, as well as the authority and identification of all persons purporting to act on their behalf.  
   • anonymous accounts, accounts under fictitious names, and all other similar accounts shall be absolutely prohibited.  
   exception: peso and foreign currency non-checking numbered accounts shall be allowed; but the BSP may conduct annual testing solely limited to the determination of the existence and true identity of the owners of such accounts. (Sec. 9(a))  
2. Record Keeping  
   • all records of all transactions of covered institutions shall be maintained and safely

67 This topic was asked in 2006.
stored for five years from the date of transactions.
• with respect to closed accounts, the records on customer identification, account files and business correspondence, shall be preserved and safety stored for at least five years from the dates when they were closed. (Sec. 9(b))

3. Reporting of Covered and Suspicious Transactions

• report to the Anti-Money Laundering Council (AMLC) all covered transactions and suspicious transactions within 5 working days from occurrences thereof, unless the Supervising Authority prescribes a longer period not exceeding 10 working days.
• when reporting covered or suspicious transactions, covered institutions and their officers and employees shall not be deemed to have violated the Secrecy of Bank Deposits Act (RA 1405), the Foreign Currency Deposits Act (RA 6426) and the General Banking Law of 2000 (RA 8791) and other similar laws, but they are prohibited from communicating, directly or indirectly, in any manner or by any means, to any person, the fact that a covered or suspicious transaction report was made, the contents thereof, or any other information in relation thereto. In case of violation thereof, the concerned officer and employee of the covered institution shall be criminally liable. However, no administrative, civil or criminal proceedings, shall lie against any person for having made a covered or suspicious transaction report in the regular performance of his duties in good faith, whether or not such reporting results in any criminal prosecution under this Act of any other law.
• when reporting covered or suspicious transactions to the AMLC, covered institutions and their officers and employees are prohibited from communicating directly or indirectly, in any manner or by any means, to any person or entity, the media, the fact that a covered or suspicious transaction report was made, the contents thereof, or any other information in relation thereto. Neither may such reporting be published or aired in any manner or form by the media, electronic mail, or other similar devices. In case of violation thereof, the concerned officer and employee of the covered institution and media shall be held criminally liable. (Sec. 9(c))

7. WHEN IS MONEY LAUNDERING COMMITTED?

Money laundering is a crime whereby the proceeds of an "unlawful activity" are transacted, thereby making them appear to have originated from legitimate sources. It is committed by the following:

1. transacting or attempting to transacts with monetary instrument or property, knowing such to represent, involve, or relate to the proceeds of any "unlawful activity";
2. facilitating the offense of money laundering referred to in (1) by knowingly performing or failing to perform any act; or
3. knowingly failing to disclose and file a report with the AMLC of any monetary instrument or property as required. (Sec. 4)

8. UNLAWFUL ACTIVITIES

Unlawful activity refers to any act or omission or series or combination thereof involving or having direct relation to following:

1. Kidnapping for ransom (Art 267 RPC)
2. Drug Trafficking (Sections. 4-6, 8-10, 12-16 Comprehensive Dangerous Act of 2002);
4. Plunder (RA 7080);
5. Robbery and extortion (Articles 294-96, 299-302 RPC);
6. Piratey on the high seas (RPC and PD 532);
7. Piracy on the high seas (RPC and PD 532);
8. Qualified theft (Art. 310 RPC);
9. Swindling (Art. 315 RPC);
10. Smuggling (RA 455 and 1937);
12. Hijacking (RA 6235); destructive arson and murder, including those perpetrated by terrorists against non-combatant persons and similar targets (RPC);
13. Fraudulent practices and other violations under Securities Regulation Code of 2000;
14. Felonies or offenses of a similar nature that are punishable under the penal laws of other countries.”(Sec. 3(i))

NOTE
Any person may be charged with and convicted of both the offense of money laundering and the unlawful activity. Any proceeding relating to the unlawful activity shall be given precedence over the prosecution of any offense or violation under RA 9160, as amended, without prejudice to freezing and other remedies provided RA 9160. (Sec. 6)

9. FREEZING OF MONETARY INSTRUMENT OF PROPERTY

• The Court of Appeals may issue a freeze order which shall be effective immediately:
  1. upon application ex parte by the AMLC and
  2. after determination that probable cause exists that any monetary instrument or property is in any way related to an "unlawful activity",
• The freeze order shall be for a period of twenty days unless extended by the court. (Sec. 10)
10. EXAMINATION OF ACCOUNTS

1. Examination by the AMLC
   - Notwithstanding the provisions of the Secrecy of Bank Deposits Act (RA 1405), the Foreign Currency Deposits Act (RA 6426) and the General Banking Law of 2000 (RA 8791) and other laws, the AMLC may inquire into or examine any particular deposit or investment with any banking institution or non-bank financial institution.
   - This inquiry must be upon order of any competent court in cases of violation of the Anti-Money Laundering Act, when it has been established that there is probable cause that the deposits or investments are related to an "unlawful activity" or a money laundering offense, except that no court order shall be required in unlawful activities:
     1. Kidnapping for ransom
     2. Drug Trafficking;
     3. Hijacking; destructive arson and murder, including those perpetrated by terrorists against non-combatant persons and similar targets;

2. Examination by the BSP
   - To ensure compliance with this Act, the Bangko Sentral ng Pilipinas (BSP) may inquire into or examine any deposit or investment with any banking institution or non-bank financial institution when the examination is made in the course of a periodic or special examination, in accordance with the rules of examination of the BSP. (Sec. 11)

11. FORFEITURE PROVISIONS

1. Civil Forfeiture
   - When there is a covered transaction report made, and the court has, in a petition filed for the purpose ordered seizure of any monetary instrument or property, in whole or in part, directly or indirectly, related to said report, the Revised Rules of Court on civil forfeiture shall apply.

2. Claim on Forfeited Assets
   - Where the court has issued an order of forfeiture of the monetary instrument or property in a criminal prosecution for any money laundering offense, the offender or any other person claiming an interest therein may apply, by verified petition,
   - for a declaration that the same legitimately belongs to him and
   - for segregation or exclusion of the monetary instrument or property corresponding thereto.
   - The verified petition shall be filed with the court which rendered the judgment of conviction and order of forfeiture, within fifteen days from the date of the order or forfeiture, in default of which the said order shall become final and executory. This provision shall apply in both civil and criminal forfeiture.

3. Payment in Lieu of Forfeiture
   - Where the court has issued an order of forfeiture of the monetary instrument or property subject of a money laundering offense, and said order cannot be enforced because any particular monetary instrument or property cannot, with due diligence, be located, or
   - has been substantially altered, destroyed, diminished in value or otherwise rendered worthless by any act or omission, directly or indirectly, attributable to the offender, or
   - has been concealed, removed, converted or otherwise transferred to prevent the same from being found or to avoid forfeiture thereof, or
   - is located outside the Philippines or has been placed or brought outside the jurisdiction of the court, or
   - has been commingled with other monetary instruments or property belonging to either the offender himself or a third person or entity, thereby rendering the same difficult to identify or be segregated for purposes of forfeiture,
   - the court may, instead of enforcing the order of forfeiture of the monetary instrument or property or part thereof or interest therein, accordingly order the convicted offender to pay an amount equal to the value of said monetary instrument or property. This provision shall apply in both civil and criminal forfeiture. (Sec. 12)

NOTE
Restitution for any aggrieved party shall be governed by the Civil Code. (Sec. 17)

12. ANTI-MONEY LAUNDERING COUNCIL (AMLC)

Composition: Three Members
1. Governor of the BSP (chairman),
2. Commissioner of the Insurance Commission
3. Chairman of the SEC.

Functions
The AMLC shall act unanimously in the discharge of its functions which are as follows:
- to require and receive covered or suspicious transaction reports from covered institutions;
- to issue orders addressed to the appropriate Supervising Authority or the covered institutions or to request for assistance from a foreign State to determine the true identity of the owner of
any monetary instrument or property subject of a covered transaction or suspicious transaction report, believed by the Council, on the basis of substantial evidence, to be, in whole or in part, wherever located, representing, involving, or related to directly or indirectly, in any manner or by any means, the proceeds of an unlawful activity.

- to institute civil forfeiture proceedings and all other remedial proceedings through the Office of the Solicitor General;
- to cause the filing of complaints with the DOJ, ordering the Office of the Prosecutor of the Sandiganbayan or of a court in the requesting State ordering the forfeiture of said monetary instrument or property alleged to be the proceeds of any "unlawful activity";
- to implement such measures as may be necessary and justified under the Anti-Money Laundering Act to counteract money laundering;
- to record and take action in respect of, any request from foreign states for assistance in their own anti-money laundering operations provided in this Act;
- to develop educational programs on the pernicious effects of money laundering, the methods and techniques used in the money laundering operations, which may include the use of its personnel, facilities and resources for the more resolute prevention, detection, and investigation of money laundering offenses and prosecution of offenders; and
- to impose administrative sanctions for the violation of laws, rules, regulations, and orders and resolutions issued pursuant thereto. (Sec. 7)

**Secretariat**

- The AMLC is also authorized to establish a secretariat to be headed by an Executive Director who shall be appointed by the Council for a term of 5 years.
- The Executive Director must be a member of the Philippine Bar, at least thirty-five years of age and of good moral character, unquestionable integrity and known probity.
- All members of the Secretariat must have served for at least 5 years either in the Insurance Commission, the SEC or the BSP and shall hold full-time permanent positions within the BSP. (Sec. 8)

13. **MUTUAL ASSISTANCE AMONG STATES**

1. **Request for Assistance from a Foreign State.**

- Where a foreign State makes a request for assistance in the investigation or prosecution of a money laundering offense, the AMLC may execute the request or refuse to execute the same and inform the foreign State of any valid reason for not executing the request or for delaying the execution thereof. The principles of mutuality and reciprocity shall, for this purpose, be at all times recognized.

2. **Power of the AMLC to Act on a Request for Assistance from a Foreign State.**

- The AMLC may act on a request for assistance from a foreign State by:
  1. tracking down, freezing, restraining and seizing assets alleged to be proceeds of any unlawful activity under the procedures laid down in the Anti-Money Laundering Act;
  2. giving information needed by the foreign State within the procedures laid down in this Act; and
  3. applying for an order of forfeiture of any monetary instrument or property in the court: Provided, That the court shall not issue such an order unless the application is accompanied by an authenticated copy of an affidavit of a competent officer of the requesting State stating that the conviction and the order of forfeiture are final and that no further appeal lies in respect or either.

3. **Obtaining Assistance from Foreign States.**

- The AMLC may make a request to any foreign State for assistance in:
  1. tracking down, freezing, restraining and seizing assets alleged to be proceeds of any unlawful activity;
  2. obtaining information that it needs relating to any covered transaction, money laundering offense or any other matter directly or indirectly, related thereto;
  3. to the extent allowed by the law of the Foreign State, applying with the proper court therein for an order to enter any premises belonging to or in the possession or control of, any or all of the persons named in said request, and/or seize any or all such persons named therein and/or remove any document, material or object named in said request: Provided, That the court shall not issue such an order unless the application is accompanied by an authenticated copy of the order of a court in the requesting State ordering the forfeiture of said...
monetary instrument or property of a person who has been convicted of a money laundering offense in the requesting State, and a certification of an affidavit of a competent officer of the requesting State stating that the conviction and the order of forfeiture are final and that no further appeal lies in respect or either.

4. Limitations on Request for Mutual Assistance.

- The AMLC may refuse to comply with any request for assistance where the action sought by the request contravenes any provision of the Constitution or the execution of a request is likely to prejudice the national interest of the Philippines unless there is a treaty between the Philippines and the requesting State relating to the provision of assistance in relation to money laundering offenses.

5. Requirements for Requests for Mutual Assistance from Foreign State.

- A request for mutual assistance from a foreign State must
  1) confirm that an investigation or prosecution is being conducted in respect of a money launderer named therein or that he has been convicted of any money laundering offense;
  2) state the grounds on which any person is being investigated or prosecuted for money laundering or the details of his conviction;
  3) gives sufficient particulars as to the identity of said person;
  4) give particulars sufficient to identity any covered institution believed to have any information, document, material or object which may be of assistance to the investigation or prosecution;
  5) ask from the covered institution concerned any information, document, material or object which may be of assistance to the investigation or prosecution;
  6) specify the manner in which and to whom said information, document, material or object detained pursuant to said request, is to be produced;
  7) give all the particulars necessary for the issuance by the court in the requested State of the writs, orders or processes needed by the requesting State; and
  8) contain such other information as may assist in the execution of the request.

6. Authentication of Documents.

- A document is authenticated if the same is signed or certified by a judge, magistrate or equivalent officer in or of, the requesting State, and authenticated by the oath or affirmation of a witness or sealed with an official or public seal of a minister, secretary of State, or officer in or of, the government of the requesting State, or of the person administering the government or a department of the requesting territory, protectorate or colony. The certificate of authentication may also be made by a secretary of the embassy or legation, consul general, consul, vice consul, consular agent or any officer in the foreign service of the Philippines stationed in the foreign State in which the record is kept, and authenticated by the seal of his office.

7. Extradition.

- The Philippines shall negotiate for the inclusion of money laundering offenses as herein defined among extraditable offenses in all future treaties. (Sec. 13)

13. WHAT ELSE SHOULD I KNOW ABOUT THE ANTI-MONEY LAUNDERING ACT?

- The complete title of the Act is “An Act Defining the Crime of Money Laundering, Providing Penalties Therefor and for Other Purposes.”
- The Act was approved by President Macapagal-Arroyo on Sept. 29, 2001. It was subsequently amended by RA 9194 which was approved by the same President on Mar. 7, 2003.
- One of the many amendments made by RA 9194 was the deletion of the phrase that provided that “The provisions of this Act shall not apply to deposits and investments made prior to its effectivity.”
- The Act provided the AMLC with an initial appropriation of Php 25,000,000.
- The Act also required the BSP, the Insurance Commission and the SEC to (1) promulgate rules and regulations implementing the act, which would be submitted to a Congressional Oversight Committee, and (2) to formulate money laundering prevention programs in accordance with the Act.
INTELLECTUAL PROPERTY CODE (RA 8293, as amended by RA 9150)

Chapter I.
INTELLECTUAL PROPERTY RIGHTS IN GENERAL

1. State Policies

Sec. 2. Declaration of State Policy. - The State recognizes that an effective intellectual and industrial property system is vital to the development of domestic and creative activity, facilitates transfer of technology, attracts foreign investments, and ensures market access for our products. It shall protect and secure the exclusive rights of scientists, inventors, artists and other gifted citizens to their intellectual property and creations, particularly when beneficial to the people, for such periods as provided in this Act. The use of intellectual property bears a social function. To this end, the State shall promote the diffusion of knowledge and information for the promotion of national development and progress and the common good.

It is also the policy of the State to streamline administrative procedures of registering patents, trademarks and copyright, to liberalize the enforcement of intellectual property rights in the Philippines.

2. Intellectual Property Rights

Sec. 4.1 The term "intellectual property rights" consists of:
1. Copyright and Related Rights;
2. Trademarks and Service Marks;
3. Geographic Indications;
4. Industrial Designs;
5. Patents;
6. Layout-Designs (Topographies) of Integrated Circuits; and
7. Protection of Undisclosed Information [TRIPS].

Kho v. CA, et al., 379 SCRA 410 [2002]

Trademark, copyright and patents are different intellectual property rights that cannot be interchanged with one another. A trademark is any visible sign capable of distinguishing the goods (trademark) or services (service mark) of an enterprise and shall include a stamped or marked container of goods.

In relation thereto, a trade name means the name or designation identifying or distinguishing an enterprise. Meanwhile, the scope of a copyright is confined to literary and artistic works which are original creations in the literary and artistic domain protected from the moment of their creation. Patentable inventions, on the other hand, refer to any technical solution of a problem in any field of human activity which is new, involves an inventive step and is industrially applicable.

3. Reverse Reciprocity

Sec. 231. Reverse Reciprocity of Foreign Laws. - Any condition, restriction, limitation, diminution, requirement, penalty or any similar burden imposed by the law of a foreign country on a Philippine national seeking protection of intellectual property rights in that country, shall reciprocally be enforceable upon nationals of said country, within Philippine jurisdiction.

Chapter II.
PATENTS

1. What are Patentable

1.1. Inventions

Sec. 21. Patentable Inventions. - Any technical solution of a problem in any field of human activity which is new, involves an inventive step and is industrially applicable shall be patentable. It may be, or may relate to, a product, or process, or an improvement of any of the foregoing. (Sec. 7, RA 165a)

Sec. 23. Novelty. - An invention shall not be considered new if it forms part of a prior art. (Sec. 9, RA 165a)

Sec. 24. Prior Art. - Prior art shall consist of:

24.1. Everything which has been made available to the public anywhere in the world, before the filing date or the priority date of the application claiming the invention; and

24.2. The whole contents of an application for a patent, utility model, or industrial design registration, published in accordance with this Act, filed or effective in the Philippines, with a filing or priority date that is earlier than the filing or priority date of the application: Provided, That the application which has validly claimed the filing date of an earlier application under Section 31 of this Act, shall be prior art with effect as of the filing date of such earlier application: Provided further, That the applicant or the inventor identified in both applications are not one and the same. (Sec. 9, RA 165a)

Sec. 26. Inventive Step. - An invention involves an inventive step if, having regard to prior art, it is not obvious to a person skilled in the art at the time of the filing date or priority date of the application claiming the invention.

Sec. 27. Industrial Applicability. - An invention that can be produced and used in any industry shall be industrially applicable.

1.2. Utility Model

Sec. 109.1 (a) An invention qualifies for registration as a utility model if it is new and industrially applicable.

(b) Section 21, "Patentable Inventions", shall apply except the reference to inventive step as a condition of protection.
1.3. Industrial Designs

Sec. 112.1 An Industrial Design is any composition of lines or colors or any three-dimensional form, whether or not associated with lines or colors: Provided, That such composition or form gives a special appearance to and can serve as pattern for an industrial product or handicraft;

1.4. Lay-out Designs (Topographies) of Integrated Circuits

Sec. 112.2 Integrated Circuit means a product, in its final form, or an intermediate form, in which the elements, at least one of which is an active element and some or all of the interconnections are integrally formed in and/or on a piece of material, and which is intended to perform an electronic function; and

Sec. 112.3 Layout-Design is synonymous with 'Topography' and means the three-dimensional disposition, however expressed, of the elements, at least one of which is an active element, and of some or all of the interconnections of an integrated circuit, or such a three-dimensional disposition prepared for an integrated circuit intended for manufacture.

2. Exclusions from Patent Protection

Sec. 22. Non-Patentable Inventions. - The following shall be excluded from patent protection:

22.1. Discoveries, scientific theories and mathematical methods;
22.2. Schemes, rules and methods of performing mental acts, playing games or doing business, and programs for computers;
22.3. Methods for treatment of the human or animal body by surgery or therapy and diagnostic methods practiced on the human or animal body. This provision shall not apply to products and composition for use in any of these methods;
22.4. Plant varieties or animal breeds or essentially biological process for the production of plants or animals. This provision shall not apply to micro-organisms and non-biological and microbiological processes. Provisions under this subsection shall not preclude Congress to consider the enactment of a law providing sui generis protection of plant varieties and animal breeds and a system of community intellectual rights protection: 22.5. Aesthetic creations; and
22.6. Anything which is contrary to public order or morality. (Sec. 8, RA 165a)

3. First-To-File Rule

Sec. 29. First to File Rule. - If two (2) or more persons have made the invention separately and independently of each other, the right to the patent shall belong to the person who filed an application for such invention, or where two or more applications are filed for the same invention, to the applicant who has the earliest filing date or, the earliest priority date. (3rd Sentence, Sec. 10, RA 165a.)

4. Right of Priority

Sec. 31. Right of Priority. - An application for patent filed by any person who has previously applied for the same invention in another country which by treaty, convention, or law affords similar privileges to Filipino citizens, shall be considered as filed as of the date of filing the foreign application: Provided, That: (a) the local application expressly claims priority; (b) it is filed within twelve (12) months from the date the earliest foreign application was filed; and (c) a certified copy of the foreign application together with an English translation is filed within six (6) months from the date of filing in the Philippines. (Sec. 15, RA 165a)

5. Contents of the Application for Patent

Sec. 32. The Application. -

32.1. The patent application shall be in Filipino or English and shall contain the following:
(a) A request for the grant of a patent;
(b) A description of the invention;
(c) Drawings necessary for the understanding of the invention;
(d) One or more claims; and
(e) An abstract.

32.2. No patent may be granted unless the application identifies the inventor. If the applicant is not the inventor, the Office may require him to submit said authority. (Sec. 13, RA 165a)

Sec. 34. The Request. - The request shall contain a petition for the grant of the patent, the name and other data of the applicant, the inventor and the agent and the title of the invention.

Sec. 35. Disclosure and Description of the Invention. -

35.1. Disclosure. - The application shall disclose the invention in a manner sufficiently clear and complete for it to be carried out by a person skilled in the art. Where the application concerns a microbiological process or the product thereof and involves the use of a micro-organism which cannot be sufficiently disclosed in the application in such a way as to enable the invention to be carried out by a person skilled in the art, and such material is not available to the public, the application shall be supplemented by a deposit of such material with an international depository institution.

35.2. Description. - The Regulations shall prescribe the contents of the description and the order of presentation. (Sec. 14, RA 165a)

Sec. 36. The Claims. -
36.1. The application shall contain one (1) or more claims which shall define the matter for which protection is sought. Each claim shall be clear and concise, and shall be supported by the description.

36.2. The Regulations shall prescribe the manner of the presentation of claims.

Sec. 37. The Abstract. - The abstract shall consist of a concise summary of the disclosure of the invention as contained in the description, claims and drawings in preferably not more than one hundred fifty (150) words. It must be drafted in a way which allows the clear understanding of the technical problem, the gist of the solution of that problem through the invention, and the principal use or uses of the invention. The abstract shall merely serve for technical information.

6. Procedure for Grant of Patent

6.1. Filing Date

Sec. 40. Filing Date Requirements. -

40.1. The filing date of a patent application shall be the date of receipt by the Office of at least the following elements:

(a) An express or implicit indication that a Philippine patent is sought;
(b) Information identifying the applicant; and
(c) Description of the invention and one (1) or more claims in Filipino or English.

40.2. If any of these elements is not submitted within the period set by the Regulations, the application shall be considered withdrawn.

Sec. 41. According a Filing Date. - The Office shall examine whether the patent application satisfies the requirements for the grant of date of filing as provided in Section 40 hereof. If the date of filing cannot be accorded, the applicant shall be given an opportunity to correct the deficiencies in accordance with the implementing Regulations. If the application does not contain all the elements indicated in Section 40, the filing date should be that date when all the elements are received. If the deficiencies are not remedied within the prescribed time limit, the application shall be considered withdrawn.

1. Formality Examination

Sec. 42. Formality Examination. -

42.1. After the patent application has been accorded a filing date and the required fees have been paid on time in accordance with the Regulations, the applicant shall comply with the formal requirements specified by Section 32 and the Regulations within the prescribed period, otherwise the application shall be considered withdrawn.

42.2. The Regulations shall determine the procedure for the re-examination and revival of an application as well as the appeal to the Director of Patents from any final action by the examiner. (Sec. 16, RA 165a)

6.2. Classification and Search

Sec. 43. Classification and Search. - An application that has complied with the formal requirement shall be classified and a search conducted to determine the prior art.

6.3. Publication

Sec. 44. Publication of Patent Application. -

44.1. The patent application shall be published in the IPO Gazette together with a search document established by or on behalf of the Office citing any documents that reflect prior art, after the expiration of eighteen (18) months from the filing date or priority date.

44.3. The Director General, subject to the approval of the Secretary of Trade and Industry, may prohibit or restrict the publication of an application, if in his opinion, to do so would be prejudicial to the national security and interests of the Republic of the Philippines.

6.4. Inspection

Sec. 45. Confidentiality Before Publication. - A patent application, which has not yet been published, and all related documents, shall not be made available for inspection without the consent of the applicant.

Sec. 44.2. After publication of a patent application, any interested party may inspect the application documents filed with the Office.

Sec. 47. Observation by Third Parties. - Following the publication of the patent application, any person may present observations in writing concerning the patentability of the invention. Such observations shall be communicated to the applicant who may comment on them. The Office shall acknowledge and put such observations and comment in the file of the application to which it relates.

6.5. Request for Substantive Examination

Sec. 48. Request for Substantive Examination. -

48.1. The application shall be deemed withdrawn unless within six (6) months from the date of publication under Section 41, a written request to determine whether a patent application meets the requirements of Sections 21 to 27 and Sections 32 to 39 and the fees have been paid on time.

48.2. Withdrawal of the request for examination shall be irrevocable and shall not authorize the refund of any fee.

SEC. 49. Amendment of Application. - An applicant may amend the patent application during examination: Provided, That such
amendment shall not include new matter outside the scope of the disclosure contained in the application as filed.

6.6. Grant or Refusal of Application

Sec. 50. Grant of Patent. -

50.1. If the application meets the requirements of this Act, the Office shall grant the patent: Provided, That all the fees are paid on time.
50.2. If the required fees for grant and printing are not paid in due time, the application shall be deemed to be withdrawn.

50.3. A patent shall take effect on the date of the publication of the grant of the patent in the IPO Gazette. (Sec. 18, RA 165a)

Sec. 51. Refusal of the Application. -

51.1. The final order of refusal of the examiner to grant the patent shall be appealable to the Director in accordance with this Act.
51.2. The Regulations shall provide for the procedure by which an appeal from the order of refusal from the Director shall be undertaken.

6.7. Publication of the Grant of Patent

Sec. 52. Publication Upon Grant of Patent. -

52.1. The grant of the patent together with other related information shall be published in the IPO Gazette within the time prescribed by the Regulations.
52.2. Any interested party may inspect the complete description, claims, and drawings of the patent on file with the Office. (Sec. 18, RA 165a)

7. Rights Conferred by Patent

Sec. 71. Rights Conferred by Patent. -

71.1. A patent shall confer on its owner the following exclusive rights:

(a) Where the subject matter of a patent is a product, to restrain, prohibit and prevent any unauthorized person or entity from making, using, offering for sale, selling or importing that product;
(b) Where the subject matter of a patent is a process, to restrain, prevent or prohibit any unauthorized person or entity from using the process, and from manufacturing, dealing in, using, selling or offering for sale, or importing any product obtained directly or indirectly from such process.

71.2. Patent owners shall also have the right to assign, or transfer by succession the patent, and to conclude licensing contracts for the same. (Sec. 37, RA 165a)

Pearl and Dean, Inc v. Shoemart Inc (2003)

To be able to effectively and legally preclude others from copying and profiting from the invention, a patent is a primordial requirement. No patent, no protection. The ultimate goal of a patent system is to bring new designs and technologies into the public domain through disclosure. Ideas, once disclosed to the public without the protection of a valid patent, are subject to appropriation without significant restraint.

8. Term

Sec. 54. Term of Patent. - The term of a patent shall be twenty (20) years from the filing date of the application. (Sec. 21, RA 165a)

Sec. 109.3. A utility model registration shall expire, without any possibility of renewal, at the end of the seventh year after the date of the filing of the application.

Sec. 118. The Term of Industrial Design or Layout-Design Registration. - 118.1. The registration of an industrial design shall be for a period of five (5) years from the filing date of the application.

118.2. The registration of an industrial design may be renewed for not more than two (2) consecutive periods of five (5) years each, by paying the renewal fee. xxx xxx xxx

118.5. Registration of a layout-design shall be valid for a period often (10) years, without renewal, and such validity to be counted from the date of commencement of the protection accorded to the layout-design. The protection of a layout-design under this Act shall commence:

a) on the date of the first commercial exploitation, anywhere in the world, of the layout-design by or with the consent of the right holder: Provided, That an application for registration is filed with the Intellectual Property Office within two (2) years from such date of first commercial exploitation; or
b) on the filing date accorded to the application for the registration of the layout-design if the layout-design has not been previously exploited commercially anywhere in the world.

9. Limitations on Rights of Patentees

Sec. 72. Limitations of Patent Rights. - The owner of a patent has no right to prevent third parties from performing, without his authorization, the acts referred to in Section 71 hereof in the following circumstances:

72.1. Using a patented product which has been put on the market in the Philippines by the owner of the product, or with his express consent, insofar as such use is performed after that product has been so put on the said market;
72.2. Where the act is done privately and on a non-commercial scale or for a non-commercial purpose: Provided, That it does not significantly prejudice the economic interests of the owner of the patent;

72.3. Where the act consists of making or using exclusively for the purpose of experiments that relate to the subject matter of the patented invention;

72.4. Where the act consists of the preparation for individual cases, in a pharmacy or by a medical professional, of a medicine in accordance with a medical prescription or acts concerning the medicine so prepared;

72.5. Where the invention is used in any ship, vessel, aircraft, or land vehicle of any other country entering the territory of the Philippines temporarily or accidentally: Provided, That such invention is used exclusively for the needs of the ship, vessel, aircraft, or land vehicle and not used for the manufacturing of anything to be sold within the Philippines. (Secs. 38 and 39, RA 165a)

Sec. 73. Prior User. -

73.1. Notwithstanding Section 72 hereof, any prior user, who, in good faith was using the invention or has undertaken serious preparations to use the invention in his enterprise or business, before the filing date or priority date of the application on which a patent is granted, shall have the right to continue the use thereof as envisaged in such preparations within the territory where the patent produces its effect.

73.2. The right of the prior user may only be transferred or assigned together with his enterprise or business, or with that part of his enterprise or business in which the use or preparations for use have been made. (Sec. 40, RA 165a)

Sec. 74. Use of Invention by Government. -

74.1. A Government agency or third person authorized by the Government may exploit the invention even without agreement of the patent owner where:

(a) the public interest, in particular, national security, nutrition, health or the development of other sectors, as determined by the appropriate agency of the government, so requires; or

(b) A judicial or administrative body has determined that the manner of exploitation, by the owner of the patent or his licensee, is anti-competitive.

74.2. The use by the Government, or third person authorized by the Government shall be subject, mutatis mutandis, to the conditions set forth in Sections 95 to 97 and 100 to 102. (Sec. 41, RA 165a)

10. Notice Requirement

Sec. 75. Notice Requirement

75.1. Notification of the invention or preparation of the invention to the patent owner constitutes notice requirement.

75.2. Notification of the invention or preparation of the invention to the patent owner is presumed to have been given on the date of the notice.

11. Patent Infringement

11.1. Civil Action

Sec. 76. Civil Action for Infringement. -

76.1. The making, using, offering for sale, selling, or importing a patented product or a product obtained directly or indirectly from a patented process, or the use of a patented process without the authorization of the patentee constitutes patent infringement.

76.2. Any patentee, or anyone possessing any right, title or interest in and to the patented invention, whose rights have been infringed, may bring a civil action before a court of competent jurisdiction, to recover from the infringer such damages sustained thereby, plus attorney’s fees and other expenses of litigation, and to secure an injunction for the protection of his rights.

76.3. If the damages are inadequate or cannot be readily ascertained with reasonable certainty, the court may award by way of damages a sum equivalent to reasonable royalty.

76.4. The court may, according to the circumstances of the case, award damages in a sum above the amount found as actual damages sustained: Provided, That the award does not exceed three (3) times the amount of such actual damages.

76.5. The court may, in its discretion, order that the infringing goods, materials and implements predominantly used in the infringement be disposed of outside the channels of commerce or destroyed, without compensation.

76.6. Anyone who actively induces the infringement of a patent or provides the infringer with a component of a patented product or of a product produced because of a patented process knowing it to be especially adopted for infringing the patented invention and not suitable for substantial non-infringing use shall be liable as a contributory infringer and shall be jointly and severally liable with the infringer. (Sec. 42, RA 165a)

11.2. Criminal Action

Sec. 80. Damages; Requirement of Notice. - Damages cannot be recovered for acts of infringement committed before the infringer had known; or had reasonable grounds to know of the patent. It is presumed that the infringer had known of the patent if on the patented product, or on the container or package in which the article is supplied to the public, or on the advertising material relating to the patented product or process, are placed the words "Philippine Patent" with the number of the patent. (Sec. 44, RA 165a)
Sec. 84. Criminal Action for Repetition of Infringement. - If infringement is repeated by the infringer or by anyone in connivance with him after finality of the judgment of the court against the infringer, the offenders shall, without prejudice to the institution of a civil action for damages, be criminally liable therefor and, upon conviction, shall suffer imprisonment for the period of not less than six (6) months but not more than three (3) years and/or a fine of not less than One hundred thousand pesos (P100,000) but not more than Three hundred thousand pesos (P300,000), at the discretion of the court. The criminal action herein provided shall prescribe in three (3) years from date of the commission of the crime. (Sec. 48, RA 165a)

Sony Computer v Supergreen, Inc. (2007)

Supergreen is engaged in reproduction and distribution of counterfeit “PlayStation” game software, consoles and accessories, violative of Sony’s intellectual property rights. NBI served search warrants on subject premises [Cavite] and seized a replicating machine and several units of counterfeit “PlayStation” consoles, joy pads, housing, labels and game software. Respondent filed Motion to quash - which was granted by RTC - alleging improperty of venue/lack of jurisdiction. SC: The alleged acts constitute a transitory or continuing offense under Section 168, IPC [RA 8293] – in relation to Art. 189(1) RPC on unfair competition. Respondent’s imitation of the general appearance of petitioner’s goods was done allegedly in Cavite, but sold such in Mandaluyong City, Metro Manila.

12. Tests of infringement

Godines v. CA, 226 SCRA 576 [1993]

Tests have been established to determine infringement. These are [a] literal infringement; and [b] the doctrine of equivalents. In using literal infringement as a test, resort must be had in the first instance to the words of the claim. To determine whether the particular item falls within the literal meaning of the patent claims, the court must juxtapose the claims of the patent and the accused product within the overall context of the claims and specifications, to determine whether there is exact identity of all material elements. On the other hand, under the doctrine of equivalents, an infringement also occurs when a device appropriates a prior invention by incorporating its innovative concept and, although with some modification and change, performs substantially the same function in substantially the same way to achieve substantially the same result. The principle or mode of operation must be the same or substantially the same.

13. Patent infringement

Del Rosario v CA (1996)

It is elementary that a patent may be infringed where the essential or substantial features of the patented invention are taken or appropriated, or the device, machine or other subject matter alleged to infringe is substantially identical with the patent invention. In order to infringe a patent, a machine or device must perform the same function, or accomplish the same result by identical or substantially identical means and the principle or mode of operation must be substantially the same.

SMITH KLINE BECKMAN CORPORATION v CA (2003)

The doctrine of equivalents provides that an infringement also takes place when a device appropriates a prior invention by incorporating its innovative concept and, although with some modification and change, performs substantially the same function in substantially the same way to achieve substantially the same result. The principle or mode of operation must be the same or substantially the same.

14. Voluntary Licensing

Sec. 85. Voluntary License Contract. - To encourage the transfer and dissemination of technology, prevent or control practices and conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition and trade, all technology transfer arrangements shall comply with the provisions of this Chapter.

Sec. 88. Mandatory Provisions. - The following provisions shall be included in voluntary license contracts:

88.1. That the laws of the Philippines shall govern the interpretation of the same and in the event of litigation, the venue shall be the proper court in the place where the licensee has its principal office;

88.2. Continued access to improvements in techniques and processes related to the technology shall be made available during the period of the technology transfer arrangement;

88.3. In the event the technology transfer arrangement shall provide for arbitration, the Procedure of Arbitration of the Arbitration Law of the Philippines or the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) or the Rules of Conciliation and Arbitration of the International Chamber of Commerce (ICC) shall apply and the venue of arbitration shall be the Philippines or any neutral country; and
88.4. The Philippine taxes on all payments relating to the technology transfer arrangement shall be borne by the licensor.

Sec. 87. Prohibited Clauses. - Except in cases under Section 91, the following provisions shall be deemed prima facie to have an adverse on competition and trade:

87.1. Those which impose upon the licensee the obligation to acquire from a specific source capital goods, intermediate products, raw materials, and other technologies, or of permanently employing personnel indicated by the licensor;

87.2. Those pursuant to which the licensor reserves the right to fix the sale or resale prices of the products manufactured on the basis of the license;

87.3. Those that contain restrictions regarding the volume and structure of production;

87.4. Those that prohibit the use of competitive technologies in a non-exclusive technology transfer agreement;

87.5. Those that establish a full or partial purchase option in favor of the licensor;

87.6. Those that obligate the licensee to transfer for free to the licensor the inventions or improvements that may be obtained through the use of the licensed technology;

87.7. Those that require payment of royalties to the owners of patents for patents which are not used;

87.8. Those that prohibit the licensee to export the licensed product unless justified for the protection of the legitimate interest of the licensor such as exports to countries where exclusive licenses to manufacture and/or distribute the licensed product(s) have already been granted;

87.9. Those which restrict the use of the technology supplied after the expiration of the technology transfer arrangement, except in cases of early termination of the technology transfer arrangement due to reason(s) attributable to the licensor;

87.10. Those which require payments for patents and other industrial property rights after their expiration, termination arrangement;

87.11. Those which require that the technology recipient shall not contest the validity of any of the patents of the technology supplier;

87.12. Those which restrict the research and development activities of the licensee designed to absorb and adapt the transferred technology to local conditions, or introducing innovation to it, as long as it does not impair the quality standards prescribed by the licensor;

87.14. Those which exempt the licensor for liability for non-fulfillment of his responsibilities under the technology transfer arrangement and/or liability arising from third party suits brought about by the use of the licensed product or the licensed technology; and

87.15. Other clauses with equivalent effects. (Sec. 33-C[2], RA 165a)

15. Compulsory Licensing

Sec. 93. Grounds for Compulsory Licensing. - The Director of Legal Affairs may grant a license to exploit a patented invention, even without the agreement of the patent owner, in favor of any person who has shown his capability to exploit the invention, under any of the following circumstances:

93.1. National emergency or other circumstances of extreme urgency;

93.2. Where the public interest, in particular, national security, nutrition, health or the development of other vital sectors of the national economy as determined by the appropriate agency of the Government, so requires; or

93.3. Where a judicial or administrative body has determined that the manner of exploitation by the owner of the patent or his licensee is anti-competitive; or

93.4. In case of public non-commercial use of the patent by the patentee, without satisfactory reason;

93.5. If the patented invention is not being worked in the Philippines on a commercial scale, although capable of being worked, without satisfactory reason: Provided, That the importation of the patented article shall constitute working or using the patent. (Secs. 34, 34-A, and 34-B, RA 165a)

Sec. 97. Compulsory License Based on Interdependence of Patents. - If the invention protected by a patent, hereafter referred to as the "second patent," within the country cannot be worked without infringing another patent, hereafter referred to as the "first patent," granted on a prior application or benefiting from an earlier priority, a compulsory license may be granted to the owner of the second patent to the extent necessary for the working of his invention, subject to the following conditions:

97.1. The invention claimed in the second patent involves an important technical advance of considerable economic significance in relation to the first patent;

97.2. The owner of the first patent shall be entitled to a cross-license on reasonable terms to use the invention claimed in the second patent;
16. Assignment and Transfer of Patent

Sec. 104. Assignment of Inventions. - An assignment may be of the entire right, title or interest in and to the patent and the invention covered thereby, or of an undivided share of the entire patent and invention, in which event the parties become joint owners thereof. An assignment may be limited to a specified territory. (Sec. 51, RA 165)

Sec. 105. Form of Assignment. - The assignment must be in writing, acknowledged before a notary public or other officer authorized to administer oath or perform notarial acts, and certified under the hand and official seal of the notary or such other officer. (Sec. 52, RA 165)

Sec. 106. Recording. -

106.1. The Office shall record assignments, licenses and other instruments relating to the transmission of any right, title or interest in and to inventions, and patents or application for patents or inventions to which they relate, which are presented in due form to the Office for registration, in books and records kept for the purpose. The original documents together with a signed duplicate thereof shall be filed, and the contents thereof should be kept confidential. If the original is not available, an authenticated copy thereof in duplicate may be filed. Upon recording, the Office shall return the original to the party who filed the same and notice of the recording shall be published in the IPO Gazette.

106.2. Such instruments shall be void as against any subsequent purchaser or mortgagee for valuable consideration and without notice, unless, it is so recorded in the Office, within three (3) months from the date of said instrument, or prior to the subsequent purchase or mortgage. (Sec. 53, RA 165a)

17. Cancellation of Patent

Sec. 61. Cancellation of Patents. -

61.1. Any interested person may, upon payment of the required fee, petition to cancel the patent or any claim thereof, or parts of the claim, on any of the following grounds:

(a) That what is claimed as the invention is not new or patentable;
(b) That the patent does not disclose the invention in a manner sufficiently clear and complete for it to be carried out by any person skilled in the art; or
(c) That the patent is contrary to public order or morality.

61.2. Where the grounds for cancellation relate to some of the claims or parts of the claim, cancellation may be effected to such extent only. (Secs. 28 and 29, RA 165a)

Sec. 62. Requirement of the Petition. - The petition for cancellation shall be in writing, verified by the petitioner or by any person in his behalf who knows the facts, specify the grounds upon which it is based, include a statement of the facts to be relied upon, and filed with the Office. Copies of printed publications or of patents of other countries, and other supporting documents mentioned in the petition shall be attached thereto, together with the translation thereof in English, if not in English language. (Sec. 30, RA 165)

Sec. 63. Notice of Hearing. - Upon filing of a petition for cancellation, the Director of Legal Affairs shall forthwith serve notice of the filing thereof upon the patentee and all persons having grants or licenses, or any other right, title or interest in and to the patent and the invention covered thereby, as appears of record in the Office, and of notice of the date of hearing thereon on such persons and the petitioner. Notice of the filing of the petition shall be published in the IPO Gazette. (Sec. 31, RA 165a)

Sec. 66. Effect of Cancellation of Patent or Claim. - The rights conferred by the patent or any specified claim or claims cancelled shall terminate. Notice of the cancellation shall be published in the IPO Gazette. Unless restrained by the Director General, the decision or order to cancel by Director of Legal Affairs shall be immediately executory even pending appeal. (Sec. 32, RA 165a)

Chapter III.

INDUSTRIAL DESIGNS AND LAY-OUT DESIGNS (TOPOGRAPHIES) OF INTEGRATED CIRCUITS

1. Substantive Conditions for Protection

Sec. 113. Substantive Conditions for Protection. - 113.1. Only industrial designs that are new or ornamental shall benefit from protection under this Act.

113.2. Industrial designs dictated essentially by technical or functional considerations to obtain a technical result or those that are contrary to public order, health or morals shall not be protected.

113.3. Only layout-designed integrated circuits that are original shall benefit from protection under this Act. A layout-design shall be considered original if it is the result of its creator’s own intellectual effort and is not commonplace among creators of layout-designs and manufacturers of integrated circuits at the time of its creation.

113.4. A layout-design consisting of a combination of elements and interconnections that are commonplace shall be protected only if the combination, taken as a whole, is original.
1.1. Rights Conferred on Registered Owner of Lay-out Design

Sec. 119.4. Rights Conferred to the Owner of a Layout-Design Registration. - The owner of a layout-design registration shall enjoy the following rights:

1. to reproduce, whether by incorporation in an integrated circuit or otherwise, the registered layout-design in its entirety or any part thereof, except the act of reproducing any part that does not comply with the requirement of originality; and
2. to sell or otherwise distribute for commercial purposes the registered layout design, an article or an integrated circuit in which the registered layout-design is incorporated.

Sec. 119.5. Limitations of Layout Rights. - The owner of a layout design has no right to prevent third parties from reproducing, selling or otherwise distributing for commercial purposes the registered layout design in the following circumstances:

1. Reproduction of the registered layout-design for private purposes or for the sole purpose of evaluation, analysis, research or teaching;
2. Where the act is performed in respect of a layout-design created on the basis of such analysis or evaluation and which is itself original in the meaning as provided herein;
3. Where the act is performed in respect of a registered lay-out-design, or in respect of an integrated circuit in which such a layout-design is incorporated, that has been put on the market by or with the consent of the right holder;
4. In respect of an integrated circuit where the person performing or ordering such an act did not know and had no reasonable ground to know when acquiring the integrated circuit or the article incorporating such an integrated circuit, that it incorporated an unlawfully reproduced layout-design; Provided, however, that after the time that such person has received sufficient notice that the layout-design was unlawfully reproduced, that person may perform any of the said acts only with respect to the stock on hand or ordered before such time and shall be liable to pay to the right holder a sum equivalent to at least 5% of net sales or such other reasonable royalty as would be payable under a freely negotiated license in respect of such layout-design; or
5. Where the act is performed in respect of an identical layout-design which is original and has been created independently by a third party.

1.2. Grounds for Cancellation of Registration

Sec. 120. Cancellation of Design Registration. -

120.1. At any time during the term of the industrial design registration, any person upon payment of the required fee, may petition the Director of Legal Affairs to cancel the industrial design on any of the following grounds:

(a) If the subject matter of the industrial design is not registerable within the terms of Sections 112 and 113;
(b) If the subject matter is not new; or
(c) If the subject matter of the industrial design extends beyond the content of the application as originally filed.

120.2. Where the grounds for cancellation relate to a part of the industrial design, cancellation may be effected to such extent only. The restriction may be effected in the form of an alteration of the effects of the design.

120.3. Grounds for Cancellation of Layout-Design of Integrated Circuits.- Any interested person may petition that the registration of a layout-design be canceled on the ground that:

(a) the layout-design is not protectable under this Act;
(b) the right holder is not entitled to protection under this Act; or
(c) where the application for registration of the layout-design was not filed within two (2) years from its first commercial exploitation anywhere in the world.

Where the grounds for cancellation are established with respect only to a part of the layout-design, only the corresponding part of the registration shall be canceled. Any canceled layout-design registration or part thereof, shall be regarded as null and void from the beginning and may be expunged from the records of the Intellectual Property Office. Reference to all canceled layout-design registration shall be published in the IPO Gazette.

Chapter IV. TRADEMARKS

1. Marks and Names

Sec. 121. Definitions. - As used in Part III, the following terms have the following meanings:

121.1. "Mark" means any visible sign capable of distinguishing the goods (trademark) or services (service mark) of an enterprise and shall include a stamped or marked container of goods; (Sec. 38, RA 166a)

121.2. "Collective mark" means any visible sign designated as such in the application for registration and capable of distinguishing the origin or any other common characteristic, including the quality of goods or services of different enterprises which use the sign under the control of the registered owner of the collective mark; (Sec. 40, RA 166a)

121.3. "Trade name" means the name or designation identifying or distinguishing an enterprise; (Sec. 38, RA 166a)
1.1. Product name and container not proper subjects of copyright and patent registration

Kho v. CA, et al., 379 SCRA 410 [2002]

The name and container of a beauty cream product are proper subjects of a trademark inasmuch as the same falls squarely within its definition. In order to be entitled to exclusively use the same in the sale of the beauty cream product, the user must sufficiently prove that she registered or used it before anybody else did. The petitioner's copyright and patent registration of the name and container would not guarantee her right to the exclusive use of the same for the reason that they are not appropriate subjects of the said intellectual rights. Consequently, a preliminary injunction order cannot be issued for the reason that the petitioner has not proven that she has a clear right over the said name and container to the exclusion of others, not having proven that she has registered a trademark thereto or used the same before anyone did.

2. Acquisition of Ownership

Sec. 122. How Marks are Acquired. - The rights in a mark shall be acquired through registration made validly in accordance with the provisions of this law. (Sec. 2-A, RA 166a)

Sec. 165. Trade Names or Business Names. -

165.1. A name or designation may not be used as a trade name if by its nature or the use to which such name or designation may be put, it is contrary to public order or morals and if, in particular, it is liable to deceive trade circles or the public as to the nature of the enterprise identified by that name.

165.2. (a) Notwithstanding any laws or regulations providing for any obligation to register trade names, such names shall be protected, even prior to or without registration, against any unlawful act committed by third parties.

(b) In particular, any subsequent use of the trade name by a third party, whether as a trade name or a mark or collective mark, or any such use of a similar trade name or mark, likely to mislead the public, shall be deemed unlawful.

3. Use of Mark as a Requirement

Sec. 124.2. The applicant or the registrant shall file a declaration of actual use of the mark with evidence to that effect, as prescribed by the Regulations within three (3) years from the filing date of the application. Otherwise, the application shall be refused or the mark shall be removed from the Register by the Director.

4. Non-Registrable Marks

Sec. 123.1. A mark cannot be registered if it:

(a) Consists of immoral, deceptive or scandalous matter, or matter which may disparage or falsely suggest a connection with persons, living or dead, institutions, beliefs, or national symbols, or bring them into contempt or disrepute;

(b) Consists of the flag or coat of arms or other insignia of the Philippines or any of its political subdivisions, or of any foreign nation, or any simulation thereof;

(c) Consists of a name, portrait or signature identifying a particular living individual except by his written consent, or the name, signature, or portrait of a deceased President of the Philippines, during the life of his widow, if any, except by written consent of the widow;

(d) Is identical with, or confusingly similar to, any such use of a similar trade name or mark, or of the same, or cause confusion;

(e) Is identical with, or confusingly similar to, or constitutes a translation of a mark which is considered by the competent authority of the Philippines to be well-known internationally and in the Philippines, whether or not it is registered here, as being already the mark of a person other than the applicant for registration, and used for identical or similar goods or services: Provided, That in determining whether a mark is well-known, account shall be taken of the knowledge of the relevant sector of the public, rather than of the public at large, including knowledge in the Philippines which has been obtained as a result of the promotion of the mark;

(f) Is identical with, or confusingly similar to, or constitutes a translation of a mark considered well-known in accordance with the preceding paragraph, which is registered in the Philippines with respect to goods or services which are not similar to those with respect to which registration is applied for: Provided, That use of the mark in relation to those goods or services would indicate a connection between those goods or services, and the owner or the registered mark: Provided further, That the interests of the owner of the registered mark are likely to be damaged by such use;

(g) Is likely to mislead the public, particularly as to the nature, quality, characteristics or geographical origin of the goods or services;

(h) Consists exclusively of signs that are generic for the goods or services that they seek to identify;

(i) Consists exclusively of signs or of indications that have become customary or usual to designate the goods or services in everyday language or in bona fide and established trade practice;

(j) Consists exclusively of signs or of indications that may serve in trade to designate the kind, quality, quantity, intended purpose, value, geographical origin, time or production of the goods or rendering of the services, or other characteristics of the goods or services;
(k) Consists of shapes that may be necessitated by technical factors or by the nature of the goods themselves or factors that affect their intrinsic value;

(l) Consists of color alone, unless defined by a given form; or

(m) Is contrary to public order or morality.

A mark is valid if it is distinctive and hence not barred from registration under the Trademark Law. However, once registered, not only the mark’s validity but also the registrant’s ownership thereof is prima facie presumed.

5. Tests to Determine Confusing Similarity Between Marks

5.1. Colorable imitation

Societe des Produits Nestlé, S.A. v. CA, 356 SCRA 207 [2001]

Colorable imitation denotes such a close or ingenious imitation as to be calculated to deceive ordinary persons, or such a resemblance to the original as to deceive an ordinary purchaser giving such attention as a purchaser usually gives, as to cause him to purchase the one supposing it to be the other. In ascertaining whether one mark is confusingly similar to or is a colorable imitation of another, no set rules can be deduced. Each case must be decided on its own merits. The complexities attendant to an accurate assessment of likelihood of confusion require that the entire panoply of elements constituting the relevant factual landscape be comprehensively examined.

5.2. Holistic test

Del Monte Corporation, et al. v. CA, 181 SCRA 410 [1990]

To determine whether a trademark has been infringed, we must consider the mark as a whole and not as dissected. If the buyer is deceived, it is attributable to the marks as a totality, not usually to any part of it. The court therefore should be guided by its first impression, for the buyer acts quickly and is governed by a casual glance, the value of which may be dissipated as soon as the court assumed to analyze carefully the respective features of the mark.

5.3. Test of dominancy

Asia Brewery v. CA and San Miguel, 224 SCRA 437 [1993]

Infringement is determined by the test of “dominancy” rather than by differences or variations in the details of one trademark and of another. Similarity in size, form and color, while relevant, is not conclusive. If the competing trademark contains the main or essential or dominant features of another, and confusion is likely to result, infringement takes place.

Societe Des Produits Nestle, S.A. v. CA (2001)

The totality or holistic test is contrary to the elementary postulate of the law on trademarks and unfair competition that confusing similarity is to be determined on the basis of visual, aural, connotative comparisons and overall impressions engendered by the marks in controversy as they are encountered in the marketplace. The totality or holistic test only relies on visual comparisons between two trademarks whereas the dominancy test relies mainly on the visual but also on the aural and connotative comparisons and overall impressions between the two trademarks.

McDonald’s Corporation v. L.C. Big Mak Burger, Inc., et al., 437 SCRA 10 [2004]

This Court, xxx, has relied on the dominancy test rather than the holistic test. The dominancy test considers the dominant features in the competing marks in determining whether they are confusingly similar. Under the dominancy test, courts give greater weight to the similarity of the appearance of the product arising from the adoption of the dominant features of the marks, not the entire marks disregarding minor differences. Courts will consider more the aural and visual impressions created by the marks in the public mind, giving little weight to factors like prices, quality, sales outlets and market segments.

McDonald’s Corp v MACJOY Fastfood Corp (2007)

Applying the dominancy test to the instant case, the Court finds that herein petitioner’s “MCDONALD’S” and respondent’s “MACJOY” marks are confusingly similar with each other such that an ordinary purchaser can conclude an association or relation between the marks.

To begin with, both marks use the corporate “M” design logo and the prefixes “Mc” and/or “Mac” as dominant features. The first letter “M” in both marks puts emphasis on the prefixes “Mc” and/or “Mac” by the similar way in which they are depicted i.e. in an arch-like, capitalized and stylized manner. For sure, it is the prefix “Mc,” an abbreviation of “Mac,” which visually and aurally catches the attention of the consuming public. Verily, the word “MACJOY” attracts attention the same way as did “McDonalds,” “MacFries,” “McSpaghetti,” “McDo,” “Big Mac” and the rest of the MCDONALD’S marks which all use the prefixes Mc and/or Mac.

Besides and most importantly, both trademarks are used in the sale of fastfood products. Indisputably, the respondent’s trademark application for the “MACJOY & DEVICE” trademark covers goods under Classes 29 and 30 of the International Classification of Goods, namely, fried chicken, chicken barbeque, burgers, fries, spaghetti, etc. Likewise, the petitioner’s trademark registration for the MCDONALD’S marks in the Philippines covers goods which are similar if not identical to those covered by the respondent’s application.

6. Well-known Marks

Sec. 123.1. (e) Is identical with, or confusingly similar to, or constitutes a translation of a mark which is considered by the competent authority of the Philippines to be well-known internationally and in the Philippines, whether or not it is registered here, as being already the mark of a person other than the applicant for registration, and used for identical or similar goods or services: Provided: That in determining whether a mark is well-known, account shall be taken of the knowledge of the
relevant sector of the public, rather than of the public at large, including knowledge in the Philippines which has been obtained as a result of the promotion of the mark;
(f) Is identical with, or confusingly similar to, or constitutes a translation of a mark considered well-known in accordance with the preceding paragraph, which is registered in the Philippines with respect to goods or services which are not similar to those with respect to which registration is applied for: Provided, That use of the mark in relation to those goods or services would indicate a connection between those goods or services, and the owner of the registered mark: Provided further, That the interests of the owner of the registered mark are likely to be damaged by such use;

Sec. 147.2. The exclusive right of the owner of a well-known mark defined in Subsection 123.1(e) which is registered in the Philippines, shall extend to goods and services which are not similar to those in respect of which the mark is registered: Provided, That use of that mark in relation to those goods or services would indicate a connection between those goods or services and the owner of the registered mark: Provided further, That the interests of the owner of the registered mark are likely to be damaged by such use.

7. Registration

7.1. Requirements for Registration

Sec. 124. Requirements of Application. -

124.1. The application for the registration of the mark shall be in Filipino or in English and shall contain the following:
(a) A request for registration;
(b) The name and address of the applicant;
(c) The name of a State of which the applicant is a national or where he has domicile; and the name of a State in which the applicant has a real and effective industrial or commercial establishment, if any;
(d) Where the applicant is a juridical entity, the law under which it is organized and existing;
(e) The appointment of an agent or representative, if the applicant is not domiciled in the Philippines;
(f) Where the applicant claims the priority of an earlier application, an indication of:
   1) The name of the State with whose national office the earlier application was filed or it filed with an office other than a national office, the name of that office,
   2) The date on which the earlier application was filed, and
   3) Where available, the application number of the earlier application;
   (g) Where the applicant claims color as a distinctive feature of the mark, a statement to that effect as well as the name or names of the color or colors claimed and an indication, in respect of each color, of the principal parts of the mark which are in that color;
(h) Where the mark is a three-dimensional mark, a statement to that effect;
(i) One or more reproductions of the mark or as prescribed in the Regulations;
(j) A transliteration or translation of the mark or of some parts of the mark, as prescribed in the Regulations;
(k) The names of the goods or services for which the registration is sought, grouped according to the classes of the Nice Classification, together with the number of the class of the said Classification to which each group of goods or services belongs; and
(l) A signature by, or other self-identification of, the applicant or his representative.

124.2. The applicant or the registrant shall file a declaration of actual use of the mark with evidence to that effect, as prescribed by the Regulations within three (3) years from the filing date of the application. Otherwise, the application shall be refused or the mark shall be removed from the Register by the Director.

124.3. One (1) application may relate to several goods and/or services, whether they belong to one (1) class or to several classes of the Nice Classification.

124.4. If during the examination of the application, the Office finds factual basis to reasonably doubt the veracity of any indication or element in the application, it may require the applicant to submit sufficient evidence to remove the doubt. (Sec. 5, RA 166a)

7.2. Priority Right

Sec. 131. Priority Right. -

131.1. An application for registration of a mark filed in the Philippines by a person referred to in Section 3, and who previously duly filed an application for registration of the same mark in one of those countries, shall be considered as filed as of the day the application was first filed in the foreign country.

131.2. No registration of a mark in the Philippines by a person described in this section shall be granted until such mark has been registered in the country of origin of the applicant.

131.3. Nothing in this section shall entitle the owner of a registration granted under this section to sue for acts committed prior to the date on which his mark was registered in this country: Provided, That, notwithstanding the foregoing, the owner of a well-known mark as defined in Section 123.1(e) of this Act, that is not registered in the Philippines, may, against an identical or confusingly similar mark, oppose its registration, or petition the cancellation of its registration or sue for unfair competition,
without prejudice to availing himself of other remedies provided for under the law.

131.4. In like manner and subject to the same conditions and requirements, the right provided in this section may be based upon a subsequent regularly filed application in the same foreign country: Provided, That any foreign application filed prior to such subsequent application has been withdrawn, abandoned, or otherwise disposed of, without having been laid open to public inspection and without leaving any rights outstanding, and has not proceeded, nor thereafter shall serve, as a basis for claiming a right of priority. (Sec. 37, RA 166a)

7.3 Classification of Goods and Services

Sec. 144. Classification of Goods and Services. -

144.1. Each registration, and any publication of the Office which concerns an application or registration effected by the Office shall indicate the goods or services by their names, grouped according to the classes of the Nice Classification, and each group shall be preceded by the number of the class of that Classification to which that group of goods or services belongs, presented in the order of the classes of the said Classification.

144.2. Goods or services may not be considered as being similar or dissimilar to each other on the ground that, in any registration or publication by the Office, they appear in different classes of the Nice Classification. (Sec. 6, RA 166a)

7.4 Registration Procedure

Sec. 132. Application Number and Filing Date. -

132.1. The Office shall examine whether the application satisfies the requirements for the grant of a filing date as provided in Section 127 and Regulations relating thereto. If the application does not satisfy the filing requirements, the Office shall notify the applicant who shall within a period fixed by the Regulations complete or correct the application as required, otherwise, the application shall be considered withdrawn.

132.2. Once an application meets the filing requirements of Section 127, it shall be numbered in the sequential order, and the applicant shall be informed of the application number and the filing date of the application will be deemed to have been abandoned.

Sec. 133. Examination and Publication. -

133.1. Once the application meets the filing requirements of Section 127, the Office shall examine whether the application meets the requirements of Section 124 and the mark as defined in Section 121 is registrable under Section 123.

133.2. Where the Office finds that the conditions referred to in Subsection 133.1 are fulfilled, it shall, upon payment of the prescribed fee. Forthwith cause the application, as filed, to be published in the prescribed manner.

133.3. If after the examination, the applicant is not entitled to registration for any reason, the Office shall advise the applicant thereof and the reasons therefor. The applicant shall have a period of four (4) months in which to reply or amend his application, which shall then be re-examined. The Regulations shall determine the procedure for the re-examination or revival of an application as well as the appeal to the Director of Trademarks from any final action by the Examiner.

133.4. An abandoned application may be revived as a pending application within three (3) months from the date of abandonment, upon good cause shown and the payment of the required fee.

133.5. The final decision of refusal of the Director of Trademarks shall be appealable to the Director General in accordance with the procedure fixed by the Regulations. (Sec. 7, RA 166a)

Sec. 134. Opposition. - Any person who believes that he would be damaged by the registration of a mark may, upon payment of the required fee and within thirty (30) days after the publication referred to in Subsection 133.2, file with the Office an opposition to the application. Such opposition shall be in writing and shall be made on the application being similar or dissimilar to any record in the Office which concerns an application or registration of marks registered in other countries or other supporting documents mentioned in the opposition shall be filed therewith, together with the translation in English, if not in the English language. For good cause shown and upon payment of the required surcharge, the time for filing an opposition may be extended by the Director of Legal Affairs, who shall notify the applicant of such extension. The Regulations shall fix the maximum period of time within which to file the opposition. (Sec. 8, RA 165a)

Sec. 135. Notice and Hearing. - Upon the filing of an opposition, the Office shall serve notice of the filing on the applicant, and of the date of the hearing thereof upon the applicant and the oppositor and all other persons having any right, title or interest in the mark covered by the application, as appear of record in the Office. (Sec. 9 RA 165)

Sec. 136. Issuance and Publication of Certificate. - When the period for filing the opposition has expired, or when the Director of Legal Affairs shall have denied the opposition, the Office shall issue the certificate of registration. Upon issuance of a certificate of registration, notice thereof making reference to the publication of the application shall be published in the IPO Gazette. (Sec. 10, RA 165)

Sec. 138. Certificates of Registration. - A certificate of registration of a mark shall be prima facie evidence of the validity of the registration, the
registrant’s ownership of the mark, and of the registrant’s exclusive right to use the same in connection with the goods or services and those that are related thereto specified in the certificate. (Sec. 20, RA 165)

7.5. Duration of Registration

Sec. 145. Duration.- A certificate of registration shall remain in force for ten (10) years: Provided, That the registrant shall file a declaration of actual use and evidence to that effect, or shall show valid reasons based on the existence of obstacles to such use, as prescribed by the Regulations, within one (1) year from the fifth anniversary of the date of the registration of the mark. Otherwise, the mark shall be removed from the Register by the Office. (Sec. 12, RA 166a)

Sec. 146. Renewal. -

146.1. A certificate of registration may be renewed for periods of ten (10) years at its expiration upon payment of the prescribed fee and upon filing of a request. The request shall contain the following indications:

(a) An indication that renewal is sought;
(b) The name and address of the registrant or his successor-in-interest, hereafter referred to as the "right holder";
(c) The registration number of the registration concerned;
(d) The filing date of the application which resulted in the registration concerned to be renewed;
(e) Where the right holder has a representative, the name and address of that representative;
(f) The names of the recorded goods or services for which the renewal is requested or the names of the recorded goods or services for which the renewal is not requested, grouped according to the classes of the said Classification; and
(g) A signature by the right holder or his representative.

146.2. Such request shall be in Filipino or English and may be made at any time within six (6) months before the expiration of the period for which the registration was issued or renewed, or it may be made within six (6) months after such expiration on payment of the additional fee herein prescribed.

146.3. If the Office refuses to renew the registration, it shall notify the registrant of his refusal and the reasons therefor.

146.4. An applicant for renewal not domiciled in the Philippines shall be subject to and comply with the requirements of this Act. (Sec. 15, RA 166a)

7.6. Rights Conferred by Registration

Sec. 147. Rights Conferred. -

147.1. The owner of a registered mark shall have the exclusive right to prevent all third parties not having the owner’s consent from using in the course of trade identical or similar signs or containers for goods or services which are identical or similar to those in respect of which the trademark is registered where such use would result in a likelihood of confusion. In case of the use, of an identical sign for identical goods or services, a likelihood of confusion shall be presumed.

147.2. The exclusive right of the owner of a well-known mark defined in Subsection 123.1(e) which is registered in the Philippines, shall extend to goods and services which are not similar to those in respect of which the mark is registered: Provided, That use of that mark in relation to those goods or services would indicate a connection between those goods or services and the owner of the registered mark: Provided, further, That the interests of the owner of the registered mark are likely to be damaged by such use.

7.7. Protection limited to goods specified in registration certificate


The certificate of registration can confer upon the petitioner the exclusive right to use its own symbol only to those goods specified in the certificate, subject to any conditions a limitations stated therein. One who has adopted and used a trademark on his goods does not prevent the adoption and use of the same trademark by others for products which are of a different description.

8. Infringement and Remedies

Sec. 155. Remedies; Infringement. - Any person who shall, without the consent of the owner of the registered mark:

155.1. Use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark or the same container or a dominant feature thereof in connection with the sale, offering for sale, distribution, advertising of any goods or services including other preparatory steps necessary to carry out the sale of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive; or

155.2. Reproduce, counterfeit, copy or colorably imitate a registered mark or a dominant feature thereof and apply such reproduction, counterfeit, copy or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive, shall be liable in a civil action for infringement by the registrant for the remedies hereinafter set forth: Provided, That the
infringement takes place at the moment any of the acts stated in Subsection

155.1. or this subsection are committed regardless of whether there is actual sale of goods or services using the infringing material. (Sec. 22, RA No 166a)

Sec. 156. Actions, and Damages and Injunction for Infringement. -

156.1. The owner of a registered mark may recover damages from any person who infringes his rights, and the measure of the damages suffered shall be either the reasonable profit which the complaining party would have made, had the defendant not infringed his rights, or the profit which the defendant actually made out of the infringement, or in the event such measure of damages cannot be readily ascertained with reasonable certainty, then the court may award as damages a reasonable percentage based upon the amount of gross sales of the defendant or the value of the services in connection with which the mark or trade name was used in the infringement of the rights of the complaining party. (Sec. 23, First Par., RA 166a)

156.2. On application of the complainant, the court may impound during the pendency of the action, sales invoices and other documents evidencing sales. 156.3. In cases where actual intent to mislead the public or to defraud the complainant is shown, in the discretion of the court, the damages may be doubled. (Sec. 23, First Par., RA 166)

156.4. The complainant, upon proper showing, may also be granted injunction. (Sec. 23, Second Par., RA 166a)

Sec. 157. Power of Court to Order Infringing Material Destroyed. -

157.1. In any action arising under this Act, in which a violation of any right of the owner of the registered mark is established, the court may order that goods found to be infringing be, without compensation of any sort, disposed of outside the channels of commerce in such a manner as to avoid any harm caused to the right holder, or destroyed; and all labels, signs, prints, packages, wrappers, receptacles and advertisements in the possession of the defendant, bearing the registered mark or trade name or any reproduction, counterfeit, copy or colorable imitation thereof, all plates, molds, matrices and other means of making the same, shall be delivered up and destroyed.

157.2. In regard to counterfeit goods, the simple removal of the trademark affixed shall not be sufficient other than in exceptional cases which shall be determined by the Regulations, to permit the release of the goods into the channels of commerce. (Sec. 24, RA 166a).

Sec. 170. Penalties. - Independent of the civil and administrative sanctions imposed by law, a criminal penalty of imprisonment from two (2) years to five (5) years and a fine ranging from Fifty thousand pesos (P50,000) to Two hundred thousand pesos (P200,000), shall be imposed on any person who is found guilty of committing any of the acts mentioned in Section 155, Section 168 and Subsection 169.1. (Arts. 188 and 189, Revised Penal Code)

Sec. 159. Limitations to Actions for Infringement. - Notwithstanding any other provision of this Act, the remedies given to the owner of a right infringed under this Act shall be limited as follows:

159.1. Notwithstanding the provisions of Section 155 hereof, a registered mark shall have no effect against any person who, in good faith, before the filing date or the priority date, was using the mark for the purposes of his business or enterprise: Provided, That his right may only be transferred or assigned together with his enterprise or business or with that part of his enterprise or business in which the mark is used.

159.2. Where an infringer who is engaged solely in the business of printing the mark or other infringing materials for others is an innocent infringer, the owner of the right infringed shall be entitled as against such infringer only to an injunction against future printing.

159.3. Where the infringement complained of is contained in or is part of paid advertisement in a newspaper, magazine, or other similar periodicals or in an electronic communication, the remedies of the owner of the right infringed shall not be available to the owner of the right infringed with respect to an issue of a newspaper, magazine, or other similar periodical or an electronic communication containing infringing matter where restraining the dissemination of such infringing matter in any particular issue of such periodical or in an electronic communication would delay the delivery of such issue or transmission of such electronic communication is customarily conducted in accordance with the sound business practice, and not due to any method or device adopted to evade this section or to prevent or delay the issuance of an injunction or restraining order with respect to such infringing matter.

Mighty Corporation v. E. & J. Gallo Winery, 434 SCRA 473 [2004]

A crucial issue in any trademark infringement case is the likelihood of confusion, mistake or deceit as to the identity, source or origin of the goods or identity of the business as a consequence of using a certain mark. Likelihood of confusion is admittedly a relative term, to be determined rigidly
according to the particular (and sometimes peculiar) circumstances of each case. In determining likelihood of confusion, the court must consider: [a] the resemblance between the trademarks; [b] the similarity of the goods to which the trademarks are attached; [c] the likely effect on the purchaser; and [d] the registrant's express or implied consent and other fair and equitable considerations.

McDonald’s Corporation v. L.C. Big Mak Burger, Inc., et al., 437 SCRA 10 [2004]

To establish trademark infringement, the following elements must be shown: [1] the validity of the mark; [2] the plaintiff's ownership of the mark; and [3] the use of the mark or its colorable imitation by the alleged infringer results in "likelihood of confusion." Of these, it is the element of likelihood of confusion that is the gravamen of trademark infringement. Two types of confusion arise from the use of similar or colorable imitation marks, namely, confusion of goods (product confusion) and confusion of business ("source or origin confusion"). While there is confusion of goods when the products are competing, confusion of business exists when the products are non-competing but related enough to produce confusion of affiliation.

Canon Kabushiki Kaisha v. CA, et al., 336 SCRA 266 [2000]

The likelihood of confusion of goods or business is a relative concept, to be determined according to the particular, and sometimes peculiar, circumstances of each case. In cases of confusion of business or origin, the question that usually arises is whether the respective goods or services of the senior user and the junior user are related as to likely cause confusion of business or origin, and thereby render the trademark or tradenames confusingly similar. Goods are related when they belong to the same class or have the same descriptive properties; when they possess the same physical attributes or essential characteristics with reference to their form, composition, texture or quality. They may also be related because they serve the same purpose or are sold through the same channels of distribution.

Samson v. Daway, 434 SCRA 612 [2004]

R.A. No. 8293 and R.A. No. 166 are special laws conferring jurisdiction over violations of intellectual property rights to the Regional Trial Court. They should therefore prevail over R.A. No. 7691, which is a general statute. Hence, jurisdiction is properly lodged with the Regional Trial Court even if the penalty therefore is imprisonment of less than six years, or from 2 to 5 years and a fine ranging from P50,000 to P200,000.

8.1. Notice Requirement

Sec. 158. Damages; Requirement of Notice. - In any suit for infringement, the owner of the registered mark shall not be entitled to recover profits or damages unless the acts have been committed with knowledge that such imitation is likely to cause confusion, or to cause mistake, or to deceive. Such knowledge is presumed if the registrant gives notice that his mark is registered by displaying with the mark the words "Registered Mark" or the letter R within a circle or if the defendant had otherwise actual notice of the registration. (Sec. 21, RA 166a)

9. Unfair Competition

Sec. 168. Unfair Competition, Rights, Regulation and Remedies. -

168.1. A person who has identified in the mind of the public the goods he manufactures or deals in, his business or services from those of others, whether or not a registered mark is employed, has a property right in the goodwill of the said goods, business or services so identified, which will be protected in the same manner as other property rights.

168.2. Any person who shall employ deception or any other means contrary to good faith by which he shall pass off the goods manufactured by him or in which he deals, or his business, or services for those of the one having established such goodwill, or who shall commit any acts calculated to produce said result, shall be guilty of unfair competition, and shall be subject to an action therefor.

168.3. In particular, and without in any way limiting the scope of protection against unfair competition, the following shall be deemed guilty of unfair competition:

(a) Any person who is selling his goods and gives them the general appearance of goods of another manufacturer or dealer, or the goods themselves or in the wrapping of the packages in which they are contained, or the devices or words thereon, or in any other feature of their appearance, which would be likely to influence purchasers to believe that the goods offered are those of a manufacturer or dealer other than the actual manufacturer or dealer, or who otherwise clothes the goods with such appearance as shall deceive the public and defraud another of his legitimate trade, or any subsequent vendor of such goods or any agent of any vendor engaged in selling such goods with a like purpose;

(b) Any person who by any artifice, or device, or who employs any other means calculated to induce the false belief that such person is offering the services of another who has identified such services in the mind of the public; or

(c) Any person who shall make any false statement in the course of trade or who shall commit any other act contrary to good faith of a nature calculated to discredit the goods, business or services of another.

168.4. The remedies provided by Sections 156, 157 and 161 shall apply mutatis mutandis. (Sec. 29, RA 166a)
Del Monte Corporation, et al. v. CA, 181 SCRA 410 [1990]

The following are the distinctions between infringement of trademark and unfair competition:

1. Infringement of trademark is the unauthorized use of a trademark, whereas unfair competition is the passing off of one’s goods as those of another.

2. In infringement of trademark, fraudulent intent is unnecessary, whereas in unfair competition fraudulent intent is essential.

3. In infringement of trademark the prior registration of the trademark is a prerequisite to the action, whereas in unfair competition registration is not necessary.

Mighty Corporation v. E. & J. Gallo Winery, 434 SCRA 473 [2004]

The law on unfair competition is broader and more inclusive than the law on trademark infringement. The latter is more limited but it recognizes a more exclusive right derived from the trademark adoption and registration by the person whose goods or business is first associated with it. Hence, even if one fails to establish his exclusive property right to a trademark, he may still obtain relief on the ground of his competitor’s unfairness or fraud. Conduct constitutes unfair competition if the effect is to pass off on the public the goods of one man as the goods of another.

McDonald’s Corporation v. L.C. Big Mak Burger, Inc., et al., 437 SCRA 10 [2004]

The elements of an action for unfair competition are: [1] confusing similarity in the general appearance of the goods, and [2] intent to deceive the public and defraud a competitor. The confusing similarity may or may not result from similarity in the marks, but may result from other external factors in the packaging or presentation of the goods. The intent to deceive and defraud may be inferred from the similarity in appearance of the goods as offered for sale to the public. Actual fraudulent intent need not be shown.


An action for unfair competition is based on the proposition that no dealer in merchandise should be allowed to dress his goods in simulation of the goods of another dealer, so that purchasers desiring to buy the goods of the latter would be induced to buy the goods of the former. The most usual devices employed in committing this crime are the simulation of labels and the reproduction of form, color and general appearance of the package used by the pioneer manufacturer or dealer.

Chapter V.
COPYRIGHTS

1. Basic Principles

1. Works are protected by the sole fact of their creation.
   Sec. 172.2. Works are protected by the sole fact of their creation, irrespective of their mode or form of expression, as well as of their content, quality and purpose. (Sec. 2, PD No. 49a)

2. Protection extends only to the expression of an idea, not the idea itself.
   Sec. 175 Unprotected Subject Matter. - Notwithstanding the provisions of Sections 172 and 173, no protection shall extend, under this law, to any idea, procedure, system method or operation, concept, principle, discovery or mere data as such, even if they are expressed, explained, illustrated or embodied in a work; xxx xxx xxx

2. Definition

Sec. 177. Copy or Economic Rights. - Subject to the provisions of Chapter VIII, copyright or economic rights shall consist of the exclusive right to carry out, authorize or prevent the following acts:

177.1. Reproduction of the work or substantial portion of the work;

177.2. Dramatization, translation, adaptation, abridgment, arrangement or other transformation of the work;

177.3. The first public distribution of the original and each copy of the work by sale or other forms of transfer of ownership;

177.4. Rental of the original or a copy of an audiovisual or cinematographic work, a work embodied in a sound recording, a computer program, a compilation of data and other materials or a musical work in graphic form, irrespective of the ownership of the original or the copy which is the subject of the rental;

177.5. Public display of the original or a copy of the work;

177.6. Public performance of the work; and

177.7. Other communication to the public of the work (Sec. 5, PD No. 49a)

3. Copyrightable Works

Sec. 172. Literary and Artistic Works. -

172.1. Literary and artistic works, hereinafter referred to as “works”, are original intellectual creations in the literary and artistic domain protected from the moment of their creation and shall include in particular:

   (a) Books, pamphlets, articles and other writings;
   (b) Periodicals and newspapers;
   (c) Lectures, sermons, addresses, dissertations prepared for oral delivery, whether or not reduced in writing or other material form;
   (d) Letters;
The format of a show is not copyrightable. Section 2 of PD No. 49, otherwise known as the Decree on Intellectual Property, enumerates the classes of work entitled to copyright protection. This provision is substantially the same as Section 172 of the Intellectual Property Code (R.A. No. 8293). The format or mechanics of a television show is not included in the list of protected works. For this reason, the protection afforded by the law cannot be extended to cover them. Copyright, in the strict sense of the term, is purely a statutory right. Being a statutory grant, the rights are only such as the statute confers, and may be obtained and enjoyed only with respect to the subjects and by the persons, and on terms and conditions specified in the statute.

4. Non-copyrightable Works (175, 176)

Sec. 175. Unprotected Subject Matter. - Notwithstanding the provisions of Sections 172 and 173, no protection shall extend, under this law, to any idea, procedure, system method or operation, concept, principle, discovery or mere data as such, even if they are expressed, explained, illustrated or embodied in a work; news of the day and other miscellaneous facts having the character of mere items of press information; or any official text of a legislative, administrative or legal nature, as well as any official translation thereof.

Sec. 176. Works of the Government. -

176.1. No copyright shall subsist in any work of the Government of the Philippines. However, prior approval of the government agency or office wherein the work is created shall be necessary for exploitation of such work for profit. Such agency or office may, among other things, impose as a condition the payment of royalties. No prior approval or conditions shall be required for the use of any purpose of statutes, rules and regulations, and speeches, lectures, sermons, addresses, and dissertations, pronounced, read or rendered in courts of justice, before administrative agencies, in deliberative assemblies and in meetings of public character. (Sec. 9, First Par., PD No. 49)

176.2. The Author of speeches, lectures, sermons, addresses, and dissertations mentioned in the preceding paragraphs shall have the exclusive right of making a collection of his works.

176.3. Notwithstanding the foregoing provisions, the Government is not precluded from receiving and holding copyrights transferred to it by assignment, bequest or otherwise; nor shall publication or republication by the government in a public document of any work in which copy right is subsisting be taken to cause any abridgment or annulment of the copyright or to authorize any use or appropriation of such work without the consent of the copyright owners. (Sec. 9, Third Par., PD No. 49)

5. Standard for Copyright Protection

Ching Kian Chuan v. Court of Appeals, 363 SCRA 142 [2001]
A person to be entitled to a copyright must be the original creator of the work. He must have created it by his own skill, labor, and judgment without directly copying or evasively imitating the work of another.

**Ching v Salinas (2005)**

Ownership of copyrighted material is shown by proof of originality and copyrightability. By originality is meant that the material was not copied, and evidences at least minimal creativity; that it was independently created by the author and that it possesses at least same minimal degree of creativity. Copying is shown by proof of access to copyrighted material and substantial similarity between the two works. The applicant must thus demonstrate the existence and the validity of his copyright because in the absence of copyright protection, even original creation may be freely copied.

### 6. Economic Rights

**Sec. 177. Copy or Economic Rights.** - Subject to the provisions of Chapter VIII, copyright or economic rights shall consist of the exclusive right to carry out, authorize or prevent the following acts:

- **177.1.** Reproduction of the work or substantial portion of the work;
- **177.2.** Dramatization, translation, adaptation, abridgment, arrangement or other transformation of the work;
- **177.3.** The first public distribution of the original and each copy of the work by sale or other forms of transfer of ownership;
- **177.4.** Rental of the original or a copy of an audiovisual or cinematographic work, a work embodied in a sound recording, a computer program, a compilation of data and other materials or a musical work in graphic form, irrespective of the ownership of the original or the copy which is the subject of the rental;
- **177.5.** Public display of the original or a copy of the work;
- **177.6.** Public performance of the work; and
- **177.7.** Other communication to the public of the work (Sec. 5, PD No. 49a)

### 7. Droit de Suite

**Sec. 200. Sale or Lease of Work.** - In every sale or lease of an original work of painting or sculpture or of the original manuscript of a writer or composer, subsequent to the first disposition thereof by the author, the author or his heirs shall have an inalienable right to participate in the gross proceeds of the sale or lease to the extent of five percent (5%). This right shall exist during the lifetime of the author and for fifty (50) years after his death. (Sec. 31, PD No. 49)

**Sec. 201. Works Not Covered.** - The provisions of this Chapter shall not apply to prints, etchings, engravings, works of applied art, or works of similar kind wherein the author primarily derives gain from the proceeds of reproductions. (Sec. 33, PD No. 49)

### 8. Moral Rights

**Sec. 193. Scope of Moral Rights.** - The author of a work shall, independently of the economic rights in Section 177 or the grant of an assignment or license with respect to such right, have the right:

- **193.1.** To require that the authorship of the works be attributed to him, in particular, the right that his name, as far as practicable, be indicated in a prominent way on the copies, and in connection with the public use of his work;
- **193.2.** To make any alterations of his work prior to, or to withhold it from publication;
- **193.3.** To object to any distortion, mutilation or other modification of, or other derogatory action in relation to, his work which would be prejudicial to his honor or reputation; and
- **193.4.** To restrain the use of his name with respect to any work not of his own creation or in a distorted version of his work. (Sec. 34, PD No. 49)

### 9. Ownership of Copyright

**Sec. 178. Rules on Copyright Ownership.** - Copyright ownership shall be governed by the following rules:

- **178.1.** Subject to the provisions of this section, in the case of original literary and artistic works, copyright shall belong to the author of the work;
- **178.2.** In the case of works of joint authorship, the co-authors shall be the original owners of the copyright and in the absence of agreement, their rights shall be governed by the rules on co-ownership. If, however, a work of joint authorship consists of parts that can be used separately and the author of each part can be identified, the author of each part shall be the original owner of the copyright in the part that he has created;
- **178.3.** In the case of work created by an author during and in the course of his employment, the copyright shall belong to:
  - (a) The employee, if the creation of the object of copyright is not a part of his regular duties even if the employee uses the time, facilities and materials of the employer;
  - (b) The employer, if the work is the result of the performance of his regularly-assigned duties, unless there is an agreement, express or implied, to the contrary.
- **178.4.** In the case of a work-commissioned by a person other than an employer of the author and who pays for it and the work is made in pursuance of the commission, the person who so commissioned the work shall have
ownership of work, but the copyright thereto shall remain with the creator, unless there is a written stipulation to the contrary;

178.5. In the case of audiovisual work, the copyright shall belong to the producer, the author of the scenario, the composer of the music, the film director, and the author of the work so adapted. However, subject to contrary or other stipulations among the creators, the producers shall exercise the copyright to an extent required for the exhibition of the work in any manner, except for the right to collect performing license fees for the performance of musical compositions, with or without words, which are incorporated into the work; and

178.6. In respect of letters, the copyright shall belong to the writer subject to the provisions of Article 723 of the Civil Code. (Sec. 6, PD No. 49a)

Sec. 179. Anonymous and Pseudonymous Works. - For purposes of this Act, the publishers shall be deemed to represent the authors of articles and other writings published without the names of the authors or under pseudonyms, unless the contrary appears, or the pseudonyms or adopted name leaves no doubts as to the author's identity, or if the author of the anonymous works discloses his identity. (Sec. 7, PD 49)

10. Limitations on Copyright

Sec. 184. Limitations on Copyright. -

184.1. Notwithstanding the provisions of Chapter V, the following acts shall not constitute infringement of copyright:

(a) the recitation or performance of a work, once it has been lawfully made accessible to the public, if done privately and free of charge or if made strictly for a charitable or religious institution or society; (Sec. 10(1), PD No. 49)

(b) The making of quotations from a published work if they are compatible with fair use and only to the extent justified for the purpose, including quotations from newspaper articles and periodicals in the form of press summaries: Provided, That the source and the name of the author, if appearing on the work, are mentioned; (Sec. 11, Third Par., PD No. 49)

(c) The reproduction or communication to the public by mass media of articles on current political, social, economic, scientific or religious topic, lectures, addresses and other works of the same nature, which are delivered in public if such use is for information purposes and has not been expressly reserved: Provided, That the source is clearly indicated; (Sec. 11, PD No. 49)

(d) The reproduction and communication to the public of literary, scientific or artistic works as part of reports of current events by means of photography, cinematography or broadcasting to the extent necessary for the purpose; (Sec. 12, PD No. 49)

(e) The inclusion of a work in a publication, broadcast, or other communication to the public, sound recording or film, if such inclusion is made by way of illustration for teaching purposes and is compatible with fair use: Provided, That the source and of the name of the author, if appearing in the work, are mentioned;

(f) The reproduction made in schools, universities, or educational institutions of a work included in a broadcast for the use of such schools, universities or educational institutions: Provided, That such recording must be deleted within a reasonable period after they were first broadcast: Provided, further, That such recording may not be made from audiovisual works which are part of the general cinema repertoire of feature films except for brief excerpts of the work;

(g) The making of ephemeral recordings by a broadcasting organization by means of its own facilities and for use in its own broadcast;

(h) The use made of a work by or under the direction or control of the Government, by the National Library or by educational, scientific or professional institutions where such use is in the public interest and is compatible with fair use;

(i) The public performance or the communication to the public of a work, in a place where no admission fee is charged in respect of such public communication, by a club or institution for charitable or educational purpose only, whose aim is not profit making, subject to such other limitations as may be provided in the Regulations;

(j) Public display of the original or a copy of the work not made by means of a film, slide, television image or otherwise on screen or by means of any other device or process: Provided, That either the work has been published, or, that original or the copy displayed has been sold, given away or otherwise transferred to another person by the author or his successor in title; and

(k) Any use made of a work for the purpose of any judicial proceedings or for the giving of professional advice by a legal practitioner.

184.2. The provisions of this section shall be interpreted in such a way as to allow the work to be used in a manner which does not conflict with the normal exploitation of the work and does not unreasonably prejudice the right holder's legitimate interest.

Sec. 187. Reproduction of Published Work. -
187.1. Notwithstanding the provision of Section 177, and subject to the provisions of Subsection 187.2, the private reproduction of a published work in a single copy, where the reproduction is made by a natural person exclusively for research or study, shall be permitted, without the authorization of the owner of copyright in the work.

187.2. The permission granted under Subsection 187.1 shall not extend to the reproduction of:

(a) A work of architecture in form of building or other construction;
(b) An entire book, or a substantial past thereof, or of a musical work in which graphics form by reprographic means;
(c) A compilation of data and other materials;
(d) A computer program except as provided in Section 189; and
(e) Any work in cases where reproduction would unreasonably conflict with a normal exploitation of the work or would otherwise unreasonably prejudice the legitimate interests of the owner of copyright.

Sec. 188. Reprographic Reproduction by Libraries.

188.1. Notwithstanding the provisions of Subsection 177.6, any library or archive whose activities are not for profit or may, without the authorization of the owner of copyright, make a single copy of the work by reprographic reproduction:

(a) Where the work by reason of its fragile character or rarity cannot be lent to users in its original form;
(b) Where the works are isolated articles contained in composite works or brief portions of other published works and the reproduction is necessary to supply them; when this is considered expedient, to person requesting their loan for purposes of research or study instead of lending the volumes or booklets which contain them; and
(c) Where the making of such a copy is in order to preserve and, if necessary in the event that it is lost, destroyed or rendered unusable, replace a copy, or to replace, in the permanent collection of another similar library or archive, a copy which has been lost, destroyed or rendered unusable and copies are not available with the publisher.

188.2. Notwithstanding the above provisions, it shall not be permissible to produce a volume of a work published in several volumes or to produce missing tomes or pages of magazines, coteries or similar works, unless the volume, tome or part is out of stock; Provided, That every library which, by law, is entitled to receive copies of a printed work, shall be entitled, when special reasons so require, to reproduce a copy of a published work which is considered necessary for the collection of the library but which is out of stock. (Sec. 13, PD 49a)

Sec. 189. Reproduction of Computer Program.

189.1. Notwithstanding the provisions of Section 177, the reproduction in one (1) back-up copy or adaptation of a computer program shall be permitted, without the authorization of the owner of, or other owner of copyright in, a computer program, by the lawful owner of that computer program: Provided, That the copy or adaptation is necessary for:

(a) The use of the computer program in conjunction with a computer for the purpose, and to the extent, for which the computer program has been obtained; and
(b) Archival purposes, and, for the replacement of the lawfully owned copy of the computer program in the event that the lawfully obtained copy of the computer program is lost, destroyed or rendered unusable.

189.2. No copy or adaptation mentioned in this Section shall be used for any purpose other than the ones determined in this Section, and any such copy or adaptation shall be destroyed in the event that continued possession of the copy of the computer program ceases to be lawful.

189.3. This provision shall be without prejudice to the application of Section 185 whenever appropriate.

Sec. 190. Importation for Personal Purposes.

190.1. Notwithstanding the provision of Subsection 177.6, but subject to the limitation under the Subsection 185.2, the importation of a copy of a work by an individual for his personal purposes shall be permitted without the authorization of the owner of copyright in, the work under the following circumstances:

(a) When copies of the work are not available in the Philippines and:

1) Not more than one (1) copy at one time is imported for strictly individual use only; or
2) The importation is by authority of and for the use of the Philippine Government; or
3) The importation, consisting of not more than three (3) such copies or likenesses in any one invoice, is not for sale but for the use only of any religious, charitable, or educational society or institution duly incorporated or registered, or is for the encouragement of the fine arts, or for any state school, college, university, or free public library in the Philippines.

(b) When such copies form parts of libraries and personal baggage belonging to persons or families arriving from foreign countries and are not intended for sale: Provided, That such copies do not exceed three (3).
190.2. Copies imported as allowed by this Section may not lawfully be used in any way to violate the rights of owner the copyright or annul or limit the protection secured by this Act, and such unlawful use shall be deemed an infringement and shall be punishable as such without prejudice to the proprietor's right of action.

190.3. Subject to the approval of the Secretary of Finance, the Commissioner of Customs is hereby empowered to make rules and regulations for preventing the importation of articles the importation of which is prohibited under this Section and under treaties and conventions to which the Philippines may be a party and for seizing and condemning and disposing of the same in case they are discovered after they have been imported. (Sec. 36, PD No. 49)

11. Doctrine of Fair Use

Sec. 185. Fair Use of a Copyrighted Work. -

185.1. The fair use of a copyrighted work for criticism, comment, news reporting, teaching including multiple copies for classroom use, scholarship, research, and similar purposes is not an infringement of copyright. Decompilation, which is understood here to be the reproduction of the code and translation of the forms of the computer program to achieve the inter-operability of an independently created computer program with other programs may also constitute fair use. In determining whether the use made of a work in any particular case is fair use, the factors to be considered shall include:

(a) The purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit education purposes;
(b) The nature of the copyrighted work;
(c) The amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
(d) The effect of the use upon the potential market for or value of the copyrighted work.

185.2. The fact that a work is unpublished shall not by itself bar a finding of fair use if such finding is made upon consideration of all the above factors.

12. Notice of Copyright

Sec. 192. Notice of Copyright. - Each copy of a work published or offered for sale may contain a notice bearing the name of the copyright owner, and the year of its first publication, and, in copies produced after the creator's death, the year of such death. (Sec. 27, PD No. 49a)

13. Duration of Copyright

Sec. 213. Term of Protection. - 213.1. Subject to the provisions of Subsections 213.2 to 213.5, the copyright in works under Sections 172 and 173 shall be protected during the life of the author and for fifty (50) years after his death. This rule also applies to posthumous works. (Sec. 21, First Sentence, PD No. 49a)

213.2. In case of works of joint authorship, the economic rights shall be protected during the life of the last surviving author and for fifty (50) years after his death. (Sec. 21, Second Sentence, PD No. 49)

213.3. In case of anonymous or pseudonymous works, the copyright shall be protected for fifty (50) years from the date on which the work was first lawfully published: Provided, That where, before the expiration of the said period, the author's identity is revealed or is no longer in doubt, the provisions of Subsections 213.1 and 213.2 shall apply, as the case may be: Provided, further, That such works if not published before shall be protected for fifty (50) years counted from the making of the work. (Sec. 23, PD No. 49)

213.4. In case of works of applied art the protection shall be for a period of twenty-five (25) years from the date of making. (Sec. 24(B), PD No. 49a)

213.5. In case of photographic works, the protection shall be for fifty (50) years from publication of the work and, if unpublished, fifty (50) years from the making. (Sec. 24(C), PD 49a)

213.6. In case of audio-visual works including those produced by process analogous to photography or any process for making audio-visual recordings, the term shall be fifty (50) years from date of publication and, if unpublished, from the date of making. (Sec. 24(C), PD No. 49a)

Sec. 214. Calculation of Term. - The term of protection subsequent to the death of the author provided in the preceding Section shall run from the date of his death or of publication, but such terms shall always be deemed to begin on the first day of January of the year following the event which gave rise to them. (Sec. 25, PD No. 49)

14. Transfer and Assignment of Copyright

Sec. 180. Rights of Assignee. -

180.1. The copyright may be assigned in whole or in part. Within the scope of the assignment, the assignee is entitled to all the rights and remedies which the assignor had with respect to the copyright.

180.2. The copyright is not deemed assigned inter vivos in whole or in part unless there is a written indication of such intention.

180.3. The submission of a literary, photographic or artistic work to a newspaper, magazine or periodical for publication shall constitute only a license to make a single publication unless a greater right is expressly granted. If two (2) or more persons jointly own a copyright or any part thereof, neither of the owners shall be entitled to grant licenses without the prior written consent of the other owner or owners. (Sec. 15, PD No. 49a)
Sec. 181. Copyright and Material Object. - The copyright is distinct from the property in the material object subject to it. Consequently, the transfer or assignment of the copyright shall not itself constitute a transfer of the material object. Nor shall a transfer or assignment of the sole copy of one or several copies of the work imply transfer or assignment of the copyright. (Sec. 16, PD No. 49)

Sec. 182. Filing of Assignment of License. - An assignment or exclusive license may be filed in duplicate with the National Library upon payment of the prescribed fee for registration in books and records kept for the purpose. Upon recording, a copy of the instrument shall be, returned to the sender with a notation of the fact of record. Notice of the record shall be published in the IPO Gazette. (Sec. 19, PD No. 49a)

Sec. 183. Designation of Society. - The copyright owners or their heirs may designate a society of artists, writers or composers to enforce their economic rights and moral rights on their behalf. (Sec. 32, PD No. 49a)

15. Neighboring Rights

Sec. 203. Scope of Performers’ Rights. - Subject to the provisions of Section 212, performers shall enjoy the following exclusive rights:

203.1. As regards their performances, the right of authorizing:

(a) The broadcasting and other communication to the public of their performance; and

(b) The fixation of their unfixed performance.

203.2. The right of authorizing the direct or indirect reproduction of their performances fixed in sound recordings, in any manner or form;

203.3. Subject to the provisions of Section 206, the right of authorizing the first public distribution of the original and copies of their performance fixed in the sound recording through sale or rental or other forms of transfer of ownership;

203.4. The right of authorizing the commercial rental to the public of the original and copies of their performances fixed in sound recordings, even after distribution of them by, or pursuant to the authorization by the performer; and

203.5. The right of authorizing the making available to the public of their performances fixed in sound recordings, by wire or wireless means, in such a way that members of the public may access them from a place and time individually chosen by them. (Sec. 42, PD No. 49a)

Sec. 208. Scope of Right. - Subject to the provisions of Section 212, producers of sound recordings shall enjoy the following exclusive rights:

208.1. The right to authorize the direct or indirect reproduction of their sound recordings, in any manner or form; the placing of these reproductions in the market and the right of rental or lending;

208.2. The right to authorize the first public distribution of the original and copies of their sound recordings through sale or rental or other forms of transferring ownership; and

208.3. The right to authorize the commercial rental to the public of the original and copies of their sound recordings, even after distribution by them by or pursuant to authorization by the producer. (Sec. 46, PD No. 49a)

Sec. 211. Scope of Right. - Subject to the provisions of Section 212, broadcasting organizations shall enjoy the exclusive right to carry out, authorize or prevent any of the following acts:

211.1. The rebroadcasting of their broadcasts;

211.2. The recording in any manner, including the making of films or the use of video tape, of their broadcasts for the purpose of communication to the public of television broadcasts of the same; and

211.3. The use of such records for fresh transmissions or for fresh recording. (Sec. 52, PD No. 49)

Sec. 215. Term of Protection for Performers, Producers and Broadcasting Organizations.

215.1. The rights granted to performers and producers of sound recordings under this law shall expire:

(a) For performances not incorporated in recordings, fifty (50) years from the end of the year in which the performance took place; and

(b) For sound or image and sound recordings and for performances incorporated therein, fifty (50) years from the end of the year in which the recording took place.

215.2. In case of broadcasts, the term shall be twenty (20) years from the date the broadcast took place. The extended term shall be applied only to old works with subsisting protection under the prior law. (Sec. 55, PD 49a)

16. Infringement

Habana, et al., v. Robles, et al., 310 SCRA 511 [1999]

Infringement consists in the doing by any person, without the consent of the owner of the copyright, of anything the sole right to do which is conferred by statute on the owner of the copyright. The act of lifting from another’s book substantial portions of discussions and examples and the failure to acknowledge the same is an infringement of copyright. For there to be substantial reproduction of a book it does not necessarily require that the entire copyrighted work, or even a large portion of it, be copied. If so much is taken that the value of the original work is substantially diminished, there is an infringement of copyright and to an injurious
extent, the work is appropriated. It is no defense that the pirate did not know whether or not he was infringing any copyright; he at least knew that what he was copying was not his, and he copied at his peril. In cases of infringement, copying alone is not what is prohibited. The copying must produce an “injurious effect”.

Columbia Picture Entertainment, Inc v CA

It is evidently incorrect to suggest, as the ruling in 20th Century Fox may appear to do, that in copyright infringement cases, the presentation of master tapes of the copyrighted films is always necessary to meet the requirement of probable cause and that, in the absence thereof, there can be no finding of probable cause for the issuance of a search warrant. It is true that such master tapes are object evidence, with the merit that in this class of evidence the ascertainment of the controverted fact is made through demonstrations involving the direct use of the senses of the presiding magistrate. (City of Manila v. Cabangis, 10 Phil. 151 [1908]; Kabase v. State, 31 Ala. App. 77, 12 So. 2ND, 758, 764). Such auxiliary procedure, however, does not rule out the use of testimonial or documentary evidence, depositions, admissions, or other classes of evidence tending to prove the factum probandum (See Phil. Movie Workers Association v. Premiere Productions, Inc., 92 Phil. 843 [1953]) especially where the production in court of object evidence would result in delay, inconvenience or expenses out of proportion to its evidentiary value.

17. Remedies for Infringement

17.1. Civil Action

Sec. 216. Remedies for Infringement. -

216.1. Any person infringing a right protected under this law shall be liable:

(a) To an injunction restraining such infringement. The court may also order the defendant to desist from an infringement, among others, to prevent the entry into the channels of commerce of imported goods that involve an infringement, immediately after customs clearance of such goods.

(b) Pay to the copyright proprietor or his assigns or heirs such actual damages, including legal costs and other expenses, as he may have incurred due to the infringement as well as the profits the infringer may have made due to such infringement, and in proving profits the plaintiff shall be required to prove sales only and the defendant shall be required to prove every element of cost which he claims, or, in lieu of actual damages and profits, such damages which to the court shall appear to be just and shall not be regarded as penalty.

(c) Deliver under oath, for impounding during the pendency of the action, upon such terms and conditions as the court may prescribe, sales invoices and other documents evidencing sales, all articles and their packaging alleged to infringe a copyright and implements for making them.

(d) Deliver under oath for destruction without any compensation all infringing copies or devices, as well as all plates, molds, or other means for making such infringing copies as the court may order.

(e) Such other terms and conditions, including the payment of moral and exemplary damages, which the court may deem proper, wise and equitable and the destruction of infringing copies of the work even in the event of acquittal in a criminal case.

216. 2. In an infringement action, the court shall also have the power to order the seizure and impounding of any article which may serve as evidence in the court proceedings. (Sec. 28, PD 49a)

17.2. Criminal Action

Sec. 217. Criminal Penalties. -

217. 1. Any person infringing any right secured by provisions of Part IV of this Act or aiding or abetting such infringement shall be guilty of a crime punishable by:

(a) Imprisonment of one (1) year to three (3) years plus a fine ranging from Fifty thousand pesos (P50,000) to One hundred fifty thousand pesos (P150,000) for the first offense.

(b) Imprisonment of three (3) years and one (1) day to six (6) years plus a fine ranging from One hundred fifty thousand pesos (P150,000) to Five hundred thousand pesos (P500,000) for the second offense.

(c) Imprisonment of six (6) years and one (1) day to nine (9) years plus a fine ranging from Five hundred thousand pesos (P500,000) to One million five hundred thousand pesos (P1,500,000) for the third and subsequent offenses.

(d) In all cases, subsidiary imprisonment in cases of insolvency.

217. 2. In determining the number of years of imprisonment and the amount of fine, the court shall consider the value of the infringing materials that the defendant has produced or manufactured and the damage that the copyright owner has suffered by reason of the infringement.

217. 3. Any person who at the time when copyright subsists in a work has in his possession an article which he knows, or
ought to know, to be an infringing copy of the work for the purpose of:

(a) Selling, letting for hire, or by way of trade offering or exposing for sale, or hire, the article;
(b) Distributing the article for purpose of trade, or for any other purpose to an extent that will prejudice the rights of the copyright owner in the work; or
(c) Trade exhibit of the article in public, shall be guilty of an offense and shall be liable on conviction to imprisonment and fine as above mentioned. (Sec. 29, PD No. 49a)

**19. Presumption of Ownership**

Sec. 219. Presumption of Authorship. -

219.1. The natural person whose name is indicated on a work in the usual manner as the author shall, in the absence of proof to the contrary, be presumed to be the author of the work. This provision shall be applicable even if the name is a pseudonym, where the pseudonym leaves no doubt as to the identity of the author.

219.2. The person or body, corporate whose name appears on an audio-visual work in the usual manner shall, in the absence of proof to the contrary, be presumed to be the maker of said work.

**SUMMERVILLE vs. CA (2007)**

Summerville holds copyrights and patents over ROYAL brand playing cards; it alleges that fakes thereof proliferate. Stemming from a letter-complaint, seizure of cards [CROWN brand] inside a [fake, allegedly] ROYAL brand plastic container, and the printing machines manufacturing the cards were seized.

Are the machines and cards inside the supposedly infringing case proper subjects of the seizure? NO. First, private respondents are the owners of copyrights and patents pertaining to the CROWN brand. Second, the cards, and the machines are useless to prove trademark infringement with respect to the plastic container, hence unnecessary to retain.

**18. Affidavit Evidence**

Sec. 218. Affidavit Evidence. -

218.1. In an action under this Chapter, an affidavit made before a notary public by or on behalf of the owner of the copyright in any work or other subject matter and stating that:

(a) At the time specified therein, copyright subsisted in the work or other subject matter;
(b) He or the person named therein is the owner of the copyright; and
(c) The copy of the work or other subject matter annexed thereto is a true copy thereof, shall be admitted in evidence in any proceedings for an offense under this Chapter and shall be prima facie proof of the matters therein stated until the contrary is proved, and the court before which such affidavit is produced shall assume that the affidavit was made by or on behalf of the owner of the copyright.

218.2. In an action under this Chapter.

(a) Copyright shall be presumed to subsist in the work or other subject matter to which the action relates if the defendant does not put in issue the question whether copyright subsists in the work or other subject matter; and
(b) Where the subsistence of the copyright is established, the plaintiff shall be presumed to be the owner of the copyright if he claims to be the owner of the copyright and the defendant does not put in issue the question of his ownership.

(d) Where the defendant, without good faith, puts in issue the questions of whether copyright subsists in a work or other subject matter to which the action relates, or the ownership of copyright in such work or subject matter, thereby occasioning unnecessary costs or delay in the proceedings, the court may direct that any costs to the defendant in respect of the action shall not be allowed by him and that any costs occasioned by the defendant to other parties shall be paid by him to such other parties.